

Capacity Building Institute

501(c)(3) Financial
Management

Kerry Gajewski, MPA



Key Points of Training Session

- Overview of 501 (c)(3) Organizations
- Accounting Systems & Controls
- Budgeting
- Review of IRS Forms 990-N, 990-EZ, 990
- Audits

501 (c)(3) Organizations

What is a 501 (c)(3) organization?

- Non-profit corporation classified by IRS as either “public charity” or “private foundation”.
- Non-profits do not generate revenue for stakeholders rather use revenue to support mission of organization
- Types of 501c3 orgs: Religious; educational; charitable; scientific; literary; testing for public safety; fostering national or international amateur sports competition; or promoting the prevention of cruelty to children or animals

501 (c)(3) Organizations

What are the advantages to becoming a 501 (c)(3)?

- Tax Exemption Status
- Donor Deducts Charitable Contributions
- Eligibility for Government & Foundation Grants
- Exemption from F.U.T.A
- Gambling Permits
- Credibility
- Limited Liability

501 (c)(3) Organizations

What are the disadvantages?

- Must operate exclusively for charitable, educational or religious purposes
- Severe restrictions on lobbying
- Prohibitions on giving direct financial benefit to members, directors, etc.
- Political

501 (c)(3) Organizations

501 (c)(3) Responsibilities

- Keep adequate records
- File Required Returns
- Provide Donor Substantiation
- Obey Disclosure Laws
- Generate Public Support
- Avoid Excess Benefit
- Shun Political Activity
- Limit Legislative Activity
- Limit Unrelated Business Activity

501 (c)(3) Organizations

Legal Issues Checklist

- Maintain current copy of your
 - Articles of Incorporation
 - Bylaws
 - Federal Tax Exempt Recognition Letter
 - Sales Tax Exemption Letter
- Are you filing the required Form 990 with the IRS?
- Is your Form 1023 available for public inspection at your principal place of business?

501 (c)(3) Organizations

Legal Issues Checklist (Con't)

- Do you keep permanent records, minutes of all meetings of the board, your members, and committees including formal actions? If so, do you have a formal “minute book” where all such records are stored in chronological order?
- Do you prepare an annual financial statement or audit?

501 (c)(3) Organizations

Legal Issues Checklist (Con't)

- Are your financial statements prepared in accordance to generally accepted accounting principles (GAAP)?
- Are you retaining your financial records for at least seven years?
- Do you acknowledge in writing gifts over \$250?
- If you are exempt under 501(c)(3), are you taking full advantage of your exemption from state sales and property tax?

Financial Management & Administration of 501(C)(3) Organizations

- Accurate financial data
- Understandable financial statements
- Timely financial statements
- Actual versus projected budget figures
- Annual audit

Financial Management & Administration of 501(C)(3) Organizations

NPO's require accounting and auditing procedures and policies

- Designate a Fiscal/Financial Officer
- Develop fiscal policy and procedural manual
- Create Accounting System
 - $\text{Assets} = \text{Liabilities} + \text{Net Assets (Fund Balance)}$
 - Cash basis v. accrual basis accounting system
 - Manual v. automated accounting systems

Financial Management & Administration of 501(C)(3) Organizations

Steps involved in the accounting cycle:

- Create and prepare financial transactions
- Analyze transactions
- Record transaction in journals
- Post journal information to general ledger
- Analyze general ledger account and make corrections
- Prepare financial statements from general ledger

Financial Management & Administration of 501(C)(3) Organizations

Setting up Chart of Accounts

- What reports do you want to prepare?
- What financial decisions, evaluations and assessments do you need to make on a regular basis?
- What level of detail do you require?
- What is your capacity for tracking financial information?

Financial Management & Administration of 501(C)(3) Organizations

- Design chart of accounts by considering what reports will satisfy external requirements and help you with internal management assessment and decision making.
- Correlate chart of accounts to the categories in your budget so you can easily prepare reports comparing budgeted with actual income and expenses.

Financial Management & Administration of 501(C)(3) Organizations

SAMPLE CHART OF ACCOUNTS

- Assets
 - tangible items, cash, accounts receivable, equipment & property. Assets are usually listed in descending order. Asset accounts usually start with the number 1.
- Liabilities
 - Obligations due to creditors, such as loans and accounts payable. Liabilities usually start with the number 2.

Financial Management & Administration of 501(C)(3) Organizations

Net Assets

- Formally referred to as fund balance(s), reflect the financial worth of the organization.
- They represent the balance remaining after the obligations are subtracted from an organizations assets.
- Organizations which only receive unrestricted gifts will have only one net asset account.
- Those with temporarily or permanently restricted net assets will have more (see FASB #116 & #117).
- Net assets begin with the number 3.

Financial Management & Administration of 501(C)(3) Organizations

How chart of accounts is set up depends on:

- The level of detail you require
- Types of income and expenses you want to track
- If multi-program, how to record and track separately
- Keep simple & revise as necessary

Annual Budget Process

- What is a Budget?
 - Educated guess
 - A process that establishes financial goal for future and monitors progress towards goal
- Why Budget?
 - To ensure sufficient funds are available to cover services and programs
- Who is responsible for developing the budget?
 - Board of Directors are legally responsible for ensuring budgets meet applicable laws and regulations
 - Director/CEO starts the process, involves the staffing

Annual Budget Process

- Develop two type budgets
 - Operating budget
 - Program budget(s)
- Budget Tools
 - Historical Data
 - Easy to use forms

Annual Budget Process

Eight Steps for an Effective Budget

1. Know your organization's mission
2. Ensure that everyone involved in budget process understands basic accounting principles
3. Keep the budget process simple, consistent and easy to understand
4. Make sure all personnel involved in budget process know their roles
5. Tie budget to long range goals
6. Make sure organization has effective budget approval process
7. Track progress toward budgeted goals by analyzing monthly financial statement
8. If budget problems exist be prepared to correct them

Annual Budget Process

- Timing of budget:
 - Prepare budget 3 months prior to new fiscal year
- Who should be involved in budget?
 - Usually driven by the chief executive but staff and board members should be involved in the budget planning process
- How often should you review the budget?
 - Monthly - prepare monthly budgets that reflect anticipated timing of revenue and expenses

Annual Budget Process

Budget could include:

- Long term and short term operating expenses
- Operating budget for wages and supplies
- Equipment (capital budgets)

Annual Budget Process

A good budget should:

- Help management reach financial objectives
- Give detailed picture how money moves in and out of organization
- Help to forecast income & expenses
- Provide resource to monitor organization's progress toward its goals

Annual Budget Process

What are steps in budget process?

- Review program & management achievements and fiscal performance over past year. Match to strategic plan and mission.
- Estimate the costs required to achieve objectives. Including staff, supplies, and other resources. Include both program and financial staff in discussions of programmatic costs to make sure that all resources required by programs are considered. Management costs should be included in departmental budgets.

Annual Budget Process

- Personnel costs account for 60% – 70% of budget
- Account for unanticipated fluctuations
- Project new staffing costs
- Training costs
- Advertising costs
- New program costs

Annual Budget Process

- Budget for income as well as expenses
- Develop contingency budgets
- Compare revenue and expense projections
- Once preliminary budget is complete and revenue & expense relationship is evaluated, management is ready to make decisions based on projections

Annual Budget Process

- Prepare trial balances once a month
- Update budget to include actual revenue and expenses
- Compare planned revenue and expenses to projected revenue and expenses

Annual Budget Process

NOT FOR PROFIT, INC							
FY 2010-11 BUDGET PROJECTION							
<i>DRAFT</i>							
REVENUE AND SUPPORT							
Individual Donations	\$	5,000					
Fundraising		5,000					
Grant A		25,000					
Grant B		15,000					
Total Revenue and Support		50,000					
Program Budgets			Supporting Services				
	Grant A	Grant B	Total Program Budgets	Management and General	Fund Raising	Total Supporting Services	TOTAL BUDGET
EXPENSES							
Salaries and Wages	7,000	5,000	12,000	1,200	-	1,200	13,200
Salaries Taxes	257	183	440	44	-	44	484
Utilities	500	500	1,000	500		500	1,500
Liability Insurance	200	300	500	700		700	1,200
Occupancy	1,000	1,000	2,000	10,000	-	10,000	12,000
Office Supplies			-	500	300	800	800
Program Services	5,000	4,000	9,000	500		500	9,500
Postage & Mailing			-	50	200	250	250
Contract Services	2,000	2,000	4,000	-	-	-	4,000
Transportation/Travel	500	500	1,000	1,000	250	1,250	2,250
Telephone & Communications	201		201	500		500	701
Fundraising			-	-	200	200	200
Advertising	-	-	-	1,000	1,500	2,500	2,500
Other	100	100	200	300	100	400	600
Total Expenses	\$16,758	\$13,583	\$30,341	\$16,294	\$2,550	\$18,844	\$49,185
Net Operating							\$815

No This budget projection is just an estimate and to be used solely as a sample.

Annual Budget Process

Prepare financial statements once a month, 10 days after close of following month

- Statement of Financial Position
- Statement of Activity
- Cash Flow Statement

IRS Forms 990-N, 990-EZ & 990

- Must file the 15th day of the 5th month after the organization's end of the accounting period
- Small tax exempt organizations whose annual gross receipts are less than \$25,000 can submit electronic form 990-N (electronic postcard).
- Failure to file 990-N, 990-EZ or complete 990 Form with IRS for three consecutive years will result in loss of tax exempt status.
- Information available on www.irs.gov

IRS Form 990

Form 990 “Return of Organization Exempt From Income Tax”

- File electronic postcard Form 990-N each year with IRS if annual gross receipts are less than \$25,000
- File Form 990-EZ or 990 if gross receipts are greater than \$ 25,000

Overview of IRS Form 990

- Form 990 serves two purposes:
 1. Provides information that helps government agencies enforce the laws that govern nonprofits.
 2. Provides financial information about the organization's financial condition, strengths & weaknesses and sources of income.

IRS Form 990

Tips when filing and submitting IRS Form 990-N, 990-EZ or 990

- Know your organization's annual tax year
- Know your organization's 9 digit employer identification (EIN) number
- Know the legal name and address of your organization
- Know the name of your principal officer of your organization
- Are your gross receipts \$ 25,000 or less?

Audits

Audits may be required by law of every organization, or only of certain organizations.

An audit may be useful to the board in evaluating its oversight of the organizations financial transactions, or to the executive director in evaluating its oversight of the organization's financial transactions, or to the executive director in evaluating the NPO's financial situation.

An audit may provide transparency, or reassure the public that a previous problem has been resolved. Audited financial statements may also provide additional credibility with donors.

From Robert A. Connor, Health Care Finance and Financial Management (2000)

Audits

An audit tests the completeness and accuracy of information in an organization's financial statements.

An independent CPA issues an opinion on how fairly the agency's financial statements represent its financial position and whether they comply with GAAP.

Board members, staff, and their relatives cannot perform audits.

Audits

Internal Controls

- Separation of duties
- Procedure for monitoring assets
- Secondary signature requirement of disbursements over large \$ amounts
- Audit by outside professional

Audits

Auditors will:

- Request information to confirm bank balances, contribution amounts, conditions & restrictions, contractual obligations, and monies owed by your organization.
- Review physical assets, journals & ledgers, and board minutes
- Select sample of financial transactions to determine proper posting
- Interview key personnel to review internal controls

Audits

How to prepare for audit:

- Have detailed financial statements available, include footnotes
 - Statement of financial position
 - Statement of activities
 - Statement of cash flows
- Prepare annual reports

Disclosure Requirements

Exempt organizations must disclose

- All documents submitted with Form 1023
- All documents the IRS requires the organization to submit in support of its application
- The exemption ruling letter issued by the IRS

Additional Resources

- McMillan, Edward J., CPA, CAE, *Not-For-Profit Budgeting and Financial Management*, Hoboken, N.J: John Wiley & Sons, Inc. 2003.
- www.irs.gov/eo
- www.floridacdc.org
- www.idealists.org
- www.allianceonline.org
- www.managementhelp.org



QUESTIONS ?