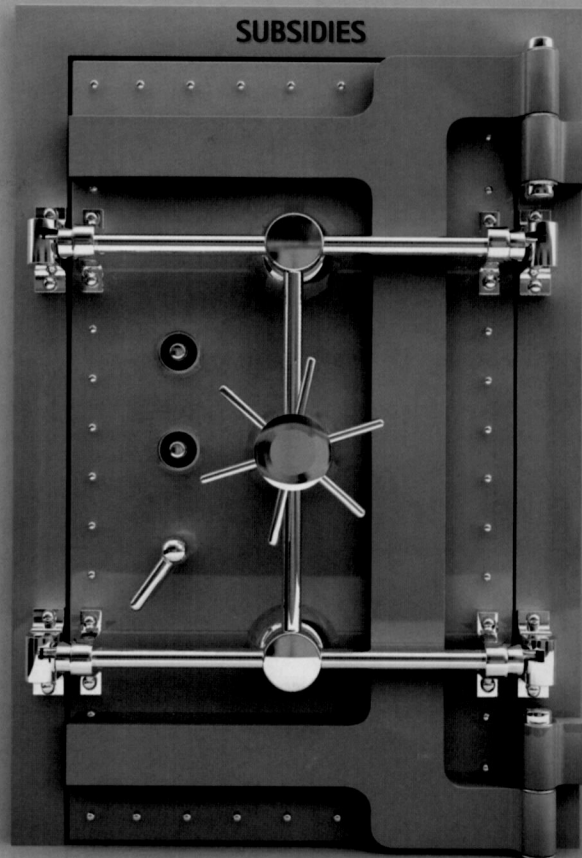


Fund accounting by non-profit entities



INTRODUCTION

Many non-profit entities set aside specific amounts of money received from third parties exclusively aimed at achieving a certain objective. A college, for example, may set aside money donated by third parties in order to generate investment income, which is then exclusively applied to subsidise the studies of certain students, in accordance with donor's wishes. The initial fund capital is generally kept intact and utilised to generate additional income for the fund and not distributed to any beneficiaries. A fund, as defined, is created. Such a fund is referred to as a special purpose fund, distinguishing it from the general or equity fund of the non-profit entity, as the application of the funds resources is limited to the special purpose intended by the parties to the fund agreement.

No formal founding documentation necessarily exists upon creation of a fund, as it is not an entity created by the operation of law. It is however, common practice that the parties involved enter into a fund agreement (written or verbal), similar in nature to a trust deed. This ensures that the money received from third parties and subsequent income generated thereon is administered, by the non-profit entity, in accordance with the wishes of the donors.

In accounting for the fund the argument exists that non-profit entities need not apply Statements of Generally Accepted Accounting Practice (GAAP) but merely their own generally accepted accounting practice (gaap). In certain instances this may hold true but what of the section 21 companies, associations not for gain, incorporated in terms of the Companies Act No 61 of 1973?

In terms of Circular 5/2003 issued by SAICA, as well as the legal opinion obtained by SAICA per Circular 8/1999, in order to meet the requirements of the Companies Act GAAP must be applied. Should material departure from GAAP be considered appropriate then disclosure of the departure, the particulars thereof, the reasons therefore and the effect of such departure on the financial statements should be disclosed.

Even if GAAP is not legally enforceable, the *Framework for Preparation and Presentation of Financial Statements* (the Framework) should be considered as it is concerned with general purpose financial

statements that are prepared and presented at least annually for the purpose of meeting the information needs of a wide range of users, including the members of the non-profit entity and the parties to any fund agreements.

Furthermore the Framework para 14 states the following Objective of Financial Statements, "*Financial statements also show the results of the stewardship of management for the resources entrusted to it.*" This is often referred to this as "*responsibility accounting*". This will assist in the transparent management of the fund assets by the non-profit entity for the purposes intended by all parties to the fund agreement.

ACCOUNTING

The following journals are applicable on creation of the fund or the increase of the fund capital as a result of money being received by the non-profit entity from a donor:

	Dr	Cr
Non-profit entity bank account	10 000	
Fund account		10 000

The principle applied in this journal entry is supported by the Implementation Guidance for IAS 39 (AC 133) Question D1.1 *Financial Instruments: Recognition and Measurement*, dealing with cash received as collateral for another transaction. The ultimate realisation

of a financial asset is conversion into cash and, therefore, no further transformation is required before the economic benefits of cash transferred can be realised. The receiving entity must recognise an asset and a liability. The fund account is a financial liability, as defined by IAS 32 (AC 125) *Financial Instruments: Disclosure and Presentation*, being a contractual obligation, in terms of the fund agreement, to deliver cash to another entity, either the donor or beneficiary as identified in the fund agreement.

It is common practice, in order to achieve good governance, that amounts of money allocated by a non-profit entity to a special purpose fund (the fund) received from a third party, are kept in a separate investment account.

	Dr	Cr
Fund bank (investment) account *	10 000	
Non-profit entity bank account		10 000

* The subsequent measurement of this account is dependent on the appropriate classification of financial assets in terms of IAS 39 (AC 133)

Income generated by the fund, such as investment income on fund money, cannot be recorded as revenue of the non-profit entity as IAS 18 (AC 111), *Revenue*, para 08 disallows the recognition of amounts received on behalf of third parties as revenue. The non-profit entity is merely acting as an agent for the fund (the donor) and in terms of IAS 18 (AC 111) Appendix A, agency transactions should not be recognised as revenue. The income generated by the fund is a financial liability as defined in IAS 32 (AC 125) as it is a contractual obligation to deliver cash to another entity, either the donor or beneficiary as identified in the fund agreement.

In accounting for the fund the argument exists that non-profit entities need not apply Statements of Generally Accepted Accounting Practice (GAAP).

	Dr	Cr
Fund loss	200	
Fund account		200

The non-profit entity has no right to the revenue or profits of the fund, unless the fund agreement provides for a distribution by the fund to the non-profit entity. Any surplus revenue is therefore retained in the fund investment and fund account. These amounts remain outstanding as contractual obligations to deliver cash to the donor or beneficiaries.

By implication the fund creates a self-contained accounting entity for which the accounting system must make provision as a self-balancing unit. The fund account and fund investment account continually equalise.

In practice it often occurs that the revenue and disbursement transactions of the fund are effected from the non-profit entities bank account as and when they occur during the period, rather than the investment account of the fund that is not necessarily designed as a transactional account e.g. fixed deposit. At the end of the period any surplus cash still held in the non-profit entities account is transferred to the fund investment account. Should a deficit occur a journal identical to that discussed above is recorded for the resultant loss suffered by the fund.

Three types of funds have been identified based on the subsequent application of fund income:

- Fund income used to defray general expenses of the non-profit entity;
- Fund income used for a specific purpose such as bursaries; and
- Fund income used to acquire assets for the non-profit entity.

When the fund income is applied to the general benefit of the non-profit entity, all the revenue of the fund is distributed to the non-profit entity and included as revenue for the non-profit entity. The principle of 'conduit pipe' is not applicable and the revenue does not retain its initial nature as, for example, interest income. The income is now income distribution received from the fund and is recorded as follows.

	Dr	Cr
Fund account	1 000	
Income distribution from fund		1 000
Non-profit entity bank account	1 000	
Fund account bank account		1 000

The following journal is applicable to fund revenue:

	Dr	Cr
Fund bank account	800	
Fund account		800

Any disbursements of the fund cannot be automatically regarded as an expense of the non-profit entity, as it does not necessarily comply with the requirements of an expense as defined in the Framework. The fund account is reduced as the contractual obligation to deliver cash to another entity (financial liability) has been reduced by the payment to that entity.

The following journal is applicable to fund disbursements that are not regarded as expenses of the non-profit entity:

	Dr	Cr
Fund account	1 000	
Fund bank account		1 000

Generally the non-profit entity administers the fund and the fund agreement contains a provision, that in the event of the fund disbursements exceeding the fund revenue, the non-profit entity will be responsible for the resultant loss. This loss meets the definition contained in the Framework for an expense and must be recognised by the non-profit entity as an expense.

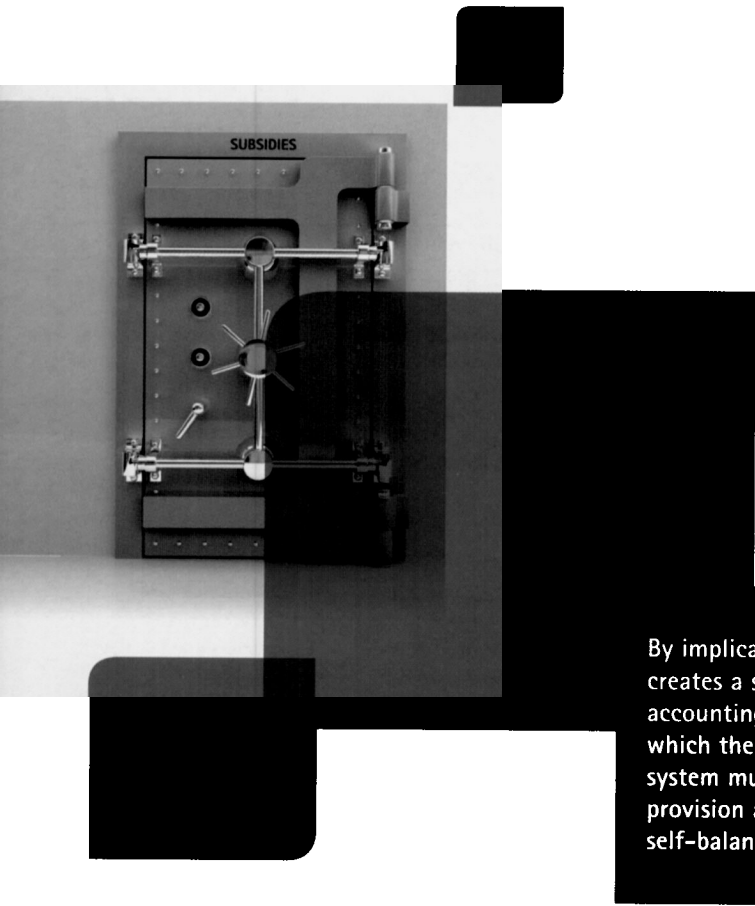
It is common practice, in order to achieve good governance, that amounts of money allocated by a non-profit entity to a special purpose fund (the fund) received from a third party, are kept in a separate investment account.

Assuming the fund generates revenue amounting to R800 and incurs disbursements amounting to R1 000, as recorded above, the following journal becomes applicable to the resultant loss suffered by the fund at the end of the reporting period:

A similar process is followed if the fund income is used to purchase assets for the non-profit entity.

Where the fund disburses its income to a third party, such as a bursary recipient, the fund disbursement journal is passed between the fund investment account and the fund account, as discussed above, and has no effect on the non-profit entities income statement.

	Dr	Cr
Fund account	1 000	
Fund bank account		1 000



By implication the fund creates a self-contained accounting entity for which the accounting system must make provision as a self-balancing unit.

PRESENTATION AND DISCLOSURE

IAS 1 (AC 101), *Presentation of Financial Statements*, disallows the offsetting of the fund investment account and the fund account in the financial statements of the non-profit entity unless it is permitted by a Standard or Interpretation.

IAS 32 (AC 125) para 42 only allows offsetting of a financial asset and financial liability when an entity has a current legally enforceable right to offset the recognised amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously. The application of IAS 32 para 42 must be determined on a case-by-case basis with reference to the provisions of the underlying fund agreement and any other relevant factors surrounding a particular fund.

The fund donors entrust the management of a non-profit entity with the assets transferred to the fund. These assets are invested in a fund account and are administered by the non-profit entities management for a specific purpose, which does not necessarily benefit the non-profit entity.

On this basis the following three options are available to the reporting non-profit entity:

- Separate presentation of the fund investment and fund account on the face of the balance sheet of the non-profit entity together with a note or supplementary schedule of movement on the fund account; or
- Presentation of the fund investment and fund account within similar line items and disclosure of the associated movement in the notes and supplementary schedules of the non-profit entity; or
- If offsetting is deemed appropriate then disclosure of the fund investment and fund account with associated movement in the notes of the non-profit entity in accordance with para 21 of the Framework.

CONCLUSION

When engaging in fund accounting any entity, whether profit motivated or not, would do well to follow the general principles embodied in the Code of Professional Conduct (2003:4-15), *Clients money* issued by SAICA, even if not legally subject to it:

- Keep the fund money separate from the entity's money;
- Use the fund money only for the purposes contained in the fund agreement; and
- Be ready and able to account to the relevant stakeholders at all times. **ASA**

Stephen Coetzee, CA(SA), is Senior Lecturer, Department of Accounting, University of Pretoria.

Editor's note: There is no formal guidance on this treatment as many of these entities do not comply with Statements of GAAP. If you have alternative views on the treatment, please let us know.

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