DISTRICT TREASURERS' SEMINAR

Background Information-Non-profit Accounting:

Accounting for non-profits is very similar to project accounting. Revenues and expenses are tracked in greater detail than for-profit organizations. Non-profits generally detail information such as the source, purpose and where to allocate revenues and expenses in terms of various funds. Generally non-profits utilize a fund accounting approach where each revenue and expense is booked in the right fund, the right revenue or expense general ledger account and department. The main purpose of fund accounting is to show the flow of resources and how those resources have been spent based on certain restrictions such as donor requirements.

Generally Accepted Accounting Principles (GAAP) is an international convention of good accounting practices. It is based on the following core principles:

- **The business entity concept** provides that the accounting for an organization be kept separate from the personal affairs of its owner, or from any other business or organization. This means that the balance sheet of an organization must reflect the financial position of the organization alone.
- **The going concern concept** assumes that an organization will continue to operate, unless it is known that such is not the case. The values of the organization that is alive and well are straightforward.
- **The principle of conservatism** provides that accounting for an organization should be fair and reasonable. Accountants are required in their work to make evaluations and estimates, to deliver opinions, and to select procedures. They should do so in a way that neither overstates nor understates the affairs of the organization or the results of operation.
- **The objectivity principle** states that accounting will be recorded on the basis of objective evidence. Objective evidence means that different people looking at the evidence will arrive at the same values for the transaction. Simply put, this means that accounting entries will be based on fact and not on personal opinion or feelings.
- **The time period concept** provides that accounting take place over specific time periods known as fiscal periods. These fiscal periods are of equal length, and are used when measuring the financial progress of an organization.
- **The revenue recognition convention** provides that revenue be taken into the accounts (recognized) at the time the transaction is completed. Usually, this just means recording revenue when the bill for it is sent to the customer or a contribution is received from a donor.
- **The matching principle** is an extension of the revenue recognition convention. The matching principle states that each expense item related to revenue earned must be recorded in the same accounting period as the revenue it helped to earn. If this is not done, the financial statements will not measure the results of operations fairly.
- **The cost principle** states that the accounting for purchases must be at their cost price. This is the figure that appears on the source document for the transaction in almost all cases. There is no place for guesswork or wishful thinking when accounting for purchases.
- **The consistency principle** requires accountants to apply the same methods and procedures from period to period. When a method is changed from one period to another, it must be explained clearly on the financial statements.

- **The materiality principle** requires accountants to use generally accepted accounting principles except when to do so would be expensive or difficult, and where it makes no real difference if the rules are ignored. If a rule is temporarily ignored, the net income of the organization must not be significantly affected, nor should the reader's ability to judge the financial statements be impaired.
- **The full disclosure principle** states that any and all information that affects the full understanding of an organization's financial statements must be included in the form of accompanying notes. Examples of such items are outstanding lawsuits or tax disputes.

Accounting Policy & Procedures:

It is imperative that non-profit organizations follow policies and procedures. Just as in any other business, correct policy and procedures provide employees and others guidance on how to navigate the challenges that businesses face. One of the fundamental requirements of a sound and strong financial management system is for organizations to document their policies and procedures used in establishing and maintaining internal controls, accounting and reporting. This document is an important tool for clarifying roles, responsibilities and ensuring accurate financial data is used for decision making. The accounting policies and procedures manual will serve as a basic framework and will ensure:

- Consistent policies and procedures across the organization
- Compliance with accounting standards
- Assets are safeguarded
- Financial statements are produced that are accurate and reliable
- Job descriptions and responsibilities are well documented
- Finances are managed with responsible stewardship
- Proper communication for new personnel and existing employees
- Effective internal controls over accounting and financial reporting
- Promote operational efficiency and governance

***An example is available upon request**

Accounting Software:

Deciding whether or not to use accounting software is a personal preference. If you are not comfortable using computers, accounting software is not recommended because it does require a certain level of computer knowledge. Also, accounting software will not allow you to get out of understanding the basics of accounting and balancing a check book. In fact, accounting software requires just as much skill as doing it by hand. It is only as good as the information you put into it. Should you decide to use accounting software, be sure to shop around. There are many accounting packages on the market in many different price ranges. Find one you like that produces the information you need at a price you can afford.

Methods of Accounting (Accrual vs Cash Basis):

Accrual basis: The accrual basis of accounting is based on the accrual principal, under which revenue is recognized (recorded) when earned, and expenses are recognized when incurred. Totals of revenues and expenses are shown in the financial statements whether or not cash was received or paid out in that period. Accrual basis accounting conforms to the provision of generally accepted accounting principles (GAAP) in preparing financial statements for external users, and is employed by most companies except very small ones (which use cash basis accounting). With the accrual method, sometimes it is not easy to know when the sale or purchase has occurred. The key date is the job completion date. Income should not be recorded until the service is finished. Expenses should not be recorded until the service is completed or all goods have been received.

Cash basis: The cash basis of accounting records income when cash is received, and expenses when cash is paid out. Cash basis accounting does not conform with the provisions of GAAP and is not considered a good management tool because it leaves a time gap between recording the cause of the action (sale or purchase) and its result (payment or receipt of money). It is, however, simpler that the accrual basis of accounting and quite suitable for small organizations that transact business mainly in cash.

Chart of Accounts:

The chart of accounts is the backbone of a good accounting system. Basically, the chart of accounts is a list of categories used to group the organization's financial activities. Each account is assigned an identifying number. Accounts are presented in a specific order: assets, liabilities, net assets, income (revenue), expenses.

A numbering system is not absolutely necessary, but if you decide to utilize one the COA numbering system typically follows the following guidelines:
1000-1999 Assets
2000-2999 Liabilities
3000-3999 Net Assets
4000-4999 Revenue
5000-5999 Expenses
6000-6999 Expenses

When creating the balance sheet accounts, the most important parts are cash and investment accounts. Each bank account or investment account should have a separate account in the chart of accounts. This allows for easier reconciling.

***An example is available upon request**

Financial Statements:

The basic financial statements that are typically prepared by a non-profit entity include:

- **Statement of Financial Position (balance sheet**) - this statement summarizes the assets, liabilities, and net assets of the organization at a specified date.
- **Statement of Activity (profit and loss statement)** - this statement reports the organization's financial activity over a period of time. It shows income minus expenses, which results in either a profit or a loss.
- **Statement of cash flow**- this statement summarizes the resources that become available to the organization during the reporting period and the uses made of such resources.

***Examples are available upon request**

Budgets:

Purpose:

- The foundation from which all of your work will be carried out
- Allows you to establish benchmarks and gauge financial health
- Determines priorities

Steps in developing one:

- Establish your budget period
- Review financial performance for the prior period
- Set organizational goals for the budget period
- Estimate expenses
- Estimate anticipated revenue (be conservative)
- Plan for needed cash flow and development of cash reserves
- Adjust the budget to align expenses and revenue

Process for Approval: Your Executive Committee should be called upon to comment and approve your budget. Your budget should also be provided at quarterly meetings, along with comparisons to the prior month and/or quarter, and actual to budget variances.

Contribution Classifications:

Unrestricted: Contributions that are free from any external restrictions and available for general use.

Temporarily Restricted: If a non-profit receives a contribution that has a donor-imposed restriction (other than to be held in perpetuity), the amount is usually recorded as an asset and as temporarily restricted contribution revenue. Purpose restricted contributions consist of funds that are donor-restricted for use on a particular project (mission grants). Time-restricted contributions are funds that are donor-restricted for use in a certain time period. Mite contributions would be an example of temporarily restricted contributions.

Permanently Restricted: If a donor stipulates that the contribution must be held by the non-profit in perpetuity (forever, not to be spent), the amount is recorded as an asset and as permanently restricted contribution revenue. The most prevalent example is an endowment fund. Typically the organization is not able to use the principal but is able to use the investment earnings. The earnings on permanently restricted funds may be further restricted for use for a given purpose, thus resulting in temporarily restricted revenue.

Compilation vs Financial Review vs Audit:

Compilation: Compiled financial statements represent the most basic level of service provided by an independent accounting firm with respect to financial statements. In a compilation engagement, the accountant assists management in presenting financial information in the form of financial statements without obtaining or providing any assurance that there are no material modifications that should be made to the financial statements. There are no analytical or other testing procedures performed.

Financial Review: A financial review provides limited assurance on an organization's financial statements. During a review, inquiries and analytical procedures present a reasonable basis for expressing limited assurance that no material modifications to the financial statements are necessary; they are in conformity with generally accepted accounting principles (GAAP). This type of analysis is useful when the organization needs some assurance about their financial statements, but not the higher level of assurance provided by an audit.

Audit: An audit most commonly refers to an independent review of an organization's financial books. An audit must be prepared by a licensed independent certified public accountant (CPA). Once engaged, an auditor performs a series of selective tests that provide a basis for judging whether the financial reports can be relied upon. Auditors will examine, among other things, bank reconciliations, selected restricted donations, grant letters, journals, ledgers and board minutes. Based on the review of this information, the auditor issues a formal opinion about the accuracy of the financial reports. If you do undergo an audit, you will want to establish an audit committee. The audit committee is typically responsible for selecting (or approving selection of) an auditor, reviewing the auditor's outputs, and meeting with the auditor pre-and post- audit to address any issues or questions.

Record Retention:

Policy: A records retention policy sets guidelines for the length of time that various documents-ranging from contracts to employment agreements to vendor receipts- will be held in the files of an organization. The adoption of a records retention policy serves to notify employees, officers, and directors of the time periods for which documents should be maintained, and helps to guard against improper disposal or destruction of documents with the intent of obstructing an investigation.

A records retention policy should contain a list of document categories, along with the length of time (months or years) the organization should retain such documents. In addition, these policies should contain a provision that restricts employees, officers, and directors of the organization from destroying documents in anticipation of litigation.

The records retention policy should include guidelines for handling electronic files and voicemail. Electronic documents and voicemail messages have the same status as paper files in litigation-related cases.

Procedures: Guidelines should be established for file naming conventions that are adhered to by all individuals responsible for records retention.

***An example is available upon request**

Restricted Gifts Specific to Mission Grants:

Donations received that are 100% designated to a specific mission grant should be recorded in a separate income account that is specifically maintained for these types of donations. This revenue is to be used solely for grant purposes.

Donations:

Types of donations:

Cash- a donation given with cash, check, money order or credit card.

Quid pro quo- a donation in exchange for which the donor receives goods and/or services. Example: if a donor gives a charity $100 and in exchange receives an event ticket with a fair market value of $40, the donor has made a quid pro quo contribution. Only the amount in excess of the ticket price is tax-deductible ($60). When the total amount of the quid pro quo contribution exceeds $75, the charity must send a written acknowledgment.

In-Kind- a donation of goods instead of money. An acknowledgment should be sent to the donor which includes a description of the property donated.

Planned giving-gifts made through wills, bequests and trusts.

Timely and meaningful acknowledgments are essential to donor satisfaction and retention. They demonstrate a donor's generosity is appreciated and that the gift will advance the mission of your organization. Good acknowledgments affirm to the donor that they have made a worthwhile investment. They also set the stage for ongoing strategic communication about a donor's gift that will deepen the connection with your organization. Acknowledgments should be sent within 48 hours.

Tax Receipts:

A charitable donation receipt provides documentation to those who donate to your organization and serves as a record for tax purposes. Donations over $250 require a written receipt to the donor. A separate acknowledgment may be provided for each single contribution of $250 or more, or one acknowledgment, such as an annual summary. If the donation is less than $250, a tax receipt is not required by the IRS; but it is always a good idea to thank donors anyway.

Essential information to include on the receipt:

- Name of the organization
- A statement stating that the organization is a registered 501(c) (3)

  Sample tax statement: **FOR TAX PURPOSES:** The Lutheran Women's Missionary League is a 501(c)(3) nonprofit organization, EIN xx-xxxxxxx and acknowledges that no goods or services were provided to you in return for your contribution other than intangible, religious benefits.

- Date that the donation occurred
- Donor's name
- Type of contribution made (cash, goods, service)
- Value of the contribution
- If anything was received in exchange for the donation sample statement: "No goods or services were received in exchange for this gift".
- Name and signature of authorized representative of the organization

Donor acknowledgment letter:

The donor acknowledgment letter is one of the most important communication pieces for a non-profit organization. A well-crafted thank you letter is an important step to creating lifelong, loyal donors. The donor acknowledgment letter can be sent at the same time as the donation receipt or can be sent separately. Letters can be tailored to the specific donation given. Make the letters personal by addressing the donor by name in the greeting line. Show supporters-through photos, statistics, or compelling stories- how their gift is bringing about real change. Adding in a Bible verse also helps to create an emotional connection to the donor.

Investment Policy:

Any non-profit organization that invests assets should have an investment policy. This is a document that outlines your overall strategy for investing, your short and long-term goals and the process by which investment decisions are made. Two critical decisions should be made in regard to the investment policy: asset allocation (commonly referred to as diversification) and spending parameters. These decisions will provide insights into an organization's investment practices, its historical return on the investments, and its asset allocation.

Information that should be included in the Investment Policy Statement:

- Investment objectives of the organization
- Asset allocation strategy
- Performance benchmarks
- How endowment earnings or returns relate to spending policy
- The degree of risk permitted in the investment portfolio
- Portfolio rebalancing strategies and frequency of rebalancing
- Considerations relevant to the hiring, retaining and firing of investment managers
- The degree of liquidity required in the investment portfolio
- Frequency of investment policy statement review

***An example is available upon request**

Helpful Websites for Non-Profits:

https://www.councilofnonprofits.org/

https://www.boardsource.org/eweb/

http://www1.networkforgood.org/

http://www.idealist.org/info/Nonprofits

http://nonprofit.about.com/

http://www.blueavocado.org/

http://www.nonprofitexpert.com/

Please send requests for document examples to:

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