City & County of San Francisco

Finance Guide for Nonprofits

An Overview of Financial Management Practices for San Francisco's Nonprofit Partners

Prepared by

OFFICE OF THE CONTROLLER

CITY PERFORMANCE DIVISION

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About the Controller's Office

The Controller is the chief financial officer and auditor for the City and County of San Francisco. We produce regular reports on the City's financial condition, economic condition, and the performance of City government. We are also responsible for key aspects of the City's financial operations — from processing payroll for City employees to processing and monitoring the City's budget.

Our team includes financial, tech, accounting, analytical and other professionals who work hard to secure the City's financial integrity and promote efficient, effective, and accountable government. We strive to be a model for good government and to make the City a better place to live and work.

About the City Performance Division

The City Performance team is part of the City Services Auditor (CSA) within the Controller's Office. CSA's mandate, shared with the Audits Division, is to monitor and improve the overall performance and efficiency of City Government. The team works with City departments across a range of subject areas, including transportation, public health, human services, homelessness, capital planning, and public safety.

City Performance Goals:
- Support departments in making transparent, data-driven decisions in policy development and operational management.
- Guide departments in aligning programming with resources for greater efficiency and impact.
- Provide departments with the tools they need to innovate, test, and learn.

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Disclaimer

This Finance Guide for Nonprofit Organizations provides nonprofit organizations with a broad overview and general guidance on organizing and managing their financial systems. It is not a comprehensive manual on the full scope of nonprofit financial operations, and it should not be relied on as an authoritative guide on managing nonprofit financial systems. The Guide identifies additional resources that nonprofits may use to find more detailed information.

Nonprofit organizations using the Guide should also seek the advice of financial experts, such as certified public accountants or other professionals specializing in the finances of nonprofit organizations, to guide them in decisions regarding their financial systems.

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Preface

The Controller's Office first produced the Finance Guide for Nonprofit Organizations (guide) in 2004 as a result of a recommendation by the 2003 Nonprofit Contracting Task Force. The Task Force determined that City and County of San Francisco (City) departments' fiscal or accounting requirements for the nonprofit organizations they contract with were inconsistent, which posed an unnecessary administrative burden. In addition to producing this comprehensive guide, the Controller's Office subsequently convened the Citywide Nonprofit Monitoring and Capacity Building Program, which includes the Fiscal Monitoring Program. As of 2024, Sixteen City departments participate in the Fiscal Monitoring Program to conduct coordinated fiscal and compliance monitoring of nonprofit contractors, with approximately 85% of all City spending with nonprofits monitored through this process. Additionally, the Fiscal Monitoring Program uses a Standard Monitoring Form built on the concepts and best practices conveyed through this guide to ensure consistency in requirements across departments.

In the years since the Controller's Office first produced the guide, the City has adopted policies or developed additional guidance for nonprofits doing business with the City. While the Controller's Office developed the 2004 version of the guide to be applicable to all nonprofits regardless of their contracting status with the City, this new version attempts to show how the City interprets general principles of nonprofit finance to support current or future nonprofit contractors to be in alignment with City standards. The specific standards used by the Fiscal Monitoring Program change periodically, but essential elements of the form remain consistent year to year, and this Guide notes when specific practices align with standards the City monitors.

This guide is available on the Citywide Nonprofit Monitoring and Capacity Building Program website.

Introduction

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

ABOUT THIS GUIDE

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

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

Finally, this guide includes an annotated list of resources for nonprofit organizations seeking specific information about their administrative and finance needs, as well as clarification of formal City policy related to nonprofit financial management practices.

CITYWIDE NONPROFIT MONITORING AND CAPACITY BUILDING PROGRAM

The Controller's Office has administered the Citywide Nonprofit Monitoring and Capacity Building Program since 2006. At its inception, the program focused on fiscal and compliance monitoring of nonprofits. However, beginning in Fiscal Year 2024-2025 (FY24-25), the Controller's Office is expanding the program to include two components: a Fiscal Monitoring Program and a Contract Monitoring Program.

The Controller's Office coordinates the Fiscal Monitoring Program to streamline and standardize fiscal and compliance monitoring of nonprofit organizations funded by multiple City departments. The City departments participating in the Fiscal Monitoring Program jointly conduct annual monitoring so that it is done efficiently and uses consistent standards and methods. The Monitoring Program includes approximately 200 nonprofit providers annually, representing an aggregate of nearly $1.5 billion in City funding from fourteen participating departments. With new fiscal monitoring requirements established in FY24-25, the Fiscal Monitoring Program may grow over time, with new participating departments and new nonprofits being monitored.

Core to the Fiscal Monitoring Program is an annual assessment of a contractor's ability to meet specific fiscal and compliance standards that act as indicators of organizational health. The standards that must be met by nonprofits contracting with the City and the documentation and steps that the City uses to test compliance with these standards are available on the Citywide Nonprofit Monitoring and Capacity Building Program website.

The Controller's Office provides support to nonprofits and City monitors to facilitate the annual assessment, help nonprofits comply with City standards, and generally improve nonprofit financial and administrative management.

With the goal of ensuring the monitoring is consistent, efficient, reduces duplication across City departments and minimizes the burden on nonprofit contractors, the Controller's Office centrally coordinates monitoring activities, including:

- Providing standard forms, templates, and an automated system for collaboration.
- Managing a Citywide Corrective Action Policy and process for Corrective Action designation of Tier 1, 2, or 3 when necessary.
- Providing individualized coaching services and workshops on nonprofit financial management practices for the City's nonprofit contractors.
- Providing workshops and peer learning events related to monitoring activities and nonprofit financial management practices for City staff.
- Publicly publishing reports on monitoring activities and outcomes, leveraging results to improve program performance.

City department staff ("monitors") conduct the annual assessment, often via a desk review of documentation submitted by the nonprofit, or at the discretion of the monitors, a site visit where monitors engage staff as part of the monitoring. When a contractor does not meet a standard, this is considered a "finding." City monitors document all findings in a Monitoring Report Letter, deliver direction on how to meet the standard, and provide the opportunity to do so within the monitoring cycle.

At the end of the monitoring cycle, City monitors record the final outcome for each contractor in a Final Status Letter that describes the findings that have been corrected by the contractor and are now "in conformance" with City standards, as well as findings that must still be addressed by the nonprofit contractor, and thus "not yet in conformance." Per the Citywide Nonprofit Corrective Action Policy, contractors that do not adequately address findings from year to year may receive a corrective action designation of Tier 1, 2 or 3.

The standards assessed via the Fiscal Monitoring Program align with the financial management practices described in this guide, and, when appropriate, the guide indicates these standards when describing the practice.

Financial Planning

KNOW YOUR FUNDING SOURCES

To adequately design and administer a finance system, you must have a thorough understanding of your grant agreements and contracts, including key information such as funding sources, effective dates, and ineligible costs.

- Know where the money comes from and account for it by funding source.
- If you receive federal or state funds, research all the compliance issues that might be tested by your independent certified public accountant (CPA) as part of an annual audit.
- Read and understand your grant agreement or contract and know what restrictions your funding sources have placed on the use of the funds they provide. If you have a grant agreement or contract that requires that your organization provide matching funds to earn the full grant or contract amount, it is essential that these funds are identified early and accounted for properly.
- Know the beginning and ending dates of your grant agreement or contract so that the accounting and payroll records can accurately reflect the sources of funds for each of your program components by funding cycle.

BUDGET DEVELOPMENT AND CONTROLS

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

- **Board oversight**—The board approves the use of the organization's resources by approving the budget. It also monitors actual and budgeted costs to ensure that resources are used as intended.
- **Goal focus**—An effective budget helps the organization focus resources on its long-term goals.
- **Financial control**—The budget helps control finances by setting practical limits on the amount that can be spent on specific programs and activities. It also helps ensure that program and activity costs are consistent with revenue.
- **Cash forecasting**—A special cash forecast budget allows management and the board to see if the organization will have the cash on hand from month to month to meet its financial obligations.

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

Who Should Participate in the Budget Process?

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

Steps in the Budget Process

Use the following steps to develop and maintain your budget:

1. **Determine the desired programs and activities for the next year(s).** The board, executive director, program director(s) and others can decide, given available resources and using performance data about your lines of business.

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

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

3. **Assemble and review a draft budget document.** After budgeted revenue and expense amounts are determined, assemble the information in a draft format for review by staff before providing to the board of directors. Usually the board's finance committee, including the treasurer and president, has the responsibility to review and approve the draft budget for recommendation to the board.

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

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

COST ALLOCATION GUIDELINES

Cost allocation is a process that seeks, through reasonable and documented means, to allocate costs appropriately to programs and funding sources. Many funders, including the City, require that the percentage of shared and indirect costs charged to the funds they are providing be consistent and reasonable. In other words, there has a to be a clear logic behind the charge and percentage. For example, contractors often charge rent expenses based on the square footage allocated to a particular program.

The City requires a written cost allocation plan that describes how shared costs are charged, and the logic behind the percentage allocation.

Cost allocation is required when a nonprofit agency has:

- multiple activities with one funding source
- one activity with multiple funding sources
- multiple funding sources and multiple activities

Federal Guidelines and City Requirements

Federal regulations are the primary driver for nonprofit cost allocation requirements. The City's cost allocation guidelines for nonprofit contractors largely follow those described by Generally Accepted Accounting Principles (GAAP) and in the Federal Office of Management and Budget (OMB) Uniform Guidance. Specifically, OMB Uniform Guidance dictates that costs must be:

- ***Reasonable.*** Ordinary, necessary, and comparable to market prices.
- ***Consistently applied***: Contractors cannot switch methods to generate more revenue or treat one cost as direct for one contract and indirect for another (see below for more on direct costs).
- ***Allowable***: The City follows the guidelines under Federal OMB Uniform Guidance. Exceptions are any costs prohibited by local law (e.g., costs made ineligible under City prohibitions).
- ***Allocable***: Costs must benefit the objective(s) being funded (e.g., the supplies charged to the program are used by the program).
- ***Documented***: The methodology for allocating the cost should be documented, for example, using time studies, functional time sheets and percentage of direct salaries.

Terminology

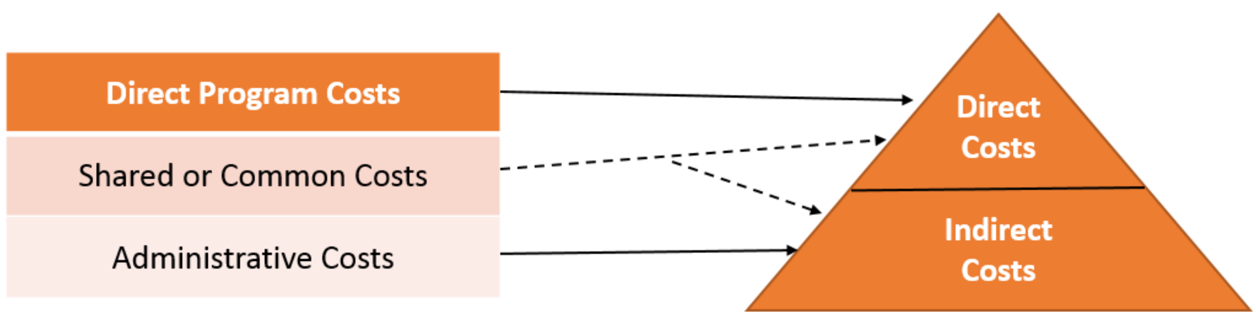
Nonprofit organizations typically categorize their expenses into three categories: Direct Program Costs, Shared or Common Costs and Administrative Costs.

- ***Direct Program Costs***: These are costs that are clearly and easily attributable to a specific program or activity (or specific programs or activities, e.g., when a staff person's time is clearly allocated to multiple programs).

- ***Shared or Common Costs***.
    - Costs that are necessary to the operation of all programs or activities.
    - Costs without which the programs or activities could not function.
    - Costs which can be prorated using a basis which reasonably measures the benefits provided to each activity.
- ***Administrative Costs***. These are costs that are necessary to the operation of an organization, but the benefits can't be traced to a particular program, for example, finance and executive activities.

For the City and many other funders, all costs for organizations with multiple programs should be divided into two categories: ***Direct Costs*** and ***Indirect Costs***.

For the purposes of City budgeting, Direct Costs include a nonprofit's Direct Program Costs and the portion of Shared Costs allocated to program functions. Indirect Costs include Administrative Costs and the portion of Shared Costs allocated to administrative functions. See the figure below for a crosswalk between nonprofit and City terminology.



Direct Costs

Per federal guidelines, direct costs are those which are clearly and easily attributable to a specific program or funding source. Direct costs can generally be identified with a specific final cost objective (i.e., a particular award, project, service, or other direct activity of an organization).

Direct costs are those costs that are required to carry out a program or function. Direct costs may be specific to one program, but, commonly, direct costs are shared by multiple programs. For example, rent is a direct cost for all programs that make use of the facility to plan, manage, and deliver the program. However, the cost of rent charged to each program must be based on how much of the space the program uses.[1] Office supplies may also be a direct cost that should be allocated based on a reasonable methodology, such as staffing levels. Sometimes direct costs will be allocated to all program areas and cost centers, including fundraising and administration.

The costs of activities performed primarily as a service to members, clients, or the general public, when significant and necessary to the organization's mission, must be treated as direct costs

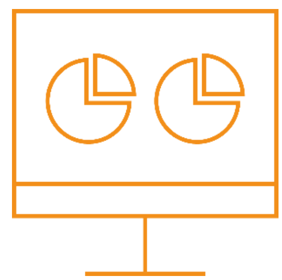
[1] The portion of rent charged to the Administration function would be categorized as an indirect cost.

whether or not allowable, and be allocated an equitable share of indirect costs. *This means that fundraising costs, while not allowable in City contracts, must be treated as direct costs and should have indirect costs allocated to them.*

Indirect Costs

Indirect costs are those which are not easily identifiable with one specific program, but which are, nonetheless, necessary to the operation of the program. The Finance Director's salary is a common example of an expense which benefits all programs and functions.

Because of the diverse characteristics and accounting practices of nonprofit organizations, it is not possible to specify all the types of costs which may be classified as indirect costs in all situations. However, typical examples of indirect costs for many nonprofit organizations may include use allowances on buildings and equipment, the costs of operating and maintaining facilities, and general administration and general expenses, such as the salaries and expenses of executive officers, personnel administration, and accounting. Depreciation costs may also be categorized as indirect; however, these are subject to review by the granting agency and/or the Controller's Office.



In an effort to clarify the appropriate categorization of the most common direct and indirect costs, the Controller's Office produced "***Guidelines for Cost Categorization in Nonprofit Contracts and Grants***."[2]

For organizations receiving federal funding, certain costs are not allowable and, therefore, are not reimbursable. OMB Uniform Guidance specifies which costs are and are not allowable for organizations receiving federal funding. To be allowable, costs must generally:

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

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

Organizations should also refer to their contract or grant agreement for any specific allowable or

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[2] The Controller's Office may update and re-publish the Guidelines periodically as new questions help clarify the treatment of specific costs, or as federal guidance changes.

unallowable cost provisions they may contain. Allowable costs may differ due to Federal or other funding source requirements.

Usually, allowable indirect costs are administrative costs that benefit more than one activity and are not included in an indirect cost rate agreement. These costs may be allocated to all benefiting activities or programs by pooling like costs and allocating them using a reasonable methodology and basis.

Reasonable Costs

A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations that receive the preponderance of their support from awards made by Federal agencies. In determining the reasonableness of a given cost, consideration should be given to:

- Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.
- The restraints or requirements imposed by such factors as generally accepted sound business practices, arm's length bargaining, comparable market rate prices, Federal and State laws and regulations, and terms and conditions of the award.
- Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal government.
- Significant deviations from the established practices of the organization, which may unjustifiably increase the award costs.

Allocable Costs

A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

- Is incurred specifically for the award
- Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received, or
- Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown

Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award.

The City's Cost Allocation Requirements

The City requires a written cost allocation plan that is reasonable and based on a documented logic. "Documented or logical" could be, for example, allocating rent costs by square footage associated with a specific program and funding source, dividing up phone charges by staff and program, and paying for salaries based on the project hours documented on staff timesheets.

FISCAL MONITORING PROGRAM SPOTLIGHT

The Fiscal Monitoring Program requires nonprofits to maintain agency-wide budgets that show income and expense by program, and that show allocation of shared and indirect costs by program. Fundraising must be separate from all program expenses (i.e., must be its own cost center), and the budget must clearly identify all revenue sources. During fiscal monitoring, City monitors will verify the following:

- Cost allocation procedures are written, either in a budget narrative or in footnotes to the budget.
- The cost allocation plan includes treatment of both shared costs and indirect costs.
- The processes for allocating both shared and indirect costs are consistent and reasonable.
- Written procedures match actual cost allocation practices, as demonstrated through testing of financial documents and invoices.

Steps for Developing a Program-Based Budget

A nonprofit may operate several programs and will also have administrative and fundraising expenses. Each program may have one or more funding sources, which may or may not cover all the costs incurred by that program. To understand the true cost of programs and to allocate shared and indirect costs appropriately, nonprofits should develop a detailed program-based budget.

The following steps and principles will help your organization develop a budget that meets City standards. Further, program-based budgets provide insights into program needs, and allow for more nuanced planning for program shortfalls or opportunities for expansion.

1. **Define your programs**. The definition of a program is based on the activities carried out or lines of service. While some programs may have just one funding source, funding source should not be the primary driver of program definition. Program definitions do not need to be overly detailed or complicated, but should be meaningful to your agency, clarifying which agency activities have similar goals, measures, costs, and staffing.

   Ensure that Administration (also called "Management and General") is separated into its own program or cost center, and that Fundraising costs are also separate, per City and nonprofit GAAP requirements.

2. **Define direct and indirect costs**. Identify all costs directly attributable to each program. Identify which costs should be treated as shared or common costs for which an appropriate allocation method will be needed. Identify which costs should be considered purely indirect (i.e., placed in the Administration cost center).[3]

3. **Determine allocation methodology for shared costs**. Some shared costs can be directly applied (e.g., based on actual use), while others require a reasonable and consistent allocation methodology.

   For example, multiple programs use the copy machine. If the copy machine requires program staff to use a code to make copies, then copy costs could be directly applied to each program. If direct application of these costs is not feasible, then you must develop a consistent, reasonable, and documented method to allocate these shared costs to each program, e.g., FTE.

   You may use different allocation methods for different types of costs but must consistently use each method for all programs. For example, if you allocate copy machine costs using FTE for Program A, you must also use FTE to allocate copy machine costs to all other programs. However, you may choose to use a different methodology for rent, e.g., square footage.

   If staff members work in multiple programs (e.g., an Executive Director that also spends significant time working on program activities), a time survey or functional timesheet must be used to allocate time. When budgeting, a review of prior time surveys can be used to plan an allocation percentage for salaries of staff working across programs. Staff working in a single program may be directly charged to that program.

4. **After allocating shared costs, allocate indirect costs.** Some indirect costs are specific to the Administration cost center, such as the audit. Others are shared across the agency, such as Administration's portion of rent. This is why you must first complete all direct expense allocation before allocating indirect costs to each program or cost center. Nonprofits commonly allocate indirect costs using a percentage of total direct costs of each program or the percentage of FTE of each program.[4]

   You may subsequently allocate fundraising costs using an appropriate percentage, e.g., percentage of funding received by each program. This will show the true cost of the program. However, per City policy, no City funds should be used to support fundraising activities and these costs must not be included in any City grant budgets or invoices.

5. **Identify funding sources**. Some funding sources are connected to specific programs, while others may be used at the agency's discretion. The budget must show each funding

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[3] See the current version of *Guidelines for Cost Categorization in Nonprofit Contracts and Grants* for detailed information about this topic.

[4] Some organizations choose to incorporate some or all shared costs in the administration cost center, thus treating these as indirect costs. This may reduce the burden of allocating shared costs across programs, but this practice has the disadvantage of increasing the proportion of costs categorized as "indirect." Reimbursement for indirect costs is often capped, so this practice can limit full cost recovery.

source used for each program. After you have assigned restricted funding to each program, you will be able to identify resource gaps that will need to be filled using discretionary funding.

6. **Check your work.** Review the final product carefully for accuracy (e.g., are formulas working correctly) as well as to ensure the financial results match your expectations. The program-based budget should help you identify whether the agency has sufficient resources to support each program's operations.

See **Appendix A** for additional resources related to program-based budgeting, including templates (available online) that support the technical steps of budgeting and allocating costs to programs. See **Appendix C** for examples for applying indirect costs across programs.

Indirect Cost Rates

Government contracts and grants rarely cover the full cost of a program's operations. This includes direct program costs, but more often applies to indirect expenses. Commonly, a government contract includes an "indirect rate," or a fixed percentage to be used to support administrative costs associated with program delivery. Some funders may request a line-item budget of the administrative costs included in the indirect rate, while others will fund the rate without examining the underlying costs. Some funders use a fixed rate or capped rate for all grants and contracts, while others allow negotiation of the rate. Understanding the true costs of services, including the percentage used to allocate total indirect costs to a given program per Step 4 above, will assist you in negotiating with funders, as permitted.

Organizations that receive direct federal funding may be required to obtain a federal indirect cost rate from the federal agency that provides most of the organization's funding. For the rules for determining a federal indirect cost rate, see the OMB Uniform Guidance. Smaller organizations usually do not have a federal indirect cost rate, but if they receive federal funds, they are required to follow federal guidelines for allocating indirect costs. These guidelines are also contained in the OMB Uniform Guidance.

City departments that pass federal dollars through to nonprofit service providers are also required to follow OMB Uniform Guidance, including complying with a nonprofit's federally approved indirect cost rate even if it is higher than the department's standard, and including applying a de minimus indirect rate of 15% to all federally funded grants and contracts if no negotiated rate exists. However, these requirements only apply to the federally funded portions of grants and contracts; departments may choose to set alternate indirect rates on contracts using general funds.

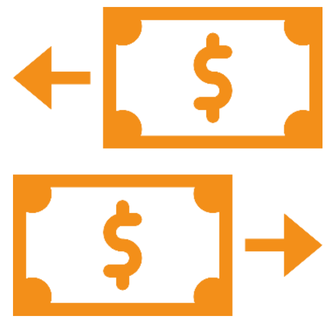
CASH FLOW MANAGEMENT

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

What Is a Cash Flow Budget?

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

How to Develop a Cash Flow Budget



Projections of receipts and expenditures are typically developed as part of the budget process so that you can anticipate and develop strategies for funding the shortages or investing the surpluses. Cash flow projections follow a format similar to your budget. For each month, anticipate how much money you will receive and how much you will spend in each category. (Some organizations may choose or need to project cash flow over more frequent intervals.)

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

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

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

Using the Cash Flow Forecast or Budget

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

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

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

Useful Strategies for Adjusting the Timing of Cash Flow

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

Cash Shortfalls

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

- Postpone fixed asset purchases
- Negotiate extended payment terms on large annual expenses or fixed asset purchases, or finance the purchase of equipment by leasing
- Postpone raises in salaries or hiring additional employees
- Postpone implementing new programs or services
- Reduce operating expenses
- Reduce program services
- Move up or schedule additional fundraising events (note that this may also entail moving up the timing of associated expenses)
- Pursue uncollected membership dues or other receivables
- Withdraw funds from operating reserve funds
- Borrow funds from either financial institutions or supporters of the organization
- Request advances from funding sources

- Liquidate investments
- Ask vendors about the possibility of delaying payments in the short term and determining a mutually agreeable date for making payments

Cash Surpluses

To address cash surpluses, an organization can:

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

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

Board Review of Cash Flow Forecast

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

Cash Flow Forecast Versus Statement of Cash Flows

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

Financial Management Systems

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

ACCOUNTING CYCLES

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

1. **Revenue, Accounts Receivable, and Cash Receipts**—This cycle includes making deposits, processing cash receipts, recording receipts, and performing month-end reconciliations.
2. **Purchases, Accounts Payable, and Cash Disbursements**—This cycle includes processing invoices, issuing checks, recording checks in the general ledger, and performing month-end reconciliations.
3. **Payroll**—This cycle includes gathering payroll information for processing, computing wages, and withholding, preparing payroll checks and depositing payroll taxes, performing month-end reconciliations, preparing quarterly tax returns, and preparing annual returns and other forms (W-2s, W-3s, and so on).
4. **General Ledger and Financial Statements**—This cycle includes preparing monthly journal entries, reconciling bank accounts, reviewing general ledger activity, posting, and adjusting entries, and producing general ledger and financial statements. At year-end, there may also be audit adjustments determined by the organization's outside auditors or contract disallowances generated by funders.

General Journal Posting

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

Adjusting Entries

At times, you will need to correct any transactions that are known to be in error. This step is called adjusting. Adjustments also include allocating revenue and expenses to the appropriate cost centers out of the shared or indirect cost centers. See the Financial Planning section above for more details about policies and guidelines for allocating shared and indirect costs.

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

Costs must be actual costs, not budgeted costs. When choosing an allocation method, keep in mind that each cost center should only be charged with the amount of indirect costs that represents the best approximation of the actual relative benefit that the cost center received from the services that the indirect costs provided.

TIP

This is the time to reconcile all your balance sheet accounts to source documents such as bank and loan statements and to internal schedules such as depreciation and amortization schedules.

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

ACCOUNTING RECORDS

At minimum, your accounting system must include:

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

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

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

Chart of Accounts

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

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

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

TIP

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

General Accounting Procedures Manual

A procedures manual documents how the organization approves and records transactions such as paying bills, depositing cash, and transferring money between funds, including who is responsible for what. The procedures can be simple descriptions or memos describing how bills, deposits, and transfers between funds are handled. These descriptions or memos should be kept together to form a basic procedures manual.

Writing and revising an accounting procedures manual is a good opportunity to see whether adequate controls are in place (see Internal Accounting Control section below). A procedures manual is especially useful when there is turnover in financial management staff and new personnel need to quickly understand how the organization's accounting system functions. A procedures manual should include:

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

FISCAL MONITORING PROGRAM SPOTLIGHT

The Fiscal Monitoring Program requires a nonprofit to complete a review of its policy and procedures manual upon turnover of executive leadership (executive director or chief financial officer) and considers biannual reviews of the manual a best practice regardless of turnover. The Fiscal Monitoring Program requires the manual to include specific elements, such as those in the list above, and monitors will test that actual practices match what the nonprofit has documented in the manual.

For further guidance on developing a fiscal policies and procedures manual, see **Appendix E**.

Financial and Other Records

It is important to retain all original purchase orders, invoices, receipts, canceled checks, bank account records, and any other documents related to program expenses. Other records you should maintain include:

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

Retention of and Access to Records

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

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

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

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

> **FISCAL MONITORING PROGRAM SPOTLIGHT**
>
> The Fiscal Monitoring Program requires nonprofits to maintain public access according to Administrative Code Section 12L. During fiscal monitoring, City monitors will verify that the nonprofit has a written policy that it will maintain and make available for public inspection within 10 days of the request:
>
> (1) most recent budget,
> (2) most recently filed State and federal tax returns, and
> (3) any financial audits and performance evaluations performed by or for the City
>
> Additionally, the nonprofit must ensure that at least two board of directors meetings with quorum status are open to the public each year, that these two meetings are announced to the general public at least 30 days in advance through the SF Public Library and the Clerk of the Board of Supervisors, and that board by-laws include requirements for client representation on Board, or Contractor makes other good–faith efforts to ensure client representation.

INTERNAL ACCOUNTING CONTROL

Internal accounting control is a series of procedures designed to promote and protect sound management practices, both general and financial. Financial information must be reliable so that managers and the board can make decisions based on accurate information.

Following internal accounting control procedures will help ensure that:

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

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

- **Cash receipts**—Ensure that all cash intended for the organization is received, promptly deposited, properly recorded, reconciled, and kept under adequate security before deposit.
- **Cash disbursements**—Ensure that cash is disbursed only upon proper authorization of management for valid business purposes, and that all disbursements are properly recorded.
- **Petty cash**—Ensure that petty cash and other working funds are disbursed only for proper purposes, are adequately safeguarded, and properly recorded.
- **Payroll**—Ensure that payroll disbursements are made only upon proper authorization to bona fide employees.
- **Grant funds, contract funds, gifts, and bequests**—Ensure that all these sources of funds are received and properly recorded, and that compliance with the terms of any related restrictions are adequately monitored.
- **Fixed assets**—Ensure that fixed assets are acquired and disposed of only upon proper authorization, are adequately safeguarded, and are properly recorded.

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

Internal Controls for Cash Receipts

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

- Promptly deposit all cash received. Segregate the functions of depositing and recording receipts.
- Properly identify and record all restricted donations.
- Properly record in your accounts receivables any cash payments received from all funders.

Internal Controls for Cash Disbursements

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

Segregation of Duties

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

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

Authorization and Processing of Disbursements

Your written policies should document who can authorize payments. Some organizations designate the executive director for this responsibility, or in very small organizations, the board president or treasurer may approve all purchases. Larger organizations generally require that managers who are responsible for a budget cost center approve any expenses charged to that manager's cost center.

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

Unbudgeted purchases may need additional approval, and significant purchases, such as computers or items over a specific threshold amount, may need authorization by the board.

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

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

FISCAL MONITORING PROGRAM SPOTLIGHT

During monitorings, City staff will choose two months of invoices for review. Your agency will be required to supply all supporting documentation showing that agency staff followed protocol in purchasing grant-funded items and receipts have been retained. Monitors will also ensure that expenses in the invoices have been allocated appropriately in the financial system and reasonably align with the grant and agency budget.

Managing Restricted Funds

Restricted contributions—funds designated for specific purposes by the donor such as buying a building, expanding an existing program, starting a new program, and so on—should be accounted for separately in your organization's books. This can often be accomplished by using a "cost center" or other segmentation of your organization's accounting software system to track restricted contributions and associated expenses.

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

Check Signing

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

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

Internal Accounting Checklist for Paying Bills

Your procedures for paying bills should include the following:

- All disbursements, except petty cash, should be made with prenumbered checks/e-checks.
- Voided checks should be preserved and filed after mutilation.
- No checks should be made payable to "cash."
- No checks should be signed in advance.
- For electronic transactions such as those processed by the Automated Clearing House (ACH), segregation of duties and dual controls should be implemented. Dual controls mean that two people should log in to approve transactions.

See **Appendix F** for a complete checklist of internal controls associated with paying bills.

Internal Accounting Controls for Payroll

You must ensure that payroll disbursements are made only upon proper authorization to bona fide employees, that payroll disbursements are properly recorded, and that related legal requirements, such as payroll tax deposits, are complied with. To better ensure appropriate payroll controls, it is generally advisable to use a third-party vendor to process payroll. This can help with segregation of duties as well as ensuring compliance with tax and withholding regulations. The following procedures will help ensure internal accounting controls for payroll.

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

- A **personnel manual** should describe the organization's policies, established by the board, regarding vacations, holidays, and sick leave. Records should be kept for each employee to ensure that these policies are being followed.
- A **timesheet** is the most common tool used to document employee hours, including overtime, and authorize payments to employees. Timesheets can be designed to incorporate information about vacation, sick leave, and holidays. Government funders often require timesheets to document employee time spent on specific programs or on their specific grants or contracts, as well as all other duties employees perform. Timesheets should be signed by the employee, are usually submitted by the employee to his or her immediate supervisor for signature and may also be reviewed periodically by senior management. The person authorizing an employee's hours should **not** also prepare the paychecks. Timesheets might be used as follows:
    - **Direct staff** (staff that provide services directly to clients, or as defined by the contract or grant) costs that are paid for by more than one contract, grant, or other funding source, should keep "functional" timesheets, which show actual hours worked each shift by each separate cost center, or a separate timesheet for each contract or grant.

    - **Indirect staff** (administrative and finance staff that provide services to all parts of the organization) costs may be allocated based on time studies or other objective and measurable criteria such as direct cost ratios, personnel cost ratios, units of service, and so on. Although functional timesheets are not required of indirect staff if one of the aforementioned allocation methods is used, a timesheet showing all hours must still be kept to document use of paid time off by the employee.
    - If administrative staff are split between direct services and indirect services (such as the executive director serving part-time as a program director), then a functional timesheet is one way of showing the types of hours worked. Alternative methods of allocating time between direct and indirect services usually involve conducting a periodic time study to document how employees spend their time.
    - If e-timesheets are used, they must have verifiable e-signatures for both the employee and the supervisor. Your agency should have written procedures about how e-timesheets are signed. Any changes to the e-timesheet are acceptable provided that the approval process for changes can be verified and the process for doing so has been documented in the personnel manual.

For more information on timesheets specific to City contracts, see **Appendix G**.

FISCAL MONITORING PROGRAM SPOTLIGHT

During the expanded monitoring, City staff will verify that the nonprofit has personnel policies and that personnel files for a sample of grant-funded employees contain required documents. Additionally, City staff will review payroll records and timesheets for this sample to verify that invoiced salary costs match actual staff time spent on grant-funded activities.

- For stronger controls, direct deposit is preferable to paper checks. However, if you use **payroll checks**, they should be written using the same procedures used for all other cash disbursements (see above). For additional segregation of duties related to the payroll function, someone other than the payroll check signer (or the person "calling in" payroll to the outside payroll processor) should perform the following functions:
    - Hold unclaimed paychecks.
    - Add or remove employees to-from the payroll schedule.
    - Review the payroll register and post to the general ledger.
    - Review payroll-related tax withholding, deposits, and reporting. This is an especially important function for the board since board members may have personal liability for payroll taxes that have not been properly deposited with the appropriate government agencies.
    - Distribute year-end tax summaries (W-2s) to employees and respond to inquiries regarding W-2s.
- A **separate bank account** for payroll, while not required, may be used for issuing paychecks and paying government withholding and other taxes related to payroll. For example, having a dedicated payroll account keeps the check numbers in order since no checks other than payroll checks are issued from the account. Also, since payroll accounts should "zero-out" shortly after each payroll period, any errors are apparent from looking at the account bank statement. Further, because the account contains minimum funds most days of the month, an overdrawn account will help alert finance staff of any unauthorized activity, such as thieves using the account to float counterfeit checks.

TIP

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

- A **payroll register** listing who was paid, how much, withholding amount, and check number should be maintained, either as a subsidiary journal if there is a separate payroll account, or as part of the cash disbursements journal when payroll is integrated with other cash disbursements in a manual system. Some organizations require that employees sign the employee register to acknowledge receipt of their paycheck.
- **Payroll advances or loans** generally should be avoided. In addition to the extra bookkeeping required, allowing advances could adversely affect the organization's cash flow. Your organization should state clearly in its written employee policies that pay advances are either not permitted, or if they are, under what conditions, and who in the management staff has authority to approve them. When allowed, advances should be limited to a few, exceptional circumstances and should be required to be paid back within a specified period, usually through withholding from the next pay period's paycheck.

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

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

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

FISCAL MONITORING PROGRAM SPOTLIGHT

During the expanded monitoring, City staff will verify that payroll taxes have been paid. Failure to pay taxes could lead to designation to a Corrective Action Tier and may put City funding at risk.

Internal Controls for Petty Cash

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

The board or senior management should develop a policy of how much money should be available in cash and a maximum expenditure that can be paid with petty cash. For example, you may establish a

TIP

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

petty cash fund of $100 and have a policy that states payments for items costing over $15 must be made by check rather than reimbursed through petty cash.

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

Maintaining Your Petty Cash Fund

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

Use the following procedures to maintain your petty cash fund:

- **Reimbursements**—The custodian should obtain proof of purchase from the employee, usually a receipt. The employee should also complete a petty cash voucher, detailing the reason for and nature of the purchase. After the appropriate person approves the voucher, the employee is reimbursed with cash from the fund.
  - In some cases, an advance from the petty cash fund can cover an upcoming purchase. For example, an employee needs cash to mail a package and upon returning to the office, completes a voucher for the final amount, attaches a receipt, and returns the change to the custodian.
- **Replenishing the fund—**When the fund is substantially depleted, the custodian adds up the vouchers and assigns them to appropriate categories (postage, printing and copying, office supplies, etc.). For a petty cash fund of $100, the total of receipts plus cash available should equal $100 so that all funds are accounted for. When the account is balanced, the accountant Issues a check in accordance with a check authorization procedure established for all disbursements, and the fund is replenished to its original balance of $100.

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

Petty Cash Policies

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

- An imprest cash fund should be maintained for small, incidental expenses.
- There should be a limit to the amount that can be reimbursed.
- Supporting documentation should be required for all petty cash disbursements.

- A petty cash voucher should be filled out with supporting documentation, name of person being reimbursed, and proper authorization from a designated person(s) in the organization.
- Access to petty cash should be limited to one person who is the fund custodian.
- Someone within the organization other than the fund custodian should make unannounced counts of petty cash.

Internal Controls for Gifts, Grants, and Bequests

Use the following controls to properly account for gifts, grants and bequests:

- Reconcile monthly reports sent to funders with reports from the accounting records for each cost center.
- Distribute monthly income statements that include year-to-date information to program staff that manage grants and development staff that monitor gifts and bequests.

Internal Controls for Fixed Assets

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

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

General Internal Controls

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

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

FINANCIAL REPORTING

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

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

In addition, nonprofits must provide information about expenses as reported in their financial classifications (program services and supporting services).

Nonprofits are also required to present a statement that reports expenses by their natural classification (for example, salaries, rent, telephone, printing, and so on). The following sections briefly describe the information included in each statement.

Statement of Financial Position

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

- **Assets**—Properties and resources the agency owns and can use to achieve its goals.
- **Current Assets**—Cash accounts, certificates of deposits and other investments, and items such as receivables that will be converted to cash within one year (fixed assets, which is not a category, include land, buildings, and equipment).
- **Liabilities**—Debts of the organization (what is owed). Current liabilities typically include accounts payable to vendors, short-term loans due, withheld payroll taxes due, and so on. Long-term liabilities include long-term debt, mortgages, and so on.
- **Net assets** (previously called fund balances)—Represents the net of assets over liabilities. There are two classes of net assets that must be reported: net assets without donor restrictions and net assets with donor restrictions. Restrictions are determined by the conditions that donors place on their contributions.

FISCAL MONITORING PROGRAM SPOTLIGHT

The Fiscal Monitoring Program requires nonprofits to produce a current (within 4 months) Statement of Financial Position. The report should align with the budget and cost allocation plan and should reflect a recent bank reconciliation. City monitors will use the report to calculate a working capital ratio, dividing current assets by current liabilities. This number should always be greater than 1, showing the agency has funds to carry out current work.

Statement of Activities

The Statement of Activities reports revenues, expenses, and the resulting change in net assets for the year. Changes are reported for each of the two classes of net assets (with or without donor restrictions). This statement was previously known as the Income Statement or Statement of Revenue, Expenses, and Changes in Fund Balances, and is also referred to as the Profit and Loss (or P&L) Statement.

FISCAL MONITORING PROGRAM SPOTLIGHT

The Fiscal Monitoring Program requires nonprofits to produce a current (within 4 months) Statement of Activities showing year-to-date income and expense by program, including indirect costs. City monitors use the report to determine whether the agency projects a surplus or deficit by year-end.

Statement of Cash Flows

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

Other Reports

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

Internal Reports

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

Monthly Reports

Many nonprofit organizations produce the following reports monthly to support financial management, often distributing them to the board or finance committee:

- **Statement of Financial Position** (or Balance Sheet) shows in a monthly format what the annual statement shows (see above). The report will answer questions like, "What is our financial health?" and "Can we pay our bills?"
- **Statement of Activities** (or Income Statement) shows in a monthly format what the annual statement shows (see above). The report allows budget-to-actual comparisons and helps answer the question, "What has been our overall financial performance this month and to date?"
- **Income and Expense Statement** also shows budget-to-actual information. This report helps answer, "How does actual financial experience compare with the budget?" "Is specific

action called for, such as limiting expenses in certain areas?" and "Does experience indicate a change in the budget is appropriate?"

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

FISCAL MONITORING PROGRAM SPOTLIGHT

The Fiscal Monitoring Program seeks to ensure that nonprofit boards are fulfilling their fiduciary responsibilities and requires that board minutes show that financial reports (e.g., those listed above) are shared with the board or its finance committee at least quarterly, or more regularly when financial concerns warrant it. The board must also approve the agency-wide budget and review the most recent audit.

Quarterly Reports

Many nonprofit organizations produce the following reports quarterly, sharing with the board or finance committee as well:

- **Fundraising report** shows actuals versus projections for donations and serves as a status report on all foundation proposals. This report helps answer the question, "Are fundraising results on track?"
- **Cash Flow Projection** for the next six months helps answer the question, "Do we anticipate a cash surplus or shortage?" This report should be updated monthly, as noted in the Financial Management chapter above, but may be shared with leadership quarterly at minimum or when cash flow issues arise.
- **Payroll Tax Report** answers the question, "Have payroll tax reports been submitted on time and tax deposits been made?"
- **Fee for Service Report** shows the number of fee-paying clients and revenue against projections. This report helps answer the questions, "Are we servicing approximately the same number and type of clients as we had anticipated?" and "If not, what action or change is appropriate?"

Annual Reports

Many nonprofit organizations produce the following reports annually:

- **Annual Federal Forms**, including Form 990 and Schedule A, and state reports, are required for most nonprofit organizations. The board should review these forms to answer the question, "Has the organization fulfilled its reporting responsibilities to federal and state governments?"
- **Draft Financial Statements for the Year** should include the Statement of Activities, Statement of Position, and Income Statement for each program. Aggregate financial statements should include a narrative and show key trends. This report should focus on internal management decision-making and help answer the following questions:

- What was our financial performance over the past year?
    - In what ways and for what reasons was performance different from the budget?
    - What financial implications must be considered when planning the upcoming year?
- **Audited Financial Statements** for the entire organization should include the Statement of Position, Statement of Activities, Statement of Cash Flows, and Statement of Functional Expenses (see Section 3 Audits). This report should focus on external accountability and financial disclosure to funders and the public.
- **Management Letter from the Auditor** may include recommendations related to the accounting system, internal controls, and financial planning.

Who Should Prepare the Financial Reports?

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

Small Organizations

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

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

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

Large Organizations

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

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

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

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

Reporting Requirements of State Agencies

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

- California Secretary of State

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

Commercial Fundraiser and Nonprofit Raffle Program Forms— There are numerous forms for organizations engaging in a variety of charitable fundraising activities

Audits

Financial Audits

A financial audit is a process for testing the accuracy and completeness of information presented in an organization's financial statements. The testing process enables a certified public accountant (CPA) to issue what is referred to as an opinion on whether the agency's financial statements represent its financial position fairly and whether they comply with generally accepted accounting principles (GAAP). GAAP is determined by the American Institute of Certified Public Accountants (AICPA).

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

- **Cover letter**—Signed by the auditor, stating the opinion, described above.
- **Financial statements**—Including the statement of financial position (balance sheet), statement of financial activity (income statement), and statement of cash flows. Nonprofits also have a statement of functional expenses that reports expenses by both functional and natural classifications. Functional expenses include costs for major programs or services and natural expenses include fixed costs like salaries and discretionary costs like grants to subrecipients. Many audits show comparative information

Auditor's Report

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

between fiscal years.

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

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

Performance Audits

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

WHAT DOES AN AUDITOR DO?

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

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

An **Unmodified Opinion** includes wording such as, "In our opinion, the accompanying financial statements present fairly the financial position of ABC agency at the fiscal year ending June 30, 2017, in conformity with generally accepted accounting principles."

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

WHAT AN AUDITOR DOES NOT DO

An auditor is not expected to perform the following functions:

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

WHEN IS AN AUDIT NECESSARY?

An independent, annual audit may be required by your funding organization or by a lender you have a loan agreement with. If nonprofits receive any government funds – city, state or federal – it is always a good idea to determine whether there is an accompanying audit requirement.

According to new City requirements and a policy issued by the Controller's Office in December 2024, nonprofits receiving $1 million or more in City funding from any source in a fiscal year are required to prepare and submit audited financial statements for that fiscal year. Nonprofits that receive $1 million or more in City funding in a fiscal year, but do not receive $2 million in gross revenues in that same year (i.e., are not subject to California Government Code section 12586.1) are exempt from the requirement to prepare audited financial statements unless one or more City department fully covers the cost of preparing the audit via a direct allocation of funds.

California law requires nonprofits that receive a certain level of funding to conduct an independent audit, per the Cal. Gov. Code §12586(e)(1), which states that "a charitable corporation with gross annual revenue of **$2 million** or more and that is already required to file report(s) with the General Attorney must file an audited financial statement prepared by an independent CPA."

Nonprofits that expend $1 million in federal dollars in a given fiscal year (whether direct or pass-through funds) are required to have an audit performed by a CPA (see "Federal Awards," below, for more information).

All nonprofits must abide by city, state and federal law and secure an audit if required. Some City departments have established formal policies requiring their contractors to obtain an audit from an outside CPA on an annual basis. These departments have made the audit requirement part of the City's contract. Although your contract may not have an audit requirement, all nonprofits must abide by City requirements and secure an audit when city, state, or federal law requires. The City Controller recommends that all nonprofit, community-based organizations that have contracts with the City undergo an annual financial audit by an independent auditing firm. Additionally, any documentation related to the audit must be retained no less than five years after the audit issuance date or until all litigation, claim and audit issues have been resolved, whichever is longer, per the G100 Single Audit Policy and the City P-600 Contract Terms. This requirement covers books, files and accounting records relating to its services.

FISCAL MONITORING PROGRAM SPOTLIGHT

While not all nonprofits will be required to have complete an annual audit (e.g., very small nonprofits may be exempted), when City or State law require an audit, the Fiscal Monitoring Program ensures the audit meets certain standards. The audit should be complete, have an unmodified opinion, and no findings or material weaknesses noted. Findings in these areas may be cause for designation to a corrective action tier, which could put City funding at risk. Additionally, City monitors will use the audit to calculate ratios that are indicators of the financial health of the agency. When these ratios represent risk of instability for the nonprofit, this may lead to a designation to a corrective action tier.

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

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

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

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

Alternatives to an Audit

A *financial review* is a more limited examination of the financial statements by a certified public accountant. During the review, the CPA asks questions of management and conducts some analysis but does not undertake the extensive testing required for an audit. During a review, the CPA examines the financial statements but does not conduct an examination of the nonprofit's internal controls (which is normally included in the scope of an independent audit). Instead, the review provides a limited level of assurance that the financial statements are free of misrepresentations. The CPA's report after a review will note whether the CPA is aware of any "material modifications" that should be made to the financial statements. The report after a review does not provide a professional opinion about the nonprofit's financial statements as a whole.

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

HOW TO PREPARE FOR AN AUDIT

Most nonprofit organizations use the services of outside CPAs. These services most often relate to performing the annual audit or preparing tax returns.

Generally, fees charged for a CPA's services are based on the actual or estimated time spent on an engagement. Therefore, minimizing the time CPAs spend on an engagement can often lower fees.

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

Choosing an Auditor

To support selection of an appropriate auditor, it is a good idea to use a request for proposals. The board's finance or audit committee should outline the scope of work and solicit proposals from a variety of firms. There are online resources that provide templates for this type of solicitation. For example, www.strongnonprofits.org publishes a "Nonprofit Auditor Selection Guide" to support nonprofits in seeking and selecting a qualified auditor.

Some important considerations when selecting an auditor are:

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

Tip

The Controller's Office surveyed CPA firms and publishes a list of firms that are interested in taking on nonprofit audit jobs in San Francisco. Visit the Auditing Firm Directory for Nonprofits to search for a firm that meets your needs.

- **Experience with other nonprofits in your area of work**—You may want to consider an auditor experienced with similar agencies who knows the specific reporting requirements of your primary funding sources.
- **Training in Government Accountability Office (GAO) standards**—If you are required to have an audit that meets government standards, your auditor must fulfill GAO's continuing education requirements, among others. Be sure to specify that the audit must meet "Government Auditing Standards."
- **References for the Audit Firm and the Auditor**—In addition to experience, you are looking for indications the auditor has the technical expertise, communications skills, and flexibility to conduct your audit in an efficient and effective manner. A good working relationship with your auditor will help ensure the audit goes smoothly.
- **Fee**—Compare bids from auditors regarding the fees they charge to do the work you require. Some good auditors work for nonprofits for a reduced fee. The fee may be related to the size of the organization's budget.
    - Some firms produce a low bid the first year then raise their fee substantially in subsequent years. Auditors without nonprofit auditing experience may take longer to produce an audit, causing them to raise their fee in later years. They may also prepare a report that has less value to the board and the public because the work supporting it is not sufficient. Also, they may require nonprofit staff, which is typically overburdened, to do more work for the audit than should be expected. Finally, some auditors who charge a lower fee do not do sufficient work in preparing a management letter detailing areas of weakness in the accounting system. Such a letter is an important management tool, of benefit to both the board and staff.
    - On the other hand, an expensive audit does not guarantee an excellent product. Your goal is to get the reports and advice that you need and can understand for a reasonable fee. Note that auditors charge different fees at different times of year. If audit starts in the winter or spring, it may be less expensive but also less meaningful as a management tool due to the delay.

Changing Auditors

The recommendations regarding changing auditors after you have established a relationship with one individual or firm differ depending on whom you ask.

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

What Information is Needed for an Audit

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

Confirmations

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

Evidence of Internal Controls

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

Documentation

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

- Assets
    - **Accounts receivable**—Who owes you money, how much, and when was it due?
    - **Property and equipment (fixed assets)**—When were assets acquired, how much did you pay, how long are they expected to last, how much are they depreciated each year, and how much has been depreciated to date? Many nonprofits ask their auditors to maintain this schedule for them and to prepare the annual calculation of depreciation.

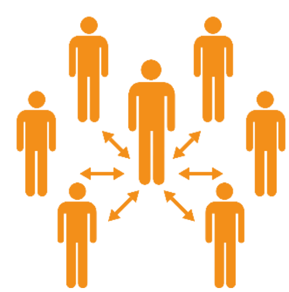
- Liabilities
    - **Payables**—Who you owe money to, how much you owe each individual/organization, and copies of invoices or loan agreements.
    - **Deferred Revenue**—Any contributions deferred due to donor conditions or restrictions. Provide the information under grants and contributions, in the Revenue section below.
- Revenue
    - **Grants and contributions**—Funder/donor names and addresses, grant period, grant amount, when received, restrictions, and copies of the grant letters and grant applications. In the case of individual contributions, your auditor will specify which donors to include on this list based on a minimum level of contributions they will establish for you based on your overall budget and total contributions.
    - **Donated services and materials**—You may be required to place a dollar value on contributions of certain services and materials. Prepare a list of these donations to discuss with your auditor.

  - **Special events and benefits**—Show income and expenses, and documentation for the value of goods or services which donors received (and, therefore, are not included in the tax-deductible portion of their payment).
  - **Documentation**—Such as contracts and invoices, names and addresses, registrations, and so on, for fees from memberships, tuition, performances, and other services.
  - **Inventory**—If you sell t-shirts, books, or other products, keep a record of sales throughout the year so that beginning inventory can be reconciled with inventory at the end of the year.
- Expenses
  - **Payroll records**—Including federal and state tax returns related to payroll, and vacation records.

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

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

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



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

When Does the Audit Begin and End?

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

The single audit must be completed and submitted in machine-readable format to the Federal Audit Clearinghouse either 30 days after receiving the auditor's report, or nine months after the end of the nonprofit's fiscal year, whichever comes earlier.

FISCAL MONITORING PROGRAM SPOTLIGHT
When an audit is required of a City-funded nonprofit, the Fiscal Monitoring Program also requires that the audit be completed within nine months of the close of the agency's fiscal year, though it is a best practice to complete the audit within six months. A timely audit is more effective as a management tool.

Federal Awards

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

On December 26, 2013, OMB published its comprehensive overhaul of federal grant administrative, cost accounting, and audit policies in the Federal Register, to be codified in Title 2 of the Code of Federal Regulations. This final guidance, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance), supersedes and combines the requirements of eight existing OMB Circulars (A-21, A-50, A-87, A-89, A-102, A-110, A-122 and A-133). The Uniform Guidance was effective December 26, 2014.

In April 2024, OMB revised the Uniform Guidance. Effective October 1, 2024, the revisions include an increase to the single audit threshold from $750,000 to $1 million and a de minimis rate increase from 10 percent to 15 percent. See below for more on the OMB Uniform Guidance audit requirements.

What Are Your Responsibilities When Receiving Federal Awards?

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

As a recipient of federal awards, it is your organization's responsibility to comply with both the specific grant requirements and with all the corresponding government laws and regulations regardless of the size of your organization or whether or not your organization is subject to a single audit. This is accomplished by:

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

Internal Control for federal awards is essentially the same as our discussion above. Internal control is a process established to provide reasonable assurance that:

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

See **Appendix H** for a reference of federal government document resources for more detailed information.

Recipient, Subrecipient, or Contractor?

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

If your organization is simply a contractor, it is generally not subject to the various grant compliance requirements. Only subrecipients—not contractors, which used to be called vendors under previous guidance—are subject to the monitoring requirements outlined in the Uniform Guidance. Therefore, the difference between a contactor and a subrecipient is significant and can greatly affect an organization's level of responsibility to the government. (Refer to OMB Uniform Guidance for more detailed information on differences between subrecipient and vendor, see **Appendix D**).

Pass-Through Entity Responsibilities

Nonprofits, **regardless of award size**, will be monitored under **Subpart D** of the Uniform Guidance, which provides a list of a pass-through entity's related responsibilities. Many of the requirements are administrative in nature. Other requirements are more involved, particularly these three: 1) performing a risk assessment of the nonprofit, 2) monitoring the nonprofit, and 3) following up on any audit findings or other issues revealed in that process. While nonprofit organizations may receive pass-through funding from a variety of sources, this funding most commonly passes through City departments, which establish contracts and grants with the nonprofits to perform specific services and programs. Let's look at some best practices that City departments, as pass-through entities, may implement in each of these key areas.

Risk Assessment

A pass-through entity should assess the risk of a subrecipient's noncompliance with federal statutes, regulations, and the terms and conditions of the subaward at the outset of the relationship and at least annually afterward. City departments may consider the following factors in evaluating subrecipient risk: prior experience with the same or similar subawards; results of previous audits; personnel and management systems; policies and procedures; financial stability; and extent and results of any monitoring by the federal awarding agency. The overall level of risk the pass-through entity identifies in the subrecipient should dictate the frequency and depth of the monitoring practices, including how to mitigate identified risks.

Ongoing Monitoring

City departments can monitor the subrecipient by reviewing the single audit (if available), performing expanded monitorings, reviewing the subrecipient's records, maintaining regular contacts with the subrecipient, reviewing the federal debarment lists regularly to ensure the subrecipient have not appeared on them, having an independent auditor perform a limited scope audit, among other types of monitoring. Generally, the fiscal and compliance monitoring conducted via the Monitoring Program serves as sufficient monitoring to meet the federal standards, though additional programmatic monitoring may also be necessary.

Follow Up Monitoring Efforts

The Uniform Guidance makes it explicit (rather than implied) that a pass-through entity must actively issue management decisions regarding audit findings identified during the monitoring process and that any deficiencies must be identified to the subrecipient and should be given a specified period—for example, 30 days—to submit a corrective action plan for the pass-through entity's approval. This plan should not only correct the immediate problem but also should create future controls that prevent the situation from reoccurring. For example, if federal funds were used toward an unallowable activity, those funds should be recovered or otherwise resolved, and the corrective action plan might create a new preapproval process for future expenditures. Some of this follow-up monitoring and corrective action may occur within the Monitoring Program.

OMB Uniform Guidance Administrative Requirements

OMB Uniform Guidance imposes administrative requirements for nonprofit organizations receiving federal grants (awards). These administrative requirements include the following categories (see **Appendix H** and the respective sections of OMB Uniform Guidance for more detailed information).

Financial and Program Management

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

Property Standards

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

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

Procurement Standards

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

- **Recipient responsibilities**—Includes contractual responsibilities
- **Codes of conduct**—A written code of conduct is required for employees engaged in the award and administration of contracts
- **Competition**—Procurement is to be conducted in a competitive environment
- **Procurement procedures**—Establishment of procurement procedures and use of disadvantaged businesses
- **Cost and price analysis**—Nonprofits should perform and document this analysis
- **Procurement records**—These are records to be maintained as they relate to procurement
- **Contract administration**—Requires a contract administration system be maintained
- **Contract provisions**—Requires any procurement-specific provisions for all contracts and subcontracts

Reports and Records

These reports and records are required of nonprofits:

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

Termination and Enforcement

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

- Temporarily withhold payments until the problem is corrected

- Disallow all or a part of the cost of items relating to the noncompliance
- Suspend or terminate the current award
- Withhold further awards
- Take other legal remedies

OMB Uniform Guidance Audit Requirements

OMB Uniform Guidance defines audit requirements for nonprofits receiving federal funding. Your organization may be subject to these audit requirements even if the funding you receive is passed through another agency. For example, a City department may make a grant to a local nonprofit housing developer that contains US Department of Housing and Urban Development (HUD) funding. The local housing developer is subject to OMB audit requirements even though the grant was not directly from HUD. The most current information on OMB audits is at the Office of Management and Budget website (see **Appendix H** for more information).

The threshold expenditure amount for receiving a single audit has been raised several times; the most recent change raised the threshold from $750,000 to $1 million, effective October 1, 2024. The requirement for a nonprofit to conduct a single audit is triggered when a nonprofit receives federal funds from either one or several government funding sources (whether in the form of a government contract or a grant) and when that nonprofit expends $1 million or more in federal funding in a single year.

While the increase in the threshold relieves a burden for many organizations, it also leaves pass-through entities with the task of ensuring their subrecipients are using funds appropriately in the absence of a single audit.

Organizations not required to undergo a single audit must still be prepared to make their records available for review or audit by the federal agency or inspector general of the federal agency that provided funds or the Government Accountability Office (GAO). In addition, the City department that is the primary recipient (pass-through entity) of the federal funds is responsible for the subrecipient's compliance with laws and regulations, providing the subrecipient with the federal requirements that must be followed. If the primary recipient determines that the subrecipient is not in compliance with applicable laws and regulations, it must act expeditiously to address the noncompliance. In addition, these organizations must make records available for review or audit by appropriate officials of the federal agency and GAO in addition to the primary recipient (pass-through entity) (see OMB Uniform Guidance, Subpart F—Audit Requirements).

NOTE

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

Organizations that are required to have a single audit may choose to have a program-specific audit (see OMB Uniform Guidance, Subpart F—Audit Requirements) if the organization expends federal monies under only one federal program (excluding research and development programs) and the program's laws, regulations or grant agreements do not require a financial statement audit of the auditee (see OMB Uniform Guidance, Subpart F—Audit Requirements).

Smaller organizations may be able to combine a regular audit of the whole agency with a program-specific OMB audit of the program receiving federal funding. The amount of your total combined federal funding will determine the type of audit you are required to have under OMB Uniform Guidance.

FISCAL MONITORING PROGRAM SPOTLIGHT
When a nonprofit must complete an OMB audit, the Fiscal Monitoring Program verifies that the audit contains no findings, material weaknesses or questioned costs.

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

OMB Uniform Guidance Summary

In summary, if your organization expends $1 million or more in federal funding, whether directly or indirectly, and that funding is for more than one program, you are required to have an agency-wide OMB audit. In addition, a program which receives more than $750,000 in combined federal awards is likely to be classified as a major program, and, therefore, subject to significantly more testing by the auditor. Whether a program is major or non-major is based on the dollar value of expenditures during the audit period. A program is a major program when total expenditures equal or exceed three percent of total federal funds expended by your organization or $1 million, whichever is greater. A program is non-major when expenditures are below this threshold.

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

If your organization receives funds from a non-federal agency or grantor, you should ask if the grant includes federal funds. In some cases, the grantor may not know the answer even though they are required to notify you whenever federal funds are included in the award. You are required to make a good faith effort to determine if federal funds are included in the award. Each federal award is identified with a number from the Catalogue of Federal Domestic Assistance (CFDA) and granting agencies should provide the CFDA number(s) for any federal funds included in your award since you are required to report this number as part of an audit.

When you do receive federal funding, **alert your auditor right away so you can get help setting up the proper systems for complying with government regulations**. You may also want to get a copy of the OMB Compliance Supplement, which describes the audit requirements and serves as a guide for auditors performing single audits. You should identify someone on your staff who will be responsible for monitoring compliance with federal guidelines.

Board of Directors Responsibilities

ROLES OF THE BOARD

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

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

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

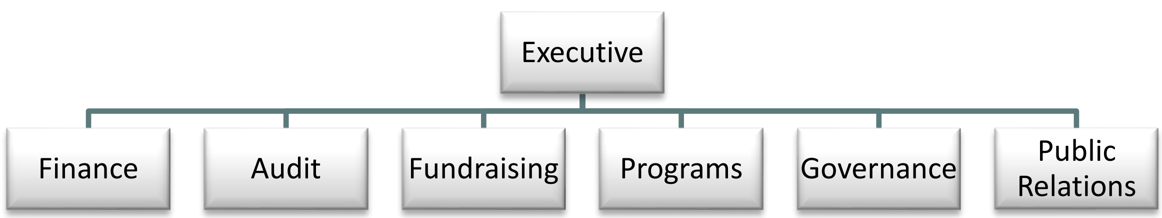
Governance	Support
Vision: Affirm the mission, purpose, and values of the organization. **Legal**: Ensure compliance with federal, state, and local regulations and fulfillment of contractual obligations, including payment of payroll taxes and filing required reports. **Financial**: Ensure the organization establishes a realistic budget. Safeguard assets from misuse, waste, and fraud. Ensure the organization's financial viability. **Executive Director**: Select the executive director and evaluate performance; delegate the day-to-day management to the CEO. If necessary, fire the executive director. **Evaluation and Planning**: With staff, determine program strategies and priorities, develop an implementation plan, and evaluate services to	**Fundraising**: participate with staff in raising financial and in-kind support **Public Relations**: Act as an ambassador for the organization and its clients **Professional Expertise**: Advise staff in areas of expertise, and volunteer or recruit volunteers as needed **Credibility**: Use name recognition to support the organization

monitor effectiveness and impact. **Policies**: Approve personnel and other policies. Periodically review to ensure policies are up to date and relevant.	

Typical Board Committee Structure

Boards establish committees based on the needs of the organization. The structure offered here represents the most common needs typical nonprofit organizations have of their boards. Board bylaws should define standing committees and meeting frequency. Boards may also establish ad hoc committees as required, such as creating an Event Subcommittee to plan a fundraiser, which would disband after the event occurs.

Boards typically have an Executive Committee that includes the Board Chair, Vice Chair, Secretary and Treasurer, and which may also include chairs of certain standing committees.



BOARD OBLIGATIONS

Legal Obligations

A nonprofit board is the "legal guardian" of the organization. To fulfill this role, board members have three legal duties by which they must abide:

- **Duty of Care**: Board members must act with the same care as would a "reasonably prudent person" under similar circumstances. They must stay informed of organizational activities via trustworthy sources and use sound judgement to make decisions reasonably believed to be in the best interest of the organization.
- **Duty of Loyalty**: Board members must apply undivided loyalty in decision-making. They must uphold confidentiality and disclose any conflicts of interest, recusing themselves as necessary. They must not engage in any activities that would injure or take advantage of the organization, including self-dealing.
- **Duty of Obedience**: Board members must ensure the organization is compliant with all federal, state, and local laws, properly files all tax documents, adheres to the organization's bylaws, and follows any contractual agreements.

Conflict of Interest

The duty of loyalty means that board members must put aside personal interest and instead act in the best interest of the organization they serve. Boards are required to establish a conflict-of-interest policy. This policy should establish how board members should act in cases of potential or actual conflict, and to prohibit self-dealing. Self-dealing includes situations when a board member advocates for a decision that results in personal advantage to him or herself or to a family member.

As components of a conflict-of-interest policy, it is best practice for organizations to carry out the following activities to avoid conflicts of interest or the appearance of a conflict of interest:

- Board members should disclose all potential conflicts as a normal habit or practice (e.g., by revisiting such issues annually).
- Organizations should obtain at least three competitive written bits for major purchases or services to ensure that prices and products are comparable if a board member stands to benefit financially from the purchase.

Fiduciary Obligations

Typically, the Board Treasurer chairs the Finance Committee. In this role, the Treasurer oversees the annual budget process, provides regular financial updates to the full board, and ensures the organization is compliant with fiscal policies and procedures.

The Finance Committee fulfills the following functions:

- Monitors financial records and reviews financial statements
- Reviews and approves annual budget and major budget revisions
- Establishes, reviews and updates financial policies
- Assesses assets and determines investment strategy

Review of Financial Statements

To safeguard and ensure the appropriate use of agency funds, the Finance Committee should carry out regular reviews of financial reports and report areas of strength and weakness to the full board as needed. The Finance Committee may review different documents at various times during the fiscal year.

Before

Annual Budget

Cash Flow Projection

During

(Monthly or Quarterly)

Balance Sheet

Profit and Loss Statement

Variances

Cash Flow Projection

After

Budget vs. Actuals

IRS Form 990

Audit

FISCAL MONITORING PROGRAM SPOTLIGHT

The Fiscal Monitoring Program pays special attention to the role of boards in financial oversight. City monitors will review board meeting minutes to assess the following fiscal standards:

- The board approved the current agency-wide budget
- The board reviewed financial reports at least quarterly (or more frequently if there are significant financial concerns)
- The board reviewed the most recent audit within the fiscal year it was completed

City monitors will also review board meeting minutes to assess the following compliance standards:

- Executive directors who are voting members of the board did not vote on his or her compensation The board conducts an annual performance review of the executive director

While not formal standards, the Monitoring Program has established a list of best practices that City Monitors review as indicators of good organizational governance, including:

- Board members assist with the raising of funds
- Board members participate in annual giving to the agency
- The board achieves a quorum at every meeting
- The board reviews IRS Form 990 (or it is distributed to members)
- Bylaws define term limits, quorum, committee structures and voting process
- Board leadership positions are filled (e.g., chair, vice chair, secretary, treasurer)
- If there are vacancies on the board, it is conducting active recruitment for those positions
- A conflict-of-interest policy exists
- The organization has a Board Manual documenting these best practices and other requirements

For a sample table of contents for a board manual or handbook, see **Appendix I**.

Taxes

NONPROFIT TAX STATUS

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

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

- Religious
- Educational
- Charitable
- Scientific
- Literary
- Testing for public safety
- Fostering national or international sports competition
- Prevention of cruelty to children or animals

STATE AND FEDERAL TAX REPORTING REQUIREMENTS

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

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

http://www.irs.gov/pub/irs-pdf/p557.pdf

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

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

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

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

Form 990 or 990EZ, Annual Return, must be filed within 4 ½ months after the end of the fiscal year. An organization may request an automatic three-month extension, without showing cause, by filing Form 8868, "Application for Extension of Time to File an Exempt Organization Return," by the initial due date for filing Form 990.

FISCAL MONITORING PROGRAM SPOTLIGHT
The Fiscal Monitoring Program verifies that the 990 has been filed by the deadline, or an extension has been submitted on time.

Prohibition on Provision of Excess Benefits

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

Prohibition on Lobbying and Participation in Political Campaigns

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

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

San Francisco Laws and Policies

If you have a contract with the City, you should be aware of the following laws, policies, and provisions.

CONFLICT OF INTEREST PROVISIONS

City boilerplate contract forms, including the P-600 Professional Services Contract, contain a conflict-of-interest provision prohibiting City officials and employees from participating in certain decision-making activities of organizations that contract with the City. Activities that constitute a conflict of interest are described under Section 15.103 of the City Charter, Article III, Chapter 2 of the City's Campaign and Governmental Conduct Code, or Section 87100 et seq. and Section 1090 et. seq. of the Government Code of the State of California. The San Francisco Ethics Commission administers and implements the provisions of the Charter and City ordinances relating to campaign finance, lobbying, conflicts of interest, and governmental ethics. To see a comprehensive source for information on the laws and how they may apply to your organization, you can obtain the "San Francisco Ethics Commission Manual" by contacting the Ethics Commission or downloading the manual from the Ethics Commission Website: www.sfgov.org/ethics Refer to **Appendix H** for more information on contacting the Ethics Commission.

City boilerplate contract forms, including the P-600 Professional Services Contract, also contain a provision prohibiting contractors, or person(s) who contract with the City, from contributing to the campaign of an elective officer who approves (or the board on which the officer sits approves) the contract or the contractor's transactions. This prohibition is effective from the commencement of negotiations through the termination of negotiations, or three months after the date the officer or the board on which he/she sits approved the contract, whichever is later.

RESTRICTIONS ON CERTAIN POLITICAL ACTIVITIES

The San Francisco Administrative Code, Appendix 65, Sec. 12G (known as "Chapter 12G"), prohibits using for political activity any funds appropriated by the City and County of San Francisco for contracts, grants, and loans. Boilerplate contracts, such as the P-600 Professional Services Contract, contain language incorporating these provisions. The contract boilerplate states a contractor may not participate in, support, or attempt to influence any political campaign for a candidate or for a ballot measure (collectively, "political activity") in the performance of the services provided under the agreement. A contractor agrees to comply with San Francisco Administrative Code Chapter 12G and any implementing rules and regulations promulgated by the City. In the event the contractor violates the provisions of this section, the City may, in addition to any other rights and remedies available, (i) terminate the agreement, and (ii) prohibit the contractor from bidding on or receiving any new City contract for two (2) years.

Under Chapter 12G, the Controller's Office is required to annually perform political activity audits of at least ten persons or entities that enter into contracts, grant agreements, or loan agreements with the City.

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

MINIMUM COMPENSATION ORDINANCE

The City's boilerplate contracts, such as the P-600 Professional Services Contract, require City contractors with over 20 employees and $50,000 or more in contracts with one City department to comply with provisions of the City's Minimum Compensation Ordinance (MCO), as set forth in San Francisco Administrative Code Chapter 12P. The ordinance requires contractors to pay their employees a minimum hourly wage specified by the City and to provide compensated and uncompensated time off. There are also monetary thresholds for funds received by the contractor under which an organization is exempt. The MCO is enforced by the Office of Contract Administration (OCA), Living Wage/Living Health Unit. For specific information about the current wage, MCO rules and regulations, forms, and how to contact OCA's Living Wage/Living Health Unit, go to OCA's website: www.sfgov.org/oca/lwlh.htm

HEALTH CARE ACCOUNTABILITY ORDINANCE

The City's boilerplate contracts, such as the P-600 Professional Services Contract, require contractors to comply with provisions of the City's Health Care Accountability Ordinance (HCAO), as set forth in San Francisco Administrative Code Chapter 12Q. Nonprofit organizations with fewer than 50 employees are exempted and the ordinance requires the contractor to provide its employees with a health care benefit as set forth in Section 12Q.3 of the HCAO. There are also monetary thresholds for funds received by the contractor under which an organization is exempt. Like the MCO, the HCAO is enforced by OCA's Living Wage/Living Health Unit. For specific information about the health benefit requirement, HCAO rules and regulations, and forms, go to OCA's website at www.sfgov.org/oca/lwlh.htm

SUNSHINE ORDINANCE REQUIREMENTS

The following summarizes provisions of San Francisco Administrative Code Section 12L. For a complete understanding of the ordinance's provisions, see the City's website at http://www.sfgov.org/sunshine and click on "documents." Note that these provisions only apply to organizations receiving at least $250,000 in City funds.

Access to Meetings

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

Meeting Notice

The ordinance also requires nonprofit organizations to provide public notice of each public meeting at least 30 days in advance of the meeting. Such notice should be submitted to the Clerk of the Board of Supervisors and to the San Francisco Public Library Government Information Center. Nonprofit organizations should retain proof of this public notice to show during monitoring visits by the City.

Access to Records

Nonprofit organizations are required to maintain and make available for public inspection and copying a minimum amount of financial information about the organization. These include Form 990, the organization's recent budget, and relevant audit documents. The public may request additional information, but its provision is voluntary and not compulsory. Nonprofit organizations should document these requirements in a written policy.

Dispute Resolution

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

Community Representation

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

FISCAL MONITORING PROGRAM SPOTLIGHT
When a nonprofit receives more than $250,000 in City funding, the Fiscal Monitoring Program ensures that the agency has a written Sunshine policy and complies with its provisions.

To see a sample written policy, see **Appendix J**.

ANNUAL ECONOMIC STATEMENT

San Francisco Administrative Code, Section 10.1, requires an annual economic statement from every legal entity receiving funding in excess of $100,000 from or through the City to provide direct services to the public (not including other governmental entities). These statements are to be filed with the Department of Administrative Services, or otherwise make publicly available in a manner authorized by the City Administrator's Office.

The City Administrator's Office requires nonprofits to post the annual economic statement to the nonprofit's public website and notify the City Administrator with the link to where documents are posted annually. The City Administrator will ensure that the annual economic statement information received is made publicly accessible.

The statement should contain the following information:

- Name of the CEO, or other person possessing daily managerial responsibilities
- Names of all officers or directors and names of all other boards on which they serve
- Total expenditures during calendar year or fiscal year, whichever is applicable; and budget for calendar or fiscal year, whichever is applicable, showing the sources of all monies received or budgeted, and a program-by-program description of all monies expended or budgeted
- A letter from the Internal Revenue Service establishing the current valid nonprofit status of the organization or its fiscal sponsor, if applicable
- A public copy of the most recent federal tax return filed under Section 990
- Verification of current valid registration with the State of California's Registry of Charitable Trusts
- For organizations required by federal, state, or City law to prepare audited financial statements, a copy of the most recent audited financial statement; and
- Such other information or documentation as the City Administrator from time to time determines would be necessary to evaluate and ensure that organizations are qualified to receive City funds.

Appendix A: Sample Program-Based Budget

Program-Based Budget		**Budget Start Date: 7/1/2017**						
		PROGRAMS			**SUPPORTING ACTIVITIES**			**TOTAL**
INCOME		**Program 1**	**Program 2**	**Program 3**	**Fundraising**	**Admin**	**Shared Cost**	**Agency Total**
Earned Income								
	Fees	$9,050	$600					$9,650
	In-Kind							$0
Total Earned Income		$9,050	$600		$0	$0	$0	$9,650
Government Income								
	Government Grant 1	$95,000						$95,000
	Government Grant 2			$60,000				$60,000
	Government Grant 3		$15,550					$15,550
Total Government Income		$95,000	$15,550	$60,000	$0	$0	$0	$170,550
Contributed Income								
	Foundation	$150,000	$0					$150,000
	Corporate	$75,000	$7,000					$82,000
	Individual donor	$15,000	$10,200	$1,200	$55,000			$81,400
Total Contributed Income		$240,000	$17,200	$1,200	$55,000	$0	$0	$313,400
TOTAL INCOME		$344,050	$33,350	$61,200	$55,000	$0	$0	$493,600
EXPENSES								**Total**
Personnel Expenses								
	Salaries	$171,662	$6,000	$8,400	$12,362	$45,392	$0	$243,816
3.5 %	*Medical*	$6,008	$210	$294	$433	$1,589	$0	$8,534
18 %	*Fringe Rate*	$30,899	$1,080	$1,512	$2,225	$8,171	$0	$43,887
Total Operating Expenses		$208,569	$7,290	$10,206	$15,020	$55,151	$0	$296,236
Operating Expenses								**Total**
	Consultants	$58,000	$10,820	$31,000				$99,820
	Equipment rental		$250	$0		$160		$410
	Equipment		$3,300	$1,700			$1,295	$6,295
	Incentive/Prizes	$400	$1,000	$0				$1,400
	Insurance						$15,000	$15,000
	Intern Stipend			$500				$500
	Legal & prof. services					$8,600		$8,600
	Maintenance/Janitorial						$1,950	$1,950
	Meals / food	$6,500	$2,800	$2,388				$11,688
	Field Trips	$5,500						$5,500

Postage & messenger				$550		$900	$1,450
Printing	$2,700	$2,300	$0	$150	$175		$5,325
Production Costs		$2,060					$2,060
Rent						$8,500	$8,500
Supplies	$13,500	$1,200	$2,500		$275	$550	$18,025
Telephone/Internet						$750	$750
Travel	$1,100				$65		$1,165
Utilities						$2,200	$2,200
Total Operating Expenses	$87,700	$23,730	$38,088	$700	$9,275	$31,145	$190,638
PERSONNEL & OPERATING EXPENSES	$296,269	$31,020	$48,294	$15,720	$64,426	$31,145	$486,874
Shared Cost Pool Allocation %	65%	7%	11%	3%	14%		
Shared Cost Pool Allocation	$20,247	$2,120	$3,300	$1,074	$4,403	-$31,145	
EXPENSES BEFORE ADMIN ALLOCATION	$316,516	$33,140	$51,594	$16,794	$68,829	$0	
Administrative Allocation %	76%	8%	12%	4%			
Administrative Allocation	$52,113	$5,456	$8,495	$2,765	-$68,829		
TOTAL EXPENSES (WITH SHARED COSTS AND ADMIN)	$368,629	$38,596	$60,089	$18,485	$0		
Net Income or Loss	-$24,579	-$5,246	$1,111	$36,515			$6,726

Appendix B: Sample Cash Flow Budget

	Total Budget	Jan	Feb	Mar	Apr	May	Jun
Expected Revenues							
Gov Grants	35,000				12,000	4,000	16,000
Foundation Grants	50,000		5,000		7,500	15,000	
Individuals	12,000			1,500			30,000
Fees for Service	55,000	3,000	4,500	4,500	5,000	5,000	3,000
Total Revenue	**152,000**	**3,000**	**9,500**	**6,000**	**24,500**	**24,000**	**49,000**
Expected Expenditures							
Salaries & Fringe							
Executive Dir.	38,000	3,167	3,167	3,167	3,167	3,167	3,167
Program Dirs.	50,000	4,167	4,167	4,167	4,167	4,167	4,167
Secretary	27,000	2,250	2,250	2,250	2,250	2,250	2,250
Rent	12,000	1,000	1,000	1,000	1,000	1,000	1,000
Supplies	11,000	5,000					6,000
Telephone	3,300	300	250	300	500	350	250
Postage	2,500	150	150	150	1,500	150	150
Copying	2,950	100	100	100	1,000	100	100
Total Expenses	**146,750**	**16,134**	**11,084**	**11,134**	**13,584**	**11,184**	**17,084**
Cash Flow	**Total Budget**	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**
Net Income (Loss)	5,250	(13,134)	(1,584)	(5,134)	10,916	12,816	31,916
Cash on Hand – Beginning	2,648	2,648	(10,486)	(12,070)	(17,204)	(6,288)	6,528
Ending Cash Available (Before Loan Activity)	7,898	(10,486)	(12,070)	(17,204)	(6,288)	6,528	38,444
Loan or (Loan Payback)	0	12,000	0	6,000	(10,000)	(8,000)	0
Cash After Loan Activity	7,898	1,514	(70)	796	1,712	6,528	38,444

Appendix C: Indirect Cost Guidance

The Controller's Office produced the *Guidelines for Cost Categorization in Nonprofit Contracts and Grants*. to clarify and create consistency around how costs are treated, including what costs are allowable and whether cost items should generally be considered direct or indirect. The Controller's Office will update the *Guidance* periodically as federal rules change and as new questions from nonprofits and City staff help clarify the treatment of specific costs. The most recent version of the Guidance will be posted on the website above, and that should be considered the source for both nonprofits and City staff as they negotiate and manage agency-wide and contract budgets.

EXAMPLES OF INDIRECT COST ALLOCATION

The following examples help to illustrate various methods agencies might use to allocate indirect costs to programs.

Example 1: Indirect costs of a medium-to-large size organization

The Helping Hands In-Home Support Agency has administrative (Executive Director, Administrative Assistant, Front Office Receptionist, Human Resources Coordinator) and finance (Controller, accounts payable, accounts receivable, and payroll) salaries and benefits costs each month totaling $30,000. The agency must allocate these indirect costs to all its cost centers on a reasonable, consistent basis.

Helping Hands also has a Development Director who has an Administrative Assistant. The salaries and benefits of these two staff people must be reported as fundraising staff whose salaries and benefits may not be allocated to programs.

Each of Helping Hands' three programs use direct program staff in positions that have similar salary ranges. This makes allocation of indirect salaries and benefits based upon percentages of direct salaries a reasonable method. Total direct costs could also be a basis as long as one program didn't have disproportionately larger operating costs for some reason. The objective is to find an allocation basis that somehow shares out indirect costs in a manner that approximates the benefits received by each cost center. So, monthly indirect salaries and benefits could be allocated across its programs in the following manner:

	Program A	**Program B**	**Program C**	**Development**	**Administration**
Direct Salaries	$20,000	$50,000	$15,000	$5,000	$30,000
% of Total Direct Salaries ($90,000)	22.22%	55.56%	16.67%	5.56%	
Allocated Portion of Indirect Costs	$6,667	$16,667	$5,000	$1,666	

This allocates all of the $30,000 of indirect salaries and benefits.

Example 2: Indirect costs of a smaller organization

The Helping Hearts Counseling Center has administrative (Executive Director, Administrative Assistant/Receptionist) and finance (Controller, accounts payable, and payroll) salaries and benefits cost each month totaling $15,000. The agency must allocate these indirect costs to all its cost centers on a reasonable, consistent basis.

The Executive Director is a licensed counselor who also serves as the program director for the smaller of Helping Hearts' two programs. She keeps a functional time sheet that shows how much time each week she works in this capacity. The program operates out of a different facility than the administrative offices, so she dedicates one day on site at the program facility and records any program-specific meeting time on her timesheet during the rest of the week. For our sample one month, her time as Executive Director amounts to 75% and her Program Director time amounts to 25% of her total time during the month. The 25% of her monthly salaries and benefits totals $1,300. This reduces the indirect salaries and benefits to $13,700.

Each of Helping Hearts' two programs has total direct costs that are similar (no highly paid professional staff in just one program, no large payments to contractors in only one program, no more than one work shift per day for direct staff in just one program, etc.) So, monthly indirect salaries and benefits could be allocated across its programs in the following manner:

	Program A	**Program B**	**Administration**
Direct Salaries	$45,000	$25,000 (including 25% of E.D.'s salary)	$13,700
% of Total Direct Salaries ($70,000)	64.29%	35.71%	
Allocated Portion of Indirect Costs	$8,807	$4,893	

This allocates all of the $13,700 of indirect salaries and benefits.

Example 3: Allocable Direct Costs

The Helping Hand Agency is housed in a 3,500 sq. foot facility. Approximately 1,400 square feet consists of kitchen areas, which are used to produce meals for Helping Hand's Brown Bag Lunch Program. Consequently, forty percent of Helping Hand's square footage is allocated to this particular program. Helping Hand pays $4,000 per month in rent. This means that 40% of Helping Hand's total monthly rent ($1,600 per month or $19,200 annually) can be directly allocated to the funding source which finances the Brown Bag Lunch Program. Other Helping Hand Agency programs can be charged with direct rent expense based upon each program's relative percentage of actual square footage used. If administrative and finance offices reside in the same facility, the percentage of square footage used for those offices would be charged to programs as indirect costs.

Appendix D: Chart of Accounts

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

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

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

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

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

> **NOTE**
>
> An internet search for "Unified Chart of Accounts" and "nonprofit" will provide numerous useful resources to help you get started building or revising a chart of accounts, including templates that align with IRS Form 990 reporting and tips for setting up a chart of accounts in various financial systems.

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

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

Chart of Accounts Basics

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

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

- Assets
  - Tangible items your organization owns, including cash, accounts receivable, equipment, and property. Assets are listed in descending order of liquidity with cash and assets easily converted to cash listed first, and fixed assets like property and equipment listed last. Asset accounts usually start with the number "1."
- Liabilities
  - Liabilities are obligations due to creditors such as loans and accounts payable. Current liabilities that are due within the current year are usually listed first, followed by long-term liabilities. Accounts payable and payroll taxes are usually listed before other payables. Deferred revenue and other liabilities are listed further down the list. Liabilities accounts begin with the number "2."
- Net Assets (fund balances)
  - Net assets (formerly known as fund balances) reflect the financial worth of the organization. Net worth shows the balance remaining after obligations are subtracted from your organization's total assets. If your organization receives only unrestricted funds, you will have one net asset account, but if you receive temporarily or permanently restricted funding you will have more than one net asset account. Net asset accounts begin with the number "3."

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

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

Capturing complex financial information in the chart of accounts requires a multi-tiered chart. For example, you may need to track temporarily and permanently restricted funds, separate programs or departments, separate sites, and so on.

If your organization has three programs—counseling, tutorial, and recreation—you might assign each its own account code as follows:

Counseling	**01**
Tutorial	**02**
Recreation	**03**

When these codes are added to other codes for expense items in the chart, you would attribute salaries for counselors to **7210 - 01**:

7210	**- 01**
Salary	**Counseling Program**

Supplies for a recreational program would be posted to **7710 - 03**:

7710	**- 03**
Supplies	**Recreational Program**

You could also track two programs and sites by adding a third tier. If you had two sites where tutorial programs were given, the first site could be assigned the letter "A" and the second the letter "B," so salaries would be divided between **7210 – 02 – A** and **7210 – 02 - B**:

7210	**-02 B**
Salary	**Tutorial Site B Program**

As the chart becomes more complex, you will be able to produce more detailed reports. As the accounting system becomes more complex, computerized accounting systems become more necessary.

Appendix E: Policies and Procedures Manual

Key Elements of a Fiscal Policies and Procedures Manual

Organizations maintain policies and procedures to ensure transparency, accountability and as a training resource for their staff. Fiscal policies and procedures should protect the agency's resources from waste, fraud and inefficiencies.

At a high level, policies and procedures manuals should address the following elements:

- Policies should be clearly documented and able to be understood by individuals outside of the particular department or agency.
- Staff members involved in processes should be listed by job title.
- Agency forms relevant to the policy should be cited.
- Relevant time frames should be indicated.
- Policies and procedures should be "current" meaning they have been reviewed and updated as needed within the last two years. If there has been turnover in executive leadership, policies should be reviewed within a year of that turnover.
- Staff should be trained on the policies and procedures on a regular basis.

The following sections discuss the basic information to be included within a Fiscal Policies and Procedures Manual.

Internal Controls

- Process for authorizing expenditures
  - Who is allowed to authorize expenses?
  - Is that individual familiar with the expenses and does it make sense to have that individual authorizing?
- Authorized check signers
  - Check signers should not be involved in the authorization process or basic accounting procedures.
- Non-accounting staff opening and reviewing bank statements and checks
- Bank Reconciliation occurring in a timely manner
  - Statements should *normally* be reconciled within 30 days of receipt (some flexibility is acceptable, but reconciliation should not go beyond two months).
  - An individual removed from the day-to-day accounting functions should review and approve the reconciliation.
- Processes for handling cash and checks received in a secure manner
  - Are cash and checks stored in safe?
  - Are deposits made frequently (e.g., at least weekly)?

- Program-specific controls
    - *For example* - is the organization responsible to handling client funds? If so, is there a written policy and procedures for how to do so?

Finance Reporting

- A listing of what reports are being created on a regular basis
    - E.g., profit and loss statements, income statements, departmental or program budgets, balance sheet, etc.
- The cycle in which the reports are produced, e.g., Monthly, quarterly or annually
- Who the reports are intended for, e.g., program directors, management and the board

Accounts Payable

- How invoices come into the organization
- Approval process
- Purchase order systems
- Credit cards usage and authorization
- Business lines of credit and access to usage

Accounts Receivable

- Procedure for invoicing clients
- Procedure for invoicing City contracts
- Procedure for recognizing restricted funding (foundation grants)
- Handling of payments coming into the organization
    - Secure handling of funds
    - Timely deposit to bank accounts

Petty Cash

- Secure location
- Accounting for expenses and retention of receipts
- How funds are replenished

Payroll Procedure

- Processing of timesheets
- If time studies are used, there should be a documented review process
- Authorization of timesheets – by whom and when
- Overview of processing activities, including transferring of funds if needed and payment of payroll taxes

Conflicts of Interest

- Definition of what would constitute a conflict for the organization
  - Issue between funders and board members?
  - Issues between clients and staff?
- Process for and requirements to disclose conflicts
- Consequences and remedies

Examples

Bank Statements and the Reconciliation Process

Policy: All bank statements will be opened and reviewed in a timely manner. Bank reconciliation and approval will occur within 45 days of the close of the month.

Procedure: All bank statements and cancelled checks will be opened, reviewed and initialed by the Administrative Manager upon receipt. Once reviewed, bank statements are submitted to the finance department for the Senior Account or designee for reconciliation. Either the CFO or CEO will review and approve reconciliations by signing and dating the reconciliation in the upper right corner of the document.

Authorization and Payment of Invoices

Policy: All invoices must be approved by the department head, which the expense was incurred for. Approved invoices will be paid within 30 days of receipt.

Procedure: Invoices and bills will be opened and reviewed by the Fiscal Manger or the Senior Fiscal Associate. A Deputy Director or the Controller will be notified of any unexpected or unauthorized expenses. Invoices are then routed to the appropriate department head for authorization prior to payment being issued. If the expense is greater than $300 and was not authorized through the purchase order system, either the Executive Director or Deputy Director must also approve the expenditure. Copies of all invoices paid will be filed in the finance department. After two years these documents will be archived and they will not be destroyed.

Petty Cash

Policy: Two Project Coordinators and the Office Manager will keep a petty cash box not to exceed $100. Petty cash will be used primarily to purchase office supplies, snacks, delivery tips etc. Petty cash will be kept in a lockbox that is locked in a cabinet. Keys to the cash box and cabinet should be kept on the custodian's person.

Procedure:

- The petty cash custodians will be given $100 to be kept in a lock box locked in their desk.
- When cash is used a record must be entered in the individuals petty cash spreadsheet

- Receipts for all purchases need to be kept in the lock box.
- When cash is low the custodian will submit a check request form signed by their supervisor with a print out of the tracking spreadsheet and all receipts.
- A check will be cut in the amount to bring petty cash back to $100. It is the custodian's responsibility to cash the check and keep track of funds in the box.

Appendix F: Internal Controls for Paying Bills

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

- All disbursements, except petty cash, should be by pre-numbered check.
- Voided checks should be preserved and filed after mutilation.
- No checks should be made payable to “cash.”
- No checks should be signed in advance.
- A cash disbursement voucher should be prepared for each invoice or request for reimbursement. The voucher should show check date, check number, payee, amount, description of account to be charged, authorization signature, and accompanying receipts.
- Authorized persons should approve all expenditures in advance.
- Signed checks should be mailed promptly.
- The check signer should review the cash disbursement voucher for each amount for proper authorization and supporting documentation of expenses.
- Invoices should be marked “paid” with the date and the amount of the check.
- Requests for reimbursement and other invoices should be checked for mathematical accuracy and reasonableness before approval.
- The cash disbursement journal should be prepared monthly with details of checks written (number, payee, amount, and description of expense account to be charged).
- Check-signing authority should be vested in persons at appropriately high levels in the organization. The number of authorized check signers should be kept at a minimum.
- Checks over a certain amount require two signatures.
- Bank statements and cancelled checks should be received and reconciled by someone other than the person who authorizes expenditures and signs the checks.
- Unpaid invoices should be kept in an unpaid invoice file. A list of unpaid invoices should be prepared and reviewed periodically.
- Someone other than the person(s) who approves the invoices for payment should review invoices from unfamiliar or unusual vendors.
- Payments should be promptly recorded in accounts payable register to avoid double payments.
- If purchase orders are used, pre-numbered purchase orders should be used with all transactions.
- Advanced payments to vendors and/or employees should be recorded as receivables and controlled in a manner that assures, they will be offset against invoices or expense vouchers.
- Employees should be required to submit expense reports for all travel-related expenses timely.

Appendix G: Timesheets and Time Study Guidance

Charges to the City for salaries and wages must be based on records that accurately reflect the work performed. Contractors have the option of using functional timesheets or conducting regular time studies to appropriately allocate staff time to programs. Although the City allows time studies, contractors should also understand the requirements of other funders. For example, some City funds may be a pass-through of federal funds. The Office of Management and Budget (OMB) Uniform Guidance for federal funding is open to interpretation and nonprofits should ask their funding department(s) if the funding source requires timesheets.

The City does not require that its nonprofit contractors prepare detailed reports that have specific time increments, but it does need to know the total hours worked, including paid time off, by employees paid using any City funding, in what cost objective(s) each funded employee worked (i.e., program or funding source) for the invoice period.

Timesheets should be:

- Prepared monthly or more frequently
- Represent actual time and effort (i.e., prepared after-the-fact and by program staff)
- Distributed by programs or funding sources
- Encompass all activities performed by employee (i.e., account for 100% of an employee's time, including paid time off)

An example of a functional time sheet might look like the table below:

Week of January 1	Program A	Program B	Paid Time Off	Total Time (100%)
Monday	8			8
Tuesday	4.5	2.5	1	8
Wednesday	5	3		8
Thursday			8	8
Friday	2.75	5.25		8

Tips for time studies:

- Employees should track their time in 30-minute increments by program for at least two weeks or up to one month.
- The contractor should choose a period of time to study that is representative of how staff members spend their time. Do not choose a time period when a large event is occurring or other activity that is not representative of how time is normally distributed.

- Agencies should conduct time studies on a regular basis. The frequency should depend on the variability of activity within the agency. If staff activities remain constant throughout the year, time studies can occur annually. If there is a significant event that may impact how staff members spend their time, or if there are consistent or seasonal changes in work duties, then time studies should occur once per quarter.
- Management should provide a uniform format for all employees conducting time studies. A simple solution to time studies is a uniform Excel spreadsheet that each staff member uses to document time (e.g., similar to the functional time sheet example above).
- There are also free online tools or phone-based applications that can support an agency to track time within programs or funding sources. Some online sources include Toggl, PACO, or Harvest. A web search may identify additional tools online.

Appendix H: Government Resources

US INTERNAL REVENUE SERVICE

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

- For the current ***Form 990 and 990EZ, Return of Organization Exempt from Income Tax,*** go to: www.irs.gov/eo and type "990" in the "Search Forms and Publications" search box. You may also call (866) 816-2065 (toll free). Note that ***Form 990 or 990EZ,*** must be filed within 4 ½ months after the end of the fiscal year.
- To file for an employer identification number (EIN) and for comprehensive tax information, including applying for tax exemption for nonprofit organizations, forms and other resources, go to http://www.irs.gov or call (866) 816-2065.
- Also, for complete information on tax status and reporting requirements for nonprofit organizations, see the IRS publication 557, "Tax Exempt Status for Your Organization" at the following website: http://www.irs.gov/pub/irs-pdf/p557.pdf
- The IRS website's special area for exempt organizations at https://www.irs.gov/charities-and-nonprofits has tax information for nonprofit organizations

US OFFICE OF MANAGEMENT AND BUDGET

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

Federal government documents can also be obtained from:

Superintendent of Documents
U.S Government Printing Office
P.O. Box 371954 Pittsburgh, PA 15250-7954
Order desk telephone: (202) 512-1800
Order desk fax: (202) 512-2250

The following OMB documents affect nonprofit organizations receiving federal grants:

- OMB Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards ("Uniform Guidance") imposes administrative requirements for nonprofit organizations receiving federal grants (awards). It also provides guidance for determining the allowability of costs for federal grants. It establishes audit requirements for entities that receive federal awards.
- OMB Uniform Guidance increased the dollar threshold used to determine when a single audit or program-specific audit is required for fiscal years beginning after October 1, 2024.

- The Single Audit Act of 1984 is the federal statute that requires audits of entities receiving federal awards over a certain dollar amount.
- The Single Audit Act Amendments of 1996 increased the threshold for when a single audit or program-specific audit is required for fiscal years beginning after June 30, 1996.
- OMB Compliance Supplement explains how to determine which compliance requirements are applicable to a federal award. In July 2016, OMB released an updated edition of the Compliance Supplement that added two new federal programs and removed two compliance requirements from the standard list of such requirements: Davis Bacon (formerly compliance requirement D) and Real Property Acquisition and Relocation Assistance (formerly compliance requirement K).

CALIFORNIA FRANCHISE TAX BOARD

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

- California tax forms and information can be obtained by going to www.ftb.ca.gov or by calling (800) 852-5711 or (800) 338-0505. Note that Form 199, Exempt Organization Annual Information Return, must be filed within 5 ½ months after the end of the fiscal year, as must Form 109, Exempt Organization Business Income Tax Return.
- On the state exemption, see the Franchise Tax Board publication, "Exempt Organizations" at the FTB's California Taxes Information Center at http://www.taxes.ca.gov/exemptbus.html
- Another Franchise Tax Board publication, "Overview of Exempt Organizations," summarizes tax-filing requirements for California nonprofits and discusses differences between state and federal requirements. This publication can be obtained at the website: https://www.ftb.ca.gov/forms/misc/927.html
- You may reach the Franchise Tax Board at:

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

CALIFORNIA TAX SERVICE CENTER

The California Tax Service Center Publication 18, "Nonprofit Organizations (Publication 18)," contains comprehensive sales and use tax information for various types of nonprofit organizations. The publication describes in detail what types of sales by nonprofit organizations are exempt from taxation. Go to the CTSC Website at: https://www.cdtfa.ca.gov/formspubs/pub18.pdf.

CALIFORNIA EMPLOYMENT DEVELOPMENT DEPARTMENT

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

CALIFORNIA SECRETARY OF STATE

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

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

For further information, contact:

Secretary of State
Statement of Information Unit
1500 11th Street
Sacramento, CA 95814
Telephone: (916) 657-5448
Website: www.sos.ca.gov
Filing fee: $20

CALIFORNIA OFFICE OF THE ATTORNEY GENERAL–REGISTRY OF CHARITABLE TRUSTS

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

- There are two required forms, the CT-1 Registration Form for registration of a new organization, and the RRF-1 Registration/Renewal Fee Report, which must be filed annually within 4 months and fifteen days of the end of an organization's accounting period.
- In September 2004, the California legislature enacted a new law that amended various existing laws relating to charitable organizations. The law (Senate Bill 1262) contains numerous provisions relating to registration, reporting and auditing requirements for organizations and individuals soliciting funds for charitable purposes. For information, contact the California Office of the Attorney General at the websites below:
  - https://oag.ca.gov/charities Also, for comprehensive legal information about nonprofit organizations in California, see "Attorney General's Guide for Charities" at https://www.oag.ca.gov/system/files/media/Guide%20for%20Charities.pdf. Also, see the supplement to this guide at https://oag.ca.gov/charities/publications The California Attorney General may also be reached at:

Office of the Attorney General– Charitable Trusts 455 Golden Gate Avenue, #11000 San Francisco, CA 94102-3664 Telephone: (415)703-5500	Or	Office of the Attorney General– Charitable Trusts 1300 I Street, Suite 1101 P.O. Box 944255 Sacramento, CA 94244-2550 Telephone: (916) 445-2550

FISCAL MONITORING PROGRAM SPOTLIGHT
During fiscal monitoring, the City checks whether a nonprofit is in good standing with the California Attorney General Registry of Charitable Trusts.

CITY AND COUNTY OF SAN FRANCISCO ETHICS COMMISSION

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

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

Appendix I: Sample Board Handbook Contents

A comprehensive Board Handbook may include some or all of the following information.

Corporate and historical documents • Description of programs and constituencies • Annual report • Bylaws and amendments • Articles of incorporation • History of the organization • Brochures and other descriptive materials • Strategic and annual plan, including an up-to-date mission statement **Rosters** • Board members, including occupations and other information • List of committees and membership • Resume of the executive director • Names, titles and telephone extensions of staff • Organization chart **Calendar** • Dates of meetings for upcoming year and special events • Dates for Board review of financial documents (should be frequent) and program goals • Date for Executive Director performance review	**Responsibilities** • Board member contract and/or job description for board members • Conflict of interest policy • Conflict of interest statement (two copies pre-signed by the board president, one copy to be signed by the new board member and returned) **Financial information** • Current budget • Current financial statements • Audit report from previous year • Copy of insurance policy certificate for Directors and Officers (D&O) insurance • List of funders and individual contributors • Proposed Board of Directors fundraising plan for fiscal or calendar year **Working tools** • Membership application forms for membership organization • Contribution response envelope • "Talking points" for making the case for donor solicitation • Other promotional material

Appendix J: Sample Public Access Policy

Sample Nonprofit Contractor Policy Regarding Public Access

As a contractor receiving at least $250,000 in public funds from the City and County of San Francisco, it is the policy of this organization to comply with San Francisco Administrative Code Section 12L, the Nonprofit Public Access Ordinance.[5]

[Agency] will comply with the Nonprofit Public Access Ordinance in the following ways:

I. Public Access to Meetings (per SEC. 12L.4)[6]

The [Agency] Board of Directors will designate and hold at least two public meetings per year. Issues addressed by the Board at these designated meetings will be of approximately the same general nature and significance to the agency as those addressed at regular or special meetings.

Unless otherwise specified through actions of the Board of Directors, [*Example:* the May and December regular meetings of the Board of Directors have been designated as public each year]. If either public meeting does not achieve a quorum, the Board of Directors will designate a subsequent meeting as public. The policies in the sections described below will apply to all designated public meetings.

A. Closed Sessions

It will be the policy of this agency that the Board of Directors will have the discretion to close a portion of a designated public meeting when:

- Discussing any matters pertaining to the particular recipients of services or donors to the agency when the discussion would necessarily reveal the identity of the clients or donors.
- Discussing any matters pertaining to litigation; real estate negotiations; the appointment, employment, evaluation of performance, or dismissal of an employee of the nonprofit organization; labor negotiations in which the nonprofit organization is involved.
- Hearing complaints or charges against an employee of the nonprofit organization.
- Discussing attorney-client privileged information, or information which constitutes a trade secret.

B. Public Comment

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[5] See http://www.sfbos.org/index.aspx?page=5553 for full text

[6] Nonprofit organizations engaged primarily in the provision of abortion counseling services, domestic violence sheltering services, or suicide prevention counseling services are exempt from SEC12L.4(a)(1) requiring public access to meetings.

At every designated public meeting, the public will have an opportunity to directly address the Board of Directors on any item of interest to the public relating to the operations of or services provided [Agency]. One or both of the meetings will include an agenda item for public comment regarding membership on the Board.

C. Notice

[Designated staff position] will provide the public with notice of each designated public meeting at least 30 days in advance of the meeting. The notice will include the date, time, and location of each designated public meeting. [Designated staff position] will send the notice to the Clerk of the Board of Supervisors (Board.of.Supervisors@sfgov.org) and to the San Francisco Main Library Government Information Center (sfdocs@sfpl.org) by 4:00 pm on the date the notice must be posted to meet the 30-day requirement.[7] Requests for meeting information by members of the public will be referred to [Designated staff position], who will provide the date, time, and location of the designated meeting. [Designated staff position] will retain a copy of the sent emails noticing both public meetings with the Board of Supervisors and the Public Library for at least one year. These will be used to show proof of compliance with the San Francisco Administrative Code during any annual contractual fiscal and compliance monitoring that may occur.

II. Public Access to Records (SEC. 12L.5)

A. Disclosure of Financial Information

It is the policy of this organization that the following financial information will be available for public inspection and copying:

- Most recent budget as already provided to the City in connection with contract applications or renewals.
- Most recent filed State and federal tax returns (except to the extent the returns are privileged).
- Any financial audits and/or performance evaluations performed by or for the City pursuant to our contract(s) with the City, as long as
    - We have such documents in our possession
    - We are allowed to disclose the information in the documents per our contract with the City, and
    - The information relates to performance under contract within the past two years.

Disclosure of any financial information requested by a member of the public outside of these parameters will be at the discretion of the Executive Director.

It will be the policy of this agency that [designated staff position] will prepare a packet of financial information annually, to be stored in the administrative office of [Agency]. Requests for the financial

[7] See https://sfpl.org/sites/default/files/2024-04/SFnonprofit_factsheet_2024.pdf for posting information.

information by members of the public will be directed to [designated staff position], who will make the packet available to the requesting party within 10 days.
The packet will be available for inspection at [address of administrative location] during normal business hours, which are [8:00 am – 5:00 pm, Monday through Friday, excepting national holidays].
If the member of the public requests the packet by photocopied or mailed, [designated staff position] will collect $0.10 per page to be photocopied and/or the cost for first class mail in advance of complying with the request and will supply or mail the packet within 10 days of receipt of funds.

B. Dispute Resolution

Grievance by a member of the public related to public access to records will be managed by [designated staff position], who will forward such grievances to funding City agencies. If necessary, we may choose to seek an advisory opinion from the Sunshine Ordinance Task Force.

C. Donor Confidentiality

It is the policy of this agency that disclosure of financial information that reveals the identity of any donors or amounts or nature of individual donations will be at the discretion of the Executive Director.

III. Community Representation (SEC 12L.6)

It is the policy of this agency to make good-faith efforts to promote the membership to our Board of Directors at least one person who is a recipient of our services or member of the community we serve. We will take the following actions toward this purpose:

- Distribute/post notice of vacancies on the Board of Directors in client-oriented settings or client-directed newsletters.
- Provide an opportunity for members of the public to propose him/herself or another person for nomination for appointment to the Board at one designated public meeting each year.
- Provide an opportunity for members of the public to comment on membership of the Board at one designated public meeting each year.

Appendix K: Additional Resources

There are far too many websites about all aspects of organizing and managing nonprofit organizations to list here but searching the Internet for information is a primary means for getting answers to just about any question you may have about your organization, so be sure to take advantage of it. Simply searching "nonprofit finance" will yield millions of pages of information.

The Wallace Foundation has partnered with Fiscal Management Associates to create a library of resources to help nonprofit organizations build their fiscal strength. StrongNonprofits.org features more than 60 free tools, "how-to's" and guides for anyone involved in nonprofit financial planning, monitoring, operations, or oversight.

The Controller's Office has aggregated a list of resources on the Monitoring Program's website. The Fiscal Monitoring Resources for Nonprofits page includes manuals and guidance on many of the topics covered here, and also links to City-specific policies and webpages.