HAC

Housing Assistance Council

ACCOUNTING & FINANCIAL OPERATIONS FOR NONPROFITS IN RURAL HOUSING

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HAC, founded in 1971, is a nonprofit corporation that supports the development of rural low-income housing nationwide. HAC provides technical housing services, seed money loans from a revolving fund, housing program and policy assistance, research and demonstration projects, and training and information services. HAC is an equal opportunity lender.

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INTRODUCTION

Many nonprofit organizations engaged in rural housing development are so small that no one on staff has extensive accounting and financial operations experience, so it is especially important for boards of directors and managers of those organizations to be knowledgeable about accounting and financial management. Yet, while the board members and managers of such organizations may be very skilled in their particular fields of expertise, they often lack an understanding of accounting practices and principles, budgeting, and financial management systems for nonprofit housing developers.

The sanctions imposed on nonprofits that cannot demonstrate adherence to laws and regulations include penalty assessments, a loss of tax-exempt status, return of government grant funds, and, in cases of fraud, criminal prosecution. As a fiduciary over a public trust, the board of directors should educate itself about these responsibilities, and an organization's management should acquire an understanding of accounting and financial operations.

The purpose of this manual is to convey, in terms that are as straightforward as possible, the basic information necessary to manage the accounting and financial areas of the organization. Although information is included concerning the actual processing of transactions and reconciling of accounts, this manual is not intended to provide detailed bookkeeping instruction, but rather to provide an overview of the critical accounting and financial areas for which nonprofits are responsible. The board of directors and management are encouraged to consult with recognized professionals in carrying out their duties, and lists of material referenced by topic are included in the back of this publication to direct the reader desiring more detail.

This publication "is sold with the understanding that the publisher is not engaged in rendering legal, accounting or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought."[1] This publication is an update of a 1997 accounting guide published by the Housing Assistance Council (HAC) under the same title. To the best of HAC's knowledge, the information in this guide is current as of September 2004.

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[1]From a Declaration of Principles jointly adopted by a Committee of the American Bar Association and a Committee of Publishers and Associations.

RESPONSIBILITIES OF THE BOARD OF DIRECTORS

The oversight role and the degree to which it is exercised by the board of directors of a nonprofit organization have a direct correlation to the success or failure of the organization in fulfilling its mission and minimizing its financial and regulatory liability. After the initial flush of organizational activities such as drafting the mission statement, electing board members and officers, drafting bylaws and articles, and registering with tax and other regulatory bodies, the board must define its ongoing role, establish accountability in each functional area of responsibility, and provide for regular communication with management and the community at large. The board is responsible for setting overall policies and making fundamental decisions with respect to monitoring adherence to these policies. The board should not attempt to micro-manage the organization, but rather should provide advice and support to the organization's staff. Generally, the authority of the board over the accounting and financial operations of the organization is exercised by the treasurer.

The treasurer is charged by the board with the responsibility for overseeing accounting, tax, grant, contract, and other financial matters on behalf of the organization. Although the day-to-day responsibilities in these areas are usually delegated to management personnel, it is the treasurer who must ensure that critical financial and regulatory issues are being properly monitored by the organization. In selecting a treasurer, the board should choose an individual who has the financial management skills and experience necessary to fulfill these responsibilities, as well as the time commitment necessary to work with management and the board. It makes no difference how qualified an individual is if s/he cannot devote the time and effort necessary to fulfill this critical role properly.

Tax-Exempt Status

The Internal Revenue Service (IRS) defines a tax-exempt organization as an organization exempt from income taxes, primarily under Section 501 of the Internal Revenue Code (IRC). There are more than 25 categories of tax-exempt organizations classified under Section 501(c) of the IRC as well as additional types of organizations under other sections of the Code. An organization may qualify for exemption from federal income tax if it is organized and operated exclusively for one or more of eight specified purposes: charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and the prevention of cruelty to children or animals.

To apply for tax-exempt status, an organization must file federal form 1023 "Application for Recognition of Exemption," form 8718 "User Fee for Exempt Organization Determination Letter Request," and form SS-4 "Application for Employer Identification Number." Form 1023 requests activities and operational information, technical requirements, and financial data. An organization should use form 8718 to determine the appropriate fee ($150 or $500 depending on the organization's anticipated annual gross receipts). Form SS-4 simply requests an identification number. Based on form 1023 and its supporting documentation, a ruling or determination letter will be issued to your organization. The IRS will not ordinarily issue rulings or determination letters recognizing exemption if an issue involving the organization's exempt status is pending in litigation or is under consideration within the IRS.

A ruling or determination letter may be issued in advance of operations if your organization can describe its proposed operations in enough detail to permit a conclusion that it will clearly meet the particular requirements of the section under which it is claiming exemption. When an organization does not provide the information requested in applications or fails to furnish a sufficiently detailed description of its proposed activities to permit a conclusion that it will clearly be exempt, a record of actual operations may be required before a ruling or determination letter is issued.

The basic responsibility of the board, as exercised by its treasurer, is to make sure that the initial application for tax-exempt status is accurate and reflects the true nature of the organization and its proposed activities. The treasurer is then responsible for seeing that internal accounting controls and procedures are established that ensure that the organization's funds are raised, applied, and reported consistently with its mission as communicated to its donors[2] and the IRS.

Donor Restrictions

The treasurer, as charged by the board, should represent the interests of donors to ensure that the resources they have provided are applied consistently with the mission of the organization and the general or specific terms by which their contributions were made.

The Budget

The starting place for defining the sources and uses of an organization's funds comes with the preparation of an annual or multi-year budget. Although management personnel may develop the actual document, the treasurer is responsible for making sure that the budget is prepared and presented on a timely basis (ideally three months before the beginning of the period to which it relates) and for reviewing, in detail, the sources and related amounts of funds, the nature and amounts of budgeted expenses, and the underlying assumptions for projecting the sources and uses of funds. Before presenting the budget to the board, the treasurer should determine that:

- budget assumptions are realistic and objective with respect to market conditions (e.g., personnel costs are in line with similar positions in the community or field of expertise);

- specific types of revenue and/or expenses (e.g., unrelated business income, lobbying expenses, unallowable costs) will not jeopardize the organization's tax-exempt status;

- relative seasonality of the organization has been addressed, and provisions have been made to manage funds available or short-term borrowings (cash receipts and disbursements seldom occur uniformly over a twelve-month period);

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[2] Donors/contributors can be individuals, corporations, foundations, faith-based organizations, and government agencies.

- distinctions are made between contributions with permanent restrictions, those with temporary restrictions, and those without donor-imposed restrictions;

- indirect costs associated with management and general activities can be justified to donors in relation to total program expenses;

- the budget is prepared in sufficient detail, including a narrative that clearly explains the magnitude of the projected dollars for both revenue and expense categories; and

- projected individual expenses as a percentage of total projected revenues, gains, and other resources are reasonable in relation to other nonprofit organizations of a similar size and nature of operations.

The Accounting Function

Many small nonprofit organizations do not have the resources necessary to support a full-time accountant with the experience necessary to ensure compliance on a daily basis with regards to accounting, tax, grant/contract, and other regulations. In working with management to set up the organization's accounting function, the treasurer faces a difficult task in applying limited resources to this supporting area which, if handled incorrectly, can lead to an entity's disgrace or even demise. The following are suggestions to consider when staffing the accounting function to meet the organization's basic financial responsibilities while minimizing administrative expenses.

- Attempt to secure the services of an accountant with an interest in housing issues who might volunteer or provide services at a reduced rate. Such an individual might be found by contacting the local institute of Certified Public Accountants (CPAs), chamber of commerce, or an organization of similar size and type. However, the initial set-up of the accounting system is critical, and therefore, it is more important that the organization engage an individual or firm with nonprofit accounting experience to set up the system and to review it periodically than to hire an individual who will provide pro bono services but who does not have sufficient experience. If the accounting system is already in existence, it should be reviewed periodically to determine if it is operating efficiently. This review is usually performed in conjunction with the annual audit. The following are initial and on-going duties to be performed by an outside firm and/or other qualified individual.

    - Set up the accounting system, as well as the recording, reconciliation, and reporting procedures.
    - Work with treasurer and management to develop a budget.
    - Answer on-going staff questions with respect to the daily operations and issues that may arise.
    - Prepare monthly or quarterly financial statements and grant reports (if necessary). The financial statements should include a comparison of actual-to-budget expenditures.
    - Meet and review with the treasurer on a monthly or quarterly basis.

- In counsel with the organization's executive director, employ a bookkeeper or staff accountant with experience in maintaining the books and in accounting systems. Make sure this individual is allocated ample time to perform the accounting aspects of his/her job.

- Consider outsourcing the payroll function. A payroll service agency will prepare paychecks, make the appropriate tax deposits, and file the required tax forms. These services typically charge a nominal fee per pay period to perform functions that, if not performed properly, present a high degree of exposure (liability) to any small operation. Such exposure includes a 10 percent penalty for late depositing of federal taxes, interest charged on past due amounts, and, in extreme cases, loss of tax-exempt status.

Internal Accounting Controls

Internal controls are policies and procedures established to ensure that an organization's objectives can be achieved. Accountability is the key to setting up an adequate system of internal controls to ensure proper safeguarding of assets and timely recording, reconciling, and summarizing of transactions. Although management may be responsible for the actual drafting of receipts and disbursement procedures, reporting calendars, bonding of employees with access to cash,[3] etc., it is the treasurer and the board of directors of the organization who bear ultimate responsibility to donors to ensure that an adequate system of internal controls is in place and operating efficiently and effectively.

One of the most important characteristics of a good system of internal controls is separation of duties, yet this is often impossible for small organizations to achieve due to staff size and cost constraints. For example, the person responsible for opening the mail should not be the same person responsible for making deposits, recording receipts, and reconciling bank accounts. In spite of the limitations posed by a small staff and few resources, the treasurer should be aware of the following with regard to implementing an effective and efficient system of internal controls. (A more detailed discussion is included in the Management's Responsibilities section of this publication.)

- Two check signers should be required for all disbursements and wire transfers, if possible. The treasurer should be one of these signers, and an employee having no other recording or reconciling responsibility should be the other. This policy should be communicated to banks and investment firms via signature cards.

- Signature stamps or plates should not be used since their unauthorized use can pose a greater liability than their potential benefit.

[3] The term "cash" hereafter refers to checks as well as currency.

- To prevent misappropriation of cash, banks and investment firms should be instructed (in writing) to wire transfer funds only to accounts in the name of the organization and with the specific account numbers provided.

- Each piece of documentation in the internal control chain (e.g., the receipts log, the disbursements journal, check authorizations, and bank reconciliations) should have a signature and date line for the preparer and the reviewer.

- Even the best system of internal control cannot protect against fraud in the case of employee collusion. Therefore, an organization should obtain fidelity insurance to cover employees who have access to the organization's funds.

- When a regular accounting employee is on vacation, the assumption of these duties by another employee provides a good opportunity to spot inefficiencies or fraud.

- Large employee cash advances (over $100) and company credit cards should not be permitted without strict controls. Generally, employees should use their own money or credit cards and request reimbursement through the submission of timely expense reports.

Interim Financial Reports

Generally, interim financial reports do not consist of a complete set of financial statements like those issued at the completion of the year-end audit. The following reports (except for the operating statement) are typically produced during the audit. On at least a quarterly basis, the treasurer should provide the board with a set of these reports (see Exhibit B).

- Statement of Financial Position (Balance Sheet)
- Statement of Activities and Changes in Net Assets (Income Statement)
- Statement of Changes in Cash Flows
- Schedule of Functional Expenses
- Operating Statement - Budget and Actual
- Notes to the Financial Statements

The information in these statements can be a useful tool for:

- monitoring revenue, support, and expenses, and comparing them to prior periods and budgeted amounts;
- planning additional programs and services for the current or future years;
- determining if additional fund-raising activities are warranted; and
- analyzing the results of a specific program area.

The Need for an Audit

No matter how accurate or timely the organization's reporting of interim financial information, most organizations are required by their by-laws or funding sources to have an annual financial audit or review performed by an independent Certified Public Accountant. An audit is an examination of the organization's financial statements by an independent CPA to ensure that they are presented fairly in all material respects according to Generally Accepted Accounting Principles (GAAP). An audit involves detailed levels of testing. An "unqualified" or "clean" opinion is the highest form of assurance provided by an independent CPA. A "review or compilation" is limited in scope and involves certain analytical review procedures applied to the financial statements that provide the organization with "negative assurance" (i.e., a statement that nothing has come to the accountant's attention that would indicate that the financial statements as presented are other than in accordance with GAAP).

Non-federal entities that expend $300,000 ($500,000 for fiscal years ending after December 31, 2003) or more in federal awards in a given year, either directly or indirectly, are required to have a single or program-specific audit conducted for that year in accordance with the applicable criterion outlined in the Office of Management and Budget's (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." Although the audit costs directly attributable to a given grant are chargeable to that grant, the board should take these costs into account when applying for and acquiring such grants. OMB Circular A-133 audits are performed in accordance with Government Auditing Standards (GAS) issued by the Government Accountability Office (GAO, formerly the General Accounting Office).

Non-federal entities that expend less than $300,000 ($500,000 for fiscal years ending after December 31, 2003) in federal awards in a given year are exempt from federal audit requirements for that year, but records must be available for review or audit by appropriate officials of applicable federal agencies, pass-through entities, and the GAO.

Financial audits focus on the financial statements balances and disclosures, while an A-133 audit concentrates on internal accounting controls and on compliance with laws and regulations.

The treasurer should make a recommendation to the board as to the type and timing of the accountant's engagement based on his/her familiarity with the organization's accounting function and funding source requirements.

Selecting an Independent Certified Public Accountant

A Request For Proposals (RFP) should be prepared to solicit bids for accounting services. The RFP should briefly describe the organization, its accounting system, the type of service requested (e.g., audit of basic financial statements, an A-133 audit, preparation of the 990 tax return, a management letter, and a presentation to the board), and the desired timing of the work and delivery of the reports. The type of audit requested is typically dictated by the organization's funding sources. Other requested services are particular to specific preferences of the board of each organization. Although all firms who report in accordance with Generally Accepted Auditing Standards are required to perform the same procedures regardless of their size or reputation, the firm should have nonprofit auditing experience. The following points should also be considered when choosing a firm.

- Reports from well-known firms can be effective in fundraising.
- Small firms are typically less expensive, faster, and more willing to get involved in the audit preparation work.
- Larger firms are typically more experienced with government grant audits.
- Savings can be realized through multi-year contracts and good audit preparation by the organization.

When negotiating for audit and other accounting services, remember to:

- insist on a fixed contract price to avoid surprises if the firm incurs more hours than anticipated;
- get at least three comparable bids (state CPA societies can provide the names of small and large firms specializing in nonprofit accounting); and
- always check references!

Audit Findings

At the conclusion of the accountant's annual audit engagement, a meeting should be held between the treasurer, management, and representatives of the accounting firm to discuss findings, observations, and recommendations. In addition to the audited financial statements, the accounting firm will supply a management letter containing its observations and recommendations for improvement in the system of internal control. The treasurer and/or management should report these results to the board and ask the board to vote on acceptance of the reports. Most importantly, the treasurer, in conjunction with management, should draft a response and a corrective action plan for the board that responds to the accounting firm's management letter.

Cash Management

In overseeing cash management, the treasurer should make sure that:

- idle funds are earning interest unless prohibited by funders;
- dues, grants, and other billings are prepared on a timely basis (in some cases, discounts for early remittance or penalties for late payment might be appropriate);
- bills are paid no less than 30 days after receipt (when they are not paid on time, always communicate with creditors about the organization's ultimate plans/ability to pay); and
- "interest only" loans are managed to ensure adequate principal is available when due.

It is also important in the cash management area for the treasurer to keep in mind that:

- in most cases, organizations are better off paying off debts than making investments; and

- furniture and equipment leases, although convenient, often contain implicit rates of interest between 15 and 30 percent. Therefore, these items should be purchased rather than leased if funds are available. Negotiations for financial leases or leases with an option to buy can often minimize monthly payments.

RESPONSIBILITIES OF MANAGEMENT

System of Internal Control for Fund Accounting

The system of internal control consists of a group of accounting controls and procedures designed to ensure (through the principles of accountability and separation of duties) proper safeguarding of assets and the timely recording, reconciling, and summarizing of transactions in the accounting system and financial statements of the organization. The challenge for the management of the small nonprofit organization is to set up a system that accomplishes these objectives while recognizing the limitations of a small staff and a scarcity of funds.

The process of setting up a system of internal control begins by identifying control objectives in each of the two primary functional areas, cash receipts and disbursements. These primary functional areas can be broken down into smaller functional areas, such as payroll, travel, accounts receivable, and accounts payable, and objectives can be set for each of these smaller functional areas. Following are examples of basic control objectives in the cash receipts and disbursements areas and the procedures designed to achieve these objectives.

Cash Receipt Control Objectives

- Receipts are logged in and deposited daily into the designated financial institution(s).

- Contributions, grants, and loans are properly inputted, classified, summarized, and reported in the accounting system on a monthly basis.

- Contributors are notified as to the receipt, amount, and tax deductibility of contributions.

Cash Receipt Procedures

- Mail is opened and stamped with the date it was received. Receipts are logged into a receipts log by date, amount, payee, and restriction (if any) by an employee with no other cash or accounting responsibilities. Checks received should be photocopied and attached to the supporting documentation.

- Receipts are deposited daily by an employee who checks that the total on the receipts log agrees with the deposit slip. When deposits cannot be made the same day, the check(s) should be locked in a secure location.

- A copy of the deposit slip, funds transferred, and daily receipts log are coded pursuant to an approved chart of accounts (see page 12) and entered into the accounting system.

- Deposits are reconciled to the general ledger cash account each month as part of the bank reconciliation process.

- Contribution acknowledgments are sent to contributors based on the daily receipts log. Contributors are encouraged to contact the organization if amounts and restrictions are not reflected accurately. The relative deductibility of a contribution is noted on acknowledgment letters based on the solicitation. Usually, general contributions to a 501(c)(3) organization are 100 percent deductible. Contributions that include a purchase or a receipt of services are reduced by the value of the good or service. For example, tickets purchased for a charity dinner given by a 501(c)(3) organization are deductible to the extent the ticket price exceeds the fair value of the dinner and entertainment provided.

Cash Disbursement Control Objectives

- Invoices are paid only for goods and services requested by the organization in furtherance of its mission.
- Payroll is disbursed for actual employee hours worked, consistent with time card/logs and employee job descriptions.
- Expenses are properly summarized, classified, and reported in the accounting records on a monthly basis.

Cash Disbursement Procedures

- Approved purchase orders are completed for all orders.
- Invoices for goods and services are matched with purchase orders and receiving documents before they are approved for payment.
- Three competitive bids are sought for each large purchase.
- Two check signers are required for all disbursements and wire transfers.
- Voided checks are defaced and retained for reconciliation purposes.
- Approved time sheets are used as a basis for preparing the checks, journals, payroll tax deposits, and the monthly, quarterly, and year-end payroll tax returns.

The Annual Operating Budget

Management should work with the treasurer and accounting personnel to prepare an annual or multi-year budget that translates the organization’s program objectives and strategic plan into projected support and costs. Points to consider in this process are outlined in the “Responsibilities of the Board of Directors” section of this guide (and see Exhibit A).

Chart of Accounts

A chart of accounts is a listing of accounts by classification (e.g., assets, liabilities, revenue, expenses, and net assets) and reference number (e.g., 1000's = assets, 2000's = liabilities, 3000's = net assets, 4000's = revenue, 5000's = expenses) that is used by individuals responsible for recording transactions to code the receipts and disbursements of the entity.

Accurate coding is a critical factor in producing reliable financial statements. Accordingly, the process of setting up the chart of accounts warrants careful consideration. The following points should be considered in designing the chart of accounts.

- The desired format of internal and external reports (e.g., financial statements, grant reports, project actual-to-budget reports) and the expected magnitude of account balances should determine the level of detail and method of summarizing accounts.

- The most useful measure of financial performance for the nonprofit organization is the report of actual results against an approved budget. Therefore the chart of accounts should be designed to produce reports that are comparable to the board-approved budget.

- Always leave room between account numbers to add accounts (for example, if supplies is account number 5820, the next account might be numbered 5830).

Allocating Costs

The tracking of revenue and expenses overall and by project or cost center is typically a necessity for nonprofits, either for internal purposes (to manage and report on projects) and/or external purposes (to support billings and status reports for grants). Most accounting software packages will easily accommodate such an expense breakdown. The more difficult task is correctly accumulating and allocating direct and indirect costs (such as administrative salaries, office supplies, and postage) to the appropriate cost center in accordance with the provisions of a particular contract or grant.

Although each organization and most contracts and grants are different, the following points should be considered when allocating costs.

- Contract/grant documents and governing regulations (e.g., for the federal government this may include the Federal Yellow Book and OMB Circulars A-110, A-122, and A-133) will define allowable, unallowable, and acceptable methods for allocating costs.

- Ignorance is no defense. When an organization accepts grant money, it accepts the accounting and audit responsibilities.

- The method of allocating costs should be reasonable, supportable, and applied consistently (e.g., based on hours worked supported by approved time sheets).

- Unallowable and/or undocumented government grant expenditures that have been reimbursed are typically required to be refunded upon such an audit finding.

- Always consult an expert when calculating or attempting to defend the organization's indirect rate, or the percentage that is used to calculate the amount of management and general expenses such as supplies, telephone, and administrative costs to be charged to a grant/project. Remember, monthly monitoring of indirect cost rate is critical. Contributors are always assessing an organization's ability to stay within the budgeted cost and rate.

- Just because an expense is direct (i.e., 100 percent attributable to carrying out grant supported programs) does not mean that it is 100 percent chargeable to a single grant or contract. It may be necessary to allocate the expense across multiple contracts/grants.

The Accounting System

The components of an accounting system will be determined, for the most part, by the budget and by the skills and experience of the individual and/or firms responsible for the accounting function. The following guidelines should be considered when recommending or approving a system.

- The more steps used for recording and summarizing the data in producing financial statements, the more frequently the information is susceptible to errors.

- No matter how simple an accounting software package is to use, it cannot make coding judgements or properly apply the knowledge of GAAP required to produce reliable financial statements.

- Utilizing a bookkeeper and/or a payroll services firm will reduce the staff responsibility of processing accounting transactions. The staff employee should review the work of the bookkeeper or payroll service.

Documentation Procedures

The documentation of financial and accounting procedures serves several purposes:

- it demonstrates a system of internal control to internal and external parties;

- it provides a training tool to minimize the disruption of staff turnover;

- it provides a criterion for job evaluations in the accounting area; and

- it meets a requirement for receiving federal financial assistance.

The trick to drafting user-friendly procedures is in striking a balance between being overly comprehensive – spelling out every single step in a process – and being too general to be useful. Procedures should be prepared (or at least reviewed) by an individual with knowledge and background in nonprofit accounting, tax, and grant issues to determine that they are accurate and complete. It is also useful to have such procedures reviewed by a person with relatively no accounting experience to ensure that they are user-friendly. A process should be established to ensure that procedures are constantly being evaluated and updated as organizational changes occur.

Accounting Basis and Financial Statements

For non-accountants, the concept of accrual accounting versus cash basis accounting can be a difficult one. Accrual basis accounting means that revenue is recognized when earned and expenditures recorded when incurred.

It is recommended that accrual basis accounting be used by nonprofits. This method presents the fairest picture and is the only method accepted according to GAAP. However, some small organizations will keep accounting records on a cash basis, or use the "checkbook method," recording revenue when cash is received and recording expenses when cash is paid. When financial statements are prepared, general journal entries are made to make accrual adjustments necessary to keep the statements from being materially misleading (having large dollar errors). Such a modification to the reporting results in a modified accrual basis. For example, unearned dues, interest expense due though not paid, accounts payable, and pledges receivable are recorded when preparing financial statements. It is most important that financial statements are not materially misleading and that the basis of presentation is disclosed on the face of the statements or in accompanying footnotes. Since the organization's annual audit must be in accordance with GAAP, the independent CPA selected will typically make the adjustments required to present the year-end financial statements on an accrual basis.

A major factor that impacts management's decision regarding what basis to use in this area is the technical knowledge and ability of the individual keeping the books.

Managing the Accounting Function and Report Deadlines

A common problem for nonprofit managers with little or no accounting experience is determining how to manage the accounting function properly and supervise staff responsible for accounting tasks. Very often managers do not know what they should be asking for or what to look at when they receive it. Maintaining a calendar that highlights due dates for specific financial, grant, and tax reports is one tool recommended to ensure compliance with internal and external deadlines. To make sure that the reports are accurate and understandable, nonprofit financial and accounting managers should also:

- be careful not to overload the individual(s) responsible for financial matters with other administrative tasks (if this is unavoidable, make sure that priorities are established and communicated);

- allow ample time to review and revise financial reports before a filing deadline or meeting;

- ask questions to understand the report and to confirm that an audit trail exists to support it (there are no stupid questions);

- if in-house personnel cannot supply adequate answers to questions or concerns, make inquiries of experts or nonprofit managers in other organizations;

- be involved in the accounting/record-keeping process throughout the period (for example, review cash reconciliations and closing checklists, spot-check payroll reports and invoice codings).

At a minimum, the following reports should be reviewed and approved by management prior to submission:

- financial statements (see Exhibit B);
- monthly or bi-weekly payroll reports;
- grant draw down requests and quarterly financial status reports;
- quarterly 941 tax return;
- annual 990 tax return; and
- audit reports, adjustments, and management letter.

Staffing the Accounting Function

As discussed in the section on board responsibilities, staffing of the accounting function presents a small organization with the difficult task of applying limited resources to a critical, though non-programmatic, function. Many small nonprofits find that an in-house accounting system is not practical given the costs and staff turnover. As an alternative, many small organizations employ a mix of individuals and outside agencies – possibly consisting of a part-time bookkeeper, a bookkeeping and payroll services firm, and an independent accounting firm – to fulfill the internal and external reporting needs of the organization at rates commensurate with their technical abilities.

Insurance

Management is responsible for obtaining the proper types and coverages of insurance. Of particular importance is director's and officer's (D&O) and employee fidelity insurance. These types of insurance provide for recovery of losses in cases of breaches in board member fiduciary responsibility or employee theft.

ACCOUNTING FUNCTIONS

The purpose of this section is to provide the non-accountant responsible for the accounting function in a small nonprofit organization with a general understanding of the basic accounts for which s/he will be responsible and the important concepts that s/he should understand in maintaining them. For a detailed discussion regarding specific accounting controls and procedures, the reader should consult the "Internal Accounting Controls" section of this publication.

Cash

The control over cash and the proper tracking, recording, classification, reconciliation, and reporting of its inflows and outflows are the most significant factors in properly conducting accounting for a small nonprofit organization. The critical controls and procedures in the cash area were previously discussed in the section on internal control. The focus of this section is to highlight points to consider in accounting for cash.

Cash Receipts

When classifying receipts (assigning account codes via the chart of accounts), remember that a receipt of cash can represent:

- a transfer from another cash account of the organization;
- payment on a receivable (e.g., grant, dues, pledge, advance, interest) already recorded on the books;
- contribution, grant, or income, not previously recorded in the books;
- sale of an asset (e.g., investment, furniture);
- reimbursement of an expense; or
- refund of a deposit.

Cash Disbursements

When classifying disbursements (coding to the chart of accounts) remember that a disbursement of cash can represent:

- a transfer to another cash account of the organization;
- payment on a liability (e.g., accounts payable, payroll liability, debt, obligation under capital lease) already recorded on the books;

- an expense incurred (e.g., supplies, rent, postage) not previously recorded on the books;
- an employee advance or prepaid expense not yet incurred; or
- purchase of an asset (e.g., investment, furniture).

General

- When reconciling cash, any items to be reconciled to the organization's checkbook balance (e.g., unrecorded deposits, void checks, interest, bank service charges) must be recorded both in the checkbook and in the general ledger accounts of the organization.
- Multiple sources of funding do not require multiple bank accounts unless required by one of the funding sources or there is a prohibition against earning interest. Fund accounting concepts and procedures (see page 10) provide for the proper tracking of commingled cash.

Investments

The investments of small nonprofit organizations are typically held by banks or investment firms and usually contain short-term investments such as certificates of deposit, government securities, treasury bills, and mutual funds. The purpose of investing idle funds for the small nonprofit is not to generate large gains for the organization as a result of active trading, but rather to ensure a higher level of return than is available in a typical savings or money market account until the funds are needed. Therefore, the investment objectives for a nonprofit organization should follow a low risk strategy that ranks investment criteria as follows:

- Preserve capital.
- Provide liquidity.
- Maximize returns.

Investments should be recorded at cost on the settlement date of the purchase as evidenced by cost slips received from the financial institution executing the purchase. Each month after receiving a statement from the custodial financial institution, a reconciliation should be performed that records interest and dividends earned and adjusts the cost recorded in the general ledger for any realized or unrealized gains or losses from sales or changes in market value on investments held in the portfolio. Statement of Financial Accounting Standards (SFAS) No. 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations," requires marketable securities with readily determinable fair values and all debt securities to be reported at their fair value.

Receivables

The receivables on the books of nonprofit organizations typically represent amounts due for revenue services such as membership dues, government/and or foundation grants, and employee advances. Whether the books are kept on a cash basis or an accrual basis (see previous discussion), these receivables must be tracked and payments properly applied to ensure that the organization has proper control over the amounts that are due.

Many small nonprofits track membership dues receivables simply by entering the invoice number, date, name of member, dues amount, and membership period on a manual or computer spreadsheet that adds the total and allows for posting of cash receipts or other approved adjustments. By utilizing a database program or the receivables module of a fully integrated general ledger package, however, an organization can more effectively manage cash flow by tracking the age of receivables (e.g., over 30, 60, 90, or 120 days).

Government or foundation grants typically involve a small number of large draw downs against an approved amount, which are typically easy to track. The accounting difficulty for grants more often involves properly preparing draw down requests and financial status reports. Determining which costs can properly be applied to the grant and when revenue can be recognized to the extent of those costs is also difficult.

As a policy, employee advances should be minimized and the dollar amounts of the advances should be limited. To the extent that they occur, they should be approved, documented through receipts, and identified in the cash disbursements journal. Advances can be tracked via spreadsheets as outlined with membership dues receivables. Any advances outstanding at year-end should be paid in the next year. Repayment of employee advances can be made through payroll deduction.

Inventory

Inventory is typically not a major asset category for the small nonprofit. Office supplies are usually expended as purchased and not set up as inventory on the books. To the extent that the organization has inventory (for example, publications for sale), the critical accounting issues are physical control (locked up and proper indexing); determination and proper recording of costs (labor, material, and overhead), profits, and tracking; and payment of sales taxes (unless exempt).

Periodically (monthly or quarterly), a supervised physical inventory should be taken by the organization, priced, and compared to amounts carried on the books. If an adjustment is necessary, it should be approved by management, and steps should be taken to address the cause of the need to readjust (for example, discounts not being properly recorded).

Fixed Assets

Fixed assets are long-term assets most often comprised of land, buildings, furniture, equipment, and leasehold improvements for which an organization has acquired title. These assets can be purchased for cash, a combination of cash and debt, or via a "capital lease" (see page 23).

To differentiate office supplies consumed in the regular course of business from actual fixed assets, most organizations establish a capitalization policy. The policy determines which purchases are recorded as assets on the books. To remove subjective judgement, a dollar value limit is usually determined as a threshold amount. This criterion may not be appropriate in all instances; however, the adherence to such a policy ensures that all "big ticket" items are properly classified.

Physical identification (tags, ID numbers) and the maintenance of a subsidiary ledger that tracks the asset by date of purchase, cost, description, classification (e.g., computer equipment), and location (e.g., headquarters) are key control features in the fixed asset area. A periodic physical inventory should be performed to reconcile this ledger with the fixed assets on hand to determine if any adjustments are needed due to unrecorded sales, retirements, or other changes. If an adjustment is necessary, it should be approved by management and steps should be taken to address the cause of the need for the readjustment.

Fixed assets purchased with restricted funds (foundation or government funds, for example) present special considerations for the nonprofit organization. Under a grant, title to any assets purchased with grant funds may reside with the grantor; some organizations will expense these purchases and track these assets separately (off the books). When there is doubt as to the proper treatment of fixed assets purchased with restricted funds, the grant officer and the organization's independent accounting firm should be consulted.

Depreciation is the systematic and rational allocation of an asset's cost over its useful life. Depreciation illustrates the accounting concept of matching in that, because a fixed asset benefits multiple future periods, its cost should be properly matched against funding for those future periods. GAAP requires nonprofit organizations to record depreciation for fixed assets purchased with unrestricted funds. Although several methods of computing depreciation are acceptable, the straight line method (equal allocation over the asset's useful life) is recommended since the nonprofit does not derive a tax benefit from using accelerated methods.

Other Assets

In addition to the major classes of assets (e.g., cash, investments, receivables, inventory, and fixed assets), there are typically other purchases made by organizations such as prepaid insurance that, because of the long-term nature of their benefit, should be recorded as assets and amortized (recognized as expenses prorated over the period of benefit). For example, an insurance period might overlap the fiscal period.

Accounts Payable

Accounts payable represent the routine obligations of an organization that arise from routine purchases. Whether the organization decides to keep its books on a cash or accrual basis, accounts payable must be properly monitored for purposes of cash flow, budgetary control, and proper authorization of expenditures.

As noted in the internal control section on cash disbursements, purchases should be properly authorized, approved, and received prior to releasing payment. A worksheet or a simple accounts payable check-writing software program can be employed to code and track approved invoices awaiting payment. In general, the following should be noted with regard to accounts payable.

- To avoid an excessive administrative burden, bills should be paid in batches no more than twice a month.
- Discounts are typically not worth tracking, though interest charges should be avoided.
- Bills should be paid no less than 30 days from the date of receipt.
- Never pay from a statement, only from an original invoice. Statements are useful only for reconciling outstanding invoices and payments.
- Invoice numbers should be controlled to avoid duplicate payments.

Payroll Liabilities

Typically the largest ongoing financial obligation of an organization is to its employees in the form of salary, fringe benefits, and payroll taxes. As stated in the internal control section on payroll, due to the complexity involved in managing the payroll function for even a small group (e.g., calculating tax withholdings, depositing tax payments, and preparing tax and unemployment insurance returns), the use of a payroll service bureau is recommended. The remainder of this discussion assumes the use of such a service.

Outsourcing an accounting function such as payroll can be efficient and cost effective, although the organization's overall accounting responsibilities can never be delegated. Whether the organization keeps its books on a cash or accrual basis, the following should be noted with regard to managing the overall payroll function and specific payroll-related liabilities.

- Time sheets by major category of responsibility/project should be prepared and submitted by all employees for approval on a timely basis.
- A check should not be disbursed to an employee until a time sheet is received and approved.

- ⌂ Although time and attendance reports can be collected and reported to the payroll service by the individual responsible for accounting, the checks and reports should be reviewed and approved by an individual with no control over cash or responsibility for recording transactions.

- ⌂ Payroll errors should be reported to, and corrected by, the payroll service immediately, as carryforward mistakes will misstate monthly, quarterly, and annual tax reporting.

- ⌂ Personnel files and payroll data are confidential and therefore should be maintained in locked file cabinets with limited access.

- ⌂ Vacation can be a material liability to an organization that allows year-end carryovers. Records should be current and accurate, and employees should not be allowed to accrue excess leave. Generally, many nonprofit organizations will establish a maximum balance for carrying over accrued vacation to restrict the exposure to a potential liability.

- ⌂ Good file documentation is the key to avoiding or defending disputes with employees.

- ⌂ Independent contractor status is, in most cases, a misnomer. All employees (full- and part-time) should be subject to tax withholdings. When unsure, consult your local unemployment office or municipal employment agency.

Deferred Support

Nonprofit organizations receive contributions from donors with restrictions on the time or manner of the contributions' use. Under SFAS No. 116, restricted support should be recognized in the statement of activities and changes in net assets in the period received as an increase in temporarily or permanently restricted net assets (rather than deferred support on the statement of financial position). If support is temporarily restricted, the amounts should be reclassified to unrestricted net assets when the restrictions have been met.

Refundable Advances

An organization may receive funds from a third party (such as the federal government or a foundation) for which goods or services have yet to be provided, or for which donor conditions have yet to be met. In these instances, funds received should be reported as refundable advances. Refundable advances are commonly associated with grants. Grants can be either reciprocal exchange transactions or nonreciprocal contribution transactions.

Debt

Nonprofit organizations' debts usually consist of one or a combination of the following.

Working Capital Line of Credit

Typically provided by the entity's bank, a working capital line of credit is a short-term, usually one-year, loan agreement secured by the net assets of the organization that provides for cash flow during funding shortfalls. Such shortfalls typically occur in seasonal environments (e.g., income might be dependent on convention registration occurring once a year), funding lags, or when an organization is expanding operations to take on a new grant that has been approved, but not received.

Interest expense, principal draw downs, and repayments should be properly recorded, classified, and reconciled on a monthly basis. From a cash flow standpoint, the organization should view working capital lines of credit as temporary and not become dependent on such financing for its survival. Furthermore, it should be noted that such agreements typically require that the principal of the loan be paid down, on a consistent basis, (e.g., within 30 days) for the initial credit line period to qualify for renewal. If this condition is not met, the loan could be called in its entirety on the date of maturity.

Property Mortgage

Some nonprofits are able, through subsidized government loans, seller financed loans, restricted fund drives, and other methods, to purchase land and a building to house their operations. The terms, conditions, and amortization (number and amount of payments, classified by interest and principal breakdown of those payments) should be fully understood by individuals responsible for the accounting of the organization. The following points should also be noted with regard to property mortgages.

- The purchase of property should make economic and programmatic sense for the entity.
- Direct or indirect subsidized loans from federal sources can create audit requirements for the organization under OMB Circular A-133.
- Adjustable Rate Mortgages (ARMs) pose interest rate risk exposure to the organization.
- Interest-only or balloon loans must be carefully managed from a cash flow standpoint.
- Purchasing with the intent to sublet excess space can effectively put the organization in the real estate business.
- The carrying costs of property, other than the mortgage (e.g., property taxes, if no exemption is available, utilities, and insurance) must also be carefully evaluated.
- Interest expense and principal repayments should be properly recorded, classified, and reconciled on a monthly basis.

- ⌂ If payments are less frequent than monthly, and accrual basis statements are prepared, accrued interest payable (incurred though not yet paid), if material (relatively large dollars), should be recorded.

Obligation Under Capital Leases

A capital lease obligation typically arises from furniture and equipment purchases. The lease is structured for durations greater than one year. There is normally a contract with a lessor for a specified period of time in which the nonprofit pays interest and principal towards the lease. Capitalization of such items generally requires a policy created by the board of directors establishing the terms and conditions for entering into such contracts. The recording of this liability is commonly overlooked by small nonprofit organizations recording on a cash basis.

Other Liabilities

Liabilities that do not arise as a result of day-to-day operations should also be monitored, whether the books are kept on a cash or accrual basis. Such liabilities or "accruals" might include the organization's portion of amounts owed to the employees' retirement plan(s), an estimate of the liability and professional fees expected to be paid as a result of a lawsuit or tax audit, the difference between the stated office rent and the actual rent paid under a free rent provision, and other items. For example, if the landlord gives the organization six months' free rent, this discount should be amortized over the entire term of the lease and the effective rent (stated less actual) during this period should be either funded (put aside in the bank) or at least tracked through a liability account.

Net Assets

Under SFAS No. 117, "Financial Statements for Not-for-Profit Organizations," organizations are required to present, at a minimum, aggregated financial data: total assets, total liabilities, total net assets (excess of assets over liabilities), and total change in net assets. The term "fund balance" is replaced with "net assets." Net assets are classified into one of the following three categories depending on the presence or absence of donor-imposed restrictions:

- ⌂ unrestricted net assets, which are not restricted either by donors or by law;
- ⌂ temporarily restricted net assets, the use of which has been limited by donor-imposed time restrictions; or
- ⌂ permanently restricted net assets, which have been restricted by donor or by law to be maintained by the organization in perpetuity.

Financial, Tax, and Grant Reporting

The most important objectives in preparing financial reports and tax returns are that they be done accurately and in a timely manner and that individuals responsible for preparing the reports can adequately support and explain amounts contained therein. The following recommendations are provided in meeting these objectives.

- Know your users. The format of the reports and any analysis or footnotes should be designed to provide further understanding on complicated concepts or significant trends.

- Allow yourself enough time not only to prepare the reports, but to review, correct, and thoroughly understand them prior to presenting them to the users.

- Request more time for follow-up and analysis before presenting a report you are not comfortable with.

- Keep a calendar of due dates for key financial, tax, grant, and other required reports.

- Avoid off-the-book worksheets to support your reports. If the financial statements are not in a format/content to support required reports, the chart of accounts should be modified and the reporting format should be changed.

- Charts and graphs are excellent tools for communicating financial data to a non-financial audience.

- Control report drafts to ensure that all users are provided with comparable information.

- Consider changes in report format and/or the chart of accounts based on user comments.

- Ensure that the costs allocated to a restricted grant are proper and that those costs, as a percentage of the grant, are reflective of the progress on completing the projects tasks. Otherwise, at some point, unrestricted funds may be required to cover the overruns.

Before financial reports of any kind can be prepared, the books of the organization must be properly closed. A closing checklist that outlines the tasks (e.g., reconcile cash, have reconciliations reviewed and approved by management, post reconciling items to the checkbook and general ledger) should be developed as part of the internal control process. This list will help ensure, and can document, that all necessary procedures have been performed and can assign accountability accordingly.

In general, the tasks involved in the closing process include the following.

- Reconcile and post subsidiary ledgers to the general ledger, including:

    - receivables;
    - fixed assets;
    - payroll; and
    - accounts payable.

⌂ Prepare routine journal entries.

- Record the release of net assets from restrictions.
- Record depreciation and amortization on fixed and intangible assets.
- Record interest income and bank service charges on cash accounts.
- Record realized and unrealized gains and losses on sale of investments.
- Prepare cost to fair market adjustments on investments held.
- Accrue interest receivable on certificates of deposits and short-term investments.
- Accrue interest payable on debt.
- Post period-to-date net revenue, gains, and other supports and expenses to net assets.

Organizations are free to use any method of recordkeeping as long as the final result – the financial statements seen by the public – are in the proper format (see Exhibit B 2). The following external financial report can be modified for internal reporting needs. These reports should be prepared monthly or quarterly.

⌂ Statement of Financial Position;
⌂ Statement of Activities and Changes in Net Assets;
⌂ Statement of Changes in Cash Flows;
⌂ Schedule of Functional Expenses; and
⌂ Footnotes.

In general, the small nonprofit is required to file the following tax reports.

⌂ federal payroll taxes deposit;
⌂ state withholding deposit;
⌂ Quarterly Employer Tax Return (941);
⌂ Quarterly State Unemployment Tax Return;
⌂ Quarterly Sales Tax Return (if applicable);
⌂ Annual Return of Organization Exempt from Income Tax (form 990);
⌂ Annual Personal Property Tax Return (if applicable);
⌂ Annual State Reconciliation of Amounts Withheld and Deposited;
⌂ Annual Wage and Tax Statement (W-2/W-3); and
⌂ Annual Report to Third Party Payers (1099).

In general, the small nonprofit is required to file the following financial reports in connection with federal government grants. Corporate and foundation grant requirements vary widely.

⌂ drawdown requests;
⌂ Federal Cash Transaction Report;
⌂ financial status report; and
⌂ A-133 audit (90 days following year end).

REFERENCES

Tax Forms & Publications

These forms and publications are available from the Internal Revenue Service or, in the case of state tax forms or publications, from your state tax agency. You can also obtain the information from the IRS's website at www.irs.gov or by calling the forms distribution center at 1-800-829-3676.

Tax Exempt Status for Your Organization (Pub 557)
Application for Recognition of Exemption (Package 1023)
Charitable Contributions (Pub 526)
Election/Revocation of Election by an Eligible Section 501(c)(3) Organization
    To Make Expenditures To Influence Legislation (Form 5768)
Application for Employer Identification Number (Form SS-4)
State Combined Registration Form (varies)
Sales Tax Exemption Form (varies)
Circular E, Employer's Tax Guide (Pub 15)
Employer's Supplemental Tax Guide (Pub 15-A)
Federal Employment Tax Forms (Pub 393)
Tax Withholding and Estimated Tax (Pub 505)
Employee Withholding Exemption Certificates:
    Federal (Form W-4)
    State (varies)
Employer Tax Deposit Coupons:
    Federal (Form 8109)
    State (varies)
Employer Federal Quarterly Tax Return (Form 941)
Quarterly State Unemployment Tax Return (varies)
Return of Organization Exempt From Income Tax (990)
Annual State Reconciliation of Amounts Withheld and Deposited (varies)
Annual Wage and Tax Statement (W-2, W-3)
Employee's Withholding Allowance Certificate (W-4)
Annual Return/Report of Employee Benefit Plan (Form 5500)
Request for Taxpayer Identification Number and Certification (Form W-9)
Guide to Free Tax Services (Pub 910)

Board Member Reference Materials

The following publications are available through BoardSource at www.boardsource.org or 1-800-883-6262.

	Item #
The Legal Obligations of Nonprofit Boards	39
Hiring the Chief Executive	50A
Board Bookshelf	74

Accounting and Grant Reporting for Nonprofits

"Accounting and Financial Reporting: A Guide For United Ways and Not-for-Profit Human Service Organizations" (United Way of America)
"Financial and Accounting Guide for Not-for-Profit Organizations" (Wiley Nonprofit Series)

Audit and Accounting Guide, Not-for-Profit Organizations (AICPA)
SFAS No. 116 "Accounting for Contributions Received and Contributions Made" (FASB)
SFAS No. 117 "Financial Statements of Not-for-Profit Organizations" (FASB)
GAO Government Auditing Standards ("Yellow Book") (GPO)
OMB Circular A-110 "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations" (GPO)
OMB Circular A-122 "Cost Principals for Nonprofit Organizations" (GPO)
OMB Circular A-133 "Audits of States, Local Governments, and Non-Profit Organizations" (GPO)

Federal Grants Management Handbook (Thompson Publishing Group)

Ordering Information

American Institute of Certified Public Accountants (AICPA)	www.aicpa.org 202-737-6600
United States Government Printing Office (GPO)	www.access.gpo.gov 202-512-1991
Thompson Publishing Group	www.thompson.com 202-872-4000
Internal Revenue Service (IRS)	www.irs.gov See local listings or dial 1-800-829-1040
BoardSource	www.boardsource.org 202-452-6262
United Way of America	www.unitedway.org 703-836-7112

EXHIBITS

EXHIBIT A
Sample Annual Budget

ABC NONPROFIT GROUP
ANNUAL BUDGET
FISCAL YEAR 20XX

	Program A	Program B	Management & General	Fund-Raising	Total
Revenue:					
Contributions and donations	$ 500,000	$ 25,000	$ 875,000	$ 345,000	$ 1,745,000
Contracts and grants	2,375,800	900,000			3,275,800
Interest and investment income	75,000	21,000	5,000		101,000
Conference income	281,000				281,000
Membership dues			16,000		16,000
Other support		15,000	30,000	3,500	48,500
TOTAL REVENUE AND OTHER SUPPORT	3,231,800	961,000	926,000	348,500	5,467,300
Expense:					
Salaries and related benefits	2,014,521	676,252	473,801	97,853	3,262,427
Professional fees	300,000	35,500	20,275	95,075	450,850
Travel costs	87,999	47,367	23,098	48,628	207,092
Supplies	63,000	32,462	60,666	35,777	191,905
Occupancy	250,000	65,000	55,200	-	370,200
Communications	75,375	19,073	41,984	53,201	189,633
Postage and shipping	57,300	18,500	38,000	9,700	123,500
Maintenance and repairs	52,010	28,540	27,560	-	108,110
Conferences, conventions	268,000	-	-	-	268,000
Depreciation and amortization	24,500	18,655	120,454	-	163,609
Miscellaneous	30,158	15,380	62,530	5,876	113,944
TOTAL EXPENSES	3,222,863	956,729	923,568	346,110	5,449,270
INCREASE IN NET ASSETS	**$ 8,937**	**$ 4,271**	**$ 2,432**	**$ 2,390**	**$ 18,030**

EXHIBIT B-1
Sample Statement of Financial Position

ABC NONPROFIT GROUP
STATEMENT OF FINANCIAL POSITION
SEPTEMBER 30, 20XX

ASSETS		
Cash and cash equivalents	$	101,389
Investments	$	11,114,765
Loan receivable		3,563,495
Contract and grant receivable		170,976
Fixed assets (net of accumulated depreciation)		548,870
Other assets		2,561
TOTAL ASSETS	**$**	**15,502,056**
LIABILITIES		
Accounts payable	$	356,954
Accrued and other liabilities		87,243
Refundable advances		270,440
Capital lease obligations		32,741
Notes payable		3,075,657
TOTAL LIABILITIES		3,823,035
NET ASSETS		
Unrestricted		302,205
Temporarily restricted		8,726,553
Permanently restricted		2,650,263
TOTAL NET ASSETS		11,679,021
TOTAL LIABILITIES AND NET ASSETS	**$**	**15,502,056**

The accompanying notes are an integral part of these financial statements.

EXHIBIT B-2
Sample Statement of Activities

ABC NONPROFIT GROUP
STATEMENT OF ACTIVITES AND CHANGES IN NET ASSETS *(Comparison of Actual to Budget)*
FOR THE SIX MONTH PERIOD ENDED MARCH 31, 20XX

	Current Month Actual	Year-to-Date Actual	Annual Budget	% to Date	Remaining Budget Balance
Revenue:					
Contributions and donations	$ 186,001	$ 1,154,684	$ 1,745,000	66%	$ 590,316
Contracts and grants	425,484	2,031,649	3,275,800	62%	1,244,151
Interest and investment income	36,700	60,800	101,000	60%	40,200
Conference income	96,401	173,500	281,000	62%	107,500
Membership dues	1,250	12,300	16,000	77%	3,700
Other support	354	25,468	48,500	53%	23,032
TOTAL REVENUE AND OTHER SUPPORT	746,190	3,458,401	5,467,300	63%	2,008,899
Expense:					
Salaries and related benefits	305,438	2,219,814	3,262,427	68%	1,042,613
Professional fees	75,000	354,621	450,850	79%	96,229
Travel costs	63,486	102,678	207,092	50%	104,414
Supplies	36,781	85,461	191,905	45%	106,444
Occupancy	26,011	175,648	370,200	47%	194,552
Communications	6,510	84,521	189,633	45%	105,112
Postage and shipping	11,325	54,684	123,500	44%	68,816
Maintenance and repairs	9,635	79,611	108,110	74%	28,499
Conferences, conventions	89,100	156,487	268,000	58%	111,513
Depreciation and amortization	46,257	88,137	163,609	54%	75,472
Miscellaneous	16,547	45,874	113,944	40%	68,070
TOTAL EXPENSES	686,090	3,447,536	5,449,270	63%	2,001,734
INCREASE IN NET ASSETS	**$ 60,100**	**$ 10,865**	**$ 18,030**		

EXHIBIT B-3

Sample Statement of Activities

ABC NONPROFIT GROUP

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED SEPTEMBER 30, 20XX

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue:				
Contributions and donations	$ 30,000	$ 1,448,600	$ 150,000	$ 1,628,600
Contracts and grants		3,103,456	-	3,103,456
Interest and investment income	250,717			250,717
Conference income		291,000		291,000
Membership dues	14,666	-	-	14,666
Other support	9,854	-	-	9,854
Net assets released from restrictions	5,017,072	(5,017,072)	-	-
TOTAL REVENUE AND OTHER SUPPORT	5,322,309	(174,016)	150,000	5,298,293
Expenses:				
Program A	3,120,850	-	-	3,120,850
Program B	946,060	-	-	946,060
Management and general	928,864	-	-	928,864
Fund-raising	289,681	-	-	289,681
TOTAL EXPENSES	5,285,455	-	-	5,285,455
CHANGE IN NET ASSETS	36,854	(174,016)	150,000	12,838
NET ASSETS, beginning of year	265,351	8,900,569	2,500,263	11,666,183
NET ASSETS, end of year	**$ 302,205**	**$ 8,726,553**	**$ 2,650,263**	**$ 11,679,021**

EXHIBIT B-4
Sample Statement of Cash Flows

ABC NONPROFIT GROUP
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED SEPTEMBER 30, 20XX

CASH FLOWS FROM OPERATING ACTIVITIES		
Decrease in net assets	$	(564,212)
Adjustments to reconcile decrease in net assets to net cash used in operating activities:		
Depreciation and amortization		579,215
Contributions restricted for long-term purposes		(268,612)
Decrease in accounts receivable		75,416
Decrease in inventory		30,875
Decrease in other assets		2,541
Increase in accounts payable		142,987
Decrease in accrued and other liabilities		(23,568)
Increase in refundable advances		67,642
NET CASH PROVIDED BY OPERATING ACTIVITIES		42,284
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of fixed assets		(63,905)
Proceeds from sale of investments		2,500
NET CASH USED BY INVESTING ACTIVITIES		(61,405)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings		597,874
Repayments of debt and capital leases		(653,127)
NET CASH PROVIDED BY FINANCING ACTIVTIES		(55,253)
NET(DECREASE) IN CASH AND CASH EQUIVALENTS		(74,374)
CASH AND CASH EQUIVALENTS, beginning of year		175,763
CASH AND CASH EQUIVALENTS, end of year	**$**	**101,389**

The accompanying notes are an integral part of these financial statements.

EXHIBIT B-5
Sample Schedule of Functional Expenses

ABC NONPROFIT GROUP
SCHEDULE OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED SEPTEMBER 30, 20XX

	Program A	Program B	General and Administrative	Fund-raising	Total
Salaries and related benefits	$ 1,901,452	$ 667,513	$ 490,306	$ 95,632	$ 3,154,903
Professional fees	325,890	49,520	30,755	85,210	491,375
Travel costs	95,760	52,864	19,751	46,365	214,740
Supplies	58,200	23,548	51,704	40,016	173,468
Occupancy	254,905	53,645	55,200	-	363,750
Communications	36,330	12,587	25,201	6,547	80,665
Postage and shipping	58,220	17,802	36,875	13,758	126,655
Maintenance and repairs	61,888	24,540	27,249	-	113,677
Conferences, conventions	248,563	-	27,984	-	276,547
Depreciation and amortization	21,800	18,300	128,358	-	168,458
Miscellaneous	57,842	25,741	35,481	2,153	121,217
Total	**$ 3,120,850**	**$ 946,060**	**$ 928,864**	**$ 289,681**	**$ 5,285,455**

EXHIBIT B-6
Sample Notes to Financial Statements

ABC NONPROFIT GROUP
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 20XX

NOTE A - NATURE OF ACTIVITIES

The ABC Nonprofit Group (the "Group") is a not-for-profit organization incorporated in Yourtown, USA in 1962. Its stated purpose is to support and develop programs for low cost-single family housing. These activities are funded by various federal and state agencies.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The financial statements of the Group have been prepared on the accrual basis. Contributions, grants and contracts are recognized as income as earned through expenditure in accordance with the respective agreements. Funds received in advance of expenditure are recorded as refundable advances.

Basis of Presentation

Financial statements presentation follows the recommendation of the Financial Accounting Standards Board (FASB) in its Statement of Financial Accounting Standards (SFAS) No. 116, *Accounting for Contributions Received and Contributions Made.* In accordance with this standard, prospective application of the recognition of restrictions is reflected in the financial statements. The Group also adopted FASB's Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*. Under SFAS No. 117, the Group is required to report information regarding its financial position and activities according to three classes of net assets:

Unrestricted net assets	Net assets that are not subject to donor-imposed restrictions.
Temporarily restricted net assets	Net assets stipulated by donors for specific operating activities or for use in specified future period. When donor restrictions expire, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.
Permanently restricted net assets	Net assets subject to donor-imposed stipulations that they be maintained permanently by the Group.

Income Tax Status

The Group is exempt from Federal income taxes under Internal Revenue Code Section 501(c)(3). The Group is also exempt from state income taxes. Accordingly, the Group has made no provision for Federal or state income taxes.

Fixed Assets

Fixed assets include furniture and equipment stated at cost. Depreciation is provided using the straight-line method over the estimated useful life of the assets.

Functional Expenses

The Group allocates its expenses on a functional basis among its two primary program activities, general and administration and fund-raising.

Cash and Cash Equivalents

Cash and cash equivalents include all monies in banks and highly liquid investments with original maturities of three months or less.

Fixed Assets

Fixed assets are stated at costs. Depreciation and amortization is provided over the estimated useful life of the respective assets using the straight-line method. Costs of minor repairs are charged as expense to current year operations.

Investments

Investments are recorded at fair market value.

NOTE C - LOANS RECEIVABLE

As of September 30, 20XX, the Group had the following loan receivables:

Contract I	$1,346,945
Contract II	935,111
Contract III	612,845
Other	668,594
Total	$3,563,495

NOTE D - ACCRUED AND OTHER LIABILITIES

Accrued and other liabilities represent the following:

Payroll tax payable	$53,456
Accrued salaries	21,542
Accrued vacation	12,245

Total	$87,243

NOTE E - CAPITAL LEASE OBLIGATIONS

The Group leases office equipment under capital leases expiring in various years. Interest rates on capitalized leases varies from 12.2% to 18.5% and are imputed based on the lower of the Groups incremental borrowing rate at the inception of each lease or the lessor's implicit rate of return. At September 30, 20XX, the cost of equipment under capital leases was $36,468.

Future minimum lease payments for assets under capital leases at September 30, 20XX are as follows:

20XX	$31,983
20XX	29,032
20XX	25,785
20XX	22,467
Total minimum obligations	109,267
Less interest	(61,453)
Present value of obligations	$47,814

NOTE F - LONG-TERM DEBT

Long-term debt comprises the following:

Bank I -	loan bearing interest 1.25% per annum and payable quarterly	$1,600,000
Bank II -	loan bearing interest 3% per annum and repayable on March 20XX	500,000
Bank III -	loan bearing interest at 5% annum payable annually, principal due September 30, 20XX	900,000
Foundation -	loan bearing interest at 3% per annum and paid quarterly, principal due on December 31, 20XX	75,657
	Total Long-Term Debt	$3,075,657

NOTE G - NET ASSETS RELEASED FROM RESTRICTIONS

Net assets of $5,017,072 for the year ended September 30, 20XX were released from donor restrictions by incurring expenses satisfying the restricted purposes.

NOTE H - CONTINGENCIES

All cost incurred on contracts and grants are subject to review by grantors agencies. In the opinion of management, any such review will not result in adjustments having material effect on the financial statements.

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Many nonprofit organizations engaged in rural housing development are so small that no one on staff has extensive accounting and financial operations experience. This manual, which updates a 1997 accounting guide published by the Housing Assistance Council, provides the basic information necessary to manage the accounting and financial activities of such an organization, written using terms that are as straightforward as possible.

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