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Are the Financial Accounting Standards Board's Current Standards for Nonprofit Organizations More Useful Than Previous Guidance?

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Are the Financial Accounting Standards Board's Current Standards for Nonprofit Organizations More Useful Than Previous Guidance?

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ABSTRACT:

The purpose of this paper is to find out whether the Statement of Financial Accounting Standards No. 117 provides more useful information to users than previous nonprofit financial accounting guidance under individual audit guides. More information is required under the new standards, as well as different financial statement formats. However, some users may find new financial statements confusing. Furthermore, the financial statements require no measure of operating income, despite users' request for some type of "bottom line". However, most users should find the new information helpful and the new format more useful.

In my study, I administered a questionnaire to 66 accounting students to determine if they could assess from the financial statements information deemed to be useful. Overall, the statements prepared under SFAS No. 117 appear to present that information better than the financial statements under the audit guides.

Introduction

Nonprofit organizations have a larger presence in today's economy than commonly thought. There are 1.1 million tax exempt organizations in the United States (Waters 1996). As of June 1996, these organizations accounted for 6% of the gross domestic product. They employ seven million people, which is one out of every eighteen people in the labor force. 45,000 of these organizations are being added each year, leading to a sector growth rate four times as fast as the economy since 1970 (Waters 1996).

The amount of resources dedicated to nonprofit organizations show their importance in the economy. Revenues of nonprofits amount to $1.1 trillion, up from just $200 billion in 1978 (Herzlinger 1996). Endowments entrusted to nonprofits total nearly $325 billion (Prenatt 1995). As Regina Herzlinger stated in The Harvard Business Review, "we entrust them with society's most important functions -- educating our minds, uplifting our souls, and protecting our health and safety" (1996, 97).

Increasing Importance of Financial Information of Nonprofits

Ms. Herzlinger also stated about nonprofits, "when they are bad, they are horrid" (Harvard Business Review 1996, 97). Recent fiascoes such as the former president of United Way of America defrauding the organization of over $1 million has raised public scrutiny on nonprofit accounting matters. The result of this is that donors today are increasingly comparing the relative value of nonprofits (Ensman 1996). This includes judging both their accomplishments and evaluating their annual reports. In fact, just ten years ago, financial reports were seldom examined, while today's donors want to know how efficient and effective an organization is (Ensman 1996).

Financial information is one of the keys to finding the efficiency of organizations. Increasingly, donors want to know how their contributions are being used. They are interested in expense information, such as whether the organization is spending too much on administration and to little on the major purpose of the organization (Herzlinger 1996).

Donors today demand accountability. Accountability is essentially "proof" of efficient use of donations. Such proof can be given in several forms. Fund Raising Management suggests ideas such as giving donors photographs showing the nonprofit's activities and testimonials by those benefiting from the service (Ensman 1996). Such tactics may appeal to the emotional side of donors, encouraging them to donate, but they do not show accountability. Donors are demanding relevant and reliable financial information. Ultimately, generally accepted accounting principles have to address user needs, making financial statement presentation very important. As Crenshaw says in Foundation News & Commentary, "the public uses audit reports [and financial statements] as a measure of organizational excellence..." (1994, 29).

History

Before the Financial Accounting Standards Board developed standards specifically covering not-for-profit organizations, each major nonprofit sector developed its own manuals on how to account for their individual circumstances (Robbins and Polinski 1995). These manuals addressed unique problems and needs. These classifications were based on industries and included colleges, hospitals, and community service organizations. The result of this industry-by-industry approach was that different nonprofits in similar economic circumstances with similar transactions, reported different financial information.

In the early 1970's the American Institute of Certified Public Accountants (AICPA) became more active in providing guidance for nonprofit entities. Between 1972 and 1974, they published audit guides for hospitals, colleges and universities, and voluntary health and welfare organizations. These guides were similar to the manuals already in use by each nonprofit sector (Robbins and Polinski 1995).

Rules Under Audit Guides

There were four general guides from the AICPA governing nonprofit organizations. These were Audits of Certain Nonprofit Organizations, Audits of Providers of Health Care Services, Audits of Colleges and Universities, and Audits of Voluntary Health and Welfare Organizations.

All of these general nonprofit sectors required a Balance Sheet. However, it was required that organizations report individual fund balances. Examples of funds include operating, plant, and endowment. The difference between assets and liabilities in each fund was called "fund balance". Aggregate reporting of all the funds was not required but optional. The focus was on funds rather than the entire organization.

A Statement of Revenues, Expenses, and Changes in Fund Balance was required for voluntary health and welfare and for certain other nonprofits only. Only revenues and their associated expenses were required. Changes in the fund balance account were to be reported on a fund-by-fund basis.

A Statement of Cash Flows was required for providers of health care services only. This followed the requirements of Statement of Financial Accounting Standard No. 95, Statement of Cash Flows. A Statement of Functional Expense was also required for voluntary health and welfare organizations, listing expenses by functional and natural classifications. Functional classifications show general purpose. Examples include program, management, and general. Natural classifications explain what the expense is actually for. Examples include salary, supplies, and utilities.

Throughout the 1980's and early 1990's, there was growing concern over the diversity of financial reporting among nonprofit sectors. The problem still existed that different nonprofit organizations with similar economic circumstances and similar transactions reported different financial results.

New Guidance: SFAS 117 and 116

The Financial Accounting Standards Board (FASB) recognized the concern over diversity in accounting treatment among nongovernmental nonprofits. The board also recognized its own responsibility to take an active role in developing standards for nonprofits. In 1992, the FASB produced Statement of Financial Accounting Standards (SFAS) Nos. 116 and 117.

SFAS No. 116 addressed accounting for contributions received and contributions made. It significantly changed accounting for donations received and made and resulted in consistent treatment of donations across all nonprofit organizations. Essentially, the statement requires all donations to be considered revenue when the donations are made. It listed criteria for the recognition of donations with donor-imposed conditions, the recognition of pledges, and the recognition of donated services.

While SFAS No. 116 remains both important and controversial, my discussion will focus on SFAS No. 117, Financial Statements of Not-for-Profit organizations. The aim of this statement was to improve the usefulness of nonprofit financial reporting through consistency across industries.

SFAS No. 117 established the types of statements required. The first is the statement of financial position, which is similar to the balance sheet required in the for-profit sector and the balance sheet required under previous nonprofit guidance. It must report entity-wide information about assets, liabilities, and the difference of the two, called "net assets". However, these items are reported in the aggregate. This is a noticeable change from funds previously required. It shifts the focus of the financial statement to the entity as a whole, rather than focusing on fund groups. Furthermore, SFAS No. 117 requires that assets and liabilities with similar characteristics must be combined in relatively homogenous groups. Assets and liabilities are ordered according to liquidity and nearness to maturity.

The second statement required by SFAS No. 117 is the statement of activities. This is comparable to the income statement used in the for-profit sector and the statement of revenues, expenses, and changes in fund balances used previously by certain nonprofits, which was not required for all nonprofits. The statement of activities must show revenues and expenses, gains and losses, and changes in permanently restricted, temporarily restricted, and unrestricted net assets.

These three classifications of assets are new under SFAS No. 117. Unrestricted net assets are those that are not subject to donor-imposed stipulations. Temporarily restricted net assets are those subject to donor-imposed stipulations that may be met by actions of the organization or the passage of time. Permanently restricted net assets are those subject to donor-imposed stipulations that they be permanently maintained by the organization. Generally, donors of permanently restricted assets allow organizations to use some or all of the income earned on those investments.

SFAS No. 117 also requires all revenues to be reported as increases in unrestricted net assets unless specifically limited or restricted by the donor. All expenses are reductions in unrestricted net assets. Revenues and expenses should be reported at gross amounts to facilitate comparability between organizations.

The third statement required by SFAS No. 117 is the statement of cash flows. This statement is similar to that used by for-profit businesses . It must report changes in cash and cash equivalents, cash provided for and used by operations, cash provided for and used by investing activities, and cash provided for and used by financing activities. It is important to point out that under the new standards, receipt of donor restricted long-term resources are financing activities, not operating activities. This statement was not required for all nonprofits before the passage of SFAS No. 117.

The fourth and final statement required by SFAS No. 117 is the statement of functional expenses for voluntary health and welfare organizations. This was required before the passage of new standards under the audit guides for voluntary health and welfare organizations. This statement, as in the past, shows expenses broken down by functional and natural classifications.

The overall emphasis of the new standards is on donor intent rather than fund balances. Previously, under fund accounting, funds were grouped by purpose, such as operating funds, endowment funds, and plant funds. Now the classifications of unrestricted, temporarily restricted, and permanently restricted are used for disclosing donations.

Benefits of SFAS No. 117

These new standards produce significant changes in the way nonprofits report financial data. They also should result in changes in the ways donors interpret, analyze, and use nonprofit financial information.

According to FASB Concepts Statement No. 4, financial reporting should focus on the interest of resource providers. "The objectives of [financial reporting by not-for-profit organizations] stem from the common interests of those who provide resources to not-for-profit organizations in the services those organizations provide and their continuing ability to provide services" (SFAS No. 117). The objective of financial reporting is to provide information that is useful to those groups.

To be useful, financial statements must provide information about the following:

- the amount and nature of an organization's assets, liabilities, and net assets;
- transactions and other events that change the amount and nature of net assets;
- inflows and outflows of economic resources;
- how the organization obtains and spends cash; and
- its service efforts

The FASB believes the new standards (116 and 117) better achieve these purposes and that this information is more useful to users.

The main effect of SFAS No. 117 is improved comparability. The diversity that existed in financial reporting among nonprofits caused a significant amount of confusion to both users and accounting professionals (Lang and Berson 1994). This diversity existed because the reporting of transactions emphasized the different fund structures that existed in each of the nonprofits. Therefore, similar transactions were reported differently, causing a lack of comparability between the nonprofits. Under the new standards, all nonprofits must now report similar transactions in similar manners in the same types of financial statements.

The focus on the organization as a whole, rather than fund balances, facilitates an overall understanding of financial position, results of operations, and cash flows. Summary amounts required help users assess financial strengths and weaknesses over time and help them compare the organization to others. The Board found that donor imposed restrictions affect the types and levels of service the nonprofit can provide. It is important for users to see these in aggregate. The restrictions may influence the liquidity of some assets and disclosing them allows users to make an assessment of the financial flexibility of the organization.

The Board and many accounting professionals believe that the flexibility SFAS No. 117 gives organizations is also a benefit. Individual nonprofit organizations are probably in the best position to determine what information is the most useful to users and should have the flexibility to present this information. For example, nonprofits such as hospitals and universities may want to report information in manners similar to their for-profit counterparts. Additionally, the flexibility the statement provides allows room for future changes in nonprofit reporting.

Problems With SFAS No. 117

The flexibility that is a benefit to nonprofit organizations also poses a problem. SFAS No. 117 does not require operating income to be reported. It allows it, but gives no definition of operating income. The result is that users have no general benchmark or "bottom line" as they do with financial statements of for-profit organizations. The board states that changes in unrestricted net assets may serve as an operating measure. However, are unrestricted net assets actually operating measures? Professor Robert Anthony does not think so. Unrestricted net assets include both donations of buildings and board-designated endowments. According to Professor Anthony, these items benefit multiple periods and are essentially donations of capital. They should not be mixed with operating revenues and expenses (Anthony 1995).

Even if an organization chooses to include a measure of operating income in its reports, there is no standard definition of operating income and no standard list of what should be included. Companies have the potential of manipulating this figure by including the measures they see fit and excluding others to inflate or narrow the measure of operating performance.

The board considered inclusion of such a measure in the standard but, after consideration, decided that there were too many potential definitions. Everyone who wrote comments on SFAS No. 117 presented different ideas of what the measure should include and exclude based on their individual nonprofit sector. Using too many potential measures and too much of a debate as an excuse to exclude an important financial measure strikes me as faulty logic. Virtually every aspect of accounting must cater to different groups with different needs who desire different measures of key financial ratios. Such an excuse is not a basis for excluding important measures. If the debate was over what revenue, for example, should include and exclude, the FASB would certainly never think of simply excluding it from the financial statements because they could not please everyone with their definition.

However, SFAS 117 was not intended to resolve the operating income problem for each nonprofit because of the differences between nonprofit segments. Therefore, it was left to the American Institute of Certified Public Accountants' audit guides to provide the detail. Now, audit guides are being written for hospitals, colleges, and other nonprofits. Hospitals measure operating income now.

Study

Is the presentation under SFAS No. 117 more useful to users than traditional fund accounting? To answer this question, it was first necessary to determine what users actually find useful. This can be done by assessing user needs.

In the March/April 1996 issue of Foundation News & Commentary, Susan Kenny Stevens identified key information users need to assess nonprofits. Some of her suggestions of what to look for are as follows:

- What type of money is coming into the organization?

  Is it support, such as contributions, or revenue, such as contract or fee revenue? If much of the support is from government funding, the organization may have future problems with government cutbacks.

- What percentage of expenses is spent on program, administrative, and fundraising?
- Is the nonprofit "building rich but cash-poor"?

Examine the cash flow and financial flexibility of the organization.

- Have funds been advanced and reserved for the future?

  Examine the deferred revenue and refundable advances to see whether contributed funds must be returned if a contract or grant cannot be executed.

- Compare cash on hand to current liabilities.
- Is the nonprofit bringing in enough money to cover its expenses? (operating income)
- Look for an explanation of any deficit in unrestricted net assets.
- What portion of net assets was temporarily restricted or permanently restricted?

Questionnaire

Using these suggestions under the assumption that "useful" information is what is needed to answer such questions, I developed a questionnaire to determine whether new or old standards are actually more useful. Questionnaire A, which is in Appendix A on page 26, includes a questionnaire and a set of financial statements that follow the requirements of SFAS No. 117. Questionnaire B, which follows A, contains a questionnaire and a set of financial statements presented under previous standards that follow the audit guides.

Questions one through six on both forms address the questions asked in the Susan Kenny Stevens article. Assuming participants can answer these questions, they can assess the information the Steven's article requested, making the statements useful. Question seven on Form A was asked to determine if participants can differentiate between unrestricted changes in net assets and operating income. Question eight on Form A (seven on Form B) was asked to determine whether participants could understand the economic events underlying the reported financial information. Question nine on Form A (eight on B) was used for consistency. If participants could answer question four correctly, they should be able to answer this question correctly, although the two questions had different answers. Essentially, this question determined whether or not participants understood the meaning of the restrictions. Question ten (nine on B) was asked to determine whether presentation of financial information alone influences how much one would donate to a nonprofit. Questions eleven, twelve, and thirteen (ten, eleven, and twelve on B) were used to determine what factors affected donations.

The statements under the new and old standards are different in other ways than simply presentation. First, the Statement of Financial Position on Form A and the Balance Sheet on Form B differ in that Form A reported a balance in net assets of $2,009,570 but B had a fund balance of $1,663,669. The $345,901 difference was a liability call "deferred services" under prior rules but under SFAS 116 they must be included in net assets.

Second, the Change in Net Assets under form A's Statement of Activities is $217,983. The "Excess of Revenue Over Expenses After Capital Additions" in the previous Statement of Revenue, Expenses, and Changes in Fund Balances is $177,765. The difference of $40,220 is a result of SFAS No. 116's requirement that restricted receipts are reflected as income in the year received.

These statements were taken from the January, 1994, article in <u>Association Management</u> by Lang and Berson.

I administered the questionnaire to a group of 66 accounting students. This group represented two classes of students enrolled in an intermediate financial accounting class.

This sample was chosen because I wanted a sample of people with some general business knowledge and a little experience working with financial statements, who have not had a governmental and not-for-profit accounting class. All students in the class met these criteria.

Results and Discussion

Of the 34 form A questionnaires distributed, 23 were returned. Of the 32 form B questionnaires distributed, 15 were returned.

Question 1, Form A and B

How does the organization obtain most of its revenue?

a. contributions b. investments c. publications d. membership dues

Results to Form A

Answer	*a*	*b*	*c*	*d*	*%correct*
# Responses	1	1	5	16	70%

Results to Form B

Answer	*a*	*b*	*c*	*d*	*%correct*
# Responses	0	0	1	14	93%

The first question relates to how the organization obtained most of its revenue. Students scored considerably better on Form B than Form A (93% versus 70%). This result was expected. Under old standards, types of revenue, such as membership dues, were reported only in the aggregate. Under SFAS No. 117, classifications of revenues are broken down by unrestricted, restricted, and permanently restricted, along with the total. This may have caused some confusion. The second highest choice on Form A was publications (22%). This was the biggest source of unrestricted revenue. These results show that while new standards present more information which may be useful, it has the potential to confuse more people.

Question 2, Form A and B

Does this organization incur more expenses for administrative expenses (such as salaries and fund raising) or for the major reason for the existence of the organization?

a. more money spent on administrative
b. more money spent on reason for existence

Results to Form A

Answer	a	b	%correct
# Responses	18	5	78%

Results to Form B

Answer	a	b	%correct
# Responses	13	2	87%

Question 2 asks students whether more expenses were incurred for the major reasons of the organization's existence or on administrative expenses. Again, students scored slightly higher on Form B than Form A. The difference in answers is probably not significant. While the Form A presentation shows classifications for temporarily restricted and permanently restricted, all expenses are always reported as reductions in unrestricted net assets. Whether students were using the unrestricted column to answer the question or the total column, they should have been able to assess the same information as would have been shown on Form B. Those who answered incorrectly may have been confused over which expenses were administrative and which were incurred for the organization's cause.

Question 3, Form A and B

Rank the following assets of this organization by liquidity. Please place 1 by the most liquid asset and 4 by the least liquid asset.

_____property and equipment _____investments
_____cash and cash equivalents _____accounts receivable

Results, Form A

Answer	cash	A/R	Prop/Equip	Invest.	%correct
# who put as 1	23				100%
#who put as 2		21		2	91%
# who put as 3		2	15	6	65%
# who put as 4			8	15	65%

Results, Form B

Answer	cash	A/R	Prop/Equip	Invest.	%correct

# who put as 1	15				100%
#who put as 2		14		1	93%
# who put as 3			10	5	67%
# who put as 4		1	5	9	60%

The third question was asked to try to determine whether students could assess the liquidity of assets from the financial statements. The presentation of these assets differs on the two financial statements in that on Form B, assets were divided into "current" and "other". On Form A, this classification did not exist. However, on both forms, assets were listed in the order of liquidity. It is from the order of liquidity that students should have been able to answer the questions. Students on both forms scored relatively closely, with the percent correct decreasing with less liquid assets.

Question 4, Form A and B

Can all of the membership dues be used for any purpose that the management of this organization sees fit?

a. yes b. no

Responses to Form A

Answer	*a*	*b*	*%correct*
# Responses	4	19	83%

Responses to Form B

Answer	*a*	*b*	*%correct*
# Responses	6	9	60%

The fourth question asks whether one of the revenues, membership dues, could be used for any purpose the organization saw fit. Students on Form A scored better than those on Form B (83% and 60% respectively). Over one third of these membership due revenues, or $148,000, were temporarily restricted by donors, and therefore, are not available for any purpose. However, this information is only presented on financial statements prepared under SFAS No. 117, such as those presented under Form A.

Students using Form B had no way to assess this information. This shows a significant improvement in usefulness under new standards.

Question 5, Form A and B

If a current ratio (current assets/current liabilities) of 2 or more is "good" for this type of organization, is this organization probably going to be able to meet its obligations as they become due?

a. yes b. no

Results, Form A

Answer	*a*	*b*	*%correct*
# Responses	23	0	100%

Results, Form B

Answer	*a*	*b*	*no response*	*%correct*
# Responses	7	7	1	47%

Question 5 essentially asks students to determine the current ratio. The difference in responses under Form A and Form B was enormous. All of the students using financial statements prepared under the new standards (Form A) correctly answered this question. Of those using the statements under the Audit Guide, only 47% correctly answered the question. This result was extremely surprising. Under new standards, only total assets and total liabilities are shown, so students had to determine what constituted current assets and current liabilities on their own and then divide the two. Under old standards, current assets and liabilities were shown separately, so students only had to divide the two. Although the answer differs from that on Form A, it should be easier to determine. Therefore, the difference in answers must not have been attributable to financial statement presentation.

Question 6, Form A and B

Did this organization bring in enough revenue to cover its expenses (was operating income earned)? a. yes b. no

Results, Form A

Answer	*a*	*b*	*not answered*
# Responses	20	2	1

Results, Form B

Answer	*a*	*b*

# Responses	15	0

Question 6 is very ambiguous and does not have a correct answer. It was asked only to observe the responses of the participants. It asks both whether revenue was greater than expenses and whether operating income was earned. Both statements show revenues and expenses, so if students were only trying to determine whether revenues are greater than expenses, that information is available and most students responded correctly. However, if students were trying to determine operating income, it was impossible to determine unless it is assumed to be the same as the increase in unrestricted net assets.

Question 7, Form A

Do you think that the term "unrestricted", as used in these financial statements, probably means the same thing as "operating" (operating means related to the principal activities of the business)? a. yes b. no

Results, Form A

Answer	*a*	*b*	*not answered*
# Responses	8	14	1

Question 7 on Form A addresses the issue of whether or not students felt unrestricted was the same as operating. Approximately one third felt that the two are probably the same. Because the term "unrestricted" only appears on Form A, this question only appears on Form A.

Question 8, Form A

What events would cause "net assets" to change?

a. increases in revenue b. increases in expenses

c. increases in cash due to collection of accounts receivable in full

d. all of the above e. a and b only

Results, Form A

Answer	*a*	*b*	*c*	*d*	*e*	*%correct*
# Responses	1	0	3	9	10	43%

Question 7, Form B

What events would cause "fund balance" to change?

a. increases in revenue b. increases in expenses

c. increases in cash due to collection of accounts receivable in full

d. all of the above e. a and b only

Results, Form B

Answer	a	b	c	d	e	%correct
# Responses	1	1	1	2	10	67%

Question 8 on Form A asks students to determine which transactions would change "net assets". Question 7 is the equivalent on Form B, only it asks which transactions would change "fund balance". Students scored slightly better using financial statements under old standards. Most students were able to assess that changes in revenues and expenses affected nets assets and fund balance. However, the biggest mistake made on Form A (by nine students) was that they also thought that an increase in cash due to a collection of accounts receivable would cause a change in net assets. This was also the biggest mistake made on Form B, although by a smaller percentage of students. The assets are presented similarly under new and old standards, so it is unlikely that the new standards are the cause of differences in responses.

Question 9, Form A (Question 8, Form B)

Can all of the registration fees be used for any purpose that the management of this organization sees fit? a. yes b. no

Results, Form A

Answer	a	b	%correct
# Responses	18	5	78%

Results, Form B

Answer	a	b	%correct
# Responses	8	7	53%

Question 9 on Form A (8 on B) is asked to determine whether students could determine what uses a source of revenue could be put to. This is similar to question 4 except that the answer is different. Under question 4, a portion of the membership dues are restricted, while the registration fees in question 9 are not. If students understood that management could not use the membership dues in question 4 for any purpose because of the temporary restrictions, they should understand that they can use the registration fees for any purpose since they are all unrestricted. 83% of the students who used Form A answered this correctly on question 4 and 78%, or one less student, answered this correctly on question 9. This one student probably thought that these revenues could not be used as management sees fit for some reason other than restrictions. Overall, presentation of restrictions helped students recognize the availability of revenues for different uses.

Again, students using Form B really had no way of assessing this information. The 47% of students who answered question 8 incorrectly apparently thought that there was some other restraint on management's ability to use revenues for the purposes they see fit. Oddly enough, 9 students using Form B felt that membership dues could not be used for any purpose management sees fit, but only 8 of these students answered the same way for registration fees, when they were given the same information for both questions. I would attribute the different response given by this student to probably be due to simply guessing.

Question 10, Form A (Question 9, Form B)

Assume that you have $10,000 that must be donated to a nonprofit organization. Based on this organization's financial information only, how much would you donate? $__________

Results, Form A

Answer	-	1,000	5,000	5,500	7,500	8,000	10,000	>10000	no response
# Responses	4	3	6	1	1	1	5	1	1

Total donation = $209,000

Average donation per student = $9087

Results, Form B

Answer	-	1,000	4,000	5,000	5,500	7,000	7,500	8,000	10,000
# Responses	5	0	2	2	0	2	0	0	4

Total donation = $72,000

Average donation per student = $4800

Question 10 on Form A, or 9 on B, asks students how much they would contribute to the organization. Students responding to Form A gave $9087 on average while those who filled out Form B gave an average of $4800, or approximately half of what those using form A would have. However, the average on Form A is slightly skewed because one of the students who filled it out wished to donate $105,000 out of the $10,000. If this response were decreased to the maximum allowable $10,000, to make the average slightly less skewed, the average donation per student on Form A would be approximately $4,522. This figure is very close to the $4,800 from Form B. Therefore, presentation is probably not a significant influence on the amount donated.

Question 11, Form A (Question 10, Form B)

Did any of the financial factors in questions 1 through 8 influence your decision?

a. yes b. no

Results, Form A

Answer	a	b
# Responses	18	5

Results, Form B

Answer	a	b
# Responses	9	6

Question 12, Form A (Question 11, Form B)

If you answered yes to 11 (10 on B), then which financial factors mentioned in the following questions influenced you to donate more (circle as many as are applicable)? 1 2 3 4 5 6 7 8 9

Which financial factors mentioned in the following questions influenced you to donate less (circle as many as are applicable)? 1 2 3 4 5 6 7 8 9

Results, Form A

Answer	1	2	3	4	5	6	7	8	9
donate more	6	2	1	3	5	2	1	1	5
donate less	1	11	0	1	5	4	1	1	3
no response	6								

Results, Form B

Answer	1	2	3	4	5	6	7	8
donate more	0	1	1	2	2	2	0	3
donate less	2	5	1	1	5	2	0	1
no response	6							

Questions 11 and 12 on Form A (10 and 11 on Form B) asked students what influenced them on the amount donated. All financial factors seemed to influence students. The students filling out Form A indicated that the strongest influence that would cause them to donate more was how the organization obtained most of its revenues (in question 1). Oddly, this influenced no one filling out Form B to donate more. The ability of management to use registration fees as they see fit (question 9) and the assessment on the organization's ability to remain a going concern based on use of the current ratio (question 5) were also large influences on students using Form A to donate more. Students filling out Form B found most factors to be relatively equal in influencing them to donate more.

By far, the greatest factor influencing students to donate less on both forms was the relative amount of administrative expenses as opposed to expenses relating to the organization's major reason for existence (question 2). This response was anticipated. Ironically enough, students using both forms also found their assessment of the organization's ability to remain a going concern based on their computation of the current ratio (question 5) a large factor on why not to donate. On Form A, which had a very "good" current ratio, the same number of students who found this to be a reason to donate more found this to be a reason to donate less (five students in both cases). On Form B, where the current ratio was "bad", five students found this to be a reason to donate less and two found it to be a reason to donate more. Again, the determinations of what constitutes a bad or good current ratio is arbitrary. Students were told to use a ratio of two to one to make this determination.

Question 13, Form A (Question 12, Form B)

Did any additional financial factors not contained in questions 1 through 8 influence your donation decision? If so, please describe them below.

Five students using Form A and one who used Form B answered the final question, which asked for additional comments. Two of the respondents indicated that the organization's cause, not its financial information, determined how much they would donate. Two respondents stated that they donated less because the organization had enough of an excess of revenues over expenses. Two of the respondents also indicated that they felt the organization spent too much money on administration. Finally, one respondent said that he (she) would donate less to this organization based on what he could assess from the financial statements but he couldn't understand enough of the statements to determine if there were any factors to cause him to donate more. This person filled out Form A.

Limitations

A major limitation of this study is that it did not consider all of the users of nonprofit financial statements. It used only the perspective of donors, ignoring the usefulness of the statements to lenders.

The second major limitation is that the purpose of the study was to examine the effects of financial statement classifications and presentations only under SFAS No. 117. However, most nonprofit organizations implemented SFAS No. 116 at the same time as No. 117, so the statements included the effects of both. The differences caused by the new requirements of No. 116 may have changed the results of the questionnaires.

Another major limitation is that the participants of the study may not have been using the care in analyzing the financial statements that they would have had they been using them as a real donor. Had they used this care, there may have been more correct responses.

Conclusion

This study has shown that more users can find information that is useful if financial information is disaggregated. This usefulness is proven by the greater percentage of correct responses of the students using Form A. However, as more information is shown, there is a greater potential for users to be confused by information overload. This probably explains many of the mistakes that were made.

Overall, SFAS No. 117 is a benefit to users of nonprofit financial statements. It brings consistency to financial statements across industries and it gives users a better ability to assess of the financial flexibility of the organization. Overall, SFAS No. 117 brings more useful information to users.

APPENDIX

The following pages are a set of incomplete financial statements. They are missing the auditors' reports and some of the notes. Please answer the following questions using the information found in these statements. You may not know all of the answers, but please use your best guess.

1. How does this organization obtain most of its revenue?
a. contributions b. investments c. publications d. membership dues

2. Does this organization incur more expenses for administrative expenses (such as salaries and fund raising) or for the major reason for the existence of the organization?
a. more money spent on administrative
b. more money spent on reason for existence

3. Rank the following assets of this organization by liquidity. Please place 1 by the most liquid asset and 4 by the least liquid asset.
_____property and equipment _____investments
_____cash and cash equivalents _____accounts receivable

4. Can all of the membership dues be used for any purpose that the management of this organization sees fit?
a. yes b. no

5. If a current ratio (current assets/current liabilities) of 2 or more is "good" for this type of organization, is this organization probably going to be able to meet its obligations as they become due?
a. yes b. no

6. Did this organization bring in enough revenue to cover its expenses (was operating income>operating expenses)? a. yes b. no

7. Do you think that the term "unrestricted", as used in these financial statements, probably means the same thing as "operating" (operating means related to the principle activities of the business)?
a. yes b. no

8. What events would cause "net assets" to change?
a. increases in revenue c. increases in cash due to collection of accounts receivable in full
b. increases in expenses d. all of the above e. a and b only

9. Can all of the registration fees be used for any purpose that the management of this organization sees fit?
a. yes b. no

10. Assume that you have $10,000 that must be donated to a nonprofit organization. Based on this organization's financial information only, how much would you donate? $__________

11. Did any of the financial factors in questions 1 through 9 influence your decision?
a. yes b. no

12. If you answered yes to 11, then which financial factors mentioned in the following questions influenced you to donate more (circle as many as are applicable)? 1 2 3 4 5 6 7 8 9
Which financial factors mentioned in the following questions influenced you to donate less (circle as many as are applicable)? 1 2 3 4 5 6 7 8 9

13. Did any additional financial factors not contained in questions 1 through 9 influence your donation decision? If so, please describe them below.

Exhibit B (old)

Nonprofit Organization B

Balance Sheets

December 31, 19X2 and 19X1

	19X2	19X1
Assets		
Current assets		
Cash and cash equivalents	$ 410,199	$ 366,006
Accounts receivable	41,051	29,050
Prepaid expenses	9,337	2,210
Total current assets	460,587	397,266
Property and equipment	1,216,518	1,102,880
Other assets		
Other deposits	5,259	2,953
Investments	355,000	350,000
Total assets	$2,037,364	$1,853,099
Liabilities and Fund Balances		
Current liabilities		
Accounts payable	$14,391	$46,408
Accrued expenses	13,403	15,104
Deferred dues	169,536	141,174
Deferred restricted revenue	176,365	164,507
Total current liabilities	373,695	367,193
Fund balances	1,308,669	1,135,906
Unrestricted	355,000	350,000
Endowment	1,663,669	1,485,906
Total liabilities and fund balances	$2,037,364	$1,853,099

Exhibit D (Old)

Nonprofit Organization B

Statements of Revenue, Expenses and Changes in
Fund Balances
Year Ended December 31,19X2 and 19X1

	19X2	19X1
Revenue		
Contributions	$139,652	$133,958
Registration fees	112,778	87,640
Membership dues	348,351	301,039
Publications	266,345	280,048
Interest income	88,218	73,367
Total revenue	955,344	876,052
Expenses		
Annual meeting	112,169	111,591
Publications	210,113	183,497
Management and general	434,599	357,451
Fund-raising	25,700	9,596
Total expenses and losses	782,581	662,135
Excess revenue over expenses before capital additions	172,763	213,917
Capital additions	5,000	3,000
Excess revenue over expenses after capital additions	177,763	216,917
Fund Balances, beginning of year	1,485,906	1,268,989
Fund balances, end of year	$1,663,669	[illegible]

Exhibit F (Old)

Nonprofit Organization B

Statements of Cash Flows

Year Ended December 31, 19X2 and 19X1

Increase (Decrease) in Cash and Cash Equivalents

	19X2	19X1
Cash flows from operating activities		
Excess revenue over expenses before capital additions	$172,763	$213,917
Adjustments to reconcile excess revenue over expenses to cash provided by operating activities		
Depreciation	30,570	29,493
Changes in operating assets and liabilities;		
(increase) decrease in receivables	(12,001)	3,739
Increase in prepaid expenses	(7,127)	(9,245)
Increase in other deposits	(2,306)	—
(Decrease) increase in accounts payable	(32,017)	14,791
(Decrease) increase in accrued expenses	(1,701)	9,680
Increase (decrease) in deferred revenue	40,220	—
Total adjustments	15,638	48,458
Net cash provided by operating activities	188,401	262,375
Cash flows from investing activities		
Purchases of investments	(5,000)	(3,000)
Purchases of equipment	(144,208)	(37,190)
Net cash used by investing activities	(149,208)	(40,190)
Cash flows from financing activities		
Capital additions in endowment fund	5,000	3,000
Net cash used by financing activities	5,000	3,000
Net increase in cash and cash equivalents	44,193	225,185
Cash and cash equivalents, beginning of year	366,006	140,821
Cash and cash equivalents, end of year	$410,199	$366,006

1. Summary of Significant Accounting Policy
    a. Accrual Basis
    The financial statements of Nonprofit Organization A have been prepared on the accrual basis.
    b. Basis of Presentation
    The Organization applies Statement of Financial Accounting Standards No. 117, "Financial Statements for Not-For-Profit Organizations". Under these provisions, net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Organization and changes therein are classified and reported as follows:
        Unrestricted net assets - Net assets that are not subject to donor-imposed stipulations
        Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Organization and/or the passage of time.
        Permanently restricted net assets - Net assets subject to donor-imposed stipulations that they be maintained permanently by the Organization. Generally, the donors of these assets permit the Organization to use all of part of the income earned on related investments for general or specific purposes.
    c. Investments
    Fair market value is used in order to present more fairly the realizability of assets.
    d. Property and Equipment
    Property and Equipment are stated at cost at the date of acquisition or fair value at the date of donation in the case of gifts. Depreciation is provided over the estimated useful lives of the respective assets on a straight line basis.
    e. Fair Value of Financial Instruments
    Under Statement of Financial Accounting Standards No. 107, the fair value of all financial instruments for which it is practical to estimate fair value is disclosed. The carrying amount of cash and cash equivalents, accrued interest receivable, and contributions receivable approximates fair value because of the short maturity of these financial instruments. The carrying value which is the fair value of investments and funds held in trust by others is based upon values provided by an external investment manager or quoted market values. In the limited cases where such values are not available, historical cost is used as an estimate of market value.

The following pages are a set of incomplete financial statements. They are missing the auditors' reports and some of the notes. Please answer the following questions using the information found in these statements. You may not know all of the answers, but please use your best guess.

1. How does this organization obtain most of its revenue?
a. contributions b. investments c. publications d. membership dues

2. Does this organization incur more expenses for administrative expenses (such as salaries and fund raising) or for the major reason the organization exists?
a. more money spent on administrative
b. more money spent on reason that the organization exists

3. Rank the following assets of this organization by liquidity. Please place 1 by the most liquid asset and 4 by the least liquid asset.
_____property and equipment _____investments
_____cash and cash equivalents _____accounts receivable

4. Can all of the membership dues be used for any purpose that the management of this organization sees fit? a. yes b. no

5. If a current ratio (current assets/current liabilities) of 2 or more is "good" for this type of organization, is this organization probably going to be able to meet its obligations as they become due?
a. yes b. no

6. Did this organization bring in enough revenue to cover its expenses (was operating income>operating expenses)? a. yes b. no

7. What events would cause "fund balance" to change?
a. increases in revenue c. increases in cash due to collection of accounts receivable in full
b. increases in expenses d. all of the above e. a and b only

8. Can all of the registration fees be used for any purpose that the management of this organization sees fit? a. yes b. no

9. Assume that you have $10,000 that must be donated to a nonprofit organization. Based on this organization's financial criteria only, how much would you donate? $__________

10. Did any of the financial factors in questions 1 through 8 influence your decision?
a. yes b. no

11. If you answered yes to 10, then which financial factors mentioned in the following questions influenced you to donate more (circle as many as are applicable)? 1 2 3 4 5 6 7 8
Which financial factors mentioned in the following questions influenced you to donate less (circle as many as are applicable)? 1 2 3 4 5 6 7 8

12. Did any additional financial factors not contained in questions 1 through 8 influence your donation decision? If so, please describe them below.

Exhibit A (New)

Nonprofir Organization A

Statements of Financial Position

December 31, 19X2 and 19X1

Assets	**19X2**	**19X1**
Cash and cash equivalents	$ 410,199	$ 366,006
Accounts receivable	41,051	29,050
Prepaid expenses	9,337	2,210
Property and equipment	1,216,518	1,102,880
Other deposits	5,259	2,953
Investments	355,000	350,000
[redacted]		**$1,853,099**
Liabilities and net assets		
Accounts payable	$ 14,391	$ 46,408
Accrued expenses	13,403	15,104
[redacted]		**61,512**
Net assets		
[redacted]		$1,135,906
		305,681
		350,000
[redacted]		**1,791,587**
Total liabilities and net assets	**$2,037,364**	**$1,853,099**

FASB rules

Exhibit C (New)

Nonprofit Organization A

Statements of Activities

Year Ended December 31, 19X2

(With Comparative Totals for 19X1)

	19X2				19X1
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Changes in net assets					
Revenues and gains:					
Contributions	$ 139,652	$ —	$ 5,000	$144,652	$ 136,958
Registration fees	112,778	—	—	112,778	87,640
Membership dues	200,351	148,000	—	348,351	301,039
Publications	266,345	—	—	266,345	280,048
Income on long-term investments	88,218	—	—	88,218	73,367
Total revenues and gains	807,344	148,000	5,000	960,344	879,052
Net assets released from restrictions:					
Satisfaction of program restrictions	57,780	(57,780)	—	—	—
Expiration of time restrictions	50,000	(50,000)	—	—	—
Total net assets released from restrictions	107,780	(107,780)	—	—	—
Total revenues, gains, and other support	915,124	40,220	5,000	960,344	879,052
Expenses and losses:					
Annual meeting	112,169	—	—	112,169	111,591
Publications	210,113	—	—	210,113	183,497
Management and general	394,379	—	—	394,379	357,451
Fund raising	25,700	—	—	25,700	9,596
Total expenses and losses	742,361	—	—	742,361	662,135
Change in net assets	172,763	40,220	5,000	217,983	216,917
Net assets at beginning of year	1,135,906	305,681	350,000	1,791,587	1,574,670
Net assets at end of year	$1,308,669	$345,901	$355,000	$2,009,570	$1,791,587

Exhibit E (New)
Indirect Method
Nonprofit Organization A
Statements of Cash Flows
Year Ended December 31, 19X2 and 19X1
Increase (Decrease) in Cash and Cash Equivalents

	19X2	19X1
Cash flows from operating activities:		
[redacted]	[redacted]	$216,917
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Depreciation	30,570	29,493
(Increase) decrease in receivables	(12,001)	3,739
Increase in prepaid expenses	(7,127)	(9,245)
Increase in other deposits	(2,306)	—
(Decrease) increase in accounts payable	(32,017)	14,791
(Decrease) increase in accrued expenses	(1,701)	9,680
Investment and dividends restricted for long-term investment	(12,000)	(9,775)
[redacted]	[redacted]	255,600
Cash flows from investing activities:		
Purchase of investments	(5,000)	(3,000)
Purchase of equipment	(144,208)	(37,190)
[redacted]	[redacted]	(40,190)
Cash flows from financing activities:		
Interest and dividends restricted for reinvestment	12,000	9,775
Net cash provided by financing activities	12,000	9,775
[redacted]	[redacted]	225,185
[redacted]	[redacted]	140,821
[redacted]	[redacted]	$366,006

1. Summary of Significant Accounting Policy
   a. Accrual Basis
      The financial statements of Nonprofit Organization B have been prepared on the accrual basis.
   b. Cash and cash equivalents
      Cash and cash equivalents are defined as highly liquid investments which have original maturities of three months or less.
   c. Investments
      Fair market value is used in order to present more fairly the realizability of assets.
   d. Property and Equipment
      Property and Equipment are stated at cost at the date of acquisition or fair value at the date of donation in the case of gifts. Depreciation is provided over the estimated useful lives of the respective assets on a straight line basis.
   e. Fair Value of Financial Instruments
      Under Statement of Financial Accounting Standards No. 107, the fair value of all financial instruments for which it is practical to estimate fair value is disclosed. The carrying amount of cash and cash equivalents, accrued interest receivable, and contributions receivable approximates fair value because of the short maturity of these financial instruments. The carrying value which is the fair value of investments and funds held in trust by others is based upon values provided by an external investment manager or quoted market values. In the limited cases where such values are not available, historical cost is used as an estimate of market value.

Form A responses

Question #	Numbers of Responses to Each Answer									
1	*a*	*b*	*c*	*d*	*%correct*					
	1	1	5	16	70%					
2	*a*	*b*	*%correct*							
	18	5	78%							
3		*cash*	*A/R*	*Prop/Equip*	*Invest.*	*%correct*				
	# who put as 1	23				100%				
	#who put as 2		21		2	91%				
	# who put as 3		2	15	6	65%				
	# who put as 4			8	15	65%				
4	*a*	*b*	*%correct*							
	4	19	83%							
5	*a*	*b*	*%correct*							
	23	0	100%							
6	*a*	*b*	*not answered*							
	20	2	1							
7	*a*	*b*	*not answered*							
	8	14	1							
8	*a*	*b*	*c*	*d*	*e*	*%correct*				
	1	0	3	9	10	43%				
9	*a*	*b*	*%correct*							
	18	5	78%							
10	*-*	*1,000*	*5,000*	*5,500*	*7,500*	*8,000*	*10,000*	*>10000*	*no response*	
	4	3	6	1	1	1	5	1	1	
	Total donation=			209,000						
	Average donation/student			9,087						
11	*a*	*b*								
	18	5								
12		*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*
	donate more	6	2	1	3	5	2	1	1	5
	donate less	1	11	0	1	5	4	1	1	3
	no response	6								
13	# of responses		5							

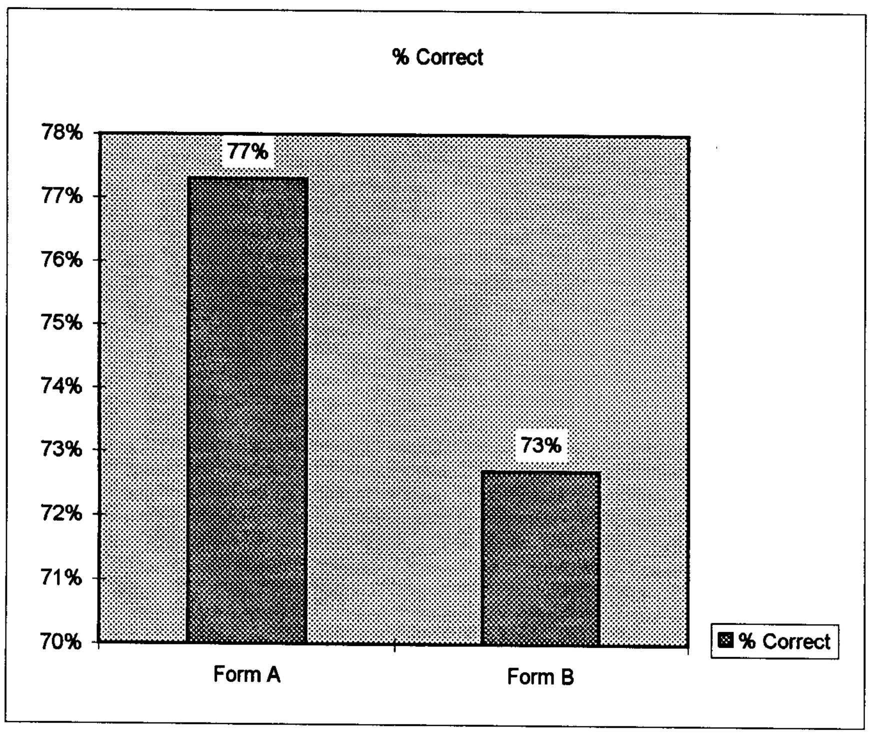
Form B responses

Question #	Numbers of Responses to Each Answer								
1	*a*	*b*	*c*	*d*	*%correct*				
	0	0	1	14	93%				
2	*a*	*b*	*%correct*						
	13	2	87%						
3		*cash*	*A/R*	*Prop/Equip*	*Invest.*	*%correct*			
	# who put as 1	15				100%			
	#who put as 2		14		1	93%			
	# who put as 3			10	5	67%			
	# who put as 4		1	5	9	60%			
4	*a*	*b*	*%correct*						
	6	9	60%						
5	*a*	*b*	*no response*	*%correct*					
	7	7	1	47%					
6	*a*	*b*							
	15	0							
7	*a*	*b*	*c*	*d*	*e*	*%correct*			
	1	1	1	2	10	67%			
8	*a*	*b*	*%correct*						
	8	7	53%						
9	-	*1,000*	*4,000*	*5,000*	*5,500*	*7,000*	*7,500*	*8,000*	*10,000*
	5	0	2	2	0	2	0	0	4
	Total Donations			72,000					
	Average donation/response			4,800					
10	*a*	*b*							
	9	6							
11		*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*
	donate more	0	1	1	2	2	2	0	3
	donate less	2	5	1	1	5	2	0	1
	no response	6							
12	# of people who responded			1					

Percent of Correct Responses by Form

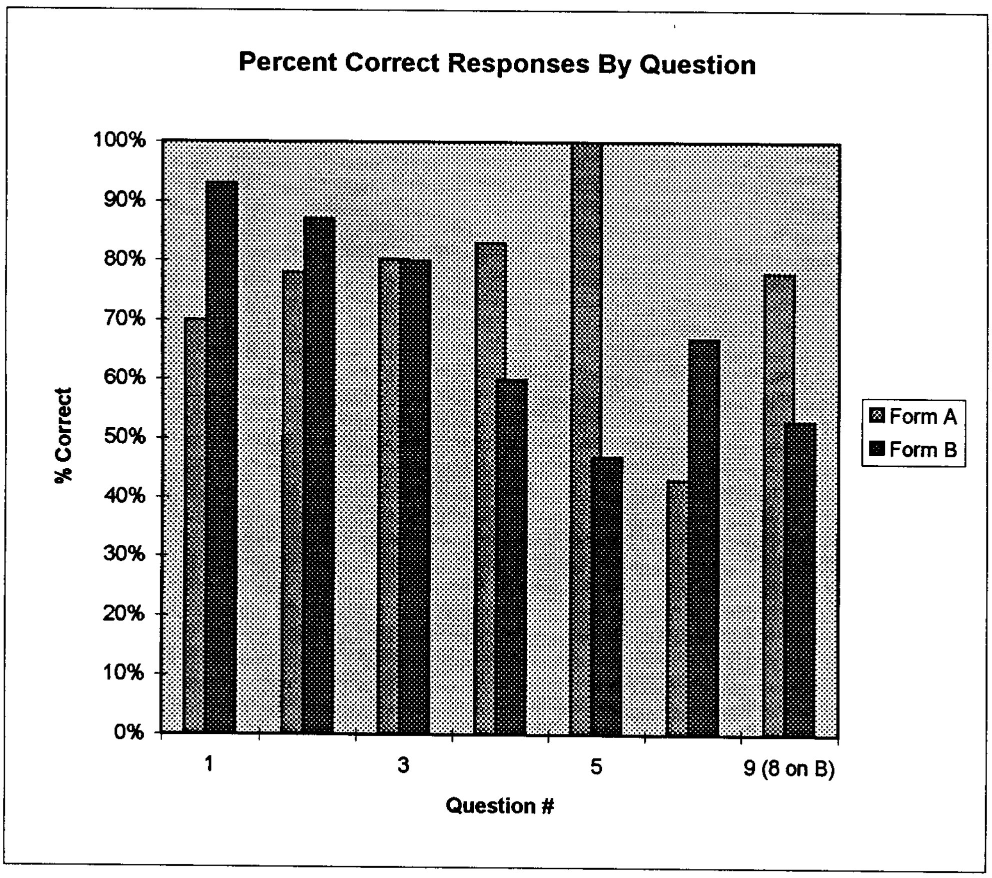
	Form A	Form B
% Correct	77%	73%
# of Responses	23	15

Overall, students did better on form A than form B.



Percent Correct of Each Question by Form

Question	Percent Correct Form A	Percent Correct Form B
1	70%	93%
2	78%	87%
3	80%	80%
4	83%	60%
5	100%	47%
8 (7 on B)	43%	67%
9 (8 on B)	78%	53%



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Accounting Pronouncements:

Financial Accounting Standards Board Concepts Statement No. 4

Statement of Financial Accounting Standards No. 116

Statement of Financial Accounting Standards No. 117