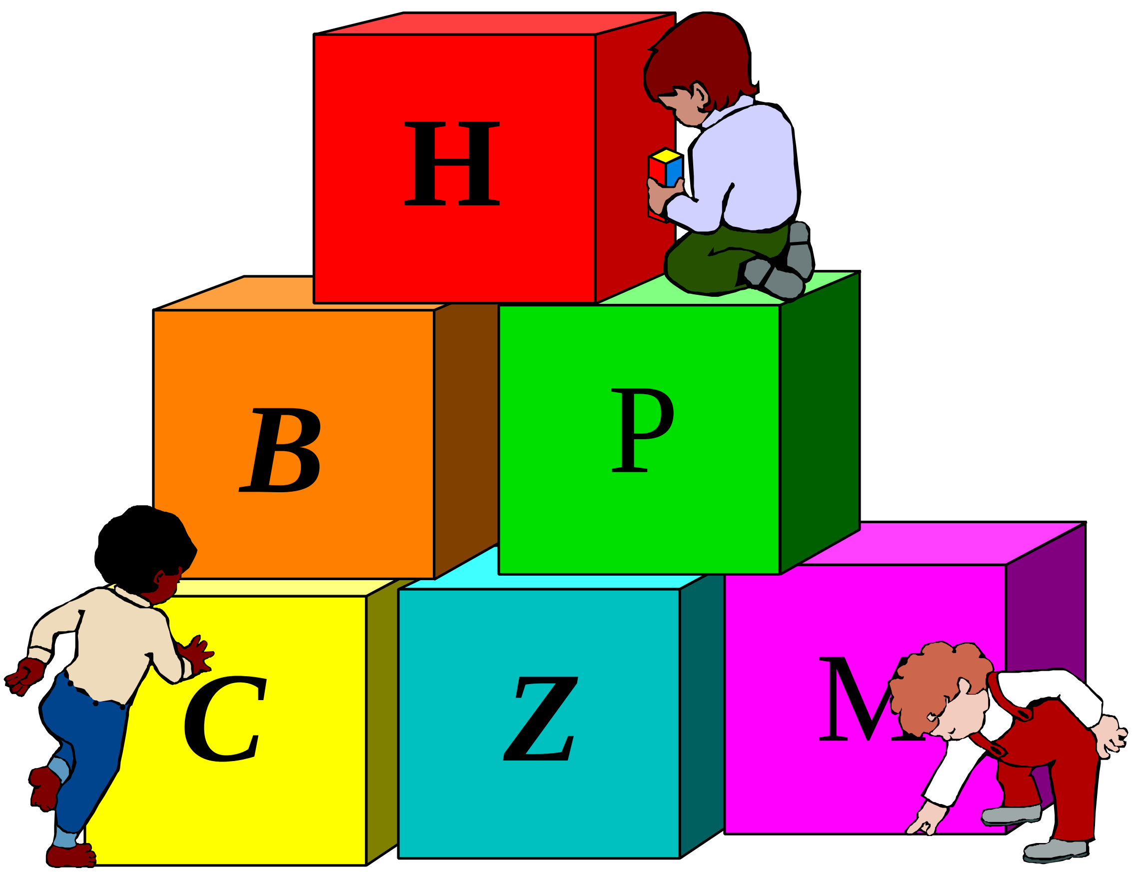
Financial Management Handbook for Human Service Agencies

Department of Health and Family Services
May 1999



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May 1999

Dear Directors of Human Services Agencies:

Managers of nonprofit agencies in the human services sector share many of the same management challenges. Tight budgets combined with rising demands on agency services are prompting agency boards and staff to be increasingly creative in finding new revenue sources. The complexity of client problems appears to be growing, as are expectations that agencies will be accessible, accountable, and better able to document outcomes. Funding limits constrain agency efforts to offer competitive salaries and to fully fund training programs for all staff and board members.

While grappling with these complex policy and program challenges, agency managers also have to address the nuts-and-bolts issues of running an agency. Meeting contract and compliance requirements, maintaining accounting records, setting spending priorities and approving payments, safeguarding investments and other agency assets, are only a few of the many legal, contractual and other requirements broadly captured under the concept of financial management.

The Department of Health and Family Services (DHFS) has, through its contract and other documents such as the *Allowable Cost Policy Manual*, informed agencies of financial management standards and practices that agencies must meet. However, direction on strategies to meet these requirements has been limited. In order to fill this void, the Department is issuing the *Financial Management Handbook for Human Services Agencies*.

The *Handbook* is not a complete and comprehensive text on the subject of financial management requirements. Rather, it is intended to be a practical and accessible summary of the key financial management duties and responsibilities human service agencies must fulfill. The *Handbook* is designed to be user-friendly and offers many suggestions on how boards and managers can meet their financial management obligations. It is our sincere hope that the *Handbook* will produce a number of positive results, such as:

- better informing agency managers and board members of financial management requirements and good management standards;

- answering questions agencies may have about how to interpret standards and requirements;

- stimulating discussion and interest among agency board members and staff in assessing how agencies could improve financial management practices;

- encouraging agencies to take practical, effective actions to improve financial management practices; and

- increasing the efficiency of agency administration, so that agencies will be able to confidently take care of the "nuts and bolts" of financial management and still have ample time to creatively tackle substantive policy and program issues.

This *Handbook* is likely to be more useful for smaller community based organizations that may not have the resources to hire the more experienced experts in financial management. However, we hope that the larger nonprofit agencies can find something of value in the *Handbook*, even if the use is limited to providing quick reminders to financial managers of the essential requirements of good financial management that need to be covered.

The *Handbook* was originally compiled by the Department's Office of Program Review and Audit (OPRA) for use by domestic abuse agencies, with considerable input and ideas contributed by DHFS central and regional office staff, some agency directors, and several independent auditors. OPRA staff also relied heavily on other written materials and information found on several web sites, which are noted in the *Handbook* for your use. Once the *Handbook* had been distributed to the domestic abuse agencies, it became clear to us that the materials in it were generally applicable to most other human services programs. We decided that, with some minor modifications, we would make it available to a much wider audience of potential users.

We hope you find the material in this handbook (which is also published on our website at www.dhfs.state.wi.us) to be useful and informative. If you have any questions about the handbook, please feel free to contact Patrick Cooper, the Director of the Office of Program Review and Audit at (608) 267-2846.

Sincerely,

Richard W. Lorang
Deputy Secretary

Patrick W. Cooper, Director
Office of Program Review and Audit

FINANCIAL MANAGEMENT HANDBOOK FOR HUMAN SERVICES AGENCIES

A. ALLOWABLE COST

Issue: *An agency may only charge allowable costs to each grant.*

- By contract every agency needs to comply with the *DHSS Allowable Cost Policy Manual.* (ACPM). Consequently, every agency should have a current edition of the ACPM. (Latest edition is dated February, 1995.) It is now out on the DHFS web site, www.dhfs.state.wi.us/grants.

- The requirement to comply with allowable cost policies applies largely to cost reimbursement contracts. Most allowable cost limitations do not apply to agencies that have capitated contracts. Over time, the Department intends to rely increasingly on capitated payment mechanisms, where possible. In the meantime, most contracts involving DHFS funds continue to reimburse contractees according to allowable costs.

- Generally, allowable costs per the *DHSS Allowable Cost Policy Manual* must not be prohibited by specific restrictions provided in the ACPM, including OMB Circular A-122. If you find no specific prohibitions, the expenditure must then meet the general criteria. "Section I – DHSS General Principles for Allowability" has been inserted on pages 3-10 of this handbook.

- One of the general criteria is that for a cost to be allowable, it must "be supported by the agency's accounting records and be adequately documented." This means for any check written by the agency, it should:

  a) be in accordance with the agency's cash disbursements policies,

  b) have the appropriate authorizing signature(s) on the check,

  c) have an invoice indicating that the goods or services were indeed received and approved for payment, and

  d) be recorded in the check register, general ledger, and/or cash disbursements journal.

- Payroll is typically the biggest cost billed to a grant. For these costs to be allowable, the following documentation is needed:

  a) Compensation and payroll policies established by the board;

  b) employee personnel files including date of hire, application/resume, interview notes and/or references, start date, anticipated work schedule, rate of pay, federal forms W-4 (payroll tax withholding exemptions) and I-9 (proving US citizenship), and authorization from the director approving the hire and any subsequent pay raises;

  c) time sheets or other record of actual work hours, along with supervisor or authorizing signature, including time distribution records when required;

  d) appropriate deductions for payroll and benefits along with schedules of these amounts; and

  e) entries in the check register, payroll journal, cash disbursements journal and/or general ledger.

- Allocated and indirect costs are an area of concern to DHFS. These are discussed under Item "B."

- Another area of concern is related party transactions, in which one party to a transaction can influence the management or financial operating policies of the other party. The following considerations need to be made when determining the allowability of rental charges between related parties and of costs incurred under cost-reimbursement contracts:

  a) When an agency rents or leases property from a related party, allowable costs are limited to actual costs that would have been allowed had title to the asset been vested with the agency. Examples of allowable expenses of ownership include interest, depreciation or usage allowance, maintenance costs, and utilities, if not charged separately.

  b) As indicated in the *DHSS Allowable Cost Policy Manual*, there is no intent for a provision for profit or other increment above allowable costs, except where specifically authorized by the Wisconsin Statutes.

- Excess revenue under contracts limited to allowable costs or to a percentage of allowable costs must be returned to the granting agency, unless the granting agency specifically authorized the agency to keep the revenue.

- Most agencies under direct contract with DHFS are paid through CARS (Community Aids Reporting System). Payment is received after an agency submits a CARS report listing grant expenses for the month in question. A high ranking agency official must sign the form and attest to the claimed expenses all being allowable costs. Questions on what to report should be directed to the Contract Administrator listed in the contract. For more information on how to submit a complete and accurate CARS report, contact the BFS CARS Unit in DHFS @:

  www.dhfs.state.wi.us.bfs/CARS/index.htm

Ideas/Suggestions?

1. Make certain key people – board members, managers, and fiscal staff – have copies of, or at least access to, the *DHSS Allowable Cost Policy Manual*.
2. Build into board and agency control procedures the review of the appropriateness and allowability of expenses, including confirming that expenditures are fully documented.
3. Call the Office of Program Review and Audit at (608) 266-2924 if you have any questions.

Introduction

Grant funds from the Department of Health and Social Services may only be used for allowable costs. The *Allowable Cost Policy Manual* sets forth the principles for determining the allowable costs of programs from the Department. The purpose of these principles is to determine costs, and they do not dictate the extent to which the Department will reimburse these costs. They are designed to provide that the Department's programs bear their fair share of costs, except where restricted or prohibited by law or contract. There is no intent for grant recipients to make a profit or other increment above allowable costs, except where specifically authorized by Wisconsin Statutes.

When determining whether a cost is allowable, an agency shall consult the following:

- The DHSS general principles for allowability that all costs must meet -- see Section I, "General Principles for Allowability."

- The federal cost principles applicable to that type of agency -- see Section II, "Federal Cost Principles."

- Items of selected cost where state policy differs from or expands on federal policy -- see Section III, "Selected Items of Cost."

- The contract or other program specific guidance for provisions applicable to the particular grant/program. Specific statutory provision, administrative rule, departmental policy or federal regulations may require exceptions to the provisions contained in this document. Where these exceptions occur, they will be specifically indicated in the contractual agreements between the state and the provider or county as exceptions to the allowable cost policy. In no instance shall the same cost be reimbursed more than once.

The guidance in this manual shall not be construed in any way to dictate or limit the amounts which agencies may expend. However, this material does specify what costs may or may not be allowable for inclusion in contracts and/or reimbursable from the Department of Health and Social Services. Agencies shall obtain written approval from the Department of Health and Social Services <u>prior</u> to incurring special or unusual costs.

Section I -- DHSS General Principles for Allowability

All costs that are reimbursed by Department programs must meet the following DHSS general principles for allowability, each of which is discussed in detail in this section:

- General criteria
- Direct Costs, Allocated Costs, and Indirect Costs
- Procurement and Purchase of Care and Services
- Related Party Transactions
- Revenue in Excess of Allowable Costs
- Third Party Revenue

General Criteria

In order to be allowable for reimbursement by programs funded by the Department of Health and Social Services, all costs must meet the following general criteria:

- Be necessary and reasonable for proper and efficient program administration and allocable thereto under these guidelines. A cost is *reasonable* if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. In determining the reasonability of a given cost, consideration shall be given to:
  - whether the cost is ordinary and necessary to the operation of the agency or to the performance of the award;
  - the restraints or requirements imposed by such factors as sound business practices, arms-length bargaining, laws and regulations, and terms and conditions of the program;
  - the market prices for comparable goods and services;
  - whether the individuals involved acted with prudence considering their responsibilities to the agency, the public at large, and the granting agency; and
  - whether the costs were incurred in accordance with the agency's established procurement policy.

Only costs that are directly attributable to specific work under a grant or to the normal administration of the grant are allowable for reimbursement. Costs that result in personal benefit are not allowable.

A cost is *allocable* to a program if the goods and services involved are chargeable or assignable to the program in proportion to the relative benefits received. See "Direct Costs, Allocated Costs, and Indirect Costs" for discussion of criteria for methods of charging costs to programs.

- Be authorized by the agency administrator or funding agency and not prohibited by state or local laws.

- Be in conformance with any limitations or exclusions set forth in this *Manual*, federal or state laws, or other governing limitations as to types or amounts of cost items.

- Be consistent with policies, regulations, and procedures that apply uniformly to both financially assisted activities and to other activities of the agency.

- Be accorded consistent treatment. Consequently, a cost may not be assigned to a program as a direct cost if any other cost under the same circumstances has been charged to a program as an indirect cost.

- Be determined in accordance with generally accepted accounting principles or other accounting method appropriate to the circumstances.

- Not be allocable to or included as a cost of any other federal, state, or other agency financed program in either the current or prior period.

- Be net of all applicable credits. *Applicable credits* are receipts or reduction of expenditure-type transactions that offset or reduce expense items allocable to programs as direct or indirect costs, including discounts or rebates subsequently received for prior purchases. Agencies are expected to take advantage of available discounts on purchases of goods and services. The granting agency may disallow the excess costs if a sub-grantee's costs are inflated due to failure to take advantage of available discounts or to report those discounts that were received.

- Be supported by the agency's accounting records and be adequately documented. See Chapter B2 "Accounting Records and Source Documentation" of the *Financial Management Manual for Counties, Tribes and 51 Boards* and the OMB Circulars for additional information on accounting records and source documentation.

Direct Costs, Allocated Costs, and Indirect Costs

The total cost of a grant program is comprised of the allowable direct costs incident to its performance plus its allocable portion of allocated and indirect costs, less applicable credits. The term "applicable credits" is defined above. The terms "direct costs," "allocated costs," and "indirect costs" are defined in the following way:

> *Direct Costs* - A direct cost is any cost that can be identified with a particular program or cost objective. For example, the entire salary of an individual who spends all of his or her time working on a single program can be charged as a direct cost to that program.
>
> *Allocated Costs* - A direct cost can directly benefit more than one program or function and can, therefore, be allocated (or charged) to the benefiting programs or functions on some reasonable and equitable basis. For example, an individual spends his or her time working on a number of different programs that the agency operates. Salary and related fringe benefits can be charged to the respective programs based on the number of hours reported to each program on employee time sheets.
>
> *Indirect Costs* - Indirect costs are those costs that are incurred by an agency that are not readily chargeable to a particular program or function, but benefit all programs and functions operated by the agency. Indirect costs are necessary to the overall operation of the agency, but a direct relationship to a specific program cannot be shown. An example of an indirect cost might be the salary and related fringe benefits paid to the agency's accounting staff and/or the executive director. Generally, these kinds of costs are identified, pooled, and charged against individual programs or funding sources using a rate designed to recover the costs.

The same type of cost may be a direct cost in one agency and an indirect cost in another agency, because each agency has to determine for itself which costs are direct, which are indirect, and how these costs can best be allocated to the benefiting programs. However, an agency must treat each item of its costs consistently as a direct, allocated, or indirect cost. Also, as noted under the general criteria, a cost may not be assigned to a program as a direct cost if any other cost under the same circumstance has been charged to a program as an allocated or indirect cost.

Direct costs shall be claimed whenever possible based on the nature of the costs and the accounting system in place. When indirect costs are charged, they shall be accumulated by logical cost groupings and distributed equitably to <u>all</u> programs or functions of the agency using a rate designed to recover the costs of the pool established through the indirect cost plan. Costs must not be charged to programs based on funds available or revenues received. The basis used shall be an equitable measure of the extent to which the cost incurred actually benefits the program to which it is charged. For example, square footage used by the various programs operated by the agency would be an equitable basis to allocate the total rent or utility costs incurred by the agency. Costs that are part of the agency indirect cost pool shall not duplicate any costs that are charged directly, and total costs charged <u>may not</u> exceed the actual costs incurred.

General departmental policies governing the allowability of allocated direct and indirect costs are as follows:

- **County Agencies -** Indirect costs for county agencies are allowable if the county develops and retains on file an approvable county-wide indirect cost allocation plan. Any allocated costs must be supported by a cost allocation plan. Both plans must be in accordance with the requirements of Office of Management and Budget (OMB) Circular A-87 and must be reviewed by the county's independent auditor as a part of the annual single audit.

- **Tribal Governments -** Indirect costs for the Tribal governments are allowable based on the receipt of an approved indirect cost rate that has been negotiated with the United States Department of Interior's Office of Inspector General and is included in the Departmental/Tribal contract. Any allocated costs must be supported by a cost allocation plan.

- **Other Agencies -** Indirect costs for other agencies, such as nonprofit organizations, for-profit businesses, local units of government (other than Counties), and educational institutions, must be reasonable; must be documented in writing in an agency-wide Cost Allocation Plan and an agency-wide Indirect Cost Plan; and must be allocated in a manner consistent with the above plans. These plans must be in accordance with the requirements of the applicable federal cost principles and must be reviewed by the agency's independent auditor as a part of the annual audit.

Procurement and Sub-Contracting

Each agency shall have policy and procedures in place to provide reasonable assurance that the agency's procurement and sub-contracting activities are in the best interest of the agency, considering its responsibilities to the organization, its members, employees, clients, the public at large, and the granting agency. Detailed guidance on procurement and sub-contracting can be found in OMB Circular A-102/Common Rule and OMB Circular A-110. These documents should be consulted when developing or assessing an agency's policy on procurement and sub-contracting.

All care and services purchased by the department, a county social services department, a county department of public welfare, or a board established under sections 46.23, 46.036, 51.42, or 51.437 of the Wisconsin Statutes shall be authorized by a written contract with the provider. For purchases of $10,000 or less, the requirements for a written contract may be waived upon written request to the appropriate DHSS contract administrator.

When procuring or sub-contracting under a grant from the Department, an agency will use its own policies and procedures, provided they adhere to the following minimum standards:

- **Written Standard of Conduct -** The agency shall maintain a written standard of conduct that includes a prohibition against any employee, officer, or agent of the recipient participating in the selection, award, or administration of a contract in which financial assistance funds are used, where, to his knowledge, he or his immediate family, partners, or organization in which he or his immediate family or partner has a financial interest or with whom he is negotiating or has any arrangement concerning prospective employment.

Public officials and employees should also be aware of Sec. 946.13 of the Wisconsin Statutes, which prohibits a public official or employee, acting in his private capacity, from negotiating, bidding, or entering into a contract in which he has private pecuniary interest at the same time he is authorized in his official capacity to exercise discretion in making or administering the contract.

Agencies should consult their corporation counsels, or equivalent, if they have concerns regarding conflict of interest.

- **Open and Free Competition -** Procurement and sub-contracting shall be conducted in a manner to provide, to the maximum extent possible, open and free competition.

    1. The agency shall be alert to organizational conflicts of interest or non-competitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade.
    2. Those who develop or draft specifications, requirements, bid invitations, requests for proposals, etc. shall be excluded from competing.
    3. Awards shall be made to the bidder/offerer whose bid/offer is responsive to the solicitation and is most advantageous to the agency.
    4. Solicitations shall clearly set forth all requirements that the bidder/offerer must fulfill in order for his bid/offer to be evaluated by the agency.
    5. Any and all bids/offers may be rejected when it is in the agency's interest to do so.

- **Minimum Procedural Requirements -** Recipients shall establish written procedures that provide for, at minimum, the following requirements:

    1. Procurement and sub-contracting actions shall follow a procedure to avoid purchasing unnecessary or duplicative items.
    2. Solicitations for goods and services shall clearly and accurately describe the goods and services to be procured or sub-contracted.
    3. Some form of price or cost analysis shall be made in connection with every procurement and sub-contract action to ensure that costs incurred are reasonable, that costs are allowable if they are charged to financial assistance programs, and that the agency is not paying for services which are otherwise available free of charge to the agency.

4. A system of contract administration shall be in place to ensure contractor conformance with terms, conditions, and specifications of contracts or purchase orders.

Related Party Transactions

A *related party transaction* occurs when one party to a transaction can influence the management or financial operating policies of the other party. Examples of related party transactions include, but are not limited to, transactions between: (a) divisions of an organization; (b) organizations under common control through common officers, directors, or members; and (c) an organization and a director, trustee, officer, or key employee of the organization or his immediate family either directly or through corporations, trusts, or similar arrangements in which they hold controlling interest.

The fact that two parties in a transaction are related does not automatically mean the costs incurred are inappropriate and unallowable. However, the public interest requires that an agency receiving state and federal funds act in a manner consistent with the public interest, which includes spending funds cost-effectively. Transactions between two related parties raise concerns that the public interest may not be adequately considered.

Therefore, a cost incurred as the result of a related party transaction will be considered allowable only if:

- The cost meets allowability criteria articulated in this policy manual, applicable federal cost circulars, and/or other pertinent state and federal guidelines; <u>and</u>

- The cost results from the agency following procurement and sub-contracting policies and practices that meet minimum federal and Department guidelines. (See the previous section for discussion of the Department's guidelines for procurement and sub-contracting policy.)

Additional considerations need to be made when determining the allowability of rental charges between related parties and of costs incurred under cost-reimbursement contracts:

- When an agency rents or leases property from a related party, allowable costs are limited to actual costs that would have been allowed had title to the asset been vested with the agency. Examples of allowable expenses of ownership include interest, depreciation or usage allowance, maintenance costs, and utilities, if not charged separately.

- As indicated in the introduction to this manual, there is no intent for a provision for profit or other increment above allowable costs, except where specifically authorized by the Wisconsin Statutes (See "Profit for For-Profit Agencies Which Provide Client Care" and "Reserved Amount for Nonprofit Agencies Using a Prospectively Set Rate" in Section III). In keeping with this intent, no profit or other increment above allowable costs shall be incurred for cost-reimbursement contracts that involve purchases or sub-contracts between related parties. Allowable costs are limited to the actual allowable costs incurred by the related party.

Revenue in Excess of Allowable Costs

Under contracts where payments are limited to allowable costs or to a percentage of allowable costs or contracts with for-profit agencies, any revenue in excess of the contracted limit must be returned to the granting agency unless the granting agency specifically authorized the agency to keep the revenue.

Third Party Revenue

Some contracts provide a specified level of funding and require additional revenues to be collected from various types of third parties. Typically an agency's accounting records need to show all revenues received by an agency regardless of source. Also, the agency must identify all revenues collected by a subcontractor that would reduce the amount of state or federal funds paid to the subcontractor and claimed by the agency from DHSS.

The Department expects that all agencies (both counties and private vendors) record gross revenues and expenditures in the appropriate accounts. Revenues should be clearly identified in the appropriate revenue ledger. The same principle applies to the recording of expenditures.

All contracts must be written to require that the revenue from sources other than the grant is to be used to offset the expenditures that would otherwise be charged to the grant. For example, there are cases where as a condition of the contract the contractor is expected to provide services up to a specific dollar amount identified in the contract with an expectation that the contractor would be billing other responsible parties, that is, private insurance companies, the client, or Medical Assistance (MA), for the service rendered. In cases where the amount collected from third parties exceeds the planned amount, the excess revenue must be used to offset expenditures previously charged to grants.

The Department's intent is for the agency's accounting system to include sufficient detail to identify the total cost of services and total revenue received by service and source.

B. COST ALLOCATION

<u>Issue</u>: *An agency is required to have an up-to-date cost allocation plan, and to <u>use</u> the plan to allocate costs among programs and grants.*

- A cost is allocable to a grant if it is treated consistently with other costs incurred for the same purpose in like circumstances, and if it:

  a) is incurred specifically for the grant;

  b) benefits both the grant and other work and can be distributed in reasonable proportion to the benefits received; or

  c) is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective (grant) cannot be shown.

- Any cost allocable to a particular grant or other cost objective <u>cannot be shifted</u> to other grants to overcome funding deficiencies, or to avoid restrictions imposed by the law or by terms of the grant.

- Some nonprofit organizations treat all costs as direct costs, except general administration and general expenses. These organizations separate their costs into three basic categories:

  a) general administration and general expenses,

  b) fundraising (which is not to be charged to any federal or state grant), and

  c) other direct allowable costs such as charging each grant its proportional share of joint costs (e.g., depreciation, rental costs, building maintenance, telephone, etc.)

- Allocating costs as above is acceptable provided each joint cost is prorated using a base which: (a) accurately measures the benefits provided to each grant or other activity; (b) is established in accordance with reasonable criteria; and (c) can be supported by current data. (See pg. 13 for examples of ways to allocate costs.)

- The other attachment (pg. 14 and 15) illustrates how allocated costs should be supported with essential documentation. Document #1, which is a CARS report for a month showing $500 in rent being charged to a DHFS grant, is supported by three documents:

  a) A <u>cost allocation worksheet</u>, showing how all agency rent costs for the month were allocated to the various grants, including the $500 to the DHFS grant (document #2);

  b) A <u>cost allocation plan</u>, which describes, documents, and supports the basis for allocating the various percentage of overall rent costs to the various grants (document #3);

  c) <u>Documentation of payment</u>, which is evidence that the agency actually incurred the allocated costs (document #4).

Ideas/Suggestions?

1. Make certain the agency's cost allocation plan is updated annually, at a minimum.
2. Both direct and indirect costs should be allocated (charged) to each grant on a monthly basis.
3. Retain all monthly cost allocation worksheets along with the cost allocation plan.

Allocation Bases for Cost Distribution

The allocation bases used to distribute central service costs to benefiting departments (or funding agencies) should equitably measure the level of the service provided to the user of the service. The allocation base must be both measurable and quantifiable. Common allocation bases include the following:

Central Service	Possible Allocation Bases
Accounting	Number of transactions processed
Auditing	Direct audit hours
Budgeting	Direct hours of service by budget staff
Building management	Square feet of space
Data processing	Systems usage (cpu time input/output time, printing time, etc.)
Disbursing services	Number of checks issued
Employee retirement system administration	Number of employees contributing
Equipment	Asset inventory values
Equipment services	Equipment maintenance provided
Insurance management	Dollar value of insurance premiums
Legal services	Direct hours
Management	Number of employees
Office space	Square feet of space occupied
Payroll services	Number of payroll checks
Personnel administration	Number of employees
Purchasing	Number of purchase orders
Utilities	Square feet of space occupied

Source: *Guide to Single Audits, paragraph 1525.16*, Fort Worth, Texas, Practitioners Publishing Company, June 1997, (800) 323-8724, www.ppcinfo.com.

Document 1

Auditor

April 199?

May 199?

CARS Report Expenses for June 199?

Expenditure Types	Month	Y-T-D
…………		
Rent	$ 500	$ 3,000
…………		
Total	$ 10,000	

Document 2

April, 199?

May 199?

Cost Allocation Worksheet Allocated Expenses for June 199?

Program Total	Utilities	%	Insurance	%	Rent	%	Cost #4	%	Etc.
Program/Grant A					$ 500	16.7			
Program/Grant B					$ 350	23.3			
DHFS Grant					$ 500	33.0			
Etc.					$ 400	26.6			
Total					$ 1,500				

Document 3

Cost Allocation Plan

Includes narrative describing the chosen methods for allocating certain costs to the agency's programs. It is the source of the percents used in document #2 to allocate costs among the programs listed in the left hand column. The chosen allocation method for rent could be the square footage of space occupied by the staff in each program. Or, if staff in programs are commingled and space differences between staff are not relevant, the plan might show how rental costs are allocated by number of FTE positions for each program.

For the example above, this plan would show that the agency is allocating 33 percent of rental costs to the DHFS funded program, based on some reasonable criteria.

Document 4

Documentation of Payment

Evidence of payment, plus supporting documentation, for rental costs which were incurred in the month of June. Since rental charges are typically prenegotiated and established by contract, and do not have invoices sent by the property owner, the type of supporting documents that we would expect to see is:

- A cancelled check (in the above example, for the amount of $1,500);
- A signed contract stipulating the agreed-upon monthly and annual rental costs.

C. ROLE OF THE BOARD

Issue: A *competent, well trained, focused, and active board is a key ingredient to an agency's efforts to effectively obtain and manage agency resources.*

- There can be a direct link between boards not knowing or doing their jobs, and nonprofits encountering financial and compliance troubles.

- An effective board…

  a) understands the organization's mission and acts to implement that mission consistently and effectively;

  b) sets the broad policies and lets the staff implement them;

  c) works primarily with the Executive Director, and sets clear expectations and uses these to evaluate the Director's performance at least annually; and

  d) changes over time, filling its membership fully by recruiting new members to meet the changing needs of the organization.

  e) creates and utilizes a Finance Committee for in-depth review and monitoring of agency finances.

- Getting the right people to serve on the board is crucial. The agency should identify skills needed; e.g., a small business operator, officer of a bank, etc. are good choices for a finance committee. The board should appoint a nominating committee to pursue the recruitment and approval of board members in accordance with agency by-laws.

- Board members must meet certain standards of conduct in carrying out their duties to the organization. Board members may be held personally accountable if they fail to exercise reasonable oversight of corporate affairs. Clarity of roles and responsibilities of board members and of each committee is vital, as is obtaining training in this area. For example, Board members should maintain an organization-wide, long term view, understand the legal concepts of "duty," "loyalty," and "obedience", and focus on board operations in addition to matters of central concern to the agency.

- The board also needs to fulfill all of its duties and responsibilities. These are too numerous to mention here, but some key ones in the fiscal area (most of which are discussed later in this packet) are to:

  a) Ensure that fiscal policies are in place and followed;

  b) Help develop and adopt budgets, and make sure the budget reflects policies and organizational goals set by the board through long-range planning;

  c) Monitor income and expenditures throughout the year, and make changes to the budget as needed;

d) Ensure compliance with funding sources' policies and regulations, including IRS and state nonprofit reporting requirements;

e) Hire the independent auditor, and review and follow up on findings and recommendations in the audit; and

f) Oversee fundraising and/or raise funds. In the absence of a fund raising department and/or staff, the board may assume full responsibility for fund raising.

- Many boards delegate the oversight of financial operations to a Finance Committee whose key responsibility is the financial well being of the agency. The Finance Committee provides routine governance of finances and reports regularly to the full board. For example, monthly financial reports must be reviewed in detail yet this task is time consuming. A Finance Committee can complete these reviews and report its findings to the full board. Many examples of other Finance Committee duties are discussed throughout this handbook.

Ideas/Suggestions?

1. Develop a position description for the "position" of board member. Use it to define board member duties and responsibilities. Include it in a board packet containing vital board information; e.g., by-laws, mission statement, policies, etc.
2. Have the board annually evaluate the board's performance.
3. Develop and use committees. Write out responsibilities, scope and limit of authority, and operating procedures of each committee. Keep clear what the committee's job is, its relationship to the full board, and on what issues the full board must act.
4. Work with peer agencies to develop training for board members in order to spread cost, get critical mass of attendance, and cultivate relationships with others holding similar duties.
5. Obtain and share further written information on board operations – legal duties, best practices, tools for self-evaluation, etc. (See list of attached web sites and resources.)

D. FINANCIAL REPORTING

Issue: *Producing informative, timely, and accurate financial reports - and* using *them - is a key element of effective financial planning and maintaining control.*

- An agency needs to have monthly budget-to-actual comparisons for both income and expenses and to be able to see where budget plans may be going awry. The reports should contain comparisons for the month and year-to-date and, possibly, for the previous fiscal year.

- Obtain monthly, or at least quarterly, balance sheets in order to track changes in an agency's cash position, payables, receivables, and other key financial indicators.

- The timely posting of expenses, and claiming of revenues, is critical to accurate monthly reports. These reports are useful for monitoring and planning. They also alert the board to when and where intervention may be needed to problem solve or avert crisis.

- Effective formatting of these reports is critical, as it can help to navigate through a potentially confusing maze of numbers that may be hard to analyze; e.g., include percentage differences to help in efficiently isolating variances, group expenditures in common areas, provide meaningful descriptors of types of expenditures and revenues.

- The agency (i.e., executive director, board members, designated management staff) needs to analyze these reports, ask lots of questions, and follow-up as needed to get answers to the issues raised by the financial reports.

- Individual programs or departments incurring sizeable expenses and revenue may require their own separate income and expense reports to detail cash flow and program efficacy.

For additional information see pages 19-22, "Reports and Board Financial Leadership".

Ideas/Suggestions?

1. Work with your agency's available software to design useful, informative financial reports, either by using knowledgeable agency staff or an outside paid consultant like your auditor. If the current software has limited capabilities, new software should be investigated as an option.
2. Strive to get reports in the hands of finance committee members prior to committee meetings. This gives members enough time to meet and/or review the material resulting in effective board reporting and review.
3. Create the expectation that staff will, at each meeting, explain significant variances (e.g. income lagging behind budget, or spending above budget) and that the board will take proper action.

REPORTS AND BOARD FINANCIAL LEADERSHIP

The board of directors of any nonprofit agency has certain duties related to financial leadership, planning and oversight. The board's goal should be to carefully define these duties and responsibilities and ensure that they are effectively carried out. Some of these responsibilities include: 1) reviewing and approving an annual budget, 2) monitoring the status of the budget (both revenues and expenses) throughout the year, 3) establishing short and long range fiscal goals, 4) monitoring the fiscal stability of the agency, 5) ensuring that the agency's assets are adequately protected, and 6) reviewing and approving action plans put forth by agency management to adequately address fiscal issues.

Evidence of efforts to fulfill these responsibilities should, among other places, show up in board and committee meeting minutes. Information on board meetings that the agency should maintain include meeting agendas, information provided to the board prior to or at each meeting, and minutes of the meeting. Minutes should reflect points of discussion and decisions; e.g., questions posed by board members, responses offered by agency management, and actions taken by the board. Minutes should also reflect discussion regarding dollar discrepancies as compared to the approved annual budget projections.

The board must ensure that financial reports are completed and maintained by someone with a working understanding of accounting. The reports should be reviewed on a regular basis by board or committee members (usually a finance committee) comprised of individuals who understand business finances.

Processes and reports critical to nonprofit agencies' financial awareness and stability are listed below. The board as a whole should expect to receive a copy of the annual budget. They also need regular progress reports via copies of the financial statements (e.g., balance sheet, income and expense statements, etc.) and/or through reports to the board. Financial progress must always be viewed in terms of meeting the agency's mission and funding needed programs and services. The actual work of scrutinizing the reports is time consuming and, therefore, should be a committee function. These reports must be reviewed in great detail and a finance committee can devote an entire meeting to this important task. Board members should expect a summarized report followed by a question and answer session at the regular board meetings.

The following section provides a narrative description of important items needed by the board in exercising its financial leadership of the agency. It identifies tools and/or questions that board members can use to assess the financial performance of the agency they are charged with leading.

Policies

Policies that govern agency practices must be approved by the board and on file with the agency. Board members should have copies, also. Some of these policies will impact directly on finances; e.g., personnel policies. Personnel policies detail the accrual and disbursement of staff salaries and paid time off. These costs must be projected for the next budget year and regularly maintained in the financial records. Personnel costs tend to be the largest operational expense for agencies. (See section E for further detail regarding policies and finances)

Budget Development

Several months prior to the end of the fiscal year the development of the following year's budget should commence. Staff and board may collaborate on this document which will forecast agency revenue, expenses and potential cash flow issues. It is important to anticipate changes (increases or decreases) in revenue and expenditures. A plan must be developed to address these changes to ensure the agency can afford to cover operations over the next year. The new budget should be board reviewed, revised (if necessary) and approved, and ready for implementation at least one month prior to year end. Some important items to consider during this process may include:

- To what extent have the needs of the target population served by the agency been reflected in the proposed budget?

- Has the agency provided for input from all major program directors in the budget development process?

- Are unusual expenses (e.g., new heating/air system, van) anticipated and revenue sources identified to cover these expenses?

- Is it anticipated that any regular sources of revenue will be decreased or eliminated entirely? If so, are there plans to adjust operations accordingly? For example, do services need to be reduced or staff cut or both?

- Is an increase in revenue projected? If yes, is it realistic? Where are additional dollars coming from and when will they arrive?

Units of Service

An agency needs to have some way of measuring the success of its programs in meeting overall agency objectives. In addition, the board needs to understand the budget within the context of providing services and meeting the agency's mission. A useful task is to consider the success in meeting program objectives along with the cost of achieving them.

One tool helpful in providing this information is a monthly report regarding the numbers served/admitted to the program(s)/agency, terminated from services, refused services; the capacity of the program, the ratio of staff-to-consumers, or other program management data useful to your agency. Because staff should be compiling these numbers for various internal and external reports, sharing this information with the board is fairly simple. Some considerations regarding units of service may include:

- Are units of service defined clearly? Do you understand the numbers reported in relationship to the services delivered?

- Is the level of performance acceptable for the money you're spending?

- If units are low, why isn't the community accessing your services? Should action be taken to address this issue? Is this service needed locally?

- If expenses increased, did something happen (e.g., increase in numbers served, extra staff needed, etc.) in the programs that contributed to the increase?

- It's useful when assessing performance to have some base level performance from which to start. For example, how is the current performance compared with previous performance or with other agencies with similar services?

Balance Sheet

In monitoring the overall fiscal condition of the agency, balance sheets contain useful indicators of an agency's financial performance. The balance sheet allows the board to clearly see the progression of monetary activities reflected through agency assets and liabilities. Although balance sheets are typically prepared monthly, board review of balance sheet information may be done on a quarterly basis. It is helpful if the balance sheet contains the previous year's level of assets, liabilities, net assets and the percentage changes (variance) between the years. Comparison of the current year to the prior year is essential to determine the overall financial position. When reviewing balance sheets, some things to consider may include:

- Is the agency's cash position at a level considered reasonable? Look at the agency's cash position in relation to current liabilities; are there sufficient funds on hand to meet current expenses? If not, is there a plan in the works to deal with the situation?

- If receivables are increasing over time is this due to the age of the receivables? If yes, the agency may need to be more aggressive in pursuing payment, or, in the case of grants receivable, submitting timely expenditure reports.

- Are the agency's payables on the rise? If increases in payables are periodic, that probably is not a problem. However, high and increasing payables, combined with dwindling amounts of cash, could indicate that the agency is heading toward financial difficulties. (This is especially true if payables are attributable to unpaid employee withholding or insurance premiums for staff benefits.)

- What is the reserve position of the agency? Is the fund balance declining? If yes, what is your plan to address the decline? If expenses exceed revenue year after year, the agency's fund balance will diminish and could eventually become negative. If possible, keeping one month's operating costs in reserve helps the agency if unforeseen events occur.

- If the agency needs to borrow money, the lender may review the balance sheet to assess an organization's potential ability to repay a loan or line of credit. The debt/equity ratio (or in the case of nonprofit organizations, the ratio of long term debt to the agency's fund balance) is a quantitative way of assessing borrowing potential.

Income and Expense Statements

Income and expense reports provide important information regarding the actual performance of the monthly finances in relationship to the projected budget. The reports reflect actual financial activities for the previous month(s), that month's profit or loss, and the percentages of income and expenses to date compared to the projected budget amounts. A more comprehensive review of income and expense data will be facilitated if the information presented also contains prior year data and percentage differences between one year and the next.

Grouping related items together and calculating subtotals for each group is a helpful format. For example, payroll expenses can be captured under the heading, Personnel. Building overhead (rent, shelter, insurance, cleaning, repairs, etc.) may be called Building or Physical Plant. This will help to focus attention on spending at a more general level rather than risk getting lost in all of the detail. The committee assigned finances will perform the important task of scrutinizing details, a job that must be done.

- Are revenues collected to date meeting the budget projections? If not, is there a good explanation? For example, if there is a gap between projected and actual funds raised and major fund raising activities have not taken place yet, the gap may not indicate a problem.

- If expenses were higher than revenue last month, was this anticipated? Is it readily explained or is it alerting you to a potential trend or problem?

- Are funds being expended more quickly than anticipated? If yes, why? How will this impact on funding services for the rest of the year?

- Are there any cases where spending for a particular line item substantially exceeds prior year spending? If so, is the increase traceable to a current year budget action by the board?

Audit

An annual audit by an independent firm is required by DHFS for agencies receiving more than $25,000 in DHFS funds. In addition, this is a valuable tool for the agency for comprehensive understanding of the previous year's financial activities. Actual dollars and agency financial procedures are analyzed and tested. Recommendations for changes and/or improvements are provided by the auditors to help the agency comply with rules and regulations and operate at a greater level of efficiency. In the worst case scenario, they may also find funds mismanagement and abuses, critical information needed by the board as soon as possible. (See Section G for more information about audits.)

E. FINANCIAL POLICIES AND PROCEDURES

Issue: *An agency needs approved, up-to-date, and effective financial policies and procedures.*

- Policies and procedures are needed for a variety of reasons, including:

  a) clarity and consistency in communicating who does what job in key fiscal processes;
  b) minimizing disputes and performance gaps due to confusion on duties and responsibilities;
  c) handling training needs more efficiently during staff turnover; and
  d) establishing a firmer legal basis for action when staff performance issues arise - policies are considered the internal law of the agency.

- Finding the time to write - and especially update - policies and procedures is difficult to do.

- To develop good policies and procedures that people will support, involvement of many people (i.e., board members, managers, fiscal staff) is needed.

- The best written policy and procedure statements have common elements, including:

  a) a purpose or goal(s) statement in the policy;
  b) a date the policy was enacted (or revised) and documentation of policy approval in the board minutes;
  c) specific steps in the procedures being established to implement a policy, including delegated responsibility (i.e., who, what & when);
  d) a statement of performance expectations to be met in each step of the process; e.g. a timeliness requirement ("something taking no longer than 2 days to complete") or a thoroughness requirement ("a request for purchase needs to include the following seven elements…");
  e) model or required formats for documents that are created as a result of the policy; and
  f) references and links to other policies, as appropriate.

- Which written policies to start with is an issue if none or few have been developed. Some areas that should be considered a high priority for developing policies and procedures include: (1) the review and approval of expenditures; (2) receipt handling and deposits of cash and checks; (3) financial reporting to the board and outside funders; (4) preparation of and amending the annual budget, and (5) personnel policies.

Ideas/Suggestions?

1. Create an inventory of existing policies and procedures and the date they were last reviewed. Include policies the agency does not yet have, and use this list to set priorities on financial policy development work.
2. Develop and select a consistent format for all policies to promote efficient development and review.
3. Consult with peer agencies to obtain policies in your areas of need.
4. Seek literature and/or guidance on model policies and procedures from national nonprofit board associations, or check with local UW-Extension agent on available resources.
5. In areas where work is needed, consider establishing teams that involve staff and board members to promote mutual awareness of agency practices, gain the benefit of various perspectives, and build consensus on policies that are developed.
6. Obtain professional advice from your independent auditor through review of existing, as well as drafts of new, policies and procedures.
7. The board is responsible for the review and approval of all policies and procedures. Periodic policy review should be on the board agenda.
8. A policy committee may be developed and assigned the job of policy review and recommending revisions. Also, the board may rely on input from other committees and staff liaison to those committees to ensure practical policies and procedural recommendations prior to approval.
9. Get the board to commit to a part of maybe two meetings a year to review existing policies, with a focus on working with staff to confirm that the policies and procedures are accurate and work.

F. RECONCILING FINANCIAL RECORDS

<u>Issue</u>: *An agency needs to reconcile financial records on a periodic basis.*

- Agencies are responsible for timely, monthly reconciliation of various accounting records. Reconciliation of records should include:

  a) Tying out and totaling subsidiary ledgers to the general ledger.

  b) Reconciling the agency's bank statements to the agency's accounting records.

  c) Reconciling expenditures reported to funding sources for reimbursement with the agency's accounting records.

- There are many reasons why an agency should perform reconciliation. Reconciliations are required by contract, and are necessary to ensure that expense reports are accurate. Reconciliations also help to prevent and detect fraud or misuse of funds, and can quickly identify problems that may occur in financial records, prompting corrective action.
- From the DHFS perspective, reconciliation is a key component of an agency's commitment to ensuring that expenditures in the monthly CARS report are backed up by, and can be tied out to, actual entries of expenditures in the agency's accounting records.
- This is something that auditors test. An agency can show it is complying with this requirement by having a written policy on reconciliations, using and retaining standard worksheets showing that reconciliations are being done on a timely basis, and retaining evidence of supervisory review and approval of reconciliation work and any adjusting entries.
- On two related issues: (1) the DHSS Allowable Cost Policy Manual requires accrual accounting, that is, expenditures should be recorded as they are incurred, rather than when the bill is paid; and (2) agencies should be charging depreciation and other allocable expenditures to the various funding sources on a monthly basis, rather than only at year-end.

Ideas/Suggestions?

1. Set a standard that bank reconciliations should be completed within 3-5 days of receipt of the bank statement.
2. Have the finance committee on a periodic basis ask for and review the latest reconciliation worksheets.
3. Any adjusting entries made as a result of the bank reconciliation should be promptly recorded.
4. Follow-up on large discrepancies to figure out why they happened and whether procedural changes are needed to avoid them in the future.
5. Bank service fees should be promptly recorded in the general ledger. Large bank service fees should be investigated for validity that may lead the agency to seek a bank with lower or no additional fees.

G. ROLE AND USE OF ANNUAL AUDITS

Issue: *Agencies need to have - and use - annual independent audits.*

- Agencies receiving more than $25,000 in DHFS funds are required to submit an annual audit to DHFS and other state funding agencies, as required by the grant contract, the DHFS *Provider Agency Audit Guide (PAAG)*, and state statute. As a result of a change in federal audit policy, agencies expending less than $300,000 in federal funds no longer need to have agency wide or program specific single audits. The cost of such audits would not be chargeable to federal programs.

- The attached chart (see page 29) "Audit Standards and Report Elements for Different Types of Agencies" should be used by both your auditor and agency as a final checklist prior to placing the audit report in the mail to DHFS. Questions about these elements can be answered by your auditor or by calling DHFS' Office of Program Review and Audit (OPRA) at (608) 266-2924.

- For an audit to comply with the PAAG, the audit needs to: (1) have an opinion on the agency's financial statements, which is in conformance with *Generally Accepted Auditing Standards (GAAS), (2)* meet *Government Audit Standards: 1994 Revision (a.k.a. "The Yellow Book*") standards, and (3) have an opinion attesting to the degree to which an agency complied with the DHFS general requirements listed in the PAAG.

- Audits must be received by DHFS within six months after the end of the agency's fiscal year . DHFS uses audit reports to monitor agency fiscal performance. DHFS follows up on late audits not received and may impose fiscal sanctions on agencies that fail to comply. Audits should be sent to DHFS/OPRA; Room 951, One West Wilson; P. O. Box 7850; Madison, WI 53707.

- The most common missing required element is the agency's written management responses and corrective action plans for any audit findings. A complete response needs to include:

  a) whether management agrees with the finding and, if not, why not;

  b) anticipated corrective actions that have been or will be implemented to rectify the findings; and

  c) dates of actual or anticipated corrective actions.

- In addition to assessing compliance, audits provide useful analysis of the agency's fiscal performance. An audit is a source of objective information on key questions, such as:

  a) how much money the agency earned and spent last year, and with how much cash the agency ended the year;

  b) what the value of agency assets was at year end, and how these compare to liabilities;

  c) whether the agency's accounting system is working well, and whether records are in good shape;

d) whether the agency's control systems are functioning properly to safeguard assets; and

e) whether improvements in agency fiscal policies and processes are needed.

- The board plays a pivotal role in the audit process. Bids can be obtained from several auditing firms to secure auditors and plan for costs to the agency. The board – not management -- hires the independent CPA firm to perform the audit. The web site (http://home.gvi.net/~edoig/prochand.txt) offers pointers on how to go about hiring a good audit firm. The engagement letter is the means by which the board tells the firm what it wants out of the audit:

  a) The board should carefully review the audit engagement letter to ensure that the audit will be performed in accordance with the *PAAG* and other contractual requirements and include all required elements (see attached schedule).

  b) The engagement letter is the perfect opportunity for the board to include any additional analytical or performance reviews of the agency to provide the board with additional information in areas of special interest.

- The board is responsible for reviewing the completed audit report and subsequent corrective action plans.

  a) The board should review the audit for completeness of required elements, as well as the quality of any additional analytical or performance reviews performed by the auditor.

  b) Board members or representatives of the board (e.g. the finance committee or the executive committee) should meet face-to-face with the auditor to go over audit findings and recommendations for improvement.

  c) The board should review the executive director's corrective action plan that addresses audit findings or recommendations for reasonableness, timeliness, and cost effectiveness. The recorded implementation dates should prompt the board to follow up to ensure that corrective action occurred as projected.

Ideas/Suggestions?

1. Read the audit and ask lots of questions. To make the process educational, ask the auditor to fully explain why recommended changes are important and how they will benefit the agency.
2. Hire your auditor early in the fiscal year to avoid a last minute rush in completing the audit. Projected costs for next year's audit should be included in the annual budget.
3. Encourage feedback from the auditor, viewing this as an important learning process critical to the agency's well-being. Try not to be defensive.
4. Check with the auditor to find out how much prep work with financial records the auditor had to do that could have been handled by staff beforehand helping to reduce audit costs and staff stress.
5. Make sure corrective actions are taken on a timely basis. Strive to avoid repeat findings.
6. Consider the following efforts to promote quality auditing: (a) check references during the hiring phase; (b) rebid the contract every 3 to 5 years to promote independence; and (c) ask for a copy of the auditor's latest peer review report, to see what the auditor's peers say about the quality of the auditor's work.

Audit Standards And Report Elements For Different Types Of Agencies

	Nonprofit Organization which expended more than $300,000 in federal financial assistance	For Profit Organization or Nonprofit Organization, Tribe, or Local Government which expended less than $300,000 in federal financial assistance	Local Government or Tribe which expended more than $300,000 in federal financial assistance
Applicable audit standards:			
Generally accepted auditing standards (gaas)	T	T	T
Government Auditing Standards (GAS)	T	T	T
OMB Circular A-133 (A-133)	T	NA	T
Provider Agency Audit Guide (PAAG)	T	T	NA
State Single Audit Guidelines (SSAG)	NA	NA	T
Report elements to be sent to funding agency (and source of requirement for this element):			
Opinion on the financial statements (gaas)	T	T	T
Financial statements and notes thereto (gaas)	T	T	T
Schedule of expenditures of federal awards (A-133)	T	NA	T
Report on compliance and internal control over financial reporting based on an audit of financial statements performed in accordance with Government Auditing Standards (GAS)	T	T	T
Report on compliance with requirements applicable to each major program and internal controls over compliance in accordance with OMB Circular A-133 (A-133)	T	NA	T
Schedule of findings and questioned costs, including a summary of the auditor's results (A-133)	T	Note 1	T
Summary schedule of prior audit findings (A-133)	T	Note 1	T
Data collection form (A-133)	T	NA	T
Additional report on immaterial noncompliance and other items not required to be reported according to A-133 (management letter) or assurance one was not issued (A-133, *PAAG*, and *SSAG*)	T	Note 1	T
Corrective action plan (Management's responses) (A-133, *PAAG*, and *SSAG*)	T	T	T
Assurance that the audit was in conformance with the State Single Audit Guidelines (*SSAG*)	NA	NA	Note 2
Assurance that the audit was in conformance with the Provider Agency Audit Guide (*PAAG*)	Note 2	Note 2	NA
Summary of audit results (*PAAG*, page 27.8)	Note 3	T	NA
Disclosure of Adjustments to Reported Expenses Checklist (*PAAG*, page 27.1)	Note 4	Note 4	NA
Supplemental Schedule and Reconciliation of Audited Expense to Contract Expense (*PAAG*, page 27.3)	Note 5	Note 5	NA
Supplemental schedule for group homes and child caring institution facilities (applicable only if the agency operates such facilities) (*PAAG*, pages 27.4 & 104-115)	T	T	NA

Notes:

1. Noncompliance and internal control weaknesses identified in the current audit and uncorrected prior year audit findings need to be reported to the funding agency. These issues can be reported in a schedule of findings and questioned costs, a summary schedule of prior audit findings, and/or a management letter.

H. INTERNAL CONTROL PROCEDURES

<u>Issue</u>: *The keys to internal control procedures include having good oversight in reporting, good theft prevention by reducing temptation, and good records to allow for easy auditing and analysis.*

- The types of controls employed by an agency need to be well thought out and right for the agency. Avoid unnecessarily lengthy or complicated controls that create inefficiency and may result in…

- … a breakdown in controls (e.g., fraudulent use of funds) that can seriously damage an agency's reputation. Negative publicity can severely compromise an agency's ability to raise funds and remain viable. Diligence is needed.

- Types of controls needed to implement and maintain functional controls:

  a) <u>Cash controls</u> - Segregate duties so that one person logs in checks and cash, another deposits, and a third reconciles the bank statement. Note: all employees handling cash should be bonded. Also, funds mismanagement should be covered in the agency's insurance policies.

  b) <u>Payables controls</u> - To prevent collusion and overpayment, the person who receives goods or services should not be the person who writes the check to the vendor.

  c) <u>Debt policy</u> - Be specific. For example, can the executive director increase a line of credit without board approval or can the finance committee enter into new debt without board approval?

  d) <u>Dual check signatures</u> - Many providers find that requiring two signatures on all checks over a certain amount lessens the opportunity for fraudulent payments.

  e) <u>Reporting</u> - Who generates what reports, how often, and to whom are they distributed? These are discussed under Item "F."

  f) <u>Confidentiality</u> -- Agency policy should state that financial information is confidential and is not to be shared with others outside the agency, except for auditors, funding agencies, and designated others who need the information, and only with the express written approval of the board.

Ideas/Suggestions?

1. Tips for maintaining control over agency resources:
   a. Regulate the authority given to each person who has financial responsibilities.
   b. Regulate the executive director's ability to accept gifts or commit to investments without board approval.
   c. Review all insurance policies for sufficiency to meet current needs.
   d. Periodically trace randomly selected items in the accounting records and compare them to the underlying source documentation, looking for authorization, validity, reasonability and accuracy.
   e. Set a maximum amount for expenditures made by staff without board approval. (This does not include recurring payments such as rent, utilities, etc.)
2. Consider the following -- In offices where the small staff size makes segregation of duties impractical, implement the periodic rotation of duties among employees. In addition to job continuity and back-up during staff absences, staff will provide informal auditing of the tasks (e.g., is there any noticeable change in amounts recorded by different individuals?) and employees' performance.
3. Periodically evaluate accounting data for reasonableness. For example, are costs increasing despite a decrease in the number of clients served?
4. Ensure that computer records are backed up daily and the backup tape (or disks) stored in a secure location offsite. If an offsite location is impractical, at least store the backups in a fireproof safe to allow the re-establishment of the agency's records should the agency be destroyed by a fire or other disaster.
5. Access to cash, the computer and other valuable assets should be restricted to only authorized employees. Physical safeguards such as locks on cash boxes and computer passwords limiting access should be employed.
6. Eliminate use of agency credit cards or, at least, tightly restrict their use. When the monthly bill arrives, require strict accounting for every charge on the agency's credit card.
7. Have the finance committee review bank statements, canceled checks, or at least a list of checks, at each committee meeting. This becomes a more important process if a board member is not required to be a co-signer of checks. For example, ensuring payroll taxes are paid on a timely basis is critical to avoiding agency liability, interest and penalties. The process could be refined to include only checks over a certain amount, or for items not already approved in the budget, such as monthly rent or utility charges.

I. FUND RAISING

Issue: *The need for nonprofit agencies to raise funds is significant and growing.*

- An agency cannot truly "get ahead" only on cost reimbursement contracts. An agency needs to successfully raise funds if it wants to raise capital and increase net equity.
- Fund-raising needs to be done in a creative and cost-effective manner. See Strategies Checklist, page 34, for a laundry list of fund-raising and budget cutting ideas.
- The pattern of raising funds among nonprofits in Wisconsin shows a wide range of success, with some showing comparatively large portions of their budgets funded through donations.

Ideas/Suggestions?

1. Have fund raising as a topic at meetings with peer agencies where others in attendance have like needs and concerns. Share ideas on what works and learn good lessons from peers that have encountered fund raising successes. Bring in experts to offer advice.
2. Pull in local marketing experts in your area for advice/consultation re: your agency's plans and/or as members of your fund raising committee.
3. Maintain good donor relations; e.g., timely "thank yous", keep them apprised of how you used their funds.
4. If your agency does not have development staff, involve board members in fund raising, especially in coordinating fund raising with agency long-range financial plans.
5. Inform potential board members of their expected level of involvement in fund raising as a board member.

Issue: *Agencies need to make certain that fund raising efforts comply with requirements.*

- The Department's *Allowable Cost Policy Manual* includes certain limits and requirements on fund raising. Specifically,

  a) Item 3(b) "Costs of organized fundraising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions are unallowable." (OMB Circular A-122 as amended 8/29/97)

  b) Page B3-16, Item 12. "**Gifts and Donations to the Agency –** Gifts and donations to the agency shall be reported as permanently restricted net assets, temporarily restricted net assets, or unrestricted net assets based on the existence or absence of donor-imposed restrictions. The governing board of an agency may choose to designate its unrestricted funds for specific purposes. Information about restrictions and designations shall be provided in the financial statements or notes thereto. Unrestricted gifts and donations that have not been designated for a specific purpose at the time of receipt shall be used to offset expenses."

- Designate uses of the funds raised at the time donations are received, in order to avoid having donations viewed as general revenues that can offset grant costs.

- Designating uses of funds should be tied to financial plans based on identified needs. One of many valid needs is an operating reserve that is board approved and is reviewed and updated periodically.

- Fund raising costs are not allowable expenses that can be charged to federal or state grants. These costs can, of course, be charged to the fund raising proceeds. The agency needs to be certain its accounting system keeps fund raising costs separate.

- Funds expended in preparing bids, proposals or applications for grant funds are allowable costs. Such costs incurred during the current accounting period (i.e., the agency's fiscal year) are allowable as indirect costs and are chargeable in accordance with the agency's mechanism for recovering indirect costs. Such costs incurred in past accounting periods are unallowable in the current period. Other treatment of these costs may be acceptable if it results in reasonable and equitable charges. (See Code of Federal Regulations, 45 CFR, Part 74, Section 74.27)

- Ensure fund raising efforts comply with state and local requirements (e.g., obtain license for raffle) and are covered under the agency insurance policies.

Ideas/Suggestions?

1. Make certain everyone fund raising on behalf of your agency is informed of the rules.
2. Develop an operating reserve policy (e.g., a typical reserve is equal to two months of the operating budget).
3. Document fund designations – and any changes in classification; i.e., restricted to unrestricted, in the board minutes, and make certain the audit accurately reflects status of equity and fund designations in the agency.

STRATEGIES CHECKLIST
Coping with Cutbacks:
The Nonprofit Guide to Success When Times Are Tight

We offer this checklist as a thinking tool and as a route to direct action. A more in-depth list is in the book. We hope that you can use this list to help you think creatively about your organization, its culture, its mission, its future, its response to immediate financial crises, and its long-term preparation for the changing culture.
Use these suggestions as a starting point for your own brainstorming, and use the categories to help you organize your thinking and analyze your current approach to fulfilling your mission. But don't get locked into any one strategy--cut them up, pull them out of a hat, mix and match them. Do whatever helps you spur new ideas that fit your specific situation.

Here's our caveat: Just because we've listed a strategy, don't think we endorse it. In fact, we dislike some, and some may conflict with your mission, values, or human resource policies.

No doubt you'll think of many more strategies than we've listed here, as well as other ways to organize them. Tell us about them and we'll include them in the next edition of this book.

Financial Strategies A: Cut or Control Costs

Analyze purchasing

1. Improve purchasing procedures
2. Seek in-kind contributions
3. Network to get better prices on supplies
4. Seek new competitive bids and new suppliers
5. Analyze purchases to see if they are necessary
6. Simplify paperwork and forms; use electronic files
7. Refurbish and reuse supplies

Adjust payables

1. Consolidate or restructure debt
2. Negotiate delayed or reduced payments
3. Barter for needed services

Evaluate facilities and infrastructure

1. Share space or maintenance costs
2. Delay maintenance
3. Save space by moving, reducing size, using home offices, or using split shifts
4. Negotiate a decreased rent with your landlord
5. Find a cheaper phone system; eliminate toll-free lines
6. Eliminate or consolidate newsletters and brochures
7. Eliminate vehicles or shift to less costly vehicles
8. Save energy

Modify staffing and related costs

1. Reduce hours or work week
2. Cut, freeze, or delay wages;
3. Lay off staff; offer voluntary separation; offer unpaid leave; remove poor performers
4. Freeze hiring
5. Share jobs, consolidate staff, increase workload
6. Use volunteers and graduate interns
7. Hire temporary staff or consultants
8. Remove management layers; don't funnel high performers into management merely to reward them
9. Reduce benefits, staff training, and staff development
10. Limit or eliminate travel
11. Cancel subscriptions; use the Internet and libraries
12. Cancel professional association memberships
13. Switch to a direct reimbursement status for unemployment compensation
14. Ask board not to submit expenses for reimbursement
15. Convert some paid staff to volunteers
16. Share staff with other organizations

Reduce services

1. Analyze your programs and services against your mission and financial goals
2. Reduce or eliminate non-core programs
3. Limit eligibility for programs; reduce the number of clients served

4. Reduce or eliminate core programs
5. Temporarily shut down some or all services
6. Plan to go out of business humanely

Financial Strategies B: Increase Revenues

Manage money differently

1. Speed the inflow of cash by invoicing promptly or offering incentives
2. Try to get grants in the door earlier than the promised date
3. Change management of cash reserves to improve unearned income
4. Sell assets
5. Spend down reserves
6. Borrow money
7. Diversify your sources of income

Increase fees

1. Analyze all the costs of providing a service
2. Change fee structure to result in increased income

Initiate or accelerate fund-raising

1. Research the larger community and current donors to improve response
2. Hire development director or staff
3. Add special events, fund drives, charitable gambling
4. Increase board involvement in fund-raising
5. Increase planned giving
6. Build an endowment
7. Find new donors and diversify funding base
8. Reach out to under-asked populations
9. Collaborate on fund drives; join a federated fund drive
10. Mobilize everyone in the search for new resources
11. Link with a business or credit card company to receive a percentage of sales
12. Seek in-kind contributions that can be converted to cash
13. Increase the search for foundation and government grants

Expand or add services

1. Boost enrollment in or expand offerings of successful services
2. Sell staff expertise and time
3. Add income-generating product or service that fulfills mission
4. Rent office space or equipment to others
5. Sell valuable information that others need
6. Seek related niche markets
7. Charge others for a service you also use (for example, maintenance)
8. Develop a catalog of products used by your organization and other nonprofits
9. Charge a fee to serve as the fiscal agent for other organizations

Increase productivity

1. Provide incentives for productive staff
2. Simplify production or service without loss of quality
3. Invest in an educated staff; provide training as needed
4. Research and implement "best practice" in all functions
5. Upgrade staff while cutting back
6. Invest in technology that improves productivity

Structural Strategies

Modify the mission

1. Reexamine the mission and realign the organization accordingly
2. Modify the mission to build clients' capacity to solve their own problems
3. Change the mission to enable the organization to respond to rapidly changing conditions
4. Move out of direct support services and into prevention services
5. Be a pilot site for some foundation, academic, or government program

Modify the organization's structure

1. Eliminate programs that are redundant with those of other organizations or combine them to improve services
2. Position yourself higher in the "food chain" when intense competition accompanies a changing environment
3. Respond to a changing environment by changing programs
4. Spin off a struggling or "orphan" program to another organization where it has a better chance to thrive
5. Merge with or acquire a competitor's or an ally's

program
6. Relocate with a group of related organizations to form a one-stop shop
7. Become a for-profit; add a for-profit subsidiary; be acquired by a for-profit

Modify the organization's culture
1. Enlist the support of potential funders as you modify your programs, and then request funds to support changes
2. Share resources and expenses with other organizations that have similar needs
3. Make your services more culturally sensitive
4. Educate the board of directors to make them more effective
5. Mobilize everyone in the organization to help market its mission, message, services, and needs
6. Tear down bureaucracies that interfere with the creative flow of ideas
7. Replicate rather than reinvent
8. Link with a complementary but different organization to bring resources into the organization
9. Take a more entrepreneurial approach to accomplishing your mission

Engagement Strategies

Engage other nonprofits
1. Work with state and national nonprofit associations
2. Form associations to negotiate with contracting agencies as a block
3. Establish cooperative programs with other nonprofits to increase the number of stakeholders in each other's organization
4. Collaborate with like-minded nonprofits; seek funding to support collaboration
5. Develop a bartering resource system among nonprofits
6. Create a nonprofit organization to insure nonprofits; return surplus income to policyholders
7. Pool funds with other nonprofits to get a better return on the investment of capital
8. Acquire or merge with another nonprofit whose services complement yours
9. Establish national goals and standards for nonprofits to increase sector quality, public awareness, and public support
10. Form a consortium with other nonprofits to take advantage of federal block grants
11. Facilitate networks and collaboration by making your space available for such activities
12. Find ways to work with local providers of educational services at all levels

Engage the community
1. Seek funding to help those constituents least able to represent themselves have a voice
2. Involve all members of the community in teaching children the value of community involvement and philanthropy
3. Connect with local media to inform the community about issues related to your mission
4. Show the community that your crisis is a community crisis
5. Hold community issues forums; discuss community goals

Engage the business community
1. Form partnerships with businesses; find a host that will provide space, staff, funds, resources, or technical assistance
2. Advocate for your organization's values and goals while seeking business involvement
3. Know the people, values, and goals of the businesses you are engaging
4. Share your vision of the future with businesses so they can see how they and their community will benefit
5. Link with businesses that will benefit from the positive public relations your organization's cause will generate
6. Network with small and midsize businesses with a personal stake in the local community
7. Show businesses how to get involved in community issues that affect them
8. Collaborate with businesses and other nonprofits to create "incubators" for new, innovative organizations
9. Form nonprofit/for-profit partnerships to advocate for common interests

Engage the public/government sector

1. Advocate for tax incentives that encourage businesses to be involved in community efforts
2. Use the public schools to teach philanthropy; set up student-operated philanthropies at schools and universities
3. Seek ways to work with educational institutions at all grade levels, public and private, nonprofit and for-profit
4. Advocate for a nonprofit contribution check-off on tax forms
5. Advocate for making charitable giving a tax credit rather than a deduction
6. Use publicly owned facilities as a site for delivering nonprofit community services

J. PROGRAM EFFECTIVENESS

<u>Issue</u>: *Good financial management cannot focus exclusively on efficiency and internal control, but also must pay close attention to whether expenditures were effective in achieving intended objectives.*

- An agency might have great internal controls, stay within budget, and meet all sorts of other commonly used fiscal management objectives. But, if the services purchased are not effective, arguably the ultimate fiscal measure will not have been achieved. What is the ultimate objective?

<u>Achieve the greatest number of desired successful outcomes at the lowest feasible cost.</u>

- Knowing how well an agency is doing related to this measure starts with knowing what is meant by "successful result." Essentially, it means having appropriate measures of success, and tracking them.

- This is an area where the program experts are needed. Some questions to pose in defining and measuring success are:

  a) What do your customers at the point of discharge say about quality of services, and how they benefited from the services they received?

  b) Assuming returning is a good thing, how many customers return for services (especially under crisis circumstances), and what is this trend over time?

  c) What measurable internal goals has the agency established regarding quality or effective services, and what progress can the agency show in meeting these goals?

  d) How does your agency compare with outside standards, trends, etc. regarding quality programs?

  e) How successful is the agency in using the information gained through program efforts and results to make programming and financial decisions?

Ideas/Suggestions?

1. Have the Board, managers, and staff reflect upon what the agency's "measures of success" are, and whether they give the agency and others a fair and accurate picture of what the agency is truly accomplishing.
2. Do some benchmarking and see what approaches peer agencies are using to measure success.
3. Tackle the above questions in a systematic manner.
4. Use this information to help make budget decisions.
5. Celebrate successes, but also take seriously and act on measures that indicate potential concerns.

K. MANAGING SUBCONTRACTORS

Issue: *When an agency chooses to achieve its program objectives by employing subcontractors to perform all, or a portion of, program activities, it is necessary to direct and monitor the work of the subcontractors to ensure program success.*

- Some preliminary subcontracting activities include:

  a) Selecting subcontractors using a system that ensures maximum open and free competition.

  b) Executing signed contracts between the agency and the subcontractor.

  c) Ensuring that contracts specify the nature, quantity, and quality of service that must be delivered in order for a contractor to receive payment. Any other conditions or limitations relating to contractor payments should also be addressed in a payment section of the contract.

  d) Ensuring that contracts include language that describes any financial and program reports that are needed to monitor subcontractor performance or to meet conditions of the grant or contract under which funds were originally provided.

- Some activities to perform during the period of the contract include:

  a) Obtaining program and fiscal reports at the intervals specified by contract.

  b) Reviewing the reports in a timely fashion to determine whether they indicate any financial or program issues that need to be addressed with the subcontractor.

  c) Determining whether the subcontractor is providing service up to the levels specified in the contract.

  d) Providing any training and technical assistance that the subcontractor might require to perform up to expectations.

  e) Making site visits to the subcontractor's premises, if necessary, to analyze operations.

- Some activities to perform as part of the year-end close out of the contract period include:

  a) Reviewing the subcontractor's year-end program and financial reports. This could include reminding the subcontractor to submit any invoices associated with services performed during the contract period in time to be paid.

  b) Assessing the subcontractor's program performance. Should the next year's contract include special conditions addressing the performance of the subcontractor during the period just ended?

  c) Determining whether performance warrants a renewal of the contract or whether a new service provider should be found.

d) Obtaining and reviewing the subcontractor's audit report, if one is required, to follow-up on any findings and recommendations that need to be addressed through development and implementation of a corrective action plan.

Ideas/Suggestions?.

1. The best way to ensure that a subcontractor, or anyone else, will perform up to expectations is to start by telling what's expected. In developing our contracts we should be as clear as we can about our expectations.

2. Pay special attention, when drafting reporting requirements for the contract, to requiring reports that will provide useful information on subcontractor performance.

3. Refer to the section of this handbook on Program Effectiveness for ideas on measuring vendor program performance.

4. Establish criteria for determining when agency staff should perform a site visit for subcontractors.

L. SUGGESTED RESOURCES

Angelica, Emil. *The Nonprofit Guide to Success When Times are Tight.* St. Paul, Minnesota: Amherst H. Wilder Foundation, 1997, 114 pages, www.wilder.org.

A user-friendly book that presents practical, direct, clear options to address fiscal cuts while being honest about realities.

Brinckerhoff, Peter C. *Mission-Based Management: Leading Your Not-For-Profit into the 21st Century*. Oak Park, Illinois: Alpine Guild, Inc., 1994, 258 pages.

A reference and guide for not-for-profit administrators offering remarkable and practical insight into the needs, functions, and output of not-for profit agencies.

Bryce, Herrington J. *The Nonprofit Board's Role in Establishing Financial Policies.* Washington, D.C.: National Center for nonprofit Boards, 1996, 31 pages, (202) 452-6262, www.ncnb.org.

Tips for fulfilling the board's legal financial responsibilities are presented, along with steps for developing financial policies.

Carver, John. *Carver Guide: Basic Principles of Policy Governance.* San Francisco, California: Jossey-Bass Publishers, 1996, 29 pages, (800) 956-7739, www.josseybass.com.

Nine basic principles and nine steps to policy governance are given to assist the board.

Dalsimer, John Paul. U*nderstanding Nonprofit Financial Statements: A Primer for Board Members.* Washington, D.C.: National Center for nonprofit Boards, 1991, 24 pages, (202) 452-6262, www.ncnb.org.

Sample documents are explained in detail to assist anyone needing to become more comfortable with financial statements, from the bookkeeper to the treasurer, to the board itself.

Lang, Andrew S. *The Financial Responsibilities of Nonprofit Boards: An Overview of Financial Management for Board Members.* Washington D.C.: National Center for Nonprofit Boards, 1993, 32 pages, (202) 452-6262, www.ncnb.org.

Provides information on financial questions board members should ask, systems that protect nonprofits, and understanding the financial condition.

Leifer, Jacqueline C. *The Legal Obligations of Nonprofit Boards: A Guidebook for Board Members,* Washington D.C.: National Center for Nonprofit Boards, 1993, 32 pages, (202) 452-6262, www.ncnb.org.

Sets out established standards of conduct for board members, liability as it affects board members, and specific requirements of corporate law. The tips for avoiding personal liability of board members are both valuable and insightful.

M HELPFUL WEB SITES

Center on Budget and Policy Priorities................................www.cbpp.org

Charity Village ....www.charityvillage.com

Electronic Policy Network..www.epn.org

HandsNet ....www.handsnet.org

Independent Sector...www.indepsec.org

Indiana University Center on Philanthropy ....www.tcop.org

Minnesota Council of Nonprofits..www.mncn.org

Support Center for Nonprofit Management.........................www.igc.apc.org/sf

WI DHFS Home Page-Grants...www.dhfs.state.wi.us/grants