

Financial Management for Centers for Independent Living

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IL-NET

CIL-NET · SILC-NET

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The manual was extensively overhauled in 2016 to incorporate changes brought about by the consolidation of federal Office of Management and Budget (OMB) guidance on grantmaking, which replaced the OMB Circulars on the subject—sometimes referred to as Uniform Guidance or the “Super Circular” or 2 CFR 200. With the change of oversight of IL programs from the Rehabilitation Services Administration to Administration for Community Living, the specific reference for financial management for Health and Human Services grantees changed to 45 CFR 75. We gratefully acknowledge the team of experts who contributed substantially to bringing the material up to date: Tiffany Winters Kessler, Jennifer Segal, and Erin Auerbach of Brustein & Manasevit, PLLC; John Heveron, Jr. CPA, Heveron & Company, CPAs; and Paula L. McElwee, IL-NET Technical Assistance Coordinator.

Preface

Welcome to *Financial Management for Centers for Independent Living*. This course is designed to instruct center for independent living (CIL) directors, managers, fiscal staff, and board members on the critical importance and “know how” of sound fiscal management. The focus of these training materials is to outline effective financial management practices and suggest strategies for running a fiscally sound organization regardless of the adequacy of resources.

While a CIL may have a strong mission and core set of operating values, the absence of sound fiscal management and practices will ultimately force a center to close its doors. Many CILs, as well as other nonprofit organizations, are faced with reduced funding, increased public scrutiny, and an increased demand for services. Regular demands are being placed on nonprofit organizations by various funding sources and outside agencies for better accountability and operational detail. Now more than ever, CILs must practice and continue to strive toward sound and effective management strategies.

Effective financial management strategies and policies will not guarantee program and/or CIL success, or compliance, but are tools that help facilitate both. Processes such as budgeting and fiscal planning can ensure the continued growth and development of CILs.

We hope this course will teach you new concepts and practices, make you aware of what you don't know relative to financial management, and most importantly, inspire you to assess your financial management practices, make necessary changes, maintain solid practices, and forever appreciate the value of sound fiscal management.

Chapter One: Centers for Independent Living Governing Body

If you don't know where you're heading, you're probably gonna end up somewhere else.
Yogi Berra

Board of Directors: Overall Role in Financial Management

A board of directors governs nonprofit (not-for-profit) organizations. The board is often referred to as trustees of the public. In other words, boards have the primary responsibility of protecting and guiding the public interest of a particular nonprofit organization. The board of directors is the governing or policy-setting body that bears legal responsibility for the organization. It is ultimately responsible for every major decision an organization makes. Through its charter, bylaws, policies and other legal regulatory authority, the board of directors maintains full responsibility for the fiscal oversight, liability, and overall well-being of the organization. Boards usually involve themselves more in the area of financial activity rather than program operations, as it is not their role to oversee day-to-day operations and in many cases board members do not have expertise in program/service development and delivery. However, the board must maintain an active role in preserving not only the financial integrity but also the mission, values, and beliefs of the organization.

Generally speaking, boards have three governing functions: (1) preserve the integrity of the trust, (2) set policy, and (3) support and promote the organization (Burgess, 1993). While the board is not limited to these three functions, it is imperative that, at a minimum, each board member understands what is involved and his or her respective role and responsibility in each of these governing functions.

1. Preserve the Integrity of the Trust

This role includes both *overseeing the mission* and *preserving the organization's autonomy*.

Overseeing & Being True to the Mission: The board must make sure that the philosophical basis of the CIL concept is maintained throughout the center's programs, services, and daily operations. While the mission statement of CILs may vary, it is important to note that they were established by individuals with disabilities as an alternative to traditional service agencies. CILs challenge medical models of service and services delivered using a patronizing or "poor you" approach. The primary funding to Centers nationally specifies Independent Living philosophy as foundational to CILs,

Some of the unique characteristics or distinguishing traits of CILs as defined by Title VII of the Rehabilitation Act, as amended, include:

- Consumer Control—at every level of the organization: board governance, organization management, consumer service delivery, and decisions about consumer services accessed.

- Systems and Individual Advocacy— an overriding philosophy is that disability rights are human rights, and individuals with disabilities are full contributing members of society and should have equal access and equal opportunity in every facet of life.
- Services for All—no one who declares that he or she has a significant disability is denied services based on the type of disability. CILs promote cross-disability services and continually assess and respond to community need.

How does preserving the integrity of the trust relate to fiscal management?

The board of directors and the organization management must constantly apply the “does this decision support our mission?” test to all major financial decisions. The following questions may need to be asked:

- Does this Request for Proposals fit within the mission of our CIL?
- Does this contract or fee for service support our mission?
- Is the way we are budgeting or spending our dollars supporting our mission?
- Does our salary and benefit structure support our mission and beliefs?

2. Set Policy

This role involves making decisions about the overall operational framework of the organization, NOT management of the day-to-day operations. In most cases, the executive director will recommend policy changes or initiatives to the board for their approval.

How does setting policy relate to fiscal management?

Board members must formulate financial policies that ensure the organization’s stability and support its ability to accomplish its mission. These policies must be linked to the organization’s strategic mission. In addition, all policies must adhere to and be consistent with the regulatory guidelines set forth for CILs. Policy decisions relating to fiscal operations that may come before the board and require board approval and action may include some or all of the following:

- a) The annual operating budget, prior to the beginning of the new fiscal year
- b) Annual independent audit
- c) Fee for services rates
- d) Staff organizational and salary structure
- e) Executive director compensation
- f) Endowment decisions
- g) Fundraising events

- h) Dues-paying membership campaigns
- i) Purchase or sale of property, lease arrangements
- j) Banking and check signing agreements

Decisions and board recommendations regarding any of the above should be grounded in both research and in governing documents such as the bylaws, policies, and/or the mission of the organization.

3. Support and Promote the Organization

In addition to attending the board meetings and serving on board committees, board members have a responsibility to support and promote the organization in the community. At times, board members can be thought of as ambassadors for the organization. It is expected that board members will attend organization functions, i.e., events and fundraisers, support the organization financially, and provide professional support as needed, i.e., legal, accounting, banking, etc. Board members play a key role in creating and shaping the public image of the center.

How does supporting and promoting the CIL relate to fiscal management?

Board members' support (or in some cases lack of support) of fundraising events and any other fiscal campaigns or drives sets the stage for CIL staff and the community to participate and contribute. As CILs look to increase and diversify their funding, board-sponsored and supported fundraising becomes increasingly more critical. Strong and active board support and leadership increases a center's ability to raise money in the community: networking becomes easier and people are more likely to give to an organization with a solid reputation supported by an involved and committed board of directors.

Board of Directors: Structure and Committees

Ideally, the board of directors is organized and operated with a committee structure. This structure is advantageous for a couple of reasons. First, much of the "leg work" for board discussions and decisions can more efficiently be accomplished outside of the board meeting. Many boards have both *standing committees* and *ad hoc committees*.

Ad hoc committees are intended to be short-term and are formed for a very specific issue or project. Anyone can serve on an ad hoc committee, and it is not unusual to have non-board members on the committee. Examples of such committees are public relations, executive search, bylaws, and personnel policy handbook. These committees work on their specific project, and report directly to the full board, usually in the form of a motion to accept the committees' work.

Standing committees are long-term, meet regularly (usually meet at least once a month) and usually address ongoing issues and concerns. The most prevalent standing committees among CILs are as follows:

- Executive Committee – usually board officers. These members may make decisions that do not require full board approval (depending on the bylaws and policies) and are actively

involved in long-range planning. This committee often deals with issues that require immediate attention and/or are highly confidential or sensitive.

- Program Committee – can be anyone on the board. These members are familiar with the CIL’s programs and services. They address questions relating to program mandates, adding or deleting programs, and overall program development.
- Nominating Committee – can be anyone, board members or community members, but the chairperson should be a board member. It usually consists of individuals who thoroughly understand the board’s responsibility and functions. Its primary task is to recruit and nominate new board members. It may also be involved in interviewing the recruit before submitting the name to the board for consideration.
- Development Committee – can be anyone, board members or community members, with the chairperson always being a board member. It is ideal to have individuals with a marketing and/or development background on this committee. The main charge of this committee is to work with the appropriate staff in planning fundraising activities.
- Finance Committee – individuals on the board with a finance, business, or banking background, and should include the board treasurer. These members work closely with the CIL’s business office and the executive director on fiscal reporting and other fiscal matters. The chart in *Appendix A* gives a broad overview of some of the finance committee and staff functions relative to the CIL’s fiscal matters. One of the key roles of this committee is to review and recommend policies and procedures (including internal controls) to the board that reflect and meet the requirements of standard accounting practices.
- Audit Committee – The audit committee is responsible for hiring an auditor, reviewing the audit report, and presenting the report to the board. The audit committee may also have responsibility for monitoring adherence with the whistleblower and conflict of interest policies.

In smaller organizations, where the standing committees do not need to meet monthly, some of these (Program Committee and Nominating Committee typically) may be considered ad hoc committees for the purposes of indicating that they meet when something comes up, rather than monthly.

There are several reasons, in addition to contract compliance, why CILs should adopt internal control policies and procedures. Some of the most compelling reasons include accountability both to funder and donor, efficiency, community and board expectation, fraud prevention, and program/service sustainability.

CILs must safeguard ALL grant property, whether cash or other assets, and assure that it is used solely for the authorized purposes. One key to controlling financial management risks is the development and use of effective internal controls. Every CIL needs policies, procedures, and proper oversight to control the access and use of its fiscal resources. This includes having both general management and accounting procedures in place.¹

¹ See *IL-NET Sample Fiscal Policies and Procedures Handbook: A Set of Policies and Procedures with Annotations for Use in Training for Centers for Independent Living* at <http://www.ilru.org/il-net-sample-fiscal-policies-and-procedures-handbook>.

The board of directors through the finance committee, along with the CIL senior management team, must ensure that proper internal financial accounting policies are in place. The development of these policies and procedures needs to focus primarily on four areas: approval and authority, physical security, proper documentation, and regular checks and balances to allow for early detection of fraud or human error.

The board of directors should view this process of developing internal controls as a way to protect the CIL's assets and to assure continuation of programs and services.

Chapter Two: Accounting Basics and Regulations

While the board of directors maintains legal authority and responsibility for the CIL, the executive director is charged with overseeing and maintaining the day-to-day financial processes. This duty involves at least four critical components: (1) oversight and maintenance of all financial records and systems; (2) assurance of complete, timely, and accurate financial reports for the board and constituents; (3) protection of the CIL's assets, including both cash and real property; and (4) compliance with reporting requirements of funders, including federal, state, and local government.

CIL executive directors and managers do not need to be certified public accountants (CPAs); however, they do need to have a basic understanding of accounting practice and procedures. Given that sound fiscal management is the responsibility of every executive director, the more one understands the finances of the organization, the higher the likelihood of effective fiscal management.

This chapter provides an overview of basic nonprofit accounting terms, practices, and bookkeeping activities as well as a brief summary of the more relevant statutory regulations and guidelines. Many of these terms will be referred to throughout this training and will be discussed in much more detail in subsequent chapters.

It is critical that every level of the organization has a basic understanding of nonprofit accounting. This supports board members and staff in developing and working within budgets, reading financial statements, understanding contract obligations, and responding appropriately to funders. While the executive director is charged with seeing that the CIL's financial records and finances are maintained in an appropriate and legal manner, all members of the organization contribute to the financial success of the center through their understanding and management of the finances.

The following terms are not meant to represent a full glossary of nonprofit accounting terms and definitions. Rather, they are some of the more frequently used terms and basic building blocks of sound fiscal management.

Basic Nonprofit Terms and Activities

Account: Building block of financial statements. Each line on a balance sheet and activities statement is called an account. These accounts are a summary of detailed transactions. For example, the rental account, in a year-end activities statement, would be a summary of all the rent payments made during the year. Each account is assigned an *account number*.

Accrual Basis of Accounting: Recording revenues when they are earned rather than when you actually receive them. Expenses are recorded when you receive the related product or service. The accrual method gives a more accurate picture of the CIL's financial picture at any given moment. (See Cash Basis of Accounting for an alternative method.)

Adjusting Entries: Any accounting adjustment for items that are not routine transactions. These entries may include accrued interest or depreciation expenses. Adjusting entries are often made at

year-end to make final adjustments to your books. If you secure an audit of your financial statements, the auditor often makes these final adjustments as you close out the fiscal year.

Allocable Costs: A cost is allocable to the federal award if the goods or services involved are chargeable or assignable to the federal award in accordance with the relative benefit received. This means that the federal grant program derived a benefit in proportion to the funds charged to the program.² Typically direct and indirect costs are identified and an approved indirect cost rate or cost allocation plan guides how they are allocated.

Allowable Costs: Allowable costs are costs that are not otherwise prohibited from recovery by state law, regulation, uniform guidance or grant guidelines.³

Note: Allocable & Allowable does not always mean reimbursable.

Audit Opinion, Clean: An independent CPA's opinion that your financial statements are a fair presentation of the organization's finances according to generally accepted accounting principles.

Award: Grants, cooperative agreements, cost reimbursement contracts, and other contracts in which costs are used in pricing, administration, settlement, or payment. Typically, the CIL's income results from grant awards.

Capital Budget: Shows necessary expenses needed to develop and/or operate major pieces of equipment or property for the upcoming year.

Cash Basis of Accounting: Recognizing cash receipts when they are received and disbursements as expenses when they are paid. An organization can pick to work on a cash basis rather than an accrual basis.

Cognizant Federal Agency: The federal agency that generally provides the predominant amount of direct federal awards to the organization. Cognizance is to the primary funding source. For the CILs this is the Department of Health and Human Services, the Administration for Community Living, specifically Subchapter C grants given directly from ACL to the CIL.

Cost Objective: A program, function, activity, award, organizational subdivision, contract, or work unit where the CIL measures the cost separately. A cost objective may be a major function of the non-federal entity, a particular service or project, a federal award, or an indirect cost activity.⁴

Cost Sharing/Cost Matching: Some federal and other awards require that your organization provide a portion of funding for the program. This can be done with unrestricted monies that you have or with donated labor or certain other donated items.⁵

Depreciation Expense: The offset to an asset's (typically equipment) economic value over a period of time. This is estimated by allocating its cost over expected useful life.

² 45 C.F.R. § 75.2.

³ 45 C.F.R. § 75.2.

⁴ 45 C.F.R. § 75.2.

⁵ 45 C.F.R. §§ 75.2 and 75 Appendix III through Appendix VII and Appendix IX.

Direct Expense: Cost expenses that can be identified specifically with a particular cost objective.

Endowment: A gift or bequest usually in the form of cash, securities or other financial assets, which is invested to earn income. The principal is maintained while the investment income can be used.

Expenses: The cost of items or services you use to carry on activities or run your organization.

Federal Form 5500: A federal form that must be filed by organizations that have an employer-funded qualified retirement plan or an employee benefits plan. This form is intended to assure that employee benefit plans are operated and managed in accordance with certain prescribed standards and that participants and beneficiaries, and regulators, are provided access to information to protect the rights and benefits of participants and beneficiaries under the plan.

Fiscal Policies and Procedures Manual: A CIL document that details procedures for recording income, expenses, and other financial transactions, and for reconciliations and other controls. The manual, often developed by the chief financial officer (CFO), executive director, and board treasurer, assures consistency. The manual should be approved by the board. (The first footnote in Chapter 1 is a link to a sample fiscal policies and procedures manual which can be adapted by any CIL.)

Form 990: The annual federal tax return form that must be filed by most nonprofits, based on the nonprofit's fiscal year.

GAAP—Generally Accepted Accounting Principles: Accounting rules and principles used to prepare, present, and report financial statements. The basis of financial accounting and reflects federal financial accounting standards in accordance with the Accounting Standards Codification of the Financial Accounting Standards Board (FASB).

Indirect Costs: Costs that are incurred for common or organization-wide objectives and cannot be assigned to or readily identified with a specific cost objective. These include costs associated with general CIL fiscal management, board activities, legal and accounting expenses, management salaries, facilities rent and maintenance, and any other costs or tasks not specific to any one program, service or project.⁶ Each center identifies the specific direct and indirect costs in its chart of accounts, and applies an approved indirect cost rate plan or cost allocation plan to assure indirect costs are properly distributed among cost objectives.

Indirect Cost Rate: All Subchapter C-funded CILs with more than one cost objective, regardless of size, are required to obtain an approved Indirect Cost Rate unless they can allocate everything directly to each of their cost objectives (and can prove it, which is highly unlikely) or qualify for and request the 10% de minimis rate. The rate identifies indirect costs that they will be charging as an expense to the grant. More information about applying for an indirect cost rate can be found on ILRU's website.⁷

Internal Controls: Policies and procedures to protect the assets of the organization and to allow for proper record keeping, effectiveness and efficiency of operations, and compliance with

⁶45 C.F.R. § 75.2.

⁷ <http://www.ilru.org/training/how-prepare-indirect-cost-rate-proposal>

applicable laws and regulations. These controls also help to minimize employee theft, fraud, and mistakes.⁸

Net Income (or Loss): The difference between revenue and expenses during an accounting period: a month and/or a year. Nonprofits usually call this a surplus or an excess of support and revenue over expenses.

Non-federal entity: A state, local government, Indian tribe, institution of higher education (IHE), or nonprofit organization that carries out a federal award as a recipient or subrecipient.⁹

Notes To Financial Statements: Information or notes included in a financial statement that are relevant to a center's finances but not adequately explained in the statements. Notes also explain any major (usually over 10 percent) variances in budget and actual numbers.

Obligation: Orders placed for property and services, contracts and subawards made, and similar transactions during a given period that require payment by the non-federal entity during the same or a future period.¹⁰

Operating Budget/Annual Budget: This shows the planned revenue and expenses for the upcoming year.

Overhead Costs: Costs which support the entire organization, not just one program. Sometimes referred to as indirect costs, administrative costs, general and administrative, or general costs.

Pass-through entity: A non-federal entity that provides a federal award to a subrecipient entity to carry out part of a federal program.¹¹ *Note:* Recipients are responsible for managing and monitoring each project, program, subaward, function or activity supported by the award, including monitoring subawards to ensure subrecipients have met the audit requirements.¹²

Payable: A liability that results after goods or services have been received and not yet paid for.

Period of Performance: The time during which the non-federal entity may incur new obligations to carry out the work authorized under the federal award.¹³

Petty Cash: Cash available for small expenses that need to be paid immediately. This fund needs to be accounted for through a voucher system that records who spent the cash, what was purchased, and on what date.

Program Budget: The budget for a service or program that you provide to consumers. You will have multiple program budgets.

⁸ 45 C.F.R. §§ 75.275303.

⁹ 45 C.F.R. § 75.2.

¹⁰ 45 C.F.R. § 75.2.

¹¹ 45 C.F.R. § 75.2.

¹² 45 C.F.R. § 75.2.

¹³ 45 C.F.R. §§ 75.2, 75.210(2)(5) and 75.352(a)(1)(v).

Program Income: Income you receive from carrying on a program for which you receive federal or other funding. There are special rules about how this income can be used.¹⁴

Program Services: Those services and programs that directly benefit the consumer.

Reasonable Costs: Costs incurred with proper consideration of the circumstances prevailing at the time. A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision to incur the cost was made.¹⁵

Recipient: A non-federal entity that receives a federal award directly from a federal awarding agency (e.g., Department of Health and Human Services) to carry out an activity under a federal program.¹⁶

Revenue: Payments you receive or will receive for providing services.

SF-425: A federal financial report to cognizant agency that occurs in a specified time frame (usually quarterly or annually) and that confirms that expenses are recorded and the expenditures, disbursements, and cash receipts are for the purposes and intent set forth in the award documents.

Subaward: A federal award provided to a recipient organization (CIL) and with board of directors' approval, is awarded to another entity to carry out part of the federal award resulting in a subrecipient relationship. It does not include payments to a contractor or payments to an individual that is a beneficiary of a federal program. A subaward may be provided through any form of legal agreement, including an agreement that the pass-through entity considers a contract.¹⁷

Subrecipient: A non-federal entity that receives a subaward from a pass-through to carry out part of a federal program. This does not include an individual that is a beneficiary of such program. A subrecipient may also be a recipient of other federal awards from a federal awarding agency.¹⁸

Uniform Administrative Guidelines: UAG or 45 CFR 75, the HHS specific version of the Uniform Guidance.¹⁹

Uniform Guidance: A consolidation of federal Office of Management and Budget (OMB) guidance on grantmaking, which replaced the OMB Circulars on the subject. (Also referred to as Uniform Grant Guidance or the Super Circular" or 2 CFR 200.)

¹⁴ 45 C.F.R. §§ 75.2, 75.307, 75.407 and 35 U.S.C. 200-212 (applied to inventions made under federal awards.

¹⁵ 2 C.F.R. § 200.404.

¹⁶ 45 C.F.R. § 75.2.

¹⁷ 2 C.F.R. § 200.92.

¹⁸ 2 C.F.R. § 200.93.

¹⁹ UAG is available on line at https://www.ecfr.gov/cgi-bin/text-idx?node=pt45.1.75#se45.1.75_12

Nonprofit and For-Profit—Fiscal Differences?

Nonprofit or not-for-profit accounting follows many of the same rules and principles as for-profit accounting with a few notable differences. In a very simplified manner, one might describe five key differences as:

- Nonprofits exist to meet a social need, NOT to make money.²⁰
- Nonprofits are charged with accountability and stewardship of “public monies.”
- Nonprofits use their net proceeds to maintain, improve, and/or expand their operations.
- Nonprofits have a heightened sense of fiscal accountability, given governmental regulations and the need to be good stewards of both taxpayer and donor dollars.

In every aspect of nonprofit accounting, these key differences influence the way business is conducted.

Regulatory Requirements

Whenever the federal government awards money to carry out its legislative intentions, it does so with a great deal of regulation and guidance as to how that money is to be allocated, administered and accounted for. For CILs this includes Title VII Parts B and C of the Rehabilitation Act funding as well as any other federal funding.

In understanding these guidelines and regulations it is helpful to have a grasp of the agencies involved and their respective roles in the administrative and reporting processes. The four principal agents and their order of precedence are:

1. The Rehabilitation Act of 1973 (as amended by WIOA in 2014) (“the Act”);
2. Independent Living Regulations (found at 45 CFR 1329);
3. The Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards (Uniform Guidance) (2 C.F.R. Part 200) HHS Regulations (45 CFR Part 75 and 92); and
4. FASB (Financial Accounting Standards Board), 116, 117.

Order of Precedence

It is important to note that in following these regulations there is an order of precedence for both clarity and also in matters of discrepancy. For purposes of federal funding, if state law is stricter than federal law—in this case “the Act”—the state statute supersedes. Otherwise, “the Act”

²⁰ Although the purpose of a nonprofit is neither to generate income nor to share profits with stockholders as for-profits do, they are permitted to accumulate a fund balance or net assets (see a discussion on this point in Chapter 12). Good financial management is a key to increasing funds available to nonprofits. Increased funding expands the CIL’s service delivery capacity.

supersedes all, followed in order of authority by the IL Regulations, UG/UAG and finally FASB (see illustration below). GAAP should be used as the basis of all financial accounting.

A notable example highlights this:

- CIL fundraising—which Uniform Guidance²¹ disallows but “the Act” authorizes (section 725(b)(7)).

The Rehabilitation Act of 1973 (The Act) (as amended 1978, 1992, 1998, 2014)

“The Act,” as it is more commonly referred, is the landmark Congressional legislation that legally attempts to open the doors of equal rights to people living with disabilities in the United States. While critical for the social policy it developed, it was also essential to the IL movement in allocating finances through Title VII Subchapter B and Subchapter C funding for the creation of CILs and statewide independent living councils (SILCs) along with the program and services they sought to provide.

As such, all monies received from the federal government are subject to the authority of the United States Department of Health and Human Services and its regulations outlined and detailed in 2 CFR Part 200 (Uniform Guidance on financial requirements for all federal grants) and HHS specific requirements at 45 CFR Parts 74 (financial), 92 (non-discrimination) and 1329 (Independent Living).

Independent Living Regulations

The Act was passed in 1973, and was most recently reauthorized in 2014 with the passage of the Workforce Investment Opportunity Act (WIOA). Along with the reauthorization, authority for the Act was moved from the Department of Education to the Department of Health and Human Services.

Please Note:

- The CFR presents the official and complete text of federal agency regulations in an organized fashion (codification) in a single publication.
- The CFR is divided into 50 titles covering broad subject areas of federal regulations – Education being 34th and HHS being the 45th.
- There are separate sections for HHS financial regulations (45 CFR 75) and Independent Living regulations (45 CFR 1329) and both are applied to centers.
- Some requirements are stated in the Act itself, as amended, and not further clarified in regulations at this time.

²¹ 2 C.F.R. § 200.31.

Among the fiscal and administrative procedures spelled out specifically in either the Uniform Administrative Requirements or the Independent Living Regulations are:

- Retention requirements for keeping fiscal and program activity records (45 CFR 75 Parts 361, 364 and 365.)
- Definition and administrative processes for program income (45 CFR 75 Parts 307 and 407.)
- The coordination of federal and state funding (45 CFR Part 1329.2 and the Act Section 704(5)(g-k))
- State funds available to provide IL core services (34 CFR 361.35(a) (Innovation and Expansion funds through Vocational Rehabilitation))
- Conditions for cash or in-kind contributions to awards to grantees, subgrantees, or contractors (45 CFR 75.306)
- Financial assistance for training and technical assistance (45 CFR 1329.24)
- How an award is made to a new center (45 CFR 1329.22)
- The requirements for continuation funding (the Act Sec. 725)

Uniform Guidance

In addition to subjection to the Independent Living Regulations of 45 CFR 1329, when CILs accept Title VII Subchapter C funding they are also subject to the fiscal and administrative rules and regulations applicable to all federal grants and those specific to HHS grants. The Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards (Uniform Guidance or UG) applies to all federal awards. The UG is found in 2 CFR Part 200. The Uniform Administrative Requirements specific to HHS grantees are found in 45 CFR 75 and are divided into these parts:

- Subpart A: Acronyms and Definitions
- Subpart B: General Provisions
- Subpart C: Pre-Federal Award Requirements and Contents of Federal Awards
- Subpart D: Post-Award Requirements—includes Standards for Financial and Program Management, Property Standards, Procurement Standards, Performance and Financial Monitoring and Reporting, Subrecipient Monitoring and Management, Record Retention and Access, and Remedies for Noncompliance.
- Subpart E: Cost Principles—includes basic cost considerations, direct and indirect costs, and selected items of cost.
- Subpart F: Audit Requirements.
- There are also a number of Appendices that provide more information regarding this section of the Uniform Administrative Requirements.

FASB (Financial Accounting Standards Board)

Since 1973 the Financial Accounting Standards Board (FASB) has been the designated organization in the private sector for establishing standards of financial accounting. While such standards are critical to the efficient functioning of the economy, as investors, creditors, auditors, and others rely on credible, transparent, and comparable financial information, those factors also are true when it comes to nonprofits. Thus, it is wise for CIL directors and managers to know and apply them.

Simply put, the mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information.

U.S. generally accepted accounting principles have now been codified into an electronic format with 90 topics, each with its own subtopics. Topic 958 of the codification is about nonprofit organizations. It has several subtopics covering matters such as financial statements, property plant and equipment, liabilities, consolidations, leases and other topics.

Indirect Cost Rate

Prior to the 2014 reauthorization, all Subchapter C-funded CILs were required to have a cost allocation plan. Currently, HHS requires all Subchapter C-funded CILs with more than one cost objective, regardless of size, to obtain an approved Indirect Cost Rate unless they can allocate everything directly to each of their cost objectives (and can prove it, which is difficult). In some cases, the DSE is requiring a cost allocation plan for state funds, so the CIL may want to discuss this with their Project Officer in the Administration for Community Living/Independent Living Administration. If this does not seem feasible, the organization may qualify for and request the 10% de minimis rate.²²

Indirect costs are those costs that cannot be identified with a particular grant or project yet are common to all projects in an organization. Examples of indirect costs may include leadership and administrative salaries, board expenses, common space expenses, legal and insurance costs, and facility maintenance.

Establishing an Indirect Cost Rate

An indirect cost rate is a device for determining the proportion of indirect costs each program should bear. It is expressed as a ratio: indirect cost pool/direct costs. In determining an indirect cost rate, all costs must be treated consistently, meaning a cost may not be assigned to a federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the federal award as an indirect cost.²³ Further, all costs must be allowable under

²² Information about ICRs is available at <http://www.ilru.org/topics/cil-financial-management>, including An Introduction to the Requirements, How to Prepare an Indirect Cost Rate Proposal and Applying Your Indirect Cost Rate .

²³ 45 C.F.R. §§75.412-415 and in Appendices IV.

the UAR, the terms of the grant award, and any state-specific laws and policies. *See* Chapter 10 for more information on determining allowability of costs.

For a nonprofit organization that receives more than \$10 million in direct federal funding each year, a breakout of the indirect costs into two components is required: 1) Facilities and 2) Administration. “Facilities” is defined as depreciation on buildings, equipment and capital improvements, interest on debt associated with certain buildings, equipment and capital improvements, and operations and maintenance expenses. “Administration” is defined as general administration and general expenses, such as the director’s office, accounting, personnel, library expenses, and all other types of expenditures not listed specifically in one of the subcategories of “Facilities.”²⁴

Types of Indirect Cost Rates²⁵

1. **Provisional rate** or billing rate means a temporary indirect cost rate applicable to a specified period that is used for funding, interim reimbursement, and reporting indirect costs on awards pending the establishment of a final rate for the period.
2. **Final rate** means an indirect cost rate applicable to a specified past period that is based on the actual costs of the period. A final rate is not subject to adjustment. A final indirect cost rate is established after an organization’s actual costs are known, typically a fiscal year. Once established, a final indirect cost rate is used to adjust the indirect costs claimed. The use of provisional and final rates will likely result in final audited expenditures being higher or lower than those reported for awards, which are terminated during the organization’s fiscal year. A final rate may be issued as a provisional rate in the ensuing year, adjusted for anticipated changes in funding levels or costs.
3. **Predetermined rate** means an indirect cost rate, applicable to a specified current or future period, usually the organization’s fiscal year. The rate is based on an estimate of the costs to be incurred during the period. A predetermined rate is not subject to adjustment. A predetermined rate may be used on awards where there is reasonable assurance that the rate is not likely to exceed a rate based on the organization’s actual costs.
4. **Fixed Rates with carryforward** means an indirect cost rate that has the same characteristics as a predetermined rate, except that the difference between the estimated costs and actual costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period.
5. **De Minimis Rate** is an opportunity for first-time award recipients to receive an indirect cost rate of 10 percent of modified total direct costs if the entity never had a negotiated indirect cost rate.

²⁴ 45 C.F.R. § 75.415.

²⁵ See 2 C.F.R. Appendix IV, C.1; U.S. Department of Labor, A Guide for Indirect Cost Rate Determination (January 2015).

Determination of Indirect Cost Rates and Cost Allocation

Under the UAR, there are four methods for calculating indirect cost rates:²⁶

- **Simplified** – generally applied if the organization has only one major function, or where all of its major functions benefit from its indirect costs to approximately the same degree.
- **Multiple Allocation Base** – generally applied where an organization’s indirect costs benefit its major functions in varying degrees.
- **Direct Allocation Methods** – generally applied when an organization treats all costs as direct costs except general administration and general expenses.
- **Special Indirect Cost Rates** – generally applied when work under a federal program is conducted in an offsite location and the level of administrative support is different than for other programs.

Applying for an Indirect Cost Rate

Under the UAR, a nonprofit organization that has never received a negotiated indirect cost rate may elect to charge a *de minimis* rate of 10% of modified total direct costs (MTDC), which may be used indefinitely. If chosen, this method must be used consistently for all federal awards until the organization chooses to negotiate for a rate, which it may do at any time.²⁷ MTDC means all direct salaries and wages, applicable fringe benefits, materials and supplies, services travel, and up to the first \$25,000 of each subaward (regardless of the period of performance of the subawards under the award). MTDC excludes equipment, capital expenditures, charges for patient care, rental costs, tuition remission, scholarships and fellowships, participant support costs, and the portion of each subaward in excess of \$25,000. Other items may only be excluded when necessary to avoid a serious inequity in the distribution of indirect costs, and with the approval of the cognizant agency for indirect costs.²⁸

Subject to the approval of its cognizant agency for indirect costs, if an organization has a current federally negotiated indirect cost rate, it may apply for a one-time extension of the rates in that agreement for a period of up to four years. If an extension is granted, the organization may not request a rate review until the extension period ends. At the end of the four-year extension, it must re-apply to negotiate a rate. Subsequent one-time extensions (up to four years) are permitted if a renegotiation is completed between each extension request.²⁹

A nonprofit organization that has not previously established an indirect cost rate with a federal agency must submit its initial indirect cost proposal immediately after the organization is advised that a federal award will be made and, in no event, later than three months after the effective date of the federal award.

Subject to 2 C.F.R. § 200.414, an organization that has previously established indirect cost rates must submit a new indirect cost proposal to the cognizant agency for indirect costs within six

²⁶ These methods are explained in detail under 45 C.F.R. Appendix IV, B2-B5.

²⁷ 45 C.F.R. § 75.414(f).

²⁸ 2 C.F.R. § 200.68.

²⁹ 45 C.F.R. § 75.414(g).

months after the close of each fiscal year. However, the organization does have an option to request an extension of time to continue using its current indirect cost rate for up to four years. Organizations that previously had an indirect cost rate cannot elect the 10% *de minimis* rate.

Chapter Three: Business Office Structure

The hiring of staff and structure of the CIL business office are perhaps some of the most important areas for serious consideration by both the executive director and board of directors. In addition, the oversight of both staff and processes in this department are of critical importance.

As a new CIL or small CIL, it is common to have only one staff performing the majority of the business office functions. However, as the center grows in terms of the number of contracts and its overall budget, there will be an increasing need for more staff and a more structured and sophisticated business office. While we immediately look to hire more staff and buy more technology, we are often confronted with the reality of a budget that cannot keep pace with the much-needed administrative and support staff necessary to carry out effective and efficient fiscal management policies and procedures. For this reason we may need to consider alternative options for meeting our fiscal and contractual obligations.

The business office function within the nonprofit organization will depend upon a host of factors. These include considerations such as:

- Organization/budget size
- Number of staff
- Scope and complexity of services
- Number of funding sources
- Amount of administrative overhead

There are differing views on what the appropriate level of administrative overhead³⁰ should be for a nonprofit. The percentage level depends on several factors, including the size of the overall budget and the mission of the organization. Helpful discussions of the topic are available from Blue Avocado at <http://blueavocado.org/content/board-members-guide-nonprofit-overhead> and the Houston Chronicle at <http://smallbusiness.chron.com/much-can-nonprofit-legally-spend-overhead-72388.html>.

Within the overhead calculation, the business, accounting, or finance function (department) will be allocated. Organizations that are under \$3 million in annual revenue may find it difficult to achieve a “critical mass” in the business office that will allow for these efficiencies while meeting the day-to-day information and reporting needs of the organization. In this situation, often the business office will consist of a single bookkeeper. These are described as “full charge” bookkeepers that are responsible for almost all of the accounting, reporting, and business office functions. *See page 4 in IL-NET Sample Fiscal Policies and Procedures Handbook: A Set of Policies and Procedures with Annotations for Use in Training for Centers for Independent Living.*

³⁰ Administrative overhead is not precisely the same as indirect costs, although administrative overhead costs typically form the major portion of the indirect costs allocated across fund objectives.

The activities a bookkeeper will conduct would include such items as:

- Accounts receivable
- Accounts payable/check preparation
- Payroll
- Employee time and accruals
- Cost reports
- Rudimentary finance reports

Given the multiple functions of a single-person business office, it is difficult to assure segregation of duties and therefore internal controls. Several alternatives to an in-house business office exist for small organizations. Any of these options may serve as an alternative to the traditional center business office, depending on the needs of the organization.

Business Office Alternatives

Service Bureau

A service bureau is an accounting or bookkeeping company that performs this service for a host of small businesses. It provides the technical and clerical support necessary to perform a wide range of functions that can be contracted. This approach can also be an adjunct to staff capabilities within the organization. This outsourcing of functions can assure better segregation of activity (such as cash receipts and accounts receivable) while maintaining a smaller overhead due to limited funds.

Consultant

A CPA firm can be contracted for bookkeeping functions or more advanced functions, such as income statements, cost reporting or General Ledger (GL) account reconciliation. The CIL's independent auditor or a separate CPA firm could perform this.³¹ Contracting out bookkeeping usually requires an internal bookkeeper who compiles the information and supplies it to the CPA for data input and report generation. This relieves the CIL from some of the transactional responsibility while maintaining some level of control over information flow for management decision-making purposes. Costs for a consultant model can range from two or three thousand dollars upwards to \$20,000, depending on the consultant range of services and geographic location of the CIL. Urban organizations will typically incur greater costs.

³¹ New rules issued January 2013 require that auditors must identify any threat to their independence such as having any management or accounting responsibilities for the organization that they audit. In such cases, an auditor's independence would be considered impaired unless the CIL's management has the skill to, is willing to, and actually accepts responsibility for the results of those services.

Collaboration

Developing inter-organization collaborations is an excellent way to capitalize upon a larger organization's size and administrative capabilities while maintaining a low administrative overhead in the smaller organization. Purchasing the range of services that are not internal to the organization from another nonprofit can be very affordable and efficient. There are, however, careful considerations that should be evaluated before this option is implemented.

In looking for another organization to perform these functions, consider the history of the organization, its reputation in the community, familiarity with funding sources and contracts, stability of management, and cost. Determine, prior to engagement, the exact scope of services or "deliverables," their time frame, and alternate options if the other party fails to perform.

A written service agreement should be developed and approved by both organizations, either through the executive level or the governing bodies. Such an agreement should include the following provisions:

1. Term
2. Specific scope of service (deliverables)
3. Time frame for deliverables (e.g., monthly, quarterly)
4. Modification clauses
5. Cancellation clauses
6. Cost or consideration
7. Hold harmless clauses
8. Signature blocks

Administrative Service Organization

Another form of collaboration is to create an administrative service organization or ASO. This is a separate organization with the purpose of performing accounting and finance functions for a related group of organizations where by combining resources, a larger and more capable finance function can be created. This requires significant collaboration with other nonprofit organizations, and a willingness to "give up" some level of control by the executive director of each, since the accounting function is performed for multiple organizations outside the "four walls" of the organizations.

Considerations for the same factors outlined above apply to *all* the organizations involved. The inter-organization agreement should contain the same provisions identified above, in addition to information on governance of the ASO, its legal structure, and member organization costs. The development of such an entity will typically require legal counsel in the formation of some corporate structure that is decided upon by the constituent member organizations.

Each of these different approaches should be examined with the board's input prior to selection of any one particular approach, with the unique needs of the CIL kept in mind. Remember, the board has a legally mandated fiduciary responsibility in the oversight of the CIL. None of these options relieves them of that responsibility in governing the organization.

Personnel Considerations

For organizations that choose to perform the accounting function from within the organization, consideration should be given to the level of education and experience required by the staff that will perform this work.

For a small organization with revenues under \$300,000 to half a million dollars, a full charge bookkeeper may suffice. This is an individual with applied bookkeeping experience and/or some level of specialized education. The education will typically consist of a business degree or an associate degree in accounting from an accredited college. A degree from a business-training institute is often an appropriate alternative at this level. If this is the case, be sure it is from an accredited school. However, experience is usually the most important credential at this level. Finding someone who is familiar with nonprofit bookkeeping and accounting, has handled federal funds, and is familiar with fund accounting (accounting costs to specific grants) is preferred, although years of experience with a single type of employer can also bring “old habits” which may not necessarily translate to an effective working relationship. Be sure to evaluate the balance of experience in relation to the culture of the organization.

For organizations with half a million to one million dollars in revenue, a single employee *may* not be sufficient, depending on how diverse the organization’s funding and revenue are. If there are more than eight to ten funding sources, the contract management and cost report requirements in an organization this size would probably require additional staff in order to support this activity.

It is recommended that this individual should hold a minimum of an associate’s degree in accounting and complete some of the training specific to the federal income, such as training on the ILRU.org website. Experience with fund accounting will be an asset, but individuals meeting the educational requirement with two to three years accounting experience should provide adequate technical advice.

Organizations with revenues and expenses greater than \$1.5 million will be well advised to consider an accounting manager with a minimum of a bachelor’s degree in accounting, or several years’ experience plus applied understanding in nonprofit fund accounting.

In addition to experience and education requirements, there are several qualities that are highly desirable in any staff that will work in the business office. Confidentiality is a critical attribute. Accounting staff have virtually unlimited access to all organization information. Discretion is imperative in maintaining an effective and trustworthy department.

Prior experience in working with an auditor is another added benefit in selecting staff for these positions. This experience should include compiling the general ledger for audit, and accurate filing and retrieval of information such as income statements, canceled checks, bank statements, and cost reports.

An individual who sees him- or herself as a resource and service to management will have a positive impact on the organization. An orientation to timeliness of deadlines and attention to detail are also positive traits.

Lastly, do not underestimate the importance of communication and negotiation skills. An individual who can effectively communicate problems in a budget with a funding source is an invaluable asset to the organization and will save time and money in applying these skills.

An excellent resource for pricing the salary of accounting staff is the **Robert Half Annual Salary Guide for Accounting and Finance**. Robert Half is a national temporary personnel service agency that publishes annually a national survey of salaries for accounting and other professionals. Information is “weighted” for size of organization, type of industry, and geographic factors. This is an excellent way to measure the relative cost of the various positions identified above.

Chapter Four: Financial Management and Statements

Under the Uniform Administrative Requirements, the CIL's financial management systems, including records documenting compliance with federal statutes, regulations, and the terms and conditions of the federal award, must be sufficient to permit the preparation of reports required by general and program-specific terms and conditions. They must also permit the tracing of funds to a level of expenditures adequate to establish that such funds have been used according to the federal statutes, regulations, and the terms and conditions of the federal award.³²

The CIL's financial management system must provide for the following:

1. **Identification:** The CIL must identify, in its accounts, all federal awards received and expended and the federal programs under which they were received. Federal program and award identification must include, as applicable, the CFDA title and number, federal award identification number and year, name of the federal agency, and, if applicable, name of the pass-through entity.
2. **Financial Reporting:** Accurate, current, and complete disclosure of the financial results of each federal award or program must be made in accordance with the financial reporting requirements set forth in 45 C.F.R. §§ 75.341 through 343. *See also* recommendations for financial statements section below.
3. **Accounting Records:** The CIL must maintain records which adequately identify the source and application of funds provided for federally assisted activities. These records must contain information pertaining to federal awards, authorizations, obligations, unobligated balances, assets, expenditures, income and interest, and be supported by source documentation.
4. **Internal Controls:** Effective control and accountability must be maintained for all funds, real and personal property, and other assets. All such property must be adequately safeguarded and used solely for authorized purposes.
5. **Budget Control:** Actual expenditures or outlays must be compared with budgeted amounts for each federal award.
6. **Cash Management:** The CIL must maintain written procedures to implement the cash management requirements found in UG at 2 C.F.R. §200.305 and 45.C.F.R. 75.302(4).
7. **Allowable Costs:** The CIL must maintain written procedures for determining allowability of costs in accordance with UAR at 45 C.F.R. Part 75, Subpart E, specifically 405, 408, 409 and 410.

³² 45 C.F.R. §§ 75.302 and 361.

Financial Statements

Financial statements, or what are commonly referred to as “monthly statements” and “income statements,” must conform to GAAP standards and must provide for accurate, current, and complete disclosure of the financial results of the terms of each award. Financial statements and reports are necessary to monitor the actual expenses and revenue as they are posted to the general ledger. These statements should conform to the format of the CIL budget, and include comparison to the year-to-date (YTD) actual and budgeted income and expenses on a line-by-line basis.

The board of directors should require that they receive accurate and timely financial statements. CIL administration should require that board members review financial statements and come to meetings prepared to comment on them. The frequency of the financial statements is a decision made by the board in concert with the executive director and the controller. Organizations typically review financials monthly, but it is not uncommon to do this on a quarterly basis. Another option to the presentation of financials to the board is to have the center’s contract accountant firm present the financials on a quarterly basis. (This is not the independent accountant who performs the year-end audit.) If the organization has an active finance committee of the board, that group might review the monthly statements, with the full board reviewing quarterly. It is necessary that the board be aware of and proactive regarding financial statements and especially any trends or evidence of potential funding shortfalls.

In addition to the board’s request for financial statements, other individuals and/or entities may request and have the right to review financials. This group may include:

- Funders, contract compliance
- Contributors
- Financial institutions
- Creditors
- Government regulatory bodies
- Auditors
- Any other beneficiary of the center

Review/Analysis

Generally speaking, the center fiscal office will prepare the monthly financial statements, review them with the executive director and present them to the finance committee for further analysis and questions. The board treasurer then presents the statements to the full board at the next board meeting. Typically, the controller will attend the finance meeting and the board meeting to address any specific questions or concerns that only he/she may know, given the nature of the position.

While it is not expected that everyone on the finance committee or on the board is a financial wizard, it is expected that these individuals will take the initiative to ask common sense kinds of questions such as:

- Does anything look unusual this month?
- Were there any significant adjustments to the books this month?
- Does anything look off budget?
- Are there any unusual expenses?
- How is our cash flow to date?
- Is there anything coming up that we need to prepare for?
- Where are we in terms of our contract obligations?

(This last question is an important one and is often overlooked by the board.)

Analysis of contract obligations can tell if the organization is underspending or overspending its contract budgets. The time to look at this is early in the contract period, at least by the first quarter. A system should be in place to measure program spending against contract budgets. This system should be monitored by both the fiscal manager and the program managers. If this is not in place, the center runs the risk of either returning unspent dollars or running out of dollars prior to the end of the contract.

Notes to Financial Statements

Any significant variance of the information contained in the financial statements on any expense or revenue item should be identified and explained. This explanation or note is often referred to as a “note to financial statements” and is found in the body of the monthly financials. This establishes an ongoing understanding as to the reasons for an unanticipated surplus or deficit.

EXAMPLE: Personnel costs were 10 percent higher in May and June due to overtime on our fundraising project and a maternity leave in the employment program.

In reviewing financial statements, keep in mind that these are historical. This sets a framework for understanding the organization’s financial needs in supporting programming and ultimately your mission. However, they are “after-the-fact” information. If upon review, one finds changes in either expenses or revenue that negatively impact operations, a reclassification of expenses in the next month may reverse this negative impact.

EXAMPLE: A charitable gift that is restricted and is donated at year’s end may, when applied to a specific contract, reduce a government contract funding allocation. Asking the donor to “defer” the gift into the next year will allow the organization to maximize both revenue sources.

Reviewing financial statements regularly is the key to sound nonprofit fiscal management. This helps to insure financial viability and ultimately services to your consumers. Another key aspect of fiscal management is the development and analysis of financial projections. This will be discussed in a later chapter.

General Ledger

The General Ledger (GL) requires consideration in its initial setup in order to generate financial reports, which are compiled in a format that facilitates ease of use by management for review and analysis. If you are initially setting up your accounts on a software package and do not have staff educated and experienced in this process, you can seek assistance from your treasurer, finance committee members, or CPA. A properly designed accounting system will produce meaningful financial information for management and the board.³³

Accounts Payable Coding Guidelines

One of the most important concepts regarding financial statements is the concept “garbage in, garbage out.” In other words, the statements are only as reliable as the information put in the system to generate the statements.

1. Coding of an invoice for payment ensures that the expense is categorized to the correct general ledger account classification and program cost center. These two pieces of information must be known to determine the code number.
2. Invoices for services or materials can be a direct expense of one program, a shared invoice of direct expenses for several or all programs, or an allocated expense. When an expense is allocated, the allocation will be based on the organization’s indirect cost rate allocation plan.
3. Payments for certain designated items are made in the absence of an invoice, for example, lease/rent agreements, consumer personal needs allowances, petty cash payment, etc. However, other records are maintained. In the case of lease/rent agreements a list of payment to landlords is kept current by the signed lease agreements executed by the organization.

Monthly Statements: The monthly budget and a grant management report are two examples of statements that track spending of a particular grant and/or contract. The important piece in each of these statements is the tracking of spending against the actual budget. Again, this practice will help to prevent underspending or overspending of a contract. Stated variances helps draw attention to any problem areas.

Organization Budget: This report provides an overview of the overall organization budget broken down by specific programs. This is often helpful for the board to compare to actual results as the fiscal year moves forward.

³³ The national center for charitable statistics provides a unified chart of accounts for nonprofits with some additional tools that will allow you to automatically import this information into certain accounting systems. Techsoup.org also provides guidance on setting up a nonprofit chart of accounts.

Statement of Operations (or Statement of Activity): This statement summarizes the income and the expenses of the center over a period of time. This kind of report should always provide a comparison to budget. If there are significant variances (a rule of thumb is 10 percent), these should be explained in a narrative or footnote.

Additional reports and statements may be included, depending on the needs of the organization. The format of the statements also may vary, depending on the accounting software and the needs of the organization. Accuracy and timeliness are the two critical features with any organization financial report.

Balance Sheet: This summarizes the assets, liabilities, and net assets of the center.

Annual Financial Reports

Annual financial reports take a look at the organization over the entire fiscal year, showing support, revenue and expenses for the year and year-end account balances.

If the financial statements are audited or reviewed by an independent CPA, the annual reports include but are not limited to

- Independent CPAs' report
- Balance sheet or statement of financial position
- Statement of activities
- Statement of functional expenses
- Statement of cash flows
- Notes to financial statements

In addition to the financial reports, management will normally receive a management letter from the independent CPAs. It is important to address any recommendations in these letters, usually by a written response approved by the board.

Chapter Five: Cash Flow & Management

Cash vs. Accrual

In addition to the other policy questions the board must examine, the issue of the *method* of accounting must be determined. Occasionally, this is determined by the funding source, although the board, on recommendation of the finance committee, should establish this policy based on management's recommendation.

The *cash method* of accounting reflects cash receipts and disbursements when payment is made or funds are received. The *accrual method* of accounting reflects income when it is earned and expenses when the organization receives the service or product. As an example, the cash method would record a donation when the check or cash is received. Accrual method would record the transaction when the donation is committed or promised (e.g., a funding letter by a foundation). For purposes of accuracy and to depict the most current financial status of the organization, many nonprofits use the accrual method. The cash method can be misleading because, if an organization is running short on funds and not paying its bills, those expenses won't be included in the financial statements. However, the board, based upon your funding source requirements, should decide this.

Banking

Important and often overlooked needs in the nonprofit are bank products. Most banks, including small local, regional, and national entities, encourage their employees to participate in local community organizations, particularly nonprofit charitable organizations. Having a board member with a banking background brings important technical expertise to the organization as well as establishing a valuable link to the community. Also, utilizing the expertise of the bank professional can add dimension to the board discussion regarding segregation of duties, internal controls, and generally accepted business practices.

With respect to bank products, these are typically viewed as including checking and payroll accounts. Such products as depository accounts (federal and state withholding), operating and reserve accounts, lines of credit for cash flow management and other products should be considered. Additional products include short- and long-term investment accounts, capital leasing programs, business loans, and cash management programs, including online banking and daily checking account reconciliation services. Because these products and their fees (cost) vary greatly, it is important to act through your finance committee in determining the best array of products that meets the unique needs of your organization.

Cash Management

Cash management simply means managing the cash inflow and outflow in the organization. While it is a simple concept, it can be one of the most difficult things to manage. The inflow and outflow of cash depends on factors like:

- Timely submission of contract reports

- Consistent oversight of cash expected and received—phone calls if necessary
- Updating of cash flow reports
- Timing of large expenditures
- Timing of personnel/payroll changes, i.e., bonuses, salary increases, etc.
- State Budget passage or delays

If oversight and management are lacking in any of the above areas, the organization may experience serious cash flow problems.

The UG requires CILs comply with applicable methods and procedures for payment that minimize the time elapsing between the transfer of funds and disbursement by the CIL in accordance with the Cash Management Improvement Act at 31 CFR Part 205. Federal agencies and pass-through entities must require recipients to use only OMB-approved standard government-wide information collection requests to request payment.

Approved methods of payment generally include:

- **Reimbursements:** Using this method, the CIL initially charges federal grant expenditures to nonfederal funds and then seeks reimbursement from the federal awarding agency. The federal awarding agency must make payment within 30 calendar days after receipt of the billing.

Under certain circumstances the CIL may be required to use this method of payment.³⁴ Consistent with state and federal requirements, it is necessary for the CIL to maintain source documentation supporting the federal expenditures (invoices, time sheets, payroll stubs, etc.) and to make such documentation available for the Department of Health and Human Services for review upon request.

Unlike the advance payment method (described below), reimbursements of actual expenditures do not require interest calculations.

- **Advances:** Using this method, the CIL receives advance payments of federal grant funds. The CIL must maintain: 1) written procedures that minimize the time elapsing between the transfer of funds and their disbursement; and 2) a financial management system that meets the standards for fund control and accountability. See financial management section above.

Any advance payments must be limited to the minimum amounts needed and be timed to be in accordance with the CIL's actual, immediate cash requirements for carrying out the purpose of the federal program. Further, to the extent possible, the CIL must disburse funds available from program incomes (including repayments to a revolving fund), rebates, refunds, contract settlements, audit recoveries, and interest earned on such funds before requesting additional cash payments.

³⁴ See 45 C.F.R. § 75.302(b) and 305(b)(3).

The CIL must hold federal advance payments in an interest-bearing account, unless an allowable exception applies, and may retain up to \$500 of interest earned per year. Any additional interest earned must be remitted annually to the Department of Health and Human Services Payment Management System (PMS) in accordance with 45 C.F.R. § 75.305(b)(9).

Timely Obligation of Funds:

The CIL must ensure that only obligations made during the period of performance and approved pre-award costs are charged to the federal grant. Any funds not obligated by the end of the period of performance are said to lapse and must be returned to the awarding agency. Pursuant to 45 C.F.R. § 75.308(d), to the extent it is permitted by the federal awarding agency, the CIL may receive an extension of the period of performance.

Pre-award Costs

Pre-award costs are obligations incurred prior to the start date of a federal award.³⁵ Pre-award costs may be allowable if:

1. The obligation was incurred directly pursuant to the negotiation and in anticipation of the federal award;
2. The cost is necessary for the efficient and timely performance of the scope of work of the federal award;
3. The cost would have been allowable had it been incurred after the start date of the award; and
4. The CIL has received written approval from the federal awarding agency to incur such costs.

Line of Credit

One helpful product to obtain from a bank may be a *line of credit* (LOC). This is either a secured (collateral is pledged or the “line” remains open) or unsecured (time limited promissory notes or 90-day notes) loan. The purpose is to allow for a continuation of payments for expenses incurred by the organization when cash flow is interrupted or cash needed *temporarily* exceeds the available cash. It is important to establish a line of credit **before** you need it. You will need a board resolution to do this and appropriate board and organization signatures before you can access the LOC.

Typically, LOCs are determined by the organization’s size, operating budget, and methods of receiving revenue. Your bank and treasurer should assist in establishing the type, amount, and cost of a LOC. Remember, many contracts do not allow short-term interest as an allowable or reimbursable expense. Therefore, LOC borrowing should be kept to an absolute minimum, and all borrowing and payments should be routinely reported to the treasurer, finance committee, or the board in order for them to meet their fiduciary responsibility. Typically, banks charge an annual fee to establish and use a line of credit. This fee is negotiable. It is common for banks to waive the

³⁵ See 45 C.F.R. §§ 75.458 and 75.308(d).

fee if you establish the line of credit at the bank where you have all or the majority of your center's accounts.

An example of when you may need to use your line of credit would be when a state or federal award is late due to the failure of government to pass a timely budget. Obligations such as payroll, rent, and federal withholding all must continue to be made in a timely manner. When cash received is less than cash outlay, this requires a *short-term* infusion of cash.

Many LOCs issued by banks require that the line be “retired” or dormant for a minimum period of 30 days annually. Be sure to not rely upon LOCs to the point that the line is in constant use. This increases non-reimbursed business expenses and jeopardizes your business relationship with the bank.

Secured LOC

A *secured LOC* is a predetermined loan amount that the organization can access at will, which is secured by assets of the organization or some other collateral. This can also include a personal guarantee by the board (collectively or individually), although **this is not** a preferred method. If an organization has poor credit or insufficient assets to pledge against a secured LOC, the bank may require such guarantees. A more preferable alternative would be a 90-day promissory note whereby a receivable (identified amount of cash that can be used as collateral) is used to secure the short-term loan while cash flow is interrupted.

Unsecured LOC

An *unsecured LOC* is a predetermined loan amount that the organization can access at will, but is not secured with assets of the organization. In effect, any loans are pledged for payments based upon the financial strength or ability of the organization to repay them and the accounts receivable, which are due to the organization.

Often, these are preferable as nonprofits typically do not have significant assets for a bank to lay claim in the event of a default of payment (e.g., inventory, capital equipment, real property, etc.).

Uniform Commercial Credit Filings or UCCs

UCCs or Uniform Commercial Credit are filings made by the bank in any event of a loan and at the time LOCs are granted. This filing is made with the Secretary of State and filed in the county in which the nonprofit is located. This filing at the state and county level “perfects” the lien against the pledged asset. UCCs identify the assets of the organization, which are then pledged against any outstanding debt in the event of default, bankruptcy, or closure (failing). When UCCs are required it is good practice to include board officers' signatures on the filing statements. This is customary practice, and one that should not be overlooked.

Cash Flow Statements

One of the most critical mistakes a CIL executive director can make is to underestimate the importance of cash flow. In short, what you as a leader want to ensure is that your organization has

enough money to pay its bills month-to-month regardless of what its annual budget and billings suggest. While there are many strategies (discussed throughout this and other chapters) to help safeguard against an unforeseen cash flow problem, it's never good practice to place your faith in others' paying their bills on time. Rather, you may want to budget in the event that they don't.

The executive director should expect to receive monthly cash flow statement reports from the director of finance. This is not only an important internal control but also a good way for the director to receive notice if the organization is anticipating any cash flow problems in the near future. Ideally, the cash flow report should reflect the cash flow projections for at least three months out. This projection of cash needs and availability allows time for any adjustments that need to be made to cash inflow or outflow.

Chapter Six: Procurement

Under the Uniform Administrative Requirements, CILs must develop written procurement procedures. The following describes the five procurement methods permitted under federal law at 45 C.F.R. § 75.327 through 329. While the federal rules provide a basic structure for each procurement method, it is important for each CIL to have documented procurement policies that provide detail on the process by which all purchases are made.

Purchases up to \$3,500 (Micro-Purchases)

Micro-purchase means a purchase of supplies or services using simplified acquisition procedures, the aggregate amount of which does not exceed \$3,500. The micro-purchase method is used in order to expedite the completion of its lowest-dollar small purchase transactions and minimize the associated administrative burden and cost. Procurement by micro-purchase is the acquisition of supplies or services, the annual aggregate dollar amount of which does not exceed the micro-purchase threshold.

To the extent practicable, the CIL must distribute micro-purchases equitably among qualified suppliers. Micro-purchases may be awarded without soliciting competitive quotations if the CIL considers the price to be reasonable; however, it is important for the CIL to maintain evidence of this reasonableness in the records of all micro-purchases.

Purchases between \$3,500 and \$150,000 (Small Purchase Procedures)

Small purchase procedures are those relatively simple and informal procurement methods for securing services, supplies, or other property that exceed \$3,500 but do not cost more than \$150,000. If small purchase procedures are used, price or rate quotations must be obtained from an adequate number of qualified sources.

Purchases over \$150,000

Sealed Bids (Formal Advertising): For purchases over \$150,000, bids must be publicly solicited and a firm fixed price contract (lump sum or unit price) is awarded to the responsible bidder whose bid, conforming with all the material terms and conditions of the invitation for bids, is the lowest in price. The sealed bid method is the preferred method for procuring construction, if the following conditions apply:

- A complete, adequate, and realistic specification or purchase description is available;
- Two or more responsible bidders are willing and able to compete effectively for the business; and
- The procurement lends itself to a firm fixed price contract and the selection of the successful bidder can be made principally on the basis of price.

If sealed bids are used, the following requirements apply:

- Bids must be publicly advertised and solicited from an adequate number of known suppliers, providing them sufficient response time prior to the date set for opening the bids, for state, local, and tribal governments;
- The invitation for bids, which will include any specifications and pertinent attachments, must define the items or services in order for the bidder to properly respond;
- All bids will be opened at the time and place prescribed in the invitation for bids, and for local and tribal governments, the bids must be opened publicly; and
- A firm fixed-price contract award must be made in writing to the lowest responsive and responsible bidder.

Where specified in bidding documents, factors such as discounts, transportation cost, and life cycle costs must be considered in determining which bid is lowest. Payment discounts may only be used to determine the low bid when prior experience indicates that such discounts are usually taken advantage of. Any or all bids may be rejected if there is a sound documented reason.

Competitive Proposals: The technique of competitive proposals is normally conducted with more than one source submitting an offer, and either a fixed-price or cost-reimbursement type contract is awarded. It is generally used when conditions are not appropriate for the use of sealed bids. If this method is used, the following requirements apply:

- Requests for proposals must be publicized and identify all evaluation factors and their relative importance. Any response to publicized requests for proposals must be considered to the maximum extent practical;
- Proposals must be solicited from an adequate number of qualified sources; and
- Contracts must be awarded to the responsible firm whose proposal is most advantageous to the program, with price and other factors considered.

The CIL may use competitive proposal procedures for qualifications-based procurement of architectural/engineering (A/E) professional services whereby competitors' qualifications are evaluated and the most qualified competitor is selected, subject to negotiation of fair and reasonable compensation. The method, where price is not used as a selection factor, can only be used in procurement of A/E professional services. It cannot be used to purchase other types of services, though A/E firms are a potential source to perform the proposed effort.

Under the UAG, it is necessary for all CILs to have written methods for conducting technical evaluations of the proposals received and for selecting recipients. The method should address, among other issues, the factors considered in the evaluation, what position/office performs the evaluation, the number of evaluations performed, the timeframe for conducting any evaluations and the selection of a vendor, and whether another position reviews the evaluation.

Contract/Price Analysis: The CIL must perform a cost or price analysis in connection with every procurement action in excess of \$150,000, including contract modifications.³⁶ A cost analysis generally means evaluating the separate cost elements that make up the total price, while a price analysis means evaluating the total price, without looking at the individual cost elements.

The method and degree of analysis is dependent on the facts surrounding the particular procurement situation; however, the CIL must have a process in place to come to an independent estimate prior to receiving bids or proposals.³⁷ When performing a cost analysis, it is necessary to negotiate profit as a separate element of the price. To establish a fair and reasonable profit, consideration must be given to the complexity of the work to be performed, the risk borne by the contractor, the contractor's investment, the amount of subcontracting, the quality of its record of past performance, and industry profit rates in the surrounding geographical area for similar work.³⁸

Noncompetitive Proposals (Sole Sourcing)

Procurement by noncompetitive proposals is procurement through solicitation of a proposal from only one source and may be used only when one or more of the following circumstances apply:

- The item is available only from a single source;
- The public exigency or emergency for the requirement will not permit a delay resulting from competitive solicitation;
- The federal awarding agency expressly authorizes noncompetitive proposals in response to a written request from the CIL; or
- After solicitation of a number of sources, competition is determined inadequate.

It is important for the CIL to have in place a written policy for how and when it may use a noncompetitive proposal. This should include who is required to provide approval and what documentation must be maintained to justify sole sourcing.

A cost or price analysis must be performed for noncompetitive proposals when the price exceeds \$150,000.

Full and Open Competition

All procurement transactions must be conducted in a manner providing full and open competition consistent with 45 C.F.R §75.328 and 329. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, or invitations for bids or requests for proposals must be excluded from competing for such procurements. Some of the situations considered to be restrictive of competition include but are not limited to:

³⁶ 45 C.F.R. § 75.327.

³⁷ 45 C.F.R. § 75.332.

³⁸ 45 C.F.R. § 75.332.

- Placing unreasonable requirements on firms in order for them to qualify to do business.
- Requiring unnecessary experience and excessive bonding.
- Noncompetitive pricing practices between firms or between affiliated companies.
- Noncompetitive contracts to consultants that are on retainer contracts.
- Organizational conflicts of interest.
- Specifying only a “brand name” product instead of allowing an “equal” product to be offered and describing the performance or other relevant requirements of the procurement.
- Any arbitrary action in the procurement process.

Geographical Preferences Prohibited

The CIL must conduct procurements in a manner that prohibits the use of statutorily or administratively imposed state, local, or tribal geographical preferences in the evaluation of bids or proposals, except in those cases where applicable federal statutes expressly mandate or encourage geographic preference. When contracting for A/E services, geographic location may be a selection criterion provided its application leaves an appropriate number of qualified firms, given the nature and size of the project, to compete for the contract.

Prequalified Lists

The CIL must ensure that all prequalified lists of persons, firms, or products that are used in acquiring goods and services are current and include enough qualified sources to ensure maximum open and free competition. Also, it is important not to preclude potential bidders from qualifying during the solicitation period.

Solicitation Language

The CIL must ensure that all solicitations incorporate a clear and accurate description of the technical requirements for the material, product, or service to be procured. Such description must not, in competitive procurements, contain features that unduly restrict competition. The description may include a statement of the qualitative nature of the material, product or service to be procured and, when necessary, must set forth those minimum essential characteristics and standards to which it must conform if it is to satisfy its intended use. Detailed product specifications should be avoided if at all possible.

When it is impractical or uneconomical to make a clear and accurate description of the technical requirements, a “brand name or equivalent” description may be used as a means to define the performance or other salient requirements of procurement. The specific features of the named

brand that must be met by offers must be clearly stated, and identify all requirements that the offers must fulfill and all other factors to be used in evaluating bids or proposals.³⁹

Federal Procurement System Standards

Avoiding Acquisition of Unnecessary or Duplicative Items

CILs must avoid the acquisition of unnecessary or duplicative items. It is important to consider consolidating or breaking out procurements to obtain a more economical purchase. And, where appropriate, an analysis must be made of leases versus purchase alternatives, and other appropriate analysis to determine the most economical approach.

These considerations are a necessary part of the process to determine the allowability of each purchase made with federal funds.

Use of Federal Excess and Surplus Property

CILs should consider the use of federal excess and surplus property in lieu of purchasing new equipment and property whenever such use is feasible and reduces project costs.

Debarment and Suspension

CILs must award contracts only to responsible contractors possessing the ability to perform successfully under the terms and conditions of a proposed procurement. Consideration will be given to such matters as contractor integrity, compliance with public policy, record of past performance, and financial and technical resources.

CILs may not contract with or award subgrants to any person or company who is debarred or suspended. It is important that the CIL has a process in place to check for excluded parties at the System for Award Management website before any procurement transaction. This list is located at: <http://www.sam.gov/>.

Maintenance of Procurement Records

CILs must maintain records sufficient to detail the history of all procurements. These records should include, but are not necessarily limited to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, the basis for the contract price (including a cost or price analysis), and verification that the contractor is not suspended or debarred.

Time and Materials Contracts

CILs may use a time and materials type contract only (1) after a determination that no other contract is suitable; and (2) if the contract includes a ceiling price that the contractor exceeds at its

³⁹ 45 CFR 75.327(j).

own risk. Time-and-materials type contract means a contract whose cost to the CIL is the sum of: the actual costs of materials and direct labor hours charged at fixed hourly rates that reflect wages, general and administrative expenses, and profit.

Since this formula generates an open-ended contract price, a time-and-materials contract provides no positive profit incentive to the contractor for cost control or labor efficiency. Therefore, each contract must set a ceiling price that the contractor exceeds at its own risk. Further, the CIL must assert a high degree of oversight in order to obtain reasonable assurance that the contractor is using efficient methods and effective cost controls.

Protest Procedures to Resolve Dispute

CILs must maintain protest procedures to handle and resolve disputes relating to procurements and, in all instances, disclose information regarding the protest to the federal awarding agency.

Conflicts of Interest Prohibited

Employees and members of the board of directors have an obligation to conduct business within guidelines that prohibit actual or potential conflicts of interest. This policy establishes only the framework within which the CIL will operate. The purpose of these guidelines is to provide general direction for all employees and members of the board of directors. Employees are expected to seek further clarification from their supervisor on issues related to the subject of acceptable standards of operation if any question arises. Board members, as well as any employees involved in the procurement/purchasing process, are expected to disclose any potential conflict of interest and to remove themselves from discussion and decision-making in any item of business in which they have a potential conflict of interest.

An actual or potential conflict of interest occurs when the employee, officer, or agent, any member of his or her immediate family, his or her partner, or an organization that employs or is about to employ any of the parties indicated herein has a financial or other interest in the firm selected for an award. The basic principles that apply are that any potential conflict must be disclosed and the individual who has a potential conflict cannot be involved in debate or decision-making related to the area in which they have a conflict.

Minority Businesses and Woman-Owned Businesses

The organization should take affirmative steps to encourage minority businesses, woman's business enterprises, and labor surplus area firms to be used, including:

- Identifying qualified organizations.
- Soliciting from these organizations.
- Dividing total requirements, when economically feasible, into smaller tasks to permit maximum participation by these organizations.

Chapter Seven: Internal Controls

Two primary responsibilities of any organization's directors and leadership staff is to ensure that the organization is accountable to its constituents, supporters, government regulators, and the public at large for its programs and finances, and that the assets of the organization are protected. The development and maintenance of an organization's internal controls are a critical means to ensure that accountability.

Internal controls are the financial policies and procedures that are adopted by the board to ensure proper record keeping, prevent error or fraud, and enhance public trust. While internal controls can be broken down into two basic categories—administrative controls and accounting controls—the most effective procedures are often simply those that have both segregation of duties and adequate oversight. These controls must also be accepted as the duty and responsibility of everyone in the organization, from the CEO and bookkeepers to paid and volunteer staff alike.

Internal financial controls provide a multitude of benefits including:

- Assuring fiscal prudence.
- Safeguarding the assets of the organization.
- Assuring fiscal compliance.
- Setting policy that meets the board's fiduciary responsibility.
- Creating appropriate checks and balances.
- Creating a process for assuring fiscal viability for the organization.
- Effectively catching unintentional errors.
- Fulfilling regulatory requirements.
- Demonstrating that assets are used for the mission of the center.

Setting *appropriate* internal controls considers many factors such as organization size, complexity of funding source(s), source of funds, organizational history, and capacity of management and the accounting department or business office. A \$15 million nonprofit with a CFO and staff of seven in accounting requires different internal control practices than a \$750,000 nonprofit with a part-time bookkeeper. Generally speaking, and regardless of size, segregation of duties is a key policy and procedure that can be used to set effective internal controls. Simply put, this management practice limits the amount of accounting or financial activity performed by any one individual within the organization.

For example, the executive director should not be solely vested with the authority by the board to approve all expenditures, create and endorse checks, and issue the payments.

Typical internal control procedures that may be appropriate for your organization include:

- Management demonstrates an attitude of integrity and commitment to competence—proper hiring and training practices, and attention to compliance requirements such as maintaining complete and up-to-date personnel files.

- Board members and management review and sign a conflict-of-interest policy annually.
- The CIL has a written code of conduct that describes proper business practices and ensures that everyone is familiar with the code.
- There is no tolerance for improper practices. Even minor improprieties are addressed.
- Unusual activities are questioned. This doesn't have to sound accusatory but will demonstrate the CIL's commitment to avoid improprieties.
- The CIL develops a good budget, looks at variances from that budget, and updates the budget throughout the year as appropriate for changes in funding or programs. Variances are red flags that deserve attention.
- Communicating the whistleblower protection policy regularly. Some organizations post it prominently in the workplace. Employees uncover most wrongdoing.

Separation of Duties, Verifications and Reconciliations

Generally, responsibilities for record keeping for assets and custody of those assets should be separated.

Vouchering and Billing

- Prepare vouchers from information in your accounting system.
- Have an independent person review vouchers and other billings before they are submitted or uploaded.

Receipts

- Have someone not involved with billing or accounting receive customer payments initially and list them on a deposit ticket or separate place.
- Stamp checks "for deposit only" as soon as they are received.

Reconciliations

- Reconcile all bank accounts on a timely basis.
- Have someone who isn't involved with preparing checks receive the monthly bank statement initially, and review the checks, electronic payments, and transfers.

Disbursements

- After checks are prepared, submit them to the check signer with original invoices.
- Cancel invoices by marking them paid.

- Send out checks without returning them to the check preparer after signing.
- Have an independent person review documentation for all credit card charges and for all employee expense reimbursements.
- Limit access to blank checks to authorized signers.

Payroll

- Document time worked and for what was worked on.
- Have someone other than the person entering payroll information review completed payroll reports to verify that rates and hours are proper.

Retirement Plans

IRS requires periodic updates of all retirement plans and imposes harsh penalties for noncompliance.

- Assign someone the responsibility to make sure that the CIL's retirement plan is up-to-date.
- Verify that a summary plan description is distributed to all employees each year.
- Be sure there is an investment policy for pooled accounts and that employees have access to guidance about their retirement plan investments for their individual accounts.

Securing Your Electronic Data

There are constant threats to your confidential electronic information and to bank and investment accounts that can be accessed electronically.

- Consider contracting with an outside IT organization that will assist you with backups, software upgrades, review of error logs, and security.
- Make regular backups and store them off-site periodically. (Verify that backups are working.)
- Shut down or log off computers at night.
- Continuously update anti-virus software.
- Install ISCA certified firewall and anti-spam software.
- Use passwords wherever appropriate. Make them strong and change them periodically—usually every 90 days.
- Password protect mobile devices that have access to your server (email, calendars etc.), and set them so that confidential information can be deleted remotely.

- Destroy or reformat hard drives on computers and copiers when they are disposed of.
- Establish a policy for computer, Internet, and email use. Policies should cover what happens with access when someone leaves or is terminated.

Other Procedures

- Make sure that your personnel manual is up to date, and that everyone knows how to access it.
- Consider developing an accounting procedures manual to confirm accounting procedures and internal controls.
- Consider Fidelity bond coverage for employee dishonesty. Use a carrier other than your general liability carrier to reduce the likelihood of countersuits.
- Talk to your banker about controls your bank can provide, including verification of checks that you send and restrictions on electronic transfers.

Monitoring

Your written policies set standards for performance. Monitoring should include a review of your policies to be sure they are current and appropriate. It should also determine whether staff is familiar with your policies. Is training of new and current staff appropriate? Be sure to review personnel, conflict-of-interest and whistleblower protection policies.

- Determine what security measures are in place over confidential information such as employee, donor, and credit card information.
- Your risk assessment and monitoring should also consider the safety of your staff, consumers, and others who have a relationship with your organization.
- Review your organization's hiring procedures; determine whether references are checked and background checks are used.
- Look at whether images of checks are provided with your checking account bank statement and verify whether an independent person reviews checks, electronic payments, and transfers to be sure they are proper.
- Check how up-to-date bank reconciliations are.
- Look at some invoices for purchases to determine whether they are properly marked to document approval, nonpayment of sales tax, and to note payment.
- Check whether unused checks and undeposited checks and cash received are kept in a locked/secure area.
- Review charge card statements to see if there is an independent review and the documentation for all purchases.

- Review expense reimbursements, especially for senior personnel to verify that there is proper documentation and an independent review.
- The great majority of frauds are uncovered by employees. Interview to be sure that employees know that they are encouraged to communicate any wrongdoing, and that they are familiar with the process for doing so.
- Look at how time worked is documented and whether there was an independent review of time worked.

Each of these control procedures adds some burden and reduces some risk. You have to weigh these and other possible procedures to determine the right balance for your organization.

EXAMPLE Financial Management Checklist from the Minneapolis United Way

Financial Management Checklist⁴⁰

- ___ Accounting practices conform to generally accepted accounting principles.
- ___ Fiscal systems in place to provide information for sound financial decisions to staff & board, and IRS & funding source requirements.
- ___ Fiscal system in place comports to UG requirements.
- ___ Annual operating budget approved by the board, including costs for all programs, management and fundraising, and all sources of funding.
- ___ Financial statements include budget versus actual and/or comparative numbers.
- ___ Current cash flow projections.
- ___ Timely financial statements, including balance sheet and statement of revenue & expenses.
- ___ Expenses approved by a designated person(s) before payment is made.
- ___ Report unit costs of programs and services through a cost allocation plan.
- ___ Review process to monitor timely and accurate financial information.
- ___ Board of directors reviews financial statements at least bimonthly.
- ___ Procedures for periodic billing, follow-up and collection of all accounts, and documentation that substantiates billings for contracts or other income.
- ___ Contracts, purchases of service agreements, and grant agreements in writing and reviewed to monitor compliance with stated conditions.
- ___ Designated “grants & contracts administrator” staff person.
- ___ Payroll prepared following state and federal regulations and organizational policy.

⁴⁰ Adapted with permission from a checklist developed by the United Way of Minneapolis Area.

- ___ Contract employees meet all federal requirements. Disbursement records are kept and 1099s issued at year end.
- ___ Filing timely IRS Form 990s & other regulatory forms.
- ___ Documented internal controls, including the handling of cash and deposits, and approval of all spending and disbursements.
- ___ Policy identifying authorized check signers and the number of signatures required on checks in excess of specified dollar amounts.
- ___ Adequate insurance coverage, periodically reviewed to ensure appropriate levels and types of coverage.
- ___ Employees, board members, and volunteers who handle cash and investments are bonded to help assure the safeguarding of assets.
- ___ An audit, or annual report that includes financial statements, is made available to service recipients, volunteers, contributors, funders, and others.
- ___ Year-end revenues and expenses are forecasted to assist in making sound management decisions during the year.
- ___ Approved and updated fiscal policy and procedures manual.
- ___ Capital needs are reviewed annually and priorities established.
- ___ Reserve of funds to cover at least three months of operating expenses.
- ___ Board of directors is responsible for hiring an auditor for the organization.
- ___ Annual, independent audit & management letter by an outside CPA.

These checkpoints are not in order of priority; they are all equally important!

Contract Compliance

There should be at least one person in the organization designated to be the *grant/contract administrator*. This person serves as both the liaison with the funding source and the in-house “expert” regarding the many levels of grants and contract compliance. While the executive director always has access to the funding agency, this person may be someone else from the leadership team. Ideally, this person has strengths in both fiscal management and service delivery. A center that invests the time to understand all levels of compliance and corresponding regulations will ultimately save time and money in grant applications, legal problems, and audits.

Internal Audit

Larger organizations may have a full- or part-time internal audit position. The responsibilities of the internal auditor will be to verify that the organization’s policies and procedures, funder specific requirements, and general compliance requirements are understood and being followed. Internal auditors may be able to perform the internal control monitoring procedures described in the internal control section above.

Fiscal Procedures Manual or Accounting Procedures Manual⁴¹

A fiscal/accounting procedures manual is a record of the center's policies, procedures, and guidelines for processing and handling financial transactions. This manual can serve as an excellent internal control mechanism and training tool. The manual is also valuable in providing guidance toward ensuring that there is consistency in fiscal accounting and reporting. The manual should address topics such as the nature and frequency of reports, bank reconciliation, separation of duties, and other internal controls, and outline generally accepted accounting policies and procedures concerning recording and collection of receipts and reimbursements, and records retention.

In fact, under the UG and UAR, CILs must have written policies and procedures to address the following:

- Cash Management (45 C.F.R. §§ 75.302(b)(6) and 75.305)
- Allowability (45 C.F.R. § 75.302(b)(7))
- Conflicts of interest (45 C.F.R. § 75.327(c))
- Procurement (45 C.F.R. § 75.327 through 332)
- Method for conducting technical evaluations of proposals and selecting providers/vendors (45 C.F.R. § 75.328(c)(1))
- Compensation and fringe benefits (45 C.F.R. §§ 75.430(a), 75.431(a), 75.464)
- Travel (45 C.F.R. § 75.474(b))
- Indirect cost rate development (45 C.F.R. §§ 75.414(e) and Appendix IV)

It is also highly recommended to maintain written policies and procedures to address the equipment use, inventory and disposal requirements found in 45 C.F.R. §75.320. The manual should be developed by the controller and the executive director and be approved by the board of directors.

This includes the type of internal procedures and policies used to implement them. This manual can also be used as an excellent training tool for new employees in the finance department. Remember to review and update the manual regularly, but at least annually, in order to reflect changes in practice, size, and scope of the organization, and to respond to auditor's suggestions.

⁴¹ A sample fiscal policies and procedures manual is available at <http://www.ilru.org/il-net-sample-fiscal-policies-and-procedures-handbook>.

Chapter Eight: Sharing Financial Information Internally

The financial information that every nonprofit is obliged to collect is a vital management resource for identifying business obstacles and opportunity. Sound financial management requires program managers to take ownership of their financial information and performance. Good CIL management needs good financial management; and for this, management needs good tools. Prior to a discussion regarding some of the financial tools, it is important to talk about what information to share, with whom, and why.

Who? What? Why?

Sharing financial information with other staff in the organization is a matter of board policy and/or executive management style. It can be beneficial to share financial reports and information, thereby expanding managers' knowledge and understanding of the fiscal operation and how this impacts their program area. Consideration should be given to the nature, amount, and frequency of distributing this information. "Need to know" is a good rule of thumb. If a particular program's reimbursement is based upon units of service, then a monthly statistical report shared within the team may suffice. Alternately, if the whole team is responsible for a fundraising event, the budget and results could be openly shared.

There are several benefits to sharing and giving a sense of ownership to organization financial reports and information. Following are some of the benefits.

- Staff become aware of the realities of the center's financial needs.
- Staff can be held accountable for program budgets.
- Staff can be held accountable for meeting contract obligations.
- Staff may feel empowered to assist the center in creating more cost-effective services.
- Staff can see the results (fiscal) in terms of program/service decisions.
- Assists in dispelling myths that the center is either going "under" or has a large sum of discretionary money.
- Staff may feel more invested in the center's activities and future.
- Assists in training individuals as they move up the career ladder.

Regardless of how you share the information and/or who actually receives what information, the critical point is making sure individuals have a clear *understanding* of the information so it becomes useful to supporting the program, organization, and mission. Also, all financial information must be read and understood in context. For example, you would not want a program manager to receive a single program report for one month where the program lost money that month and draw the conclusion that the center was headed toward fiscal disaster.

At a minimum, program and/or department managers should have access to and a clear understanding of their program budgets. It is impossible to manage a program effectively without being involved in the fiscal management of the program. The program budget statements need to

show expenses and revenues compared to contract budgets. Managers can then make daily operational decisions that are programmatically and fiscally sound.

Another consideration is sharing financial information with staff other than managers. Again the type and amount of information depends on the needs of the center, the culture of the center, and the leadership style of the executive director. At a minimum, staff should have access to and a basic understanding of the annual independent audit. More frequent sharing might include monthly meetings with the staff to share monthly board financial reports.

Regardless of who gets what information, two key principles need to apply. First, individuals should understand and be able to interpret the information they are receiving. Secondly, individuals need to respect the confidentiality associated with center financial information.

Tools to Support Financial Management

The tools should support the process of planning ahead, they should allow determining when and why plans are not being met, and they should become a natural and continuous part of everyday CIL activity.

The first and most important tool is the organization plan, which will look several years ahead with updates prepared each year. It should be a living document created and used, first and foremost, by the entire center staff. But it will also be a most important document for banks and other lenders, who will view a considered and credible plan as evidence of effective and informed management if you're looking to borrow or raise money. The organization plan should be used to:

- Identify (or confirm) the strategy for the future.
- Test if longer-term objectives are achievable, and identify what needs to be done in order to achieve them.
- Provide the context for setting the budget.

The planning process will involve individual plans being produced for all aspects of the center operations—program development, systems advocacy, fundraising, marketing and the overall organization process and infrastructure—and then being drawn together into one integrated plan. As part of this process you will want to carry out a SWOT analysis—setting out the *strengths*, *weaknesses*, *opportunities*, and *threats* affecting the organization. Each of these items will need to be quantified, wherever possible, in financial terms.

In carrying out this process, you will be able to identify activities and costs that do not fit into the integrated plan. You will be able to identify what organization assets and funds you need to meet your desired objectives.

Many organizations view the cash forecast as the most vital source of information. However, if a cash flow forecast is compiled outside the context of the organization planning process, it may not properly represent the organization's future.

The annual audited financial statements provide an overview of the financial position for each year of the plan. Thorough review of these summary statements is essential to ensure that the different

aspects of the plan do hang together, and that the financial implications of the plan are what you want and can be achieved.

A budget will be prepared from the first year of the organization plan. The budget is the most powerful tool available to you.

The summary information produced in the course of planning will now be developed into enough detail to form a basis for day-to-day running during the coming year, and must be sufficient to enable you to:

- Anticipate and manage change.
- Gain a satisfactory view of actions necessary to run the organization.
- Provide a basis from which to monitor and control how the organization is progressing against expectation.

The budget year will be broken down into monthly or quarterly periods to suit the center's needs. Monthly will be more appropriate in most cases as this allows you to have a tighter control over contract obligations and fiscal resources.

The budget detail should clearly reflect the structure of responsibility for control, related decision-making and action-taking with respect to individual or groups of tasks. Everyone with responsibility should understand their budget and how to meet it.

There are two schools of thought on the budget numbers remaining static (not changing) during the year. One is regardless of the organization activity, the budget numbers remain in place and any variance over 10 percent is explained each month. The other thought is that as new programs are developed or if there are any other significant changes in the center's activities, the budget is adjusted to reflect these changes. The organization has three options: (1) change the budget, (2) do not change the budget—reflect variances in footnotes, or (3) create an organization budget that remains static and an operational budget that remains up to date and reflects major fiscal changes. Regardless of the option you select, you should always use for future budget development the lessons and insights learned in comparing the prior years' actual numbers to budget numbers.

It is no use producing information unless it is used to help run the organization. After you create a strategic plan and annual budget, the next step is to develop and employ a system for comparing this to your actual numbers and outcomes. Having produced an organization plan and now developed a budget for the coming year, you need to monitor what actually happens and compare it with the budget. Use this comparison to:

- Audit corrections.
- Check that actions have been taken and have had the required effect.
- Take the lessons learned forward into the updated organization plan you produce next year.

The comparison should be made monthly or quarterly (matching the budget phasing) to provide analysis:

- According to each person's area of responsibility.
- For each department or service.
- For each location, or grouping of organization activity.

There is no blueprint for the "right information." Each organization is unique. So you must decide what information you need to run the organization and when you need it. To help you make the decisions, consider the following varieties and forms in which information can be provided.

- Analyze one month at a time, and/or cumulatively through the year, e.g., contracts might be reviewed for a month's performance, but fiscal shortfall may be made up next month, so look at both the month and cumulative position.
- Use graphs to help you interpret the information, e.g., identify trends, cash flow cycles.
- Use ratios and indicators to check the relationships of different aspects of the organization, e.g., program/organization administration costs, costs per service unit delivered, productivity of employees.
- Summarize some information and provide some in detail, e.g., you don't need the detail if the tasks are someone else's responsibility, but you do need to know that the budget is being met by reviewing a summary.
- Collect information to check that key controls are in place and are working, e.g., cash and checks recorded and banked promptly, bank reconciliation completed weekly and no outstanding problems, invoices raised promptly, debts chased according to rules, orders booked and recorded, purchases receipted and payments recorded.
- Collect some information only as needed when problems arise, e.g., machine breakdowns, deliveries not made, contracts not met on time.
- Provide snapshots to give an overview of how things are progressing, e.g., number of consumers served, number of presentations delivered.
- Provide some information when needed quickly after an event. Although the information may not need to be entirely accurate at that early stage, it may form the basis for further investigation.

At the year-end, prepare full-year management accounts as a basis for looking back over the whole year. These will include the main financial information statements prepared by the independent auditor. If they are to be a useful basis for learning from experience in the following year (for example, by comparing budget with actual), they should be prepared with appropriate accuracy as soon after the year-end as possible.

Integrating the use of management information and accounts with the organization plan and budget will enable learning from the past, quick reaction, and planning for the future in an informed and up-to-date way. This process will help the organization to succeed.

Chapter Nine: Developing Budgets

Annual Budget

The annual budget is actually a “cash” or “operating” budget, which identifies the sources of revenue and expense that the organization will utilize during its upcoming fiscal year. It is the responsibility of the executive director to ensure that a comprehensive, accurate budget and subsequent modifications are developed annually and presented to the board of directors for review and approval. It is the responsibility of the board to review and approve the annual budget prior to the beginning of the fiscal year, and any subsequent budget modifications, and ensure that, in the case of IL Subchapter C funds, Administration for Community Living pre-approval of budget modifications are obtained.

The format and structure of the annual budget are comprised of two basic elements:

- Revenue—dollars earned by service delivery, sales, donations, investments, etc.
- Expenses—outflow of cash

Beyond these two broad categories, subcomponents of the budget include four aspects, which are:

- Fixed Revenue
- Variable Revenue
- Fixed Cost
- Variable Cost

It is important to identify the elements of the organization budget by delineating all revenue and costs in terms of fixed and variable. *Fixed revenue* includes those income sources that have an annual commitment, e.g., government contracts, United Way contracts, donation commitments.

Variable revenue will be your assumptions regarding planned but not committed or “guaranteed” revenue, understanding that no revenue is guaranteed. Included in this category are fundraising, donations, sales, and any pending new contracts. Since the largest cost center for most nonprofit organizations is personnel costs, it is imperative to identify *fixed costs* that the organization must meet as a result of prior obligations before staffing levels and salary ranges are established.

Fixed costs are those in which there is no fluctuation or variance in the amount during a given time period.

Examples of a fixed cost would include items such as rent, fixed mortgage payments, vehicle leases, or insurance premiums.

Variable costs are those that fluctuate during a certain time frame, i.e., monthly or annually, and are subject to internal and external factors that can cause these costs to either increase or decrease. A variable cost that is impacted by an internal factor would be staff overtime due to vacancies in a department, employee illness, or vacations. An external factor on the same variable cost (personnel) would be consumer demand for services.

Another example of a variable cost impacted by external factors would be utility costs, which are affected by weather.

Budgeting

Once the two broad categories of revenue and expenses are delineated, the annual budget document identifies three sections:

- Cost
- Revenue
- Surplus or deficit (profit or loss)

Categories for cost in the annual budget for the nonprofit typically include five major categories. These are:

- Personnel
- Fringe Benefits (mandated and non-mandated)
- General Operating
- Property
- Administration and Overhead

Personnel costs should identify the name, title, annual salary, and/or rate of pay, and functional program area where the employee is allocated.

The fringe benefit section should include all the costs that are mandated by state and federal law. These include Social Security tax (FICA), workers' compensation, disability insurance (where applicable), and unemployment insurance. Non-mandated benefits include health/dental insurance, retirement plan payments, continuing education benefits, life insurance, etc. These costs should be allocated to the same program area where the personnel cost is allocated. The same percentage of cost should be equally allocated for employees such as a supervisor who is allocated to multiple programs (cost centers). For example, a supervisor who oversees a disability program, an IL program, and transportation service would have his or her salary distributed in thirds over these three programs. Accordingly, the fringe benefit costs of that supervisor would also be divided in thirds among the three programs.

General operating costs include those costs that are directly attributable to the operation of the program area being budgeted, which include the following:

- Telephone (local, long distance, and monthly service)
- Postage
- Staff travel
- Vehicle costs (lease or financing payments)
- Vehicle insurance
- Vehicle maintenance and operating
- Office supplies
- Program supplies (educational material, etc.)
- Equipment

- Continuing education/conferences
- Copy cost and printing
- Training/meeting (program) delivery costs

Property (occupancy) costs include:

- Program/office rent
- Office utilities
- Property insurance
- Maintenance and repairs
- Capital improvements
- Property taxes (if applicable)
- Debt service

Administrative cost centers, or management and general (M&G) costs, are those incurred in the operation of the overall organization that cannot be identified as a particular program or contract cost. These costs must be allocated on some form of rational basis that is allowed by the funding sources the organization contracts with.

M&G costs include the following:

- Administrative salaries
- Administrative fringe benefits
- Office rent (direct or allocated)
- Office utilities (direct or allocated)
- Office phone (local, long distance, and monthly line charges)
- Office equipment (lease costs and purchases)
- Office supplies (consumable)
- Administrative staff travel
- Administrative staff conference/continuing education
- Audit/legal costs
- General liability insurance
- Directors and officers insurance
- Other risk policies
- Bank fees/interest expense
- Fund development costs

The costs for management and general, or indirect, will be allocated to each cost center or program area based upon the organization's cost allocation plan.

The next section of the budget directly below each program category is the revenue section. This identifies by line item each of the revenue sources the organization utilizes. Examples include:

- Federal or state contract revenue—CIL funding
- United Way revenue
- Grants

- Fundraising revenue
- Earnings from investments
- Consumer fees
- Third party reimbursement

Identifying these and other revenues for each program area allows for a grand total to be determined for each program. A simple deduction of expenses to revenue by program identifies any surplus or deficit in funding for the overall organization or a particular program area.

NOTE: Remember, it is always necessary to identify *fixed costs* and *revenue* and to place these into the budget first, since there is no management discretion in changing these line items.

The last primary section is the net surplus or profit/loss (P&L). This is a simple calculated estimate of program or organization total revenue minus total expenses. A fiscally prudent annual budget will project a balance of revenue to expenses or a projected fund balance (profit). However, based upon the mission of the organization, a given year's annual budget may project an operating loss if the services provided are determined to be of greater benefit to the community or the organization as opposed to the potential risk to the organization (risk/benefit analysis). Management or the board of directors should only adopt a non-funded or deficit budget where there are sufficient capital operating reserves identified that can offset the deficit. Because of limited reserves (net assets) in nonprofits, a deficit budget should be limited to one fiscal year and avoided whenever possible.

Reporting

Once the annual operating or "cash" budget is established, subsequent activity should focus on recording expenses and revenue, and reporting them for management analysis and board review.

Reporting can be viewed from two primary perspectives, *internal* and *external*. While the information presented in both reports match on a mathematical basis, they vary in format and content.

Often the revenue and cost information necessary for management decision-making is very different from a cost report to a funding authority. The examples of this chapter illustrate these differences.

Internal Reporting

Internal reporting, commonly referred to as *income statements* or monthly statements, is for management, finance committee, and board review. These statements should include a minimum of seven columns of information:

- Monthly expenditure actual
- Monthly expenditure budgeted
- Variance
- YTD expenditure actual
- YTD expenditure budgeted

- Variance
- Annual budget (line item)

From these, a line-to-line comparison of each budgeted item to actual expenses can be monitored. Most commercially available accounting packages can depict this information, provided the proper coding of revenue and expenses is established during the initial setup of the general ledger.

From these statements, annual cost reports can be compiled, which will generally conform to the reporting requirements imposed upon the CIL by the various funding sources (e.g., federal/state government, United Way).

External Reporting

Cost reports and the independent audit comprise the two primary types of *external reporting*. Both of these have very distinct purposes, and serve unique functions for the nonprofit. Cost reports depict the income and expenses in a predetermined format for purposes of accountability, revenue reconciliation, allowable expenses, and compliance with contract requirements. The CIL will need to know the specific cost report requirements of each funder and assure any software purchased can meet these needs.

These reports may also be required on a periodic basis, such as quarterly, semiannually, and annually. These are generally dictated in frequency, format, and detail by the funding source. They are also typically a requirement of contract management.

NOTE: Many governmental contract agencies will provide free technical assistance in the compilation of cost reports and may provide free software for use in cost reporting.

The second component of external reporting is an independent audit conducted in accordance with 45 C.F.R. Part 75.501-5122 based on the Single Audit Act of 1984 (amended 1996). The single audit must occur in any year that the CIL has \$750,000 or more of expenditures of federal awards; federal funds cannot be used to pay the cost of this if the federal expenditures are less than \$750,000. This assures compliance with generally accepted accounting principles or GAAP, and assures that funds are received and expended in a fashion that is consistent with these standards.

NOTE: In addition to contractor requirements and the IRS, the individual state and/or municipality may require other annual filings, in some cases with an independent CPA review or audit report. Check with your auditor for these requirements in your state. You may be required, or may choose to conduct a financial statement audit even when expenditures are less than \$750,000. You may do this if the expense is in your approved budgets and properly allocated.

Cash Flow

Cash flow statements are a periodic statement of *cash* received minus actual and projected expenses. Much like a financial projection, cash flow statements project the cash needs of the organization on a week-to-week or month-to-month basis, and reconcile to the cash on hand needed to meet the operating expenses of the organization. These include such items as payroll, rent, taxes, insurance, and other scheduled payments. Because cash flow is fluid and highly

dependent upon a host of factors, it can be difficult to predict. Nonprofit organizations will be well advised to consider two primary strategies to help manage cash flow, which are:

- Generating operating reserves
- Establishing a line of credit

Operating reserves are excess net assets (cash) from prior fiscal periods, which have been retained by the organization for its legal use. These can be in various forms such as CDs, stocks, bonds, and cash. These assets, when liquid (cash), can offset interruptions in cash receipts when outlays exceed income received and operating cash on hand.

Lines of credit are bank loans that are accessed for short periods of time to meet the cash flow needs of the organization until contract revenue is received from a funding authority. (*For more information, see Chapter Five.*)

Accounts Payable & Vendor Relations Key Issues to Consider

Managing cash flow can be most directly influenced through proactive cash management principles that assist in balancing expenses to cash received.

On the expense side of the equation, managing accounts payable can assist in reducing the demand for cash on hand when contract payments are late. Some of the proactive activities include:

- Stipulate/negotiate terms of payment to new vendors.
- Pay all payments net 30-45 days.
- Identify and utilize key accounts as vendor references.
- Seek extension of terms if cash flow is restricted.
- *Call vendors when payments are late—very few businesses do!*
- *Under promise and over deliver!*

Financial Management Goals

Financial management goals and policies provide the framework for financial planning and decision-making by the CIL board, finance committee, and CIL staff. They are designed to help ensure the financial integrity of the organization, which, along with prudent management of its financial resources, is necessary if the organization is to provide the independent living services, support services, and facilities that address the needs and desires of CIL consumers and the community.

The following goals and policies for the CIL are intended to guide the organization in its financial matters. The goals are broad statements of board philosophy for financial management of the organization. The policies provide more specific direction for consistent financial management decisions.

Financial Management Goals—Example

1. The CIL will establish a financial base sufficient to support high-quality and innovative independent living programs that meet consumer and community needs.
2. The CIL will follow prudent and professional financial management practices in order to achieve and maintain long-term financial stability.
3. The CIL will demonstrate to the grantors of the organization and the financial community that its programs are well managed.
4. The CIL will provide cost-effective services to citizens by cooperating with other government agencies and other nonprofit organizations.
5. The CIL will have an adequate capital improvement program that maintains existing organization assets, provides for consumer and employee safety, maintains a quality independent living environment, and allows for enhancements that are necessary to meet changes.
6. The CIL will continually review and improve its formal budget document and other financial information so that it clearly and openly communicates its resources, expenditures, and financial position.
7. The CIL will communicate with its employees and the community so that they understand the organization's program requirements and financial status.

Start-Up Budgets for New Programs

Regardless of the funding options available, when starting a *new program*, developing a budget is a critical step in the program development process. You will want to develop both a *start-up budget* and an *annual budget*. In both of these budgets, the financial detail is developed directly from the narrative of the program/service proposal and includes all sources of revenue and a breakdown of all expenses for the program.

The *start-up budget* differs in that it will most likely contain several one-time expenses. In addition, if the program is dependent on a reimbursement method that takes into account the number of individuals served, you need to take into account that the first few months may not warrant full reimbursement unless that is accounted for in the budget narrative. If this is the case, and you are going to receive a contract for the program, it is always wise to ask for a minimal of three months start-up funding without any contract outcome expectations. In other words, you get three months of funding, which allows you to get the program pieces in place, i.e., hiring staff, purchasing supplies and equipment, and establishing program policies and procedures.

In developing the start-up budget, you need to consider the following one-time expenses:

- Furniture acquisition—desks, chairs, tables, filing drawers
- Equipment acquisition—computer, copier, adaptive equipment

- Training supplies—directories, manuals, handbooks, code books
- Training costs—costs to attend seminars, including travel expenses
- Consulting fees
- Other expenses as dictated by the program and consumer needs

Ongoing costs will vary, depending on the nature of the program. However, there are some “standard” costs that are typically included in every budget as mentioned earlier in this chapter. While it is difficult to predict to the exact penny, careful thought and consideration should go into planning the budget. An overspent or underspent budget can cause undue trouble to the program.

Developing budgets for new programs can be difficult because you do not have a spending/cost history. It may be helpful to look at comparable programs both inside and outside of the organization. In the case of needing to develop a multiyear budget, remember to allow for inflation or other possible cost increases in areas such as health insurance, salary increases, etc. Funders often want to see that you are able to support a program beyond the first year.

Once the budget is developed, you ask the Million Dollar Question: *Can we find the resources to support this program?* Initially, depending solely on donations is not sound fiscal planning. Once you have experienced some program success and a track record, this may be the answer.

Fee-for-Service Funding⁴²

If you are going to fund the program using consumer/customer fees you need to consider the following:

- Is the price competitive or realistic?
- Do we turn away people who cannot pay?
- Do we develop a “scholarship fund”?
- Do we know what it costs to deliver a unit of service?
- Can we defend our costs?

⁴² IL-NET on-demand trainings related to developing and managing fees-for-service are available at <http://www.ilru.org/training-on-demand> or enter “fees-for-service” in the search box.

Chapter Ten: Special Considerations for Budgets Developed for Federal Grants

The UAR requires recipients and subrecipients of federal funds to maintain budget control at all times.⁴³ The approved budget for the federal award summarizes the financial aspects of the project or program as approved during the federal award process. The CIL must monitor its financial performance by comparing and analyzing actual results with budgeted results and request prior approval from the federal awarding agency (e.g., Department of Health and Human Services) in order to:

1. Change the scope or objective of the project.
2. Change a key person specified in the application or the federal award.
3. Disengage from the project for more than three months, or reduce the time devoted to the project by the approved project director or principal investigator by 25 percent.
4. Include costs that require prior approval by the federal agency.
5. Transfer funds budgeted for participant support costs as defined in 2 C.F.R. § 200.75 to other categories of expenses.
6. Subaward, transfer, or contract out any work under the federal award (unless described in the application and approved in the federal award).
7. Change any approved cost-sharing or matching.
8. Request any additional federal funds to complete the project.

Further, all expenditures must be aligned with approved budgeted items. Therefore, when drafting, it is important for the CIL to review the proposed cost to determine whether it is an allowable use of federal grant funds *before* obligating and spending those funds on the proposed good or service.

All costs supported by federal HHS funds must meet the standards outlined in 2 C.F.R. Part 200, Subpart E-Cost Principles, which are provided in the bulleted list below.

- **Necessary and Reasonable for the performance of the federal award.** The CIL must consider these elements when determining the reasonableness of a cost. A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision to incur the cost was made. For example, reasonable means that sound business practices were followed, and purchases were comparable to market prices.

⁴³ See 45 C.F.R. §§ 75.302 (b)(5) and 75.308.

When determining reasonableness of a cost, consideration must be given to:

- Whether the cost is a type generally recognized as ordinary and necessary for the operation of the CIL or the proper and efficient performance of the federal award.
- The restraints or requirements imposed by factors, such as: sound business practices; arm's-length bargaining; federal, state, and other laws and regulations; and terms and conditions of the federal award.
- Market prices for comparable goods or services for the geographic area.
- Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the CIL, its employees, its consumers, the public at large, and the federal government.
- Whether the CIL significantly deviates from its established practices and policies regarding the incurrence of costs, which may unjustifiably increase the federal award's cost.⁴⁴

While 45 C.F.R. §75.404 does not provide specific descriptions of what satisfies the “necessary” element beyond its inclusion in the reasonableness analysis above, “necessary” is determined based on the needs of the program. Specifically, the expenditure must be necessary to achieve an important program objective. A key aspect in determining whether a cost is necessary is whether the CIL can demonstrate that the cost addresses an existing need, and can prove it.

When determining whether a cost is necessary, consideration may be given to:

- Whether the cost is needed for the proper and efficient performance of the grant program.
 - Whether the cost is identified in the approved budget or application.
 - Whether the cost aligns with identified needs based on results and findings from a needs assessment.
 - Whether the cost addresses program goals and objectives and is based on program data.
- **Allocable to the federal award.** A cost is allocable to the federal award if the goods or services involved are chargeable or assignable to the federal award in accordance with the relative benefit received. This means that the federal grant program derived a benefit in proportion to the funds charged to the program.⁴⁵
 - **Consistent with policies and procedures that apply uniformly to both federally financed and other activities of the CIL.**

⁴⁴ 45 C.F.R. § 75.404.

⁴⁵ 45 C.F.R. § 75.405.

- **Conform to any limitations or exclusions set forth as cost principles in 45 C.F.R. Part 75 including the Appendices, or in the terms and conditions of the federal award.**
- **Consistent treatment.** A cost cannot be assigned to a federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been assigned as an indirect cost under another award.
- **Adequately documented.** All expenditures must be properly documented.
- **Be determined in accordance with GAAP, unless provided otherwise in Part 200.**
- **Not included as a match or cost-share, unless the specific federal program authorizes federal costs to be treated as such.**
- **Be the net of all applicable credits.** The term “applicable credits” refers to those receipts or reduction of expenditures that operate to offset or reduce expense items allocable to the federal award. Typical examples of such transactions are: purchase discounts; rebates or allowances; recoveries or indemnities on losses; and adjustments of overpayments or erroneous charges. To the extent that such credits accruing to or received by the CIL relate to the federal award, they shall be credited to the federal award, either as a cost reduction or a cash refund, as appropriate.⁴⁶

UAR 45 CFR Part 75’s cost guidelines must be considered when federal grant funds are expended. As provided above, federal rules require state requirements and CIL policies regarding expenditures to be followed as well. For example, state and/or CIL policies relating to travel or equipment may be narrower than the federal rules, and the stricter state and/or CIL policies must be followed. Further, certain types of incentives are allowable under federal law, but may not be allowable under state law.

Selected Items of Cost

45 CFR Part 75 examines the allowability of 55 specific cost items (commonly referred to as Selected Items of Cost) at 45 C.F.R. §§ 75.420-75.475. These cost items are listed in the chart below along with the citation where it is discussed whether the item is allowable. Please do not assume that an item is allowable because it is specifically listed in the regulation as it may be unallowable despite its inclusion in the selected items of cost section. The expenditure may be unallowable for a number of reasons, including: the express language of the regulation states the item is unallowable; the terms and conditions of the grant deem the item unallowable; or state/local restrictions dictate that the item is unallowable. The item may also be unallowable because it does not meet one of the cost principles, such as being reasonable because it is considered too expensive. Some items may be allowable, but only if the CIL has prior approval for the item. If an item is unallowable for any of these reasons, federal funds cannot be used to purchase it.

CIL personnel responsible for spending federal grant funds and for determining allowability must be familiar with the Part 200 selected items of cost section. The CIL must follow these rules when

⁴⁶ 45 C.F.R. § 75.406.

charging these specific expenditures to a federal grant. When applicable, CIL staff must check costs against the selected items of cost requirements to ensure the cost is allowable. In addition, state, CIL, and program-specific rules may deem a cost as unallowable and CIL personnel must follow those non-federal rules as well.

The selected item of cost addressed in Part 200 includes the following (in alphabetical order):

Item of Cost	Citation of Allowability Rule
Advertising and public relations costs	45 CFR § 75.421
Advisory councils	45 CFR § 75.422
Alcoholic beverages	45 CFR § 75.423
Alumni/ae activities	45 CFR § 75.424
Audit services	45 CFR § 75.425
Bad debts	45 CFR § 75.426
Bonding costs	45 CFR § 75.427
Collection of improper payments	45 CFR § 75.428
Commencement and convocation costs	45 CFR § 75.429
Compensation – personal services	45 CFR § 75.430
Compensation – fringe benefits	45 CFR § 75.431
Conferences	45 CFR § 75.432
Contingency provisions	45 CFR § 75.433
Contributions and donations	45 CFR § 75.434
Defense and prosecution of criminal and civil proceedings, claims, appeals, and patent infringements	45 CFR § 75.435
Depreciation	45 CFR § 75.436
Employee health and welfare costs	45 CFR § 75.437
Entertainment costs	45 CFR § 75.438
Equipment and other capital expenditures	45 CFR § 75.439
Exchange rates	45 CFR § 75.440
Fines, penalties, damages and other settlements	45 CFR § 75.441
Fundraising and investment management costs	45 CFR § 75.442
Gains and losses on disposition of depreciable assets	45 CFR § 75.443
General costs of government	45 CFR § 75.444
Goods and services for personal use	45 CFR § 75.445
Idle facilities and idle capacity	45 CFR § 75.446
Insurance and indemnification	45 CFR § 75.447
Intellectual property	45 CFR § 75.448
Interest	45 CFR § 75.449
Lobbying	45 CFR § 75.450
Losses on other awards or contracts	45 CFR § 75.451
Maintenance and repair costs	45 CFR § 75.452
Materials and supplies costs, including costs of computing devices	45 CFR § 75.453

Memberships, subscriptions, and professional activity costs	45 CFR § 75.454
Organization costs	45 CFR § 75.455
Participant support costs	45 CFR § 75.456
Plant and security costs	45 CFR § 75.457
Pre-award costs	45 CFR § 75.458
Professional services costs	45 CFR § 75.459
Proposal costs	45 CFR § 75.460
Publication and printing costs	45 CFR § 75.461
Rearrangement and reconversion costs	45 CFR § 75.462
Recruiting costs	45 CFR § 75.463
Relocation costs of employees	45 CFR § 75.464
Rental costs of real property and equipment	45 CFR § 75.465
Scholarships and student aid costs	45 CFR § 75.466
Selling and marketing costs	45 CFR § 75.467
Specialized service facilities	45 CFR § 75.468
Student activity costs	45 CFR § 75.469
Taxes (including Value Added Tax)	45 CFR § 75.470
Termination costs	45 CFR § 75.471
Training and education costs	45 CFR § 75.472
Transportation costs	45 CFR § 75.473
Travel costs	45 CFR § 75.474
Trustees	45 CFR § 75.475

Likewise, it is possible for the state and/or CIL to put additional requirements on a specific item of cost. Under such circumstances, the stricter requirements must be met for a cost to be allowable. Accordingly, employees must consult federal, local and CIL requirements when spending federal funds. For example, often the state's travel rules are more restrictive than federal rules, which means the state's policies must be followed.

In order for a cost to be allowable, the expenditure must also be allowable under the applicable program statute, along with accompanying program regulations, non-regulatory guidance, and grant award notifications.

Travel Costs

Travel: Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of a grant recipient. Such costs may be charged on an actual cost basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip and not selected days of the trip, and results in charges consistent with those normally allowed in like circumstances in the recipient's non-federally funded activities and in accordance with the recipient's written travel reimbursement policies.⁴⁷

Costs incurred by employees and officers for travel, including costs of lodging, other subsistence, and incidental expenses, must be considered reasonable and otherwise allowable only to the extent

⁴⁷ 4 C.F.R § 75.474(a).

such costs do not exceed charges normally allowed by the CIL in its regular operations as the result of its written travel policy. In addition, if these costs are charged directly to the federal award, documentation must be maintained that justifies that (1) participation of the individual is necessary to the federal award, and (2) the costs are reasonable and consistent with the CIL's established policy.⁴⁸

Helpful Questions for Determining Whether a Cost is Allowable

In addition to the cost principles and standards described above, CILs can refer to this section for a useful framework when performing an allowability analysis. In order to determine whether federal funds may be used to purchase a specific cost, it is helpful to ask the following questions:

- Is the proposed cost allowable under the relevant program?
- Is the proposed cost consistent with an approved program plan and budget?
- Is the proposed cost consistent with program-specific fiscal rules?
- Is the proposed cost consistent with specific conditions imposed on the grant (if applicable)?
- Does the proposed cost require prior approval?

As a practical matter, the CIL should also consider whether the proposed cost is consistent with the underlying needs of the program and is targeted to address areas of weakness, as necessary.

Subawards

One example of a subaward situation in centers for independent living is personal assistance services.⁴⁹ These services are funded by a variety of sources across the U.S. However, Medicaid remains the largest source of funding. At this time, with the trend toward providing more community-based services and care as an alternative to institutional care, CILs are uniquely positioned to receive Medicaid or other funding for these services.

In most cases these services are consumer directed with the CIL serving only as the fiscal intermediary between the consumer and the provider. As the fiscal agent, the CIL will generally take the responsibility for tasks such as paying the service provider, withholding taxes, and conducting criminal background checks. Typically, the CIL will take an administrative fee for providing these services.

The pass-through funding the CIL receives is generally recorded as dedicated funding in the *chart of accounts* and expensed when the proper documentation is received (i.e., timesheet, employment contract).

It is important to note that the CIL (primary recipient) is ultimately responsible for the manner in which the subrecipient expends the state funds. Many states have very strict program monitoring

⁴⁸ 45 C.F.R § 75.474(b).

⁴⁹ Note that Subchapter B centers may be considered subrecipients of the DSE and it is essential to clarify if that is what the relationship is so that the DSE is applying and the center is complying with the rules properly.

requirements in place which must be followed by the CIL, the consumer, and the personal assistance provider, or funding will be terminated and fines may be imposed on the CIL. It is also possible for the CIL to be the recipient of a subaward. This is true with Subchapter B funds that are awarded to the Designated State Entity (DSE) and then awarded to the CIL or statewide independent living council (SILC) as a subaward.

Chapter Eleven: Fiscal Oversight

As we have learned through previous chapters, everyone in the organization has a role in fiscal oversight. While the board of directors is legally charged with the role of fiscal control and oversight, as well as safeguarding the organization's assets, the executive director and the controller also play important roles.

The finance committee typically plays a key role in terms of fiscal oversight. Finance committee meetings should be structured to do just that. However, each board member has a fiduciary responsibility for the center that cannot be delegated to another individual. Everyone on the board must be able to understand the implications of the financial statements, and all financial information must be made available to board members upon request.

Clear nontechnical language and financial comparisons can help improve understanding.

Finance Committee

This committee is usually comprised of three to four individuals who have a background or experience in finance, business, accounting, or some other related field and are intimately familiar with the overall CIL operations. The board treasurer usually sits on the finance committee but does not need to chair the committee. The committee works closely with the organization's chief financial officer, business office, and/or executive director, depending on the size of the organization. It is the role of the committee to oversee and make recommendations to the full board regarding fiscal management, including debt management, asset management, budget processes, auditors report, and any other aspect of fiscal or risk management.

Internal Financial Oversight

This role is concerned primarily with determining and monitoring how the center is going to spend its money to fulfill the mission. While many contracts spell out exactly how the dollars need to be allocated, there may be some discretion with some contracts and there is generally complete discretion with donations and other sources of income. While being involved in decisions of how to spend unrestricted dollars may be important, the most critical tasks related to internal financial oversight are (1) the budget process, (2) the accounting process, and (3) the financial analysis process. This committee may take on other tasks or special projects, such as oversight of buildings and grounds issues, program cost-benefit analysis, and review/analysis of employee benefit programs.

The Budget Process

The CIL executive director and management staff generally plan the budget. The finance committee should maintain at minimum an advisory role. In approving a budget, the board exercises its primary fiduciary responsibility and implicitly agrees to make sure that projected financial performance will be achieved. The board and the finance committee should continually seek answers to these four questions:

- *Does the budget reflect the center goals/mission and board policy?*
While the board does not need to examine each line of the budget, some explanation or narrative should be provided to explain in part how projections were made and any other pertinent background information that focuses on board governance matters. One should be able to examine the budget and see the CIL's mission clearly reflected. Priority programs and services need to be financially solvent.
- *Is the budget realistic?*
Previous years' figures are helpful and should be used. Projections should be objective and practical. Expenses should be estimated on the high side and income underestimated. The board needs to know how budget assumptions were made. Information should be provided to explain any significant variances from the previous year's budget.
- *Are we meeting the budget? If not, why not?*
As part of the monthly board financial reports, actual revenue and expenses will be posted against what was budgeted for the month and year to date. The finance committee and ultimately the full board should closely monitor significant budget variances. The board may want to adopt a policy to have variances greater than 10 percent footnoted for their review and consideration. The board should have access to and may want to review both individual program budgets as well as the consolidated budget.
- *How do new or lost sources of revenue affect the budget?*
Centers may receive new unanticipated funding contracts during a given year and in some cases centers may lose a source of funding during the year. These funding changes may significantly impact the annual budget. The board needs to adopt a policy as to how they want to handle these fiscal changes—revise the budget each time or simply have the changes reflected in the “actual” column of the monthly financial statements. In the event that there is a significant loss of revenue, the board may be required to help identify additional sources of revenue to cover the shortfall or make decisions regarding program and/or staffing cuts. If cuts need to be made, the finance committee should take recommendations from the staff and, if appropriate, consumers and/or other stakeholders.

The Internal Accounting Process

While the executive director controls and oversees the daily accounting process, the board of directors is legally and morally responsible for the handling of funds received and dispersed by the organization, and the overall fiscal management. The system should be reviewed by an external auditor or financial consultant and should follow generally accepted accounting principles for nonprofit organizations. The board needs to make sure that someone with an accounting background is involved in the daily accounting process. The board must also ensure that the center's internal accounting system provides for the following:

- An accurate record of incoming money and expenditures, with supporting documentation, i.e., receipts, invoices etc.
- Information regarding the cost of programs and services
- Summary information and comparisons of income & expenses

- Segregation of accounting/financial duties wherever possible

The Financial Analysis Process

The board should have complete access to and full disclosure of all the organization's financial records. As part of the financial analysis process, the finance committee should direct the board in reviewing and monitoring financial reports, budget reports, and cost reports.

At a minimum, board members need to review and understand the consolidated *financial statements* on a quarterly or monthly basis. These statements include an activities (income and expense) statement, which will provide a comparison between budget projections and actual results, and a balance sheet, which summarizes the assets, liabilities, and net assets of the organization. All financial reports should be given to the board in advance of the meeting so members have ample time to review the information and formulate questions or concerns.

A *budget analysis* is the second step after doing a financial analysis. Again the task here is to compare actual figures with what was projected. The board should be presented with an explanation of any significant variances. It is important to note variances and compare them with the terms and dates of the contract, as expenditures may need to be made in a timely fashion.

As a general rule, the finance committee should insist that all financial reports from the organization:

- Are timely and updated.
- Are concise and easy to understand.
- Are comprehensive in scope—all center activities.
- Are done according to accepted accounting principles.
- Present a focal point for comparison.
- Are footnoted and contain narrative as appropriate.
- Are given to board members prior to full discussions.

External Financial Oversight

Nonprofit organizations have many external financial reporting requirements. While the executive director is charged with complying with the various state, federal, and local requirements, the board of directors is responsible for making sure that this, in fact, occurs—all fiscal reporting requirements must be met in a timely fashion in order to avoid loss of funds, credibility or, in some cases, certification.

At a minimum the board will receive an annual report from the auditor. Many of the external state and federal financial reports will be prepared by the auditor but must be signed and mailed by the executive director and/or the board president and treasurer. Board members may want to review

some of the reports, such as the IRS Form 990. The finance committee may also want a periodic review of the relevant payroll reports so they can be assured that the proper amount of monies are being withheld to pay taxes and other costs associated with payroll.

Some funding sources require copies of the annual budget, the annual audit, the management letter if your audit produced one, and/or other fiscal reports. The audit committee will want to be specific regarding what reports are due with the audit. The finance committee may want to work with the executive director or the fiscal manager in establishing a calendar of reporting deadlines, which can be updated and reviewed periodically by the board.

Summary

Members of the board of directors do not need to be and are not expected to be financial experts; however, they are expected to make sure the CIL is in good financial health and that its assets are protected. Remember, board members are legally responsible for the organization's mission and all of its assets. The financial management duties and obligations outlined in this chapter should serve as an overview and guide for centers for independent living boards that are committed to their center's growth and prosperity.

If the center is experiencing fiscal trouble, the following questions should be asked and explored:

- Is there a problem with cash flow—a cash shortage?
- Are bills past due?
- Is debt excessive?
- Is there any open lines of credit?
- Do we have adequate controls over expenditures?
- Are all required taxes (payroll) paid up to date?
- Is there a buildup in assets/receivables?
- Are long-term fixed-fee contracts hurting the center?
- Is the controller competent?
- Are the financial statements reflective of the true financial picture?

Chapter Twelve: Independent Audit

Purpose and Scope

The function of the independent audit is critical in meeting the legal requirements that are often imposed on nonprofits by state and federal statute. These requirements are specifically mandated and outlined in 45 C.F.R. Part 75, Subpart F. However, there may be circumstances where an audit is not required. In these cases, the board may wish to consider an independent audit for the purpose of providing donors an assurance that the CIL is operating in a fiscally sound and prudent fashion. Additionally, the audit is an outside assurance that the CIL is receiving and expending revenue in a manner consistent with its legal authority to do so, and in a manner that is consistent with contractual or donor limitation. By law, an independent audit can only be conducted by an outside CPA or CPA firm. Remember that a single compliance audit for all federal awards is required if your expenditures of federal funds exceed \$750,000. If your federal expenditures are below this amount, you may still want to secure an independent audit of your financial statements.

It is important to recognize that an audit committee or the board selects and contracts with the CPA for the audit, not the executive director. This cost is borne by the CIL and, if mandated by the funding authority or authorities, is an allowable expense as long as it is budgeted and properly allocated.⁵⁰ Management may be charged in the task of bidding the process to the market, but it should be explicit and clear that the board retains the CPA. Once the auditor is selected, it is a good practice to receive a written proposal from the CPA in an engagement letter, which is accepted and signed by the president or treasurer of the board.

Compliance Audit

Centers that expend more than \$750,000 of federal funding in a calendar year will be required to have a compliance audit as well as a financial statement audit. The compliance audit assesses whether the organization has proper oversight of its federal monies and is performing necessary oversight. The audit also assesses whether the organization has proper oversight of the preparation of its financial statement and is performing necessary oversight. The Uniform Guidance prohibits the cost of this more expensive audit if the center expended less than \$750,000 in federal funds.

Independent Financial Statement Audit

If the center operates on less than \$750,000 in federal funds, a less intensive financial statement audit can be secured and paid for with federal funds. This includes an auditor's report called an Opinion Letter. The Opinion Letter issued by the CPA to the board states his or her "opinion" as to whether the financial statements fairly report the organization's activities (income and expenses) and cash flows for the year, and assets, liabilities, and net assets at year-end based on generally accepted accounting principles (GAAP). A letter that positively states this is referred to as an unmodified or a "clean opinion." If there are "material issues" that indicate compliance issues or GAAP standards that are not followed, then a "qualified" report or disclaimer of opinion

⁵⁰ 45 C.F.R. § 75.425.

stating the issues found is reported. This is a serious matter that will require board and management attention to the points identified in the audit. These may be resolved in a relatively short time or may require a more “systemic” approach to rectifying the cited concerns.

Management Letter

Most audits will also include a management letter (auditors call it a “required communications letter”) that offers suggestions by the auditor, which are intended to strengthen the fiscal practices of the organization.

See Appendix B for example auditor’s report and management letter.

Selection of the Auditor

Since the audit committee or board ultimately selects and retains the auditor, the task of identifying and coordinating the selection of the auditor is often delegated to the executive director or chief financial officer (CFO). It is prudent to coordinate this initial activity through the finance committee or treasurer.

Issuing a request for proposal (RFP) is a simple and efficient method of notifying the market that you are seeking an auditor. Initially, various CPAs and public accounting firms in your area who are licensed to perform an independent audit can submit letters of interest. Some key factors to include in the RFP are:

- Name, location, and address of the organization
- Identification of your organization as a 501(c)(3) corporation. Include status (charitable, education, religious, foundation)
- Time frame for audit (fiscal year)
- Name of contact (E.D., treasurer, etc.)
- Primary purpose or mission of the organization
- Approximate size of annual budget
- Time frame for selection of the auditor
- Funding sources
- Specific services required, such as a financial statement audit, a compliance audit, and preparation of annual filings and a letter of findings to management
- Organizational chart
- Descriptive information on the organization

Additional considerations to keep in mind include the board’s preference for local versus national firms, familiarity with the type of financing you receive, and of course cost. Remember, many auditors are interested in expanding their base of business, and the fee initially quoted is subject to negotiation. Once selected, an engagement letter by the CPA stipulating the total cost for the audit should be drafted and signed by both the CIL and CPA.

Finally, the organization should consider changing either the audit partner or the audit firm every five years. The reason behind this is that auditors may become so familiar with the fiscal practices of an organization that the auditors lose their ability to closely examine those practices or worse, intentionally overlook a negative practice because of the relationship(s) involved. This is noted in the Sarbanes-Oxley Act below.

The Sarbanes-Oxley Act

The American Competitiveness and Corporate Accountability Act of 2002, commonly known as the Sarbanes-Oxley Act (“SOX”), was signed into law on July 30, 2002. The Act was passed in response to several corporate scandals, most notably Enron and Tyco, and was intended to rebuild public trust in the corporate sector. However, since nonprofits should be good stewards of both public finances and public trust, there are seven issuances of law that, although non-enforceable to nonprofits, are recommended practices nonetheless.

1. Independent and Competent Audit Committee—SOX recognized that an independent audit would go a long way toward discovering illegal or unethical practices within an organization. Thus, the recommendation to CILs is that they establish audit committees that are not made up of members of an organization’s management team or persons receiving compensation for service to the committee. Further, it is recommended that each committee member be a board member and at least one committee member be a “financial expert” with those qualifications ultimately being decided by the committee itself.
2. Responsibilities of Independent Auditors—SOX requires the lead and reviewing partner of the auditing firm to rotate off the audit every five years, and thus it is recommended that CILs adopt this strategy. It is even suggested that the audit committee consider hiring an entirely new auditing firm every five years for the purpose of freshness and clarity in the audit.
3. Certified Financial Statements—Statement signed by both the CIL’s CEO and CFO (if present), providing formal assurance that both have reviewed the financial documents carefully and stand by them.
4. Insider Transactions & Conflict of Interest—Strongly discourages nonprofit organizations from providing personal loans to its directors or executives. Also encourages all nonprofits to have a conflict of interest policy in place.
5. Disclosure—Encourages nonprofits to practice full disclosure of its finances for the purpose of accommodating public trust. This would include prompt and complete filings for its Forms IRS 990, SF-425, and IRS 5500.

The following two provisions of the Sarbanes-Oxley Act apply to all entities because they are amendments to the federal criminal code, so all nonprofit organizations need to comply with them.

6. Whistle Blower Protection—Strong protections to individuals who risk their careers to expose and/or question fiscal irregularities sends the public a clear message that illegal or unethical practices will not be tolerated by an organization. Therefore, nonprofits are wise to develop, adopt, and disclose a formal process to acknowledge and deal with complaints and prevent retaliation.
7. Document Destruction—SOX makes it a crime to alter, cover up, falsify or destroy any document to prevent its use in any official proceeding (i.e., investigation, prosecution, etc.). CIL directors and managers should consult UAR 45 CFR 75.361, which addresses record retention.

Net Assets

In today's environment, the term "nonprofit" could, in a sense, be considered a misnomer. The operation of such a corporation is often as complex as managing a for-profit enterprise. Nonprofit designation could therefore be viewed as more of a legal status in terms of tax consequences than with respect to the business function of the organization. With this in mind, it can be argued that the nonprofit could or should earn a profit. If this occurs, this is identified as *net assets* or *fund balance*. The term "net assets" is used in the financial statements. No funds can be distributed to board members, shareholders, or principal of the corporation, since there are no "owners" of a nonprofit. However, striving to achieve surplus funds on an annual basis, which are then applied to the mission of the organization or put to underwriting operating expenses, is simply good business practice. This achieves three important outcomes by:

- Making the organization more "solvent" from a cash-flow and liquidity basis.
- Providing a "safety net" pool of funds for development or ongoing operations.
- Earning additional revenue for services based upon interest or investment earning.

Many auditors will suggest that an adequate fund balance should be three to six months of operating expenses or 25 percent of annual budget. But, development of a fund balance is very much a philosophical and policy decision that the board should evaluate. The board will want to consider how much operating reserve it should have based on such factors as tolerance for risk on investments, financial and organizational history, and capacity. It should also balance the competing needs of reduced or limited services versus net asset fund development.

Restricted Fund Balance—Excess revenues at the end of a fiscal year that were donated for a specific or restricted purpose are classified as *restricted net assets*. These must be held in reserve for the categorical use for which they were received. An example would be a donor who grants a cash gift for a specific capital project. Excess funds in reserve once the capital program is completed cannot be used for operating expenses unless the donor gives express permission. Another example would include excess revenue in a fiscal year from a contract source (although generally these amounts would not be recognized as revenue until services are performed; therefore, they do not result in net assets). The funds may be used by the organization, but, according to the terms of the contract, can only be used in the program area from which they were generated. Conversely, there are some contract sources, including government contracts, that allow for retention of funds that are not restricted to the program from which they were generated, but for general organizational use. When there is doubt about the classification of a source of

excess funds, the grantor is usually the best or most prudent decision- maker in this matter. The auditor's role is to confirm this classification of excess revenue.

Temporarily Restricted Net Assets—Temporarily restricted fund balances consist of funds that were received by the organization with a donor-imposed restriction that will lapse upon occurrence of conditions specified by the donor. An example would be a gift received by the CIL with stipulations that funds were to be used only for operating expenses of a new program yet to be implemented by the organization. The funds would not be available for use until the new program was implemented.

Unrestricted Net Assets—Those that can be used for any general purpose the board and management deem appropriate in furthering the mission of the organization. This use can include operational expenses, equipment needs, capital projects, etc. These are funds generated from a source that has placed no requirements for specific use upon its excess funding.

Another facet of net assets is the organization's *total assets*, which include unrestricted, temporarily restricted, and permanently restricted net assets. Permanently restricted net assets cannot be spent, although income from them can generally be spent.

Property and Equipment— The value of property and equipment should be recorded. Accurate property and equipment valuation stems in large part from competent inventory control measures. This begins in purchasing policy and practice when assets are either purchased or donated. In order to establish good practice in this area, some key considerations are:

- Accurate recording of the acquisition, including date and cost (valuation if donated)
- Contract that the asset is expensed or charged to
- Location
- Physically tagging or serial numbering the item with organization name and asset item number

These practices will facilitate the auditor's review of the fixed asset inventory; the organization will then make a decision on the "useful life" of the asset (possibly with a recommendation from outside accountants). This will in turn determine its depreciated value.

Remember to remove from your inventory list any equipment, furniture, etc. that is lost, stolen, damaged, or disposed of.

Additional Annual Filings

IRS Form 990

The IRS Form 990 that is required of all 501(c)(3) organizations is a public document that must be shown to anyone requesting to see this public filing form. This form reports information about the organization's income and expenses, assets and liabilities, as well as its governance and compliance with regulations. This form also contains information about the organization's mission

and its program service accomplishments. Additionally, it includes information about the organization's staff whose salaries exceed a certain dollar amount, and about the CEO's salary. It is good practice to share this annually with the board. The auditor typically prepares this filing.

SF-425

The Standard Form 425, or more commonly known as the SF-425, is a one-page financial status report that may be requested quarterly and must be filed no less than annually, the same time as your 704 Report but under separate cover. This report details how much of your federal award has been expended and how much you earned and spent in program income. The primary concern on the part of the funder is how much federal money you actually spent and whether the center has any unobligated or unspent funds at the end of the fiscal year.

Freedom of Information Act or Sunshine Law

In addition to tax filings that are public documents, nonprofits are also subject in certain circumstances to the *Federal Freedom of Information Act* or *Sunshine Law*. Generally speaking, publicly funded organizations are required to open up for public inspection any information that is required to be submitted by the organization to a governmental agency. While there are restrictions, much financial information that would be considered confidential or sensitive could be subject to this disclosure. Board and finance committee minutes are usually subject to disclosure, but executive committee sessions may not be, and executive sessions (usually to discuss personnel matters) typically are not. These requirements vary greatly from state to state, though, so you should research the Sunshine Law for your state as you develop your policies around this.

Prudent management and financial practice remains cognizant that most of your operations are public, and information should be recorded that *accurately* and *fairly* represents the decision-making and policy practice of the organization. Anyone who requests organization information under the Sunshine Law is entitled to review it and may request copies of the information. The law provides for nominal reimbursement by the inquiring party to the organization. If you have questions regarding the legality of releasing certain information, it is a good idea to check with legal counsel in your state.

Chapter Thirteen: Risk Management

Risk Management encompasses a broad range of activities, practices, policies, and business functions. This section is limited to a discussion on insurance as a risk management component (along with policies and procedures and training) and a sample financial policies document that can be tailored to meet the needs of your center. Other risk management areas such as Quality Improvement, Total Quality Management, and Quality Assurance are some of the other examples the nonprofit should consider in concert with board policy makers.

More than a simple selection of insurance products for managing risk, the process of risk management assesses the potential for risk, and determines the need for insurance products, which limit exposure to the identified risk. An organization with a service program that feeds the homeless and serves 1,500 meals a week has a very different risk exposure than an organization that provides advocacy for 1,500 people annually.

A board that has a diverse representation of business, social, and professional interests is an excellent resource for assessing the risk exposure of the service capacity of the organization. Use of consultants and independent insurance agents can also be used in an advisory capacity in assisting the board and management in assessing risk exposure.

Once the *areas* of risk have been identified, the *level* of insurance in terms of coverage and amount should be considered. For example, an organization that provides advocacy with net assets of \$50,000 has an entirely different risk exposure than an organization with net assets of \$2 million, housing individuals with mental illness who are homeless. Issues such as property and casualty, provision of medical care, and 24-hour oversight expose the organization to greater risk of a significant lawsuit in the event of a negligent action.

Balancing the level of risk to the potential for loss must be carefully considered before any risk policies are purchased. Listed below are several forms of common insurance policies that are routinely considered by nonprofit boards.

Insurance Products

Directors & Officers Insurance (D&O)—Affords protection to the governing body (board of directors) by providing coverage for costs of defending a lawsuit (e.g., wrongful discharge), settlements in a suit, and judgments in covered suits against board members and CEOs. In considering this coverage, the board (which actually contracts for the policy) should determine its tolerance for risk versus the cost of the policy. Another consideration is the protection under state law. For example, in New York, the Public Officers Law affords a certain degree of protection to board members from personal liability in a suit pertaining to an organization's affairs. If the board is acting in a "prudent" manner, the fiduciary risk they carry is limited under certain law, minimizing the need for D&O insurance. This is, however, highly variable from state to state. Legal counsel should be sought in considering this type of coverage, particularly with respect to consideration of the protections under state statute.

In reviewing D&O coverage, be sure to ascertain if the policy provisions pay for defense costs of a suit, or if the organization is required to defend itself *and lose* before a claim is paid. Most boards will want “affirmative defense” covering up-front defense costs as opposed to “post defense” coverage. Also, note the limitation of coverage, e.g., \$1 million per claim with 10 board members only covers \$100,000/MBR average before legal expenses.

General Liability Insurance (GL)—Typically included as a component of property and casualty coverage. GL insurance is usually required by a funding authority and may be a stipulated amount such as \$1 or \$3 million in aggregate coverage. This coverage protects the corporation from actions or suits brought against either the organization or an individual staff member with respect to professional practices.

Property & Casualty (P&C)—Coverage should be considered for protecting the assets of the corporation. These include real property, buildings, furnishings, and equipment. Typically, P&C and GL insurance products are “bundled” together as a package. This “bundled” product is often less expensive to purchase than the liability component alone. While they can be purchased separately, a quote for pricing both should be examined. If the organization does not require P&C coverage, consider purchasing a “nominal” amount of coverage (e.g., \$1000). You may find that the bundled package premium is lower than GL insurance alone. If you do not need P&C coverage due to little or no property and the cost is not lower for a “bundled” product, then any equipment and furnishings could be insured under a “contents” policy. This is particularly so if the organization rents space and holds no property.

Remember, if any equipment or furnishings are leased or financed, the lending institution will probably file UCCs (Uniform Commercial Codes) on the asset and will typically require some form of insurance until the lien is satisfied.

Professional Liability & Bonding Insurance—Another form of risk management insurance to consider is professional staff liability and personal bond insurance. Professional liability insurance will provide a source of funds for defense and payment of claims relating to professional malpractice. Bonding provides a source of recovery in the case of an employee theft or misuse of funds. Bonding protects an organization from financial losses resulting from either intentional or unintentional irregularities in the handling of money. As with any insurance, a premium is paid at regular agreed upon intervals and limits are placed on the maximum amount to be paid off. Naturally, the greater the limit is, the higher the premium. One way to determine a bonding limit is to anticipate the greatest amount of money an organization would have in the bank at any one time—in other words the largest amount that would ever need to be reimbursed—and add 20 percent.

Both of these coverages should be evaluated by the board with input from their insurance agent.

Tangentially, bonding may also play a role in fundraising efforts as many funding sources will require evidence of bonding before they will consider contributing dollars to a nonprofit organization. Again, this is simply one more step forward in the path of becoming a proper steward of public funding.

Errors & Omissions Insurance (E&O)—Insurance protects the organization from an act that is due to an error or omission by the staff that is unintentional. An example would be an employer who

offers health insurance but fails due to a clerical error to enlist the employee in the plan. In an event where the employee incurs economic loss due to the lack of coverage, the E&O policy might cover the loss due to the clerical error. Your insurance carrier can assist you in understanding the difference between Errors and Omissions and Professional Liability coverage and assist you in deciding on the best fit for your center's operations.

Consortia Purchasing—Often, nonprofit providers belong to or can join a trade organization. Such trade organizations usually include consortia purchasing, which can include insurance products that are typical for the trade. These organizations can serve as a clearinghouse for risk management purchasing and services, in addition to group purchasing for consumable supplies among its membership. At the very least, consortia involvement allows the organization to examine what other similar organizations are purchasing. This facilitates a review of products in terms of coverage and premium costs and can help to quickly assess the general provisions for coverage. This affords a quick synopsis of the market without having to conduct a formal RFP process.

A cautionary note: Consortia purchases, while at times less expensive, are often a “canned” or prepackaged form of coverage. Be sure to consider your individual organization needs and the total scope of coverage that is deemed necessary, rather than coverage that has the lowest cost. Also be aware that rates established in these consortia are based on the average risk of all members. Therefore, it may not be a good choice for organizations with a good record in the area of insurance they are purchasing.

After you have selected the type and amount of coverage, it is good practice to periodically re-bid your coverage to the market. This can be a labor-intensive process for CIL staff and the companies who choose to bid the RFP. As a result, a market cycle of every three to five years should afford a prudent measure of these products and their costs without causing undue work on administrative staff.

If you are working through an independent agent, inform them at the outset what your market cycle will be. This will prepare both you and your agent for this competitive bid process and may reduce your costs further *before* you reach your market cycle end date.

Executive Risk—There are emerging national trends where certain liability can be assigned to the CEO. With recent changes in Federal Welfare reform, most states have adopted managed care plans for the constituent populations many nonprofits serve. In at least one state, under certain circumstances personal liability including criminal fines and prison terms can be assigned by courts if a CEO is found in violation of federal reimbursement rules and regulation. This new phenomenon is recent and highly variable from state to state. Organizations that accept federal contracts, and particularly Medicaid reimbursement, should carefully review the provisions of their contract and seek legal counsel within their own state as to the legal liabilities and protections that can be assigned to the CEO. Based upon this information there are additional policies and procedures the CEO and the board may wish to adopt in recognition of state and federal law.

Fiscal Management Policies

In addition to meeting the requirements of regulatory guidelines, another important way to control risk and exposure is to develop and implement fiscal management policies. These policies should include the following areas:

- Resource Planning & Allocation
- Accounting & Financial Practices
- Capital Improvement
- Debt & Investment Management
- Overall Organizational Management
- Computer and Internet Policies/Computer Security Policies
- Investment of excess funds
- Retirement plan investment guidelines
- Gift acceptance (what happens when you receive a gift of stock or a potential gift of real estate)
- Code of Ethics
- Conflicts of Interest

Depending on the size and needs of the organization, other policy categories may be added. Typically, these policies are developed by the executive director, controller, and other key staff. Once the policies have been reviewed at an operational level, the board of directors or the finance committee should review the policies, make necessary adjustments, and ultimately recommend that the full board adopt the policies. This document becomes the road map for financial decisions and direction. The board as well as the center staff should be held accountable for implementing and abiding by the adopted policies.

See IL-NET Sample Fiscal Policies and Procedures Handbook: A Set of Policies and Procedures with Annotations for Use in Training for Centers for Independent Living at <http://www.ilru.org/il-net-sample-fiscal-policies-and-procedures-handbook>.

Chapter Fourteen: Ethical Dilemmas in Financial Management

Why Ethics Are Important

It is important for you and your employees to be sensitive and knowledgeable of ethical issues. Leadership at all organizational levels, including your board of directors, administrators, and other managerial staff, are responsible for establishing the culture for how your CIL does business and providing oversight. They also provide an example of appropriate behavior and education on ethical issues and decision-making. Unethical and/or fraudulent behavior can have a negative effect on both the financial and emotional state of the organization.

Some employees may not understand what is at risk if they don't behave in an accountable, ethical manner. Education and an ongoing ethics program will help reduce their rates of misconduct and provide multiple other benefits. Implementing an ethics program provides numerous benefits to the organization, administrators, employees, consumers, and funders.

Incorporating ethics in operating values and organizational roles will create a stronger organization that is proactive, not reactive, with a structure to resolve ethical dilemmas. An ethics program helps identify, align, and integrate organizational behaviors with values and decision-making. It supports employee growth and meaning and aligns employee behaviors with ethical values. Implementing an effective ethics program will also benefit your bottom line.⁵¹

Your CIL's culture influences your employees' organizational commitment, satisfaction, perceptions of leadership, and performance. Employees who trust in your ethics and integrity will believe that you won't try to cheat or deceive them. In turn, employees who are treated ethically and fairly are more likely to treat consumers fairly and honestly. Treating all employees and consumers in an ethical manner with particular care has been found to inspire loyalty, honesty, and productivity (Posters, 2003). Your employees are apt to be more motivated and work more effectively as a team. Organizational psychologist Rensis Likert said that, "The greater the loyalty of a group toward the group, the greater is the motivation among the members to achieve the goals of the group, and the greater the probability that the group will achieve its goals."

Behaving ethically also helps to create a strong positive public image, identity, and reputation, which can lead to a more supportive political and regulatory environment, as well as an increased level of confidence and trust among your constituencies and stakeholders (ERC, 2009). Being transparent in your finances will help your funders (as well as your board and consumers) understand how you spent their money and how it made a difference in achieving your mission. This public confidence not only helps you

⁵¹ International Public Management Association for Human Resources <http://ipma-hr.org/>

raise more money, but also means that the community is more willing to believe in what you do and what you stand for.

Most people understand that ethics are important to avoid illegal or criminal activities. But it is equally important to understand the value of detecting issues and violations early on so they can be appropriately addressed. Admitting and correcting errors actually enhances your credibility and makes you more believable. It gives people faith that you will right your future wrongs.

When Ethics Are Questionable

Many people have lost faith after the plethora of recent scandals and examples of unethical behavior across the U.S. from individuals, companies, government, churches, and nonprofits.

While there are many examples of unethical and fraudulent activities, the following is a list of some of the more common examples found in nonprofit organizations of any size:

- Intercepting incoming monies at the organization's location
- Refunds from intentionally overpaying or duplicate payment of a bill
- Paying a friend or family member for a service or product he or she did not actually provide
- Forging signatures on checks or other legal documents
- After the check is signed, erasing the payee name and replacing it with someone else
- Payroll checks for employees who are not employed
- Payroll rates or hours that are improper
- "Double-dipping" or double reimbursement to an employee
- Misuse of credit cards and tax exempt status, including failure to provide the detailed receipt for the items purchased on the credit card
- Improper accounting for vacation and sick time
- Theft of money and/or goods at fundraising events
- Recommending a product, then accepting a "kickback" from the vendor in the form of a cash card or other item of value

Even some CILs have engaged in unethical and illegal practices that have resulted in CIL closures, employee terminations, and legal repercussions. The ultimate outcome is a loss of services to consumers in need in any given community.

While it is an expectation that the executive director and the board of directors will keep a watchful eye on the ethical behavior of the center, this is not always the case and in some instances is not possible.

The following are a few examples of situations that may occur at a center. If not handled correctly, these can fall into the category of unethical or illegal behavior.

- A member of the finance committee is the VP of a local bank and insists that the center transfer all of its business to his/her bank.
- The CIL's auditor is the executive director's personal accountant.
- A program contract ran out of funding and you want to continue to employ the staff person in the program so you charge their salary to another contract.
- You are planning a fundraiser to support a new ramp construction program. The actual cost to run the program is \$25,000. You decide to tell the public that the cost is \$45,000 so you can raise enough funds to cover a staff retreat.
- The center CFO reports the monthly financials and does not disclose that the line of credit has been accessed in order to cover monthly expenses.
- A private foundation makes a grant to your CIL for a program that is no longer appropriate for you to operate. What do you do with the unexpended funds?
- Your CIL operates a horseback riding program and receives a donation of a horse. How do you determine its asset value for your auditors and subsequent IRS report?
- If your center newsletter accepts paid advertising, do you declare and pay the tax?
- Your center attorney (paid) is also a board member. Is this an issue?
- Your local United Way requires you to submit annual audited financial statements and the corresponding management letter. You respond with the financial statements and tell them you did not receive a management letter this year.
- As a program manager you have overspent your training budget. You have \$245 in training receipts that you need to submit so you charge them to the office supplies line item.
- You need to make a few large purchases for the organization. Given that you have a personal credit card that earns frequent flier miles, you make all of the purchases on your personal card and bill the CIL for reimbursement.
- Because you work for a nonprofit that does not pay tax, you carry a tax exempt form with you. You are school shopping with your son and decide to use the CIL's tax exempt form to save a few dollars.

Why Do Centers/Nonprofits Engage in Unethical Practices?

- Unethical individuals in key positions—it is the nature of their character.
- Business has always been conducted that way.
- Individuals are not aware of policies and regulations.
- The center is in financial trouble.

- The staff person is in financial trouble and intends to “borrow” to get through the difficulty.

Financial trouble is probably the most likely reason centers engage in unethical practices or behaviors. Instead of traveling down the path of unethical or even illegal practices, centers can engage in more productive ways to help avoid financial trouble. These suggestions include:

- Become aggressive about your accounts receivables.
- Discontinue programs/services that are no longer financially viable.
- Merge with another financially strong center or other nonprofit.
- Restructure the CIL.
- Implement a cost reduction program including layoffs and attrition.
- Increase fees.
- Prepare a plan to increase fundraising and donations.
- Apply for grants.
- Consolidate capital investments—real estate.

What Can the Board and Leadership Team Do to Help Deter Unethical Behavior?

Given the amount of overall responsibility a CIL’s leaders and board members have, it is imperative that they take every action possible to avoid any type of or suspicion of a conflict of interest. One way to do this is to have a *conflict of interest policy*. In fact, the UAR mandates that all recipients of federal funds maintain a written conflict of interest policy, including policies on gratuities and disciplinary actions for violations.⁵² The policy should be given to, understood, and signed by each member of the leadership team and board. It is also a best practice to have each staff member follow the same protocol.

Instituting annual conflict of interest disclosure questionnaires as part of a conflict of interest policy is another effective strategy to ferret out potential problems. In addition to prompting leaders to think about current conflicts, it also encourages them to consider avoiding them altogether in their future dealings.

Finally, as a way of leading by example, CIL board and other meeting minutes should reflect when conflicts of interest are revealed and, perhaps more importantly, how they were resolved, a procedure again inquired about in Form 990.

See Appendix C for Model Conflict of Interest Policy Forms.

Other steps boards and leaders can take to discourage unethical behavior include:

⁵² 45 C.F.R. § 75.327(c)(1).

- Demonstrating zero tolerance for any unethical behavior.
- Placing a high priority on developing and implementing internal controls.
- Having written policies and procedures that outline codes of conduct as required and outlined in Uniform Guidance.
- Taking the role of fiscal oversight seriously by reviewing financial reports, questioning variances, and conducting internal audits.
- Providing training on reducing the risk and opportunity for unethical behavior.

The Bottom Line: Unethical practices may promote or lead to illegal activities. Crime does not pay. Ever!

As a board member, as an executive director, as a program manager or as CIL staff, don't ever be lured into unethical practices in an effort to cover up or make up for fiscal trouble. Sound fiscal management is more likely your answer to fiscal trouble!

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Appendix A:
EXAMPLE Finance Committee and Staff
Responsibilities for Fiscal Matters

EXAMPLE Finance Committee and Staff Responsibilities for Fiscal Matters⁵³

The finance committee assists the board of directors in overseeing the finances of the organization and advises the board on the overall direction and control of the finances.

Committee Responsibilities	Management/Accounting Responsibilities
Meets on a regularly scheduled basis.	Meets with finance committee regularly.
Assures that the board of directors is well informed on the organization's finances.	Provides information and training as needed.
Reviews and recommends for board approval an annual operating budget that reflects the organization's goals and board policies.	Prepares proposed budget and presents it to the finance committee with justification for line items. Proposes budget revisions when variances occur.
Assures that income, expenditures, and program activities are consistent with projections. Presents regular financial statements to the board.	Monitors income and expenditures daily and prepares financial and program reports for finance committee review on a regular basis.
Reviews and recommends financial policies and procedures (such as internal controls) to the board that meet standard accounting practices.	Presents policy issues in a timely fashion. Prepares draft documents for committee review. Implements policies established by the board.
Conducts or oversees long-range planning for resource development.	Assists committee with analyzing goals, objectives, and outcomes for the organization's financial future.
Reviews proposed funding for financial impact on the organization and recommends acceptance or rejection by the board.	Researches sources of funding and presents recommendations to committee. Prepares information and drafts proposals and contracts for committee consideration.
Assures that the organization maintains adequate and appropriate insurance coverage.	Collects and analyzes information on insurance needs and options for finance committee consideration.
Reviews credentials and services of potential auditors and makes appropriate recommendation to the board. Reviews organization's readiness for annual audit, and receives and reviews the audit.	Prepares background information and recommendations. Assists in development of committee work plan, training, and evaluation.
Monitors management's implementation of auditor's recommendations.	

⁵³ Adapted from *The Finance Committee: The Fiscal Conscience of the Nonprofit Board*. N. Holmgren, National Center for Nonprofit Boards, 1995.

Appendix B:
EXAMPLE Independent Auditor's Report

EXAMPLE INDEPENDENT AUDITOR'S REPORT

Certified Public Accountants

To the Board of Directors

Client Name

Anywhere, USA

We have audited the accompanying financial statements of Client Name (a nonprofit organization), which comprise the balance sheets as of December 31, 2015 and 2014, and the related statements of activities, statements of functional expenses and statements of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Client Name as of December 31, 2015, and 2014, and its cash flows for the years then ended and the changes in net assets and functional expenses for the year ended December 31, 2015, in accordance with accounting principles generally accepted in the United States of America.

EXAMPLE REQUIRED COMMUNICATIONS LETTER TO MANAGEMENT (management letter)

To the Board of Directors

This letter is intended only for the board and those responsible for management and governance. It includes key findings and recommendations from our recently completed audit. Although we do have some internal control observations, we did not perform an examination of your internal control that would allow us to give an opinion on the adequacy of your controls. We welcome and encourage your response.

Those charged with management and governance are responsible for:

- ✓ safeguarding your assets,
- ✓ ensuring that your resources are used as directed by funders and donors, and as required by charities laws and your own articles of incorporation,
- ✓ assuring that you are complying with laws, regulations, contracts, and grants associated with your funding,
- ✓ properly recording and reporting results of operations and account balances, and
- ✓ proper business practices, operating procedures, documentation, and controls.

Our audit was designed to help you with those responsibilities, and is also designed and intended to help you to benchmark your administrative operations to best practices.

Our Responsibilities to You

As part of our audit we are required to inform you of significant deficiencies and material weaknesses in your controls that we become aware of.

Controls are procedures, policies, and responsibilities that you put in place to make sure that appropriate transactions take place and are reported properly on your financial statements. Examples of controls are timely billing for services you perform, ensuring proper payments are received and recorded, and measures to prevent overpayment of payroll or vendors.

Control deficiencies result when proper procedures are not in place to assure that appropriate transactions are carried out, recorded, and reported properly.

Significant deficiencies are control deficiencies or combinations of control deficiencies that are less severe than material weaknesses, yet important enough to merit attention by those charged with governance.

Material weaknesses are significant deficiencies or combinations of significant deficiencies such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

The Role of Internal Controls

Internal controls are managements' standards to safeguard your assets. They include the following components:

Setting expectations of integrity and ethical conduct, with actions such as proper hiring and training,

Assessing risks based on your operations and your staffing,

Establishing control activities, such as separation of responsibilities, to reduce risks,

Communications from senior management to all involved staff about internal controls, and

Monitoring ongoing evaluation of whether controls are appropriate and are working.

General Observations

Our general observations are that:

- ✓ Your record keeping system is appropriate for your financial recording and reporting needs, including allocation of revenue and expense to various programs.
- ✓ Record keeping appears to be done in a timely, complete and conscientious manner.
- ✓ Internal controls are good given your staff size. We do have a few recommendations.
- ✓ We did not have disagreements with management in connection with our audits or difficulties in performing the audits, and, to our knowledge, management did not consult with other CPAs about audit issues.
- ✓ We did not become aware of fraud or illegal acts, and there were no significant financial statement adjustments or unusual transactions.
- ✓ No material accounting adjustments were left unrecorded.

We had other observations and recommendations that we believe merit management's attention. They are:

Comment: The Organization does not have a formal accounting manual documenting the procedures for fiscal operations.

Recommendation: We recommend that operating guidelines for fiscal activities be prepared including a description of each fiscal procedure.

Management Response:

Comment: The size of the Organization's accounting and administrative staff precludes certain internal controls that would be preferred if the office were large enough to provide optimum segregation of duties.

Recommendation: This situation dictates that the board of directors remains involved in the financial affairs of the Organization to provide oversight and independent review functions.

Management Response:

Comment: The following internal control deficiencies were noted during systems documentation and testing:

- the daily check log is not sequentially pre-numbered nor is the date of receipt noted in the check log
- checks are stamped "for deposit only" by the same person who prepares and makes deposits.

Recommendation: We recommend the use of pre-numbered forms and review thereof. We also recommend that checks be stamped by the individual opening the mail in order to segregate the record keeping and custodial functions.

Management Response:

Comment: Cash receipts are not always deposited in a timely manner.

Recommendation:

We recommend a policy be established to deposit cash on a daily basis.

Management Response:

Comment: Instructions to execute federal wire transfers from the Rehabilitation Services Administration (RSA) and related PIN number were readily accessible.

Recommendation: We recommend that this information be secured with access limited to appropriate personnel.

Management Response:

Comment: Supervisory personnel do not review bank reconciliations.

Management Response:

Comment: The signature sheet for notification to of the Organization's personnel policies is not utilized.

Recommendation: We recommend all employees acknowledge receipt of the Employee Handbook and documentation thereof be retained in personnel files.

Management Response:

Comment: Several invoices for fixed asset additions could not be located.

Recommendation: Payments for goods and services should be made only from approved invoices and these invoices should be retained for adequate documentation.

Management Response:

DISPOSITION OF PRIOR YEAR COMMENTS

Revenues/Receivables/Unearned Revenues

Comment: In our audit of grant revenues, we also tested the related grant receivable asset account and unearned revenue liability account for reasonableness. Numerous adjusting entries were required to correct the grant receivable, unearned revenue, and grant revenue accounts. These entries were required as a result of the previous bookkeeper's lack of formal accounting training. We noted a significant improvement in the accounting records and expect few entries next year in this area with the new accountant's education, experience, and background.

We recommend that management and accounting personnel review the revenues, receivables, and unearned revenues recorded on the trial balance on at least a quarterly basis to determine if adjustments are necessary.

Status: This comment has been addressed by management.

Segregation of Duties

Comment: Under a good internal control structure, the origination and completion of a single transaction are never under the control of the same individual. To improve the structure, office functions should be planned carefully to provide cross-checks between office workers.

Overall, the Organization has done well segregating duties among office workers, considering the limited size of the Business Office. However, there are areas in the cash receipts, disbursements, and payroll cycles that could be improved. We recommend that management review these areas for opportunities for improvement and make changes in the systems when it is feasible to do so.

Status: See current year comments.

Policies and Procedures Manuals

Comment: The Organization does not maintain a manual of current accounting policies and procedures, nor a personnel policy manual.

We recommend that the Organization develop and maintain on a current basis an accounting policies and procedures manual that documents all accounting applications and the related controls. The manual should contain general accounting policies as well as specific procedures performed in processing accounting information, personnel responsible for performing such procedures, and approvals required before processing. All accounting personnel should also have a thorough working knowledge of the manual.

The Organization should also develop a personnel policy manual that includes job descriptions, duties, and responsibilities of administrative and financial personnel.

Status: See current year comments.

Fidelity Bonds

Comments: We noted that there was no clear policy as to which employees were bonded or should be bonded. We suggest that the Organization review its bonding policy and ascertain that the employees who handle cash are properly bonded for an amount equal to the necessary minimum.

Status: This comment was addressed by management.

Very truly yours,

Appendix C:
EXAMPLE Conflict of Interest Forms

Model A

**Conflict of Interest Form
ABC Center for Independent Living**

I, _____, have been fully informed and I agree to bring to the attention of the supervising authority any real or perceived conflicts of interest that may arise during the course of my employment with the organization. I understand that at all times the interests of the organization must be a priority in all decisions and actions.

Such conflicts include, but are not limited to, personal relationships and representations, professional affiliations, business dealings, involvement with other organizations, and any other vested interest that may cause me to have personal gain over organization gain.

In the event that there is conflict of interest or a perceived conflict, I agree to support and act on the decisions made in the related discussions.

Name & Title _____

Signature: _____

Date: _____

Model B

**Conflict of Interest Policy
ABC Center for Independent Living**

Conflict of interest, defined as an actual or perceived interest by employees or representatives of ABC, is an action that results in, or has the appearance of resulting in, personal gain.

Employees and representatives are obligated to always act in the best interest of the organization with an unbending duty of fidelity and loyalty. This obligation requires that the interests of the organization must be the first priority in all decisions and actions. At all times, officers and board members are prohibited from using their job title or the organization's name or property for private profit or benefit.

- A. Employees and representatives should neither solicit nor accept gratuities, favors, or anything of monetary value from contractors/vendors. This is not intended to preclude bona fide organization fundraising activities.
- B. Employees and representatives shall not participate in the selection, award, or administration of a purchase or contract with a vendor where, to their knowledge, any of the following has a financial interest in that purchase or contract:
 - 1. Employee/representative
 - 2. Member of his or her immediate family
 - 3. His or her partner
 - 4. An organization in which any of the above is an officer, director or employee
 - 5. A person or organization with whom any of the above individuals is negotiating or has an arrangement concerning prospective employment
- C. **Disclosure**—Any possible conflict of interest shall be disclosed by the person or persons concerned. Disclosure statements must be signed and filed with the organization annually by employees and representatives.
- D. **Board Action**—When a conflict of interest is relevant to a matter requiring action by the board or organization, the interested person(s) shall provide full disclosure, and shall not vote on the matter. Also, the person(s) shall not participate in the final decision or related deliberation regarding the matter under consideration. When there is a doubt as to whether a conflict exists, the matter shall be resolved by vote of the board, excluding the person(s) concerned.
- E. **Record of Conflict**—Official minutes of the board shall reflect that the conflict of interest was disclosed and the interested person(s) did not participate in the final discussion or vote and did not vote on the matter.

Official Title (e.g., ABC CIL)

Name of Employee or CIL Representative (e.g., Roger Smith, President)

Signature and Date

**Appendix D:
Regulatory Resources Web Addresses**

IL Regulations, Uniform Guidance, FASB, & More

Document	Parts/Title	Web Address
IL Regulations	45 CFR 1329	https://ecfr.io/Title-45/pt45.4.1329
ACL		http://www.acl.gov/
Uniform Guidance	2 CFR 200	https://cfo.gov/cofar/ or https://www.ecfr.gov/cgi-bin/text-idx?tpl=/ecfrbrowse/Title02/2cfr200_main_02.tpl
Uniform Administrative Requirements	45 CFR 75	https://www.ecfr.gov/cgi-bin/text-idx?tpl=/ecfrbrowse/Title45/45cfr92_main_02.tpl
Other:		
Accounting Guidelines	FASB Accounting Standards Codification	https://www.fasb.org/store/subscriptions/fasb/newf
Return of Organization Exempt from Income Tax	IRS Form 990	http://www.irs.gov/pub/irs-pdf/f990.pdf
Federal Financial Report	OMB SF 425	https://www.gsa.gov/portal/forms/download/149786