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Accounting and Reporting for Nonprofit Organizations as Elements of a Financial Management System

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ACCOUNTING AND REPORTING FOR NONPROFIT ORGANIZATIONS
AS ELEMENTS OF A
FINANCIAL MANAGEMENT SYSTEM

In Partial Fulfillment of Requirements of
Masters Degree Program in Voluntary Associations Administration

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CHAPTER I

INTRODUCTION

An objective of this thesis is to explain the theory and concepts underlying financial accounting and reporting for the voluntary field. The differences in accounting and reporting for the nonprofit sector in comparison to the private business sector will be analyzed. Accounting and reporting are the principal subjects of this study because they form the foundation of an entire financial management system. A financial management system, whether it be for a profit or nonprofit entity, is an indispensable management tool for maximizing the results of business operations. Planning systems, budgeting systems, and the related managerial controls on resource development and utilization are integral parts of an entire financial management program for a nonprofit organization, or any other type of business entity. These additional subjects, however, are considered to be beyond the scope of this study and in-depth research in these areas was not undertaken at this time.

Another objective of this thesis is to provide instruction to enable a reader to understand an accounting and reporting model for nonprofit organizations, even though the reader lacks a basic knowledge of accounting principles and concepts. If the reader is one who also has governance or management responsibilities for financial matters of a nonprofit organization, it is expected that this subject would be more meaningful and beneficial.

The study briefly describes an organizational arrangement for a financial management system with the responsibility for the system's operational aspects lodged in the business office. The expected outputs of this model would be effective management controls over the utilization of resources in day-to-day operations, plus the generation of financial reports for top management and the board. These reports should enable them to make decisions on a more informed basis. The major focus of this study is on the accounting and reporting subsystems of this financial management program. The accounting and reporting concepts to be described are recommended by the Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations since these concepts are applicable to any nonprofit organization, regardless of size. The term Standards, as used throughout this study, refers to those recommended accounting and reporting concepts.[1]

At the onset, it is stated as a premise that the objectives of accounting systems are the same, whether they be used in nonprofit organizations or profit oriented businesses. The common objectives of each of the accounting systems are: (1) to provide information to assist management in the effective allocation and use of resources, and (2) to provide information to the general public, investors, owners or contributors, creditors, and others for evaluating the effectiveness of management in achieving the organization's objectives. The nature of the organization, its resources and particular objectives will serve to influence the reporting formats but the accounting methods and processes used by nonprofit and

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[1]National Health Council and National Assembly of National Voluntary Health and Social Welfare Organizations, Inc., Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations (New York: National Health Council and National Assembly of National Voluntary Health and Social Welfare Organizations, Inc., Rev. 1974).

commercial organizations are not radically different. Where there are differences in accounting concepts, principles, or rules in the systems, these will be explained in this study.

An accounting system has been described as the financial data bank on which the vast majority of business decisions have their basis. Without basic information, financial decisions become a matter of choice.[2] A committee of the American Accounting Association stated that the objectives of accounting are, inter alia, to provide information for decisions concerning goals and the use of limited resources.[3] To the extent, then, that one of the principal activities of a nonprofit entity involves the management and conversion of economic resources, it resembles an entity in the profit sector. Accordingly, propositions that bear directly on accounting for resources (assets) should be applicable equally to the profit and nonprofit areas. Differences should emerge in connection with analysis of or reports on equity interests and changes in resources (operations).

A prime objective of a profit oriented company is to increase the economic wealth of those who supply the capital or resources to finance the business operations. These resources are expected to produce revenues to replace those which are consumed in the operating process and in addition, provide a profit margin for the investor or owner. In contrast, a nonprofit organization usually has as its ultimate objective, the meeting of some socially desirable need of the community or members. In carrying out such

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[2]Ernest W. Walker and J. William Petty II, <u>Financial Management of the Small Firm</u> (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1978), p. 114.

[3]American Accounting Association, <u>A Statement of Basic Accounting Theory</u> (Madison, Wisc.: American Accounting Association, 1966), pp. 4, 39 & 40.

an objective, resources are consumed to attain service objectives rather than making a profit. Since there is no profit, which is another way of generating resources, and since the existing resources are consumed in the normal business of the nonprofit organization, there is a continuous need to obtain new resources.

Notwithstanding the foregoing basic difference in objectives, both types of organizations must concern themselves with the proper and effective use of scarce resources. The different organizations must also employ generally accepted accounting principles and practices to accomplish their individual missions.

Gross observed that the major recognizable difference between the two organizational types is the stewardship accountability objective of the nonprofit organization in contrast to the profitability orientation of the commercial organization. He identifies and describes five accounting distinctions between the two types of organizations as being in the areas of:

- . Cash versus accrual basis accounting
- . Fund accounting
- . Treatment of fixed assets
- . Inter-fund transfers and appropriations
- . Contributions, pledges and non-cash contributions[4]

With respect to accounting concepts of fund accounting and accrual basis of accounting and reporting, the Standards pronounce rules and instructions to assist nonprofit organizations which implement these concepts in their

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[4]Malvern J. Gross, Jr., <u>Financial and Accounting Guide for Nonprofit Organizations</u> (New York: The Roland Press Co., 1972), pp. 13 - 18.

accounting systems. The rules are based upon sound accounting principles and have the endorsement of the American Institute of Certified Public Accountants, the highest professional authority in the accounting field. In addition, the Standards provide instructions covering the following subject areas:

- Uniform classification of support, revenue, and expense transactions
- Functional reporting of expenses
- Uniform financial statement formats

It must be recognized by the reader that the art of accounting was developed to accomplish various desired objectives. Accounting is not based on fundamental laws or absolute precepts but has evolved over the years through trial and error. Double-entry bookkeeping, which is the very foundation of modern accounting, dates back to 1494. Single-entry bookkeeping precedes that date.

Further, nonprofit organizations are becoming increasingly affected by accountability demands made by the various publics. The information explosion fallout resulting from the rapid development and application of computer technology to business activities is also impacting on nonprofit management requirements, yet, a significant number of nonprofit organizations are not using sophisticated techniques of modern management. Every day, organizations are asked to produce more and more information. Much of the demand comes from within, but contributors, government, and purchasers of nonprofit services keep demanding new kinds of data. In addition, professional studies and surveys are continuously being undertaken and these also require data. Many nonprofit organizations are generally not able to adequately cope with these additional demands, at least those of a financial character, because of inadequate financial management systems. This thesis addresses that issue.

The organization of this thesis is based upon major topical subjects contained in several chapters. An introduction to the study is contained in Chapter I. Chapter II provides an overview of the nonprofit sector with discussion on the paucity of financial management systems in nonprofit organizations. Chapter III describes an organizational arrangement for a financial management system in a nonprofit organization. Examples of business office functions are given and the internal organization and operation of the business office is described. Discussion of an automated administrative system with its impact on the accounting system is also included.

In Chapter IV, the basic elements of any accounting system are presented because the author believes that the general public has a serious deficiency in knowledge of the bare essentials of accounting systems. This minimal understanding results in added confusion when accounting systems and reporting for nonprofit organizations are considered. Chapter V analyzes the distinguishing features of an accounting system for nonprofit organizations. The accounting concepts of accrual accounting and fund accounting are compared to accounting concepts for profit organizations. Discussion also focuses on the accounting treatment of fixed assets and depreciation; transfers and appropriations of funds; contributions, pledges, and non-cash contributions, as these topics relate to nonprofit organizations. Financial reporting concepts and recommended reporting formats are also presented and described in this Chapter. Finally, Chapter VI contains conclusions of the author as a result of this study.

OVERVIEW OF THE NONPROFIT SECTOR
AND THE
NEED FOR FINANCIAL MANAGEMENT

CHAPTER II

OVERVIEW OF THE NONPROFIT SECTOR

AND THE

NEED FOR FINANCIAL MANAGEMENT

Private nonprofit organizations are diverse and multitudinous and have antecedents dating back to the beginning of American culture. In his visit to the United States in 1831, Alexis de Tocqueville observed that Americans are forever forming associations. He wrote: "The power of the association has reached its highest degree in America. Associations are made for purposes of trade, and for political, literary and religious interests. It is never by recourse to a higher authority that one seeks success, but by an appeal to individual powers working in concert."[5]

The magnitude of the nonprofit sector can be gleaned from the following findings and observations. The Filer Commission Study, published in 1975, estimated there were six million private voluntary organizations in the United States, when local chapters of regional or national groups are counted individually. The annual receipts (and corresponding outlays) of these agencies exceed eighty billion dollars. Nonprofit organizations also own one-ninth of the land in the United States.[6] A recent article in the Washington Post newspaper described the nonprofit economy as a large, vigorous third sector. The article states: "Many people still

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[5]Alexis de Tocqueville, Journey to America, trans. by George Lawrence, ed. by J. P. Mayer (Garden City, N.Y.: Doubleday & Co., 1971), p. 219.

[6]Report of the Commission on Private Philanthropy and Public Needs, Giving in America, Toward A Stronger Voluntary Sector (1975), pp. 34 & 36.

tend to think of the U.S. economy as primarily a private-enterprise, manufacturing-based system, but in that economic gulf between the continents of government and business stretches an archipelago of nonprofit groups that trace a vast and varied path."[7]

Nonprofit organizations are subject to a variety of laws, regulations and administrative rulings promulgated on a national, state and local level. Nonprofit organizations seeking federal recognition of tax exempt status must meet strict requirements of the Internal Revenue Service. To qualify, an organization must provide detailed answers to questions concerning an applicant's identification, type of organizational entity, activities, and past and prospective financial data.

The Internal Revenue Service has categorized nonprofit organizations into twenty-two major activity groupings listed in Figure 1 below.[8]

Figure 1 - IRS Classification of Nonprofit Organizations By Major Activity Grouping

- Religious Activities
- Schools, Colleges and Related Activities
- Cultural, Historical or Other Educational Activities
- Other Instruction and Training Activities
- Health Services and Related Activities
- Scientific Research Activities
- Business and Professional Organizations
- Farming and Related Activities
- Mutual Organizations
- Employee or Membership Benefit Organizations
- Sports, Athletic, Recreational and Social Activities
- Youth Activities
- Conservation, Environmental and Beautification Activities
- Housing Activities
- Inner City or Community Activities
- Civil Rights Activities
- Litigation and Legal Aid Activities
- Legislative and Political Activities
- Advocacy
- Other Activities Directed to Individuals
- Activities Directed to Other Organizations
- Other Purposes and Activities

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[7] Bradley Graham, "The Nonprofit Economy," The Washington Post, March 11, 1979, Sec. K, pp. K1 & K6.

[8] U.S., Department of the Treasury, Internal Revenue Service, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Service Code, Package 1023, (Washington, D.C.: Rev. May 1977), p. 8.

Within this broad grouping there are two hundred fifty-seven descriptive codes which further define the principal activities of nonprofit organizations. A representative sample of these codes follows in Figure 2.

Figure 2 - Selected Listing of Nonprofit Organizations By IRS Descriptive Code

001 Church, synagogue, etc.
030 Schools, colleges, trade schools, etc.
060 Museum, zoo, planetarium, etc.
120 Publishing activities
150 Hospital
180 Contract or sponsored scientific research for industry
200 Business promotion (chamber of commerce, business league, etc.)
230 Farming
251 Credit Union
260 Fraternal beneficiary society, order, or association
280 Country club
320 Boy Scouts, Girl Scouts, etc.
326 Care and housing of children (orphanage, etc.)
353 Soil or water conservation
355 Wildlife sanctuary or refuge
380 Low-income housing
400 Area development, re-development or renewal
430 Defense of human and civil rights
460 Public interest litigation activities
481 Voter information on issues or candidates
510 Attempt to influence public opinion concerning: Firearms control
560 Supplying money, goods and services to the poor
600 Community Chest, United Givers Fund, etc.
900 Cemetery or burial activities

The foregoing classifications of nonprofit organizations are only indicators of their diversity in service programs or philanthropic activities.

Nonprofit organizations do not exist without some friction between them and government and the private business sector. The governmental policy making process has produced legislation that was enacted for a variety of reasons and oftentimes the legislation was not necessarily planned or related to an overall economic approach. There has also been greater government scrutiny of nonprofit organizations in recent years because of the significant increases in public funding of the voluntary sector. In addition, the Congress has imposed stringent guidelines on nonprofit foundations under the Tax Reform Act of 1969, although legislators have not established public disclosure requirements for all nonprofit organizations. On the other hand, private enterprise tends to resent the special economic privileges enjoyed by nonprofit entities. For example, significant financial savings accrue to nonprofit organizations because of their exemption from taxes on income, (excepting unrelated business income) reduced mailing costs, and some exemptions on a local level from payment of property taxes.

In spite of the magnitude and age of the voluntary sector, there is continuing difficulty for the general public to obtain satisfactory information on the finances of many nonprofit organizations. This situation results from either non-reporting or insufficient reporting due to inadequate financial management systems.

Bradley defines financial management as the area of business administration devoted to enabling the spending unit to achieve its goals. He describes the activities of financial management as focusing on two areas: (1) the management of assets for growth and survival; and, (2) selecting the sources of funds to finance assets, both those on hand and new ones to be acquired.[9] Although the discussion used in support of the above definition is oriented to profit making organizations, some of the examples given are equally applicable to nonprofit entities. It is the purpose of Bradley's book to present a broader approach to basic financial management. He attempts to broaden the area of business finance and integrate it with the overall administration of a firm, whereas, the traditional approach to finance has been to analyze it solely as a functional area.

Bradley also considers the administrative process of a business firm as a systematic plan of action that enables an executive to guide the firm

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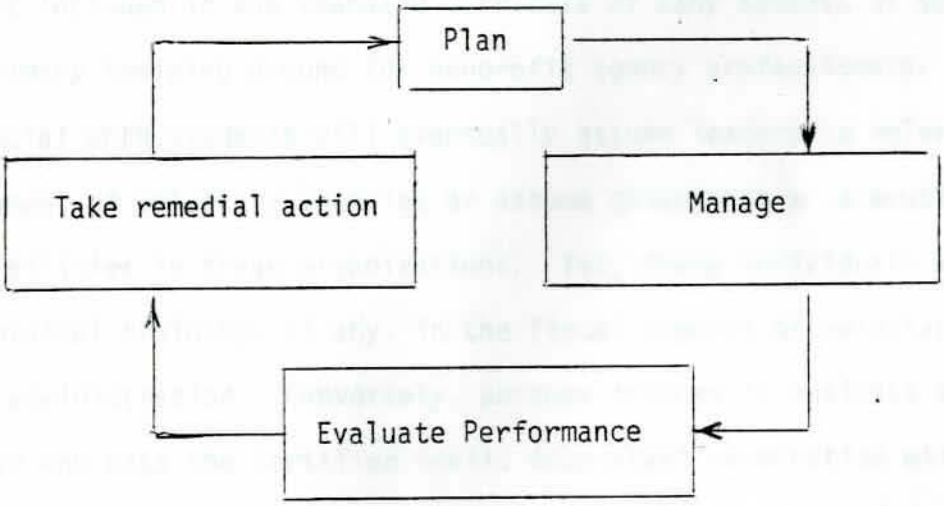
[9]Joseph F. Bradley, Administrative Financial Management (Hinsdale, Ill.: Dryden Press, 1974), p. 3.

toward its goals. The process involves four distinct actions as displayed in Figure 3 below. These actions are integrated as well as interrelated and these relationships are of vital importance to the optimal decision-making results concerning the management of assets. Too often, an organization's assets or resources are not utilized effectively because of a disjointed decision-making process. This situation can result from either the lack of a plan, or the absence of a financial management system which adequately reports on the activities or results of a plan.

Figure 3 - The Administrative Process



Planning is defined as establishing goals as well as establishing proposed actions to attain the objectives which support the goals. Managing is defined as taking the required actions to make the plans a reality. Evaluating means testing the results against the plans and against other relevant standards. Taking remedial action means either making adjustments in the firm's activities so that future operations will come closer to matching the planned results, or modifying the plans. The administrative approach to financial management gives this functional area a forward look and it stresses changes that are constantly occurring in business. The approach also focuses on top management type problems.[10]

Clearly, the foregoing discussion is applicable to nonprofit organizations. Yet, it is disappointing that the voluntary field still suffers from deficiencies in such an important accountability function as financial management. In spite of the billions of dollars spent annually by nonprofit entities, a significant and disproportionate number have not placed the required high priority on financial management systems.

This situation has continued over the years due to a number of reasons. As an academic explanation, selected business management courses are not included in the standard curricula of many schools of social work, the primary training ground for nonprofit agency professionals. Many of the social work students will eventually assume leadership roles in the management of voluntary agencies or assume governance or executive responsibilities in these organizations. Yet, these individuals will only have minimal training, if any, in the fiscal aspects of voluntary associations administration. Conversely, persons trained in business administration or who pass the Certified Public Accountant examination will, as a rule, seek employment in the profit sector where the financial rewards and opportunities are greater.

Another explanation for the paucity in financial management systems in nonprofit organizations can be related to policy-level decisions and actions of their governing boards. Budgeting or allocating scarce dollars between programs of direct services to clients rather than administrative support functions is a constant challenge to most board members in nonprofit organizations. It is not uncommon for some boards to unwittingly

[10]Ibid. p. 2.

subscribe to a philosophy that nearly all of the funds contributed to an agency should be spent on service programs and the least amount possible spent on administration or overhead functions. This kind of reasoning over a period of time will cause unnecessary hardships on an organization. It allows the effectiveness of the management function to be diluted because of the low priority placed upon its value. The leadership of a voluntary organization who permits this condition to occur neglects an important and critical stewardship responsibility for ensuring the financial accountability and stability of the organization.

The issue of inadequate financial management systems with a consequent deficiency in accounting and reporting practices is being addressed. In recent years, the accounting profession has turned its attention to the unique financial requirements and responsibilities of the nonprofit sector. The American Institute of Certified Public Accountants has promulgated accounting principles and auditing standards for the voluntary field and issued the following materials:

- Hospital Audit Guide (1972)
- Audits of Colleges and Universities (1973)
- Audits of Voluntary Health and Welfare Organizations (1974)
- Audits of State and Local Governmental Units (1974)
- Accounting and Reporting Practices for Certain Nonprofit Organizations. A Proposed Recommendation of the Financial Accounting Standards Board (1978)

Within the voluntary sector itself, major funding bodies such as the United Way, large national agencies and many other organizations have made substantial strides in the past decade in adopting and mandating the use of the Standards. Self-regulation mechanisms, such as adoption of the Standards, are becoming more prevalent for the voluntary sector since the public is insisting on nonprofit organizations becoming more responsive to accountability demands. Adoption of the Standards by an organization is one of the most important policy decisions a board can make. In so doing, it will enable an agency to meet its reporting requirements to its supporters, clients, government, and contributing public. Meeting the reporting requirements should be a vital concern of the board of a nonprofit organization since the board is held accountable for the organization in the final analysis.

Increased attention has focused in the last few years on the duties and responsibilities of board members of nonprofit organizations. What once was primarily an honorary designation has now become an important position of trust, with potential personal liability for the trustee who takes the job too lightly or otherwise fails to perform adequately.

A key area of importance for board members is the review and approval of the organization's financial reports. While the ultimate responsibility for approval of financial reports rests with the entire board, the treasurer of the board has a key role. Gross stated that treasurers of nonprofit organizations have a major responsibility for ensuring the financial health of the organization. He also observed that few positions have more opportunity to influence institutions that affect society than that of the voluntary treasurer of a nonprofit orgnaization. He summarized the treasurer's responsibilities as:

. Keeping financial records

. Preparing accurate and meaningful financial statements

. Budgeting and anticipating financial problems

. Safeguarding and managing the organization's financial assets

. Complying with federal and state reporting requirements[11]

[11]Gross, pp. 4 - 9.

In a medium to large size organization, the complexities of its operation may require a professionally trained staff to assist the board in meeting its responsibilities for financial management. Depending upon the organizational structure of the board and the corporation officers, if the organization is incorporated, the chief financial officer of the corporation could also be the assistant treasurer of the board and have additional fiduciary responsibilities. An example of staff responsibilities in the area of financial management is discussed in the next chapter.

ORGANIZATIONAL STRUCTURE FOR FINANCIAL MANAGEMENT
IN A MEDIUM/LARGE SIZE NONPROFIT ORGANIZATION

CHAPTER III

ORGANIZATIONAL STRUCTURE FOR FINANCIAL MANAGEMENT IN A MEDIUM/LARGE SIZE NONPROFIT ORGANIZATION

For the purposes of this study, a financial management system is considered an assembly of interacting elements organized to accomplish a predetermined function in an integrated manner. The system would encompass the elements of planning, accounting, budgeting, auditing and reporting. A growing number of the larger, established nonprofit agencies are maintaining such systems. In other agencies, particularly the smaller ones, a system may not exist, only cash receipts and disbursements records maintained by either volunteers or persons with minimal training in accounting practices.

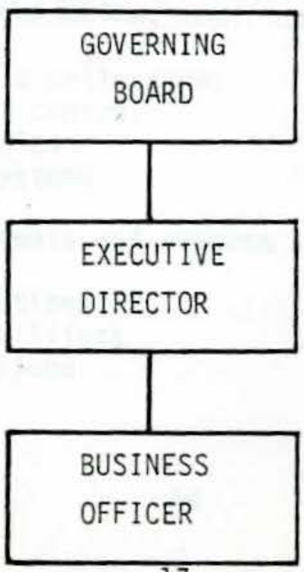
Since the board of a nonprofit organization is ultimately responsible for the organization's finances and economic health, financial management becomes one of the major responsibilities of a board. For those organizations whose board has placed a high priority on financial management, the organization may utilize an operational structure similar to the one in this chapter to execute the financial management function.

In any consideration of successful financial management systems, the organization and the personnel of the business office become critical factors. The administrative organization of the business office is directly related to the accounting system and without an adequate organization and a competent staff, no accounting system will perform satisfactorily.

It is a recent development that the business office has been established as an independent administrative unit in certain nonprofit organizations. This acceptance of the business office as an essential and integral part of the overall organization is predicated on two factors. The first is that the diverse and increasingly complicated activities of modern nonprofit organizations make it essential that the financial affairs be administered by specialists. The second factor is a recognized conviction that the chief executive of the organization should perform other duties, leaving business and financial affairs to individuals especially trained in this field. Since the chief executive usually lacks the training for handling complex financial matters, the executive should not have to divert energies and abilities from the leadership role and service objectives of the organization. Instead, he should receive and act on recommendations of a qualified financial staff.

The location of the business office in the hierarchy should be based upon the unitary type of organization. In the unitary type, the executive director receives his/her authority by delegation from the governing board. Certain administrative functions are in turn delegated by the executive director to the business officer who further delegates some responsibilities and functions to the business office staff. In this form of organization the executive director is solely responsible to the governing board. An example of this arrangement appears below in Figure 4.

Figure 4 - Unitary Form of Administrative Organization



The business office personnel handle a variety of financial and administrative matters of the nonprofit organization. Typical objectives and functions are described below.

Objectives and Functions of a Business Office

The objectives of the business office should be to:

- supervise the implementation of approved financial and administrative plans, policies and procedures, and monitor the efficiency and effectiveness of operations;
- coordinate and maintain an integrated system of support services including accounting, budgeting, payroll, and general administrative management systems;
- review, study and recommend improved management systems and procedures with special emphasis on staff and volunteer utilization.

The primary functions of the business office are those of a supportive nature to programs and services of the nonprofit organization. The office must administer the financial and administrative programs in such a way as to support the mission, goals and objectives of the organization while at the same time maintain fiscal integrity and economy. Functions of the business office may include all of the following:

- Financial planning and monitoring
- Fiscal and administrative policies coordination, implementation, and monitoring
- Budget preparation, administration and control
- Special financial analyses (costs, budgets, etc.)
- Grant/contract negotiation, modification and administrative monitoring
- Accounts receivable collections
- Internal audit and control
- Indirect cost studies
- Cost accounting systems
- Preparation of --
  - Financial statements and reports
  - Tax returns
  - Cash flow projections
  - Grant/contract billings
  - Bank reconciliations

- Maintenance of --
  - General ledger
  - Payroll
  - Voucher register
  - Cash receipts journal
  - General journal
- Management of invested funds; maintaining endowment fund records
- Publications distribution
- Support staff recruitment and development
- Personnel records management
- Communications (mail; telephone; receptionist)
- Plant or office facilities maintenance
- Procurement (space; furnishings; equipment and supplies)
- Inventory control
- Fringe benefits records and enrollment
- Reproduction services
- Travel Services

The requirements for the administration of the preceding functions are similar to those described in the discussion below on business office responsibilities for a college or university.

All records and methods of record keeping are prescribed and supervised by the business office. Although certain auxiliary accounting records may be maintained in operating departments, the business office must retain control over and responsibility for these subsidiary accounting arrangements.

Internal auditing and control are by-products of the accounting function, growing in importance as the organization grows. The business office as custodian of organizational funds must maintain a continuous review of all activities of the organization relating to the collection and disbursement of funds. The preparation of reports to the governing board and to the college president and the compilation of financial information are other functions related to accounting. In addition, the fiscal system ordinarily calls for periodic budget reports to assist those responsible for the administration of individual budgets.

The business office has a dual responsibility with respect to the budget. It assists in its preparation and participates in the control of the budget after it has been adopted by the governing board. Moreover, the business officer is given the further responsibility of advising the college president in regard to requests for changes in the operating budget. After the budget is submitted to and approved by the governing board, it must be controlled in order that the organization may function according to plan. A frequent method of budgetary control is to incorporate the budget into the accounting records. Although the primary responsibility for adherence to the approved budget should rest with the budget head, the accounting office must assume the final authority in ensuring that actual operations are in reasonable conformity with the financial plan as approved by the governing board.

Central purchasing by the business office is an important function of that office and is a necessary supplement to the accounting system. The concept of centralized procurement does not preclude the active participation of other departments in the purchasing process nor the delegation of some details of purchasing to offices outside the business office. It simply means that the ultimate responsibility for all organizational procurement rests with the business office. The control and management of storerooms are closely allied to the purchasing function, as are also the control and management of movable property, and are added responsibilities.

An important function sometimes assigned to the business office is that of the management of endowment and similar funds belonging to the organization. The extent and degree of business office responsibility for the management of invested funds depends upon the procedural arrangements at a given organization. Frequently, the primary responsibility for managing the investment of endowment funds is retained by the governing board or delegated to one of its committees. In other cases, this responsibility may be delegated to the chief business officer of the organization with the board or a committee of the board acting on matters of broad investment policy. Regardless, however, of the variety of responsibilities with respect to the handling of endowment funds, the business office usually is called upon to maintain endowment funds records. It must also perform such auditing functions as will assure the safety of the assets of those funds and the use of the funds and income in accordance with any restrictions imposed by donors.

The administration of the physical plant is oftentimes another important responsibility of the business office. This business office function includes responsibility for physical plant planning and architectural services.[12]

In most organizations of large size, the responsibilities of the business office include the administration of the personnel program. The immediate responsibility is assigned to a director of personnel or other administrative head who is responsible to the business officer.

Internal Organization of the Business Office

The internal organization of the business office has a direct bearing on the adequacy of the operation of the accounting system. An accounting system however scientific does not operate itself. Accounting personnel, although competent and well trained, cannot operate at peak efficiency without a carefully planned internal organization which clearly fixes responsibilities, eliminates duplication, and avoids vacuums in the operations of the business office.

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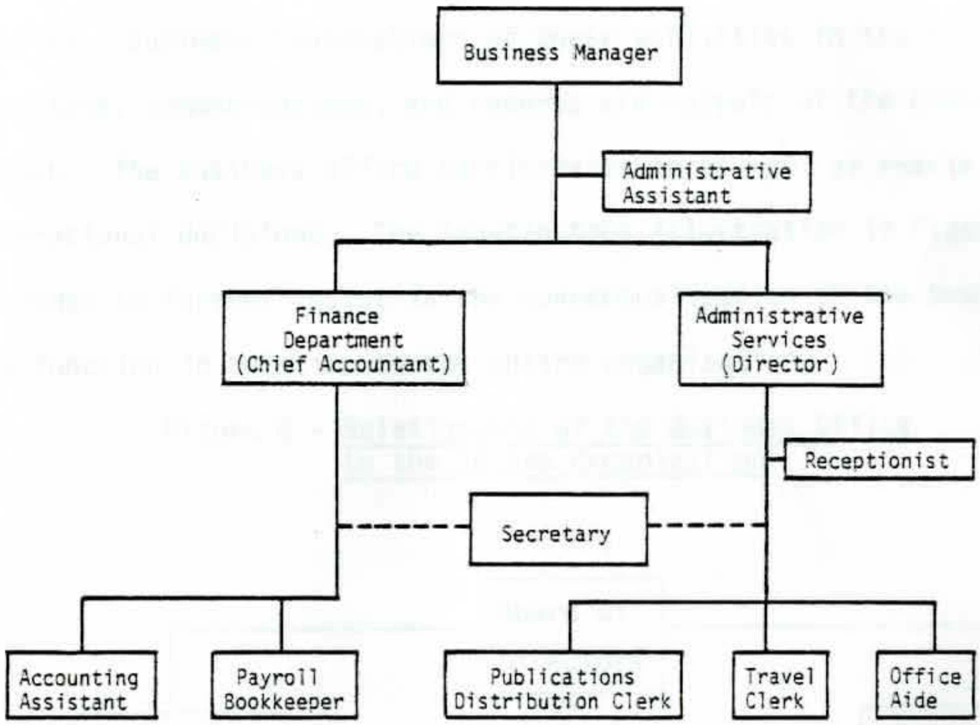
[12] Charles Scheps and E. E. Davidson, Accounting for Colleges and Universities (Baton Rouge: Louisiana State University Press, 1970), p. 20.

A representative table of organization for executing the previously described functions is shown in Figure 5 below.

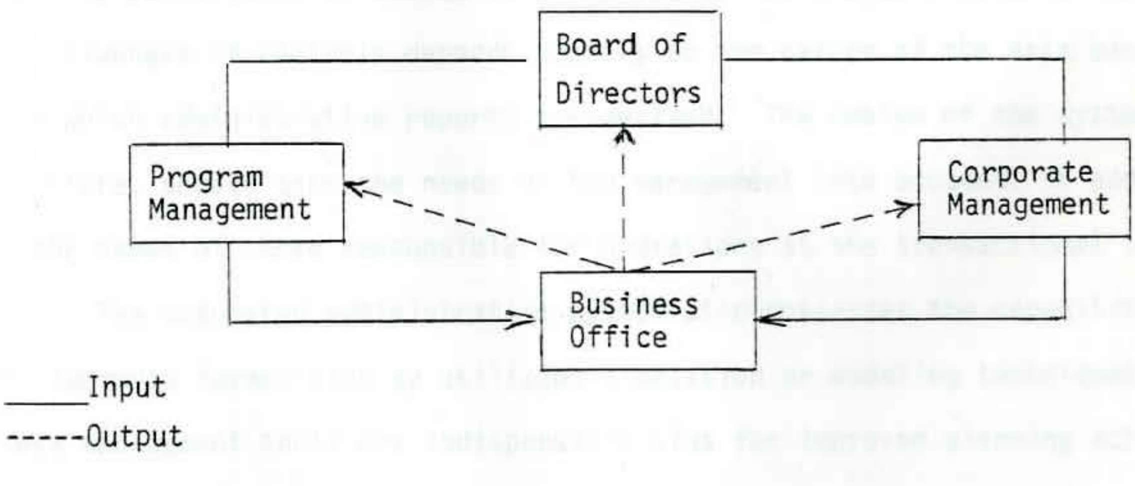
Figure 5 - Table of Organization of a Business Office In a Nonprofit Organization[13]



[13] Institute For Services To Education, Table of Organization (Washington, D.C.: 1974)

To summarize, the role of the business office staff should be one of a supporter, interpreter in financial terminology, and reporter on the activities of the organization. The programmatic and administrative decisions, activities, and processes of the entire organization are inputs to the business office operation. These events are occurring continuously as the organization carries out its program goals or meets its service objectives. Business translations of these activities in the form of money transactions, communications, and reports are outputs of the business office operation. The business office participates in as well as reacts to policy and operational decisions. The input/output illustration in Figure 6 below is provided to further assist in the conceptualization of the business office function in relation to the entire organization.

Figure 6 - Relationship of the Business Office to the Entire Organization



In an ideal setting, the majority of business office functions could be accomplished efficiently and easier if the nonprofit organization utilized an automated administrative system. Computers produce data for decision-makers in a more analytical manner and a much faster turn-around time. Frequently, time is a critical factor in decision-making activities. The functions of an automated administrative system may be grouped under three headings: (1) transactions, (2) control, and (3) planning.

Transactional purposes are served by systems which facilitate the processing of repetitious functions such as payroll, billings, and recording of voluminous or routine data such as contributions received as a result of a mass appeal or telethon. Transactions establish as well as exploit the data base of the system and the system's design must establish modes of input, storage, processing, and output of transactional data.

Control purposes require that procedures be established to ensure that the administrative system is operating as desired or required. The effectiveness of controls depends heavily on the nature of the data base from which administrative reports are derived. The design of the system, therefore, should take the needs of top management into account, in addition to the needs of those responsible for operations at the transactional level.

The automated administrative system also possesses the capability for improved forecasting by utilizing simulation or modeling techniques. These management tools are indispensable aids for improved planning activities.

Although the basic administrative uses of computers are either transactional or managerial, in almost every case, automated systems can be employed for routine accounting, payroll, budgeting, etc. Financial accounting and business management systems may be the first applications of automated data processing systems since there are many parallels for these applications in the private sector. A comprehensive financial accounting system permits complete integration of all files and procedures across departments, programs, and functions. It provides for daily processing of transactions as well as exception reporting and close control of all revenues and disbursements. It is also a sound basis for budget planning. A computerized system can provide various methods for analysis and control which are not feasible under a manual system. It should also be noted that any one phase of financial accounting may be automated all by itself with a self-contained system for inputs, processing, checking against control criteria, record maintenance, and outputs. This partial approach can be utilized by smaller organizations or by the organizations which have a need for computerized accounting data but do not have the available resources for the entire automated administrative system. In fact, entire automated administrative systems are a rarity in nonprofit organizations but individual computerized applications have been developed in the following areas:

- Budget preparation and control: current operations, research contracts, long-range development and planning
- Disbursements: accounts payable, payroll, and travel
- Revenues: accounts receivable, fee collections, contributions, rents, royalties, state and federal grants, cash deposits
- Endowment management: cash deposits, investments, securities, real estate

In recent times, outside service bureaus have developed computerized accounting systems for nonprofit organizations. Since few of these organizations possess in-house computer capability, the service bureau is a viable alternative. One bureau has a computerized system for the general ledger and related financial statements. The service includes a comprehensive set of software which presents basic accounting data in a format that can be used to monitor and control the various operations and functions it records. Given the end-user's original specifications for a chart of accounts, reporting schedules, and report printout formats, the system requires only debit and credit postings for each designated accounting period. Given this input, a complete range of reports, including journals, trial balances, general ledgers, balance sheets, and income statements will be provided. The system is also capable of providing additional reports such as source and application of funds, budget analysis reports, functional expense analyses, and other management reports designed to answer the specific needs of the nonprofit organization.

BASIC ELEMENTS OF ANY ACCOUNTING SYSTEM

CHAPTER IV

BASIC ELEMENTS OF ANY ACCOUNTING SYSTEM

It is the author's conviction that the reader should have a minimum understanding of the basic elements of an accounting system in order to better understand the differences in accounting systems for profit or nonprofit organizations. This chapter discusses those basic elements which are the same for either system while the differences or distinctions required in an accounting system for a nonprofit organization are described in the following chapter.

Accounting is the means through which financial data necessary for the efficient administration of a profit or nonprofit organization are recorded, classified and reported to the organization's officers, controlling bodies, and the general public. The accounting system must meet the requirements of the organization. The forms and documents employed in the recording of financial data will vary because of a number of factors. The size of the organization, the nature of its control, and the nature and amount of its income and expenses are a few of the considerations which determine the appropriate form of its system of financial records.

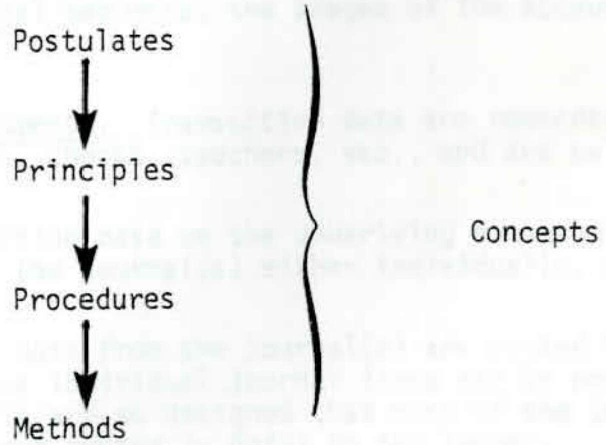
Carey states that accounting provides a special kind of information that is absolutely necessary for the intelligent use of resources available to any organization. Most resources are measured in terms of money, which represents labor, materials, or rights. Money serves as the common denominator by means of which all available resources can be described in an understandable way. Carey also asserts that the basic elements of accounting information consist of relations between capital and income, and between revenue, costs, and expenses. These terms are deceptively simple but each represents a concept of considerable complexity.[14]

An accounting system for any organization is a subsystem of a financial management system. The accounting system is also the cornerstone of a business information network and management decisions are based upon data derived from the accounting system. The reliability of the reported data has a direct relationship to the accounting principles utilized in the accounting system.

Accounting principles embody the conventions, rules,and procedures required to define accepted accounting practices at a particular time. Broad guidelines governing accounting practice, as well as detailed practices and procedures, are included in generally accepted accounting principles or "GAAP" as they are referred to by accounting professionals.

It should be understood that accounting principles are only part of the accounting system. According to Kemp, accounting principles are derived from accounting postulates as illustrated in the framework of accounting theory in Figure 7 below.

Figure 7 - Framework of Accounting Theory



[14] John L. Carey, Getting Acquainted With Accounting (Boston, Mass: Houghton Mifflin Co., 1973), p. 2.

Kemp defines accounting postulates as broad controlling assumptions upon which the principles of accounting are based. Accounting principles then become broad general guides to action in accounting practice while accounting procedures are narrow guides to action in specific areas of accounting practice. The accounting procedures implement the accounting principles. Accounting methods are defined as different ways of applying accounting principles, e.g. the cash basis or accrual basis method of accounting. Accounting concepts are derived from the relationships between postulates, principles, procedures, and methods.[15]

Notwithstanding the underlying theoretical aspects of accounting, there are basic mechanical functions to be followed in the analysis and processing of accounting data during the cycle, which is the same in either a profit or nonprofit organization. A specific bit of accounting data will flow through the various stages of the accounting cycle in consecutive order, but bits of data are being introduced into the accounting system at all times throughout the accounting period. Thus, within the organization as a whole, several parts of the cycle will be undergoing activity simultaneously. The continuous payroll process illustrated in Figure 8 on the following pages is an example of this simultaneous activity.

In the order of their classical sequence, the stages of the accounting cycle are:

- Processing underlying documents. Transaction data are recorded (noted) on forms, receipts, checks, vouchers, etc., and are called underlying documents.
- Journalizing. The transaction data on the underlying documents are sorted and entered in the journal(s) either individually, or in summarized batches.
- Posting. The transaction data from the journal(s) are posted to the ledgers. In some cases individual journal items may be posted; in other cases the journals are so designed that much of the journal data can be totalled and posted in total to the ledger.

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[15] Patrick S. Kemp, Accounting for the Manager (Homewood, Ill.: Dow Jones-Irwin, Inc.: 1970), p. 1-19.

- Preparing trial balance. A trial balance is prepared to test bookkeeping accuracy and to aid in preparation of the work sheet and statements.

- Preparing work sheets. A work sheet may be prepared at the end of the accounting period before adjusting entries are made and is a useful tool for: recording and summarizing adjusting and closing entries, and preparing financial statements.

- Making adjusting entries. The end-of-period adjusting entries are made. This means that they are (a) journalized and (b) posted to ledger accounts just as regular transaction entries are handled.

- Making closing entries. Closing entries made at the end of an accounting period clear the income statement accounts (all revenue and expense accounts) to make them ready for the accumulation of similar information in the next accounting period. The net result of the clearing operation is entered in the equity or fund balance account

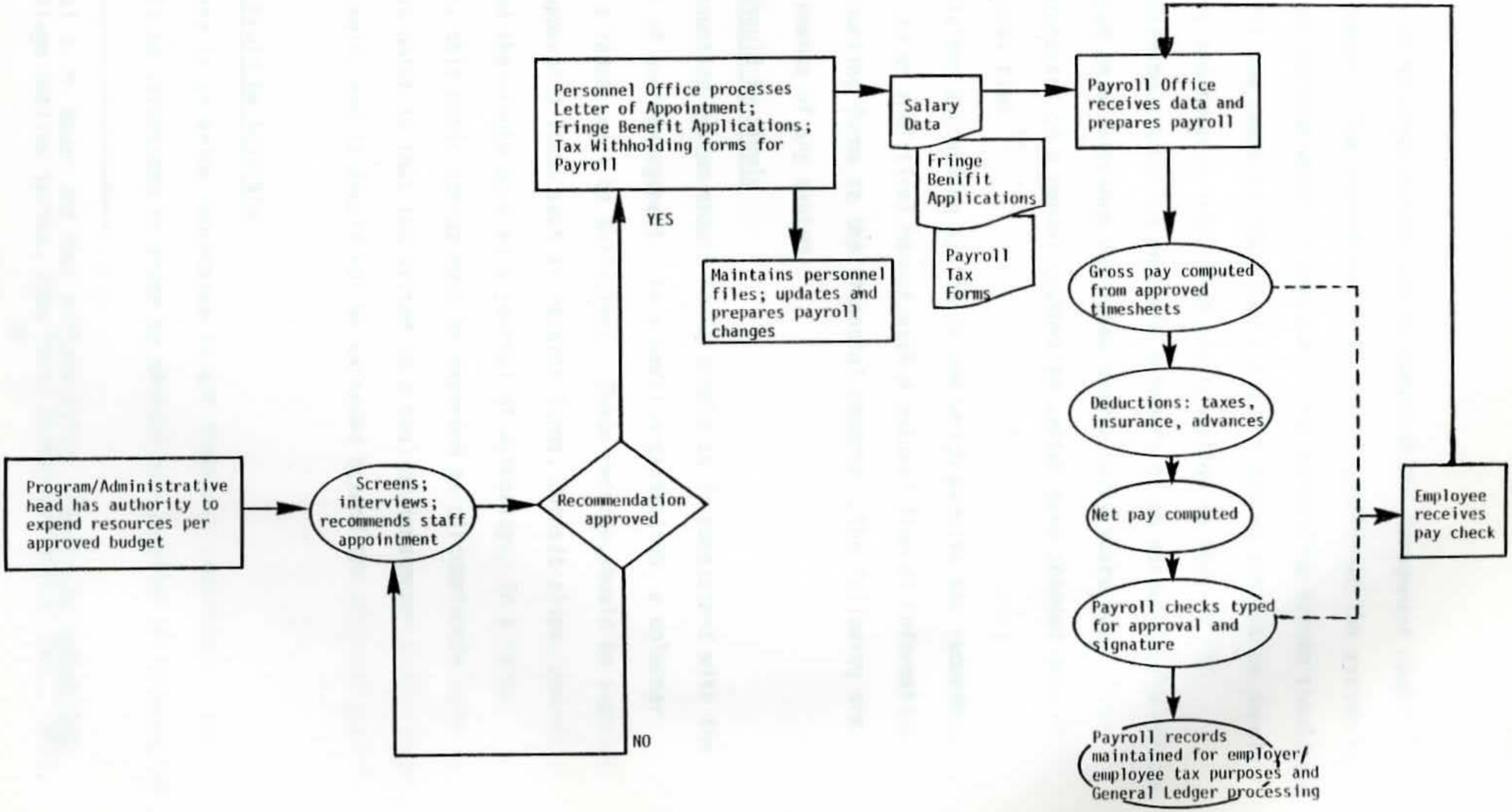
- Preparing financial statements. After everything is posted and with all accounts adjusted up-to-date, with all liabilities determined, etc., financial statements are prepared.

- Independent audit. After all the above steps have been taken, it is appropriate (or mandatory) to engage a firm of certified public accountants to perform an "independent" audit. In essence, this means outside, professional auditors examine the financial statements and, to the extent deemed necessary, they examine the accounting records, supporting documents, and whatever else is needed, and express their opinion (accountants' certificate) that the statements are prepared in accordance with generally accepted accounting principles. The audit is usually performed on an annual basis.

All of the above activities are accomplished during an accounting period, which is generally a year or a twelve months period of time. The year can end at December 31st or at the end of any month, as long as there are twelve months within the period. If the accounting period ends on December 31, the accounting period is on a calendar year basis. If the end of the period occurs in another month, the accounting period is on a fiscal year basis.

An accounting system can also be described as a plan of operation through which useful information about the financial position and results

Figure 8 - Continuous Payroll Process In The Accounting Cycle



of operations of an organization can be compiled for management control and reporting purposes. The accounting forms do not constitute the system but are the devices through which it operates. The accounting system should be designed to fit the needs of the organization it serves and not be merely a set of forms and records into which the operation is made to fit.

The remaining discussion on basic elements of an accounting system is partially based on a reference published nearly forty years ago. The mechanical processes of a manual accounting system have changed only minimally since that time.[16]

An efficient accounting system is one which permits the recording of transactions in an analytical manner with a natural flow of information from the accounting forms to the financial reports. The following are essential elements of any system.

<u>The System Should Be Simple</u>

An accounting system should be as simple as is consistent with the requirements of good management. In a small organization, a columnar journal and a ledger will be sufficient. These records should be supplemented by supporting items such as receipt forms, deposit slips, journal vouchers, and the minute book as a journal of authority. In a large organization, this basic set-up must be expanded as circumstances require. The important point is that the system is a tool of management rather than an end in itself, and it should not be expanded beyond the point of justified use.

<u>The System Should Be Accurate</u>

Accuracy is of prime importance in all financial recordings. The system should be structured in order to obviate any question of accuracy of

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[16] Royal D. M. Bauer and Paul Holland Darby, <u>Elementary Accounting</u>, 3rd ed.; College Outline Series, (New York: Barnes and Noble, Inc., 1942), pp. 28-42.

the reported financial condition. The accuracy of the work done should be checked each month through internal controls, such as trial balances of general and subsidiary ledgers, bank statement reconciliations and budget comparisons with performance. Certain items, such as cash receipts, require daily checking to detect errors which would be more difficult to locate at the end of the month.

The System Should Be Flexible

Because the volume of work varies from time to time, the accounting system should be flexible in design. One way to achieve such flexibility is through the use of subsidiary ledgers which make it possible to distribute the bookkeeping work among a number of employees. This not only makes for mechanical ease of operation, but also sets up a procedure for internal control.

The System Should Be Inclusive

The accounting system should report all essential data. As a tool of management, it will not be effective unless the entire financial picture is clearly and completely reflected in the accounts. Management must also know that the assets are under constant control and that operations are proceeding according to plan. The accounting system must be planned to fit the need of each individual situation, keeping in mind that there are two distinct objectives of control: 1) to safeguard assets; and 2), to provide information for management.

In addition to the foregoing, the accounting system should also include these additional basic elements:

. Account classifications

. Records and forms

. Internal control and Audit

Account Classification - Chart of Accounts

A chart of accounts showing the order in which the accounts are arranged is a convenient index to the general ledger and an aid in the preparation of financial statements. The chart of accounts can serve in the following ways by being:

- An aid in system installation and revision
- An index to accounts used
- A list of code numbers for ready reference
- An aid in using a uniform accounting system
- An aid in preparation of reports

Account Classification - Ledger Accounts

Accounts in the general ledger are usually arranged or classified in a systematic manner. Even in a bound ledger it is customary to arrange the accounts in some definite order when they are first placed in the book. The order of their appearance will vary according to the needs and procedures of the organization. The number of accounts will also vary, depending upon the amount of detail desired. Efficiency is promoted if care is used in planning the sequence of the accounts so that any desired account can be found quickly. Several methods of account classification are in general use as shown below:

- Financial Statement Sequence
- Alphabetical Order
- Numerical Systems
- Number and Letter Designations

Whichever system is used, it must be planned with care to provide flexibility for normal expansion and minor changes in the classification.

An account may also be defined as a systematic arrangement of the increases and decreases of some specific asset, liability, or proprietorship item, or subdivision thereof, expressed in financial terms. Such increases and decreases are usually segregated in parallel vertical columns. In its simplest form, an account may be shown as a skeleton account, as indicated below.

This is called a T account, because of its resemblance to a capital letter "T". The name of the account is placed at the top on the horizontal line. The vertical line separates the debits on the left from the credits on the right.

Accounts are used to record the effects of transactions on the assets, liabilities, proprietorship or fund balance of an organization. A nonprofit organization does not have a proprietorship account since there are no proprietary interests. The account classification used in its place is "fund balance." A business unit can use as many accounts as it deems necessary to provide the detailed information it needs.

When posting to the accounts, the principle of debit and credit is employed. Debit (abbreviated Dr.) refers to the left side of an account and credit (abbreviated Cr.) refers to the right side. When used as a noun, a debit is an entry on the left side and a credit is an entry on the right side of an account. As an adjective, the debit side of an account is the left side and the credit side is the right side. As a verb, to debit is to make an entry on the left side and to credit is to make an entry on the right side of an account. The word charge sometimes is used instead of the word debit.

Double-entry accounting books are set up in paired columns with debits always to the left and credits always to the right. Each transaction is recorded in one account category as a debit and in another category as a credit--sometimes with one of them split among several accounts. When the books are "balanced" at the end of the accounting period, but credits and debits are not equal, there is an error in "posting" (entering the transactions to the various accounts) or in arithmetic.

The rules for double-entry accounting are summarized in Figure 9 below.[17]

Figure 9 - Rules for Double-Entry Accounting

Accounts Category	To increase You Add a	To Decrease You Add a	Normal Balance
Assets (cash, accounts receivable, inventory, prepaid expenses, fixed assets)	debit	credit	debit
Liabilities (accounts payable, accrued liabilities, bank loans payable, long term debt)	credit	debit	credit
Income (contributions, sales,receipts)	credit	debit	credit
Expenses (salaries, supplies, cost of goods sold, taxes)	debit	credit	debit

Records and Forms

The "books" described below are the basic records needed for the operation of an accounting system. They should be designed to meet the needs of the organization.

1. Journals (Books of original entry or chronological record).

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[17]Patricia Jenkins, "Guide to Accounting for Nonprofits," The Grantsmanship Center News, 1977, p. 15.

The journal is the record for the chronological recording of financial transactions, dividing them into their respective debits and credits for subsequent posting to the ledger accounts affected. No entries should be made in the ledger which have not first been recorded in one of the journals.

The cash receipts journal and cash disbursements journal are adaptations or refinements of the general journal and are designed for handling a specific type of transaction. The function of a journal is one of recording original entries for later posting to a ledger. A general journal for making opening, adjusting, and closing entries should always be provided.

Journals often use the principle of columnization, which is a means of summarization. For instance, in the cash disbursements journal, a columnar spread of the expense classifications serves to group charges of similar type for later posting to the general ledger accounts affected. This method will permit summary totals of the various columns to be posted to the ledger accounts at the end of the month. The cash receipts journal uses the same procedure to summarize like items of receipts for posting to the income accounts.

The voucher register is an expanded form of the purchases journal, recording transactions relating not only to the purchases of merchandise for resale but also including all other transactions concerned with the acquisition of assets and services, or in any way connected with the disbursement of cash. When a voucher register is used, the check register becomes a simple record, since all checks are recorded with debits to one account only, the Vouchers Payable account, and credits to Cash. When a voucher register is used, the cash disbursement journal is not usually needed.

The journal and the ledger are the basic books of a double-entry accounting system and both books are essential to complete an efficient accounting system. The journal is the chronological record, and the ledger is the analytical record. The journal is the book of original entry while the ledger is the book of second entry, a derived record.

2. General Ledger (Analytical record)

The general ledger is the summary record of financial transactions by separate accounts. In it are brought together all transactions classified according to individual accounts. The general ledger is the final and permanent record of transactions and from it the data for preparation of financial statements are obtained.

Subsidiary ledgers are frequently set up to handle the detail of specific accounts in the ledger, such as payroll. When these are used, the principles remain the same and the subsidiary ledger is represented in the general ledger by a summary account known as the control account.

3. Trial Balance

A trial balance is a list of the ledger accounts at a specified date, showing their balances, or the debit and credit totals for each, in debit and credit amount columns. The totals of the two columns should be equal. When this is true, the ledger is said to be in balance. The trial balance serves the following purposes:

- It proves the equality of the total debits and credits in the ledger, thus providing at least a partial check on accuracy of the bookkeeping.
- It is an aid in the detection of errors.
- It furnishes a condensed picture of each account and a summary of all of the accounts.
- It may be used as a basis for the preparation of the financial statements.

The trial balance is prepared periodically, usually at the end of each month.

The trial balance is a valuable accounting tool. It indicates that the debits and credits in the ledger are equal, which is necessary for a correct record, but it does not prove that the books are entirely without errors. Mistakes may have occurred which the trial balance does not disclose as follows:

- Compensating errors.
- Posting to wrong account.
- Incorrect classification in journal.
- Transactions not recorded.

If a trial balance is out of balance, the difference between the totals is caused by one or more mistakes. Such errors may have occurred in the trial balance, the ledger, or the books of original entry. They can be classified as follows:

- Errors in addition or subtraction.
- Listing figures on wrong side of an account.
- Omission of amounts by which an amount may be omitted entirely and cause the records to be out of balance.
- Listing incorrect figures, such as duplicate posting of a debit or credit, incorrect copying of one or more digits, transposition of figures or transplacement of figures.

Internal Control and Audit

To safeguard against error and loss, the accounting system should be part of an internal control plan adopted by management. Internal control is "The plan of organization and all of the co-ordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed management principles."[18]

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[18] American Institute of Certified Public Accountants, Statement on Auditing Procedure No. 33, (New York: AICPA Bulletins, 1963), p. 27.

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A review and evaluation of an organization's system of internal control is a generally accepted auditing standard. This review should determine for the auditor the extent to which reliance may be placed upon the accounting records and the extent to which audit tests can be limited. The evaluation may also disclose areas of weakness in accounting control which could be significant and in need of improvement. In the accounting area, internal control is usually accomplished by a separation or segregation of duties and responsibilities of the accounting staff.

Generally speaking, any business organization should have its financial statements audited annually by a certified public accountant. The accountant's examination is usually made in accordance with generally accepted auditing standards and includes such tests of the accounting records and such other auditing procedures as the auditor considers necessary in the circumstances. The auditor and the organization should have a predetermined understanding as to the scope and type of audit to be performed. The organization should not restrict or prohibit the certified public accountant from conducting the examination in accordance with generally accepted auditing standards so as to preclude an expression of an unqualified opinion on the basic financial statements.

In concluding discussion on the basic elements of an accounting system, it must be understood that accounting is the language of business and most non-accountants are intimidated by accounting terminology. Part of the problem arises from the accounting profession's use of a specialized vocabulary. Unlike many technical areas, accounting's vocabulary consists of many words that have other meanings in ordinary usage. Understanding the concepts and using accounting reports requires that the reader know how to interpret the words used and their special meaning. Davidson, et. al., published a glossary of 1,300 business and accounting terms which could assist a layperson in understanding the meaning of certain words or expressions.[19] The terminology problem is not going to be resolved easily. Accounting as a profession is relatively new and unlike natural sciences or the older professions of medicine or law, there is not yet established a body of well-developed technical terminology. Accounting terms are a mixture of often inadequately defined technical terms and words which have general meanings, but which are used in special senses by accountants. This problem causes communication difficulties among accountants and between accountants and users of financial information.

An organization which can implement the basic elements of an accounting system discussed in this chapter will have the foundation for an accounting and reporting system capable of expansion or specialization. Figure 10 on the following page summarizes the inputs and outputs of a hypothetical accounting system which collects, records, summarizes, and reports on all business actions and activities.

The specialized features which distinguish an accounting system for a nonprofit organization from that of any other organization is discussed in the following chapter.

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[19] Sidney Davidson, et al., Accounting, The Language of Business, 1975-1976 Edition (Glen Ridge, N.J.: Thomas Horton and Daughters, Inc., 1975), pp. 5-55.

Figure 10 - Inputs/Outputs of Accounting System

ADMINISTRATION/PROGRAM MANAGEMENT INPUTS

- Personnel Actions

  Hires; Terminations;
  Promotions; Pay changes

- Procurement Actions

  Materials
  Supplies
  Services
  Equipment
  Facilities

- Employee Timesheets
- Travel - Advances/Reimbursements
- Billings and Collections Data for Services Rendered
- Contributions or Other Sources of Support Data

ACCOUNTING SYSTEM PROCESSES

- Collecting, Authenticating, Recording and Summarizing

  in

- General Ledger

  via

- Subsidiary Ledgers - (Books of original entry)
  Voucher Register
  Check Register
  Accounts Payable Journal
  Accounts Receivable Journal
  Payroll Register
  General Journal
  Travel Journal
  Cash Receipts Journal

ACCOUNTING SYSTEM OUTPUTS

- Financial Statements and Reports
- Special Reports and Analyses
- Tax Returns
- Budgets
- Payroll Checks
- Vendor Checks
- Billings/Invoices

DISTINCTIONS IN ACCOUNTING SYSTEMS
FOR NONPROFIT ORGANIZATIONS

CHAPTER V

DISTINCTIONS IN ACCOUNTING SYSTEMS FOR NONPROFIT ORGANIZATIONS

Many persons who are familiar with accounting practices or financial reporting of profit oriented businesses, become very confused over nonprofit accounting concepts and reports. These persons may understand business terms such as retained earnings, common stock, stockholders' equity, net income, etc. because of their involvement as stockholders or investors in profit oriented companies. They usually receive an annual financial report, audited by a certified public accounting firm, which sets for the net income (profit) or loss from business operations in a relatively straight-forward manner. Basically, the "botton line" is oftentimes their main concern, i.e., how much did the company make or lose during the accounting period, as reported on the last line of the income statement, and they are also interested in the stockholders' equity figure. There is more published information and literature available on profit or commercial organizations, hence, the public has a greater opportunity to see or know more about the accounting concepts. practices,and financial statements of these kinds of organizations.

In contrast, nonprofit organizations do not have equity interests or the "monetary profit" from operations. Simply stated, a nonprofit organization is created or exists to meet a socially desirable need of society. In contrast, a profit making company usually seeks to maximize profits for its owners (stockholders) and this is its primary objective. These differences will influence the accounting and reporting practices of the different organizations which are discussed in this chapter.

As stated in the introduction to this thesis, five accounting distinctions in the accounting systems for a nonprofit organization in comparison to a profit oriented organization are more evident. These distinctions or differences are:

- . Cash versus accrual basis of accounting
- . Fund accounting
- . Treatment of fixed assets
- . Inter-fund transfers and appropriations
- . Contributions, pledges and non-cash contributions

An analysis of these differences follows, but before that discussion, it should be acknowledged that a significant number of nonprofit organizations can adequately manage their affairs by using a simple accounting system, essentially based on cash receipts and disbursements. This arrangement can suffice for such small organizations with uncomplicated activities or financial transactions, as long as the data derived from the system or records is adjusted on worksheets at the end of the period to incorporate the nonprofit accounting distinctions identified above.

Cash Versus Accrual Basis of Accounting

The cash basis accounting system does not allow for recognition of income or expense as it is earned or incurred, but only when income is received in cash or checks (money), or when money is disbursed for expenses. Under the cash basis accounting system, income is recorded in the accounts only as it is received by the organization in the form of cash receipts, irrespective of the period in which the income was earned or pledged. As an example, earnings such as interest on bank accounts, stocks or bonds, and fees for service will not be recorded in the accounting period the earnings took place unless they are actually collected in that period. At the end of a given accounting period, the financial statements may not disclose a completely accurate financial condition if the accounting system is on the cash basis.

Similarly, expenses under the cash basis accounting system are likewise recorded in the accounts only when paid, rather than when incurred, and this also will not permit the financial reports for a given accounting period to disclose a completely accurate operating result and financial position. The effect can be greatly reduced if the organization paid all expenses promptly. However, on the cash basis, all expense items which may be paid in advance, such as insurance premiums, are charged to expense when paid. On the accrual basis, the unexpired portion is set up as an asset.

The principle of matching costs and revenues is at the foundation of the accrual basis of accounting. This principle states that expired costs and revenues should be matched in appropriate accounting periods in order to determine periodic business income. Although some revenues and expenses result from cash inflows and outflows in the same accounting period, many are the results of past or future receipts and payments. Under the accrual basis, the accountant concentrates on reporting revenues and expenses in the proper accounting periods, regardless of the timing of the corresponding cash receipts and disbursements.

The advantage of the cash basis accounting system is that it can be maintained by persons who lack formal training or experience in accounting theory or practice. An ordinary checkbook can become the formal accounting record or "books." When a financial report is required, the preparer uses the checkbook stubs as the data source document. This method is essentially that used by most individuals in the management of their personal finances, including the preparation of their personal tax returns.

Distortions in reported financial data caused by the cash basis system, when compared to the accrual basis of accounting, are analyzed and explained below. The exhibit in Table 1 below is a financial report prepared on the cash basis of accounting.

Table 1 - ABC Nonprofit Organization
Statement of Cash Receipts and Disbursements
For Period January 1, 1978 thru December 31, 1978

Contributions Received in Cash		$ 47,565
Less Cash Disbursements:		
Salaries	$ 35,566	
Consultant Fees	4,900	
Travel and Subsistence - Long Distance	2,269	
Local Travel, Parking and Meeting Expense	446	
Conferences and Seminars	359	
Printing and Duplication	290	
Telephone	1,142	
Rental of Office Space	940	
Equipment Rental	377	
Office Supplies	574	
Postage	174	
Membership Dues	105	
Subscriptions	8	
Research Materials; Books, etc.	222	
Fiscal Management Services	643	
Total Cash Disbursements		48,015
Cash Deficit		$ (450)

The differences in the "bottom line" for the same nonprofit organization reporting on the accrual basis, is that the organization has a $7,775 net income as illustrated in the following Table II, in comparison to the $450 deficit from operations as determined by the cash basis of accounting. The difference results in part from pledged contributions not being recognized in the computation of total organization income for the reporting period. Conversely, $700 in salaries and $1,000 in consultant fees not paid during the reporting period results in these expenses also not being recognized as applicable to the reporting period, under the cash basis of accounting.

The objective of accrual accounting is to recognize, as they occur, all substantial amounts receivable or payable by an organization. The accrual basis of accounting is accepted as providing a more appropriate record of an organization's business transactions in an accounting period. All transactions of an accounting period will not be accounted for under the cash basis because of several factors. Worse than the distortions produced normally because of the calendar, there are a number of unpredictable expense variations caused by delayed billings for purchases, slow mail delivery, and non-recognition of expenses of the organization which are not of an immediate cash nature. An example of the latter would be depreciation, i.e. the wear, tear and consequent reduced value of an organization's assets such as a building, automobile or bus. Finally, a very serious deficiency of cash basis accounting arises in an instance where someone in the organization is manipulating funds in order to not reveal a negative situation resulting from a wrong decision or poor management practices.

An executive who is permitted to recognize expenses or obligations only as payments are made, clearly has the power to manipulate the organization's reported expenses for the accounting period by withholding payment of bills until another period. This practice can significantly influence an organization's financial picture and produce information which is wholly inadequate for an informed decision-making process.

To summarize, accrual basis accounting is the recording of income and expenses when they are earned or due, regardless of when collected or paid. The major advantage of accrual basis accounting over cash basis accounting is the recognition of all financial transactions in an organization's accounts in the same accounting period in which they occur. The time of their recognition depends only on the activities of the organization and is not subject to arbitrary shifting between periods. Financial statements of nonprofit organizations represented as being in conformity with generally accepted accounting principles must be prepared using the accrual basis of accounting.

To compare differences in reported results in financial statements prepared under the cash versus accrual basis of accounting, Table II on the following page presents the data previously reported in Table I, but adjusted to reflect the accrual basis of accounting.

Table II - ABC Nonprofit Organization
Statement of Net Income-Accrual Basis Compared to Cash Basis
For Period January 1, 1978 thru December 31, 1978

	Accrual Basis	Cash Basis	Difference
Income			
Contributions Received	$ 47,565	$ 47,565	$ ---
Pledges Receivable	9,925	---	9,925
Total Income	$ 57,490	$ 47,565	$ 9,925
Expenses			
Salaries	$ 36,266	$ 35,566	$ 700
Consultant Fees	5,900	4,900	1,000
Travel and Subsistence - Long Distance	2,269	2,269	---
Local Travel, Parking and Meeting Expense	446	446	---
Conferences and Seminars	359	359	---
Printing and Duplication	290	290	---
Telephone	1,142	1,142	---
Rental of Office Space	940	940	---
Equipment Rental	377	377	---
Office Supplies	574	574	---
Postage	174	174	---
Membership Dues	105	105	---
Subscriptions	8	8	---
Research Materials; Books, etc.	222	222	---
Fiscal Management Services	643	643	---
Total Expenses	$49,715	$ 48,015	$ 1,700
Excess of Income Over Expenses	$ 7,775	$ (450)	$ 8,225

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From the foregoing example, it can be demonstrated that the variations in reported results based upon accrual versus cash basis can be significant. Timing of receipts and disbursements, management practices, volume of dollars, etc., can have a significant impact on reported results and indeed on management decisions which are based upon financial results. To summarize, under the cash basis of accounting--

Income is understated	$ 9,925
Expenses are understated	-1,700
Net understatement of income	$ 8,225

Proof

Excess of income over expenses reported under the accrual basis	$ 7,775
Deficit reported under the cash basis	+ 450
Total	$ 8,225

Fund Accounting

Fund accounting is peculiar to nonprofit organizations and accounting systems of governmental organizations. Those persons who may understand financial statements of profit making organizations, often become thoroughly confused with fund accounting concepts and the related financial reports.

Fund accounting as a concept is not difficult. It is related to the stewardship accountability function of nonprofit organizations. Assets or resources contributed to a nonprofit organization may have restrictions on their use, and management and the board are legally obligated to ensure that these restrictions are met. Assets which carry such restrictions are grouped and accounted for in a common fund established for the particular restricted purpose. According to the Standards, the recommended fund groups to be used by voluntary organizations are:

. Current Funds

- Unrestricted
- Restricted

. Land, Building and Equipment Fund

. Endowment Fund

. Custodian Fund

Vatter states: "In fund accounting, a fund is not mere cash resources, and it is more than a mere collection of assets set aside for a particular purpose. The accounts of each fund recognize not only all the equities that pertain to that fund; in addition, there are also present complete classifications of revenue, expense and income accounts."[20]

The American Institute of Certified Public Accountants defines fund accounting as:

> "14. Many nonprofit organizations receive resources restricted for particular purposes. To facilitate observance of limitations, the accounts are often maintained using fund accounting, by which resources are classified for accounting and reporting purposes into funds associated with specified activities or objectives. Each fund is a separate accounting entity with a self-balancing set of accounts for recording assets, liabilities, fund balance, and changes in the fund balance. Although separate accounts are maintained for each fund, the usual practice in preparing financial statements is to group funds that have similar characteristics."[21]

Simply stated, a fund in accounting terminology is a separately contained entity established to record assets and transactions affecting

[20] William J. Vatter, The Fund Theory of Accounting and Its Implications for Financial Reports (Chicago, Ill.: University of Chicago Press, 1974), p. 12.

[21] Accounting Standards Division, AICPA, Statement of Position, Accounting Principles and Reporting Practices for Certain Nonprofit Organizations (New York: 1979), p. 11.

these assets. The basic accounting operations for recording transactions in fund accounting are the same as described in Chapter IV. The major requirement would be proper coding of the transaction data to be certain that the transactions are posted in the proper fund.

To illustrate the differences in financial reporting formats based on a fund accounting system, a comparison is made on the following pages between the balance sheets of a profit and nonprofit organization.
The classification of funds for the nonprofit organization used in the example is based upon the Standards and contain the following data:

I. CURRENT FUNDS

A. Current Unrestricted Fund. The fund established to account for the assets, liabilities and transactions of the organization's regular actitivies and which can be administered entirely at the discretion of its board and management. This would be the organization's normal operating fund. This fund would also include amounts designated (appropriated) by the board for special purposes since these appropriations normally can be re-designated by the board for regular activities.

B. Current Restricted Funds. The funds established to account for assets available for regular activities, but only in compliance with restrictions specified by their donors or grantors. Amounts appropriated, set aside,or designated by the organization's board or management are not donor-restricted and cannot be considered as part of this group.

II. LAND, BUILDING AND EQUIPMENT FUND

A. Unexpended Fund for Land, Buildings and Equipment. The fund established to account for cash and other assets contributed by the public to an agency or designated by its board or management for the expressed purpose of acquiring, improving or replacing major property items.

B. Equity in Land, Buildings and Equipment. The fund which accounts for the value of major property and equipment owned by an organization and used in its regular activities. This fund is also to be used to report mortgages and other indebtedness related to the assets included in the fund.

III. ENDOWMENT FUND

The fund established to account for assets contributed with a stipulation by their donor that they be invested, and that only the income earned by the investment be used for operating purposes, either general or restricted, in perpetuity,or for a specified time. Sometimes the stipulation might direct that the income be added to the principal of the fund.

IV. CUSTODIAN FUNDS

The funds established to account for assets received by the organization to hold or disburse only on the instructions of the person from whom they were received or for whom they are held.

The balance sheet for the profit organization is shown in Table III on the following page.

Table III - XYZ Profit Organization
Balance Sheet
December 31, 1978

ASSETS

Current Assets:	
Cash - unrestricted	$ 75,255
- restricted	4,877
Accounts receivable	320,897
Contract billings in process	189,387
Employee advances	---
Prepaid expense	33,115
Total Current Assets	$ 623,531
Property and Equipment, at cost:	
Furniture and Equipment	$ 25,514
Leasehold improvements	16,904
Leased property under capital leases	62,128
Sub Total	$ 104,546
Less accumulated depreciation and amortization	12,192
Total Property and Equipment (Net)	$ 92,354
Other Assets:	
Deposits	$ 12,731
Total Assets	$ 728,616

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:	
Notes payable	$ 2,846
Current portion of obligations under capital leases	19,423
Accounts payable	44,343
Accrued salaries	162,670
Accrued vacation	56,342
Accrued payroll taxes	38,546
Income taxes payable	10,700
Due to subcontractors	33,194
Advances on contracts	86,197
Due to employees	4,813
Total Current Liabilities	$ 459,074
Obligations under capital leases	$ 36,357
Stockholders Equity:	
Common stock, $.01 par value -	
Authorized 200,000 shares;	
Issued and outstanding - 107,399 shares	$ 1,074
Capital in excess of par value	8,321
Retained earnings - Beginning of Period	140,899
Add Net Income For Period	82,891
Sub Total - Stockholders' Equity	$ 233,185
Total Liabilities and Stockholders' Equity	$ 728,616

The foregoing balance sheet shows that the stockholders' equity in the net assets of the corporation is $233,185. This amount is derived from the following calculation:

Total Assets	$ 728,616
Less:	
Current Liabilities	- 459,074
Obligations Under Capital Leases	- 36,357
Stockholders' Equity	$ 233,185

Although the reader is usually interested in other matters reported in the balance sheet, the essential point is that this one statement presents the financial position of a profit organization as of a given date. In contrast, the financial position of the nonprofit organization is reflected in several balance sheets, one for each fund, as displayed in Table IV on the following page.

Another key difference in the financial reports is the absence of a stockholders' equity section in the nonprofit organization's statements. In lieu of this, the section becomes "fund balance" which is the residual of assets minus liabilities to creditors and others. It must also be noted that the foregoing balance sheets for A Nonprofit Organization reflect the reporting of data contained in the accounting system, which is maintained on the accrual basis and fund basis of accounting.

The remaining distinction in a nonprofit organization accounting system, in relation to a profit organization system, concerns treatment of fixed assets and depreciation; transfers and appropriations; and contributions, pledges and non-cash transactions.

Table IV - A Nonprofit Organization
Balance Sheet
December 31, 1973

CURRENT FUNDS
General
Assets

Cash		$ 11,545
Accounts receivable (less allowance for uncollectible accounts of $226)		112,932
Pledges receivable (less allowance for uncollectible pledges of $967)		4,637
Supplies for sale or use		4,116
Prepaid expenses and deferred charges:		
Insurance	$ 385	
Deferred moving expense	1,342	1,727
Total general		$134,957

Restricted

Cash	$ 56,269
Total restricted	$ 56,269

LAND, BUILDING AND EQUIPMENT FUNDS
Unexpended Funds

Cash		$ 1,685
Marketable securities (market value $12,000)		11,400
Pledges receivable, Building Funds Campaign	$320,503	
Less allowance for uncollectible pledges	1,808	318,695
Due from Current General Fund		726
Inventory of construction materials		4,389
Total unexpended		$336,895

Equity in Land, Buildings and Equipment

Land	$ 27,015
Improvements	11,591
Buildings, less allowance for depreciation	577,745
Furniture and equipment, less allowance for depreciation	15,682
Total investment	$632,033

ENDOWMENT FUNDS

Cash		$ 5,659
Investments:		
Securities (market value $127,307)	$ 84,518	
Ajax Building, less allowance for depreciation	15,500	100,018
Total endowment funds		$105,677

CUSTODIAN FUNDS

Cash	$ 10,915
Total custodian funds	$ 10,915

CURRENT FUNDS
General
Liabilities and Fund Balances

Accounts payable and accrued expenses			$111,261
Deferred revenue--contributions received or pledged for future years' operations			325
Due to Land, Building and Equipment Unexpended Funds			726
Fund Balance:			
Appropriations for special purposes by Board		$15,000	
Unappropriated:			
Balance at beginning of year	$7,183		
Increase during year	462		
Balance at end of year		7,645	
Total fund balances			22,645
Total general			$134,957

Restricted

Fund balances	$ 56,269
Total restricted	$ 56,269

LAND, BUILDING AND EQUIPMENT FUNDS
Unexpended Funds

Accounts Payable	$ 877
Fund balances	336,018
Total unexpended	$336,895

Equity in Land, Buildings and Equipment

Investment in land, improvements, buildings and equipment	$632,033
Total investment	$632,033

ENDOWMENT FUNDS

Principal of funds:	
Endowment funds	$105,677
Total endowment funds	$105,677

CUSTODIAN FUNDS

Held for the account of others	$ 10,915
Total custodian funds	$ 10,915

Treatment of Fixed Assets; Depreciation

Unlike profit organizations, many nonprofit organizations do not record the cost of fixed assets on the books and do not depreciate them over their useful lives. Depreciation is an accounting principle which distributes the cost or other basic value of tangible capital assets, commonly referred to as fixed assets, less their salvage value, over the estimated useful life of the assets in a systematic and rational manner. It is a process of allocation of costs. Depreciation is designed to determine the complete cost of operations which utilize fixed assets in the operating processes.

Many nonprofit organizations do not record fixed assets and resultant depreciation for several reasons. A common one is the rationale that fixed assets are usually acquired through funds raised in a major capital campaign or capital funds drive and there is no need to recover the cost of these assets by depreciation charges against current income. When replacement of the assets is necessary, a new building fund campaign or capital funds drive will secure the necessary funds and the financing burden will then impact on future generations who did not pay for the original assets being replaced. Another argument given for the non-recognition of depreciation is that depreciation is a concept of matching costs with revenues in order to determine a profit. Since there is no profit in a nonprofit organization, the practice is unnecessary.

The Standards has promulgated rules that nonprofit organizations record the cost or value of fixed assets acquired and compute depreciation on them. The AICPA is also recommending that this practice become part of generally accepted accounting principles for nonprofit organizations. The AICPA proposed recommendations to the Institute's Financial Accounting

Standards Board state that nonprofit organizations should capitalize purchased fixed assets at cost and donated fixed assets should be recorded at their fair market value at date of gift. Depreciation is to be computed on the basis of the estimated useful lives of the fixed assets, even though depreciation does not require a current cash outlay. Depreciation is an element of cost and should be recognized as such.

Exceptions to the AICPA recommendation are granted for assets that are not exhaustible, such as landmarks, monuments, cathedrals or historical treasures. Most houses of worship are also excluded .

The Standards rules regarding the accounting for fixed assets and depreciation are summarized below.[22]

- A separate Land, Building and Equipment Fund is required to account for transactions, assets, mortgages, other liabilities and Fund balances involving fixed assets held for use by an organization and for contributions restricted by donors for the acquisition or construction of fixed assets for use by the organization.

- Purchased fixed assets should be recorded at actual cost and donated assets at their fair market value at the date of the gift. Where adequate cost records are not available, appraisals of historical cost or market value at date of the gift are acceptable for initial valuation. Where fixed assets are purchased for use by the organization with resources of the Land, Building and Equipment Fund, the transaction is not reflected in the operating statement as it entails only an exchange of one asset for another within the Land, Building and Equipment Fund. It will be reflected, however, in the balance sheet of the Land, Building and Equipment Fund by an increase in fixed assets and a reduction in cash.

- Fixed assets purchased for use with resources of the Current Unrestricted Fund will be reported as a transfer from the Current Unrestricted Fund to the Land, Building and Equipment Fund.

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[22]National Health Council and National Assembly of National Voluntary Health and Social Welfare Organizations, Inc., pp. 14-19.

- A donated fixed asset to be held for use by the organization should be recorded at its fair market value at date of the gift and carried as an asset of the Land, Building and Equipment Fund in the balance sheet.
- Donated fixed assets on which the donor has placed no restriction as to use or disposition, and which will be held for sale or for the production of income, should be recorded as public support in the Current Unrestricted Fund and carried as an asset in the balance sheet of that fund.
- Donations of fixed assets on which donor-imposed restrictions or conditions prevent their being immediately disposed of or currently used in carrying out the agency's normal program or supporting services should be reflected as public support in the Current Restricted Fund of the operating statement and carried as an asset in the balance sheet of the same fund. When the restrictions lapse, the assets should be transferred to the Land, Building and Equipment Fund if they are to be used by the agency or to the Current Unrestricted Fund if they are to be held for sale or investment.
- Depreciation of fixed assets held for use should be recognized as a cost of rendering current services and accordingly should be included as an element of expense.

Transfers and Appropriations

A nonprofit organization which adopts the fund accounting principle reports its activities in several distinct funds, consequently, the nature of the transactions will inevitably involve inter-fund transfers. The Board may transfer assets between unrestricted funds, which is appropriate. A profit organization is not confronted with this matter since it does not utilize several funds to account for its activities.

To avoid confusion, transfers should not be reflected in the financial statements as either an expense or income item. A transfer is an internal action not involving either. Inter-fund transfers should be reported as changes in fund balances statements as illustrated in Table V on the following page.

Table V - T Nonprofit Organization
Statement of Changes in Fund Balances
For Year Ended December 31, 1978

	Current Fund Unrestricted	Land, Building and Equipment Fund	Current Fund Restricted
Fund Balance, beginning of year	$ 100,000	$ 500,000	$ 750,000
Excess of income over expenses	36,775	---	---
Sub Total	$ 136,775	$ 500,000	$ 750,000
Transfer between funds	(10,000)	10,000	---
" " "	50,000	---	(50,000)
Fund Balance, end of year	$ 176,775	$ 510,000	$ 700,000

In the illustration above, a sum of $10,000 was authorized by the board to be transferred to the Land, Building and Equipment Fund for the acquisition of fixed assets for use by the organization. The $50,000 transfer from the Restricted Fund to the Current Unrestricted Fund represents the sum which was previously authorized by the contributor to be made available for use in the organization's unrestricted operations, as of a certain date or at the commencement of a particular activity. Restrictions can be imposed by donors for an infinite number of reasons. When they are removed by certain events or circumstances, the funds usually become available for unrestricted activities of the organization.

An appropriation is more commonly used in governmental accounting systems but has been used by certain nonprofit organizations. It is essentially an authorization by the Board to expend funds in the future for a specific and approved purpose. It is not a current expenditure nor is it an obligation that has already been incurred. Appropriations in the accounting system of a nonprofit organization should be avoided because of the potential for abuse. It is not uncommon for an appropriation to appear as an item of expense on a financial statement to create an impression that the money has already been expended. A preferable alternative is to make no reference to appropriations in the main body of financial statements but rather footnote an intended use of a portion of the fund balance, which is to be set aside for a future specific purpose.

Contributions, Pledges and Non-cash Contributions

By reference to the subject title, it is clear that profit organizations need not be concerned with distinctions in accounting systems in regard to the handling of contributions and pledges. Since a nonprofit organization often receives contributions with a myriad of conditions or restrictions, this distinction is of primary importance to a nonprofit organization. Besides, contributions are the backbone of support or the primary resource for a nonprofit organization.

Contributions can be made in a variety of ways--cash, volunteer services, gifts of securities, buildings and equipment, etc. Contributions are also made in the form of pledges to be redeemed at a future date or over a period of time.

There is wide acceptance of the accounting principle that unrestricted contributions and pledges should be reported in the general or unrestricted fund. Restricted or pledged contributions have not been uniformly handled.

The Standards recommend that expendable support restricted for specified operating purposes be accounted for in the Current Restricted Fund. Contributed real estate, furnishings and equipment to be used by the organization or any funds contributed to acquire these assets are to be accounted for in the Land, Building and Equipment Fund. The Endowment Fund accounts for contributions or support received, subject to restrictions of the gift instruments which require that the principal be held in perpetuity.

Pledges and grants receivable should be recognized and accounted for as assets, to the extent they are judged to be reasonably certain to be collected. Pledges and grants intended for support of activities of a particular year should be included as public support for that year. Pledges and grants intended for support of a future year's operations should be reported as deferred income in the year the pledge is received and until the year the pledge is utilized. Capital funds pledges should be included in total in the year they are received.

With respect to non-cash contributions, donated personal services should be recognized and accounted for to the extent that:

- The services performed are a normal part of the program or supporting services and would otherwise be performed by salaried personnel
- The agency exercises control over the employment and duties of the donors of the services; and
- The agency has a clearly measurable basis for valuing the services

Volunteer fund raising efforts are usually not recorded. In addition, donated materials of significance should be reported as contributions at their fair market value when received if their omission would be misleading.

Additional areas of difference between accounting systems for profit and nonprofit organizations arise in their report formats or financial statements. A comparison has previously been made of the differences in the balance sheets of the profit versus nonprofit organizations. For the remainder of the chapter, discussion will focus on the Standards recommendations for nonprofit organizations in the areas of:

- Uniform classification of support, revenue and expense transactions
- Functional reporting of expenditures; and
- Uniform financial statement formats

Prior to that discussion, general comments concerning financial statements are in order.

Financial statements are basic tools used in business for communicating planning and decision-making results. Financial statements should display the financial strength of an organization and the progress of an undertaking over a period of time. Two primary classifications exist for financial statement readers--the producers and users. Regardless for whom prepared, meaningful financial statements should be:

. Easily comprehensible

. Concise

. All-inclusive in scope

. Related to a focal point of comparison

. Based upon an accrual method of accounting

A major criterion for credibility of financial statements is the adherence to generally accepted accounting principles, which will result in the statements meeting the tests of fairness, materiality, and consistency.

Fairness means that the accounting alternatives used by the organization are all in accordance with generally accepted accounting principles. Materiality is the concept that the accounting report should disclose separately only those events that are relatively important for the organization, or for understanding its statements. Consistency means there is the same treatment of like transactions in different accounting periods in order that the financial statements may be comparable. Implicit in this discussion is an accounting system maintained on an accrual basis of accounting. If not, the financial data should be adjusted to an accrual basis on worksheets before presentation of the data.

Accounting is an evolutionary, logical art rather than a science, hence, future changes in accounting concepts are more likely to be extensions of recent changes rather than brand new concepts. Changes made in the past were intended to overcome dissatisfactions expressed by the users of financial reports. The more common complaints were that financial statements were not simple, uniform, or comparable. The statements were also criticized for their lack of relevancy since the information provided did not reflect current values of assets nor was an adequate assessment possible of an organization's future plans or prospects. The accounting concepts, which are the underlying basis of the financial statements, were also criticized as being too adaptive to management needs.

It is little wonder that financial statements come under attack when the divergent readers of financial reports are identified. Burns and Hendrickson compiled a partial listing of audiences, such as: "Housewives, Top management, Investment Analysts, Investors, Creditors, Owners, Accountants, Unions, Disadvantaged groups, Internal Revenue Service, State and local taxing authorities, Employees, Middle management, People interested in proving corporate evils, Charities."[23] It is becoming more universally accepted, however, that financial statements of nonprofit organizations should be oriented to the contributing public. Indeed, this segment of the public was given overriding consideration in the development of the Standards.

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[23]Thomas J. Burns and Harvey S. Hendrickson, <u>The Accounting Sampler</u> (New York: McGraw-Hill, Inc., 1967), p. 399.

Uniform Classification of Support, Revenue and Expense Transactions

Financial statements of voluntary organizations are more meaningful to the reader if they are prepared in a uniform and consistent manner. Indeed, statements of income and expense are of primary concern to contributors and others concerned with the financial needs and management of resources of nonprofit organizations. Frequent questions asked are how much did an agency receive and from what sources? How were these monies expended--for what programs or services? The Standards attempts to answer such questions in the recommended financial report entitled Statement of Support, Revenue and Expenses and Changes in Fund Balances. This statement is the equivalent of the operating or income statement used in the profit organization, however, there are marked differences between the two statements.

In Table VI on the following page, the income statement for a profit organization is illustrated. This income statement is related to the Balance Sheet shown in Table III for the profit organization. The income statement for the profit organization is more readily understandable since the only source of income was contract revenues. Contract expenses, overhead expenses, other expenses and income taxes were deducted from gross revenues and the result of the year's operations was a profit, or net income of $82,891. This sum belongs to the stockholders, and unless paid out in the form of a dividend, increases the stockholders' equity in the organization.

Table VI - XYZ Profit Organization
Statement of Income
For Year Ended December 31, 1978

Gross Contract Revenue		$ 3,137,736
Less Direct Contract Expenses:		
Salaries	$ 1,290,256	
Fringe Benefits	275,321	
Payroll Taxes	31,676	
Consultant Fees	139,390	
Temporary Clerical Help	65,413	
Travel	77,918	
Per Diem	37,641	
Supplies	18,362	
Printing/Reproduction	41,978	
Telephone/Telegraph	75,263	
Postage/Shipping and Delivery	11,711	
Office Rent	97,430	
Equipment Rental	10,760	
Meetings/Conventions	7,831	
Data Processing	11,916	
Audio Visual Costs	17,300	
Court Reporter	5,963	2,216,129
Gross Margin on Contracts		$ 921,607
Less General and Administrative Expenses:		
Administrative Salaries	$ 373,058	
Fringe Benefits	112,306	
Consultant Fees	43,217	
Travel	17,639	
Per Diem	9,321	
Office Rent	31,276	
Equipment Rental/Lease	7,358	
Office Supplies	12,978	
Postage/Shipping and Delivery	5,123	
Meetings/Conferences	3,287	
Telephone/Telegraph	28,312	
Leased Vehicles	7,220	
Employee Training/Education	10,519	
Bonuses	29,316	
Depreciation/Amortization	15,763	
Marketing	31,712	
Taxes and Licenses	10,318	
Printing and Reproduction	14,001	762,724
Income from operations		$ 158,883
Less Other Expenses:		
Penalties	$ 4,258	
Interest	8,570	
Contributions	4,028	
Advertising	182	17,038
Net income before income taxes and extraordinary item		$ 141,845
Less income taxes		58,954
Net income from operations		$ 82,891

The equivalent to the profit organization's income statement is the Statement of Support, Revenue and Expenses and Changes in Fund Balances for the nonprofit organization, as shown in Table VII on the following pages. The Standards recommends that there be three primary classifications of gross income: (1) support received from the public, both directly and indirectly, (2) fees and grants received from governmental agencies, and (3) other revenue. Further, these items and amounts are to be recorded and reported according to the "Fund" which received the support and revenue. This display will thus provide for reporting of the amount received by object (contributions, fees, dues, etc.), and the amount received for each Fund (Current, Endowment, etc.), and the source of funds.

If the data is analyzed and coded at the time of input into the accounting system, the retrieval of the data for reporting in the above format should pose no major problem. An analysis and classification of support and revenue accounts, i.e., a chart of accounts for a nonprofit organization, can be similar to the classification shown in Figure 11 below.

Figure 11 - Classification of Support and Revenue [24]

Classification based upon the Standards

Support from the Public

100 Contributions

110 Individuals

111 Restricted - Regular Services
112 Restricted - Special Services or Projects
113 Unrestricted

115 Corporations and Other Businesses

116 Restricted - Regular Services
117 Restricted - Special Services or Projects
118 Unrestricted

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[24] Community Fund of Chicago, Inc., Accounting and Budgeting Manual (Chicago, Ill.: Community Fund of Chicago, Inc., Rev. 1975), Chapter VII

120 Foundations and Trusts

121 Restricted - Regular Services
122 Restricted - Special Services or Projects
123 Unrestricted

130 Non-privilege and Sustaining Memberships

200 Contributions to Building Fund

300 Special Events

400 Endowment Legacies and Bequests

500 Legacies and Bequests Other Than For Endowment

700 Contributions by Associated Organizations

800 Community Fund Allocation and Allocations by Other Federated Fund-Raising Organizations

900 Allocated by Unassociated and Non-Federated Fund-Raising Organizations

1000 Fees and Grants from Governmental Agencies

1010 Purchase of Service Fees
1020 Grants

Other Revenue

1100 Membership Dues - Individuals

1200 Assessments and Dues - Local Member Units

1300 Program Service Fees and Incidental Revenue

1310 Program Service Fees
1320 Program Incidental Revenue

1400 Sale of Supplies and Services to Local Member Units

1500 Sales to the Public

1600 Investment Income

1610 Investment Income - Unrestricted
1620 Investment Income - Restricted
1630 Rental Income
1640 Income from Beneficial Trusts

1700 Gains or (Losses) on Investment Transactions

1710 Gains or (Losses) on Investments of Unrestricted Funds
1720 Gains or (Losses) on Investments of Restricted Funds
1730 Gains or (Losses) on Investments of Endowment Funds

1800 Miscellaneous Revenue

STATEMENT OF SUPPORT, REVENUE AND EXPENSES AND CHANGES IN FUND BALANCES
FOR YEAR ENDED, DECEMBER 31, 1978 WITH COMPARATIVE TOTALS FOR YEAR ENDED DECEMBER 31, 1977

Legal Name of Organization: A Nonprofit Organization

Number & Street: 1 Main Street

City & State: Anytown, U.S.A 20000 (zip code)

(amounts rounded to the nearest dollar)

	Current Funds: Unrestricted	Current Funds: Restricted	Land, Building and Equipment Fund	Endowment Fund	Total All Funds, Year Ended December 31, 19 78	Total All Funds, Year Ended December 31, 19 77
PUBLIC SUPPORT AND REVENUE:						
Public Support -						
Received directly -						
1. Contributions (net of estimated uncollectible pledges of $ 25,000 in 19 78 and $ 14,000 in 19 77)	$ 647,416	$ 25,000	$ –	$ –	$ 672,416	$ 590,887
2. Contributions to building fund	–	–	211,123	–	211,123	2,500
3. Special events (net of direct expenses of $ 21,500 in 19 78 and $ 17,632 in 19 77)	41,568	–	–	–	41,568	32,219
4. Legacies and bequests	15,000	37,912	–	100,000	152,912	10,000
5. Total received directly (lines 1 to 4)	$ 703,984	$ 62,912	$ 211,123	$ 100,000	$1,078,019	$ 635,606
Received indirectly -						
6. Collected through local member units	$ –	$ –	$ –	$ –	$ –	$ –
7. Contributed by associated organizations (net of their related fund-raising expenses estimated at $ 3,675 in 19 78 and $ 2,931 in 19 77)	27,562	–	–	–	27,562	22,123
8. Allocated by the Community Fund of Chicago, Inc. (net of its related fund-raising expenses estimated at $ 24,730 in 19 78 and $ 33,598 in 19 77)	562,781	–	–	–	562,781	499,501
9. Allocated by other federated fund-raising organizations (net of their related fund-raising expenses estimated at $ 279 in 19 78 and $ 219 in 19 77)	2,151	–	–	–	2,151	1,234
10. Allocated by unassociated and non-federated fund-raising organizations (net of fund-raising expenses)	64,351	–	–	–	64,351	47,798
11. Total received indirectly (lines 6 to 10)	$ 656,845	$ –	$ –	$ –	$ 656,845	$ 570,656
12. Total support from the public (lines 5 and 11)	$1,360,829	$ 62,912	$ 211,123	$ 100,000	$1,734,864	$ 1,206,262
13. FEES AND GRANTS FROM GOVERNMENTAL AGENCIES (analyze by function in Exhibit B)	$ 49,361	$ 492,333	$ –	$ –	$ 541,694	$ 391,543
OTHER REVENUE - (analyze by function in Exhibit B)						
14. Membership dues - individuals	$ 7,437	$ –	$ –	$ –	$ 7,437	$ 7,135
15. Assessments and dues - local member units	–	–	–	–	–	–
16. Program service fees	107,690	–	–	–	107,690	98,889
17. Net incidental revenue	2,199	–	–	–	2,199	1,786
18. Sales of supplies and services to local member units (net of direct expenses of $ ____ in 19 ___ and $ ____ in 19 ___)	–	–	–	–	–	–
19. Sales to public (net of direct expenses of $ ____ in 19 ___ and $ ____ in 19 ___)	–	–	–	–	–	–
20. Investment income	1,395	–	–	–	1,395	318
21. Gain or (loss) on investment transactions	–	–	–	–	–	–
22. Miscellaneous revenue	15	–	–	–	15	50
23. Total other revenue (lines 14 to 22)	$ 118,736	$ –	$ –	$ –	$ 118,736	$ 108,178
24. Total public support and revenue (lines 12, 13 and 23)	$1,528,926	$ 555,245	$ 211,123	$ 100,000	$2,395,294	$ 1,705,983

Carried Forward

Table VII - A NONPROFIT ORGANIZATION

STATEMENT OF SUPPORT, REVENUE AND EXPENSES AND CHANGES IN FUND BALANCES
FOR YEAR ENDED DECEMBER 31, 1978 WITH COMPARATIVE TOTALS FOR YEAR ENDED DECEMBER 31, 1977

Legal Name of Organization A Nonprofit Organization

(amounts rounded to the nearest dollar)

	Current Funds		Land, Building and Equipment Fund	Endowment Fund	Total All Funds Year Ended December 31,	
	Unrestricted	Restricted			19 78	19 77
24 brought forward: Total public support and revenue	$ 1,528,926	$ 555,245	$ 211,123	$ 100,000	$ 2,395,294	$ 1,705,983
EXPENSES:						
25 Program services - (identify by name and service number)						
(a) A-10 Day Care - General	$ 451,944	$ 22,961	$ –	$ –	$ 474,905	$ 450,123
(b) D-10 Camping Services-Resident	102,803	20,417	–	–	123,220	117,798
(c) D-20 Group Services-Social Rehabilitation	747,291	–	–	–	747,291	633,101
(d) G-10 Federal Research Study-Housing	–	488,720	–	–	488,720	372,514
(e)	–	–	–	–		
(f)	–	–	–	–	–	–
(g)	–	–	–	–	–	–
(h)	–	–	–	–	–	–
(i)	–	–	–	–	–	–
(j)	–	–	–	–	–	–
(k) Total program services (lines 25(a) to (j)	$ 1,302,038	$ 532,098	$ –	$ –	$ 1,834,136	$ 1,573,536
Supporting Services -						
26 Management and general	$ 188,408	$ –	$ –	$ –	$ 188,408	$ 179,176
27 Fund raising	38,018	–	–	–	38,018	32,333
28 Total supporting services (lines 26 and 27)	$ 226,426	$ –	$ –	$ –	$ 226,426	$ 211,509
29 Payments to national organization	$ –	$ –	$ –	$ –	$ –	$ –
30 Total expenses (lines 25k, 28 and 29)	$ 1,528,464	$ 532,098	$ –	$ –	$ 2,060,562	$ 1,785,045
31 Excess (deficiency) of public support and revenue over expenses: (line 24 less line 30)	$ 462	$ 23,147	$ 211,123	$ 100,000		
OTHER CHANGES IN FUND BALANCES:						
32 Property and equipment acquisitions from unrestricted funds	–	–	–	–		
33	–	–	–	–		
34	–	–	–	–		
35	–	–	–	–		
36 Fund balances, beginning of year	22,183	33,122	124,895	5,677		
37 Fund balances, end of year (lines 31 to 36)	$ 22,645	$ 56,269	$ 336,018	$ 105,677		

Functional Reporting of Expenditures

The Standards recommend that expenses be segregated by program services or functions, and supporting services. The latter expenses may be distributed among program and other activities in a reasonable way. Within the functional groupings of program and supporting services, expenses are further classified by "object" of the expense. Accounting for expenses by object means classifying them according to the nature of the goods or services, e.g., salaries, supplies, telephone and telegraph. Accounting for expenditures by function means classifying them according to the purpose served, i.e., program service, management and general, fund raising.

The Standards recognizes the following two primary functional classifications: (1) Program Services and (2) Supporting Services.

Program Services

A program service is generally considered the purpose for which the organization exists.

Supporting Services

Supporting services are the auxiliary services which support the organization so that it can provide the program services. They are either management and general or fund raising in character.

Management and General

These administrative expenses are for the general management of the organization and must be incurred in order to provide program services. They are usually not identifiable with a particular program service. Examples are expenses related to accounting, purchasing, office management, board and general committee meetings, etc.

Fund Raising

These expenses are associated with an appeal by the organization itself for financial support or a solicitation of funds. Expenses applicable to a capital funds appeal should be reported separately from a general appeal. The following are examples of general fund raising expenses.

- Publicizing fund-raising campaigns and special events
- Conducting fund-raising campaigns
- Participation in local federated or federal fund-raising campaigns
- Solicitation of bequests, foundation grants, and other special gifts
- Preparation and distribution of fund-raising manuals and instructions
- Clinics, workshops, and other activities for improvements of fund-raising techniques

The reporting of expenses on a functional basis, according to object of expense, and according to Fund is a three dimensional reporting concept. Again, this requirement should not present an undue hardship for an organization which utilizes a chart of accounts to classify expenses, similar to the manner in which support and revenue were classified. An example of such an expense classification is presented in Figure 12 below and following. The financial statement of functional expenses and directly related program services revenue is displayed in Table VIII on the following pages.

Figure 12 - Classification of Expenses[25]

Expenses

2100 Salaries

- 2110 Executive, Administrative (Non-Clerical and Professional Staff)
- 2150 Clerical Staff
- 2170 Student Stipends
- 2180 Other Staff Salaries

2200 Employee Health and Retirement Benefits

- 2210 Health Benefit Plans
- 2220 Retirement Plan
- 2290 Other Benefits

[25] Community Fund of Chicago, Inc., Chapter VII-6-VII-17.

2300 Payroll Taxes, etc.

2310 Social Security Taxes
2330 Workmen's Compensation and Disability Insurance
2340 Unemployment Compensation Contributions

2400 Professional Fees and Contract Service Payments

2410 Attorney Fees
2420 Other Legal Costs
2430 Auditing and Accounting Fees
2460 Other Purchased Services - Medical
2490 Other Purchased Services - Non-Medical

2500 Supplies

2510 Office Supplies
2520 Buildings and Ground Supplies
2530 Medical Supplies
2540 Recreation and Craft Supplies
2550 Educational Supplies
2560 Food and Kitchen Supplies
2590 Other Supplies

2600 Telephone and Telegraph

2610 Telephone and Telegraph

2700 Postage and Shipping

2800 Occupancy

2810 Rent of Space
2830 Utilities
2840 Care of Buildings and Grounds
2870 Mortgage Interest
2880 Property Insurance and Taxes
2890 Other Building Occupancy Expense

3100 Outside Printing, Art Work, etc.

3200 Local Transportation

3210 Mileage Payment and Auto Rental Plans
3250 Agency Vehicles - Operating Costs
3280 Automobile Insurance
3290 Other Transportation Services

3300 Conferences, Conventions, Meetings and Major Trips

3310 Educational Conferences and Institutes
3320 Annual Meetings
3330 Overtime Meals and Staff Luncheons

3400 Subscriptions and Reference Publications

3410 Staff Literature and Library

3500 Specific Assistance to Individuals

3510 Boarding Payments - Agencies
3512 Boarding Payments - Foster Families
3520 Financial Assistance - Loans and Grants
3530 Activity Fees
3540 Medical and Dental Service Payments
3560 Homemaker Service
3570 Food Assistance
3580 Clothing and Personal Needs
3590 Educational Assistance

4100 Membership Dues

4200 Awards and Grants

4210 Research Allocations
4220 Scholarship

4300 Equipment and Other Fixed Assets

4305 Agency Vehicles - Purchases
4310 Office Equipment - Purchases
4315 Building Equipment and Furnishings - Purchases
4320 Medical and Dental Equipment - Purchases
4325 Recreation Equipment - Purchases
4330 Training Equipment - Purchases
4335 Food Service Equipment - Purchases
4340 Educational Equipment - Purchases
4380 Equipment - Rental
4390 Equipment - Repair and Maintenance

4900 Miscellaneous

4910 Moving and Recruitment
4920 Bonding Insurance

5000 Dues/Support Payments to National "Parent" or Equivalent Organizations

5100 Depreciation or Amortization

5110 Depreciation - Equipment
5120 Amortization - Leasehold Improvements
5130 Depreciation - Automotive Equipment
5140 Depreciation - Building

	Program Services				Supporting Services			Total Program and Supporting Services Expenses Year Ended December 31,	
	(1)	(2)	(3)	(4)	(5)	(6)			
	A-10 Day Care General	D-10 Camping Services Resident	D-20 Group Services Social Rehab.	G-10 Federal Research Study Housing	Management and General	Fund Raising		19 78	19 77
FUNCTIONAL EXPENSES									
1. Salaries	$ 318,186	$ 72,700	$ 523,104	$ 332,330	$ 126,234	$ 25,472	$ -	$ 1,398,026	$ 1,167,462
2. Employee health and retirement benefits	57,273	7,211	94,159	59,819	22,722	4,585	-	245,769	238,736
3. Payroll taxes, etc.	22,279	6,543	36,617	23,263	8,836	1,783	-	99,321	93,450
4. Total salaries and related expenses	$ 397,738	$ 86,454	$ 653,880	$ 415,412	$ 157,792	$ 31,840	$ -	$ 1,743,116	$ 1,499,648
5. Professional fees and contract service payments	11,020	2,500	17,780	32,525	2,177	222	-	66,224	60,312
6. Supplies	19,318	11,530	17,362	11,853	4,683	918	-	65,664	58,732
7. Telephone and telegraph	2,078	2,170	5,129	4,397	4,563	1,687	-	20,024	18,319
8. Postage and shipping	1,111	1,586	3,611	2,813	2,310	291	-	11,722	10,630
9. Occupancy	22,719	10,750	31,325	3,674	10,321	-	-	78,789	69,576
10. Outside printing, art work, etc.	362	310	999	719	90	941	-	3,421	3,133
11. Local transportation	11,730	5,789	4,211	4,217	1,031	219	-	27,197	22,390
12. Conferences, conventions, meetings & major trips	917	250	3,619	8,722	1,106	562	-	15,176	14,200
13. Subscriptions and reference publications	980	380	1,782	1,775	411	150	-	5,478	4,970
14. Specific assistance to individuals	-	-	-	-	-	-	-	-	-
15. Membership dues	1,500	500	825	195	500	-	-	3,520	3,344
16. Awards and grants	-	-	-	-	-	-	-	-	-
17. Miscellaneous	2,713	-	1,244	2,418	213	10	-	6,598	6,011
18. Total expenses before depreciation (lines 4-17)	$ 472,186	$122,219	$ 741,767	$ 488,720	$ 185,197	$ 36,840	$ -	$ 2,046,929	$ 1,771,265
19. Depreciation of buildings and equipment	2,719	1,001	5,524	-	3,211	1,178	-	13,633	13,780
20. Total program and supporting services expenses (lines 18 and 19)	$ 474,905	$123,220	$ 747,291	$ 488,720	$ 188,408	$ 38,018	$ -	$ 2,060,562	$ 1,785,045
DIRECTLY RELATED PROGRAM SERVICES REVENUE									
21. Fees and grants from governmental agencies	$ 29,364	$ -	$ 19,997	$ 492,333				$ 541,694	$ 391,543
22. Membership dues - individuals	1,234	3,671	2,532	-				7,437	7,135
23. Assessments and dues - local member units	-	-	-	-				-	-
24. Program service fees	59,990	39,211	8,489	-				107,690	98,889
25. Net incidental revenue	-	2,199	-	-				2,199	1,786
26. Sales of supplies and services to local member units (net of direct expenses of $ ___ in 19 ___ & $ ___ in 19 ___)	-	-	-	-				-	-
27. Sales to public (net of direct expenses of $ ___ in 19 ___ and $ ___ in 19 ___)	-	-	-	-				-	-
28. Investment income	1,025	100	270	-				1,395	318
29. Gain or (loss) on investment transactions	-	-	-	-				-	-
30. Miscellaneous revenue	15	-	-	-				15	50
31. Total revenue (lines 21-30)	$ 91,628	$ 45,181	$ 31,288	$ 492,333				$ 660,430	$ 499,721

Time Reporting for Functional Accounting for Expenses

Expenses for personnel services usually constitute the largest single cost item of a nonprofit organization, hence, accounting for staff members' time spent in particular program services is essential. Of course, for those employees whose time is spent exclusively on activities of one program service, there is no need to account for their time since their salaries and related payroll costs will be charged directly to the particular service. Functional distribution of compensation of dual-function staff members may be accomplished in either of two ways.

If the proportion of time of an employee who works in several program services does not vary significantly during the accounting period, the distribution of his/her compensation can be based upon an analysis of his/her activities during a representative or sample period. Of utmost importance if this sample basis is used, is that the time selected for sampling is sufficiently random and of such duration to be statistically representative of this employee's total activities for the period reported. Regular time reporting is the most reliable basis for distributing salaries and other compensation of those employees engaged in several program services. This should pose no major burden to an organization if time records are maintained from day to day. A simplified method of time reporting which can be used for summarizing employees' time spent by service activity is illustrated in Figure 13 on the following page.

The sample monthly time sheet can be used to report time spent on various services for periods of time rounded to the nearest hour. The dates for which time is shown appear on the horizontal line across the top of the page. The program services are listed vertically and identified by account classification number and name as provided on the form. Under the appropriate

SEPTEMBER
MONTH

SEMI-MONTHLY PERIOD (Check One)
☒ 1st - 15th ☒ 16th - 31st

--
YEAR

NMT Employee
EMPLOYEE NAME

ACCT. NO.	PROJECT TITLE/ ADMINISTRATION	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15		TOTAL	OVER TIME	REG. TIME
1100	MGMT. & GEN.			7	--	--	H	7			7	--	--					21	36.36%	
5464	A Program		7						7									14	22.73%	
5611	B Program	7								7				7	7	7		35	40.91%	
																		70	100.00%	

ACCT. NO.	PROJECT TITLE/ ADMINISTRATION	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	TOTAL	OVER TIME	REG. TIME
1100	MGMT. & GEN.		7	--	--	7					--	--	7	7				28		
5464	A Program	7					7									7		21		
5611	B Program							7	7	7					7			28		
																		77		
LEAVE TIME:																				
Compensatory Time Used																				
Vacation*																				
Sick*																				
Holiday							7											7		
Leave Without Pay*																				
Other (Explain)																				
SUMMARY:																				
Regular Hours																				
Overtime Hours																				
TOTAL HOURS		14	14	7	--	7	14	14	14	14	7	--	7	14	14	14		154		

AUDITED: ____________ SUPERVISOR'S APPROVAL: ____________ DATE: ____________

EMPLOYEE SIGNATURE: ____________

APPROVED LEAVE SLIP MUST BE ATTACHED

date, the worker's time is recorded in hours beside the related program service number.

Any time spent on work that is considered part of the job as defined in the employee's position description is working time and is reported on the monthly time sheet. Time used for holiday, sick leave, vacation, etc. should be reported as such on the time sheet.

In those cases where an individual is paid a monthly salary and is not compensated for hours worked over and above the normal work week, which is typical for professional staff, the time reported on the monthly time sheet may exceed the normal total hours for a month's work. For example, an executive director may work 50 or 60 hours in one week but still be paid for the equivalent of the standard work week of the organization, which may be 35 hours. The major consideration is that the dollar amount paid is the cost to be prorated to functional areas and the excess hours worked on individual programs, in relation to the whole, are converted to a percentage and applied against that dollar amount. For example, if an employee works 200 hours in a month, whereas the normal monthly work schedule is 173 hours, and the employee has worked 50 hours on Service Program A, 100 hours on Service Program B, and 50 hours on the management and general function, the distribution of the salary amount would be based on individual percentages of 25%, 50% and 25% respectively.

In the event of an unpaid absence, this would be reflected in a lesser amount of salary received and such time would be recorded as leave without pay on the monthly time sheet.

Uniform Financial Formats

A major objective of the Standards is to attain uniform accounting and financial reporting by the voluntary health and welfare organizations.

It was the belief of those who promulgated the Standards that comparability of financial reporting is essential to secure public understanding of the financial statements of the many voluntary organizations operating in the field. Notwithstanding the diversity of programs and service objectives, the basic accounting principles and reporting practices for the various nonprofit organizations are not uncommonly different from each other and can generally be accounted for within the accounting framework of the Standards. The Standards reporting format, or some minor variation thereof, is gaining wide acceptance and application, particularly by those nonprofit organizations which receive funds from major funding bodies or are affiliates of the large national voluntary organizations. To summarize, the Standards recommend the following uniform financial formats:

- Statement of Support, Revenue and Expenses and Changes in Fund Balances
- Statement of Functional Expenses and Directly Related Program Services Revenue
- Balance Sheets for each of the Recommended Funds

Examples of these statements and their distinguishing characteristics in relation to profit organizations were discussed and exhibited in this chapter.

CONCLUSION

CHAPTER VI

CONCLUSION

This thesis attempts to highlight the universe of financial management aspects of the voluntary sector. The magnitude of the subject and limited scope of this study only permitted a recommended accounting and reporting subsystem for nonprofit organizations to be covered in some detail.

The research undertaken in behalf of this study validated an opinion of the author that the voluntary field or "third sector" of the United States economy has received inadequate attention from the various professions and scholars who are concerned with management theory and practice. Financial management requirements of nonprofit organizations cannot continue to be treated as unique or considered to be anomolies of the requirements governing business affairs of the profit sector. Adequate resources must be dedicated to improvements and/or the development and dissemination of basic financial management techniques for the voluntary field. The need exists, regardless of the availability of resources.

An urgent need also exists for additional research and dissemination of financial management concepts and techniques applicable to the voluntary field. The areas of budgeting, particularly the concepts of zero-based budgeting, need to be applied to the decision-making processes of resource allocation. Double-digit inflation and cutbacks in the federal budget for domestic social programs are current challenges that must be faced by the voluntary sector. Many of these additional pressures could be alleviated by improved management approaches, with financial management techniques receiving a high priority.

The private sector has been the pioneer in the development and application of evolving financial management concepts in order to maximize profits. There is also a growing appreciation of improved money management practices by the general public. Individuals are doing a better job of planning and budgeting their personal resources. The current taxpayer revolt over the high cost of government programs is causing governmental decision-makers to be more concerned about program decisions which can be measured in cost benefit, cost effectiveness or cost efficiency terms. The voluntary sector can do no less! The limited resources that are available to the field cannot be wasted.

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