GUIDE TO BASIC BOOKKEEPING FOR NOT-FOR-PROFIT ORGANIZATIONS

RURAL DEVELOPMENT SECTION 523
MUTUAL SELF-HELP HOUSING PROGRAM

December 2002

A Guide for Grantees of the USDA Section 523 Self-Help Housing Program

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Little Dixie Community Action Agency, Inc. (LDCAA)
National Council of Agricultural Life and Labor Research Fund, Inc. (NCALL)
Rural Community Assistance Corporation (RCAC)

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Published in 2002 by the T & MA Contractors, this guide is designed to provide accurate and authoritative information in regard to the subject matter covered. It is distributed with the understanding that the authors are not engaged in rendering legal, accounting, or other professional services. If legal or other expert assistance is required, the services of a competent professional person should be sought.

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INTRODUCTION

The Self-Help Program

Self-Help Housing is just as it sounds: Participants working together to build their own homes. This cooperative effort is a direct application of the church and barn raising techniques of the Amish and Mennonites. The participants supply the necessary labor while qualifying for mortgage financing to purchase land, materials, and subcontract work on very technical items. A private nonprofit corporation, public body, or rural town can obtain a grant from Rural Development to hire skilled staff, rent office facilities, pay for mileage, and purchase tools. This staff then works with the participants by providing the assistance and training necessary to fulfill the goals of the self-help housing program. The specifics of the program are described below.

With the assistance of the skilled staff, an association of generally 4 to 10 households is formed. (Once the grant is completed, at least 40% of the total participants served must have been very low income, 50% or less of the county median income.) They select lots, house plans, and apply for individual mortgage loans. While participants await loan approval, the group studies the responsibilities of homeownership, construction techniques, tool usage, safety, homeowner's insurance, taxes, home maintenance, and money management. This time is known as the pre-construction stage.

Once the loans are approved, the group begins to build under the guidance of a skilled construction supervisor. The participants must complete a minimum of 65% of the construction labor tasks, until the group of homes is completed; usually the more technical work is subcontracted out. The construction stage lasts from 6 to 12 months, depending on the size of the group. Participants work during their spare time (evenings, weekends, and days off) so as not to interfere with the regular household employment. Rural Development loans feature interest rates ranging from 1% to the market rate, depending on the household's adjusted annual income. The repayment period is 33 or 38 years and no down payment is required.

Rural Development

Rural Development is an agency of the United States Department of Agriculture. It was originally a credit agency for lower income farmers who could not qualify for loans elsewhere. Since the 1960's rural non-farm households have been eligible for mortgage credit. Rural Development's function as a lender is significant because private credit institutions in rural areas are relatively few in number, smaller, and often impose more rigid terms, which can be a barrier to homeownership.

The Rural Development mission is to help rural Americans improve the quality of their lives. Rural Development helps rural communities meet their basic needs by:

- Building water and wastewater systems,
- Financing decent, affordable housing,
- Supporting electric power and rural businesses, including cooperatives, and
- Supporting community development with information and technical assistance.

Rural Development has been providing the funds for the self-help housing program since the late 1960's. They provide technical assistance grants to eligible entities to start and implement the program and they thoroughly review the preapplication and final application before a grant is awarded. When a grant is awarded, Rural Development is saying that there is a need for self-help housing in this area; this agency is suited to administer a self-help housing program; the proposed plan, budget and schedule are feasible; house plans meet local, state and Rural Development building codes; adequate building sites are available; the project ingredients are in place; and Rural Development is ready to provide the financial resources necessary to make the project work. There is no charge to participating groups. Grant funds provided to grantees by Rural Development do not have to be repaid. It is an investment Rural Development is willing to make in order to see self-help housing work.

Rural Development will continue to monitor and provide oversight in the areas of construction and administration, through quarterly meetings, construction inspections, and participant accounts throughout the term of the program.

In many cases Rural Development provides another important ingredient to the self-help program, construction/permanent financing. They are independent of private or conventional lending institutions; the financing is directly between Rural Development and the borrower. While labor and construction are group efforts, each applicant must qualify and obtain a loan directly from Rural Development.

Rural Development Offices

Rural Development usually operates from four levels: national, state, area and local. The National Rural Housing Service Administrator in the National Office and the State Directors are politically appointed – all others are federal civil service employees.

Rural Housing Service National Office

The Rural Housing Service National Office is responsible for developing policy and interacts with Congress for legislation development and program funding. The National Office also awards and monitors all Section 523 grants. The program staff at the national level maintains reports and statistics on operating self-help organizations and projected needs for funding.

Rural Development State Office

The State Office has the approval authority over the smaller Section 523 grant applications. Section 502 loans are allocated on a state-by-state basis and the State Office allocates the 502 money based on a State formula. There are additional staff members who are key to the operation of a self-help program located in many State Offices:

Rural Development State Director
Rural Housing Program Director
Rural Development State Architect
Rural Development Appraiser
Rural Development Housing Specialist

Rural Development Area Office

The Rural Development Manager is responsible for the Section 523 grant. It is his or her responsibility to ensure that the grant is operated effectively and in accordance to regulations. The Rural Development Manager will evaluate the Section 523 self-help agencies on a quarterly basis and review grant applications for new and on-going programs. In addition, Rural Development Construction Analysts are usually available through this office.

Rural Development Local Office

Within this office, the Community Development Manager is responsible for making the Section 502 mortgages to participating applicants of each group. He or she will be responsible for monitoring the 502 loans and will also be the co-signer on the participant checking accounts. Usually, this office does construction inspections.

The Rural Development Section 502 Rural Housing Loan

Many applicants that participate in the self-help housing program use Rural Development Section 502 loan to finance their homes. Section 502 loans are only available to families living in rural areas. "Rural" is defined as towns with populations of 10,000 or fewer, and designated cities with populations between 10,000 and 20,000 in counties that are not associated with Standard Metropolitan Statistical Areas (SMSA) where a serious lack of mortgage credit exists.

In order to qualify for a Section 502 loan, prospective self-help applicants must meet Rural Development income eligibility requirements as low-income or very low-income. They must be credit-worthy, have repayment ability for the loan requested, and be unable to secure credit from other sources. The low-income measure is 80% or less of the county median income, based on family size. Very low-income is defined as 50% or less of the county median income, based on family size. These income standards, established by HUD and adopted by Rural Development, are subject to local variation and periodic change. Current information on income standards and eligibility requirements for Section 502 loans is available at Rural Development local offices.

The repayment period for the Section 502 loan is either 33 or 38 years, and the interest rate is between 1% and the current market rate. The actual rate of interest the borrower pays depends on the borrower's income, as does the loan term. If a borrower is eligible to pay less interest than the market rate, the borrower then receives a subsidy called “payment assistance”. The amount of payment assistance a borrower receives is determined by the loan amount, loan period, and the household income. The assistance makes up the difference between the full loan rate and the rate the participant pays.

Section 502 funds are advanced from the Rural Development finance office in St. Louis and disbursed by the local offices based on regulatory guidelines. TA grantees prepare the drawdowns and checks for each participant's account as needed to purchase materials for different phases of construction. Note that the participant's loan payments are deferred during construction.

When all the money is withdrawn from a participant's account, Rural Development's finance office sends payment books to the participant. The participant's first loan payment is due within thirty days of termination of deferred payments. Payments then go directly to Rural Development's Centralized Servicing Center (CSC) in St. Louis.

The 523 Mutual Self-Help Housing Technical Assistance Grant

In order to enable organizations to operate a mutual self-help housing program, Rural Development provides grant funds to operate and oversee mutual self-help housing programs. Each TA grant is usually for a period of up to two years, and is available to public and private nonprofit organizations and units of state or local government. The amount of grant funds an organization can receive is based upon how many houses they build in a grant period. An organization can receive 15% of the average cost of a new home financed under the 502 program in their area, for every home they are planning to build.

Activities that are allowable uses of Section 523 Technical Assistance grant funds include:

- Recruiting eligible households to participate in the self-help program;
- Holding training meetings with participants on the self-help process and homeownership topics such as mortgages, insurances, taxes, and maintenance;
- Assisting participants obtain and develop building sites; obtaining or creating Rural Development-approved house plans and helping participants select theirs;
- Helping participants bid and select building supplies and subcontractors; train participants in construction techniques and provide construction supervision;
- Supervise participant Section 502 loan accounting, including:
  - --Totaling invoices and itemizing payments to suppliers and subcontractors;
  - --Maintaining records of deposits and withdrawals;
  - --Preparing checks (accompanied with invoices and statements).

Disallowed activities using Section 523 Technical Assistance grant funds include:

- The use of any TA funds to pay staff to provide labor on the houses;
- Purchasing any real estate or building materials for participating families;
- Paying any debts, expenses or costs which should be the responsibility of the participating families;
- Any lobbying activities as prohibited in OMB Circular A-122.

The T&MA Contractors

In 1979 the appropriations language was changed to authorize the use of Section 523 grant funds to contract for technical assistance to self-help grantees. There were initially six Technical and Management Assistance (T&MA) Contractors; currently there are four.

Rural Development contracts with these groups to assist operating and potential self-help housing grantees across the country. This assistance comes in the form of staff and board training, grant management, development of applications, 502 loan program, training, newsletters and conferences, among other services. These services are provided at no cost to the grantee.

The four contractors are:

- Florida Non-Profit Housing - covering Region I, the Southeast, including the states of AL, FL, GA, MS, NC, SC, TN, Puerto Rico and the Virgin Islands.
- Little Dixie Community Action Agency, Inc. – covering Region II, the South Central US, including the states of AR, KS, LA, MO, ND, NE, NM, OK, SD, TX, WY.
- NCALL Research, Inc. – covering Region III, the Northeast and Midwest, including the states of CT, DE, IA, IL, IN, KY, MA, MD, ME, MI, MN, NH, NJ, NY, OH, PA, RI, VA, VT, WI, WV.
- Rural Community Assistance Corporation (RCAC) – covering Region IV, the Western US, including the states of AK, AZ, CA, CO, HI, ID, MT, NV, OR, UT, WA.

Additional Training Materials

The T&MA Contractors have produced a variety of other training materials for the purpose of assisting grantees and training grantee staff. The following is a list of the available guides. Please contact your T&MA Contractor for a copy or for more information.

Board of Directors

Boards of Directors play a critical role in the success of any non-profit organization. With this in mind, this guide was designed for use by board members of any housing agency. This guide is intended primarily as a reference and not to dictate that, "this way is the only way". However, it is an informational resource that may be used as a training tool and can provide new insights and a clearer understanding of nonprofit organizations, board meetings, operations, agency planning, administration of agency personnel, teamwork, orientation for new board members, federal accounting requirements, and self-help agency activities.

Project Director's Guide

It is the responsibility of the Project Director or Executive Director to administer a successful Mutual Self-Help Housing Program. This guide should be used as an important resource to assist with the goal. It can also be used as a training manual when new staff is hired. The Project Director's Guide takes a general look at the Self-Help Program as well as providing information on required reports, program criteria, grant and financial management, personnel and fair housing.

Financial Management for Federally-Funded Organizations

The purpose of this Financial Management Guide is to aid new and operating grantees with the development of financial management systems and policies that are compatible with the fiscal responsibilities set forth by the funding agency (Rural Development) and the Office of Management and Budget (OMB). While self-help housing programs that have been operating for many years may have sophisticated financial systems and policies, others are lacking written, established financial procedures that assure proper internal controls.

This Financial Management Guide offers grantees sample information, guides, and checklists for virtually all fiscal aspects of self-help housing including: Section 523 grant accounting, Section 502 participant loan accounting, establishing accounting systems, program and payroll expenditures, tax requirements, personnel records, federal accounting requirements, and audit preparation.

While this Guide has been developed specifically for self-help housing grantees, the principles and information provided are applicable to any nonprofit housing development corporation utilizing federal financing or administrative funding.

Guide to Accounting for Individual Borrower 502 Loan Accounts

In addition to establishing and maintaining an accounting system for the Section 523 grant funds, the Self-Help Housing grantee is responsible for keeping an accurate account of the disbursement of funds from the individual self-help participants' Section 502 loan accounts. Instruction 1944-I indicates that technical assistance provided by the grantee to the participants should include "providing financial supervision to individual families with Section 502 loans, which will minimize the time and effort required by Rural Development in processing borrower expenditures for materials and contract services." In order to fulfill this accounting responsibility, the grantees must establish a record keeping system with clear procedures for handling the purchase of construction supplies, invoices from subcontractors and vendors, and accounting for expenditures from participant loan funds. This guide provides guidelines for self-help grantees to use in designing the procedures necessary for a minimum standard of control and a system of checks and balances to protect the participants and the grantee.

Group Coordinator

The job duties and responsibilities of a Group Coordinator are crucial to the success of the self-help program. The Group Coordinator is the person that is responsible for locating interested participants, screening them and packaging their 502 loan applications, preparing them for the construction phase and homeownership, and helping to track their progress during construction. If one of these duties is not fulfilled, the entire program is put in jeopardy.

Because the Group Coordinator often wears so many hats in a self-help agency, there are other guides that the Group Coordinator is going to need to read in addition to this one. The 502 Loan Processing Guide is crucial to the success of qualifying and processing families, the Preconstruction Meetings Guide will help guide the Group Coordinator through these meetings, and the SHARES Manual will instruct the Group Coordinator on the task of entering information into the SHARES database.

This guide will help the Group Coordinator in the areas of recruitment, communication, forming a group, group management, motivation, and money management.

502 Loan Processing Guide

(This guide is currently under development.)

While the labor and construction is a group effort, each participant must qualify and obtain a loan individually from Rural Development. In order to qualify, a household must fall within the income guidelines set by Rural Development, must have demonstrated repayment ability, must have a good credit rating, and should have a low debt load. Because the 502 self-help loan process can be complicated for the individual, the technical assistance staff will pre-screen participants for program eligibility and prepare the application packages for Rural Development.

The 502 Loan Processing Guide will help to train the Group Coordinator or appropriate staff person in packaging these loans. The loan terms, application forms, credit reports, and the additional documentation required are all covered.

Preconstruction Meetings Guide

(This guide is currently under development.)

Each self-help grantee is responsible for organizing participants into groups, which remain together from loan processing through construction. The organization of participants into groups reinforces the "mutual" aspect of the self-help program because participants within a group are expected to work on each other's house until all houses in the group are completed. In addition to organizing participants into groups, self-help programs are responsible for explaining the self-help concept and methodology to participants, and for educating participants about their responsibilities as self-help participants, 502 loan borrowers, and homeowners. This is achieved through a series of "pre-construction meetings."

Group meetings provide self-help grantees, Rural Development, and the self-help participants with an opportunity to develop bonds which can contribute to the timely construction of houses – of which all can be proud – and which can place participants on a sound footing for assuming their homeownership responsibilities.

The information and materials contained in this guide are presented as informational resources, ready to use formats, or samples to be modified to suit each grantee's individual circumstances.

Construction Supervisor Guide

The Construction Supervisor Guide will discuss the roles and responsibilities of the construction supervisor as it relates to Self-Help Housing. This guide will cover several aspects of the construction supervisor's job; from construction specifications, house plans, schedules, bill paying procedures, to group motivation. Insight will be provided on how the self-help program operates and what is expected from the construction supervisor. This guide should not be the only source of training, but can be used as an introduction. Further exposure should be sought at conferences and networking with peers in the field.

SHARES Help Manual

SHARES stands for the Self-Help Automated Reporting and Evaluation System. It is an internet-ready application designed to manage, track, evaluate, and report on the status of the self-help program, as well as share this information with all parties that provide assistance to this program.

The SHARES Help Manual describes all aspects of the SHARES program, such as, getting started, the available screens, entering information, and printing reports.

Introduction to this Guide

Understanding basic bookkeeping procedures is just as vital for a not-for-profit organization as it is for a for-profit organization. Therefore, mastering the concepts of double entry bookkeeping is of much importance. Most non-profits are probably using computerized accounting software for their bookkeeping needs; however, it is still important to understand the concepts of double-entry bookkeeping. This manual will present the basic material for a not-for-profit organization's needs. With improved bookkeeping skills, each organization will be better able to evaluate their available resources and plan for the future.

Note that this is the most basic of the three financial management guides produced by the T&MA Contractors. The other two address topics specific to financial management of federal funds by nonprofit organizations and the management of 502 loan funds. See the previous section entitled "Additional Training Materials" above for more information on the other guides.

Basic Bookkeeping Principles

Assets, Liabilities and Net Assets

The fundamental elements of all bookkeeping systems deal with keeping records for changes that occur in **assets**, **liabilities** and **net assets**.

Definition of Assets

Assets are all things of value owned by an organization. Examples of assets for a not-for-profit organization might include the following:

- Cash & Investments
- Vehicles
- Buildings
- Land
- Equipment & Tools
- Office Furniture
- Accounts Receivables (Funds owed to the organization)
- Prepaid Expenses

Definition of Liabilities

Liabilities are the debts owed by the organization. Examples of liabilities might include the following:

- Loans/Notes Payable
- Vehicle loans
- Equipment loans

Definition of Net assets

Net assets represent the equity earned by the organization. This is calculated by subtracting total expenses from total revenue each year. It is tracked on a cumulative basis from the organization's first fiscal year. In a for-profit corporation, this amount would be known as profit or retained earnings.

Example of a net asset:

Total income	$200,000
Less all expenses	$180,000
Net Asset for current fiscal year	$ 20,000

The $20,000 would be added to net assets from all of the organization's previous fiscal years to determine the total net assets shown on the balance sheet.

Revenue

Non-profit organizations usually earn income or revenue by providing a service. Other sources of revenue may include interest earned on investments and contributions from individuals, corporations and foundations.

Expenses

Any costs incurred in connection with the earnings of revenue are called expenses. Examples of expenses are salaries, fringe benefits, rent, audits, travel, supplies and utilities.

Changes in Net Assets (Net Income/Net Loss)

If, during a fiscal period, the revenue earned exceeds the total expenses or vice versa, a change in net assets will result. In addition, recent changes in reporting requirements for not-for-profit organizations require that net assets and changes in net assets shown on audited financial statements be divided into one of three classes as determined by the absence or presence of donor-imposed restrictions. The three classes are permanently restricted, temporarily restricted, and unrestricted net assets. A thorough definition of the new requirements (FASB SFA 116 and 117) is discussed in the Addendum starting on page 33 of this manual.

The question most non-profit organizations must ask themselves is "Should the old accounting system be converted to record the three classes of net assets throughout the fiscal year or should the data merely be analyzed at fiscal year-end?" You must decide whether or not to use the new formats for your interim unaudited financial reports.

The Bookkeeping Equation

The relationship among the three fundamental elements of bookkeeping - assets, liabilities and net assets – may be stated as an equation as follows:

Assets = Liabilities + Net Assets

Assets = Everything of value owned

Liabilities = All debts owed plus Net Assets (Equity)

Variations of the Bookkeeping Equation:

When any two of the fundamental elements are known, the third can be found.

If assets total \$10,000 and liabilities total \$4,000, then net assets will equal \$6,000.

It is also true that assets less net assets equal liabilities.

Business Transactions and Changes in the Bookkeeping Equation

A business transaction always results in at least two changes in the fundamental bookkeeping equation. Since both sides of this equation must be equal, a transaction that changes total assets must also change either total liabilities or total net assets.

Each item listed as an asset, a liability, or a net asset is referred to as an account and is given a title. Examples are cash accounts, accounts receivables, accounts payable, net asset accounts and so on.

Transactions Increasing Accounts

Assume that the organization borrows \$2,500 cash from the National Bank. Assume that the original bookkeeping equation showed:

Assets = Liabilities + Net assets

\$22,265 = \$7545 + \$14,720

With the cash borrowed, the equation changes because the asset account (cash) increases and the liability account (National Bank loan) increases:

Assets	=	Liabilities	+	Net assets
22,265	=	7,545	+	14,720
+ 2,500	=	+2,500	+	-0-
24,765	=	10,045	+	14,720

This transaction resulted in increases in two accounts: total assets and total liabilities.

Assume that the organization receives a contribution in the amount of $5,000. The equation now shows an increase in the cash account and an increase in the net asset account:

Assets	=	Liabilities	+	Net assets
24,765	=	10,045	+	14,720
+5,000	=	-0-	+	5,000
29,765		10,045		19,720

Transactions Decreasing Accounts

Assume that the organization pays $1,000 cash to National Bank as a principal payment on the loan. The equation now shows a decrease in the cash account (Asset) and a decrease in the National Bank loan account (Liability).

Assets	=	Liabilities	+	Net assets
29,765	=	10,045	+	19,720
- 1,000	=	- 1,000	+	
28,765	=	9,045		19,720

This transaction resulted in decreases in two accounts: total assets and total liabilities.

The Ledger

To keep track of transactions and changes as they occur, a system of records is used. The type of record traditionally used for the purpose of recording individual transactions is called an account. A group of related accounts that comprise a complete unit, such as all of the accounts of a specific organization, is called a ledger. Accounts in the ledger are customarily listed in the order in which they appear in the financial statements and are classified according to common characteristics (e.g. assets, liabilities, net assets, revenue or expenses).

Rules for Increases/Decreases in Assets, Liabilities, and Net assets

The accepted bookkeeping abbreviations for debit and credit are Dr. and Cr., or dr. and cr. These are used in various business forms. Note carefully the following statements, if the financial statements are prepared manually:

(1) Assets are accounts that appear on the left-hand side of the balance sheet and will show increase by debits.

(2) Liabilities are accounts that appear on the right-hand side of the balance sheet and will show increase by credits.

(3) Net assets appear on the right-hand side of a statement of financial position and will show increase by credits.

Because assets increase by debits, it follows that any asset decreases are recorded as credits. Because liabilities and net assets increase by credits, it follows that any liability and net asset account decreases are recorded as debits.

In summary:

(1) Assets increase by debits and decrease by credit.

(2) Liabilities increase by credits and decrease by debits.

(3) Net assets increase by credits and decrease by debits.

T-Accounts - Assets, Liabilities, Net Assets (See Appendix I)

As transactions occur, changes are recorded in accounts. For every transaction, at least one account will be debited and one will be credited. Even though each transaction changes two or more account balances, the fundamental bookkeeping equation will always be in balance: Assets=Liabilities + Net Assets. This is the explanation of the theory of double-entry bookkeeping. For every transaction, debits always equal credits.

Manual Bookkeeping System

General Journal System

<u>Primary Journals</u>

Journals are books of original entry, where complete information about a transaction is first recorded. The journals are used to systematically record all accounting transactions categorized using the chart of accounts before they are entered into the general ledger. There are three primary journals as defined below:

- Cash Disbursements Journal – a chronological record of checks that are written;
- Cash Receipts Journal – a chronological record of all deposits made;
- General Journal – a record of transactions that do not pass through the checkbook including non-cash transactions (e.g. accrual entries and depreciation) and corrections to previous journal entries. In this journal, each page is numbered; columns provide space for a complete date – year, month, day; names of accounts debited and credited; posting references; and amount columns for debits and credits. All entries are recorded in chronological order as they occur. This becomes the diary of the business for which it is kept. (See Appendix II & VII)

<u>Subsidiary Journals</u>

In addition to the primary journals, many organizations use subsidiary journals to break out certain kinds of activity in the primary journals. These include a Payroll Journal that records all payroll-related transactions and an Accounts Payable and Accounts Receivable Journal that track income and expense accruals.

<u>Source Documents</u>

As transactions occur, source documents are prepared as evidence of these transactions. A source document is any prepared form or voucher, such as a check or check stub and/or a numbered invoice for supplies or services.

<u>Journal Entries</u>

Notice that the debit account is always listed first in each journal entry. (See Appendix VII) The account to be credited is indented. The amounts of the debit and credit line up with the account titles. Any explanation is listed below the last account title. The name of the month, with the year, is entered once and is not repeated until the next page. Only the day number is used unless the month changes.

Posting the General Journal

At some point, each amount debited or credited in the journal must be transferred to the general ledger account named in the journal entry. This step is called posting. Posting should be done on a regular basis. (See Appendix III)

Posting Procedure

Every ledger account must be numbered and each ledger account appears on a separate page with a number that identifies the type of account.

Classification	Account Number
Assets	100 series
Liabilities	200 series
Net assets	300 series
Revenue	400 series
Expenses	500 series

Journal to Ledger

The steps in posting a journal entry are as follows:

(1) Enter, for the account debited, the amount on the debit side of that account

(2) Enter the date – year, month, and day

(3) Enter the journal page number in the Posting Reference (PR) column of the account

Repeat the posting procedure for the next account listed in the journal. Continue with each journal entry, posting debits and credits to each of the accounts listed. If the work of posting is interrupted, the bookkeeper will always know exactly where to resume work – after the last Posting Reference account number in the journal PR column.

Just as debits must equal credits in each journal entry, debits must equal credits when posted to ledger accounts.

Cross Referencing

It is now possible to tie together quickly the debit and credit for each transaction. Posting references refer to each other – the journal entry to the account number, the account to the journal page number. This is called cross-referencing. It makes the work of checking the records much simpler.

Trial Balance

When all journalizing and posting have been completed at the end of the fiscal period, generally one-month, the bookkeeper makes a check on the accuracy of that work. A listing is made of all ledger accounts and their balances to ensure that total debits equal total credits. This listing is called a Trial Balance.

In preparing a trial balance, the following steps are taken:

(1) Find the balance of each account, using pencil. Total all debits and credits; these are written below the last figure on each side. This is called footing the ledger, and the totals are called pencil footings.

(2) Subtract the smaller amount from the larger. In pencil, write the balance of the account on the larger side in the item column. Accounts will normally have balances on their increase sides – assets are debits, liabilities are credits, net assets are credit, revenue is a credit, and expenses are debits.

(3) List all accounts by name in their numerical order. Each account balance is placed in either the first (debit) or second (credit) column.

(4) Finally, total each column. If all work is done correctly, the totals should be equal. Once the debits and credits are equal the Trial Balance is in balance. (See Appendix IV.)

If the trial balance is out of balance, the following steps should be taken to determine the reasons:

(1) Re-add the columns of the trial balance.

(2) Examine each account balance in the Trial Balance, and compare these account balances to the ledger account balances. Perhaps they were carried forward incorrectly, or perhaps an account was omitted, listed twice, or placed in the wrong amount column (reversing a debit or a credit). If the difference between the column totals is evenly divisible by 9, it is likely that a number was transposed.

(3) Re-foot the ledger accounts to verify each account balance.

(4) If an error is not located at this point, compare each entry in the account with the original debit and credit recorded in the journal entry.

When an error is discovered in the ledger, neatly cross out the incorrect entry and write the correction above it. Never erase amounts or mark through an error in any way that may cause the first figure to be altered. This could cause legal problems in as much as bookkeeping records are legal documents.

Errors That the Trial Balance Does Not Reveal

Not all errors show up in a trial balance. The following errors do not affect the equality of debits and credit in the ledger:

(1) Omitting an entire entry.

(2) Posting to an incorrect account – a debit to another debit, a credit to another credit.

(3) Using an incorrect amount in a journal entry and posting that amount to ledger accounts.

(4) Recording a transaction twice.

The Six-Column Worksheet (See Appendix V)

By the end of the fiscal period, usually monthly, the board of directors and the executive director want the answer to a very important question: Did we overspend so far this fiscal year? To answer that question, a worksheet is prepared. A worksheet is a ruled form of analysis paper with several columns. Because this worksheet is not part of the permanent records, it can be completed in pencil. The steps taken to complete a work sheet are as follows:

(1) List all ledger accounts in the account title column and their balances in the first pair of money columns arranged, as they would be in the Trial Balance.

(2) Extend the balance of each account to one of the remaining columns by determining whether the account is a balance sheet (Statement of Financial Position) account – assets, liabilities, net assets and a debit or a credit, or an income statement (Statement of Activities) account – revenue, expenses – and a debit or a credit.

(3) Total all remaining columns. The difference between the income statement (Statement of Activities) columns and the difference between the balance sheet (Statement of Financial Position) columns should be equal.

(4) Determine whether there was a change net assets. In the income statement (Statement of Activities) column totals, if the credit is greater than the debit, or vice versa, a change in net assets results.

(5) Identify the change in net assets in the Account title column: the amount is entered in the smaller of the two income statement (Statement of Activities) and balance sheet (Statement of Financial Position) columns. Equal totals are then entered in each pair of columns and they are double ruled.

Financial Statements

Because the work sheet can be completed easily and conveniently in pencil, all errors up to that point probably will have been corrected. Using the worksheet the bookkeeper can now prepare financial statements more formally. These will become part of the organization's permanent records.

Balance Sheet (Statement of Financial Position) (See Appendix VI)

When all three fundamental elements of bookkeeping - assets, liabilities and net assets – are examined together, they appear in a financial statement called the Statement of Financial Position. This statement was formerly known as a Balance Sheet.

A Balance Sheet is a financial statement that lists all assets owned and all claims against those assets (liabilities & net assets) as of a certain date. These claims are held by creditors to whom money is owed (liabilities) and by the organization itself (net assets). This financial statement should be prepared at the end of each month as well as at the end of the fiscal year. A 12-month fiscal period may not coincide with the 12 calendar months of the year. For example the federal government's fiscal year runs from October 1 to September 30.

Income Statement (Statement of Activities)

An Income Statement (now referred to as a Statement of Activities) is a report of the revenues, expenses and resulting change in net assets for the current fiscal period/year. It is prepared first using the information in the Income Statement columns of the worksheet. All revenues are listed first and totaled. Expenses are then listed, totaled and subtracted from total revenue. The difference is the same as shown on the worksheet. (See Appendix V & VI)

Revenue – Expenses = Net Income (Net assets)

Monthly Financial Monitoring

Organizations spend a great deal of time and resources making sure that their accounting systems and record-keeping processes allow for effective collection of funds and bill payment. Yet, many organizations fail to devote adequate attention to monitoring financial health through comparisons between their actual expenditures and their budgets.

Monthly financial monitoring can alert nonprofits to financial and other management problems early on, before they get out of hand. Regular monitoring can inform board members, mangers, and staff of the fiscal health of the organization. Management and the board of directors will have to decide on the appropriate degree of detail and complexity for their organization. The most important financial report the board of directors and managers can review is the comparison of budgeted versus actual expenditures and revenues. This report is actually an income statement with additional columns to show the budget and the balance remaining in each line item. (See Appendix XVI for sample budget comparison report.) Management can use this report to:

- Compare the actual revenues and expenditures reported for the year-to-date against the revenues and expenditures that were budgeted for the same period.
- Identify any variances between the actual and the budgeted.
- Identify what caused each variance.
- Develop a plan to correct the cause of each variance, if necessary.

In addition to the budget comparison report, the board should review the balance sheet (Statement of Financial Position).

Regardless of what financial reports the board of directors may request, it is important that regular monthly reviews take place and that an appropriate action plan be developed and monitored as needed.

Cash vs. Accrual

The availability of cash is critical to a nonprofit organization's financial health. Board and staff are always interested in knowing how much cash is available each month to carry out the organization's mission. For this reason, as well as for its simplicity, many nonprofits use the cash basis method of accounting. Transactions are only recorded when cash accounts are affected. Revenue is recorded when funds are received or deposited into a bank account. Expenses are recorded when bills are paid.

For nonprofit organizations that have few if any outstanding accounts payable or receivable, the cash basis method is a fairly accurate reflection of the organization's financial status. However, this method of accounting does not take into consideration any non-cash transactions that affect the organization's bottom line. A financial report prepared on a cash basis that shows a large cash account balance may give management a false sense of security since the organization may not yet have received the invoices to be paid with that cash.

The goal of the accrual method of accounting is to sort financial data into the time period in which it belongs. Expenses are recorded when they are incurred regardless of when the invoices are paid (e.g. when supplies are ordered or when consultants perform contracted work). Similarly, revenue is recorded when it is earned, regardless of when the income is received (e.g., when services are provided or when grant provisions are met). The resulting financial reports represent a more complete financial picture of the organization's finances throughout the fiscal year. Management will be able to use this report to evaluate whether or not the cash in the bank is adequate to meet the liabilities incurred by the organization.

Many organizations choose to use a modified cash or accrual basis throughout the fiscal year. This is done by recording expenses on an accrual basis, often using an accounts payable module of an accounting software program, but recording revenue on a cash basis when received. Other organizations keep their books on a cash basis but convert them to accrual for reporting purposes using a worksheet to show the necessary adjustments.

Year-end audited financial statements must be prepared on an accrual basis in order to conform to generally accepted accounting principles (GAAP). Many organizations rely on their independent auditor to convert their cash basis books to accrual basis at fiscal year-end as part of the audit process.

It is essential that board and management staff understand the method by which their financial reports are prepared so that they can use them appropriately in their decision-making process.

Closing the Ledger (See Appendix VII)

At the end of each fiscal year, all revenue and expense accounts are closed. These accounts list information for a specified fiscal period and should not carry over to succeeding fiscal periods. Since these accounts show the changes that take place in the net assets, their balances should be transferred to the net asset account on the balance sheet in order to bring that account up to date. After being closed, the revenue and expense accounts can be used again, starting at a zero balance, for the next fiscal year.

Revenue and Expense Summary

To close an account, an entry must be made in an amount equal to its balance that will result in posting on the opposite side of that account. The closing entry procedure will reduce the balance of all revenue and expense accounts to zero. Revenue accounts are closed first. Since they have credit balances, they must be debited in order to have zero balances. The account credited is Revenue and Expense summary, an account used for special entries, including these closing procedures. This account is used to summarize the changes caused by income and expenses each fiscal period. The second closing entry will zero out expense accounts. Since they have debit balances, they must be credited in order to have zero balances. The account debited is Revenue and Expense Summary. The third closing entry will zero out the balance of the Revenue and Expense Summary account. The amount will always be equal to the net income or net loss for the fiscal period. If there is a net income, the summary account has a credit balance; if there is a net loss, the summary account has a debit balance. This closing entry increases the Net Asset account on the balance sheet for the amount of the net income, or decreases the Net Assets account for the amount of the net loss, whichever has occurred during the fiscal period.

Accounts Closed/Accounts Open Ruling, Balancing

Accounts that are closed have zero balances – all revenue, expenses, and the summary account. To show this clearly, they are totaled on both sides and ruled with double lines.

All ledger accounts would be ruled in this way. They have no balances; they are closed at the end of the fiscal period.

Balance Sheet (Statement of Financial Position) accounts, on the other hand, have balances that carry over to the next fiscal period. These accounts are balanced and ruled. The following steps are taken.

(1) Pencil foot the ledger – should already be done to prepare a trial balance.

(2) Enter in ink on the smaller side the amount of the account balance a check mark indicating that both sides are equal.

(3) Write total amounts on the same line level on both debit and credit sides; double-rule the account through the date and money columns.

(4) Enter the account balance on the larger side as of the first day of the next fiscal period, with the word "Balance" and check mark in the posting reference column.

To prove the equality of the debits and credits after the balancing and ruling procedures, the bookkeeper prepares another trial balance – a Post-Closing Trial Balance. All debit account balances must equal all credit account balances. These accounts will list the same balances that are reported on the balance sheet (Statement of Financial Position). However, the net asset account will now be updated for any net increases or net decreases that may have occurred during the fiscal period. (See Appendix III for an example of two typical accounts balanced and ruled.)

This procedure is the final step in the complete bookkeeping cycle for each fiscal period.

Cash Systems and Checking Accounts

Most businesses make payments by checks drawn on local commercial banks. Many individuals now use checking accounts drawn on funds in savings banks and/or in money market funds. A check is a written order directing the Drawee (the bank) to make payments to the Payee (the party indicated by the words "Pay to the order of") from the account balance of the Drawer (the party who signs the check).

<u>Opening a Checking Account.</u>

When a checking account is opened, each person authorized to sign checks completes a signature card. A deposit slip is used to list items to be added to the account, including checks received from others and cash.

Endorsing Checks

Each check deposited must be endorsed, that is, signed on the back by the payee. There are several types of endorsements.

(1) An endorsement in blank. This is a simple signature of the depositor.

(2) A special endorsement (e.g. “Pay to the order of”). This states to whom a check is to be paid.

(3) A restrictive endorsement (e.g. “For Deposit Only”). This limits further purpose or use of the check.

(4) A qualified endorsement. The endorser assumes no legal responsibility for payment, should the drawer have insufficient funds to honor his/her own check.

The restrictive endorsement should be used on checks to be deposited. The blank endorsement should be used only when presenting a check for immediate payment, for example, when cashing one’s paycheck.

The Bank Statement

At the end of the month, or at a set date during each month, the bank sends each depositor a bank statement. This is the bank’s record of the deposits made, and the checks drawn and prepared for payment. These checks are cancelled – marked paid – and returned to the depositor with the bank statement. (Note: Some banks and credit unions no longer return cancelled checks with each bank statement. Copies can be obtained upon request.) If any charges have been made by the bank for handling this account, they are identified as service charges and deducted from the balance. The depositor makes a similar deduction in his/her checkbook.

Reconciling Checkbook Balance and Bank Statement (See Appendix VIII)

Frequently, the depositor’s checkbook balance and the bank statement balance do not agree by the end of the month. There are several reasons for these differences.

(1) A late deposit, or deposit in transit, is added into the checkbook balance but does not reach the bank in time to be recorded on the bank statement – add any late or omitted deposits to the bank balance on a reconciliation form.

(2) Some checks drawn and sent to distant points have not cleared back to the depositor's bank in time to be recorded on the bank statement – subtract the amount of outstanding checks from the bank balance on a reconciliation form.

(3) If the bank made any service charges, they are deducted on the bank statement – subtract the service charge in the appropriate checkbook register.

At this point the bank statement balance and the checkbook balance should be reconciled and the balances should be equal. It is also essential that adjusting entries be made to the cash account in the general ledger so that it is also reconciled with the bank statement.

The Petty Cash Fund

All cash received by a business should be deposited promptly. Also withdrawals are usually made by issuing checks signed by authorized individuals of the organization. In that way, there is a record of all funds coming in (cash debit) and all funds paid out (cash credit). However, there are times when small amounts must be paid out, for example, for postage or a package delivery, or minor office supplies purchase, for which drawing a check would not be practical. A special petty cash fund is maintained for these small payments. This fund requires strict control because of the danger of missing cash. The following procedures are recommended to safeguard the petty cash fund:

(1) Petty cash should be kept in a locked drawer or file cabinet or safe separate from any other cash on hand.

(2) Only one person (the guardian or custodian) should be held responsible for the petty cash fund.

(3) A record of each payment from petty cash should be kept, showing the person to whom it was paid, the reason, the date, the amount, a receipt and a signature of the person who received the money.

<u>Establishing the Fund</u>

Petty cash disbursements are made whenever small amounts must be paid. The maximum amount to be paid out of petty cash per transaction (usually $25) should be determined by management and included in the organization's accounting policies and procedures manual. The person requesting the amount will be required to fill out a numbered petty cash voucher, giving all required information and signing the voucher. An authorized signature is then obtained to make the disbursement from the fund. The voucher is then filed or kept in a separate petty cash box. As the amount of petty cash remaining in the fund decreases, the total dollar amount of the vouchers increases. At any time, the two added together will total the original amount in the fund. When the petty cash balance gets low, it will be replenished by drawing another check payable to petty cash. The amount of this check will be exactly equal to the total of the vouchers. Expenses paid for out of petty cash should be recorded at this time. The check is cashed and the money is placed in the petty cash box. Once again the petty cash fund equals the total amount for which the fund was established originally.

The bookkeeper is usually the custodian of petty cash funds in an organization. It is important to keep the petty cash box locked at all times when the custodian is not disbursing or replenishing the fund. It is also important to have someone other than the custodian reconcile the petty cash funds. A designated board member or the executive director could conduct these reviews; they can be surprise reviews or conducted on a regular basis. The petty cash fund should always be reconciled on the last day of the organization’s fiscal year in order to record all expenses incurred and paid during that period.

<u>Reconciling Petty Cash</u>

Assume that the original petty cash fund is $50. The following petty cash vouchers indicate that payments were made over a period of time for many items. These vouchers are sorted as follows:

Office Supplies	$17.50
Delivery Charge	$19.60
Postage	<u>$ 5.95</u>
Total	$43.05

To prove petty cash at this point, the remaining cash is counted. Since the fund started at $50, there should be $6.95 remaining in petty cash fund. This proves correct:

$ 6.95	petty cash remaining
<u>$ 43.05</u>	disbursements
$ 50.00	original petty cash fund

Replenishing the Fund

The replenishing entry prepared from the checkbook will result in a debit to the various expense items for which petty cash has been disbursed. The credit will be to the cash account. The only debit to the petty cash account is from the entry to establish the fund; that will remain the account balance, unless the petty cash fund is increased or decreased. The items for which petty cash is spent will be posted to the specific expense accounts for which petty cash was distributed.

Payroll

The term payroll is often used to refer to the total amount paid to employees for a certain period. Payroll expenditures are subject to various federal and state regulations. The major components of most payroll systems are the payroll register, employee's earnings record, and payroll checks.

Payroll Register

The multicolumn form used in assembling and summarizing the data needed at the end of each payroll period is called the payroll register. The data appearing in the payroll register is the employee name; number of hours worked, earnings, and appropriate deductions. The sum of the deductions applicable to an employee is then deducted from the total earnings to yield the amount to be paid. Recording the check numbers in the payroll register as the checks are written eliminates the need to maintain other detailed records of the payments. Columns are used in accumulating data needed to compute the employer's payroll taxes. The "Total Salaries Expense" column is used to accumulate the total salaries to be charged to the expense accounts. This process is the payroll distribution. (See Appendix IX)

Recording Employee's Earnings

The payroll register may be used for posting like a check register. It can also be used as a supporting record for a compound journal entry that records the payroll data. The journal entry based on the payroll register is as follows:

Dec 21	Salaries Expense	$ 3,850.80	
	Social Security Taxes Withheld		$ 238.75
	Medicare Taxes Withheld		55.84
	Federal Withholding Tax Payable		650.26
	State Withholding Tax Payable		77.00
	Cash		$ 2,828.95

The total expense incurred for the salaries is recorded by the debits to the salary expense accounts. Amounts withheld from employees' earnings have no effect on the debits to these accounts. All credit entries represent increases in specific liability accounts (e.g. federal withholding, state withholding, Social Security withholding, Medicare withholding, etc.) and a decrease in cash representing the net pay amount paid out to employees.

Recording and Paying Payroll Taxes

Each time the payroll register is prepared, cumulative amounts of each employee's earnings are available in the employee's earnings record. The journal entry to record the payroll tax expense for the pay period and to clear the liability for the taxes accrued is as follows:

Dec 27	Social Security Taxes Withheld		$ 238.75
	Medicare Taxes Withheld		55.84
	Social Security Taxes –Employer portion		238.75
	Medicare Taxes – Employer portion		55.84
	Federal Withholding Tax Payable		650.26
	State Withholding Tax Payable		77.00
		Cash	$ 1,316.44

Payment of the liability for each of the taxes is recorded in the same manner as the payment of other liabilities, that is, a debit to the liability account and a credit to cash. Employers are required to compute and report all payroll taxes on the calendar-year basis.

Details of the federal income tax, Social Security tax and Medicare tax withheld from employees are combined with the employer's share of FICA tax on a single return (Form 941) accompanied by the amount of tax due. Payments are required on a weekly, monthly, or quarterly basis, depending on the salary and wages paid during the "look back" period.

Most states require that nonprofit organizations pay unemployment compensation tax for all employees. This is treated as a payroll tax expense. Most nonprofits are exempt from federal unemployment tax (FUTA).

All payroll taxes levied against employers become liabilities at the time salaries are paid to employees, rather than at the time the liability to the employees is incurred (e.g. if salaries are accrued).

<u>Employee's Earnings Record</u> (See Appendix X and XI)

It is necessary to have the cumulative amount of each employee's earnings readily available at the end of each payroll period so that the appropriate amount to withhold from current earnings can be determined. It is essential that detailed records be maintained for each employee. In addition to spaces for recording data for each payroll period and the cumulative total of earnings, there are spaces for quarterly totals and the yearly total. These totals are used in various reports for tax, insurance, and other purposes. Copies of one such annual report, known as Form W-2 Wage and Tax Statement, must be given to each employee by January 31st of the following calendar year. Form W-3 must be filed with the Social Security Administration by the end of February of the following calendar year.

<u>Payroll Checks</u>

One of the principal outputs of most payroll systems is a series of payroll checks at the end of the pay period. The payroll register provides the data needed for this purpose for each individual employee. The customary practice is to provide each employee with a statement of the details of the computation.

Many nonprofits are taking advantage of the ease and cost-effectiveness of an outside payroll service. Payroll information is conveyed to the payroll service by telephone or modem several days ahead of the payroll check date. The organization receives a payroll transaction report that should be reviewed for errors before the payroll checks are processed. The outside payroll service then processes the payroll checks and maintains employee payroll records. They also take care of depositing payroll taxes for each pay period. The payroll service will provide a report to the organization that should be used to enter salary expense and payroll tax information into the general ledger for each pay period. At calendar year end, the payroll service will prepare W-2's for each employee.

Automated Accounting System

Many not-for-profit organizations have successfully made the transition from manual to automated bookkeeping systems using any one of a number of computerized accounting software packages. The decision of when to make this transition is up to each organization but your organization may want to consider it if any of the following applies:

- The number or complexity of programs, departments, locations and/or sources of funds has increased since your bookkeeping system was established;
- Your bookkeeper spends a lot of time reconciling manual ledgers in order to produce financial reports that, as a result, may not be prepared on a timely basis;
- Your funding sources are requiring special reports that reflect how their funds were used;
- You are paying an auditor to prepare numerous closing entries and to make adjustments to your books before the audit can begin, resulting in much higher than necessary audit costs;
- Your bookkeeper is entering the same information in more than one place in order to prepare a variety of financial and/or management reports.

Automating your accounting system will not replace your bookkeeper. It should make more effective use of your accounting staff and, if set up and entered correctly, will generate more meaningful management reports on a timely basis. Keep in mind, however, that the best accounting software package in the world will still produce meaningless reports if the data that is entered into it is not correct!

In an automated accounting system, software modules replace the actual journal books described earlier in the manual bookkeeping system. Depending on the sophistication of the software package, these modules may include Accounts Payable, Accounts Receivable, Payroll, Bank Reconciliation, Project Accounting, Purchasing, and Inventory. In the inexpensive software packages (e.g., QuickBooks, Peachtree), basic elements of most of these functions are integrated into the accounting system. The middle to higher priced packages (e.g. MIP, MAS90, Great Plains, Solomon) sell these modules separately so that you may only purchase the ones that you need at the time. Additional modules can be added at a later date.

All accounting software packages include the general ledger module where transactions from all other modules are summarized. Typical features of this module include budgeting and report writing for generating financial statements and management reports. Transactions like adjusting journal entries and manual disbursement checks can be entered directly into the general ledger. Other transactions are entered into the appropriate modules and then posted to the general ledger on a regular basis. A major advantage of an automated system over the manual system is that the bookkeeper need only enter a transaction once in the appropriate module (subsidiary ledger). It will appear in all appropriate financial reports produced through the general ledger once it is posted. In addition, when there is a question regarding the amount on a report, many software packages allow the user to "drill down" from a financial report to the original transaction entry simply by double clicking on the suspicious entry on the report. This saves enormous amounts of research time for the accounting staff.

Most not-for-profit organizations that automate their accounting use the Accounts Payable module or function of the software package. This allows them to maintain their expenses on an accrual basis. Data including vendor information, payment terms, and invoice numbers and amounts are entered into the module as invoices are received. An aging report can be generated easily to determine which bills are due and whether or not the organization has the cash on hand to pay all of the outstanding invoices. Disbursement checks can be generated automatically using a laser printer. Regardless of the timing of the payment, the costs are expensed to the appropriate funding sources when they are entered into the module and posted to the general ledger. This provides for accurate financial reports that show up-to-date information regarding expenses incurred. Organizations still have the option of maintaining their books on a cash basis by entering their disbursements directly into the general ledger. However, some accounting packages cannot generate computerized disbursement checks unless the accounts payable module is used.

The payroll module or feature of accounting software packages is also frequently used by not-for-profit organizations. Cumulative employee salary, vacation and leave time taken and payroll tax information is maintained in this module. Payroll checks can be automatically generated at the end of each payroll period and W-2 forms can be produced at the end of each calendar year. Some payroll modules will also include an allocation feature through which salaries can be spread across multiple funding sources based on timesheets. However, when this feature is not available, not-for-profits must develop their own method of calculating the allocation of salary expenses and enter these allocations into the general ledger through an adjusting journal entry each pay period or each month. Many not-for-profit organizations are taking advantage of third-party payroll services. For a monthly fee, these companies will prepare payroll checks, monthly, quarterly, and year-end payroll tax reports, and W-2's and will deposit the appropriate payroll taxes. There are even online payroll service companies. The not-for-profit will receive payroll reports for each pay period and these transactions must still be allocated and entered into the general ledger by the not-for-profit accounting staff.

Entering information into an accounting software package will look very different to a bookkeeper that is used to a manual system. With the exception of adjusting journal entries, the bookkeeper will not see both the debit and the credit side of each transaction because the accounting package has already been set up to post the amounts to the correct side of the equation. (This is part of the initial set up of the accounting package when it is installed at your organization.) As mentioned above, posting is very different also since it merely involves pushing a button rather than manually transferring numbers.

Another feature of most accounting software packages is that the accounting staff will not be able to enter a transaction that is not balanced. This saves a lot of time looking for errors and reduces the usefulness of a trial balance report to analyzing what was entered into individual accounts.

Whether you use a manual or automated accounting system, the chart of accounts is the most important tool in the system. It is the map that guides the production of meaningful financial reports and it must be set up correctly in the beginning. At a minimum, each general ledger account will be assigned a number that identifies whether it is an asset, a liability, a net asset, revenue or an expense.

In order to sort your financial data in other ways, additional segments can be assigned to each account to identify the program and/or department and/or funding source and/or location and/or subaccount. The more sophisticated the software package, the more flexibility you will have in laying out your chart of accounts. (That is, the larger your account number can be.) Ideally, your software package would at least allow you to identify the program (function), funding source (cost center), general ledger account and subaccount. A sample account number might be:

01-303-5100-001

with "01" = Counseling, "303" = HHS grant, "50100" – Fringe Benefits, and "001" = Workers Compensation Insurance. Using this chart of accounts setup, your organization could sort the accounting data by any of these four segments in order to generate reports on the counseling program as a whole or the HHS grant specifically or total fringe benefits paid by the organization or just the worker's compensation insurance.

Not-for-profit organizations have a number of special financial reporting needs that should be considered when developing a chart of accounts:

- ♦ Recipients of public and private grants must be able to show that they can maintain financial control for each program and/or funding source, not just for the organization as a whole. The accounting system should be able to produce income and expense reports as well as budget comparison reports for each program and/or funding source as well as for the whole organization.
- ♦ Some awards may restrict the type of expenses that can be charged to them, including what staff may charge time to them. The accounting system must be set up so that adherence to these restrictions is documented.
- ♦ Some expenses may be spread across some or all programs using a variety of cost bases and the accounting system must be set up to facilitate this allocation.
- ♦ Public and private funding periods do not necessarily coincide with the not-for-profit's fiscal year. A reporting system must incorporate funding sources that cross fiscal years.
- ♦ Underspending of a grant may require that funds be returned yet overspending of a grant will not usually be reimbursed so a close eye must be kept on expenses and their appropriate budgets.

When you set up your chart of accounts, decide on the lowest level of detail you need for your reports and set the chart of accounts up accordingly. You will then have to enter the data at this level. Also, think about where you think your organization will be in five years and plan the chart of accounts so that you can incorporate future changes and growth.

The reports generated by the accounting software package will look very different from those produced using manual ledgers. Debit and credit balances will not appear in separate columns or as negative numbers unless the balance in an account is a debit when it is expected to be a credit (e.g., a liability account). However, the biggest difference will be in time required to produce these reports rather than in their appearance. Accounting software systems can produce detailed financial statements and management reports at the touch of a button once the parameters of these reports are input into the system. See Appendix XII, XIII and XIV for sample automated financial reports.

Once your books have been audited, most accounting software packages (with the exception of Quicken and QuickBooks) have simple procedures that allow you to close the books for the fiscal year. All revenue and expense accounts are zeroed out and the difference is recorded as a change in net assets on the Balance Sheet (Statement of Financial Position). This ensures that financial reports generated based on audited information cannot be changed.

If and when you make the decision to automate your accounting system, there are a number of factors to consider when choosing the right software package:

1. ***What kind of expertise does your accounting staff have?*** Computerized systems add numbers quickly and enable you to enter the number into the system once for it to appear in journals, ledgers, and reports but it is still a human being who decides what number to enter and where to enter it. That person must understand debits and credits, decide how to code transactions based on the chart of accounts and determine if an error has been made and how to fix it.

2. ***What type of reports do you want the software to produce?*** Look at the reports that are built in to the software as well as how much flexibility you have to modify those reports. Inexpensive programs like QuickBooks have limited flexibility in the report formats but the software does allow easy exporting to Excel so that reports can be modified. Important reports for not-for-profits include budget comparison reports by funding source as well as for the organization as a whole, detailed general ledger transactions, and bank reconciliations as well as a balance sheet and income statement.

3. ***How much flexibility is there in setting up the chart of accounts?*** How many different segments does the software allow?

4. ***How many months can be open in the system at one time?*** Are there flexible reporting periods?

5. ***What are the hardware requirements for the software?*** How much will it cost to upgrade your current computer hardware?

Addendum

In 1993 the Financial Accounting Standards Board (FASB) issued two new accounting standards, SFA 116 and 117, which specifically address not-for-profit accounting and financial reporting. (See Appendix XV)

All not-for-profit organizations, regardless of their size or type, are now governed by these new standards. In addition, SFA 116 addresses agencies making contributions including for-profit organizations for which no specific standards have existed until now. One goal of the FASB in developing these standards was to make audited not-for-profit financial statements more user-friendly. The new rules are meant to both simplify and standardize the required financial reports so that all users can use these reports to measure whether or not an organization is able to continue to provide services as well as how the organization is managed.

SFA 117 – "Financial Statements for Not-For-Profit Organizations"

The major new requirements of this standard are:

1. The organization must present, at a minimum, financial data for the whole organization, not just by fund as some not-for-profits have done in the past.

2. A complete set of audited financials must include a Statement of Financial Position (Balance Sheet), a Statement of Activities (Income Statement) and a Statement of Cash Flow (not previously required of not-for-profit organizations).

3. Fund balances are referred to as Net Assets. Revenue minus expenses will represent a change in net assets rather than a change in fund balance.

4. Net assets and changes in net assets must be divided into one of three classes as determined by the absence or presence of donor-imposed restrictions:

- Permanently restricted in which the restrictions imposed by the donor will never expire.
- Temporarily restricted in which the donor-imposed restrictions will eventually expire with the passage of time or be released by some action by the recipient.
- Unrestricted which includes all other net assets including those whose use is restricted by the management of the organization but not by the donor.

5. All expenses must be reported in the unrestricted class regardless of the funding source. This will necessitate adjusting entries to match restricted revenue with the appropriate unrestricted expenses through the use of a new contra revenue account entitled "Net Assets Released from Restrictions."

6. Expenses must be reported at a minimum by the following functional categories: Program and Support (Management/General and Fundraising). All organizations are also encouraged to report expenses by natural categories (salaries, fringes and travel, etc.).

7. Organizations must restate the prior year financial information presented in the financial statement using the rules of the new FASB standards.

SFA 116 – "Accounting for Contributions Received and Contributions Made"

This standard addresses the issue of when an agency recognizes revenue. Traditionally contributions received but not used were recorded as liabilities in deferred revenue accounts. The new accounting standard states that all contributions are revenue in full upon receipt regardless of the sources.

This new method of recognizing revenue will tend to show a spike in net assets in one fiscal year and a loss in the following year. This results from recording all the income when received, even though the expenses that would be booked against these funds may not occur until the following fiscal year. For this reason it is critical that both the organization's management and funding sources understand the impact of this new standard on their financial statements.

Summary

This handbook was developed to provide the basic concepts and principles of bookkeeping for non-profit organizations. It presents a simplified step-by-step approach to bookkeeping/accounting principles and practices. Understanding basic bookkeeping procedures is vital to developing and understanding of more advanced accounting theory and practice.

List of Appendices

Sample T-Accounts

Cash

DR	CR
$10,000.00	$1,000.00
	$250.00
	$200.00
	$100.00

Rent

DR	CR
$1,000.00	

Donations

DR	CR
	$10,000.00

Utilities

DR	CR
$250.00	

Supplies

DR	CR
$200.00	

Miscellaneous

DR	CR
$100.00	

Appendix II

Acme Nonprofit Corporation

General Journal

Page _________

Date	GJ#	Account Title	PR	Debit		Credit	

Sample General Ledger Accounts

Cash							
Account #101							
		PR	**DR**			**PR**	**CR**
1/1/2002	**Beginning Balance**	X	**$10,000.00**				
1/4/2002	GJ1	1	$10,000.00				
				######	GJ2	2	$1,000.00
#######	Balance	X	$19,000.00				

Accounts Receivable							
Account # 120							
		PR	**DR**			**PR**	**CR**
1/1/2002	**Beginning Balance**	X	**$5,000.00**				
#######	Balance	X	$5,000.00				

Donations							
Account # 400							
		PR	**DR**			**PR**	**CR**
				######	GJ1	1	$10,000.00
				######	Balance	X	$10,000.00

Rent							
Account # 520							
		PR	**DR**			**PR**	**CR**
1/5/2002	GJ2	2	$1,000.00				
#######	Balance	X	$1,000.00				

Acme Nonprofit Corporation

Trial Balance

January 31, 2002

Account Title	Acct. No.	Debit	Credit
Cash		$ 21,450	
Petty Cash		100	
Accounts Receivable		5,000	
Equipment		15,000	
Accumulated Depreciation			2,000
Accounts Payable			5,100
Net Assets			17,500
Donations			10,000
Grant Income			15,000
Salaries		5,000	
Fringe Benefits		1,500	
Rent		1,000	
Utilities		250	
Supplies		200	
Miscellaneous		100	
		$ 49,600	$ 49,600

Acme Nonprofit Corporation

Work Sheet

Act #	**Account Name**	**Trial Balance**		**Balance Sheet**		**Income Statement**	
		DR	**CR**	**DR**	**CR**	**DR**	**CR**
101	Cash	$21,450.00		$21,450.00			
118	Petty Cash	$100.00		100			
120	Accounts Receivable	$5,000.00		$5,000.00			
150	Equipment	$15,000.00		$15,000.00			
170	Accumulated Depreciation		$2,000.00		$2,000.00		
290	Accounts Payable		$5,100.00		$5,100.00		
300	Net Assets		$17,500.00		$17,500.00		
400	Donations		$10,000.00				$10,000.00
410	Grant Income		$15,000.00				$15,000.00
500	Salaries	$5,000.00				$5,000.00	
505	Fringe Benefits	$1,500.00				$1,500.00	
520	Rent	$1,000.00				$1,000.00	
530	Utilities	$250.00				$250.00	
561	Supplies	$200.00				$200.00	
591	Indirect Cost						
597	Depreciation						
599	Miscellanous	$100.00				$100.00	
	Total	**$49,600.00**	**$49,600.00**	**$41,550.00**	**$24,600.00**	**$8,050.00**	**$25,000.00**
	(Revenue) over expenses				$16,950.00	$16,950.00	
	Grand Total	$49,600.00	$49,600.00	$41,550.00	$41,550.00	$25,000.00	$25,000.00

Appendix VI

Acme Nonprofit Corporation		
Balance Sheet		
January 31, 2002		
Assets		
Cash	$21,450.00	
Petty Cash	$100.00	
Accounts Receivable	$5,000.00	
Equipment	$15,000.00	
Accumulated Depreciation	-$2,000.00	
Total Assets	**$39,550.00**	
Liabilities & Net Assets		
Accounts Payable		$5,100.00
Net Assets		$34,450.00
Total Liabilities and Net Assets		**$39,550.00**

Appendix VI

Acme Nonprofit Corporation		
Income Statement		
For the period ended January 31, 2002		
REVENUE		
Donations		$10,000.00
Grant Income		$15,000.00
Total Revenue		**$25,000.00**
EXPENSES		
Salaries	$5,000.00	
Fringe Benefits	$1,500.00	
Rent	$1,000.00	
Utilities	$250.00	
Supplies	$200.00	
Miscellaneous	$100.00	
Total Expenses	**$8,050.00**	
Total Income (Revenue over expenses)		**$16,950.00**

Acme Nonprofit Corporation

General Journal Page _________

Date	GJ #	Account Title	PR	Debit		Credit	
		Closing Entries:					
#######	GJ34	Donations		$40,000			
		Grant Income		$65,000			
		Revenue & Expense Summary				$105,000	
		To close out income accounts for FY01					
#######	GJ35	Revenue & Expense Summary		$89,800			
		Salaries				$60,000	
		Fringe Benefits				$12,000	
		Rent				$12,000	
		Utilities				$2,400	
		Supplies				$2,400	
		Miscellaneous				$1,000	
		To close out revenue accounts for FY01					
#######	GJ36	Revenue & Expense Summary		$15,200			
		Net Assets				$15,200	
		To close out income and expense accounts to					
		balance sheet for FY01					

Acme Nonprofit Corporation				
Bank Reconciliation Statement				
Checking Account				
January 31, 2002				
Checkbook Balance	$21,450.00	Bank Balance		$13,725.00
Deduct Service Charge	$0.00	add: Deposit in transit		$10,000.00
		Total		**$23,725.00**
		Deduct outstanding checks		
		Check # 101	$1,725.00	
		Check # 102	$250.00	
		Check # 103	$200.00	
		Check # 104	$100.00	
		Total		**$2,275.00**
Correct Check Stub Balance	**$21,450.00**	**Available Bank Balance**		**$21,450.00**

PAYROLL FOR WEEK ENDING DECEMBER, 20--

NAME	TOTAL HOURS	REGULAR	OVER-TIME	TOTAL SALARIES EXPENSE	SOCIAL SECURITY TAX W/H	MEDICARE TAX W/H	FEDERAL INCOME TAX W/H	STATE INCOME TAX WITHHELD	TOTAL DEDUCTIONS	NET PAYCHECK	CHECK NO.
Arkin, J	40	$ 500.00		**$ 500.00**	$ (31.00)	$ (7.25)	$ (74.10)	$ (10.00)	$ (122.35)	**$ 377.65**	6857
Dawson, L	44	$ 392.00	$ 58.80	**$ 450.80**	$ (27.95)	$ (6.54)	$ (62.60)	$ (50.00)	$ (147.09)	**$ 303.71**	6858
Green, M	40	$ 840.00		**$ 840.00**	$ (52.08)	$ (12.18)	$ (186.30)	$ (10.00)	$ (260.56)	**$ 579.44**	6859
Johnson, T	46	$ 800.00	$ 180.00	**$ 980.00**	$ (60.76)	$ (14.21)	$ (186.70)	$ (5.00)	$ (266.67)	**$ 713.33**	6860
Wyatt, W	40	$ 480.00		**$ 480.00**	$ (29.76)	$ (6.96)	$ (69.20)		$ (105.92)	**$ 374.08**	6880
Zachs, A	40	$ 600.00		**$ 600.00**	$ (37.20)	$ (8.70)	$ (71.36)	$ (2.00)	$ (119.26)	**$ 480.74**	6881
		$ 3,612.00	$ 238.80	**$ 3,850.80**	$ (238.75)	$ (55.84)	$ (650.26)	$ (77.00)	$ (1,021.85)	**$ 2,828.95**	

Employee Earnings Record

Employee #:	8	Marital Status:	Married	Social Security #:	555-123-1234
Thomas Johnson		# of Withholding Allowances:	4	Date of Birth:	10/4/1952
5555 Columbus Ave.		Weekly Pay Rate:	$800	Date of Employment Terminated:	N/A
Anytown, MD 55555		Hourly Rate:	$15		
Phone: 555-1234					
Occupation:	Accounting Clerk				

PERIOD ENDED	TOTAL HOURS	REGULAR EARNINGS	OVERTIME	TOTAL EARNINGS	ANNUAL CUMULATIVE TOTAL	FICA TAX W/H	FEDERAL INCOME TAX W/H	STATE INCOME TAX W/H	TOTAL	NET AMOUNT	CHECK NO.
9/27/2001	51	$600.00	$330.00	$930.00	$23,730.00	$71.15	$139.50	$93.00	$303.65	$626.36	6175
Third Quarter Totals		$7,200.00	$330.00	$7,530.00		$576.05	$1,674.00	$1,116.00	$3,366.05	$4,163.96	
10/4/2001	40	$600.00		$600.00	$24,330.00	$45.90	$90.00	$60.00	$195.90	$404.10	6225
10/11/2001	40	$600.00		$600.00	$24,930.00	$45.90	$90.00	$60.00	$195.90	$404.10	6300
10/18/2001	40	$600.00		$600.00	$25,530.00	$45.90	$90.00	$60.00	$195.90	$404.10	6354
10/25/2001	40	$600.00		$600.00	$26,130.00	$45.90	$90.00	$60.00	$195.90	$404.10	6450
11/1/2001	40	$600.00		$600.00	$26,730.00	$45.90	$90.00	$60.00	$195.90	$404.10	6490
11/8/2001	40	$600.00		$600.00	$27,330.00	$45.90	$90.00	$60.00	$195.90	$404.10	6510
11/15/2001	41	$600.00	$15.00	$615.00	$27,945.00	$47.05	$92.25	$61.50	$200.80	$414.20	6590
11/22/2001	40	$600.00		$600.00	$28,545.00	$45.90	$90.00	$60.00	$195.90	$404.10	6615
11/29/2001	42	$600.00	$30.00	$630.00	$29,175.00	$48.20	$94.50	$63.00	$205.70	$424.31	6635
12/6/2001	50	$600.00	$150.00	$750.00	$29,925.00	$57.38	$112.50	$75.00	$244.88	$505.13	6650
12/13/2001	40	$600.00		$600.00	$30,525.00	$45.90	$90.00	$60.00	$195.90	$404.10	6690
12/20/2001	44	$600.00	$60.00	$660.00	$31,185.00	$50.49	$99.00	$66.00	$215.49	$444.51	6740
12/27/2001	46	$600.00	$90.00	$690.00	$31,875.00	$52.79	$103.50	$69.00	$225.29	$464.72	6825
Fourth Quarter Totals		$7,800.00	$345.00	$8,145.00		$623.09	$1,221.75	$814.50	$2,659.34	$5,485.66	
Yearly Total		$31,200.00	$675.00	$31,875.00		$2,438.44	$4,781.25	$3,187.50	$10,407.19	$21,467.81	

Appendix XI

a Control number		OMB No. 1545-0008
b Employer's identification number	**1** Wages, Tips, other compensation	**2** Federal income tax withheld
25-2573586	6261.00	408.00
c Employer's name, address, and ZIP code	**3** Social Security wages	**4** Social security tax withheld
Some Firm	6261.00	162.68
373 Fairveiw Lane	**5** Medicare wages and tips	**6** Medicare tax withheld
Syracuse, NY 13210	6261.00	44.66
	7 Social security tips	**8** Allocated tips
d Employee's social security number	**9** Advance EIC payments	**10** Dependent care benefits
117 : 55 : 0003		
e Employee's name, address, and ZIP code	**11** Non qualified plans	**12** Benefits included in box 1
William E. Smith		
4754 W. Promise Blvd.	**13** See instrs. for box 13	**14** Other
apt 112		
Syracuse, NY, 13210		

15 Statutory employee	Deceased	Pension plan	Legal rep.	Deferred compensation
[ ]	[ ]	[ ]	[ ]	[ ]

16 State	Employer's state I.D. no.	**17** State wages, tips, etc.	**18** State income tax	**19** Loality name	**20** Local wages, tips, etc.	**21** Local income tax
New York	23-2573587	6261.00	103.13			

Form **W-2** **Wage and Tax Statement** **1999**

Copy B To Be Filed With Employee's FEDERAL Tax Return

Appendix XII

ACME HOUSING CORPORATION

STATEMENT OF FINANCIAL POSITION

June 30, 19XX and 19XX

		19XX	19XY
ASSETS:			
Cash & Cash equivalents		$75	$460
Accounts and interest receivable		2,130	1,670
Inventories and prepaid expenses		610	1,000
Developer fee receivable		3,025	2,700
Short-term investments		1,400	1,000
Projects under construction		5,210	4,560
Land, buildings and equipment		61,700	63,590
Long-term investments		218,070	203,500
Total Assets		**$292,220**	**$278,480**
LIABILITIES AND NET ASSETS			
LIABILITIES:			
Accounts payable		$2,570	$1,050
Current portion of long-term debt			650
Grants payable		875	1,300
Construction loans		1,685	1,140
Long term debt		5,500	8,200
	Total Liabilities	10,630	12,340
NET ASSETS:			
Unrestricted		**115,198**	103,670
Temporarily restricted		**24,372**	25,470
Permanently restricted		**142,020**	137,000
	Total net assets	**281,590**	266,140
Total Liabilities and Net Assets		**$292,220**	**$278,480**

Appendix XIII

ACME HOUSING CORPORATION
STATEMENT OF ACTIVITY
Year Ended June 30, 19XX

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, gains and other support:				
Contributions & Grant Income	$8,640	$8,110	$280	$17,030
Development Fees	5400			5400
Investment income	5600	2580	120	8300
Management income	8500			8500
Net unrealized and realized gains				
on long-term investments	578	2952	4620	8150
Other	150			150
Net assets released from restrictions				
Satisfaction of program restrictions	11990	(11990)		0
Satisfaction of equipment				
acquisition restrictions	1500	(1500)		0
Expiration of time restrictions	1250	(1250)		0
Total revenues, gains and other support	43,608	(1,098)	5,020	47,530
Expenses and losses:				
Development	13,100			13,100
Property Management	8,540			8,540
Technical Assistance	5,760			5,760
Management and general	2,420			2,420
Fundraising	2,260			2,260
Total expenses	32,080	0	0	32,080
Change in net assets	**11,528**	**(1,098)**	**5,020**	**15,450**
Net assets at beginning of year	103,670	25,470	137,000	266,140
Net assets at end of year	**$115,198**	**$24,372**	**$142,020**	**$281,590**

Appendix XIV

ACME HOUSING CORPORATION

STATEMENT OF FUNCTIONAL EXPENSES

Year Ended June 30, 19XX

	Development	Property Management	Technical Assistance	Management & General	Fundraising	Total
Personnel:						
Salaries and wages	$7,205	$4,697	$3,168	$1,331	$0	$16,401
Payroll taxes	524	342	230	97		1193
Insurance	503	328	221	93		1145
Training	24	16	10	4		54
						0
Total personnel	$8,256	$5,382	$3,630	$1,525	$0	$18,793
Other:						
Project expenses	147	96	65	27		335
Professional fees	1169	762	514	216		2662
Insurance	630	411	277	116		1434
Rent	958	624	421	177		2180
Utilities	83	54	36	15		188
Telephone	218	142	96	40		497
Office expense	295	192	130	54		670
Dues and publications	77	50	34	14		176
Equipment maintenance	556	363	245	103		1266
Travel	103	67	45	19		234
Board expense	101	66	44	19		230
Public relations	17	11	7	3		38
Depreciation	318	207	140	59		723
Miscellaneous	173	112	76	32	2260	2653
Total Other	$4,844	$3,158	$2,130	$895	$2,260	$13,285
Total Expenses	**$13,100**	**$8,540**	**$5,760**	**$2,420**	**$2,260**	**$32,080**

Appendix XV

Changes in Accounting Rules for Nonprofit Organizations

By: Judy Monteux, Rural Community Assistance Corporation, West Sacramento, California

The word is out that there are new accounting rules coming for nonprofit organizations but you may be wondering what they mean for your particular agency. "Will they affect us since we're so small?" "Will I need to change my accounting system and procedures?" "Will my financial statements change?" "When do I have to make the changes?" In this article, RCAC's Judy Monteux takes a look at the new FASB rules and explains who will be affected and how.

Who is changing the rules?

In 1973, an independent organization known as the Financial Accounting Standards Board (FASB) was established to issue standards by which certified public accountants (CPAs) must rate all organizations they review or audit. Over several years, the FASB studied the financial reporting practices of many nonprofit organizations and found a wide range of report formats and accounting practices. This was largely due to the lack of an industry-wide standard for nonprofit accounting. The organizations were merely attempting to integrate the varied reporting requirements of their individual funding sources with generally accepted accounting principles (GAAP).

In June 1993, the FASB issued two new accounting standards, SFA 116 and 117, which specifically addressed nonprofit accounting and financial reporting.

Who is affected by these new standards?

All nonprofit organizations, regardless of their size or type (with the exception of investor-owned enterprises, like cooperatives and credit unions) are now governed by these new standards. In addition, SFA 116 addresses agencies making contributions including for-profit organizations for whom no specific standards have existed until now.

When do I have to implement the changes?

The new standards went into effect for fiscal years beginning after December 15, 1994. That means that if your fiscal year runs from October 1 through September 30, you must implement the new rules for your fiscal year that ends on September 30, 1996.

If your organization has total assets of less than $5 million and annual expenses of less than $1 million, you may postpone the implementation for one fiscal year. It is highly recommended, however, that you begin the transition sooner rather than later.

Appendix XV

Why did they change the rules?

The FASB recognizes that there are a wide range of users of a nonprofit organization's financial reports including internal management, the board of directors, outside funding sources and lenders, some who do not have an intricate knowledge of accounting. One goal of the FASB in developing these new standards was to make nonprofit financial statements more "user friendly." To accomplish this, the new rules are meant to both simplify and standardize the required financial reports so that all users can use these reports to measure whether or not an organization is able to continue to provide services as well as how well the organization is managed.

What does SFA 117 require?

SFA 117, Financial Statements for Nonprofit Organizations, addresses the actual format of an organization's external financial statements. The major new requirements of this standard are:

1. The organization must present, at a minimum, financial data for the whole organization, not just by fund as some not-for-profits have done in the past.
2. A complete set of financials must include a Statement of Financial Position (formerly known as a balance sheet), a Statement of Activities (formerly known as a revenue and expense statement), and a Statement of Cash Flows (not previously required of nonprofit organizations).
3. The difference between assets and liabilities will now be referred to as an agency's net assets rather than fund balance. Similarly, revenue minus expenses will represent a change in net assets rather than a net income or loss or change in fund balance.
4. Net assets and changes in net assets must be divided into one of three classes as determined by the absence or presence of donor-imposed restrictions. The three classes are:
   a. Permanently restricted in which the restrictions imposed by the donor will never expire or be fulfilled by the recipient organization;
   b. Temporarily restricted in which the donor-imposed restrictions will eventually expire with the passage of time or be released by some action by the recipient organization; and
   c. Unrestricted which include all other net assets including those whose use is restricted by the management of the organization but not by the donor.

Appendix XV

5. All expenses (with some minor exceptions relating to investment of restricted assets) must be reported in the unrestricted class regardless of the source of financing the expense. This will necessitate adjusting entries to match restricted revenue with the appropriate unrestricted expenses through the use of a new revenue account entitled "Net Assets Released from Restrictions."
6. Expenses must be reported, at a minimum, by the following functional categories: program, management and general, and fund-raising in order to group expenses according to the purpose for which the costs were incurred. This does not preclude reporting revenue and expenses by fund nor does it have to be done on the financial statements itself. This kind of information can be reported in the supporting charts or notes that accompany the audited financials. Voluntary health and welfare agencies must also report expenses by natural categories (e.g., salaries, fringe, travel) and all organizations are encouraged but not required to do so.
7. Organizations must restate the prior year financial information presented in the financial statement using the rules of the new FASB standards. You will have to analyze what is in your fund balance from the previous year in order to restate it using the three classes of net assets.

How will SFA 116 affect my organization?

SFA 116, Accounting for Contributions Received and Contributions Made, addresses the issue of when an agency recognizes revenue.

Many organizations have traditionally recorded contributions received but not used as liabilities in deferred or unearned revenue accounts. The new accounting standard states that all contributions, whether donor-restricted or unrestricted, and in whatever form (cash, in-kind, pledge) are revenue in full immediately upon receipt of the gift or unconditional pledge. The presence or absence of donor-imposed time or purpose restrictions on the use of the "gift" does not affect the timing of the revenue recognition, only the class in which it is reported.

Let's assume that your agency receives a 12-month program grant of $100,000 on the last day of your fiscal year. You probably would have recorded the income as a liability in a deferred revenue until you were able to expend the funds the following fiscal year. As you spend it, you would reduce the liability and record the expended amount as revenue.

Appendix XV

Under SFA 116, you must record the total amount received ($100,000) as temporarily restricted revenue (since it is time-restricted). This will result in a large increase in your agency's temporarily restricted net assets at the fiscal year end. During the following fiscal year, you will transfer "revenue" from the temporarily restricted class to the unrestricted class using the "Net Assets Released from Restriction" accounts to match the funds expended. (Remember, all expenses are recorded in the unrestricted class according to SFA 117.)

This method of recognizing revenue will tend to show a spike in net assets, usually in the temporarily restricted class, in one fiscal year and a "loss" in the following year. This results from recording all the income when received, even though the expenses, which would be booked against these funds may not occur until the following fiscal year. For this reason, it is critical that both the organization's management and funding sources be trained to understand the impact of this new standard on their financial statements.

This new treatment of unconditional contributions and pledges as revenue upon receipt will only impact those organizations that receive prepaid grants and/or large numbers of pledges. This standard will not affect how you record income from purchase of goods or services contracts nor advances on cost reimbursement grants, neither of which are considered contributions.

Another major change resulting from SFA 116 is the reporting of the value of donated services by nonprofit organizations. This new standard requires that this value be reported as revenue and expense only if one of the following two criteria is met:

1. The services create or enhance non-financial assets of the organization (e.g., constructing or making improvements to property, writing computer software); OR
2. The donated services require specialized skills and are provided by persons who possess these skills and the services would have been purchased by the organization if the volunteers were not available.

The value of services provided by volunteers who answer telephones, provide support services, or solicit funds for the agency will not be recognized as revenue. The organization may want to present the value of these services in the notes to the financials, however.

Appendix XV

How to make the conversion

At first glance, the thought of implementing all of the new FASB regulations may seem overwhelming. It is imperative that each agency allow enough time to analyze, plan and implement the changes necessary to comply with SFAs 116 and 117.

Both new standards allow some flexibility in interpretation, requiring the management of the organization to make decisions in a variety of areas. These decisions include:

SFA 117

1. What titles should we use for the balance sheet and revenue/expense statement since SFA 117 does not require the use of "Statement of Financial Position" or "Statement of Activities"?
2. What format (columnar, horizontal) should we use for the Statement of Activities to show the three classes of net assets?
3. Should we use the direct or indirect method to prepare the Statement of Cash Flows?
4. Should we include comparative data for the prior fiscal year on the statements?
5. Should we categorize expenses by functional or natural categories on the Statement of Activities?
6. Should we convert our accounting system to record the three classes of net assets throughout the fiscal year or merely analyze the data at fiscal year-end?

SFA 116

1. Should we report restricted contributions whose restrictions are met in the same accounting period as the funds are received as unrestricted or restricted with an accompanying reclassification to unrestricted?
2. Should we adopt the new standards earlier than the required date if we qualify for the delay in implementation?

What should my agency do to implement the changes?

There are a number of steps which should be completed convert to the new FASB standards.

1. The most important step in making the conversion is the analysis of the organization's income for the present fiscal year. Review all receipts and ask the following:
   - Did we receive unconditional contributions which were recorded as deferred revenue which should have been recorded as revenue (either restricted or unrestricted) when received?

Appendix XV

- Did we receive unconditional pledges which we have not recorded as revenue until the cash was received which should have been recorded as revenue at present value when received?
- Did we receive contributed services which meet one of the two criteria which we should have recorded as revenue and expense?

Once these analyses have been completed, adjusting entries can be made to re-class or record revenue appropriately. Use your independent auditor to assist your agency in the transition.

2. A similar analysis must be done of the current fiscal year's beginning fund balance in order to divide it among the three classes of net assets on the statement of financial position.
3. Decide which of the alternative financial statement formats allowed by SFA 117 to use. Once that decision is made, prepare comparative samples showing old and new formats to assist financial statement users. It would be a good idea to plan a training session to assist the users with the new standards and their impact on your agency's financial statements.
4. Analyze your existing accounting and record-keeping systems and determine whether or not any modifications are necessary in order to provide the necessary information for the new standards.
5. Decide whether or not to use the new formats for your interim financial reports.

Appendix XVI

ACME HOUSING CORPORATION
BUDGET COMPARISON REPORT
FOR THE PERIOD ENDING SEPTEMBER 30, 19XX

	CURRENT 9/30/XX	YEAR-TO-DATE 7/1/XX-9/30/XX	ANNUAL BUDGET	YTD % OF BUDGET	REMAINING BALANCE
REVENUE					
Unrestricted Revenue:					
Grant Revenue	$5,000.00	$6,000.00	$25,000	24.0%	$19,000.00
Contributions Released from Restriction	1,000.00	1,000.00	10,000	10.0%	9,000.00
Development Fees	5,000.00	8,000.00	25,000	32.0%	17,000.00
Management Income	4,000.00	12,000.00	48,000	25.0%	36,000.00
Total Unrestricted Revenue	$15,000.00	$27,000.00	$108,000		$81,000.00
Temporarily Restricted Revenue:					
Temporarily Restricted Revenue	$3,000.00	$3,000.00	$15,000	20.0%	$12,000.00
Net Assets Released from Restriction	-1,000.00	-1,000.00	-10,000	10.0%	-9,000.00
Total Temporarily Restricted Revenue	$2,000.00	$2,000.00	$5,000		$3,000.00
TOTAL REVENUE					
EXPENSES					
Salaries and Wages	$2,000.00	$6,000.00	$24,000	25.0%	$18,000.00
Fringe Benefits	800.00	2,400.00	9,600	25.0%	7,200.00
Travel	1,000.00	3,000.00	7,500	40.0%	4,500.00
Rent	1,000.00	3,000.00	12,000	25.0%	9,000.00
Equipment Maintenance	100.00	300.00	1,200	25.0%	900.00
Printing/Copying	200.00	600.00	2,400	25.0%	1,800.00
Postage	100.00	300.00	1,200	25.0%	900.00
Telephone	200.00	600.00	2,400	25.0%	1,800.00
Staff training	0.00	0.00	5,000	0.0%	5,000.00
Project expenses	500.00	1,500.00	6,000	25.0%	4,500.00
Board expenses	0.00	0.00	5,000	0.0%	5,000.00
Depreciation	1,000.00	3,000.00	12,000	25.0%	9,000.00
Taxes & Licenses	100.00	300.00	1,200	25.0%	900.00
TOTAL EXPENSES	$7,000.00	$21,000.00	$89,500		$68,500.00
NET ASSETS-UNRESTRICTED	$8,000.00	$6,000.00	$18,500		$12,500.00
NET ASSETS-TEMPORARILY RESTRICTED	$2,000.00	$2,000.00	$5,000		$3,000.00