City and County of San Francisco

Office of the Controller

Finance Guide for Nonprofit Organizations

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Disclaimer

This ***Finance Guide for Nonprofit Organizations*** only provides nonprofit organizations with a broad overview and general guidance on organizing and managing their financial systems. It is not a comprehensive manual on the full scope of nonprofit financial operations, and it should not be relied on as an authoritative guide on managing nonprofit financial systems. The *Guide* identifies additional resources that nonprofits may use to find more detailed information. Nonprofit organizations using the Guide should also seek the advice of financial experts, such as certified public accountants or other professionals specializing in the finances of nonprofit organizations, to guide them in decisions regarding their financial systems.

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Preface

This ***Finance Guide for Nonprofit Organizations*** is a result of a recommendation by the Nonprofit Contracting Task Force in its report of June 26, 2003. The Task Force met during the spring of 2003 and determined that City and County of San Francisco departments' fiscal or accounting requirements for the nonprofit organizations they contract with are inconsistent. The Task Force concluded that nonprofit organizations bear an unnecessary administrative burden in their efforts to meet varying requirements of different city departments, in particular when departments conduct fiscal monitoring activities of their nonprofit contractors. Among other recommendations for improving the city's contracting processes, the Task Force recommended that the Controller's Office develop a finance guide setting out accounting standards for nonprofit organizations that would help them satisfy the city's requirements and assist city departments in the conduct of their fiscal monitoring of the organizations they contract with. Further, a finance guide would provide needed technical assistance to nonprofit organizations, especially newer organizations that are just developing their financial systems and staff.

Additional copies of this guide are available on the Controller's Office Website at http://www.sfgov.org/controller Copies may also be obtained by contacting the Controller's Office at (415) 554-7500 or John Haskell at (415) 554-7659.

For more information about the Nonprofit Contracting Task Force—its meetings and report—visit the city Website at http://www.sfgov.org/npcontractingtf or contact:

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1 Introduction

The purpose of this guide is to provide recipients of city funding with an explanation of basic administrative and financial requirements for nonprofit organizations that do business with the City. It is not intended to replace the requirements that the federal or state governments have for recipients of federal or state funds.

About This Guide

This guide provides nonprofit organizations with general instructions for achieving a level of administrative and financial competency that will allow them to be eligible for funding by most government granting agencies. In many instances this guide will refer to federal publications as the best source of information concerning a specific administrative or financial issue. Compliance with federal requirements will generally assure that grant agreement requirements will be met or exceeded. By following these guidelines, you can help your organization to maintain administrative and financial systems that are adequate and will stand up to a review by your funder(s) or a formal audit.

Another purpose of this guide is to provide city department contract managers and fiscal monitors with a resource for providing ongoing technical assistance to your organization. Ongoing technical assistance can help prevent minor problems from becoming major ones that are difficult to resolve or that might result in the loss of your funding.

Finally, this guide includes in Appendix F an annotated list of resources for nonprofit organizations seeking more specific information about their administrative and finance needs.

Know Your Funding Sources and Your Contract

A thorough understanding of your grant agreements and contracts is essential to adequately design and administer a finance system. Key information such as funding sources, effective dates, and ineligible costs are crucial.

The following points are important to a successful finance system:

- Know where the money comes from and be able to account for it by funding source.

- If you receive federal or state funds, research all of the compliance issues that might be tested by your independent certified public accountant (CPA) as part of an annual audit.

> **Example:**
> Service providers who receive passed-through federal health and human services funding to provide nutrition services to individuals aged 60 or over should know that there is a "compliance supplement" appended to the federal Office of Management and Budget's (OMB) Circular A-133 which gives information concerning auditable compliance issues for many of those grants. Under the "activities allowed or unallowed" section, the supplement states that "nutrition services may be provided to handicapped or disabled individuals who are less than 60 years old but who reside in housing facilities occupied primarily by older individuals at which congregate nutrition services are provided." This might be good to know if this type of client is not currently being served by your agency and your agency has unused capacity. It also describes what type of documentation you would want to have available to auditors for this type of client (confirmation of address for disabled individuals under 60). See the resource section of this guide for the Internet address for OMB circulars.

- Read and understand your grant agreement or contract and know what restrictions your funding sources have placed on the use of the funds they provide. If you have a grant agreement or contract that requires that your organization provide matching funds in order to earn the full grant or contract amount, it is essential that these funds are identified early and accounted for properly.

- Know the beginning and ending dates of your grant agreement or contract so that the accounting and payroll records can accurately reflect the sources of funds for each of your program components by funding cycle.

2

Financial Management Systems

The accounting system for a nonprofit organization consists of certain basic components. Such a system helps ensure that financial data and economic transactions are entered properly into the accounting records and that financial reports are prepared accurately and on time. An adequate accounting system and good bookkeeping is essential for audits, tax reporting, financial analysis, and accountability to the board of directors, the public, and funders.

Accounting Cycles

There are four principle accounting processes, or cycles, in the operation of a financial management system:

- **Revenue, Accounts Receivable, and Cash Receipts**—This cycle includes making deposits, processing cash receipts, recording receipts, and performing month-end reconciliations.

- **Purchases, Accounts Payable, and Cash Disbursements**—This cycle includes processing invoices, issuing checks, recording checks in the general ledger, and performing month-end reconciliations.

- **Payroll**—This cycle includes gathering payroll information for processing, computing wages and withholding, preparing payroll checks and depositing payroll taxes, performing month-end reconciliations, preparing quarterly tax returns, and preparing annual returns and other forms (W-2s, W-3s, and so on).

- **General Ledger and Financial Statements**—This cycle includes preparing monthly journal entries, reconciling bank accounts, reviewing general ledger activity, posting and adjusting entries, and producing general ledger and financial statements.

  At year-end there may also be audit adjustments determined by the organization's outside auditors or contract disallowances generated by funders.

General Journal Posting

Journal posting includes recording transactions such as depreciation and amortization plus any other transactions that get posted in batch totals from outside the "real-time" accounting system (payroll is often posted this way) to make sure that all financial changes to the organization are included in the month's general ledger. After the general ledger is complete, it may be adjusted to move revenue or expenses from one account to another.

Adjusting Entries

At times you will need to correct any transactions that are known to be in error. This step is called *adjusting*.

TIP

This is the time to reconcile all of your balance sheet accounts to source documents such as bank and loan statements and to internal schedules such as depreciation and amortization schedules. If your organization makes allocations of shared and indirect costs as described in this section, you only want to go through this process once each month, rather than allocating adjustments to the balance sheet that may be discovered later.

Adjustments also include allocating revenue and expenses to the appropriate cost centers out of the *shared* or *indirect cost* centers. Shared cost centers are generally on the program level and include costs for shared facilities and staff that perform program administration functions. The indirect cost center includes all expenses of the organization that provide a benefit to all of the organization's programs but do not relate solely to any major function of the organization. Usually these include costs that involve the organization's executive and finance functions.

Shared costs can be allocated to all related program cost centers based upon a method that makes sense for the type of cost. Facilities costs such as lease payments, insurance, and utilities are usually allocated based upon the square footage of the space that is shared. Program administration costs are often allocated based upon program units of service or relative percentages of direct wages.

Allocation of **indirect costs** can be a highly technical and time-consuming process. Organizations that receive direct federal funding may be required to obtain a federal indirect cost rate from the federal agency that provides the majority of the organization's funding. For the rules for determining a federal indirect cost rate, see OMB Circular A-122, "Cost Principles for Non-Profit Organizations." Most organizations do not have a federal indirect cost rate, but if they receive federal funds, they are required to follow federal guidelines for allocating indirect costs. These guidelines are also contained in Circular A-122.

There are many acceptable methods for allocating indirect costs, but there are a few key principles to remember:

- Costs must be actual costs, not budgeted costs. If, for ease in producing monthly reports, a fixed percentage is used for allocating indirect costs, this allocation must be reconciled to actual costs at least annually, and preferably quarterly. When choosing an allocation method, keep in mind that each cost center should only be charged with the amount of indirect costs that represents the best approximation of the actual relative benefit that the cost center received from the services that the indirect costs provided.

- For additional considerations for disclosing indirect costs, see the Financial Accounting Standards Board (FASB) pronouncement #117, “Financial Statements of Not-for-Profit Organizations” at the FASB website: http://www.fasb.org/st/summary/stsum117.shtml Also, be aware that “Management and General” and “Fundraising” costs must be segregated on the federal income tax Form 990, “Return of Organization Exempt From Income Tax.” For IRS forms, go to http://www.irs.ustreas.gov.

Accounting Records

At minimum, your accounting system must include:

- Checkbooks and check registers
- General ledger
- Subsidiary journals
- Chart of accounts
- Accounting procedures manual
- Complete financial (purchase orders, invoices, receipts, canceled checks, bank account records) and administrative records

In small organizations, your checkbook and check register can serve as a combined ledger and journal.

The general ledger organizes information by account based on the chart of accounts. Summary totals from subsidiary journals are entered into the general ledger each month.

Subsidiary Journals

Subsidiary journals are used to record all transactions before entry to the general ledger. These journals include:

- **Cash Disbursements Journal**—A chronological record of checks written, categorized based on the chart of accounts.
- **Cash Receipts Journal**—A chronological record of all deposits made, categorized based on the chart of accounts.
- **Payroll Journal**—Records all payroll-related transactions.
- **Accounts Payable/Receivable Journal**—Tracks income and expense accruals. Some accounting software packages require setting up all bills as accounts payable and all revenue as accounts receivable, eliminating the cash disbursements and cash receipts journal altogether.

Chart of Accounts

TIP

By aggregating related cost centers such as those that support the same program or those that provide matching funds for another grant, even somewhat inexpensive accounting packages can be made to give relevant reports that save time and effort.

The chart of accounts lists each item, or account, the accounting system tracks. Each account is assigned an identifying number. Accounts are presented in a specific order:

- Assets
- Liabilities
- Net Assets
- Income (Revenue)—Income from various sources: grants and gifts, fundraising, fees, government contributions, and so on
- Expenses—Salaries and benefits, materials and supplies, rent and utilities, insurance, and so on

A well-designed chart of accounts can streamline the reporting process tremendously. For example, by segregating direct, shared, indirect, and unallowable costs into discrete number sequences you can maintain a seamless and transparent accounting system that will produce reports easily and be easy to audit. See Appendix A for a sample chart of accounts.

General Accounting Procedures Manual

A procedures manual documents procedures for approving and recording transactions such as paying bills, depositing cash, and transferring money between funds and who is responsible for what. The procedures can be simple descriptions or memos of how bills, depositing cash, and transferring money between funds are handled. These descriptions or memos can be kept together to form a basic procedures manual. Writing and revising an accounting procedures manual is a good opportunity to see whether adequate controls are in place (see Internal Accounting Control section below). A procedures manual is especially useful when there is turnover in financial management staff and new personnel need to quickly understand how the organization's accounting system functions. A procedures manual should include:

- **Budget control procedures** for comparing the budget with actual expenditures
- **Cash management procedures** for projecting cash needs and ensuring program income is used for permitted activities
- **Internal controls procedures** for defining staff qualifications and duties, lines of authority, separation of functions, and access to assets and sensitive documents (see below for more detailed information)
- **Financial reporting procedures** to provide accurate, current, and complete disclosure of financial results according to the requirements of funders and for use by the organization's management and board of directors

Financial and Other Records

It is important to retain all original purchase orders, invoices, receipts, canceled checks, bank account records, and any other documents for obligations incurred and use of program income.

Other records you should maintain include:

- Administrative, personnel, and program documents and records
- Procurement files
- Policies and procedures manuals
- Correspondence, reports, and legal files (articles of incorporation, by-laws, tax status, board minutes, contracts and other agreements)
- Tax records and audit files

Retention of and Access to Records

TIP

Retention of records is essential for audit review and for facilitating program monitoring by your funding agencies. Records may have to be retained longer if required by other local, state, or federal laws. If in doubt about whether something should be retained, do not discard it until your auditor or funder tells you it's OK.

San Francisco Administrative Code section 21.34 requires that you retain all records for at least three years after the final payment under your organization's city contract, unless a shorter period has been authorized in writing. Records should also be retained longer if there is litigation, claims, an audit, negotiation, or other action involving the records that started before the three-year period. Under these circumstances, records must be retained until resolution or the end of the three-year period, whichever is longer.

Representatives of the city's contracting departments, the city Controller's Office, and other representatives of other authorized government agencies have the right of access to any pertinent records in order to make audits, examinations, excerpts, and transcripts.

Consistent with the city's Sunshine Ordinance and other state and federal laws regarding privacy and obligations of confidentiality, your organization must also provide citizens with reasonable access to records. However, the open records requirements differ according to city, state, and federal law, so always check with your funding agencies for specific information on what is required of your organization.

Internal Accounting Control

Internal accounting control is a series of procedures designed to promote and protect sound management practices, both general and financial.

Financial information must be reliable so that managers and the board can make decisions based on accurate information. Following internal accounting control procedures will help ensure that:

- Assets and records of the organization are not stolen, misused, or accidentally destroyed
- The organization's policies are followed
- Government regulations are complied with

To develop a successful internal accounting control system, identify areas where abuses or errors are likely to occur. For example:

- **Cash receipts**—Ensure that all cash intended for the organization is received, promptly deposited, properly recorded, reconciled, and kept under adequate security before deposit.

- **Cash disbursements**—Ensure that cash is disbursed only upon proper authorization of management for valid business purposes, and that all disbursements are properly recorded.

- **Petty cash**—Ensure that petty cash and other working funds are disbursed only for proper purposes, are adequately safeguarded, and properly recorded.

- **Payroll**—Ensure that payroll disbursements are made only upon proper authorization to bona fide employees.

- **Grant funds, contract funds, gifts, and bequests**—Ensure that all these sources of funds are received and properly recorded, and that compliance with the terms of any related restrictions are adequately monitored.

- **Fixed assets**—Ensure that fixed assets are acquired and disposed of only upon proper authorization, are adequately safeguarded, and are properly recorded.

The following practices will provide reasonable assurance that abuses or errors do not occur.

Internal Controls for Cash Receipts

To ensure that cash receipts intended for the organization are received, promptly deposited, reconciled, and kept under adequate security, make sure you perform the following activities:

- Promptly deposit all cash received that is intended for your organization.

- Properly identify and record all restricted donations.

- Properly record in your accounts receivables any cash payments received from all funders.

Internal Controls for Cash Disbursements

To ensure that cash is disbursed only upon proper authorization of management for valid business purposes, and that all disbursements are properly recorded, the following procedures should be in place and your organization should perform the following activities.

Segregation of Duties

Financial transactions should not be handled by only one person from beginning to end. Different people should authorize payments, sign checks, record payments in the books, and reconcile the bank statements.

Small organizations with few employees can have one person (paid staff) sign checks and a different person (board treasurer) review disbursements, bank statements, and cancelled checks on a monthly basis.

Authorization and Processing of Disbursements

Your written policies should document who can authorize payments. Some organizations designate the executive director for this responsibility, or in very small organizations, the board president or treasurer may approve all purchases.

Larger organizations generally require that managers who are responsible for a budget cost center approve any expenses charged to that manager's cost center.

After approval at the board, executive director, or program director level, the finance director or equivalent should approve the payment for both the identification of budget line item and cost center, and confirm that the expense can reasonably be paid considering the current cash resources of the organization.

Unbudgeted purchases may need additional approval, and significant purchases, such as computers, may need authorization by the board.

All disbursements should be accompanied by adequate documentation in the form of receipts or invoices.

Should your organization's bank provide an ATM card, it should be a business ATM card only for depositing funds, not one that can be used for withdrawing cash.

Managing Restricted Funds

Restricted contributions—funds designated for specific purposes by the donor such as buying a building, expanding an existing program, starting a new program, and so on—should be accounted for separately in your organization's books.

Nonprofits can be tempted to borrow against restricted monies when facing a cash shortage. For donors that allow borrowing against funds, the organization's board should set out policies for who approves this, how often such borrowing can occur, how much can be borrowed, and what type of repayment plan should be established. Further, the board of directors should be advised regularly of any interfund loans that occur.

Check Signing

Two signatures should be required on checks over an amount agreed to be significant. More than two people should be given check-signing authority to ensure there are always two people available to sign.

If two people are not available, an *imprest account* would serve as a control on expenditure. An imprest account is separate from other accounts and has an expenditure limit, say $500. The check signer would use the account to pay bills, and when the account neared depletion, the treasurer or other board members would review expenditures for appropriateness, obtain original receipts, confirm proof of delivery, and then authorize reimbursement of the account.

Internal Accounting Checklist for Paying Bills

Your procedures for paying bills should include the following:

- All disbursements, except petty cash, should be made with prenumbered checks.
- Voided checks should be preserved and filed after mutilation.
- No checks should be made payable to "cash."
- No checks should be signed in advance.

See Appendix B for a complete checklist.

Internal Accounting Controls for Payroll

You must ensure that payroll disbursements are made only upon proper authorization to bona fide employees, that payroll disbursements are properly recorded, and that related legal requirements, such as payroll tax deposits, are complied with. The following procedures will help ensure internal accounting controls for payroll:

- A **payroll/personnel file** should exist for each employee and should contain updated salary, benefits, employment status, and withholding information, as well as beginning date of employment and termination date, when applicable. Your organization should retain these records for several years after the employee has been terminated and possibly longer if that employee participates in a pension plan.

- A **personnel manual** should describe the organization's policies, established by the board, regarding vacations, holidays, and sick leave. Records should be kept for each employee to ensure that these policies are being followed.

- A **timesheet** is the most common tool used to document employee hours, including overtime, and authorize payments to employees. Timesheets can be designed to incorporate information about vacation, sick leave, and holidays. Government funders often require timesheets to document employee time spent for their grants or contracts and all other duties they perform. Timesheets are usually submitted by the employee to his or her immediate supervisor for signature, and may also be reviewed periodically by senior management. The person authorizing an employee's hours should **not** also prepare the paychecks.

  Timesheets might be used as follows:

  – Direct staff (staff that provide services directly to clients, or as defined by the contract or grant) costs that are paid for by more than one contract, grant, or other funding source, should keep "functional" timesheets, which show hours worked each shift by each separate cost center, or a separate timesheet for each contract or grant.

  – Indirect staff (administrative and finance staff that provide services to all parts of the organization) costs may be allocated based on time studies or other objective and measurable criteria such as direct cost ratios, personnel cost ratios, units of service, and so on. Although functional timesheets are not required of indirect staff if one of the aforementioned allocation methods is used, a timesheet showing all hours must still be kept in order to document use of paid time off by the employee.

  – If administrative staff are split between direct services (such as the executive director serving part-time as an interim program director) and indirect services, then a functional timesheet is one way of showing the types of hours worked. Alternative methods of allocating time between direct and indirect services usually involve conducting a periodic time study to document how employees spend their time.

- **Payroll checks** should be written using the same procedures used for all other cash disbursements (see above). For additional segregation of duties related to the payroll function, someone other than the payroll check signer should perform the following functions:

- Hold unclaimed paychecks.
- Review the payroll register and post to the general ledger.
- Review payroll-related tax withholding, deposits, and reporting. This is an especially important function for the board, since board members may have personal liability for payroll taxes that have not been properly deposited with the appropriate government agencies.
- Distribute year-end tax summaries (W-2s) to employees and respond to inquiries regarding W-2s.

TIP

A separate bank account for payroll can help accounting staff by making reconciliations and adjustments easier. A payroll account will also help staff detect unauthorized activity and resolve it quickly.

- A **separate bank account** for payroll, while not required, is used for issuing paychecks and paying government withholding and other taxes related to payroll. For example, having a dedicated payroll account keeps the check numbers in order since no checks other than payroll checks are issued from the account. Also, since payroll accounts should "zero-out" shortly after each payroll period, any errors are apparent from looking at the account bank statement. Further, because the account contains minimum funds most days of the month, an overdrawn account will help alert finance staff of any unauthorized activity, such as thieves using the account to float counterfeit checks.

- A **payroll register**, listing who was paid, how much, withholding amount, and check number should be maintained, either as a subsidiary journal if there is a separate payroll account, or as part of the cash disbursements journal when payroll is integrated with other cash disbursements in a manual system. Some organizations require that employees sign the employee register to acknowledge receipt of their paycheck.

- **Payroll advances or loans** generally should be avoided. In addition to the extra bookkeeping required, allowing advances could adversely affect the organization's cash flow by creating an additional liability. Your organization should state clearly in its written employee policies that pay advances are either not permitted, or if they are, under what conditions, and who in the management staff has authority to approve them. When allowed, advances should be limited to a few, exceptional circumstances and should be required to be paid back within a specified period of time, usually through withholding from the next pay period's paycheck.

- **Incompatible activities** are activities or actions that can create audit exceptions or more serious problems for your organization if not curtailed. For example, use of credit cards in your organization's name is an efficient way of tracking, managing, and monitoring expenditures. However, use of your organization's credit card by an employee for personal expenses, or for expenses not approved by your organization's board or management, can become a major problem if allowed to continue. Any use of your organization's resources, funds, or equipment for personal gain or for certain political activities is against the law. For legal restrictions on use of nonprofit funds for certain political activities, see Chapter 4.

Internal Controls for Petty Cash

TIP

Your petty cash fund should have enough to cover petty cash expenditures for about a month. If it is too small you will constantly have to replenish the funds, and if it is too large then you have cash on hand which could be more safely kept in your bank account.

Petty cash allows your organization to make small purchases or reimbursements, in cash, for items such as stamps, office supplies, parking, and so on. To ensure that petty cash and other working funds are disbursed only for proper purposes, are adequately safeguarded, and are properly recorded, the following procedures should be in place.

The board or senior management should develop a policy of how much money should be available in cash, and a maximum expenditure that can be paid with petty cash. For example, you may establish a petty cash fund of $100 and have a policy that states payments for items costing over $15 must be made by check rather than reimbursed through petty cash.

The petty cash fund should be kept in a locked box or drawer. Auditors recommend that only one person, called the custodian, have access to petty cash and be responsible for all petty cash activities. To disburse petty cash funds, your organization should buy or develop petty cash vouchers for documenting each transaction, and determine who in the organization can approve petty cash payments. In some cases, this will be the director; in others, department heads or the petty cash custodian, within guidelines established by the board, may also be designated to approve petty cash.

Maintaining Your Petty Cash Fund

Once the board has determined, with staff input, how large a fund is needed, a check should be written to the petty cash custodian (not to cash) to establish the fund. The custodian should cash the check and place the money in a locked box or drawer.

Use the following procedures to maintain your petty cash fund:

- **Reimbursements**—The custodian should obtain proof of purchase from the employee, usually a receipt. The employee should also complete a petty cash voucher, detailing the reason and nature for the purchase. After the appropriate person approves the voucher, the employee is reimbursed with cash from the fund.

  In some cases an advance from the petty cash fund can cover an upcoming purchase. For example, an employee needs cash to mail a package and upon returning to the office, completes a voucher for the final amount, attaches a receipt, and returns the change to the custodian.

- **Replenishing the fund—**When the fund is substantially depleted, the custodian adds up the vouchers and assigns them to appropriate categories (postage, printing and copying, office supplies, etc.). For a petty cash fund of $100, the total of receipts plus cash available should equal $100 so that all funds are accounted for. When the account is balanced, a check is written in accordance with a check authorization procedure established for all disbursements, and the fund is replenished to its original balance of $100.

- **Shortages/Overages**—The custodian is responsible for all shortages, while overages should be credited to the organization.

Petty Cash Policies

The following practices will help ensure proper controls on petty cash:

- An imprest cash fund should be maintained for small, incidental expenses.

- There should be a limit to the amount that can be reimbursed.

- Supporting documentation should be required for all petty cash disbursements.

- A petty cash voucher should be filled out with supporting documentation, name of person being reimbursed, and proper authorization from a designated person(s) in the organization.

- Access to petty cash should be limited to one person who is the fund custodian.

- Someone within the organization other than the fund custodian should make unannounced counts of petty cash.

Internal Controls for Gifts, Grants, and Bequests

Reconcile monthly reports sent to funders with reports from the accounting records for each cost center.

Distribute monthly income statements that include year-to-date information to program staff that manage grants and development staff that monitor gifts and bequests.

Internal Controls for Fixed Assets

The following procedures will help ensure that fixed assets are protected:

- Maintain an up-to-date inventory of fixed assets that is checked to actual items at least annually. Have inventory performed without access to existing fixed asset schedule.
- Maintain a vehicle maintenance schedule that is reviewed monthly by someone outside of the program in which vehicles are used.
- Make sure that insurance policies cover current fixed asset inventories.
- Label all large-dollar-amount fixed assets with an identification number and the organization's name.
- Reconcile the organization's depreciation schedule with the fixed assets inventory annually.

General Internal Controls

Use the following procedures to monitor other aspects of your accounting system:

- Observe rigorous human resource practices over hiring and firing.
  - Obtain complete hiring documentation.
  - Check references and document results.
  - Maintain complete personnel files. Perform regular written evaluations and document disciplinary actions.
- Cross-train staff wherever possible.
- Require finance staff to take regular vacations.
- Develop procedures for backing up both software and data files from all of the agency's computers. Store backups in a fireproof location, preferably off-site.

Allowable Costs

For organizations receiving federal funding, certain costs are not allowable and, therefore, are not reimbursable. OMB Circular A-122, "Cost Principles for Non-Profit Organizations," specifies which costs are and are not allowable for organizations receiving federal funding. To be allowable, costs must generally:

- Be reasonable for the performance of the award
- Conform to any limitations or exclusions as to the types or amounts of cost items
- Be consistent with policies and procedures that apply to both federal and other organization activities
- Be treated consistently with other costs of the organization
- Be determined in accordance with generally accepted accounting principles
- Not be included as a cost or used to meet cost-sharing requirements of any other federally funded program in the current or prior period
- Be adequately documented

OMB Circular A-122 lists over 50 items of cost, defines and details them, and shows whether they are allowable, not allowable, or allowable only if approved by the granting agency. Some cost items are allowable under some circumstances and not allowable under others. For example, professional service costs such as legal fees are allowable when necessary for a program's purpose, but not allowable when related to claims against the federal government.

Organizations should also refer to their contract or grant agreement for any specific allowable or unallowable cost provisions they may contain.

Budget Development and Controls

A budget is an organization's annual plan presented in dollars and provides a "roadmap" for showing where the organization is headed. Budgets also provide:

- **Board oversight**—The board approves the use of the organization's resources by approving the budget. It also monitors actual and budgeted costs to ensure that resources are used as intended.
- **Goal focus**—An effective budget helps the organization focus resources on its long-term goals.

- **Financial control**—The budget helps control finances by setting practical limits on the amount that can be spent on specific programs and activities. It also helps ensure that program and activity costs are consistent with revenue.

- **Cash forecasting**—A special cash forecast budget allows the board to see if the organization will have the cash on hand from month to month to meet its financial obligations.

- **Budget timing**—At least two or three months before the beginning of your fiscal year you will want to start thinking about the budget for the upcoming year. The budget ordinarily corresponds to your fiscal year, which should be selected to reflect your organization's operating cycle. For most organizations, the fiscal year is July 1 through June 30.

Who Should Participate in the Budget Process?

Staff and board members must participate in each phase of the budgeting process that affects the line items for which they will later be responsible. Both program staff and financial staff should work with the executive director and board to develop budgets that truly reflect organizational priorities and act as a guide for spending and decision-making.

Steps in the Budget Process

Use the following steps to develop and maintain your budget:

1. **Determine the desired programs and activities for the next year(s)**

   The executive director, program director(s) and others can decide, given available resources, whether to expand or add to programming or whether programs should be eliminated or scaled back.

2. **Budget expenses and revenue**

   A budget should be built program-by-program using a list of assumptions that documents the reasons for, or provides explanations for, changes from the previous year. For example, assumptions might relate to the amount of salary increases for the coming year, the percentage and timing of program service fee increases, and the amounts and timing of contract funding or grants expected to be received.

   Look at the current year's budget and if the actual results are significantly over or under budget, determine the causes of the variances. Variances may be due to changes in the organization's programs after the budget was completed, or they may be due to inaccuracies in the budget itself. If so, the budget drafters may need to make changes in how they determine revenue and expense budget assumptions.

3. **Assemble and review a draft budget document**

   After budgeted revenue and expense amounts are determined, the accountant should assemble the information in a draft format for review by staff. Usually the finance committee, including the treasurer and president-elect, has the responsibility to review and approve the draft budget for recommendation to the board.

4. **Present the draft budget for board approval**

   Questions raised by the board may result in more changes to the draft budget. Once approved by the board, the draft budget becomes the final budget for the upcoming year.

5. **Monitor budget versus actuals throughout the year and amend the budget if necessary**

   The budget is a useful tool for managing the organization if actual results each month are compared to it. However, if circumstances have changed substantially from those anticipated during the budget process, staff should make management aware so the budget can be amended, if necessary.

Cash Flow Management

Cash flow management is the term used for predicting and managing the flow of revenues coming into your organization so that funds are available when they are needed to pay expenses. If, in a given period, your organization's expenses exceed income available to pay those expenses, you may have a cash flow problem. Inability to pay expenses as they come due can disrupt your operations and impede your organization's ability to accomplish its mission.

What Is a Cash Flow Forecast or Budget?

A cash flow forecast or budget projects cash receipts and disbursements by month over the coming year. If an organization has more expenses than income, sooner or later it will find itself in trouble. Even if income matches expenses in a given year, the cash from the income may not arrive in time to pay the bills as they come due.

A cash flow forecast should not be confused with a Statement of Cash Flow, which describes changes in cash from year to year due to operating surpluses or deficits, makes adjustments for non-cash items such as depreciation, and shows increases and decreases in accounts payable and accounts receivable.

How Is Cash Flow Projected?

Projections of receipts and expenditures, which comprise cash flow, are typically developed as part of the budget process, so that you can anticipate and develop strategies for funding the shortages or investing the surpluses. Cash flow projections follow a format similar to your budget. For each month, anticipate how much money you will receive and how much you will spend in each category.

To create a cash flow forecast or budget you must look at your organization's prior year's checkbook as a basis for your cash flow projection for the coming year, adjusting for any anticipated changes that will affect the timing and amount of payments and deposits. These changes might include when your programs are offered, what programs are offered, new funding sources or expiration of previous funding, increases or reductions in interest rates, and so on. While the new cash flow projection will largely correspond to the budget, some cash flow may come in from receivables from the prior year. Also, cash may go out for payments made for last year's bills, and some income and expenses for the current year will be delayed until next year, and therefore, would not be included in the current year's cash flow budget.

To create a cash flow spreadsheet, make a column for each month. Create rows with the following information (see sample in Appendix E):

- Beginning cash, which is ending cash from previous month.
- A row for each major revenue source.
- Rows for expenses using a level of detail appropriate for your organization.
- A subtotal row for "Revenues over (under) expenses." Calculate that line as revenues less expenses.
- Rows for payments on existing debt, loans to be made to others, fixed asset purchases, and fixed asset sales. Calculate a subtotal for that section.
- A subtotal row for "Cash available before new draws and payments on lines of credit." Calculate it by adding beginning cash and the two subtotals you have created.
- Rows for new net draws or payments on any lines of credit. Add another row for the net proceeds (disbursements) for any investments that will be sold (or purchased).
- A total row for "Ending cash balance." Calculate it as the sum of the cash available subtotal, the net new draws on lines of credit, and the investment

activity. Link that amount to beginning cash in the following month's column.

Using the Cash Flow Forecast or Budget

TIP

By conducting cash flow analysis on a regular basis, an organization possesses a valuable tool for anticipating any fiscal problems early so that corrective measures can be taken and a fiscal "emergency" can be avoided.

The organization should consider its cash situation on a monthly basis. If there are months when cash disbursements exceed cash receipts, the organization must address the shortfall to ensure that payroll is met and programs continue to operate. Generally, the accountant is not responsible for addressing the cash shortfall. Instead, the accountant makes sure those who are responsible for addressing the shortfall have the information they require to make prudent business decisions.

As the year progresses, cash flow projections should be updated. By comparing budgeted cash flows to actual deposits and expenditures, and understanding the nature of any variances, you can strengthen your ability to accurately anticipate cash flow in the future.

Useful Strategies for Adjusting the Timing of Cash Flow

In a simple example, an organization with no cash in the bank has a balanced budget, with $10,000 in revenue and $10,000 in expenses. If the income is received first, the organization will be able to spend it down as expenses are incurred. If, however, the expenses come in before the income, the organization cannot pay its bills until the cash is received. In this case, the organization has a problem with the timing of cash flow rather than a shortage of revenue or an excess of expenses. There are some common strategies for dealing with the timing of cash flows, whether it is a cash shortage or a cash surplus.

Cash Shortfalls

The following options can help an organization address a cash shortfall:

- Postpone fixed asset purchases
- Negotiate extended payment terms on large annual expenses or fixed asset purchases, or finance the purchase of equipment by leasing
- Postpone raises in salaries or hiring additional employees
- Postpone implementing new programs or services
- Reduce operating expenses
- Reduce program services

- Move up or schedule additional fundraising events
- Pursue uncollected membership dues or other receivables
- Withdraw funds from operating reserve funds
- Borrow funds from either financial institutions or supporters of the organization
- Request advances from funding sources
- Liquidate investments
- Ask vendors about the possibility of delaying payments in the short term and determining a mutually agreeable date for making payments

Cash Surpluses

To address cash surpluses, an organization can:

- Take advantage of projected temporary cash surplus by making short-term investments in certificates of deposit, money market funds, or US Treasury bonds
- Buy supplies on sale that you will use over the course of the year

Board Review of Cash Flow Forecast/Budget

In addition to reviewing your organization's revenue and expense budget, the board should review the organization's cash flow forecast/budget. The review should also include any measures relating to managing cash flow that involve commitments on the part of your organization, such as loans or revised terms with vendors.

Monthly Update of Cash Flow Forecast/Budget

Update the cash flow forecast/budget each month to account for any changes in the expected timing of cash receipts or disbursements. As each month passes, add another month to the forecast so that it always covers the upcoming 12-month period.

Cash Flow Forecast/Budget Versus Statement of Cash Flows

A cash flow forecast/budget should not be confused with the financial statement called "Statement of Cash Flows." The "Statement of Cash Flows" describes changes in cash from year to year due to operating surpluses or deficits, makes adjustments for non-cash items such as depreciation, and shows increases or decreases in accounts payable and accounts receivable. The "Statement of Cash Flows" is a required financial statement for nonprofit organizations. See the "Financial Reporting" section below.

Financial Reporting

Financial statements are the end products of the accounting process, summarizing all of the financial transactions of the organization for the period. The Financial Accounting Standards Board's Statement No. 117, "Financial Statements of Not-for-Profit Organizations," requires nonprofits to prepare annually three primary financial statements:

- Statement of Financial Position
- Statement of Activities (Income Statement)
- Statement of Cash Flows

In addition, nonprofits must provide information about expenses as reported in their financial classifications (program services and supporting services). Voluntary health and welfare organizations are also required to present a statement that reports expenses by their natural classification (for example, salaries, rent, telephone, printing, and so on). Other nonprofits are encouraged to report in both formats as well. The following sections briefly describe the information included in each statement.

Statement of Financial Position

The Statement of Financial Position reports amounts of the organization's assets, liabilities, and net assets (fund balances) at a specified date. This statement was previously known as the balance sheet. The statement of financial position includes:

- **Assets**—Properties and resources the agency owns and can use to achieve its goals.
- **Current Assets**—Cash accounts, certificates of deposits and other investments, and items such as receivables that will be converted to cash within one year (fixed assets, which is not a category, include land, buildings, and equipment).
- **Liabilities**—Debts of the organization (what is owed). Current liabilities typically include accounts payable to vendors, short-term loans due, withheld payroll taxes due, and so on. Long-term liabilities include long-term debt, mortgages, and so on.
- **Net assets** (previously called fund balances)—Represents the net of assets over liabilities. There are three classes of net assets that must be reported: unrestricted, temporarily restricted, and permanently restricted. Restrictions are determined by the conditions that donors place on their contributions.

Statement of Activities

The Statement of Activities reports revenues, expenses, and the resulting change in net assets for the year. Changes are reported for each of the three classes of net assets (unrestricted, temporarily restricted, and permanently restricted). This statement was previously known as the Income Statement or Statement of Revenue, Expenses, and Changes in Fund Balances.

Statement of Cash Flows

The Statement of Cash Flows reports how the organization's cash position changed during the year. Cash flow information is divided among receipts and disbursements from investing, financing, and operating activities. Many nonprofits ask their auditors to prepare this statement.

Other Reports

In addition to the financial statements required for audit purposes, nonprofits are required by federal and state governments to file various information returns to maintain their tax-exempt status and document tax compliance. For information on how to obtain forms and information from federal and state agencies, see Appendix D.

Internal Reports

Each nonprofit organization faces different financial issues and has different resources to bring to financial functions, and each organization will choose a different set of financial reports to prepare and analyze. At different times an organization will need different reports to provide information to support its decision-making. These reports can answer basic questions about an organization's activities and overall health.

Monthly Reports

The following monthly reports may be required:

- **Statement of Financial Position** (or Balance Sheet) shows in a monthly format what the annual statement shows (see above). The report will answer questions like, "What is our financial health?" and "Can we pay our bills?"

- **Statement of Activities** (or Income Statement) shows in a monthly format what the annual statement shows (see above). The report allows budget-to-actual comparisons and helps answer the question, "What has been our overall financial performance this month and to date?"

- **Department Income and Expense Statement** also shows budget-to-actual information. How does actual financial experience compare with the budget? Is specific action called for, such as limiting expenses in certain areas? Does experience indicate a change in the budget is appropriate?

- **Narrative Report** includes tax and financial highlights, important grants received, recommendations for short-term loans, or other means of managing cash flow. This is an executive summary of financial highlights, analysis, and concerns.

Quarterly Reports

The following quarterly reports may be required:

- **Fundraising report** shows actuals versus projections for donations and serves as a status report on all foundation proposals. This report helps answer the question, "Are fundraising results on track?"

- **Cash Flow Projection** for the next six months helps answer the question, "Do we anticipate a cash surplus or shortage?"

- **Payroll Tax Report** answers the question, "Have payroll tax reports been submitted on time and tax deposits been made?"

- **Fee for Service Report** shows the number of fee-paying clients and revenue against projections. This report helps answer the questions, "Are we servicing approximately the same number and type of clients as we had anticipated?" and "If not, what action or change is appropriate?"

Annual Reports

The following annual reports may be required:

- **Annual Federal Forms**, including Form 990 and Schedule A, and state reports. Has the organization fulfilled its reporting responsibilities to federal and state governments?

- **Draft Financial Statements for Year** should include the Statement of Activities, Statement of Position, and Income Statement for each program. Aggregate financial statements should include narrative and show key trends. This report should focus on internal management decision-making and help answer the following questions:

  – What was our financial performance over the past year?

  – In what ways and for what reasons was performance different from the budget?

  – What financial implications must be taken into account when planning the upcoming year?

- **Audited Financial Statements** for the entire organization should include the Statement of Position, Statement of Activities, Statement of Cash Flows, and Statement of Functional Expenses (see page 3-1). This report should focus on external accountability and financial disclosure to funders and the public.

- **Management Letter from the Auditor** may include recommendations related to the accounting system, internal controls, and financial planning.

Who Should Prepare the Financial Reports?

The person responsible for filing your financial reports depends somewhat on the size of your organization.

Small Organizations

In a smaller nonprofit, the board treasurer or outside accountant/bookkeeper might prepare the financial information for all in-house financial statements, and work with the executive director to prepare the narrative with financial highlights to be presented to the board. The program director, if you have one, would ordinarily prepare the quarterly fee-for-service report. Similarly, the director of development would prepare the quarterly fundraising report.

The executive director might report first to the board treasurer, who can then keep the full board apprised of the organization's financial status.

In addition, key staff members such as program directors and the director of development should have the opportunity to review income and expense reports for the whole organization.

Large Organizations

A controller or finance director prepares the financial reports in a larger organization.

Auditor's Report:

In addition to the internal reports an organization's management may need, the audit report and management letter should be addressed directly to the board of directors because of the board's oversight function. Typically, the auditor works with the finance staff to prepare federal and state reports and the auditor may be included at board meetings during which presentations are given.

When the board is large enough to include a finance committee, that committee reviews all financial statements and reports on financial activity to the full board. The finance committee will often review the numbers in greater detail than the full board.

The full board may be better able to respond to aggregate information with important financial trends and issues highlighted in an accompanying narrative report. While each board member should have the opportunity to review organization-wide income and expense reports to understand the impact their department's activities have on the whole organization, members who are inexperienced at reading financial statements may get lost in overly detailed statements.

To help the board fulfill its oversight function, it is important for the executive director and the finance committee to present the information in as clear and concise a manner as possible.

Reports for City Departments

Although the City is striving to make financial (and performance) reporting uniform across departments, some departments may require a special report designed for a particular purpose and only for that department.

Reporting Requirements of State Agencies

See **Appendix D** for more information and how to contact the state agencies to obtain the reporting forms listed below.

- **California Secretary of State**
  - **Form SI-100, Statement of Information**, must be filed biennially before the end of the calendar month during which the original articles of incorporation were filed.
- **California Attorney General—Charitable Trusts Forms**
  - **Form CT-1** is a registration form that must be filed before your organization engages in charitable solicitations.
  - **Form RRF-1** must be filed annually within 4 ½ months after the end of your organization's accounting period with the Registry of Charitable Trusts. Some organizations (hospitals, schools and religious organizations) are exempt from filing.
  - **Form CT-9** is used by individuals who wish to file a complaint against a charity or public benefit corporation.
  - **Instructions for Dissolving a Nonprofit Corporation** includes items such as how to handle remaining funds held in trust.
  - **Commercial Fundraiser and Nonprofit Raffle Program Forms**—There are numerous forms for organizations engaging in a variety of charitable fundraising activities.

3

Audits

A financial audit is a process for testing the accuracy and completeness of information presented in an organization's financial statements. The testing process enables a certified public accountant (CPA) to issue what is referred to as an opinion on whether or not the agency's financial statements represent its financial position fairly and whether they comply with generally accepted accounting principles (GAAP). GAAP is determined by the American Institute of Certified Public Accountants (AICPA).

The audit report is addressed to the board of directors as the trustees of the organization. The report usually includes the following:

- **Cover letter**—Signed by the auditor, stating the opinion, described above.

- **Financial statements**—Including the statement of financial position (balance sheet), statement of financial activity (income statement), and statement of cash flows. Health and social service organizations also have a statement of functional expenses that reports expenses by both functional and natural classifications. Functional expenses include costs for major programs or services and natural expenses include fixed costs like salaries and discretionary costs like grants to subrecipients. Many audits show comparative information between fiscal years.

- **Notes to the financial statements**—As required by GAAP, these might include information about functional expenses, a depreciation schedule, further information about contributions, information about volunteer services, and other significant information not obvious in the financial statements.

In addition to the materials included in the audit report, the auditor often prepares a management letter that cites areas in the organization's internal accounting control system that the auditor evaluates as weak or needing improvement.

Performance audits are audits that examine the operational or management aspects of a program; evaluate the efficiency of a program's service delivery; determine whether a program is in compliance with laws, rules, and regulations governing the program; and determine whether the program's services are effective in producing the results called for by the program's mission and by the program's funding sources. Performance audits are not done as part of a routine audit of your financial statements, and must be arranged for separately if the organization wants such an audit.

What Does an Auditor Do?

To test your organization's financial statements, the auditor requests information from individuals and institutions to confirm bank balances, contribution amounts, conditions and restrictions, contractual obligations, and monies owed to and by your organization. The auditor will review physical assets, journals and ledgers, and board minutes to ensure that all activity with significant financial implications is adequately disclosed in the financial statements. In addition, the auditor will select a sample of financial transactions to determine whether there is proper documentation and whether the transactions were posted correctly into the books. In addition, the auditor will interview key personnel and read the procedures manual, if one exists, to determine whether the organization's internal accounting control system is adequate. Depending on the size of the organization and the number of documents to be reviewed, the auditor can spend several weeks at the organization's office.

Auditors are not expected to guarantee that 100 percent of transactions are recorded correctly. They are only required to express an opinion as to whether the financial statements, taken as a whole, fairly represent the organization's financial picture.

An ***Unqualified Opinion*** includes wording such as, "In our opinion, the accompanying financial statements present fairly the financial position of ABC agency at the fiscal year ending June 30, 2004, in conformity with generally accepted accounting principles."

A ***Qualified Opinion*** is issued when the accountant believes the financial statements are, in a limited way, not in accordance with generally accepted accounting principles. A qualified opinion might include wording such as, "in our opinion, except for the omission of …the accompanying financial statements present fairly…"

What an Auditor Does Not Do

An auditor is not expected to perform the following functions:

- Create records (journals, ledgers, reports, and so on) that the organization should have created and should be maintaining as part of its accounting system.
- Initiate or record transactions.
- Perform analyses outside the scope of work of the audit.
- As noted above, auditors do not guarantee that every transaction is recorded correctly; rather they render an opinion on the organization's financial picture.
- Audits generally are not intended to discover embezzlements or other illegal acts such as fraud unless there is reason to believe such acts are taking place. Therefore, a "clean" or unqualified opinion should not be interpreted as an assurance that such problems do not exist.

When Is an Audit Necessary?

An independent, annual audit may be required by your funding organization or by a lender you have a loan agreement with.

Nonprofits that receive over a certain amount in direct or pass-through federal funding during a single fiscal year are usually required to have an audit performed by a CPA. "A-133" audits are required when organizations expend over $500,000 of federal dollars in a single year (see "Federal Awards," below, for more information).

Some city departments have an ongoing requirement that their contractors obtain an audit from an outside CPA on an annual basis. These departments have made the audit requirement part of the city's contract. Although your contract may not have an audit requirement, the city Controller recommends that all nonprofit, community-based organizations that have contracts with the City undergo an annual financial audit by an independent auditing firm.

Not all nonprofits may be subject to an annual audit requirement, but the city's boilerplate contract for professional services (P-500) requires organizations to make available accurate books and accounting records relating to its work under the contract. Further, the contractor must permit the City to audit, examine, and make excerpts and transcripts of books and records, and to make audits of all invoices, materials, payrolls, records, or personnel and other data related to all other matters covered by the agreement, whether funded in whole or in part by the agreement. All data and records are to maintained in an accessible location and condition for a period of not less than three years after final payment under the agreement or until after a final audit has been resolved, whichever is later. In other words, should the City choose to conduct an audit of your organization, you will need to provide the information the city's auditors request so they can conduct their review.

You may choose to obtain an audit even if you are not legally required to do so. For example, your organization's board of directors may seek assurance that the financial information it is considering as part of its oversight function is accurate and complete. In cases where financial problems or irregularities have occurred, the board and the general public may look to an audit to provide assurance that these problems have been resolved. Also, the audit process can be valuable to your executive director and finance staff since it confirms the financial picture and helps strengthen internal control procedures. An audit signals a new phase in an organization's maturity. As financial transactions become more complex, undergoing the rigors of an audit will help staff understand and develop the financial systems required to track and manage finances responsibly.

In some circumstances the funding department may require an audit because the organization is experiencing financial difficulty and is unable to identify or resolve the cause. In addition, an audit may be required because the funding department or other entities such as the Office of the Controller, City Attorney, or District Attorney are aware of possible inappropriate, illegal, or fraudulent activities on the part of an organization's personnel.

Many funders request audited financial statements and may accept statements prepared in-house. Funders may also accept a CPA review (see definition below) in lieu of an audit.

Alternatives to an Audit

A *CPA review* is a more limited examination of the financial statements by a certified public accountant. During the review, the CPA asks questions of management and conducts some analysis, but does not undertake the extensive testing required for an audit. However, a review does not provide assurance, as a complete audit does, that the financial picture is fairly presented.

A *compilation* is a report prepared by an accountant using financial data supplied by the organization. The accountant organizes the financial information into standard financial reporting formats, but does not review the numbers for accuracy or provide assurance regarding the information that is included.

Federal Awards

A federal award is financial assistance provided by the federal government to support or accomplish a public purpose. The assistance may be provided in cash or property, and it may come as a grant, contract, loan, or in other forms such as commodities. Federal awards do not include direct federal cash assistance to individuals, such as Social Security or Medicare payments. Federal awards can be received directly from the federal government or indirectly as pass-throughs from other award recipients. These other recipients can be states, counties, cities, or other governmental entities, even other nonprofit organizations. It is important to remember that grants from state agencies or municipalities can actually be pass-throughs of grants of federal funds and, therefore, be considered federal awards to your organization.

What Are Your Responsibilities When Receiving Federal Awards?

As a recipient of federal funds, your organization has the responsibility to spend those funds properly. Recipients also have an obligation to comply with the federal laws and regulations that relate to the grant funds. Should your organization violate the laws and regulations governing your grants(s), the government has a number of remedies: it can suspend the grant, question the grant expenditures and request a refund of its money, or worse for more severe violations.

As a recipient of federal awards, it is your organization's responsibility to comply with both the specific grant requirements and with all the corresponding government laws and regulations. This is accomplished by:

- Structuring the accounting system and internal controls to address compliance with laws and regulations.
- Complying with the requirements imposed on all entities receiving federal funds, such as administrative requirements.
- Complying with provisions specified in individual grants and contracts.

For organizations receiving federal awards, compliance with applicable laws and regulations is required, regardless of the size of the organization or whether or not the organization is subject to a single audit.

For federal awards, the term *Internal Control* means a process established to provide reasonable assurance that:

- Operations are effective and efficient
- Financial reports are reliable
- Applicable laws and regulations are complied with

See Appendix D for a list of federal government document resources.

Recipient, Subrecipient, or Vendor?

A *recipient* is a non-federal entity that expends federal awards received directly from a federal awarding agency to carry out a federal program. A *subrecipient* is an entity that expends federal awards received from a pass-through entity to carry out a federal program. A subrecipient may also be a recipient of other federal awards directly from a federal awarding agency. A *vendor* is an organization providing goods or services that are required for the conduct of a federal program (that is, a buyer-seller relationship). A nonprofit organization may be a prime recipient, subrecipient, or a vendor, depending on the circumstances.

If your organization is a subrecipient, it must comply with all the grant compliance requirements that go along with receiving federal funds, just as though it had received the funds directly from the federal government. If your organization is a recipient that passes federal funds through to a subrecipient, it is responsible for monitoring the subrecipient's compliance with grant requirements. If your organization is simply a vendor, or a contracted service provider, however, it is generally not subject to the various grant compliance requirements. Therefore, the difference between a vendor and a subrecipient is significant, and can greatly affect an organization's level of responsibility to the government. (Refer to Circular A-133 for more detailed information on differences between subrecipient and vendor, see Appendix D.)

OMB Circular A-110 Requirements

Office of Management and Budget (OMB) Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and other Non-Profit Organizations," imposes administrative requirements for nonprofit organizations receiving federal grants (awards).

These administrative requirements include the following categories (see Appendix D and the respective sections of A-110 for more detailed information).

Financial and Program Management

These requirements pertain to requirements of an accounting and financial management system, cash management requirements, treatment of contributed services, treatment of program income, rules for budget and program scope revisions, non-federal audit requirements of different entities, allowable costs detailed in OMB Circular A-122, and period of availability of funds.

Property Standards

These requirements pertain to management and disposal of property purchased with federal funds:

- **Insurance**—Minimum coverage requirements
- **Real property**—Use and disposition
- **Federally**—Owned and exempt property requirements
- **Equipment purchases**—Use and record keeping
- **Supplies and other expendable property**—Use and disposition
- **Intangible property**—Rights and title to property developed and purchased with federal funds
- **Property trust relationship**—Property to be held in trust for beneficiaries of the program

Procurement Standards

All organizations are required to follow specific procurement standards in the following categories:

- **Recipient responsibilities**—Includes contractual responsibilities
- **Codes of conduct**—A written code of conduct is required for employees engaged in the award and administration of contracts
- **Competition**—Procurement is to be conducted in a competitive environment
- **Procurement procedures**—Establishment of procurement procedures and use of disadvantaged businesses
- **Cost and price analysis**—To be performed and documented
- **Procurement records**—Records to be maintained
- **Contract administration**—Requires a contract administration system be maintained

- **Contract provisions**—Requires certain provisions for all contracts and subcontracts

Reports and Records

- Monitoring and reporting program performance
- Retention and access requirements for records

Termination and Enforcement

In the event a contract is terminated or an organization does not comply with its grant requirements or other laws and regulations, the federal government may take any of the following measures:

- Temporarily withhold payments until the problem is corrected
- Disallow all or a part of the cost of items relating to the noncompliance
- Suspend or terminate the current award
- Withhold further awards
- Take other legal remedies

OMB Circular A-133 Requirements

Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments and Non-Profit Organizations," defines audit requirements for nonprofits receiving federal funding. Your organization may be subject to these audit requirements even if the money you receive is passed through another agency. For example, a city housing authority may make a grant to a local nonprofit housing developer that contains US Department of Housing and Urban Development (HUD) funding. The local housing developer is subject to A-133 audit requirements even though the grant was not directly from HUD. The most current information on Circular A-133 is at the Office of Management and Budget website (see Appendix D for more information).

The threshold amount for having a single audit has been raised several times; the most recent change raised the threshold from $300,000 to $500,000, effective December 31, 2003. As a result, many organizations are no longer required to have a single audit. However, you should be aware that the threshold amount is the total amount of funding granted by a particular federal agency to the recipient entity (usually a city department), so while your organization may

Note

Even with the revisions of Circular A-133 and the elimination of the single audit requirement for many organizations, the responsibility to comply with laws and regulations relating to federal funds is *not* eliminated. Nonprofit organizations are still required to properly account for their federal awards, comply with applicable laws and regulations, and cooperate with any audits of federal awards that the federal government may choose to perform, even if they are not required to have a single audit.

receive $100,000 from a particular federal grant and another organization may receive $400,000 from the same grant, both organizations would be included in a single audit of that $500,000 grant award.

Organizations not required to undergo a single audit must still be prepared to make their records available for review or audit by the federal agency or inspector general of the federal agency that provided funds or the Government Accountability Office (GAO). In addition, the city department that is the primary recipient (pass-through entity) of the federal funds is responsible for the subrecipient's compliance with laws and regulations, providing the subrecipient with the federal requirements that must be followed. The department can monitor the subrecipient by reviewing the single audit (if available), performing site visits, reviewing the subrecipient's records, maintaining regular contacts with the subrecipient, or having an independent auditor perform a limited scope audit. If the primary recipient determines that the subrecipient is not in compliance with applicable laws and regulations, it must act expeditiously to address the noncompliance. In addition, these organizations must make records available for review or audit by appropriate officials of the federal agency and GAO in addition to the primary recipient (pass-through entity) (see Circular A-133, §___.200(d).

Organizations that are required to have a single audit may choose to have a program-specific audit (see Circular A-133, §___.200(a), "Audit required") if the organization expends federal monies under only one federal program (excluding research and development programs) and the program's laws, regulations or grant agreements do not require a financial statement audit of the auditee (see Circular A-133, §___.200(c).

Smaller organizations may be able to combine a regular audit of the whole agency with a program-specific A-133 audit of the program receiving federal funding. The amount of your total combined federal funding will determine the type of audit you are required to have under A-133. The following table shows when an A-133 audit is not required, when a program-specific audit may be elected, and when an agency-wide single federal audit is required:

Total Federal Awards Expended	One Program	More than One Program
$0 – $499,999	No Audit	No Audit
$500,000 or more	Program-specific or A-133 Single Audit	A-133 Single Audit

A-133 audits test financial information. However, the A-133 audit looks more closely at tracking and classifying revenue from federal sources. In addition, the audit looks for compliance with general and specific government audit requirements, which cover both financial and non-financial factors such as program effectiveness, client eligibility, efficiency with which resources are used, and so on. The audit also tests internal control procedures more rigorously than a standard audit, making sure that adequate systems are in place for complying with the requirements noted above. Because of the expanded procedure involved and increasing reporting requirements for the auditor, the audit may cost substantially more than a traditional audit and involve more time from your staff. You should be allowed to build these additional costs into your grant. In practice, however, many nonprofits receiving federal pass-through funding have had difficulty convincing their government funders to include audit costs in their grants.

In summary, if your organization receives $500,000 or more in federal funding, whether directly or indirectly, and that funding is for more than one program, you are required to have an agency-wide A-133 audit. In addition, a program which receives more than $500,000 in combined federal awards is likely to be classified as a major program, and, therefore, subject to significantly more testing by the auditor. Whether a program is major or non-major is based on the dollar value of expenditures during the audit period. A program is a major program when total expenditures equal or exceed three percent of total federal funds expended by your organization or $500,000, whichever is greater. A program is non-major when expenditures are below this threshold.

According to Position Statement No. 6, issued by the president's Council on Integrity and Efficiency Standards Subcommittee, the A-133 single audit must be annual when the nonprofit has annual financial audits. In other words, if you are usually audited annually, you must also have an A-133 audit annually if you get federal funds over the threshold. If, however, you are usually audited every other year, you may also undergo an A-133 audit every other year, but the report must cover both years under consideration.

If your organization receives funds from a non-federal agency or grantor, you should ask if the grant includes federal funds. In some cases, the grantor may not know the answer even thought they are required to notify you whenever federal funds are included in the award. You are required to make a good faith effort to determine if federal funds are included in the award. Each federal award is identified with a number from the Catalogue of Federal Domestic Assistance (CFDA) and granting agencies should provide the CFDA number(s) for any federal funds included in your award since you are required to report this number as part of an audit. When you do receive federal funding, alert your auditor right away so you can get help setting up the proper systems for complying with government regulations. You may also want to get a copy of the OMB Compliance Supplement, which describes the A-133 requirements and serves as a guide for auditors performing single audits. You should identify someone on your staff who will be responsible for monitoring compliance with federal guidelines. To obtain the compliance supplement, go to the OMB website at
http://www.whitehouse.gov/omb/circulars/a133_compliance/04/04toc.html

How to Prepare for an Audit

Most nonprofit organizations use the services of outside CPAs. These services most often relate to performing the annual audit or preparing tax returns. Generally, fees charged for a CPA's services are based on the actual or estimated time spent on an engagement. Therefore, minimizing the time CPAs spend on an engagement can often lower fees.

A nonprofit's audit is addressed to its board of directors, who have ultimate financial accountability for the organization. The board's finance or audit committee should recommend an auditor for approval by the full board. If you do not have an appropriate board committee, the director or an individual board member can bring a recommendation to the board. Some important considerations when selecting an auditor are:

- **Experience in the nonprofit sector**—Because there are differences between for-profit and nonprofit accounting and in how financial statements are interpreted, an auditor who has other clients in the nonprofit sector is likely to be more helpful and efficient.

- **Experience with other nonprofits in your area of work**—You may want to consider an auditor experienced with similar agencies who knows the specific reporting requirements of your primary funding sources.

- **Training in Government Accountability Office (GAO) standards**—If you are required to have an audit that meets government standards, your auditor must fulfill GAO's continuing education requirements, among others. Be sure to specify that the audit must meet "Government Auditing Standards."

- **References for the Audit Firm and the Auditor**—In addition to experience, you are looking for indications the auditor has the technical expertise, communications skills, and flexibility to conduct your audit in an efficient and effective manner. A good working relationship with your auditor will help ensure the audit goes smoothly.

- **Fee**—Compare bids from auditors regarding the fees they charge to do the work you require. Some good auditors work for nonprofits for a reduced fee. Some firms produce a low bid the first year to get your business then raise their fee substantially in subsequent years. Auditors without necessary nonprofit auditing experience may take longer to produce an audit, causing them to raise their fee in later years. They may also prepare a report that has less value to the board and the public because the work supporting it is not sufficient. Also, they may require nonprofit staff, which is typically overburdened, to do more work for the audit than should be expected. Finally, some auditors who charge a lower fee do not do sufficient work in preparing a management letter detailing areas of weakness in the accounting system. Such a letter is an important management tool, of benefit to both the board and staff. On the other hand, an expensive audit does not guarantee an excellent product. Your goal is to get the reports and advice that you need and can understand for a reasonable fee.

Changing Auditors

The recommendations regarding changing auditors after you have established a relationship with one individual or firm differ depending on whom you ask. Auditors argue that, if you are getting the information you need from your audit and are satisfied that the reports are complete and usable, it is unwise to start over with a new auditor. Management consultants reply that, after a period of few years, auditors may be unable to provide the organization with new insights. In addition, bidding out the audit may provide an incentive to your current auditor to maintain reasonable fees. It may be useful to talk to one or two other qualified auditors every few years to determine whether the upheaval of working with a new auditor will be offset by better quality, lower fees, and/or new perspectives.

What Information is Needed for an Audit

To prepare for an audit ask the auditor what information you will be required to provide. Many auditors prepare a list of records they will need to examine, forms you will need to complete, and questions you will need to answer. Following are some types of information that may be required.

Confirmations

A confirmation is an independent statement that supports the financial information in your records. Auditors will ask you to prepare confirmation letters on your letterhead (they will provide the format) to your bank(s), funders, attorney, and people and organizations you owe money to and who owe you money to confirm the amounts reflected in your books. Confirmations are mailed by and returned directly to your auditor to ensure their credibility.

Evidence of Internal Controls

The auditor will meet with staff members or request that they complete a questionnaire documenting the procedures relating to spending and receiving money and using other resources, complying with laws, donor restrictions and regulations, maintaining property and equipment, and recording financial information in the books.

Documentation

The auditor will request a number of schedules (lists) of information related to the following:

- Assets
  - **Accounts receivable**—Who owes you money, how much, and when was it due?
  - **Property and equipment (fixed assets)**—When were assets acquired, how much did you pay, how long are they expected to last, how much are they depreciated each year, and how much has been depreciated to date? Many nonprofits ask their auditors to maintain this schedule for them and to prepare the annual calculation of depreciation.
- Liabilities
  - **Payables**—Who you owe money to, how much you owe each individual/organization. Copies of invoices or loan agreements.
  - **Deferred Revenue**—Any contributions deferred due to donor conditions or restrictions. Provide the information under grants and contributions, in the Revenue section below.
- Revenue
  - **Grants and contributions**—Funder/donor names and addresses, grant period, grant amount, when received, restrictions, and copies of the grant letters and grant applications. In the case of individual contributions, your auditor will specify which donors to include on this list based on a minimum level of contributions they will establish for you based on your overall budget and total contributions.
  - **Donated services and materials**—You may be required to place a dollar value on contributions of certain services and materials. Prepare a list of these donations to discuss with your auditor.
  - **Special events and benefits**—Show income and expenses, and documentation for the value of goods or services which donors received (and, therefore, are not included in the tax-deductible portion of their payment).
  - **Documentation**—Such as contracts and invoices, names and addresses, registrations, and so on, for fees from memberships, tuition, performances, and other services.

- **Inventory**—If you sell t-shirts, books, or other products, keep a record of sales throughout the year so that beginning inventory can be reconciled with inventory at the end of the year.

- Expenses
  - **Payroll records**—Including federal and state tax returns related to payroll, and vacation records.

While some nonprofits rely on their auditors to prepare schedules such as those above based on information provided by an organization's staff, you can save on the cost of your audit by preparing the majority of these schedules internally—using staff or board volunteers—rather than asking the auditor to prepare them.

In addition to the schedules noted above, be prepared for the auditor to review the following items:

- Board minutes
- Leases and other contracts
- Bank statements, bank reconciliations, checkbooks, and cancelled checks
- Financial files for paid bills and deposits
- Components of the accounting system—Chart of accounts, journals and ledgers, printouts if the system is computerized, trial balance, and so on
- Budget for the fiscal year being examined

Finally, you will want to consider the non-financial aspects of an audit. The staff should understand what is involved in an audit, that it is a routine examination of financial and other information, and that they may be asked a few questions. You should assign one person to be the audit coordinator. In a small nonprofit, that may be the bookkeeper or executive director. In a larger organization, it may be the finance director. The audit coordinator should have access to all information the auditors may need, and should plan to be available to the auditors while they are on-site. In addition, some thought should be given to setting aside a physical location for the auditors so they can work efficiently.

When Does the Audit Begin?

Most organizations select an auditor prior to the end of their fiscal year. About the time your fiscal year ends, you will want to meet with your auditor to determine what information will be required for the audit. If your financial management system is reasonably well organized, the audit can usually begin within two months of the end of your fiscal year. However, new government funding and other complicating factors may extend the amount of time needed to prepare for the audit.

4

Miscellaneous

This chapter contains miscellaneous information regarding your financial systems that is not covered elsewhere.

Nonprofit Tax Status

The *Guide* will not discuss in detail the process for applying for tax-exempt status since organizations using the Guide will have already obtained an exemption. Generally, to obtain tax-exempt status, nonprofit organizations must apply for tax-exempt status and be designated as exempt by the Internal Revenue Service. For a California exemption, organizations must file an exemption application form FTB 3500 with the California Franchise Tax Board.

There are many categories of tax-exempt organizations, but a large number are organizations that provide a range of services to the public and that are funded with public and private monies. Many of these organizations are designated as 501(c)(3) organizations under the Internal Revenue Code and must have one of the following specific purposes to qualify for tax-exempt status:

- Religious
- Educational
- Charitable
- Scientific
- Literary
- Testing for public safety

- Fostering national or international sports competition
- Prevention of cruelty to children or animals

State and Federal Tax Reporting Requirements

State and federal tax reporting requirements change frequently and organizations should use the latest information available when filing returns with state and federal taxing authorities. For more information on this topic and links to websites, see the following sources of information and see Appendices D and F:

- For the state exemption, see the Franchise Tax Board publication, "Exempt Organizations" at the FTB's California Taxes Information Center at the website www.ftb.ca.gov/exemptbus.html.
- The California Board of Equalization Publication 18, "Tax Tips for Nonprofit Organizations," contains useful information on the tax status of various types of nonprofit organizations. See the BOE website at: http://www.boe.ca.gov/pdf/pub18.pdf
- "Overview of Exempt Organizations" summarizes tax-filing requirements for California nonprofits and discusses differences between state and federal requirements. This publication can be obtained at the website http://www.ftb.ca.gov/forms/misc/927.pdf
- For federal information on tax status and reporting requirements for nonprofit organizations, see the IRS publication 557, "Tax Exempt Status for Your Organization" at http://www.irs.gov/pub/irs-pdf/p557.pdf

California Franchise Tax Board (www.ftb.ca.gov)

Form 199, Exempt Organization Annual Information Return, must be filed within 5 ½ months after the end of the fiscal year.

Form 109, Exempt Organization Business Income Tax Return, must also be filed 5 ½ months after the end of the fiscal year.

Internal Revenue Service (www.irs.gov/charities)

Form 990 or 990EZ, Annual Return, must be filed within 4 ½ months after the end of the fiscal year.

Prohibition on Provision of Excess Benefits

Tax exempt, 501(c)(3) organizations are prohibited from providing excess benefits to insiders or operating for the private benefit of insiders, or for individuals who control the organization or who created the organization. For example, providing members, employees, or other insiders organizational funds or assets (private inurement) through payment of dividends, distribution of surplus funds, payment of unreasonable compensation, or making loans to insiders at less than market rates, is prohibited. There are penalties associated with these activities that can be reviewed in detail at the IRS website.

Prohibition on Lobbying and Participation in Political Campaigns

Tax-exempt organizations are prohibited from taking part in lobbying as a "substantial" part of their activities and prohibited from participating in any political campaign. The degree to which lobbying activities are "substantial" is an interpretation made by the IRS, unless the organization elects to have a specific limit placed on lobbying expenditures and files a report every year. The IRS specifically identified the following activities as unallowable when performed in relation to a political candidate:

- Engaging in fundraising
- Donating money
- Endorsing a candidate
- Distributing information
- Performing any service or action that is detrimental or beneficial to a candidate

City and County of San Francisco Conflict of Interest Provisions and Restrictions on Certain Political Activities

If you have a contract with the City, you should be aware of the following:

- City boilerplate contract forms, including the P-500 Professional Services Contract, contain a conflict of interest provision prohibiting city officials and employees from participating in certain decision-making activities of organizations that contract with the City. Activities that constitute a conflict of interest are described under Section 15.103 of the city Charter, Article III, Chapter 2 of the city's Campaign and Governmental Conduct Code, or Section 87100 et seq. and Section 1090 et. seq. of the Government Code of the State of California. The San Francisco Ethics Commission administers and implements the provisions of the Charter and city ordinances relating to campaign finance, lobbying, conflicts of interest, and governmental ethics. To see a comprehensive source for information on the laws and how they may apply to your organization, you can obtain the **"San Francisco Ethics Commission Manual"** by contacting the Ethics Commission or downloading the manual from the Ethics Commission Website: www.sfgov.org/ethics Refer to Appendix D for more information on contacting the Ethics Commission.

- City boilerplate contract forms, including the P-500 Professional Services Contract, also contain a provision prohibiting contractors, or person(s) who contract with the City, from contributing to the campaign of an elective officer who approves (or the board on which the officer sits approves) the contract or the contractor's transactions. This prohibition is effective from the commencement of negotiations through the termination of negotiations, or three months after the date the officer or the board on which he/she sits approved the contract, whichever is later.

- The San Francisco Administrative Code, Appendix 65, Sec. 12G (known as "Proposition Q"), prohibits using for political activity any funds appropriated by the City and County of San Francisco for contracts, grants, and loans. Boilerplate contracts, such as the P-500 Professional Services Contract, contain language incorporating these provisions. The contract boilerplate states a contractor may not participate in, support, or attempt to influence any political campaign for a candidate or for a ballot measure (collectively, "political activity") in the performance of the services provided under the agreement. A contractor agrees to comply with San Francisco Administrative Code Chapter 12.G and any implementing rules and regulations promulgated by the city's Controller. In the event the contractor violates the provisions of this section, the City may, in addition to any other rights and remedies available, (i) terminate the agreement, and (ii) prohibit the contractor from bidding on or receiving any new city contract for two (2) years.

- Under Proposition Q, the Controller's Office is required to annually perform political activity audits of at least 10 persons or entities that enter into contracts, grant agreements, or loan agreements with the City.

- Although there are a number of restrictions or prohibitions on political activity by nonprofit organizations, certain political activities may be allowable under some conditions. However, before engaging in any political activity, you should be familiar with local and state restrictions described above, and with Internal Revenue Service provisions and tax consequences for your organization. Generally, an organization should be able to show that it has not used any taxpayer funds or staff time paid by taxpayer funds for political activities. Complete documentation of funds (and their sources) expended, and of staff time spent on political activities is essential. A good source for information and guidance on this topic is the Alliance for Justice at www.allianceforjustice.org The Alliance for Justice publications page contains three publications on this topic: “Worry-Free Lobbying for Nonprofits”, which describes the IRS substantial activity test and the 501(h) election; “Being a Player: A Guide to the IRS Lobbying Regulations for Advocacy Charities”; and “The Rules of the Game: An Election Year Legal Guide for Nonprofit Organizations.” The Alliance for Justice also conducts workshops in the Bay Area and nationwide, as well as online, to educate the public about these issues.

Minimum Compensation Ordinance (MCO) Compliance

The city’s boilerplate contracts, such as the P-500 Professional Services Contract, require city contractors with over 20 employees and $50,000 or more in contracts with one city department to comply with provisions of the city’s Minimum Compensation Ordinance (MCO), as set forth in San Francisco Administrative Code Chapter 12P. The ordinance requires contractors to pay their employees a minimum hourly wage specified by the City and to provide compensated and uncompensated time off. There are also monetary thresholds for funds received by the contractor under which an organization is exempt. The MCO is enforced by the Office of Contract Administration (OCA), Living Wage/Living Health Unit. For specific information about the current wage, MCO rules and regulations, forms, and how to contact OCA’s Living Wage/Living Health Unit, go to OCA’s Website: www.sfgov.org/oca/lwlh.htm

Health Care Accountability Ordinance (HCAO) Compliance

The city’s boilerplate contracts, such as the P-500 Professional Services Contract, require contractors to comply with provisions of the city’s Health Care Accountability Ordinance (HCAO), as set forth in San Francisco Administrative Code Chapter 12Q. Nonprofit organizations with fewer than 50 employees are exempted and the ordinance requires the contractor to provide its employees with a health care benefit as set forth in Section 12Q.3 of the HCAO. There are also monetary thresholds for funds received by the contractor under which an organization is exempt. Like the MCO, the HCAO is enforced by OCA’s Living Wage/Living Health Unit. For specific information about the health benefit requirement, HCAO rules and regulations, and forms, go to OCA’s website at www.sfgov.org/oca/lwlh.htm

Nonprofit Organization Board Responsibilities and Development

Boards have a dual role: to support and assist with staff-led work and to provide governance over the organization.

In the support role, board members work for the success of the organization by raising money, bringing outside contacts and information to the organization, providing special skills such as law and accounting, and acting as ambassadors to the community.

In the governance role, the board's primary goal should be protecting the public interest. Governance responsibilities for board members include selection of the top executive (director or CEO), assessment of the executive's performance, review and authorization of plans and commitments including the budget, ensuring compliance with legal and contract requirements, and monitoring and evaluating the organization's work.

Sunshine Ordinance Requirements (San Francisco Administrative Code, Section 12L)

The following summarizes provisions of Section 12L. For a complete understanding of the ordinance's provisions, see the city's website at http://www.sfgov.org/sunshine and click on "documents."

Access to Meetings

Nonprofit organizations must provide public access to at least two public meetings per year. The issues addressed at these meetings should be of the same general nature and significance as those addressed at regular or special meetings. In at least one of these meetings, the public should have a chance to address the board on board membership and to propose candidates for the board. This provision does not apply to organizations providing abortion counseling or services, domestic violence sheltering services, or suicide prevention services.

Meeting Notice

The ordinance also requires nonprofit organizations to provide public notice of each public meeting at least 30 days in advance of the meeting. Such notice should be submitted to the Clerk of the Board of Supervisors and to the San Francisco Public Library Government Information Center.

Access to Records

Nonprofit organizations are required to maintain and make available for public inspection and copying a minimum amount of financial information about the organization. The public may request additional information, but its provision is voluntary and not compulsory.

Dispute Resolution

Members of the public who seek and are unable to obtain additional financial information or who have a complaint about an organization's compliance with the law can submit a request or complaint to the city agency or department that is responsible for the organization's contract. The member of the public may also seek an advisory opinion from the Sunshine Ordinance Task Force.

Community Representation

It is city policy that every nonprofit organization that contracts with the City make good-faith efforts to promote the membership of and seek candidates for its board of directors at least one person who is a recipient of that organization's goods or services, or a recipient of like goods and services provided by another nonprofit organization.

Annual Economic Statement

San Francisco Administrative Code, Section 10.1, requires an annual economic statement from every legal entity receiving funding from or through the City to provide direct services to the public (not including other governmental entities). These statements are to be filed with the Department of Administrative Services on a form provided by the department on or before April 1 of each year.

The statement should contain the following information:

- Name of the CEO, or other person possessing daily managerial responsibilities
- Names of all officers or directors and names of all other boards on which they serve
- Total expenditures during calendar year or fiscal year, whichever is applicable; and budget for calendar or fiscal year, whichever is applicable, showing the sources of all monies received or budgeted, and a program-by-program description of all monies expended or budgeted.

A

Chart of Accounts

The chart of accounts should include every account that your accounting system tracks. The chart will help you keep track of financial information on an ongoing basis and help you make good financial decisions. By using a chart of accounts to record financial information, you will be able to easily produce reliable financial reports.

In determining what to include in your chart of accounts you need to determine the following:

- What reports do you want to prepare? For example, are you required to produce external reports and internal reports for management and decision-making?
- What financial decisions, evaluations, and assessments do you need to make on a regular basis?
- What level of detail do you require?
- What is your capacity for tracking financial information?

Your chart of accounts should correlate to the categories in your budget so you can compare budgeted amounts to actual income and expenditures. It should also correlate with line-item categories you must report on IRS form 990, "Return of Organization Exempt from Income Tax."

In developing income categories for the chart, think about how you want to show different sources of income so you can track fund-raising efforts and see which sources have restrictions. If you collect fees from your activities, you will need to decide if all fee income can be combined into one account or if income from different fees should be shown. You will also need to consider the various expense categories you will want and what level of detail you need to have for reporting. You will want to have an office supplies category, for example, but you will not need to account separately for pens, paper, rubber bands, and so on.

You will also need to consider other factors in determining the categories of revenues and expenses for the chart. If your organization has more than one site, you may need to track information separately for each site. If you have more than one program, you may want to track office supply expenses separately for each program. It is important to understand that the Financial Accounting Standards Board (FASB) Statements Nos. 116 and 117, state that nonprofits should report revenues and expenses in at least three categories: unrestricted, temporarily restricted, and permanently restricted. Therefore, your chart of accounts should reflect this categorization.

Generally, the chart of accounts should be kept as simple as possible. It is a good idea to note when it is not clear which account a transaction should be assigned to, your chart needs revision or the criteria for assigning chart numbers needs to be clarified.

Example of a Chart of Accounts

The example chart of accounts on page A-5 shows how you might track income and expense items, along with conventions that are usually observed when assigning account numbers. You can use this sample as a guide for developing your own chart of accounts. Account categories are presented in standard order as they are presented in the Statement of Position (balance sheet). The account categories are assets, liabilities, and net assets (or fund balances). Income and expense accounts follow the Statement of Position accounts.

Account categories are in standard order, beginning with accounts presented in the Statement of Position (balance sheet):

- Assets

  Tangible items your organization has, including cash, accounts receivable, equipment, and property. Assets are held in descending order of liquidity with cash and assets easily converted to cash listed first, and fixed assets like property and equipment listed last. Asset accounts usually start with the number "1."

- Liabilities

  Liabilities are obligations due to creditors such as loans and accounts payable. Current liabilities that are due within the current year are usually listed first, followed by long-term liabilities. Accounts payable and payroll taxes are usually listed before other payables. Deferred revenue and other liabilities are listed further down the list. Liabilities accounts begin with the number "2."

- Net Assets (fund balances)

  Net assets (formerly known as fund balances) reflect the financial worth of the organization. Net worth shows the balance remaining after obligations are subtracted from your organization's total assets. If your organization receives only unrestricted funds, you will have one net asset account, but if you receive temporarily or permanently restricted funding you will have more than one net asset account. Net asset accounts begin with the number "3."

The numbering system for accounts in the chart allows for expansion of each category as needed. This permits a greater level of detail to be presented as your organization grows.

Certain related accounts are grouped together with related numbers. For example, the general, or heading number for payroll taxes is 7310. Note that you do not post information to this header account number, only to those below it. Below the heading number, each type of payroll tax is assigned its own number for posting, that is, "FICA" expense is 7311, unemployment insurance is 7312, and so on.

Capturing complex financial information in the chart of accounts requires a multi-tiered chart. For example, you may need to track temporarily and permanently restricted funds, separate programs or departments, separate sites, and so on. For example, if your organization has three programs—counseling, tutorial, and recreation—you might assign each its own account code as follows:

Counseling	01
Tutorial	02
Recreation	03

When these codes are added to other codes for expense items in the chart, you would attribute salaries for counselors as follows:

7210 - 01

7210	-01
Salary	Counseling Program

Supplies for a recreational program would be posted to:

7710 – 03

7710	-03
Supplies	Recreational Program

You could also track two programs and sites by adding a third tier. If you had two sites where tutorial programs were given, the first site could be assigned the letter "A" and the second the letter "B," so salaries would be divided between:

7210 – 02 – A and 7210 - 02 – B

7210	-02	B
Salary	Tutorial Site B Program	

As the chart becomes more complex, you will be able to produce more detailed reports. As the accounting system becomes more complex, computerized accounting systems become more necessary. The following is a sample chart of accounts showing broad account headings and codes presented in the model chart of accounts developed by the Nonprofit Management Group for nonprofit organizations. This example shows how the chart of accounts can be tailored to specific needs of an organization. To obtain a copy of the complete model chart of accounts, contact:

Nonprofit Management Group
Department of Public Administration
Baruch College/CUNY
17 Lexington Avenue, Box 336
New York, NY 10017

(212) 447-3659

Example Chart of Accounts

Assets

1010	Cash
	1011 Checking Account
	1012 Petty Cash
1020	Savings and Temporary Cash Investment
1030	Accounts Receivable
1060	Allowance for Doubtful Accounts
1070	Grants Receivable
1130	Prepaid Expenses
1610	Land
1620	Building
1640	Equipment

Liabilities

2010	Accounts Payable
2410	Loans From Trustees & Employees
2510	Mortgage Payable

Net Assets

3100	Current Unrestricted Net Assets

Revenue

4010	Contributions (Direct Mail)
4050	**Special Events (Gift Portion)**
4100	Donated Services & Use of Facilities
4220	Corporate Grants
4230	Foundation Grants
4510	Government Contributions
5040	Sales to Public of Program-Related Inventory
5060	Other Program Service Fees
5110	Membership Dues

Expenses

7110	Salaries- Officers, Directors, etc.
7210	Other Salaries & Wages
7310	Payroll Taxes, etc.
	7311 FICA Payments (employer)
	7312 Unemployment Insurance
	7313 Worker's Compensation
	7314 Disability Insurance
7520	Accounting Fees
	7520 Audit & Accounting Fees
	7521 Bookkeeping Services
	7522 Payroll Services (Outside)
	7523 Bank Service Charges
7710	Supplies
7810	Telephone
7910	Postage & Shipping
8010	Occupancy
8011	Office Rent
8012	Janitorial & Similar Service
8110	Equipment Rental & Maintenance
8210	Printing & Duplicating
8220	Publications
8310	Travel
8710	Insurance

B

Internal Accounting Checklist for Paying Bills

The following are a few examples of common internal accounting controls related to paying bills:

- All disbursements, except petty cash, should be by pre-numbered check.
- Voided checks should be preserved and filed after mutilation.
- No checks should be made payable to "cash."
- No checks should signed in advance.
- A cash disbursement voucher should be prepared for each invoice or request for reimbursement. The voucher should show check date, check number, payee, amount, description of account to be charged, authorization signature, and accompanying receipts.
- Authorized persons should approve all expenditures in advance.
- Signed checks should be mailed promptly.
- The check signer should review the cash disbursement voucher for each amount for proper authorization and supporting documentation of expenses.
- Invoices should be marked "paid" with the date and the amount of the check.

- Requests for reimbursement and other invoices should be checked for mathematical accuracy and reasonableness before approval.

- The cash disbursement journal should be prepared monthly with details of checks written (number, payee, amount, and description of expense account to be charged).

- Check-signing authority should be vested in persons at appropriately high levels in the organization.

- The number of authorized check signers should be kept at a minimum.

- Checks over a certain amount require two signatures.

- Bank statements and cancelled checks should be received and reconciled by someone other than the person who authorizes expenditures and signs the checks.

- Unpaid invoices should be kept in an unpaid invoice file.

- A list of unpaid invoices should be prepared and reviewed periodically.

- Someone other than the person(s) who approves the invoices for payment should review invoices from unfamiliar or unusual vendors.

- If there is an accounts payable register, payments should be promptly recorded to avoid double payments.

- If purchase orders are used, pre-numbered purchase orders should be used with all transactions.

- Advanced payments to vendors and/or employees should be recorded as receivables, and controlled in a manner that assures they will be offset against invoices or expense vouchers.

- Employees should be required to submit expense reports for all travel-related expenses on a timely basis

C

Payroll Accounting Checklist

The following are a few examples of common internal accounting controls related to payroll:

- Detailed timesheets should document employee hours, including overtime.
- Timesheets should be signed by the employee's immediate supervisor authorizing payment for work.
- Employment records maintained for each employee should detail wage rates, benefits, taxes withheld each pay period, and any changes in employment status.
- Payroll-related taxes (federal income tax, state income tax, employee and employer share of social security, and other taxes) should be withheld and paid to federal and state agencies on a timely basis.
- The executive director and board treasurer should review all the payroll tax returns.
- Written policies and procedures should include accounting for vacations, holidays, sick leave, and other benefits.
- A list of payroll checks written, with appropriate withheld taxes, should be maintained either through the cash disbursement journal or a separate payroll register.
- A separate payroll bank account should be maintained.

D

Government Documents

US Internal Revenue Service

For federal tax compliance information and forms, refer to the following sources:

- For the current ***Form 990 and 990EZ, Return of Organization Exempt From Income Tax,*** go to: www.irs.gov/eo and type "990" in the "Search Forms and Publications" search box. You may also call (866) 816-2065 (toll free). Note that ***Form 990 or 990EZ,*** must be filed within 4 ½ months after the end of the fiscal year.

- To file for an employer identification number (EIN) and for comprehensive tax information, including applying for tax exemption for nonprofit organizations, forms and other resources, go to http://www.irs.gov or call (866) 816-2065.

- Also, for complete information on tax status and reporting requirements for nonprofit organizations, see the IRS publication 557, "Tax Exempt Status for Your Organization" at the following website: http://www.irs.gov/pub/irs-pdf/p557.pdf

- The IRS website's special area for exempt organizations at http://www.irs.gov/charities has tax information for nonprofit organizations.

US Office of Management and Budget

For the most current information that includes changes or updates to the OMB circulars, go to the Office of Management and Budget website at http://www.whitehouse.gov/omb/circulars/ .

Federal government documents can also be obtained from:

Superintendent of Documents
U.S Government Printing Office
P.O. Box 371954
Pittsburg, PA 15250-7954

Order desk telephone: (202) 512-1800
Order desk fax: (202) 512-2250

The following OMB documents affect nonprofit organizations receiving federal grants:

- OMB Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Institutions," imposes administrative requirements for nonprofit organizations receiving federal grants (awards).
- OMB Circular A-122, "Cost Principles for Non-Profit Organizations," provides guidance for determining the allowability of costs for federal grants.
- The Single Audit Act of 1984 is the federal statute that requires audits of entities receiving federal awards over a certain dollar amount.
- The Single Audit Act Amendments of 1996 increased the threshold for when a single audit or program-specific audit is required for fiscal years beginning after June 30, 1996.
- OMB Circular A-133 was revised in 2003 to increase the dollar threshold used to determine when a single audit or program-specific audit is required for fiscal years beginning after December 31, 2003.
- OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," establishes audit requirements for entities that receive federal awards. The circular was revised in 1997 and 2003.
- OMB Circular A-133 Compliance Supplement explains how to determine which compliance requirements are applicable to a particular federal award. In March 2003, OMB released an updated edition of the Compliance Supplement that added federal programs and enhanced the independent

auditors' requirements that apply to subrecipient monitoring. OMB has indicated that additional federal programs will be added to the Compliance Supplement in the future.

California Franchise Tax Board

For state tax compliance information and forms, refer to the following sources:

- California tax forms and information can be obtained by going to www.ftb.ca.gov or by calling (800) 852-5711 or (800) 338-0505. Note that Form 199, Exempt Organization Annual Information Return, must be filed within 5 ½ months after the end of the fiscal year, as must Form 109, Exempt Organization Business Income Tax Return.

- On the state exemption, see the Franchise Tax Board publication, "Exempt Organizations" at the FTB's California Taxes Information Center at http://www.taxes.ca.gov/exemptbus.html

- Another Franchise Tax Board publication, "Overview of Exempt Organizations," summarizes tax-filing requirements for California nonprofits and discusses differences between state and federal requirements. This publication can be obtained at the website: http://www.ftb.ca.gov/forms/misc/927.pdf

- You may reach the Franchise Tax Board at:

  Franchise Tax Board
  Exempt Organizations Unit
  P.O. Box 1286
  Rancho Cordova, CA 95741-1286
  Telephone: (916) 845-4171

California Board of Equalization

- The California Board of Equalization Publication 18, "Tax Tips for Nonprofit Organizations," contains comprehensive sales and use tax information for various types of nonprofit organizations. The publication describes in detail what types of sales by nonprofit organizations are exempt from taxation. Go to the BOE Website at: http://www.boe.ca.gov/pdf/pub18.pdf

California Employment Development Department

- For information about payroll taxes, go to http://www.edd.ca.gov/employer.htm and look for links to information under "Taxes." You may also call (916) 653-0707 for information.

California Secretary of State

- Nonprofit organizations must file their Articles of incorporation with the Secretary of State and file Form SI-100, Annual Statement of Information, biennially before the end of the calendar month during which the articles of incorporation were filed.

- For specific information on filing for nonprofit corporations, go to the Secretary of State's website at http://www.ss.ca.gov/business/corp/corporate.htm and click on "Statement of Information" on the left. This takes you to a page where you then click on "Domestic Nonprofit Corporations" to obtain information and forms.

- For further information, contact:

  Secretary of State
  Statement of Information Unit
  1500 11th Street
  Sacramento, CA 95814

  Telephone: (916) 657-5448
  Website: www.ss.ca.gov
  Filing fee: $20

California Office of the Attorney General–Registry of Charitable Trusts

- There are three types of nonprofit corporations in California: public benefit corporations, mutual benefit corporations, and religious corporations. Nonprofit corporations or organizations that provide services for the public good are, under California law, "public benefit" organizations or charities. Such services may be for poverty relief, advancement of education or religion, promotion of health, governmental purposes, or other purposes beneficial to the community. As the legal overseer of charities that do business in California, the Attorney General works to protect the interest of all public beneficiaries within his jurisdiction. The Attorney General may conduct investigations and bring legal actions to protect the assets of California charities and insure the assets are used for their intended charitable purposes. There are also special conditions under which organizations are permitted to hold raffles to raise money for charitable purposes. Nonprofit, "public benefit" organizations' assets are irrevocably dedicated to charitable purposes and cannot be distributed for private gain. When such an organization dissolves, its assets must be distributed to another organization(s) that has a similar purpose. A public benefit corporation, except for educational institutions and hospitals, must register and report to the **Attorney General's Registry of Charitable Trusts.**

- There are two required forms, the CT-1 Registration Form for registration of a new organization, and the RRF-1 Registration/Renewal Fee Report, which must be filed annually within 4 months and fifteen days of the end of an organization's accounting period.

- In September 2004, the California legislature enacted a new law that amended various existing laws relating to charitable organizations. The law (Senate Bill 1262) contains numerous provisions relating to registration, reporting and auditing requirements for organizations and individuals soliciting funds for charitable purposes. For information, contact the California Office of the Attorney General at the Websites below:

- http://www.caag.state.ca.us/charities Also, for comprehensive legal information about nonprofit organizations in California, see "Attorney General's Guide for Charities" at
  http://caag.state.ca.us/charities/publications/gfc.pdf
  Also, see the supplement to this guide at
  http://caag.state.ca.us/charities/publications/supplement2001.pdf

- The California Attorney General may also be reached at:

  Office of the Attorney General–Charitable Trusts
  455 Golden Gate Avenue, #11000
  San Francisco, CA 94102-3664

  Telephone: (415)703-5500

  or

  Office of the Attorney General–Charitable Trusts
  1300 I Street, Suite 1101
  P.O. Box 944255
  Sacramento, CA 94244-2550

  Telephone: (916) 445-2550

City and County of San Francisco Ethics Commission

- For information on conflicts of interest, restrictions on lobbying and contributing to and participating in political campaigns, contact the San Francisco Ethics Commission. The Ethics Commission also publishes a manual, "The San Francisco Ethics Commission Manual on Governmental Ethics Laws; A Guide to State and Local Laws Governing the Conduct of Public Officials and Employees." The manual can be obtained from the Commission or from its Website:

  San Francisco Ethcs Commission
  30 Van Ness Avenue, Suite 3900, San Francisco, CA 94102
  Phone: (415) 581-2300
  Website: www.sfgov.org/ethics
  E-mail: ethics.commission@sfgov.org

E

Sample Cash Flow Budget

Sample Cash Flow Budget	Total Budget	Jan	Feb	Mar	Apr	May	Jun
Expected Revenues							
Gvmt Grants	35,000				12,000	4,000	16,000
Foundation Grants	50,000		5,000		7,500	15,000	
Individuals	12,000			1,500			30,000
Fees for Service	55,000	3,000	4,500	4,500	5,000	5,000	3,000
Total Revenue	152,000	3,000	9,500	6,000	24,500	24,000	49,000
Expected Expenditures							
Salaries & Fringe							
Executive Director	38,000	3,167	3,167	3,167	3,167	3,167	3,167
Program Directors	50,000	4,167	4,167	4,167	4,167	4,167	4,167
Secretary	27,000	2,250	2,250	2,250	2,250	2,250	2,250
Rent	12,000	1,000	1,000	1,000	1,000	1,000	1,000
Supplies	11,000	5,000					6,000
Telephone	3,300	300	250	300	500	350	250
Postage	2,500	150	150	150	1,500	150	150
Copying	2,950	100	100	100	1,000	100	100
Total Expenses	146,750	16,134	11,084	11,134	13,584	11,184	17,084

Sample Cash Flow Budget	**Total Budget**	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**
Net Income <Loss>	5,250	<13,134>	<1,584>	<5,134>	10,916	12,816	31,916
Cash on Hand – Beginning	2,648	2,648	<10,486>	<12,070>	<17,204>	<6,288>	6,528
Ending Cash Available (Before Loan Activity)	7,898	<10,486>	<12,070>	<17,204>	<6,288>	6,528	38,444
Loan <Loan Payback>	0	12,000	0	6,000	<10,000>	<8,000>	0
Cash After Loan Activity	7,898	1,514	<70>	796	1,712	6,528	38,444

F

Websites and Acknowledgements

There are far too many websites about all aspects of organizing and managing nonprofit organizations to list here, but searching the Internet for information is a primary means for getting answers to just about any question you may have about your organization, so be sure to take advantage of it. Simply searching under "nonprofit organizations" or "nonprofit finance" using the ***Google*** search engine will yield millions of pages of information. Below are a few sites that are excellent resources for information on all aspects of nonprofit organization fiscal operation and management. Some information is free while access to other information requires a membership fee.

Alliance for Nonprofit Management

http://www.allianceonline.org/

The **Alliance for Nonprofit Management** is the professional association of individuals and organizations devoted to improving the management and governance capacity of nonprofits—to assist nonprofits in fulfilling their mission. Look at the Frequently Asked Questions (FAQs) page for extensive information on nonprofit financial management.

Basic Guide to Non-Profit Financial Management

http://www.mapnp.org/library/finance/np_fnce/np_fnce.htm

This guide, written by Carter McNamara, MBA, PhD, provides extensive information on all aspects of nonprofit organization and management. It also provides numerous resources for further information. The guide includes a document titled ***Basic Overview of U.S. Nonprofit Financial Management*** that describes activities that are a regular part of the annual accounting cycle.
http://www.mapnp.org/library/finance/np_fnce/basics.htm

California Association of Nonprofits

http://canonprofits.org

CAN's mission is, "to promote, strengthen and advance the influence, professionalism, accountability and effectiveness of nonprofit organizations in a manner that builds their capacity to accomplish their missions and preserves the idealism and value of nonprofit organizations in California." CAN has information about the "Nonprofit Integrity Act" (SB1262) recently enacted into California law, Chapter 919.

Guidestar

http://www.guidestar.org/about

Guidestar facilitates access to information about the operations and finances of nonprofit organizations. Guidestar's vision is to create an interactive "marketplace of information" that connects nonprofit organizations, donors, foundations, and businesses. This connection will serve as the backbone of a more effective, efficient, and well-informed nonprofit sector.

Internet Nonprofit Center

http://www.nonprofits.org/

The Internet Nonprofit Center publishes the Nonprofit FAQ, a resource of information provided by participants in many online discussions about nonprofits and their work. First-time users may want to look at the Guide to Using the FAQ.

Kern, DeWenter, Viere, Ltd.

http://www.kdv.com/indirect.html

Kern, DeWenter, Viere, Ltd., is a consulting firm providing financial and other services to nonprofit organizations. The above link is an article on allocation of indirect costs and determining indirect cost rates.

National Council of Nonprofit Associations

http://www.ncna.org/

The National Council of Nonprofit Associations (NCNA) is a 501(c)(3) membership-based organization of state and regional associations that represent thousands of nonprofits throughout the country. Members work at the state and local level to provide training and technical assistance to improve the operations and effectiveness of organizations while promoting the value and accountability of the nonprofit sector.

Nonprofit Financial Center

http://www.nfconline.org

The Nonprofit Financial Center (NFC) is a membership organization that provides financial information and assistance to nonprofit organizations. The NFC website has a frequently asked questions page that provides information and other resources on a variety of topics: http://www.nfconline.org/main/info/faq.htm

San Francisco Human Services Network

http://www.sfhsn.org

The San Francisco Human Services Network (HSN) is an association of San Francisco nonprofits organizations that helps coordinate issues concerning the city's human services providers. The HSN website is currently under construction, but will be available in the near future. HSN can be contacted by calling (415) 668-0444.

Small Business Administration Online Women's Business Center

http://www.onlinewbc.gov/

The U.S. Small Business Administration's Office of Women's Business Ownership (OWBO) promotes the growth of women-owned businesses through programs that address business training and technical assistance, and provide access to credit and capital, federal contracts, and international trade opportunities. With a women's business ownership representative in every SBA district office, a nationwide network of mentoring roundtables, women's business centers in nearly every state and territory, women-owned venture capital companies, and the Online Women's Business Center, OWBO is helping unprecedented numbers of women start and build successful businesses.

Acknowledgements

There are many sources of comprehensive information on how to set up and manage an accounting system for nonprofit organizations. One source that was particularly helpful in developing the Guide was the **Nonprofit Financial and Accounting Manual (Ninth Edition)**, produced by the Practitioners Publishing Company. The manual is both a training manual and a technical resource for performing day-to-day nonprofit record keeping activities and for preparing internal and external financial statements. The manual also covers topics such as nonprofit taxation, processing receipts, processing purchases and payments, processing payrolls, maintaining the general ledger, federal grant compliance, audits, the budget process, and selection of accounting software products. It is especially useful for organizations just starting up and for organizations that are in the process of expanding on and improving their financial management systems.

To obtain a copy of the manual, contact:

Practitioners Publishing Company
P.O. Box 966
Fort Worth, TX 76101-0966
Telephone: (800) 323-8724
Website: www.ppcnet.com

The Alliance for Nonprofit Management

The **Alliance** (see the *Alliance* website above) is a professional association of individuals and organizations devoted to improving the management and governance capacity of nonprofits and to assist them in fulfilling their mission. The Alliance convenes a major annual conference, networks colleagues year-round online, and provides member discounts on books and other publications. Access to some services requires a membership fee.