



Why Nonprofits Need Nonprofit Accounting Software

Introduction

Nonprofit organizations rise and fall on their reputations. Increased requests for transparency and accountability in financial reporting coupled with donor demand that contributions be used as intended has nonprofit financial managers reviewing their programs and processes. In the age of digital communications, social media, and the 24-hour news cycle, perceived violations of public trust offer organizations little chance to recover from financial mistakes.

In the headlights of this increased focus on donor intent and accountability are the chief financial officer, accounting staff, and finance director. More and more often they are being asked to anticipate problems and suggest solutions, to articulate timely financial results, and to provide leadership in a dynamic nonprofit marketplace.

Unfortunately, traditional accounting systems are ill-equipped to help nonprofit financial officers meet these challenges. Managing unique revenue streams such as donations, membership dues, program revenues, grants, and investment income requires software tailored to the needs of nonprofits. Systems that are not designed to automate specific nonprofit business processes and reporting needs or those with a clumsy module for the nonprofit component cost organizations time, energy, and effort. A solution that provides the highest levels of transparency and accountability is necessary to help organizations make solid, strategic decisions and avoid violating the public's trust.

Contents

- 2 Introduction
- 3 The Benefits of a Nonprofit Accounting System
- 3 Unique Regulations and Standards for Unique Solutions
- 4 Supporting Your Distinct Nonprofit Business Processes
- 6 Nonprofit Reporting and Budgeting Made Easy
- 7 Accountability and Your Reputation
- 7 Donor Stewardship and Intent
- 7 Internal Controls
- 8 Conclusion

The Benefits of a Nonprofit Accounting System

We know that nonprofit accounting is different than for-profit accounting. Nonprofits must track and report on segregated accounts in the form of funds which have to be treated as separate entities with their own general ledger. They must provide individual income statements and balanced sheet reports in addition to total reports for the entire organization. These tasks are easy with a nonprofit accounting system that helps:

- Meet unique financial reporting requirements
- Drive different business processes, such as grant and endowment management
- Ensure that donor and grant restrictions and intent are met
- Provide internal accountability to safeguard assets
- Make timely financial information readily available to donors and prospects
- Provide actionable data to managers to use in strategic decision making
- Demonstrate accountability to multiple stakeholders—donors, volunteers, the public, and state and federal agencies

Another important note is the difference in staffing levels between nonprofits and for-profit organizations.

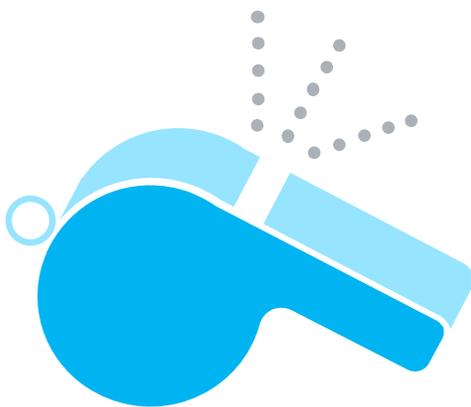
Most nonprofits have lean accounting staffs limited by time and resources. Accounting systems tailored to their business model help them save resources and increase accuracy.

Unique Regulations and Standards for Unique Solutions

Because nonprofits are fueled by grants and contributions, they have different financial accounting standards to meet than for-profit companies. In 1993, the Financial Accounting Standards Board issued two standards that established reporting requirements for nonprofit organizations: FAS 116 (Accounting for Contributions Received and Contributions Made) and FAS 117 (Financial Statements of Not-for-Profit Organizations).

For-profit accounting systems are not designed to meet these standards. To be compliant while navigating challenging accounting, reporting, and auditing processes, you need an accounting solution that allows you to quickly set up the data for the standard reports inside your system. This saves you time and money and eliminates the need for an auditor who would have to put these reports together outside of the system.

When it comes to classification of revenue by restriction, only a true fund accounting solution works. FAS 116 requires nonprofits to record and report on the use or time restrictions that funders and donors have placed on their contributions. If not met, these restrictions are carried over from one fiscal year to the next and your accounting system must be able to handle this critical function. For-profit accounting systems require an entry be made to roll the restrictions over from year to year. These entries are often made by the auditors and lead to increased audit costs.



There are several other nonprofit reporting requirements that are not met by for-profit accounting systems. A balance sheet is a poor substitute for the Statement of Financial Position, because a for-profit balance sheet cannot close net assets by class of restriction and therefore will not meet FAS 117 requirements. And while the income statement is often used in place of the Statement of Activities, it is inferior because it does not provide the amount released from restriction, as under FAS 117 all expenses are unrestricted. The Functional Expense Report is unique to nonprofits and for-profit systems aren't capable of handling this requirement without significant workarounds.

Supporting Your Distinct Nonprofit Business Processes

Contributions to nonprofits come in many forms—donations, grants, dues, events, services, pledges, planned giving, and bequests. And by their nature, they require data to be tracked and reported across multiple programs, projects, and reporting periods. This is not something a for-profit accounting software solution can do effectively. In fact, trying to use one for this can lead to a workload so overwhelming for the accounting department that it may have to limit the number of funding opportunities it is able to maintain and pursue.



In order to measure the effectiveness of grants and endowments, you need a flexible, dynamic chart of accounts that gives you an entire record so you can view financial activity, budgets, grant reimbursements, endowment allocation details, supporting documents, and change history. Nonprofit accounting software can do this; a for-profit system cannot. With a nonprofit accounting system you can:

Track grants and endowments

- Several extra levels of tracking make it easy to separate and report on activity for various projects, special events, endowments, exhibitions, scholarships, and investments without exploding the number of accounts in your system. With for-profit systems, adding just one of these items means adding numerous accounts with new segment values, which wastes time and clutters your chart of accounts.
- Tracking transactions and budgets at many different levels allows you to create reports within minutes to satisfy your board members, auditors, grantors, and donors.

Manage grant and endowment restrictions

- Major donations and grants are often restricted. This means that they are constrained by specific requirements, desires, or expected outcomes. If an organization cannot demonstrate that these donations have been used to the donor or grantor's specifications, there will be trouble, in the form of loss of funding, loss of nonprofit status, or a tarnished reputation. If you use a nonprofit accounting solution, you don't have to worry. Grant management is simplified through automatic tasks that currently require manual effort. From data entry to budget checking to report distribution, nonprofit accounting solutions significantly reduce administrative effort so that you can focus on high-value tasks.

- Reporting is easy with the ability to report by grant in detail, allowing you to make smart decisions and evaluate the performance of every initiative and department. You can reduce the amount of staff time needed to meet grant reporting requirements and manage grant activity using grant relevant dates instead of organization fiscal year.
- Grant information can be shared internally by allowing staff members access to the necessary reports when they need them. You can also ensure that funds are used only on approved expenditures by leveraging strong internal controls. You can manage grant budgets and spending limits, supervise important grant deadlines, complete grant administrative tasks, automate the indirect cost reimbursement calculation, and store relevant grant communications in one system.

Track and process grants

- Grants require an additional level of tracking and processing that isn't present with traditional donations—expense reimbursement and indirect cost allocations. These functions cannot be done in traditional for-profit accounting systems, which require you to spend a considerable amount of time gathering the necessary information and creating calculations outside of the system. Spreadsheets are often used to accomplish this, which often leads to mistakes, unnecessary delays, and a process that is not auditable and open to fraud.

Manage reimbursable grants

- For organizations that receive reimbursable grants, money is expended by the organization to meet the grant or contract in advance of funding being received. This puts considerable pressure on the nonprofit, as funds might be spent and not reimbursed if procedures aren't followed. This is when tight spending controls and budget compliance become very important. Cost overruns must come from the organization's unrestricted net assets, and this becomes prohibitive for many organizations exploring grant funding.
- A solution that provides the highest levels of transparency and accountability is necessary to help organizations make solid, strategic decisions and avoid violating the public's trust.
- Reimbursable grants need a system that quickly calculates the amount expended on each program by grant or contract and creates a corresponding report in each funder's appropriate format to facilitate quick submission of reimbursement requests. Time is money, and if you are trying to use a for-profit system to handle this process, it's going to cost you more money.



Account for more than one grant

- There are costs that aren't easily linked to a particular grant or contract that are essential to keeping the organization running. It's impractical to meter the cost of these items, and therefore most grantors, including the Federal Government, allow nonprofits to bill a percentage of the direct expenses related to the grant to recover the indirect costs. In many grants this is referred to as NICRA or Negotiated Indirect Cost Rate Agreement and is part of the grant contract. The best nonprofit accounting systems automate the process of calculating the total direct costs and associated indirect allowance and even allow for the storing of provisional and official rates by effective dates. Time spent outside of the system is minimized, along with errors and frustration, when the right tools for the job are used.

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Nonprofit Reporting and Budgeting Made Easy

A nonprofit accounting system pays dividends when it comes to reporting, because financial reporting requirements for nonprofit organizations are unique. Reports must be accurate and sophisticated enough to pass regulatory and audit criteria. Yet at the same time, the system that produces them must be easy to use and flexible enough to meet the needs of a wide variety of groups, including the board of directors, staff, constituents, and the public. By using nonprofit accounting software, fund accounting reports measure performance against budgets and income versus expenses, i.e. the net surplus/deficit. Reports from a commercial system only measure income versus expenses, resulting in time-consuming manual processes.

Budgeting is another area where a nonprofit accounting system can help an organization meet the specific needs of its constituents. While nonprofits use budgets to focus on short- and long-term strategic goals, the nonprofit's board of directors uses the budget to oversee operations. When the board approves a budget, it's approving the use of resources for specific purposes. A budget is also a financial control that sets spending limits and attempts to keep costs in line with funding coming into the organization. Third-party stakeholders such as grantors require a formal budget before considering grant applications, extending credit, or making pledges, gifts, and bequests. To these stakeholders, a budget provides a measure of accountability, transparency, and good faith.

Other benefits of a nonprofit accounting system include the ability to:

- Give the organization's managers a view of daily expenditures, allowing them to enforce spending limits directly in the system
- Efficiently project budgets over time and easily create multiple budget scenarios to examine different assumptions and projections without using spreadsheets



Accountability and Your Reputation

Accountability is the rock your organization stands on. It's about being able to answer to those who believe in you, who support you, and who work for you. And your nonprofit's reputation depends on everyone in your organization. Nonprofit accounting software keeps you focused on donor stewardship and intent and enhances the internal controls within your organization.

Donor Stewardship and Intent

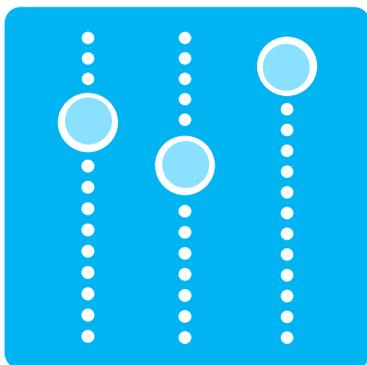
Donors and internal customers are demanding more timely information on individual donations. Responding to that demand and satisfying each customer provide your organization with the competitive advantage you need for long-term survival. A nonprofit accounting system that supports this increased demand is the answer. With it, you can improve customer service with timely reporting to show that individual donations were used as the donors intended. Specifically a nonprofit accounting system provides:

Stewardship reports

These reports integrate fundraising and financial data to provide donors and department heads with a clear understanding of the status of individual donations. These reports can incorporate contributions, investment earnings and appreciation, expenses, and most importantly, available cash. This is what fund accounting is all about.

Easy access to reliable, comprehensive information

This builds donor confidence in the management of your organization by empowering internal customers to make informed business decisions. You can provide consolidated information from multiple systems for a single view of fundraising, accounting, and program activities. You can also identify key indicators to monitor the long-term viability of the organization and provide ongoing donor recognition and proof that donated dollars were used to further the mission. This is something for-profit systems cannot provide because they do not have the capability to designate the restrictions of a donation—the function that feeds stewardship reporting.



Internal Controls

Despite the nature of the work, nonprofits are not exempt from internal or external fraud. The solution to preventing fraud is tight internal controls. Your software must provide strong internal controls both within the system and in how the organization interacts with it.

A good nonprofit accounting system helps by:

Improving data integrity

A nonprofit accounting solution should allow for reporting to take place within the system so there is no need to work outside the system for financial reporting. This is critical, because the more work that is done outside the system, the higher your organization's audit risk. If an employee is working outside of your current accounting system, this should raise a red flag as it increases the possibility for fraud.

Reducing duplicate entry through integration

If your nonprofit accounting system integrates with your fundraising and CRM system, you have less need for duplicate data entry. Entering data across multiple systems increases the likelihood of error and may create an opportunity for fraud.

Increasing confidence in the approval process

While this may sound obvious, in practice it is not so simple. In the approval process, you may have a documented policy of who can approve invoices or checks, but sometimes approval is needed quickly and the appropriate approver is out of the office. In this case, your accounting solution should provide log files so you can monitor actions and view the process from invoice or receipt entry to approval, posting, and payment.

Segmenting duties

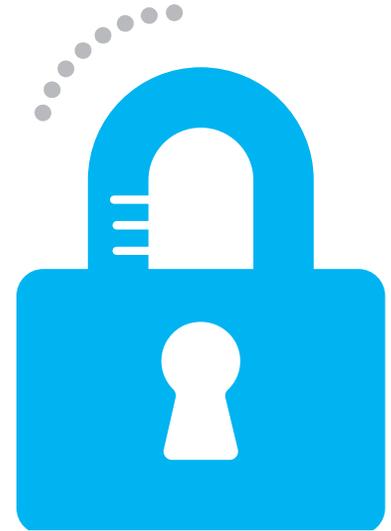
Policies must be adopted by high-performing nonprofit organizations to ensure that duties are properly segmented. For example, if an employee enters cash, he or she cannot create a deposit ticket. If an employee enters invoices, he or she cannot approve those invoices. An organization's accounting software must provide the ability to separate tasks to support these controls.

Producing accurate, timely financial reporting

Sending monthly financial reports to management is one of the best fraud deterrents, because all questions and concerns can be addressed immediately.

Conclusion

Given the challenges inherent in nonprofit accounting, along with donor and public demand for accountability and greater financial transparency, it's probable that more and more organizations will move to nonprofit accounting systems. The risks of inaccurate or incomplete reporting and the inability to deliver donor intent are too high for organizations to settle for tools that don't help advance their missions.



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