Section 5

Your Records

REQUIRED RECORDKEEPING

Requirement #5-A: ***The organization must maintain all of the records described in this section that are considered by the organization to be relevant and material to the proper administration of all of its financial activities. Any deviations or modifications must be justified.***

You will need to maintain four types of records: (1) written policies and procedures such as personnel policies, travel policies, and purchasing policies; (2) supporting documentation such as prenumbered receipts, canceled checks, time sheets, invoices, and contracts, which support the books of account; (3) budgets with supporting documentation such as budget requests and approval notifications; and (4) formal books of account such as journals and general ledgers.

The primary purposes for these records are to assist you with routine internal financial management activities and to assure the reliability and verifiability of your external financial reports. Your independent auditors will review your records annually and provide comments and suggestions in the management report that accompanies the audited financial statements.

Following are suggestions and examples to consider in developing and maintaining your records.

Written Policies and Procedures

Written policies and procedures should express management's position on how certain operational matters should be handled. Such policies and procedures may need to be changed from time to time to adapt to changing needs.

In addition, grants usually contain provisions requiring compliance with additional policies and procedures. For example, most grants from state agencies require compliance with the state's

"Comprehensive Travel Regulations." If your organization relies heavily on grant funding, consider patterning policies and procedures after those required by the grantors.

Personnel Procedures

Written personnel policies should be adopted by the governing board, and a copy furnished to every employee. The document should include your organization's policies regarding all matters concerning personnel. It should address the following:

1. Employment (including orientation, grievance, and termination procedures).

2. Salaries (including who can authorize salary increases, how often salaries can be changed, merit raises, overtime, and compensatory time).

3. Benefits:

    a) Group insurance - how much, what kind, the entity's share, employee's share, who authorizes plans, who is included or excluded.

    b) Retirement plan - how much, what kind, entity's share, employee's share, vesting, administration.

    c) Sick leave - how accumulated, rate of accumulation, definition of sick leave upon termination.

    d) Annual leave - how accumulated, rate of accumulation, how small a unit can be taken, notice required before taking, amount paid on termination, maximum amount that can be accumulated.

    e) Administrative leave - military duty, jury duty, emergencies.

    f) Other leave - maternity or paternity, other.

    g) Rights of employee and employer.

4. Travel:

    a) Approval required in region, out of region.

    b) Rate of mileage reimbursement, air fare, per diem, who is reimbursed, how, travel advances, documentation required.

5. Any other policies concerning personnel.

Purchasing Procedures

Purchasing procedures establish the authority and mechanics required in purchasing for your organization's operation. The purpose is to establish guidelines and regulations governing the purchase of supplies, equipment, contractual services, and other items, to ensure that funds are expended in accordance with an approved budget and management's wishes, with consideration of the availability of funds to pay for such purchases, and in compliance with relevant laws and regulations.

Purchasing policies and procedures may encompass, but are not limited to, the following items and policies.

1. Initiation of Purchase: Any staff member authorized by your chief executive or designee may initiate a purchase. When a purchase is initiated, a standard requisition, or a memorandum describing the type of item and quantity desired, is prepared and signed by the staff member initiating the purchase.

2. Authorization of Purchase: Staff members may make direct purchases of items when the total cost does not exceed a prescribed limit. When items may cost more than the prescribed limit, the chief executive or designee must give advance approval of the acquisition. All requisitions, regardless of amount, should be submitted to the chief executive or designee. Orders totaling less than the prescribed limit may be submitted after the order is placed.

3. Qualification of Vendors: All vendors providing supplies, equipment, or services should be reputable firms having demonstrated capacity to produce or provide supplies, equipment, services, and other items within a reasonable time or within specific time limits established by the purchaser. Vendors should be subject to disqualification if they misrepresent quality, quantity, or price of what is being purchased. Vendors that exceed reasonable time limits should also be disqualified.

4. Selection of Vendors: Whenever possible, select qualified vendors on the basis of three price quotations or competitive bids. Secure competitive bids for all items exceeding a prescribed limit in unit cost and for aggregate orders exceeding a prescribed limit. Solicit price quotations from qualified vendors for items for which unit cost exceeds a prescribed limit. Under certain circumstances supplies, equipment, services, or other items may be purchased without bids or quotations. Quotations may not be necessary if a qualified vendor is the sole source of the items to be purchased, or, in cases of emergency, when immediate delivery is necessary for the entity's continued provision of adequate services.

   All sole-source purchases should be reviewed by the chief executive or designee. In any event, the chief executive should be apprised of any sole-source purchase as soon as possible. A written memorandum explaining all emergency purchases and all other sole-source purchases exceeding an amount determined by management should be attached to the file copy of the purchase order.

5. Purchase orders: Make all purchase orders (except when specific exceptions are permitted) by submitting consecutively numbered purchase order forms to vendors. The exceptions include contracts for professional services (where the

contracts serve as detailed documentation), bills for utilities and office rental, and emergency telephone orders. Prepare requisitions or memorandums for emergency orders, travel claims, books, subscriptions, postage, proprietary fees and permits, and similar expenses. They should be approved in advance by the chief executive or designee. After approval, the telephone order or emergency purchase should be made by a person authorized by the chief executive to make emergency telephone orders or purchases.

Fill out every purchase order in triplicate. It should show the date, name of vendor, type, quantity, price of supplies and equipment, and other items to be purchased. A staff member officially designated to sign purchase orders should sign each order. Submit the original to the vendor. File the first copy numerically; it constitutes an official authorization for disbursement after the order has been satisfactorily filled.

a) Receipt of supplies and equipment should be certified by a staff member who has been assigned responsibility for receipt of all purchased items. Deliveries should be compared against the second copy of the purchase order and packing slip or invoice and should be examined for conformance to specifications in the order. The packing slip or invoice and the second copy of the purchase order should be signed if the delivery conforms to the purchase order. (If the invoice does not accompany the delivered goods, the signed packing slip should be compared to the invoice prior to the invoice being approved for payment.) The invoice, requisition, and second copy of the purchase order should be filed in invoice date order, alphabetically by vendor name.

b) Match billings with the signed invoice, purchase order or requisition. Examine the billing to ensure that the amount requested for payment matches cost, types, and quantities shown on the signed invoice(s).

c) The chief executive or designee should review the invoice, purchase order, requisition, and billing, and certify as to qualification for payment. No invoice or bill should be paid without such certification.

d) Purchase orders are not required for utility services (telephone, gas, electricity) or for rental payments. Bills for these services should be reviewed by the appropriate official and paid in accordance with standard procedures for disbursement of funds. However, retain copies of all bills received for rent and utilities and file them chronologically, by vendor, or by expense category for no less than three years.

6. Disbursement of funds: Upon proper certification of invoices and bills, make disbursements in accordance with your standard procedures for the issuance of checks and vouchers.

Supporting Documentation

Present supporting documentation to justify each journal entry. In most cases, staff members should use preprinted sequentially numbered forms, and written policies concerning the use of the forms should be established.

Following are examples of supporting documentation:

All journals and ledgers
Annual financial reports with working papers
Annual program reports, including statistics, with working papers
Bank reconciliations
Bank statements
Board of directors meeting minutes
Checks
Contracts
Contributor transmittals
Correspondence
Cumulative leave records
Deposit slips
Donor pledges
Donor restrictions
Fixed assets inventory listings
In-kind vouchers
Inventory count sheets
Invoices
Journal vouchers
Leave requests
Petty cash count sheets
Petty cash receipts
Petty cash reimbursement requests
Prenumbered cash receipts
Purchase orders
Support for sole source decisions
Telephone logs
Time sheets
Travel claims
Written policies

Maintain a current roster of grant or contract agreements. Include the following information for each grant:

1. Grantor
2. Grant number
3. Title of grant
4. *Catalog of Federal Domestic Assistance* number

5. Period covered
6. Approved budget (latest revision)
   a) Grantor share
   b) Matching share
      1) Cash
      2) In-kind
7. Purpose of grant

Keep a file on each grant. The file should contain at least the following items:

1. Grant agreement, including grant budget
2. All grant agreement amendments
3. Copy of periodic financial reports
4. Copy of close-out report
5. Other pertinent information (e.g., correspondence, monitoring reports)

Keep information on in-kind contributions and matching requirements by grant in separate file folders, as necessary.

Budgets

Budgets are a basic part of the financial management of a multifunded entity. Through budgeting, your organization decides in advance how it (a) wants to spend its resources or (b) proposes to spend the resources of others.

Your annual budget is not only vital to proper planning and control but also usually serves as the basis for developing the cost allocation plan.

Comparisons of actual expenses to the approved budget are a routine part of internal and external reporting.

Develop separate budgets for each grant for which application is made. Such budgets often do not have the same fiscal period as your organization's fiscal year. A grantor agency may require that its own form be used when budgets are submitted. This manual will not attempt to discuss the various types of grantor budgets, but be sure to provide information within your accounting system to satisfy the reporting requirements of your various funding sources.

In preparing your overall budget, review all actual expenses of the prior year, consider any anticipated changes in allocations for revenues and expenses for the coming year, and develop an annual budget for all anticipated programs.

Develop this total budget by object code (line item) and also by programs, management and general, and fundraising.

For each anticipated grant prepare a line-item budget or follow the grantor's guidelines. Include all locally funded projects.

If you have an indirect cost rate approved by all grantors, you need not list budgeted indirect costs by line item but may list them in total with the applicable approved indirect cost rate. For informational purposes only, enclose a schedule listing applicable indirect costs by individual line item.

When a cost allocation plan is used, allocate all common costs, regardless of whether such costs are allowable under a grant or exceed a grantor's prescribed funding percentages or budgets. The allocation must be done on a reasonable basis and must be supported by adequate documentation.

For grants with a grant period covering two fiscal years, present the budget information pertaining to the current budget year and the next year.

Formal Books of Account

The following accounting records (formal books of account) are also discussed in Your Accounting and Reporting System, Section 2 of this manual. Formal books of account include:

1. Cash Receipts Journal - This journal should contain a separate entry for each receipt of money. Entry sources for this journal are duplicate prenumbered cash receipts and deposit slips.

2. Cash Disbursements Journal - This journal should contain a separate entry for each check issued. Costs for each object and functional expense classification should be summarized and posted to the appropriate general ledger account at the end of each month. See 7, below.

3. General Journal - Use this journal to record transactions such as depreciation, allocations of payroll expense, and indirect costs.

4. Payroll register - Use this register to record each payroll check and provide the proper distribution of amounts withheld from employees' wages.

5. In-kind Receipts Journal - Record the receipt of in-kind contributions in this journal. Such contributions must be properly documented to show the basis of valuation and their relation to the program.

6. General Ledger - Maintain one general ledger to summarize all accounts. You may use any standard ledger form that has debit, credit, and balance columns. The chart of accounts in Section 3 includes the general ledger accounts most commonly used. An account is a device used to record and summarize increases and decreases in assets, liabilities, net assets, revenue, and expenses.

7. Subsidiary Ledgers as needed - To avoid an unmanageably large number of general ledger accounts, you can group similar accounts and summarize them in the general ledger as one account. Such a combined general ledger account is called a "control account." The detailed records on the individual accounts of a control account are maintained in a separate set of records known as **subsidiary ledgers**. Accounts receivable, accounts payable, and payroll are some of the most frequently used subsidiary ledgers.

You should have a deferred revenue control account with a subsidiary ledger for each government contract your organization is awarded. For each donor restricted grant or contribution you organization receives, you will need a separate net asset control account. For examples of the use of control accounts, refer to Section 3.

Since GAAP now requires not-for-profit organizations to report expenses functionally for program, management and general, and fundraising, you may want to establish control accounts with subsidiary ledgers for each major function. Note that, for GAAP reporting, voluntary health and welfare organizations are still required to present such functional expenses in a matrix with object expenses in a separate financial statement (AICPA Audit and Accounting Guide: *Not-for-Profit Organizations*, AAG-NPO 3.14). Other nonprofits are encouraged to do so.

Section 6

Your Internal Controls

INTERNAL CONTROL REQUIREMENTS

Requirement #6-A: ***The organization must maintain the internal controls described in this section which are considered to be relevant and material to the proper administration of all financial activities. The organization must also maintain controls that are considered by the organization or regulatory bodies to be relevant and material to the proper administration of all financial activities.***

You need to establish and maintain sound systems of internal control in two categories: (a) administrative controls, including those used in the administration of assistance programs, and (b) accounting controls.

Administrative controls include, but are not limited to, the plan of organization and the procedures and records concerned with the decision process leading to management's authorization of transactions. Such authorization is a management function directly associated with responsibility for achieving your organization's objectives. It is the starting point for establishing accounting control of transactions.

The objectives of internal control systems used in administering financial assistance programs are to provide management with reasonable, but not absolute, assurance that, in your organization's program: (1) resource use is consistent with laws, regulations, and policies; (2) resources are safeguarded against waste, loss, and misuse; and (3) reliable data are obtained, maintained, and fairly disclosed in reports.

Study each grant agreement and grantor guidelines to determine what administrative controls are appropriate for the grant. Most grants require certain standard administrative controls. Some grants also require specific administrative controls to ensure compliance with guidelines.

Some examples of administrative controls that relate to grant accountability are:

1. procedures to deter or detect expenses related to political activity;
2. independent review of participant eligibility determinations;
3. monitoring cash flow to ensure that recipients and subrecipients draw down funds on a timely basis and avoid excessive balances or deficits of grant funds;
4. monitoring subrecipients to ensure that weaknesses and noncompliance are promptly corrected; and
5. determining that construction contracts contain provisions to ensure compliance with the Davis-Bacon Act;
6. ensuring that only allowable expenses are charged to grants.
7. the reporting package required by OMB Circular 1-33 is prepared and submitted.

Accounting control is concerned with the plan of organization and the procedures and records that relate to the safeguarding of assets and the reliability of financial records. Controls should provide reasonable assurance that:

1. transactions are executed in accordance with management's general or specific authorization;
2. transactions are recorded (a) to permit preparation of financial statements in conformity with GAAP or any other criteria, such as the instructions for IRS Form 990, and (b) to maintain accountability for assets;
3. access to assets is permitted only in accordance with management's authorization; and
4. the recorded accountability for assets is compared with the existing assets at reasonable intervals, and appropriate action is taken with respect to any differences.

Accounting controls may be classified into several transaction cycles. Basic cycles include: the revenue cycle, the expense cycle (payroll and purchasing cycles are presented separately in the following discussion), and the reporting cycle.

Review these transaction cycles and determine which apply to your organization. You may also find it necessary to implement additional internal control procedures not listed here.

REVENUE CYCLE

Control Objectives

1. All revenues are received at the proper time.

2. All collections are promptly recorded and deposited.

3. All revenues are properly allocated to the appropriate accounts and funds.

4. In-kind donations are recorded and valued properly.

5. Reported amounts for support related to donated services, facilities use, and materials have been received and meet the criteria of generally accepted accounting principles.

Potential Errors

1. Assessments are incorrectly computed.

2. Notices of amounts due are not sent out on time.

3. Receivables are not recorded.

4. Recorded receivables are not collected.

5. Amounts received are diverted to personal use.

6. Amounts received and/or names of payers are incorrectly recorded.

7. Receipts are not deposited in the entity's bank account.

8. Deposits are not made on a timely basis.

9. Receipts and deposits are not recorded promptly.

10. Receipts are allocated to the wrong accounts or funds.

11. Amounts recorded in specific accounts are incorrect.

12. In-kind is not recorded based on generally accepted accounting principles (GAAP in-kind).

13. In-kind allowable for matching purposes and encouraged to be reported in the notes to the financial statements (non-GAAP in-kind) is not accounted for.

14. The value assigned to in-kind donations is not reasonable.

Controls

1. Staff is competent and well trained.

2. Supervisors recompute amounts on a sample basis.

3. Internal audit unit recomputes amounts on a sample basis.

4. Policy and procedure manual sets forth detailed requirements for revenue collection.

5. Overdue receivables are investigated and any necessary action is taken.

6. Payers write name of the recipient on the check and do not send cash.

7. Incoming checks are immediately restrictively endorsed.

8. Prenumbered receipts (cash register receipts) are issued to document each collection.

9. The cashier uses a cash register.

10. The employees whose duty it is to receive cash prepare a list of all receipts.

11. The following duties are not performed by the same individual: receiving cash, making deposits, and maintaining the accounting records.

12. Deposits are reconciled with the list or tape of cash receipts by a person independent of the receiving and recording functions.

13. Collections of receivables are reconciled with the accounts receivable subsidiary ledger by a person independent of the receiving and recording functions.

14. Write-offs of uncollected accounts receivable are approved by someone external to the cash receipts and accounts receivable functions (FASB Statement No. 78).

15. Bank reconciliations are prepared regularly and reviewed by someone independent of the receiving and recording functions.

16. Sales and shipments are recorded on prenumbered documents, and all such documents are accounted for.

17. Funds billed to grantors are subsequently reconciled with amounts received by a person independent of the receiving and recording functions.

18. Prenumbered receipts are issued every time cash changes hands.

19. Independent reconciliations of expected collections to actual collections are performed for revenue sources, where practical (i.e., expected revenue based on items sold to actual).

20. In-kind donations are recorded and a receipt issued to the donor for tangible property donations.

21. Documentation supporting volunteer services is maintained, preferably time sheets or invoices.

22. In-kind donations and volunteer services which are not subject to recording for financial statement purposes are segregated from those which are recorded in the financial statements.

23. Management should review in-kind records to determine that in-kind valuations are reasonable.

24. Records of non-GAAP in-kind are adequate for note disclosure and grant purposes.

PAYROLL CYCLE

Control Objectives

1. The number of employees in each classification does not exceed the number of authorized positions.

2. Payroll expenses are within the budget authorization.

3. Employees are paid the correct amount for work performed.

4. Deductions and net pay are computed correctly.

5. Payroll-related liabilities are accrued and evidenced properly.

6. Payroll costs are allocated to the correct fund or program.

7. Payroll expenses are recorded correctly.

8. Amounts recorded for donated services in accounting records are accurate and supported by adequate documentation.

9. Amounts reported on financial statements for donated services meet the criteria of generally accepted accounting principles for reporting.

Potential Errors

1. Too many persons are hired.
2. Duplicate payments are made.
3. Employee time sheets are not kept accurately.
4. Employees are paid for work not done.
5. Payroll expenses exceed the budget authorization.
6. Employees are overpaid or underpaid; deductions are incorrect.
7. Paycheck is not received by the correct employee.
8. Paycheck is issued to fictitious employee.
9. Vacation and sick leave records are in error.
10. Payment amount is recorded incorrectly.
11. Payroll is recorded in wrong fund or program.
12. Payment is recorded for wrong period.
13. Donated services are not recorded, or recorded amounts are misstated.

Controls

1. Management verifies the availability of positions before approving appointments.
2. Cumulative payroll disbursements are compared to the budget authorization.
3. Payroll computation for new employees and changes in deductions for existing employees are calculated by one person and recalculated by another.
4. Attendance records, time sheets, or time cards are signed by the employee, approved by a designated person, and submitted to the payroll department where the records are used to compute payroll. For volunteers, time sheets or other records are maintained substantiating the date of service, nature of service, and time.
5. Approval by a designated person is required for all overtime.
6. Payroll checks are distributed by an employee who is independent of the personnel department.

7. The distributor of payroll checks requires identification from any employee not personally known to him or her.

8. Sick leave and vacation records are reviewed periodically by both the supervisor and the employee.

9. The payroll checking account is reconciled with the payroll expense account.

10. There is an established, approved policy for the recording, valuing, and reporting of donated services.

11. There are established procedures for the supervision of volunteers.

12. Records are maintained of the value attributed to donated services.

PURCHASING CYCLE

Control Objectives

1. Purchases are properly authorized and do not exceed budgetary or contractual constraints.

2. Goods and services ordered are appropriate to the purpose and function of the department, program, or grant.

3. Goods and services ordered are actually received, and all goods and services received have been ordered.

4. Invoices for goods and services are correct.

5. Purchase amounts are recorded in the proper funds, programs, and fiscal years.

6. Disbursements for purchases are supported by adequate documentation.

7. Checks or warrants are drawn for the correct amount and made out to the proper payee.

8. Expenses related to donated services, facilities use, and materials are reported in accordance with generally accepted accounting principles.

Potential Errors

1. Goods or services are ordered that are of no use to the entity or its programs.

2. Goods or services are ordered in excessive quantities.

3. Goods or services are ordered but not received.

4. Purchase is recorded but goods or services are not received.
5. Goods or services are overpriced.
6. Invoice does not match goods and services received.
7. Invoice has incorrect prices and extensions.
8. Invoice amount is incorrectly recorded.
9. Purchase is allocated to the wrong fund or program.
10. Payment is for wrong amount and/or to wrong vendor.
11. Invoice is paid twice.
12. Disbursement is not recorded.
13. Purchases are made for personal benefit/use.
14. Expenses for in-kind are not recorded.

Controls

1. All requisitions are properly approved by management.
2. The availability of funds is determined before requisitions are approved.
3. Prenumbered purchasing forms are used, and blank forms are under the control of the purchasing officer.
4. Competitive bids are required for larger purchases.
5. The receiving department fills out a receiving report or signs a bill of lading.
6. Invoice prices are compared to order prices, and invoices are checked for mathematical accuracy.
7. When payment is made, the invoice is canceled to prevent duplicate payments. Also, notations of the check number and account distribution are made when appropriate.
8. The invoice is compared to the purchase order and the receiving report before payment is approved.
9. All checks should be signed by two authorized individuals. Checks should not be signed before they are completed.

10. Blank checks and check-signing machines are protected from unauthorized use. A check protector should be used by organizations which write 50 or more checks each month. A check protector helps reduce the possibility of a check being altered without detection.

11. To the extent possible, the following duties are not performed by the same person: approving requisitions, preparing purchase orders, receiving goods or services, approving payment, preparing checks, signing checks, and preparing the bank reconciliation.

12. Bank reconciliations are reviewed by someone independent of other cash functions.

13. When in-kind revenue is recorded for donated services, facilities, materials, etc., a corresponding expense (or asset for inventory) is recorded.

14. Records are maintained to determine when in-kind donations of tangible property are used, including inventory and depreciation records.

15. Reliable in-kind inventory records are maintained on a perpetual basis.

16. Eligibility requirements regarding recipients of pass-through in-kind inventory (i.e., food, clothing) are clearly defined.

17. In-kind materials and supplies are adequately safeguarded.

INVESTMENT CYCLE

Control Objectives

1. Acquisition and disposal of investments are properly authorized and in accordance with the organization's investment policies.

2. Investment certificates are received.

3. Acquisition and disposal of investments are properly recorded.

4. Investment certificates and interest coupons are safeguarded.

5. All investment income earned is received and recorded.

6. Investment amounts in excess of Federal Deposit Insurance Corporation coverage are identified in the records on investments.

7. Funds designated for investment by management are recorded as "unrestricted."

8. Funds designated by donor for investment in perpetuity are recorded as "permanently restricted."

9. Investments are in the legal name of the organization.

Potential Errors

1. Acquisition and sale of investments are not authorized.

2. Purchase is recorded, but investment certificate is not received.

3. Purchase is not recorded, or amount is recorded incorrectly.

4. Sale is recorded but payment is not received.

5. Sale is not recorded or the amount is recorded incorrectly.

6. Purchase or sale is classified incorrectly.

7. Investment certificates or interest coupons are lost.

8. Interest coupons are not redeemed

9. Interest is received but not recorded.

10. Matured investments are not cashed.

Controls

1. Purchases and sales are authorized before execution of transaction.

2. Investment purchases are recorded only after receipt of certificates.

3. Cash and investments are reconciled periodically.

4. Securities are kept in a vault with limited access.

5. Securities are released from vault only upon authorization by persons responsible for investment transactions.

6. Duties are segregated for the functions of cash flow management, investment transactions, safeguarding, accountability, and recording.

7. Securities are reviewed and counted periodically and reconciled with the records.

8. Specific procedures are followed for tracking maturing investments and interest payments.

9. Specific procedures are followed for reviewing risks associated with investment amounts above Federal Deposit Insurance Corporation coverage.

FIXED ASSET CYCLE

Control Objectives

1. Property and equipment represent a complete and valid recording of the cost of assets purchased, constructed, or leased, and the fair value of donated assets that should be capitalized in accordance with generally accepted accounting principles, and such assets are physically on hand.

2. Capitalizable costs are excluded from repairs and maintenance and similar expense accounts.

3. Capitalized costs and, if applicable, related depreciation associated with all sold, abandoned, damaged, or obsolete property and equipment have been removed from the accounts.

4. Depreciation has been charged on property and equipment where required by generally accepted accounting principles and has been computed on an acceptable basis consistent with that used in prior periods, and related allowance accounts are reasonable, considering expected useful lives and salvage values.

5. Restrictions on the use or disposition of property and equipment have been complied with, and financial statement presentation and disclosure properly reflect such restrictions.

6. Donated fixed assets are valued and recorded correctly as to account, period, and amount.

7. Property and equipment are properly classified in the financial statements, and disclosures related to property and equipment are adequate.

Potential Errors

1. Property and equipment balances in the general ledger are misstated.

2. Property and equipment are purchased that do not benefit the organization.

3. Purchases that should have been capitalized as fixed assets are expensed.

4. Obsolete assets no longer in use are reported on the entity's statement of financial position.

5. Computed depreciation amounts are not representative of the actual life and salvage value of the asset.

6. Computed depreciation amounts are miscalculated.

7. Restricted property and equipment are used for purposes other than allowed.

8. Donated assets are not recorded in the accounting records or on the financial statements.

9. Property and equipment are misclassified on the financial statements and disclosures related to property and equipment are inadequate.

Controls

1. Formal approval of the governing board is required for all property and equipment purchased; or items costing in excess of a specified amount require board approval.

2. Designated individuals are responsible for assuring compliance with the terms and conditions of all grants, restricted contributions, exchange contracts, etc.

3. Board approval is required for disposal of property and equipment or collections.

4. The organization has written policies that permit the accounting department personnel to:

   a) Distinguish between capital items and repairs and maintenance expenses.

   b) Determine a cutoff amount below which items are expensed.

   c) Establish depreciable life.

   d) Determine the fair value of contributed property and equipment and collections.

5. Detailed property and equipment and collection records are maintained that include description, date purchased or received by donation, cost or fair value at donation, donor or funding source restrictions on use or disposition, etc.

6. Detailed property and equipment and collections ledgers (for example, cost, accumulated depreciation, and depreciation expense for property and equipment) are reconciled to the control account.

7. Reconciliations between detailed property and equipment ledgers and the control account are reviewed by a responsible person.

8. Depreciation detail is reviewed by a responsible person.

9. At least annually, a physical inventory of property and equipment is taken that is compared with subsidiary records.

   a) Reconciliations are prepared and any discrepancies are immediately followed up and explained.

   b) Reconciliations are reviewed by a responsible person.

10. Equipment and collections are properly identified by numbered metal tags or other means of identification.

11. Fully depreciated assets are maintained in the accounting records to help provide control.

12. Items are adequately safeguarded from loss due to fire, theft, or misplacement.

13. Periodic reviews and appraisals are made relative to insurance considerations.

14. Periodic reviews of the carrying values of property are made to assess whether such values are adequate to be recoverable in the ordinary activities of the organization.

15. There are policies to ensure items considered collections (either capitalized or noncapitalized) meet the definition of a collection.

16. There are procedures to track accessions and deaccessions of collection items.

17. Periodic inspections of collections are made.

18. There are policies to monitor donor restrictions on collections.

19. Collection items are physically safeguarded.

INVENTORY CYCLE

Control Objectives

1. Inventory recorded represents a complete listing of materials, supplies, and items held for use in operations or for sale that are owned by the nonprofit organization,

including donated materials with a determinable fair value, and such assets are physically on hand at the statement of financial position date.

2. Inventory listings are accurately priced, extended, footed, and summarized, and the totals are properly recorded in the accounts.

3. Inventory is valued at lower of cost or market or, for donated items, at lower of fair value at date of donation or market, in accordance with generally accepted accounting principles.

4. Excess, slow-moving, obsolete, and defective recorded inventory is reduced to net realizable value.

5. Inventory is properly classified in the statement of financial position, and disclosure is made of restricted, pledged, or assigned inventory and the methods used to value inventory.

Potential Errors

1. Inventory recorded is incomplete.

2. Inventory listing prices are not accurate and/or extended, footed amounts and totals do not agree with amounts recorded in the accounts.

3. Inventory is not recorded in accordance with generally accepted accounting principles.

4. Obsolete inventory is not removed from the books.

5. Inventory is not safeguarded or insured.

Controls

1. Inventories are adequately safeguarded against loss, theft, physical deterioration, or misuse by being kept in locked enclosures, access to which is granted only to authorized personnel.

2. Responsibilities for quantities are fixed by assigning custody of inventories to specific individuals.

3. Inventories are released from the storeroom only on the basis of written and properly approved requisitions.

4. The individual responsible for receipt, storage, and issuance of goods is independent of responsibility for purchases, sales, and inventory records.

5. Personnel are required to report on obsolete, unusable, and overstocked items, and approval is required before such inventories are disposed.

6. Prenumbered issue slips are used.

7. Perpetual inventory records are maintained, both in dollars and in quantities, and periodically balanced to control accounts.

8. Periodic physical inventories are taken and balanced to the perpetual records.

    a) There are written instructions for such counts.

    b) Material differences are investigated and explained.

9. Adjustments to the inventory record requires approval of management.

10. Procedures are in force that will ensure proper control of items returned to the storeroom, dispositions of scrap, etc.

11. Inventories are covered by insurance, and employees with access to inventories are bonded.

12. Valuation of inventories (including donated inventories) is in accordance with generally accepted accounting principles.

DEBT CYCLE

Control Objectives

1. Debt is authorized.

2. Debt amount is correctly recorded in the proper classification.

3. Proceeds from the incurrence of debt are recorded properly.

4. Cash is available for payment of interest and matured debt.

5. Interest payments are recorded properly.

6. Redemption of matured debt is correctly recorded as to amount and classification.

Potential Errors

Since the potential errors are evident from a review of the listed objectives, a separate list of errors is unnecessary.

Controls

1. The duties of handling and recording debt are segregated.

2. Detailed records for debt instruments are periodically reviewed and reconciled with control accounts by someone other than the person who records the information.

3. Recording of cash is segregated from recording of debt.

4. Interest payments are reconciled with debt outstanding.

5. All debts are authorized by the executive financial officers.

REPORTING CYCLE

Control Objectives

1. The statements are prepared in accordance with GAAP. Specific principles include those related to accrual or modified accrual accounting, as well as inventory valuations and depreciation allocations.

2. If applicable, statements are prepared in accordance with requirements of IRS Form 990, which all NPOs except religious organizations and very small entities must file. IRS Form 990 requirements differ slightly from GAAP.

3. Transactions are properly classified and summarized by account balances, including the classification of net assets.

4. Financial statements are prepared on a basis consistent with that of the previous year. Notes to financial statements call attention to any changes required by changes in GAAP and in IRS Form 990.

5. Financial statements and accompanying notes provide adequate informative disclosures.

6. Adequate procedures exist to provide a clear cutoff of transactions at year end.

7. Adequate control is exercised over the preparation of financial statements.

8. Adjusting entries are properly approved.

Potential Errors

The types of errors that could occur are almost unlimited. The reporting of financial information involves nonroutine activities that are best controlled by more general management controls.

Controls

1. Management is kept informed of changes in GAAP and IRS Form 990 requirements. Managers, especially financial officers, are aware not only of pronouncements of the American Institute of Certified Public Accountants (AICPA) but also of the Financial Accounting Standards Board (FASB).

2. Management requires certification by departments that information submitted is accurate.

3. Compilations are checked by a person other than the original compiler and reviewed by a supervisor.

4. The procedures manual describes in detail the year-end procedures relating to cutoff, inventory, and accruals.

5. Records are sufficiently safeguarded.

6. Nonpermanent (pencil) entries in accounting records are prohibited.

Section 7

Your NPO's External Financial Reports

REQUIREMENTS REGARDING EXTERNAL FINANCIAL REPORTING

Requirement #1-B (from Section 1): ***The organization must use the same policies, procedures, and methods for all accounting, including cost allocation, and for all financial reporting, including grant reporting to State funding agencies, annual reporting to the Tennessee Secretary of State, Division of Charitable Solicitations (including IRS Form 990), and general purpose financial reporting.***

Requirement #1-D (from Section 1): ***The organization must be in compliance with all applicable federal, state, and local laws and regulations including laws and regulations regarding government funding policies, IRS regulations regarding an organization's nonprofit tax exempt status, and State of Tennessee regulations regarding registration and annual reporting with the Secretary of State, Division of Charitable Solicitations .***

At year's end, your organization will prepare most, if not all, of the following financial statements and reports to comply with external reporting requirements:

A. General purpose financial statements prepared in accordance with generally accepted accounting principles (GAAP). **GAAP financial statements** are audited by an independent, licensed certified public accountant (CPA). Refer to Section 8.

B. **Tennessee uniform grant reports** to federal, state, and local government agencies, prepared at year's end or at the end of each grant period. Refer to Section 9.

C. Three basic financial statements for the **IRS Form 990**. IRS Form 990s are required by federal law to be made available to anyone upon request. Refer to Section 10.

D. **Tennessee financial summary** based on IRS Form 990 for the Tennessee Secretary of State's Office of Charities Registration--a one-page form filed annually with a copy of IRS Form 990 and the GAAP financial statements. The financial summary and the IRS Form 990 are required by state law to be made available to anyone upon request. Refer to Section 11.

E. **Single audit reporting package** prepared in accordance with OMB *Circular A-133* (refer to Section 12).

F. Other reporting requirements including grant reports to corporate and foundation resource providers, annual reports to United Ways, and financial reports to regional and national associations with which your organization is affiliated.

The chart of accounts in Section 3 is designed to enable you to account for the financial data needed for all of the above reporting requirements throughout the year. The chart of accounts is cross referenced to the illustrative GAAP financial statements (refer to Section 8), Tennessee uniform grant reports (refer to Section 9), and IRS Form 990 financial statements (refer to Section 10).

The chart of accounts is also consistent with the typical reporting requirements of corporate and foundation resource providers, with the United Way accounting and budgeting guidebooks, and with the accounting manuals of most national voluntary health and welfare organizations.

Most corporate and foundation resource providers require that grant reports use the same expense accounts as those used in budgets submitted with proposals. Obvious problems arise when budgets are not aligned with the organization's chart of accounts. Therefore, it is useful for a not-for-profit organization to establish a policy that the line items or object expense categories used in its chart of accounts will be used with all budgets, including those in grant requests.

The universal functionalized adjusted trial balance in Section 3 demonstrates how the chart of accounts enables you to prepare a single trial balance from which all of the above reports can be produced.

This eliminates costly and possibly inaccurate year-end worksheets and reconstructions for line items, functions, and projects/grants. This also enables you and your auditors to save time and reduce costs by setting up your accounting software to produce financial data for each of these reporting requirements by pressing a button or clicking a mouse.

Standardized Non-Profit Reporting

With the Click of a Mouse

(Hard Copy, Diskette, Internet)