



# Non Profit

# Accounting 101: Building Trust



**TRUST**

Non Profit Accounting Basics E-Book

A photograph of a residential street with colorful houses and parked cars, serving as a background for the text. The street is lined with multi-story houses in various colors like blue, pink, and yellow. Several cars are parked along the sides of the road. The sky is bright with some clouds.

**Building a  
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non profits.**

The purpose of a non profit organization is to meet a need or fulfill a philanthropic role in the community. Unlike a for-profit whose primary goal is to generate a profit for the owner or shareholders, a not for profit organization focuses on reinvesting revenue back into the mission for which the organization was created. This cash flow model significantly affects the accounting processes, setting up the need for unique software offering non profit accounting procedures.

Accrual accounting is specific to non profits and carries a host of variations from accounting used in for-profit businesses. The different processes will impact payroll, overhead, tax considerations, and donations.

The quality and clarity of the reports surrounding cash flow carry significance for both internal and external entities responsible for oversight. The regular review of expenses and donation allocation by the board of directors allows the organization to plan for future operations based on current fund balances. These regular reviews can highlight the need for new fundraising activities.

Building a level of trust in the community and with donors is imperative to the success of non profits. Donors want to know that their money is being used how they expect. The government also needs to be sure that grant money is being allocated correctly. Internal reports will undergo frequent external review via government agencies as many non profits receive grant money to cover operating expenses. The ethical considerations inherent in non profit accounting demand a higher level of reporting excellence.



**Donors want to know their money is being used how they expected...**



## Non Profit Accounting Procedures

Every non profit will need to account for items not encountered in the for-profit realm. Small non profit organizations might attempt to use cash based reporting if donations and payments are made solely in cash. The benefit of this model is an immediate understanding of the current financial standing. However, as the organization grows, the Generally Accepted Accounting Practices (GAAP) dictate the need for [accrual based accounting](#) to facilitate tracking things such as grants, endowments, and individual donations. As streams of income grow in diversity, fund based accounting presents added value to the organization.

Software with non profit functionality can generate a fiscal calendar tied to a particular fund to show the creation date, current balance, projects funded, as well as the closing date. Tracking these funds is complicated by the fact that many donations do not hit the bank account until long after the pledge is made. The tracking begins on the pledge date to ensure accurate fund tracking. Running regular cash flow reports will help organizations better understand their current financial standing.

An organization cannot run based solely on future cash flow. For this reason, reports depicting details of current assets, current inventories, and current liabilities help guide daily operations and provide vital information for the budgeting staff.

## Where Did My Donations Go?

Donations are not enough to have a nebulous concept of where a donor's funds were used. Non profit accounting best practices promote accountability for every dollar. Document retention and destruction policies are intended to maintain a paper trail for every donation and how it's spent.

The organization should back up all such documents electronically to protect against loss. How long the organization is required to keep them is based on state and federal laws.

In keeping with non profit accounting standards, organizations that receive any donation are required to provide a receipt to the donor for tax deductions. Donors can use a bank record (such as a canceled check) of the transaction to claim the tax deduction; however, it is generally considered a better practice to send a receipt. Generating these receipts should be a function of the non profit accounting program. While some donors wish to be recognized, others may desire anonymity, therefore it is necessary to keep all monitoring agencies informed of current financial standings without compromising donor information in the process.

Current [non profit accounting software](#) will generate reports that meet both transparency and anonymity requirements. Donors may place restrictions on their donations. Fund based accounting will accommodate these restrictions by limiting the types of expenses that can be covered by a given fund. Respecting the donor's wishes is of utmost priority and is central to non profit accounting standards.



**An organization cannot run solely on future cash flow...**

## GAAP and Other Non Profit Accounting Standards

Every organization should be run with integrity. To provide greater oversight, ensure ethical operations in financial accounting, and aid nongovernmental entities in preparing reports, organizations such as the Financial Accounting Standards Board (FASB) were established. The standards set by the FASB are recognized by the government and the American Institute of Certified Public Accountants as authoritative. Such authoritative standards, along with generally accepted methods of recording and reporting accounting data, constitute what is collectively called Generally Accepted Accounting Practices (GAAP).

The other contributing agency to GAAP is the American Institute of CPAs (AICPA), which helps set ethical standards for the profession. The AICPA also establishes academic standards and is involved in reviewing and grading standardized tests for professionals entering or seeking further education in the accounting industry. The system of checks and balances, as well as third party advocates for public and private accountants, ensures that GAAP for non profits is followed as closely as possible and that those following the law are protected.

Voluntary compliance with GAAP is expected from any company listed on the American Stock Exchange. While non profits are not listed on the exchange, adherence to GAAP for non profits is just as important. The ideas behind these practices are simple but fundamental to good business. Take, for example, the cost principle which states accounting for purchases must be at their cost price; while this is not hard to grasp, the standard allows those reviewing accounting records to take entries at face value.

As noted earlier, not for profit organizations often receive pledges for monies to be acquired at a later date. The GAAP establishes that under the revenue recognition convention, revenues will be recognized at the time the transaction takes place. This convention dispels any ambiguity surrounding documentation of receipt of funds. Since these standards are voluntary in nature, the materiality principle exists to outline when deviation from the GAAP may be acceptable. It notes that accountants should adhere to GAAP except when to do so would be expensive or difficult, or when deviation from the guidelines will yield no material difference.

## Changing with the Times

Changing with the times to keep accountants apprised of any changes in these protocols, the FASB issues the Statement of Financial Accounting Standards (SAFS). Changes in these standards can carry significant financial impacts for organizations by affecting the processes used to record items such as derivatives.

The main purpose behind the SAFS is to promote a greater level of reporting transparency in a dynamic market. Periodic reviews and updates ensure that regulations and controls are germane to the industry in its current state. Some SAFS, such as standard #117, only apply to non profit organizations. In this example, the standard being issued addresses general-purpose external financial statements provided by non profits. The requirements address the need for a statement of financial position (SOP), a statement of activities, and a statement of cash flows. It outlines what the SOP should include and delineates the procedures for generating the report.

Not for profit organizations will want to incorporate these changes in the non profit accounting standards of the company. Maintaining up-to-date [non profit financial reporting](#) requires using proper software.





Utilize a computerized accounting system tailored to your non profit.



## Non Profit Accounting Best Practices

The unique considerations of non profit accounting procedures have brought about a list of best practices. These include, but are not limited to:

- **Implementation of a budgeting process** that supports the non profit's financial requirements and supports the core mission.
- **Regular review of financial statements** (i.e. Current Balance Sheet, Fund Raising Plan, Reserves Policy) by the CPA and board of directors.
- **Submission of financial data** to facilitate informed decision making by parties such as grantors and the board of directors.
- **Ensuring the non profit abstains from the use of restricted funds** to cover current year expenses.
- **A plan to address any cash and in-kind matches** that may arise about grant requirements.
- **Spelling out a specific Policy on Reserves** to provide clear directions on fund allocation in the event of a year-end excess or unanticipated expense.
- **Announcement of a Development Plan** outlining goals, deadlines, and assigning responsibilities to particular individuals so that budgetary considerations and accountability are maintained.
- **Utilizing a computerized accounting system** tailored to non profit accounting procedures.



Organizations following these non profit accounting best practices will enjoy a greater level of credibility in their sphere of influence.

The periodic adjustments to the GAAP protocols only serve to bolster transparency in reporting for companies across the board. It is not hard to see why non profit organizations should do all that is in their power to meet and exceed the industry standards as their continued operation depends on building trust.

While trust is not built overnight, a long history of transparency and accuracy in financial reporting through non profit accounting basics will put any non profit on the road to success.

## Climbing out of the Black Hole of Disorganization

The Enron scandal of 2001 rocked the accounting world. The tangled web of falsified documentation and sketchy accounting practices earned the accountants involved an unprecedented level of ignominy. The intent to deceive was evident and was the grounds for conviction in the case. However, there are many organizations that struggle to keep accurate records on daily operations with no intent to deceive.

The accounting practices these companies follow may be outmoded and unable to accommodate the current requirements. Disorganization creates



an atmosphere of uncertainty in most, if not all, business settings and non profit organizations are not immune. The need for credibility in the non profit accounting realm cannot be overemphasized.

Starting with the non profit accounting basics and building from there, an organization can begin to climb out of the black hole of disorganization. A proper understanding of the current financial position of the organization through detailed cash flow reports can shed light on areas of opportunity. Timely acknowledgment of donations will foster goodwill with donors. Establishing measurable goals and setting time lines will keep the organization on track and increase personal accountability. These practices can only be followed when the organization has a comprehensive accounting program tracking funds and producing usable reports and data.

## MORE ABOUT Cougar Mountain Software

Cougar Mountain Software was founded in 1982 with a vision to develop powerful business accounting, nonprofit accounting, and point of sale software solutions. Our 30 years of success comes from two key practices; (1) employing in-house accounting and business professionals for our sales, support, training, and development teams, and (2) listening to our clients. These two practices make our accounting solutions unique to competitors who outsource their support and build fixed and un-scalable solutions to meet the general needs of the masses.

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