

**Record Keeping Requirements for Community-Based Housing
Development Organizations (CHDOs)**
2000

The following information was prepared by the Texas Development Institute (TDI) and is part of a manual, "Training for CHDOs and Nonprofit Housing Development Organizations," published by the Texas Department of Housing and Community Affairs' Housing Resource Center. © 2001 TDI

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I. Why does a CHDO need accounting?

Although your CHDO is classified as a not-for-profit, it is not excused from careful accounting of funds. In today's climate of tight budgets and high competition for operational funding, every not-for-profit must keep careful and current records and use this information to plan for the future.

Good records are those that even an outsider can follow. If your bookkeeper has a prolonged illness, another person should be able to find all information and follow a clear system to keep your CHDO running. Records must also be kept safely. It does no good to keep meticulous books if your only journal is misplaced over the weekend.

An accounting system is comprised of all the financial records, established procedures and forms which will provide an audit trail of transactions during the project or year of operation.

An audit trail is the documentation of all transactions and can be reviewed by an outside party for accuracy.

When an expense is incurred or income received it is recorded in a journal or some other book of original entry. These journals should provide a detailed record of all transactions involving cash receipts and disbursements. Entries are supported by documentation such as deposit slips, canceled checks, and other relevant information. Deposit slips and canceled checks are further supported by invoices, contracts, purchase orders, copies of checks received, travel expense reports, personnel wage rate changes, and authorization for disbursement. There should be a way to verify the organization's expenditures and receipts through an outside source.

A record keeping system should include all the above mentioned records and a flow chart should be developed and utilized to ensure that all steps in maintaining records are included. Personnel, travel and other policies should dictate what forms and procedures need to be followed to maintain compliance with policies.

When assigning duties, it is necessary that no one person is in charge of receiving funds, recording transactions, reconciling cash accounts, making deposits, handling accounts receivables, authorizing disbursements, and preparing reports. There must be a separation of duties to avoid tempting employees to embezzle funds or "borrow" money intending to put it back one day.

As a rule of thumb, an employee who receives funds should not be involved in recording cash receipts, making deposits, maintaining accounts receivables, or reconciling cash. In a large firm, these responsibilities are easily separated, but what about a small organization with only a handful of employees? In a small organization, one employee may be required to handle all of these functions. A small organization must therefore have more checks and balances than a larger organization. The director and possibly the board members should get more frequent reports, or an independent individual should review the records on a periodic basis. Independent auditors are aware that small organizations do not have the separation of duties that larger organizations have and their audit procedures may include more audit tests than for larger organizations.

What is fund accounting?

Fund Accounting is an accounting method used by governmental agencies and not-for-profits and is different from commercial accounting used for for-profit firms. Fund accounting requires that a separate set of self-balancing books, or double entry, be kept for each fund. A fund is not necessarily a project and several projects may be accounted for in one fund. Also, a fund is not necessarily a bank account and several bank accounts may be accounted for as a fund.

Years ago, the accounting industry provided standards for for-profit firms while only providing recommendations for governmental and not-for-profits. It was thought that since not-for-profits were funded from public agencies whose accounting practices were regulated, these regulations would indirectly apply to governmental agencies. Currently it is still the practice to maintain not-for-profits books on the basis of fund accounting, though there have been recent changes in the accounting industries requirements for not-for-profits. While in the future not-for-profits may not have to maintain books on the fund accounting method, for now, it is advisable to continue to maintain books by this method.

For not-for-profits, funds are broken into projects which may be funded by various sources. A separate, self-balancing set of books is maintained for each project. At the end of a reporting period, financial statements are prepared which account for all the projects in which the organization is involved. Maintain a separate fund for each and every capital project that involves construction for as long as construction is in progress.

Maintain a separate fund for each and every capital project that involves construction for as long as construction is in progress. Upon completion of a construction project, close its capital project fund by transferring the total project costs to the balance sheet (i.e., into “Fixed Assets” and “Notes Payable”).

II. What controls does a CHDO need?

Authorizing expenses

The accounting system should include procedures that allow only certain individuals to authorize the disbursement of funds after reviewing supporting documentation. Contracts, agreements, and other legal documents should only be signed by individuals that are

authorized to do so by board resolution, by-laws, or executive committees, depending on the by-laws of the organization.

Use of prenumbered checks

Checks should be prenumbered by the financial institution. If possible, two different signatures should be required on checks. It is a good practice to have checks in duplicate, with one copy maintained permanently to document the checks issued. Make sure that the financial institution is honoring the organization's intent, and that no check without the proper number of signatures is approved for payment. If the financial institution approves a check for payment without the proper number of signatures, they should be notified immediately.

Use of an imprest petty cash fund

A petty cash fund is used for minor purchases such as postage and office supplies where the time needed to obtain an authorization makes it impractical. A petty cash fund can be established for the amount deemed appropriate, such as \$25, \$50, or \$100. A custodian, for instance an office manager, is responsible for authorizing disbursements from the fund. The custodian should be told what type of disbursements can be made, and what type of documentation is needed. Usually, petty cash vouchers are prepared for each disbursement with invoices attached. The petty cash vouchers are signed by the person requesting the disbursement, and by the custodian approving the disbursement. Petty cash should be replenished as needed, usually monthly.

III. What reports does the CHDO need?

Financial records are necessary for reporting purposes and to maintain accountability for funds received and expended for certain projects. Financial records are also a management tool for measuring progress toward the goals of the organization, maintaining expenses within an approved budget, making decisions regarding additional projects, making cash flow analyses, and investing excess funds on hand in interest bearing accounts.

Preparation and review of monthly financial statements

Financial statements provide information on the progress of the operation and financial well-being of the organization over a given period—a month, six months, or a year. Financial statements should be prepared monthly and reviewed. The **income and expense statement** should be reviewed in several ways:

1. Compare the expenses budgeted in that category to what has actually been spent and analyze the variances.
2. Compare income and expenses to a percentage of completion of the project; for instance, if 75% of the budget has been spent, is the project 75% complete?
3. Ensure that all income that has been received has been recorded; that any matching funds needed and obtained have been recorded; and that expenses seem reasonable.
4. Compare current year income and expenses with those from prior years. The percentage of expenditures compared to the total budget should be constant.

Balance sheet

The balance sheet provides a picture of the financial position of the organization at a given date. The line on the report entitled **Cash Account** provides information about cash available to the organization. The **Due from Funding Source** line provides information on what has been spent and has not been reimbursed from the funding source. **Due from other Funds** provides information on monies that should be transferred from one fund to another. This account is necessary when a clearing account is used such as a payroll fund or an accounts payable fund. **Unencumbered Cash** is revenue received but not restricted by the funding source and should never be commingled with cash from other projects. State and Federal agencies usually require separate reporting for various projects and one project cannot borrow funds from another project. **The Inventory Account** provides information on the value of supplies on hand, any real estate property on inventory ready to sell, or an inventory of products to sell. **The Fixed Assets Account** provides information on the value of the assets of the organization, including office furniture, equipment, vehicles, machinery, and computers.

The liability section provides information on all debts of the organization. The section also provides information on **Deferred Revenue** or revenue which has been received from the funding source, but has not been spent or committed. The **Fund Balance** section provides information on contributions received in excess of normal operating expenses. Assets less liabilities equals the fund balance. In addition, the Fund Balance section shows the organization's equity position as of a certain date. Any retained earnings from for-profit ventures would also be reported in this section.

Statement of revenues, expenses, and changes in fund balance

This statement provides information on the operations of the organization for a given period, whether it is a month, six months, or a year. The statement is generally prepared from records maintained by the organization's accountant. It contains income, matching in-kind or cash contributions, interest income, other income, and all disbursements including matching in-kind expenses. The statement would also contain other financing resources or uses such as loan proceeds, transfer of funds from one fund to the other, payment of debt service, purchase of equipment or other fixed assets, as well as the beginning and ending fund balances.

Cash flow projections

Cash flow projections over a given period, usually twelve months, provide a good tool to determine whether adequate income will be available to cover all anticipated cash disbursements. These schedules are particularly helpful when taking on revenue generating projects, such as housing development projects. They are also helpful when managing projects, determining cash requests from funding sources, or deciding whether an organization should hire staff or lay off staff if additional revenues cannot be generated.

IV. Who else gets reports?

Reports for taxing entities

Payroll records should be maintained to report employee earnings to the state unemployment agency as well as to the Internal Revenue Service. These records must account for employee's earning per payroll period, as well as monthly, quarterly, and annually. A format should be designed which closely resembles government reporting forms for more efficient use of time.

Reports for governmental entities

Quarterly and final reports are usually required by State and Federal government agencies. These reports can be prepared from monthly reports prepared by or for management. Again, reports should be structured so as to facilitate reporting to the governmental agencies.

Reports for interested external users

Interested external users may include banks, the attorney general's office for checking compliance with not-for-profit requirements, potential foundations or other funding sources, and the Internal Revenue Service for compliance with Section 501(c)(3) regulations.

Budgets

Budgets should be prepared before the beginning of the fiscal year and revised accordingly as more information is known (see Chapter 5). Funds may be anticipated for projects that never materialize. Revisions will have to be made to ensure that expenses are not incurred for which there will be no funds received. All budgets including budgets for specific projects must be developed by the staff and board and then approved by the board of directors of the organization.

Monthly financial statements should be compared to the budget and variances analyzed (see "Preparation and Review of Monthly Financial Statements"). Monthly review of budgets will indicate whether additional income will be needed or if expenses will have to be curtailed.

Self assessment

One of the most difficult things to do is to assess oneself. Self assessment usually includes compliance standards as well as adherence to financial restraints, such as the budget. A schedule should be prepared monthly which indicates the items committed to be accomplished as per the agreement or contract. On a monthly basis, determine how much has been accomplished and what needs to be done to ensure that the balance of the requirements are completed by the time indicated. Budgets should be compared to goals to determine compliance.

Compliance

All CHDOs must comply with state law, contracts, and with federal regulations, and when federal funds are used to undertake activities, the organization must comply with federal audit requirements. The auditor will perform various audit tests to ensure that the organization has complied with all the federal requirements. Organizations receiving over \$25,000 must have an independent auditor conduct an audit following the requirements of OMB Circular A-133 (see Appendix III D). The audit can be a program audit, or it may need to be an organization-wide audit performed on an annual basis. A program audit analyzes whether the CHDO fulfilled grant obligations, all planned activities were undertaken, and program goals met.

It is helpful if the organization prepares a schedule, or list of events, details, and requirements to be sure that it understands which requirements it must comply with.

V. What is an audit?

Preparation for an audit begins when the accounting books and procedures are established for the organization by providing a clear audit trail and continues daily as transactions are made and recorded. Additional time should be spent quarterly and annually to verify that all supporting documentation is available and filed in such a manner so as to facilitate easy access when needed. Financial statements and the end-of-the-year journal entries should be

prepared, and if possible, the organization should even prepare a draft of the audit report, including all necessary schedules, notes, supplemental schedules, and audit reports.

The auditor will confirm cash, accounts receivable, accounts payable, deferred revenues, and notes owed. A schedule prepared in advance by the CHDO staff will reduce audit time and reduce the cost to the CHDO. The auditor is interested in the amount of revenue received. A schedule could be prepared on all revenues received, loan proceeds, transfers, and other sources of funds received.

In addition to checking the system for accuracy and compliance, an auditor must provide an opinion on internal control of the agency. A flow chart should be prepared to show how all transactions take place. If necessary, a separate schedule showing the flow of cash receipt through the various departments should be compiled.

The auditor is also interested in what an organization has agreed to do under contract to a funder or contract agency for the grant or reimbursements to be received. A schedule should be prepared which summarizes the scope of work required by each contract and the accomplishments. In addition, the auditor will review whether all required reports were submitted to the IRS and the State Unemployment Office.

VI. What IRS rules apply to CHDOs?

Fundraising expenses

The 990 Tax Return should be reviewed prior to setting up the accounting system to ensure that revenues and expenses are separated to provide for more efficient reporting at the end of the year. Fund raising activities should be accounted for separately since these activities will be reported on the 990 tax return. Management and program expenses, government grants, public donations, and investment income also need to be accounted for separately on the 990 Tax Return. If applicable, officers salaries are reported separately from other employee salaries. Unrelated business income is reported in a separate schedule. In addition, all “in kind” contributions must also be reported to the IRS.

Lobbying expenses

While limited lobbying expenses are now allowable, exceeding the limits could cause an organization's 501(c)(3) status to be revoked by the IRS. If a CHDO anticipates lobbying activity, it should contact the IRS and obtain a copy of IRS Publication 5768 (Election/Revocation of Election by an Eligible Section 501(c)(3) Organization To Make Expenditures To Influence Legislation) which details the reporting requirements.

Personnel records

Records for new employees include W-4 forms for each employee. These forms indicate the number of exemptions claimed and are the basis for withholding income taxes each payroll period. The Immigration Service requires each employee to complete a form (the I-9) which indicates that the employee is a legal resident of the U.S. The employer can be fined if this form is not in the files.

A record should be maintained on each employee which provides the amount earned and withheld for each pay period as well as totals for the month, quarter, and annual period. Reports have to be made quarterly to the State Unemployment Office and the IRS (form 941). An employee application should be in the file, as well as any promotions, disciplinary actions, changes in position, annual leave, sick leave, applications for health insurance and retirement (see Chapter 6). Time sheets should be maintained for all employees and indicating which projects each employee worked on if hours are allocated among several projects.

Key points

- Correspondence, contracts, by-laws, minutes and resolutions of the board of directors should be maintained for a period of five (5) years unless records pertain to documents for real estate, equipment, vehicles, articles of incorporation, by-laws, minutes of the board of directors, audit reports, contracts, lease purchase agreements, and amortization of long term notes. In today's climate of tight budgets and high competition for operational funding, every not-for-profit must keep careful and current records and use this information to plan for the future.

- As a rule of thumb, an employee who receives funds should not be involved in recording cash receipts, making deposits, maintaining accounts receivables, or reconciling cash.
- Not-for-profit's funds are broken into projects which may be funded by various sources and a separate, self-balancing set of books is maintained for each project.
- The accounting system should include procedures that allow only certain individuals to authorize the disbursement of funds after reviewing supporting documentation.
- Financial records are necessary for reporting purposes and to maintain accountability. Records are also a management tool for measuring progress, maintaining a budget, making decisions, making cash flow analyses, and investing.

VII. Summary: Record keeping requirements

All CHDOs must comply with state law, contracts, and with federal regulations; when federal funds are used to undertake activities, the organization must comply with federal audit requirements.

1. Does your CHDO currently have an **adequate** accounting system in place?

Does your CHDO use fund accounting?

Are the CHDO staff responsibilities clear?

2. Does the current system provide adequate controls?

Are prenumbered checks used?

Is there a clear separation of duties among staff?

Do different people authorize expenses and sign checks?

Do different people balance bank statements and sign checks?

3. Does the board currently receive written monthly financial reports?

Does the board receive a comparison to budget?

Does the board receive an income and expense statement?

Does the board receive a balance sheet?

Does the board receive a statement of revenues, expenses, and changes in fund balance?

4. Does the CHDO prepare a cash flow analysis?
5. Does the CHDO prepare all required IRS reports?
6. Does the CHDO prepare reports for funders?
7. Has the CHDO been audited within the past twelve months?

Were no findings issued?

If findings were made, were changes made as a result?

8. Does the CHDO currently maintain adequate personnel records and other permanent files?