

# **Board and Staff Roles in Financial Management Resource Packet**

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## Red Flags for Board Members

Red Flag	What to Investigate
<p><b>Financial Reports:</b></p> <ul style="list-style-type: none"> <li>• Financial statements not available within one month following each month-end</li> <li>• No Balance Sheet provided for Board members</li> <li>• No distinction made between restricted and unrestricted Net Assets and contributions</li> <li>• No comparison of actual revenues and expenses to the annual budget</li> <li>• No organization wide revenue and expense statement</li> </ul>	<ul style="list-style-type: none"> <li>• Delays in presenting financial statements frequently reflect inadequate staffing of the accounting function. Delays may also be a strategy to deter detection of misuse of funds.</li> <li>• Failure to present the Balance Sheet indicates lack of understanding of the Board's responsibility for ensuring sound financial health. If accounting records are properly maintained, producing the Balance Sheet is not time consuming. Absence of the Balance Sheet may indicate problems with the underlying accounting system.</li> <li>• Board members must be able to determine whether restrictions exist which limit their ability to direct the use of the Net Assets/Net worth.</li> <li>• Comparison of actual revenues and expenses to budget is needed to determine whether the nonprofit's financial plan is working. The comparison of actual to budget is also a key internal control for small organizations, allowing readers to note unusual occurrences which may be indicators of fraud or error.</li> <li>• The organization-wide revenue and expense report is essential for determining overall financial health.</li> </ul>
<p><b>Financial Realities:</b></p> <ul style="list-style-type: none"> <li>• Cash – less cash on hand than is needed to meet one month's expenditures</li> <li>• Liabilities – increasing at a rate greater than the rate of increase in expenses</li> <li>• Negative Net Assets/Net Worth –total assets are less than total liabilities</li> </ul>	<ul style="list-style-type: none"> <li>• The Board needs to be aware of cash flow problems and should expect management to present a plan for addressing them.</li> <li>• Growth in liabilities which is disproportionate to growth in overall expenses may indicate either cash flow problems or financial management problems leading to late payment of bills.</li> <li>• Negative Net Worth means the organization is unable to cover all of its debts and has no reserves to fall back on. The Board should approve an explicit strategy to recover from a negative net worth position.</li> </ul>

Red Flag	What to Investigate
<p><b>Financial Realities, cont.:</b></p> <ul style="list-style-type: none"> <li>• Negative Unrestricted Net Assets</li> <li>• Net Assets are consistently dropping – consistent pattern of Expenses exceeding Revenues</li> </ul>	<ul style="list-style-type: none"> <li>• Negative Unrestricted Net Assets may reflect the use of restricted resources for improper purposes. The Board should approve a detailed strategy to recover from negation Unrestricted Net Assets.</li> <li>• A pattern of losses and the resulting declining Net Assets will weaken the organization and may eventually result in being unable to continue operations.</li> </ul>
<p><b>Board Functioning:</b></p> <ul style="list-style-type: none"> <li>• Board attendance is less than 75% over a three month period</li> <li>• Board officers are frequently absent from Board meetings</li> <li>• Board Chair seems uninformed or unengaged</li> <li>• Board meetings are “rubber stamp” for actions of staff</li> <li>• Executive Committee seems to make all the “real” decisions</li> <li>• Board committees do not meet regularly and seem overly dependent on staff</li> </ul>	<ul style="list-style-type: none"> <li>• Poor Board attendance suggests lack of involvement by Board members.</li> <li>• Absence by officers or lack of engagement by the Board chair may indicate that the Board is functioning as a “rubber stamp” and that officers are not providing meaningful oversight.</li> <li>• Board meetings should include engaged discussions by Board members of significant choices the organization is making. If meetings consist of affirming staff recommendations and actions, the Board is probably not adding much value to the organization.</li> </ul>
<p><b>Board Financial Oversight:</b></p> <ul style="list-style-type: none"> <li>• No independent audit or review</li> <li>• No audit committee or clear use of Board finance committee to function as audit committee</li> <li>• No updated written fiscal policies and procedures</li> <li>• No bonding insurance</li> <li>• No independent bank reconciliation</li> </ul>	<ul style="list-style-type: none"> <li>• Determine why the organization does not have an audit or review. If the organization has over \$1 million in annual expenses, the excuse that audits/reviews “cost too much” is questionable. Without an audit/review, the Board cannot know whether it can rely on the financial reports to present an accurate picture of the financial condition of the organization. If cost is the issue, the Board should explore alternative strategies to gain assurances about the reliability of the financial statements.</li> <li>• Find out how the Board is communicating with the auditor – Board members should have an opportunity to talk with the auditor while staff members are not present.</li> </ul>

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Red Flag	What to Investigate
<p><b>Board Financial Oversight, cont.:</b></p> <ul style="list-style-type: none"> <li>No meaningful Board discussion of financial challenges and financial reports</li> </ul>	<ul style="list-style-type: none"> <li>Lack of written fiscal policies may indicate lack of attention to internal control – the policies and procedures designed to prevent and detect error or fraud.</li> <li>Bonding insurance will repay losses from embezzlement. Every nonprofit needs this protection which is generally not expensive.</li> <li>Reconciliation of the bank statement by someone other than the person who prepares checks, journal entries, and financial reports is the single most significant internal control.</li> <li>Lack of Board discussion of financial statements may indicate lack of understanding of the Board's responsibility for financial oversight.</li> </ul>
<p><b>Fund Raising:</b></p> <ul style="list-style-type: none"> <li>Less than 100% of Board members contribute financially to the organization</li> <li>Less than 80% of Board members participate in some way in fund raising activities</li> <li>Fund raising goals are not met over a 12 month period</li> <li>Cost to raise 1 \$ vastly exceeds industry norms</li> </ul>	<ul style="list-style-type: none"> <li>Involvement in fund raising may be a transitional issue for some Boards, particularly those in organizations which have previously received almost all funding from government. See if the Board had made a commitment to transitioning to an expectation that every Board member will make a contribution at a level appropriate to their ability and that all Board members will help in some way with fund raising.</li> <li>Realistic fund raising goals are important for sound financial management. Determine whether Board members know why goals have not been achieved and whether there is agreement about how to achieve future goals.</li> <li>The cost to raise a dollar varies widely depending on how "mature" the development effort is. In general, newer efforts to raise funds from individuals are more expensive. Major donor fund raising often costs the least per dollar raised but is not possible until substantial groundwork is done. Be sure to compare the organization's cost to raise a dollar to organizations in similar stages of development.</li> </ul>
<p><b>Governmental Contracts/Grants:</b></p> <ul style="list-style-type: none"> <li>Lack of consistency between funds sought and agreed upon mission and priorities</li> </ul>	<ul style="list-style-type: none"> <li>Chasing dollars – accepting contracts to provide services that seem far outside the agency's mission – is usually a sign of poor management and tends to distract efforts from sustainability.</li> </ul>



Red Flag	What to Investigate
<p><b>Governmental Contracts/Grants, cont.:</b></p> <ul style="list-style-type: none"> <li>• Negative reports from monitoring visits</li> <li>• Findings and Questioned Costs in A-133 audits of federal funds</li> </ul>	<ul style="list-style-type: none"> <li>• Government funders send monitors to check on whether contractors are meeting the requirements of their contracts, both in terms of program services and in terms of financial management. Negative reports generally mean that the organization is not complying with requirements and is at risk of not being funded again or, in the worst case, at risk of being required to repay grant/contract funds.</li> <li>• The A-133 audit is required of organizations with more than \$500,000 in expenses paid with federal funds within the fiscal year. Questioned costs or findings arise when the auditor finds instances of noncompliance with grant or contract requirements and can result in requirements to repay funds or poor ratings for future applications for funds.</li> </ul>
<p><b>Executive Director/ Board Relationship</b></p> <ul style="list-style-type: none"> <li>• Board has not evaluated the performance of the Executive Director</li> <li>• Board appears to be very critical of or in conflict with the Executive Director</li> </ul>	<ul style="list-style-type: none"> <li>• Failure to evaluate the Executive Director reflects lack of involvement and lack of understanding of Board responsibility.</li> <li>• Boards and Executive Directors need to work together with respect and appreciation for each other. Conflict between the Executive Director and the Board detracts from the ability to raise funds, recruit good Board members, and build positive relationships in the community.</li> </ul>



## Before You Say Yes . . . .

### Questions to ask before joining Boards

Questions to Ask	Evaluating the Answers
Why do you want me to join your board?	Do the board's desires for your involvement match your skills, interests, and time availability?
What is the role of the board?	Is the role clear? Does the role make sense given the size and stage of development of the organization?
What are your expectations of board members?	Are board members expected to make financial contributions? How is the issue of differing abilities to give handled? Are all board members expected to help with fund raising? Can they describe a way that board members help with fund raising which fits your style, ability, and willingness?
Has the board adopted a Conflict of Interest policy? Do they follow it?	Lack of awareness of the need for a Conflict of Interest policy may indicate that the board is not keeping up with current pressures for charity reform. Having a Conflict of Interest policy and failing to follow it exposes the organization to increased risks.
Does the organization have Directors and Officers liability insurance coverage?	<p>While the risk of being held personally responsible for damages arising from your service as a board member is extremely low, you may have to defend yourself in the event a lawsuit names board members as well as the corporation itself. Directors and Officers insurance will cover the cost of your legal defense.</p> <p>If the organization does not currently carry Directors and Officers insurance, are they open to discussing obtaining it? Do you think that you will be able to pay enough attention to risk management issues as a board member to feel comfortable serving without Directors and Officers coverage?</p>

What are the most important choices and challenges which this organization confronts?	Do board members seem to have a clear picture of the environment in which the organization is operating? Do board members have clear understanding of the strengths and weaknesses of the organization? Are you interested in the challenges and choices they have identified?
What do board members consider to be the organization's greatest accomplishments?	Do you consider these accomplishments personally meaningful? Do you feel a deep values connection with what the organization is doing?
What has the board spent the most time on in board meetings over the past year?	Do you believe you could make a meaningful contribution to discussion of issues like these? Do the meetings sound interesting to you? Does the use of board time seem to correspond to the stated role of the board?
How often does the board evaluate the Executive Director? How does the board handle setting the Executive Director's compensation?	Does the level of board involvement in the evaluation seem appropriate for the size and stage of development of the organization? Does the approach for setting Executive Director compensation seem reasonable for an organization of this size?
What is the long term funding strategy for this organization?	Does the strategy seem consistent with what you have been told about the role of the board? The current composition of the board? The choices and challenges identified above?  If there is no agreed upon long term funding strategy, are you comfortable joining this board?
Is the organization audited or reviewed by an independent CPA? Why or why not?	If the organization has annual operating expenses above \$1 million, the lack of an audit or review may indicate under-investment in financial oversight.
Does the board consider the organization to be in good financial health? Do the board and management have clear strategies to sustain/improve the financial health?	Do the board's perceptions about financial health seem reasonable in relationship to the financial statements (see list of info you should request)? Do the strategies to sustain/improve financial health seem consistent with the strategic plan, the role and composition of the board, and the assessment of the external environment?
Has the organization experienced any allegations of financial mismanagement?	Do you sense an open attitude and board commitment to financial oversight? Has the organization changed its practices or increased its investment in financial oversight since the allegations arose?

<p>How recently has a professional reviewed the risk management policies and procedures and adequacy of insurance coverage for the organization?</p>	<p>Do you perceive the organization as high risk? Factors could include:</p> <ul style="list-style-type: none"> <li>• work with children,</li> <li>• transport clients,</li> <li>• work with extremely vulnerable adults,</li> <li>• medical and mental health services,</li> <li>• very low paid staff working with high risk populations,</li> <li>• inadequate resources for supervision and staff development</li> <li>• work on highly controversial issues</li> </ul>
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<p><b>Background written info you'll need:</b></p>	<p><b>What to look for:</b></p>
<p>Website address</p>	<ul style="list-style-type: none"> <li>• Review the website for consistency with the description you've been given and for connection with your values and priorities.</li> </ul>
<p>Strategic plan/annual report</p>	<ul style="list-style-type: none"> <li>• Review the strategic plan/annual report for consistency with the description of board role and funding strategy you were given above.</li> </ul>
<p>Annual audit or review or a copy of the 990 if the organization is not audited/reviewed</p>	<ul style="list-style-type: none"> <li>• Review the audit/review or 990 to learn about net worth, including the portion that is restricted either permanently or temporarily.</li> </ul>
<p>Current financial statements</p>	<ul style="list-style-type: none"> <li>• Review the current financial statements to be sure board members see the Balance Sheet as well as the Statement of Activities (Revenues and Expenses) with a comparison to budget.</li> <li>• Determine whether the organization is operating at a deficit or profit position during the current year. Determine whether the budget appears to have been realistic. Look for notes to financial statements which would help board members understand what strategies management is recommending to improve the financial condition of the organization</li> </ul>
<p>Copies of the board minutes for the past few months</p>	<ul style="list-style-type: none"> <li>• Review the board minutes to see if they reflect the use of board time which was described to you above. Also, notice whether the minutes provide a clear</li> </ul>

Conflict of Interest Policy	record of board action and document that the board is following its conflict of interest policy.
By-laws	<ul style="list-style-type: none"> <li>• Are By-laws understandable? Do they match what you have been told about the way the board works?</li> </ul>
Proof of tax exempt status	<ul style="list-style-type: none"> <li>• Find out whether the organization is exempt under Section 501 ( c ) ( 3 ) and whether it has an Advance Ruling or a Definitive Ruling on its status as a Public Charity. If it has an Advance Ruling, ask who is monitoring compliance to be sure that the organization will qualify as a Public Charity at the end of its Advance Ruling period.</li> </ul>
Board organization chart which shows committees  List of board members and officers	<ul style="list-style-type: none"> <li>• Review the board organization chart to see if it is clear and corresponds to the info you've been given. Think about whether any of the committees interest you.</li> <li>• Review the board and officer list to see if you think the composition of the board is appropriate for the organization's size, type of services, and funding strategy.</li> </ul>
Staff organization chart	<ul style="list-style-type: none"> <li>• Review the staff organization chart to be sure you understand where the organization is putting its resources. Use this chart as part of your assessment of whether the organization is at high risk.</li> </ul>



## Board Resources on the Web

### **TACS Helpline Online**

Frequently Asked Questions on Board of Directors from the TACS Nonprofit Helpline

<http://www.tacs.org/qa/qa.asp?tpID=3>

### **BoardSource**

Board development for nonprofits. Info on trainings, publications and answers to frequently asked questions

<http://www.boardsource.org>

### **Alliance for Justice**

For advocacy groups working in the public interest. A great resource for information on lobbying and c3/c4/PAC relationships. They publish a series of very helpful booklets.

<http://www.afj.org>

### **Nonprofit Risk Management Center**

Resources, publications, and articles about protecting your organization.

<http://www.nonprofitrisk.org>

### **Oregon Department of Justice, Charitable Activities Section**

Forms, guides, and database of Oregon charities.

<http://www.doj.state.or.us/ChariGroup/welcome2.htm>

### **Washington Charitable Solicitation Program**

Monitors charitable solicitation. Site has forms and FAQs.

<http://www.secstate.wa.gov/charities>

### **Internal Revenue Service**

User-friendly site providing information relevant to nonprofits, including information on 990's, permitted activities, etc.

<http://www.irs.ustreas.gov/charities/index.html>



## Financial Statement Basics for Non-Accountants

1. The **BALANCE SHEET**, also called the Statement of Financial Position, is the Statement of Assets, Liabilities, and Net Assets for nonprofit organizations. The **BALANCE SHEET** reports information on the financial position of the corporation at a particular point in time. For example, 6/30/X3.
2. The **STATEMENT OF SUPPORT, REVENUE, AND EXPENSES AND CHANGES IN NET ASSETS**, similar to the Income Statement in a for-profit business, is the statement of the results of operations for a period of time. It reports revenue, expenses, and "excess" or net income for the period.
3. When financial statements are presented together, the ending date for the period reported on the Statement of Support, Revenue, and Expenses and Changes in Net Assets should be the same point in time used for the Balance Sheet. For example, Statement of Support, Revenue, and Expenses and Changes in Net Assets for the calendar year 19X3 should be presented with the Balance Sheet for 12/31/X3.
4. Formal financial statements will often include a **COMPARATIVE BALANCE SHEET** which states assets, liabilities, and Net Assets at two points in time, the ending date of the prior period and the ending date of the current period. For example, a Comparative Balance Sheet would show information at 12/31/X2 and at 12/31/X3.
5. The Balance Sheet and Statement of Support, Revenue, and Expenses are connected through the Changes in Net Assets reported at the end of the Statement of Support, Revenue, and Expenses. The difference between the Net Assets at the beginning of the period covered by the Statement of Support, Revenue, and Expenses, and the Net Assets at the end of the period must equal the Net Income or Excess of Support and Revenue over Expenses reported for the period. Even when there is not a Statement of Changes in Net Assets included in the financial statements, the following equations should be checked:

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$$\text{Assets} - \text{Liabilities} = \text{Net Assets}$$

(True at both beginning and end of period)

$$\text{Support and Revenue} - \text{Expenses} = \text{Excess (Deficit)}$$

$$\text{Net Assets, beginning of period} + \text{Excess (Deficit)} = \text{Net Assets, end of period}$$

## Budget and Financial Management Terminology

Term	Definition
Budget	A projection or plan for income and/or expenses.
Financial Statement	A report drawn from accounting records of financial activity which has already occurred. Some financial statements compare revenue and expense activity as recorded in the accounting records with revenue and expense projections contained in the budget.
Fiscal Year	A 12-month period selected by an organization. Corporations cannot change fiscal years without informing the IRS. Foundation and government funders frequently utilize different fiscal years than the agencies they fund, creating accounting and reporting difficulties for the funded agencies.
Organizational Budget	Projected income and expenses for a defined period (usually the organizations fiscal year) for the operation of the <i>entire</i> organization. Can be presented on a fund and/or functional basis.
Grant Budget	Projected income and expenses for a particular project funded by a grant. The projected income and expenses are for a defined period. The grant period may or may not correspond to the agency's fiscal year. For example, an agency with a July 1 through June 30 fiscal year may receive a grant for a 12-month period beginning January and ending December.
Accrual Basis Accounting	A system of accounting in which income is recorded when it is earned (rather than when it is received by the group) and expenses are recorded when they are incurred (rather than when the expenses are paid).

Term	Definition
<p><b>Cash Basis Accounting</b></p>	<p>A system of accounting in which income is recorded when it is received by the group and expenses are recorded when they are paid. Cash accounting data can lead to errors in budget projections. If an agency is currently unable to meet all its debts, the expense figure from cash basis accounting will <i>not</i> reflect the full cost of providing services and may lead to underestimating costs in budget projections.</p>
<p><b>Zero-Based Budgeting</b></p>	<p>A process for developing organization or project budgets which begins with zero funding allocated to any purpose and constructs the budget by justifying the need for each item including staff and non-personnel items.</p>
<p><b>Incremental Budgeting</b></p>	<p>A process for developing budgets which assumes maintenance of present expenditure patterns as a starting point and adjusts each item for inflationary increases or exceptional changes.</p>
<p><b>Cash Flow Budget</b></p>	<p>A projection of anticipated cash receipts and cash disbursements for a defined period, usually three to six months. Cash flow budgets are used primarily to manage cash, i.e. assure that sufficient cash will be on hand to meet demands and that excess cash is properly invested. Cash flow budgets focus on timing—when during the year funds will be received and required. This contrasts with organization or grant budgets which are typically prepared using an accrual concept of projecting costs and revenue associated with services to be provided during the budget period, regardless of the timing of receipts or disbursements.</p>



## Key Single Asset Entity Related Terms

### Single Asset Entity Property

A property developed to provide housing for low income individuals which HUD (the federal department of Housing and Urban Development) has required to be owned by a separate nonprofit corporation. Low Income Housing Preservation Rehabilitation properties (LIHPRA) properties and HUD 202 projects are examples. While these properties are typically developed by a CDC or other nonprofit affordable housing organization, they must be owned by a separate nonprofit corporation which has as its sole purpose owning and maintaining that single property.

### Nonprofit Corporation

A corporation created under state law which has no owners. Nonprofit corporations may "make profits," i.e. have income greater than expenses, but all profits must remain in the corporation and be used for its purposes.

### Tax Exempt Corporation

A nonprofit corporation which has been granted tax exempt status by the IRS. Nonprofit single asset entity corporations apply for, and presumably receive, tax exempt status. This means they will not be liable for federal corporate income tax. It also means that donors may deduct contributions to these corporations as charitable contributions.

### Community Development Corporation (CDC)

Nonprofit corporations working in low income communities which meet specific state law requirements for purpose, activities, and inclusion of community members on their boards of directors. CDCs can hold many properties within a single corporation

### Property Management Services

Property management services typically include renting units, managing security and repairs, collecting rent, and dealing with problems on the property including disruptive tenants, etc. Property management services can also include obtaining and maintaining documentation required by HUD. Property management may also include maintenance of complete financial records and preparation of financial statements for the property. Property management can be provided by staff employed by the owner of the property, or by contracting with a property management firm.

**Asset Management**

Asset management includes oversight of the work of the property manager or property management firm, identification of major maintenance or rehabilitation needs, contracting for major maintenance/rehab, and oversight of performance of contractors. Many Single Asset Entities will contract with CDCs to provide asset management.

**Board of Directors**

The group of individuals responsible for governance and oversight of a nonprofit corporation. Oregon law gives the board of directors authority for corporate decision-making, and holds individual directors responsible for exercising care in their oversight of the affairs of the corporation.

**Directors and Officers Errors and Omissions Insurance**

A type of insurance which protects members of the board of directors of a nonprofit corporation from damages which arise out of their service as board members. This type of insurance covers the cost of defending the board members if they are sued for their errors or failure to act as board members, and will also cover damages if the court rules against the board members, except in specific situations in which the statute prohibits coverage.

**HUD Audit Requirements**

Organizations receiving funding from HUD are required to have an independent audit under HUD rules.



# Affordable Housing Financial Management Challenges

## Budget Challenges

### I. Multiple Functions

Affordable housing organizations typically engage in multiple functions: housing development, property management, tenant services, business district revitalization, and other community economic development activities. Additionally, like all nonprofits, they engage in management/administration, and fundraising functions.

While each of these functions is quite distinct from the others, a comprehensive organization-wide budget is still needed. Consequently, affordable housing organizations need to do functional budgeting which goes beyond simply listing the categories of income and expense which are expected and use a grid or matrix format to describe both line item and function for each anticipated income or expense.

### II. Cost Allocation

Cost allocation is a budget and accounting method which is used to identify costs according to the function which the cost supports, as well as according to line item description (salaries, supplies, etc.). Direct costs are those which can be directly attributed to a specific function—for example, the cost of paying a property management fee is clearly a cost of the property management function, and the cost of acquiring a property is clearly a cost of property development.

Indirect or shared costs are costs which benefit multiple functions. Not all shared or indirect costs are administrative costs. For example, if multiple programs are housed in one facility, the occupancy cost of that facility is a shared cost which should be allocated among all the functions which are carried out in the facility.

For budget purposes, you will want to assign all direct costs to their appropriate functions and then use a cost allocation formulae to allocate indirect costs. Be sure that the way that you allocate costs in the budget is the same way which you will use them in the accounting system.

### III. Dealing with Restricted Grant Funds

If you anticipate receiving grants, be sure that you reflect any restrictions which will be attached to them by your funders in your budget plan. For example, if a foundation will award \$10,000 to allow you to provide enhanced tenant services such as coordination with social service agencies, reflect both the grant income and the costs associated with providing the services in your "Tenant Services" function. If a funder will give you a grant to purchase a property for development, include it in the "Housing Development" function.

Some funders will provide "operating support" with the direction that your affordable housing organization is to decide how to use the funds. Your budget should reflect your decisions. If you decide to split the "operating support" into several categories, using some for administration, some for housing development, and some for community economic development, your budget will show the total grant split into the different functional income sections.

### IV. Borrowing and Debt Repayment

Affordable housing organizations must integrate the kind of projection done in pro formas for new housing development projects into their comprehensive organization-wide budgets, as part of the housing development function. This is particularly challenging because most housing development involves borrowing funds which will then be repaid, with interest, with proceeds from rental income or through sale of homes in home ownership programs.

However, from an accounting standpoint, borrowing money is not a source of income, and repaying debt is not an expense. Instead, borrowing money creates a liability and paying it back reduces the liability. In a pro forma for a housing development, borrowing is considered a source of funds, and debt repayment is considered a use of funds.

Because affordable housing organizations need to have their organization-wide budget correspond to their accounting system so that financial statements can compare what actually happens to what was planned, they must deal with the impact of borrowing and repaying debt in the budget in a way which will not conflict with good accounting practices.

One way to accomplish this is to create a section called "cash adjustments" in the budget format. Generally this section is placed below the listing of expenses and its total. In the "cash adjustment" section, the amounts which will be borrowed to complete projects can be attributed to the housing development function, and the amounts of debt which must be repaid within the year can be attributed to the property management function. Note that the interest portion of debt repayment will be listed in the expense section of the budget because interest is an expense.

## V. Budgeting for Development Costs

It is often challenging to predict exactly when a project which is in your development pipeline will actually be completed, or even when construction will begin. For purposes of putting an organization-wide budget together, you will have to decide which specific development projects will be underway during the fiscal year, and make some assumptions about their timing. Be sure to write down those assumptions so that if reality doesn't conform to your plan, you will be able to revise the Housing Development component of your budget accurately.

In your accounting records you will want to track the pre-development and development costs for individual projects separately so that you have documented the actual cost of bringing the project to completion. Similarly, you will want to budget on a project by project basis, and then combine all the projects which will be underway into totals for the Housing Development component of your budget. Be sure to keep the schedule which shows the plan for each project.

Some pre-development costs can't be attributed to any specific project or are invested in projects which don't come to fruition, so you may need to budget some amounts in your Housing Development budget which are "general" as opposed to attributed to specific projects.

## VI. Budgeting for "Developer Fees"

Developer fees are the amount which the developer is allowed to retain after all other costs of development are met. In a project that is entirely debt financed, developer fees amount to the portion of borrowed funds which you have not had to pay out to contractors or others to complete the project. In a project which combines debt with contributed amounts (grants, equity contributions, etc.), it is sometimes difficult to say whether the developer fee is being funded through debt or through the contributed or equity portion of the project.

While many affordable housing organizations rely upon developer fees to fund portions of their operations, if the developer fee is funded through debt, it is not income and should not be included in the revenue portion of the budget. It is debt and should be included in the "cash adjustment portion" discussed in the previous section on borrowing and debt repayment. If the developer fee will be funded through grants, it will be included in the grants line of the budget and shouldn't be double counted by being listed again. If it will be funded by grants and you want to see it separated out from the other grants, subtract the amount of the developer fee from the grants line item, and list it as "grant funded developer fee" in the income section.

One very important policy decision for affordable housing organizations is what use will be made of developer fees. Will your affordable housing organizations use developer fees to subsidize components of your budget which are projecting losses or will you retain the

developer fees to use as seed money to undertake new development projects, or limit its use to paying for staff that do housing development? Your board will need to set a clear policy to guide your budget practices.

## **VII. Depreciation**

Depreciation is an expense even though no cash is paid out to cover it. Consequently, you will want to include depreciation in your schedule of expenses for each property. However, because depreciation expense does not use cash, you will also include it in the "cash adjustment" section as if it were a source of cash. In other words, you are acknowledging that although your pro forma showed that the property could generate enough income to cover depreciation expense, from a cash flow perspective, it doesn't have to generate cash to cover the depreciation.

## **VIII. Budgeting for Home Sales**

Affordable housing organizations that sell the homes they build will budget for "home sales proceeds" as an income item in their "housing development" function. Most of the costs of building the homes will be reflected in the "cash adjustment" section. Just as in the discussion of developer fees for rental properties, your affordable housing organizations will need to set a policy about the use of your "profits" from home sales. Will you use them to subsidize administration or other operating programs or will you reserve them to use as seed money for future housing development projects?

## **IX. Budgeting for Property Management Functions**

Your "property management" function budget should reflect the income you expect to realize from renting properties and the expenses which you must pay to operate the properties. You will need to use the "cash adjustment" of your budget to deal with the debt service (principle repayment), depreciation, contributions to reserves, and major rehab costs.

Create your "property management" function section by analyzing and scheduling each of your rental properties. Then combine the schedule of individual properties into a master schedule for use in the organization-wide budget.

Project the actual income and expenses you anticipate for each property. Remember to adjust the projected rental income to reflect your predictions about vacancy rates and losses through non-collection. Don't simply use the projected rental income that was included in the pro forma for development of the property, consult your prior year accounting records and consider the actual circumstance to estimate vacancy rates and collection problems.

Similarly, use your past accounting records and detailed knowledge of the condition of the properties to project expenses for the year, including utilities, insurance, repairs, etc. If you contract for property management, be sure to include this expense. If you have your affordable housing organizations staff do the property management, be sure to include the cost of this staff time, including taxes and benefits, and associated overhead costs, in your "property management" function budget.

## **X. Pro Formas and Their Relationship to the Budget**

Applications for financing for development projects require creation of a pro forma which projects the operating income and operating costs of the proposed property. Generally, the income section is comprised of projected rental income adjusted for losses through vacancy and the operating cost section includes property management fees, utilities, debt service, and all other costs which must be met by the projected income in order for the project to "pencil," i.e. demonstrate financial viability.

While this information will be useful for budgeting the property management function for a property before you have had a year's experience operating it, it should not be used as the basis for the property management budget for subsequent years. Instead, base the projected budget on analysis of your actual experience reflected in the prior year's financial statements, adjusted for any changes which you anticipate.

The pro forma also includes information about the actual cost of acquiring and developing the property and identification of all the grant and loan sources which will be utilized to meet these costs. This information will be useful for constructing the "housing development" function in your annual budget. Be sure you are using the most recently revised version.

## **XI. Budgeting Contributions to Reserves**

Many funding sources and lenders require that as owner of the property you make an annual contribution to a reserve to be used to fund major repairs or rehabilitation of the property. You may be required to list these contributions to reserves as an expense on budget documents you submit to these funders/lenders. However, because you want your annual budget to correspond to your accounting records, include these contributions to reserves in the "cash adjustments" section of the budget. You won't actually be recording them as expenses in the accounting records even if you will physically transfer cash into a specific reserve cash account. However, doing this transfer will require having the cash available to put in the reserve account, so it should be included in the "cash adjustment" section of the budget.

If part of your property management plan for the year is to do major repairs or rehab on a property, and you will pay for the work by using funds from the reserve fund which you have established for the property, you will want to include this part of your plan in the "cash adjustments" section as well.

## **XII. Cash Flow Projection**

In addition to your comprehensive operating budget, you will need a cash flow projection which projects when cash will be received and when it must be disbursed. This projection is particularly important for organizations which receive some of their operating funding on a reimbursement basis which requires that the organization pay out cash and then submit requests for reimbursement. In most cases, you will want to separate the cash flow projection for operations from the ones you are doing for specific development projects. If you will have to use operating cash for development activities or development cash for operating activities, you will need to integrate the two projections.



## CDC Financial Management Challenges Accounting Challenges

### I. Chart of Accounts Structure

The Chart of Accounts should parallel your budget categories. It should set up cost centers (departments, divisions) for each distinct function used in your budget (property management, housing development, tenant services, administration), and for any restricted funds which you have budgeted as a separate function. The Chart of Accounts must include Balance Sheet accounts (assets, liabilities, net assets) as well as revenues and expenses

### II. Cost Allocation

Use the same method for cost allocation in the accounting system as you used in your comprehensive annual budget. Consider structuring cost pools to streamline the accounting process. For example, set up a department for "administrative costs" which includes all the line items in which administrative costs occur (salary, professional fees, occupancy, etc.) and then allocate a share of the total administrative costs to each function at the end of each month. Create a written description of your cost allocation plan which explains which costs will be allocated, and the basis for the allocation method.

### III. Pre-Development Costs

Pre-development costs are the costs of exploring the feasibility of various projects. If a project eventually goes forward, it may be possible to "capitalize" these costs, i.e., include them in the record of the investment made in the property. If the project doesn't go forward, the pre-development costs are just part of the operating costs of the housing development function. It is probably easiest to track pre-development costs by setting up a department (cost center) for them in the structure of your Chart of Accounts.

### IV. Development Costs: Acquisition, Construction, Etc.

You will need to maintain a complete record of all costs of acquiring and developing each property. These costs include both amounts which your organization disburses directly from its own cash accounts, and any disbursements made on behalf of your organization, for example, direct payments from a lender or grantor to contract for work done on a project.

You will need a system which tracks costs as they are incurred and compares the costs incurred to the development budget for each project.

## **V. In-Kind Contributions to Development Projects**

If you receive donated materials or services which make a material contribution to a development project, you will need to record them in the accounting system. Establish an "in-kind contributions" revenue account to record the increase in value in the property which results from the contribution. You will balance the journal entry, which records the contribution income, with an entry to the asset account for this property, reflecting the increase in your investment in the property. Be sure to maintain back-up documentation about the nature of the contribution and the basis for the dollar amount you have recorded as an in-kind contribution.

## **VI. Depreciation and Accumulated Depreciation**

In addition to creating "depreciation expense" accounts in the expense section of the Chart of Accounts and "accumulated depreciation" accounts in the assets section, you will need to maintain a detailed depreciation schedule which supports the entries posted to these accounts. You'll need a depreciation schedule for each property, including both the amount of your initial investment and of any major rehabs done to the property, the amount of depreciation recorded each year, and the resulting accumulated depreciation for each property (sum of all depreciation expenses recorded over the life of the property). In addition to the property by property depreciation schedules, you'll need a depreciation schedule for all your office equipment and any other fixed assets.

## **VII. Recording Debt and Debt Service**

Record all debt as it is incurred. To do this, the accountant must receive copies of all loan and line of credit agreements once they are executed. If loan proceeds will be paid through draw downs, copies of requests for draw downs must be given to the accountant to record. Copies of closing agreements must also be provided. In some lending situations, the amount of loan funds disbursed will vary from the draw down requested. These variances can be correctly recorded through adjusting entries.

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## **VIII. Non-Recourse Debt**

Some lending agreements state that the debt is "non-recourse" meaning that the lender's ability to collect repayment is significantly limited. In some cases, the lender indicates that it does not intend to require repayment. You will probably need advice from your auditor and

possibly from an attorney about whether to record "non-recourse" debt as a liability or a contribution.

## **IX. Grants with Contingent Liabilities**

Some grants to acquire or rehab property come with a contractual requirement which states that in the event that the property is no longer used for its intended purpose, or the organization sells or otherwise transfers the ownership of the property, the grantor is entitled to repayment of the grant funds. In most instances, you will still record the grant as a grant but include a note disclosing the existence of this contingent liability in the notes to the financial statements which are part of your audit. In order to handle such grants properly, you will need to be sure the accountant has a copy of the grant agreement and discuss the treatment of the grant with your auditor.

## **X. Developer Fees**

The term "developer fee" is used in several different situations, each with its own accounting treatment.

- If your organization is acting as developer for a separate entity, and receives a "developer fee" for the services which you provide to that separate entity, then the "developer fee" should be recorded as revenue.
- If your organization is developing a rental project with a combination of grants and loans, and one of the grants is explicitly designated to fund a "developer fee" for your organization, record this amount as grant income. You could use an account called "grant funded developer fee" if desired.
- If you have included a proposed "developer fee" in the pro forma for a development project and your lender(s) have approved it, you will be permitted to draw down loan proceeds to cover the "developer fee" (typically at the end of the project when other costs are met). These amounts received from lenders are loan proceeds and should be recorded as "loans payable," a liability. If you have used the Cash Adjustments approach to budgeting and have shown these loan-financed "developer fees" as a cash adjustment on the budget, you can use the information which is recorded in the liability section of your general ledger, "loans payable," to report the amount of "developer fees" collected for comparison with the budget amount.

Incidentally, if you are developing properties for sale (home ownership), you will not have developer fees. Instead, you will have "gains on the sale of homes" which provide compensation for your efforts as developer.

## **XI. Tenant Deposits, Pre-paids, Rents Receivables**

Record all **tenant deposits** in asset accounts. If you are collecting several different types of deposits, use separate accounts. You will need to maintain subsidiary accounts for each tenant which total to the control account for each type of tenant deposit in the general ledger. If you refund a tenant deposit, you will reduce the balance of the tenant deposit account (as well as recording it in the subsidiary record). If you decide to keep the tenant's deposit (i.e., to cover failure to clean or damages), you will need to use a journal entry to reduce the amount of the tenant deposit asset account, and record the amount in a revenue account (payments for damages, etc.).

Record **pre-paid expenses** in asset accounts, for example, annual insurance premiums. Create an amortization schedule for each pre-paid expense to use as the basis for journal entries which reduce the amount in the pre-paid expense asset account and increase the correct expense account (for example, insurance expense) as you use up the value of the pre-paid item.

**Rents receivable** are the amounts tenants owe your organization. Your lease agreements will establish when rent payments are due. You will need to decide whether to use a system in which all rents are initialed recorded through an entry to Rental Income and Rents Receivable and all payments are treated as a reduction in Rents Receivable or a system in which only the amounts not paid by the due date are recorded through a journal entry to Rental Income and Rents Receivable and all other payments are simply attributed to Rental Income at the time of collection. The important result is that you have a complete record of each tenant's payments and any amounts still owed which can be tied to the Rents Receivable account in the general ledger.

## **XII. Property Management Accounting**

Property management accounting requires tracking income and costs on a property by property basis. Specific property management software is used by for-profit property managers and may work well for your organization. Whether you use a specific property management software package, develop your own database or spreadsheet application, or use cost centers in your general ledger, you will want to establish a system which tracks revenues and costs on a property by property basis.

## **XIII. Dealing with Reports from Independent Property Management Firms**

Many nonprofits have some or all of their rental properties managed by an outside property management firm. Typically, the property management firm provides monthly financial statements for each property. Your organization needs to have complete financial information, including assets, liabilities, and net assets, as well as revenues and expenses. Frequently, property management firm accounting systems are designed to report on a cash

basis, and only report rents collected and cash disbursements, including both debt service payments stated as a lump sum, without separation of interest and principle. If this is the type of reporting you will be receiving, you may choose to post the information provided into your general ledger on a summary level on the cash basis, and then prepare and post year-end adjustments.

#### **XIV. Community Economic Development Activities**

First determine the type of community economic development activities your organization will conduct. If your role will be providing training for community members to start or manage businesses, or organizing various revitalization and community involvement projects, the accounting requirements will be similar to those for other grant funded programs. You will need to set up a separate cost center for each project and track both grant income and all costs associated with the grant funded project. If your project will have multiple grant sources, you will need to determine whether each will require a separate line item accounting, or whether a report of total project activities, on a line item basis, will meet the needs of all the funders.

If your economic development activity will involve your organization actually operating a business venture, you may want to consider whether it should be conducted through a separate legal entity. If so, that entity will need a complete set of books, and its own financial statements. If you will be conducting the business venture as part of your corporation, you will need to set up a separate cost center, or possibly a separate division, with multiple cost centers within the division, to track the revenues and expenses of your business.

#### **XV. Tracking Restricted Funds**

If you have structured your budget to separate costs paid with specific restricted grants, you will need to structure your chart of accounts with cost centers to capture this information. This will permit you to use the cost center report of revenues and expenses as the basis of your reports to the restricted funding source.



## Nonprofit Financial Management Self Assessment Tool

### I. FINANCIAL PLANNING/BUDGET SYSTEMS

	Don't Know	Inadequately Achieved	Partially Achieved	Fully Achieved
1. Organization has a comprehensive annual budget which includes all sources and uses of funds for all aspects of operations.				
2. All grant or contract budget agreements with funders are incorporated into the comprehensive annual budget.				
3. All grant or contract budget proposals are reviewed by fiscal staff before submission to funders.				
4. Program managers play an active role in the development of budgets for programs under their direction.				
5. A board committee has a detailed understanding of the annual budget and plays a significant role in directing the use of unrestricted funds.				
6. The full board formally authorizes the annual budget and revisions to the budget.				
8. The organization has integrated meaningful consideration of financial issues into any strategic planning processes it undertakes.				
9. The organization has a capital budget and multi-year plans for major maintenance and replacement of facilities and equipment.				

	Don't Know	Inadequately Achieved	Partially Achieved	Fully Achieved
10. The fiscal planning process includes continuous assessment of risks and identification of insurance coverage needs and appropriate risk management procedures.				
11. Risk assessment includes: general liability, professional liability, product liability, fire, theft, casualty, workers compensation/occupational safety, board and officer liability, vehicle operation, fraud and dishonest acts.				

## II. EXECUTION

	Don't Know	Inadequately Achieved	Partially Achieved	Fully Achieved
1. The organization has written policies and procedures for fiscal operations including procedures for processing payroll, purchases, accounts payable, accounts receivable, etc.				
2. Written policies and procedures are reviewed and revised regularly.				
3. Actual processing activities are consistent with written policies and procedures.				
4. The concept of separation of duties is implemented to the greatest extent feasible within the limitations of the size of the organization staff.				
a. Authorization functions for purchasing, signing checks, adjusting accounts, and extending credit are not performed by individuals who also perform recording functions such as disbursements and/or receipts, maintaining accounts receivable records, or cash handling functions such as receiving and depositing funds or preparing checks.				

	Don't Know	Inadequately Achieved	Partially Achieved	Fully Achieved
b. Review and verification functions such as reconciliation of the bank statement to the record of cash receipts and disbursements are not performed by individuals who also prepare checks, record checks, receive funds and prepare bank deposits, and/or record receipts.				
5. Payroll policies and procedures are clearly documented and consistently followed.				
a. Written authorization is required for all new hires and pay rate changes.				
b. Written timesheets are prepared by all employees, signed by the employee, and approved in writing by the employee's direct supervisor.				
c. Forms W-4 and I-9 are obtained and retained for each employee.				
d. Policies regarding overtime, vacation time, sick leave, holiday pay, and other leaves with or without pay are written clearly, and reviewed regularly for compliance with state and federal law.				
e. All fringe benefit plans are documented and in compliance with IRS and Department of Labor requirements. The proper tax treatment for all benefits and compensation arrangements has been determined and documented.				
f. Responsibility for maintaining fringe benefit records in accord with governmental requirements has been clearly assigned and records are reviewed regularly.				

	Don't Know	Inadequately Achieved	Partially Achieved	Fully Achieved
6. Written purchasing policies clearly identify the purchasing authority of each staff position, and establish appropriate dollar limits for purchasing authority at each level.				
7. There are clear procedures for review of and authorization to pay all vendor invoices.				
8. Written policies and procedures for charging and collecting fees are followed consistently and reviewed regularly.				
9. Cash handling policies and procedures are well-documented and are tested periodically.				
a. All checks are restrictively endorsed upon receipt.				
b. Receipts are given for all cash transactions and donors/clients are informed that they should receive a receipt for all cash payments. Pre-numbered, multi-copy, customized receipts are used.				
c. A receipts log is maintained by the person responsible for opening the mail.				
d. Cash reconciliation sheets are maintained by all individuals responsible for accepting cash. All cash counts are initialled by the individual preparing the initial count and the individual receiving the cash for further processing.				
e. Post dated checks are not generally accepted, and if accepted, are secured carefully.				
f. All disbursements are made by check except for small purchases made through a Petty Cash fund.				

	Don't Know	Inadequately Achieved	Partially Achieved	Fully Achieved
g. All unused check stock is carefully secured.				
h. Bank reconciliation is performed by someone who neither makes bank deposits nor prepares checks.				

### III. RECORDING

	Don't Know	Inadequately Achieved	Partially Achieved	Fully Achieved
1. A complete written chart of accounts provides appropriate account titles and numbers for Assets, Liabilities, Net Assets, Revenues, and Expenses.				
2. The Chart of Accounts clearly establishes the programs or functions which will be distinguished and the funding sources and/or distinct funds which will be tracked.				
3. The Chart of Accounts utilizes the same line item categories and the same program or function distinctions which are utilized in the comprehensive annual budget and the budgets for individual contracts or grants.				
4. Accounting policies and recording procedures are clearly documented in the written fiscal policies and procedures.				
5. Appropriate computer software and hardware is utilized to perform recording functions.				
6. Appropriate electronic and physical security procedures are utilized to protect the integrity of computerized accounting records.				
7. All accounting records are backed up daily. Back-up media are stored in a secure area away from computer equipment.				

	Don't Know	Inadequately Achieved	Partially Achieved	Fully Achieved
8. Back-ups of accounting data are stored off-site at least monthly.				
9. Detailed records of client fees and/or grants and contracts receivable are maintained and reconciled to the general ledger receivables balances.				
10. All contributions are recorded in the accounting records. If more detailed records are maintained by staff responsible for fund development, the fund development and accounting records of contributions are reconciled monthly.				
11. All general ledger balance sheet accounts are reconciled at least quarterly. All cash, payroll liabilities, and accounts receivable control accounts are reconciled monthly.				

**IV. REPORTING**

	Don't Know	Inadequately Achieved	Partially Achieved	Fully Achieved
1. Monthly financial statements are available no later than the end of the following month (i.e. April 30th statements are available no later than May 31st).				
2. Monthly financial statements include a Balance Sheet as well as a Statement of Activities and Changes in Net Assets.				
3. In organizations with multiple programs, statements of the expenses of each distinct program are prepared monthly.				
4. In organizations which receive restricted funds, separate statements of revenue and expenses are prepared for each funding source.				

	Don't Know	Inadequately Achieved	Partially Achieved	Fully Achieved
5. All revenue and expense statements (for the whole organization, for specific programs, and for specific funding sources) include the current month's activity, the fiscal year to date activity, and a comparison to the year to date or annual budget by line item.				
6. The excess (deficit) of support and revenue over expenses (net income) is reconciled to the change in fund balance between the beginning and ending of the accounting period.				

**V. MONITORING**

	Don't Know	Inadequately Achieved	Partially Achieved	Fully Achieved
1. The executive director and the program managers review the monthly financial statements carefully.				
2. The fiscal manager highlights unusual items and identifies potential problems in notes to the financial statements shared with the executive director and board committee or full board.				
3. A board committee or the full board reviews the monthly financial statements carefully.				
4. The board or a board committee selects an independent CPA to conduct an annual audit or review. The board determines whether the organization should have an audit or a review, and whether or not the audit must be conducted within the guidelines of OMB A-133, as required for organizations receiving over \$300,000 in federal funds or recommended for organizations receiving more than \$100,000 each from more than one federal source.				

	Don't Know	Inadequately Achieved	Partially Achieved	Fully Achieved
5. The board or a board committee reviews the auditor's report, including any management letters, and reports on internal controls and compliance with governmental law and regulation.				
7. The board and executive director continually review the organization's financial statements to determine whether:				
a. The use of the organization's resources is consistent with the organization's mission and priorities.				
b. The organization is solvent, i.e. has assets in excess of its liabilities.				
c. The organization has adequate cash and other liquid assets to meet its current obligations and assure its continuing ability to pay its employees, taxing authorities, and vendors on time.				
d. The organization is observing and documenting its observance of all restrictions imposed by funders and donors.				
8. The board and executive director are aware of the IRS requirements for maintaining tax exempt status and continually evaluate the organization's activities, use of funds, record keeping, and reporting to the IRS to assure compliance with all requirements.				