Forum 2

**Can someone please provide some assistance with this question. It needs to be between 350 and 450 words or so. Explain how restricted accounts can potentially confuse a board member who does not understand fund accounting and may not grasp the meaning of a restricted account……?**

**Notes for this week from class below and lecture…..**

This week we will begin looking at actual financial reports to see what information is collected and how that data is structured and reported, to give decision makers the information they need to make decisive decisions for the nonprofit corporation.

Below is the class lecture for this week, hopefully it will help with the question.

The objectives for this week

Deconstruct the uses of various financial reports and financial statements

Analyze financial statements to determine financial health of an organization

Analysis

Graduate work in any field prepares the student through the familiarization with a body of knowledge, to be able to apply that knowledge to practical applications. The historian is able to place artifacts in the context of human development with an interpretive panel in a museum exhibition. The social worker is able to use counseling skills and techniques to modify destructive behaviors of clients. The clinic supervisor uses management skills to maximize the number of patients seen at the neighborhood free clinic within the constraints of the budget and human resources under her control.

The nonprofit manager does the same thing, using the knowledge of financial management to ensure an accurate picture of the financial condition of the organization is communicated to the board of directors, so they can make wise decisions. Timely and accurate financial reports ensure the organization can monitor its financial stability and enhance its public reputation.

This section in week two of the course looks at the tools we use to capture information we need, and present it in a manner that is useful and informative. First, we begin by learning how we organize the financial information we gather. This is done through the Chart of Accounts.

The Chart of Accounts

The chart of accounts is the list of different accounts used to record the financial transactions of the organization. The chart of accounts allows for an organization to keep an accurate record of its business transactions by organizing information according to the work done by the organization. A good chart of accounts will ensure that both management and the board of directors have the information needed for strategic and operational decisions.

The chart of accounts is normally divided into sections and arranged according to the type of transaction. There normally are five major sections in the chart of accounts. The information from the chart of accounts can be used to create the financial statements that allow us to see the financial information from different perspectives and to make comparisons of information over time to spot changes in financial condition and trends that suggest future conditions. The five general categories are:

· Assets

· Liabilities

· Net Assets

· Revenues

· Expenses.

Accounting Methods

There are two methods of accounting: cash and accrual. The difference has to do with when transactions are recorded. For example, under the cash accounting method, transactions are recorded when cash is exchanged. When income is actually received it is recorded. Similarly when bills are paid, only then are expenses recorded.

Under the accrual accounting, transactions are recorded as they occur. For example, income is recorded when it is earned, not when it is received. So, if a patient has a diagnostic test done, the fee for that test is recorded as income even thought the insurance company may not actually send a check to the health center for two months. Similarly, expenses are recognized when they are incurred. So, when the health center orders a supply of hypodermic needles, the expense is incurred even though the invoice may not come for a month and the bill may not be paid for two months.

The accrual method is generally considered more appropriate, because when it is used, financial statements accurately reflect all of the organization’s assets and liabilities. There is no confusion around the timing of bill paying or the obligations that are outstanding against an organization’s assets. Accrual accounting gives a more precise representation of the relationship between revenues and expenses and assets and liabilities.

Fund Accounting

Fund accounting is used by government and nonprofit organizations. Funds are separate accounts that enable the organization to keep track of money and to keep accurate records of money designated for specified purposes. For example, if the local community foundation provided money for pre-school physical exams for children entering Kindergarten, that money would need to be kept separate from the general operating money for the health center. So, a restricted fund would be established for the grant from the community foundation so that money could be easily tracked, controlled, and reported on as needed. Funds can be permanently restricted, temporarily restricted, or unrestricted.

Fund accounting is often not a familiar concept for those who have only worked in the for-profit sector and sometimes those unfamiliar with fund accounting have difficulty understanding financial statements that appear overly complicated if many different funds are established. We sometimes hear the phrase “color of money” used in this context. The meaning of that term is that not all money is the same. Some is restricted, some not; some permanently restricted, and some only temporarily restricted. In other words, different colors of money. This can be a useful way of communicating to board members who are not familiar with fund accounting.

Restricted Funds

Restricted funds are financial resources that can be used only for predefined purposes. Their use is defined in contracts between the donor or contractor and your organization. In the case of government funding, contracts may incorporate statutes and regulations that govern the use of funds. There are several typical sources of restricted funds:

· Government contracts

· Foundation grants

· Loans

· Endowments

· Restricted gifts for specific purposes

Examples of restrictions are:

· Using funds for a specific program such as flu shots for the elderly.

· Using income from a specific invested fund to benefit a certain demographic segment of the population; e.g., pre-school children, residents of a certain neighborhood, or those whose household income is below a certain level.

Basic Financial Statements

Most nonprofit organizations produce four types of financial statements in addition to using an annual budget to monitor the organization’s financial health.

· Statement of Financial Position (or Balance Sheet)

· Statement of Activities (or the Income Statement)

· Statement of Changes in Financial Position

· Cash Flow Statement

· Budget

These financial statements are verified and, when necessary, corrected by performing an audit. Audits are preferably done annually by a Certified Public Accountant (CPA) with no direct interest in the organization. The audit provides an accurate picture of the financial health of the organization. External funders usually require nonprofits to provide these financial statements to ensure the financial viability of the organization. It is increasingly common for nonprofit boards to have an audit committee to ensure reliability of the audit as well as to manage the risk to the organization.

The nonprofit’s board of directors is legally responsible for overseeing that the organization’s financial records are maintained appropriately and clearly state what has happened during a given period of time. Although the board will rely on the Executive Director and the staff of the health center to prepare, maintain, and report on the financial activity of the organization, it is ultimately the board’s responsibility to ensure the information is accurate and complete. This is an obligation of the board that falls under the legal term, Duty of Care. Exercising the Duty of Care requires all board members to be familiar with the financial condition of the organization, to ask appropriate questions of management, and to take prudent steps to ensure the financial well-being of the organization is maintained.

Board members therefore rely primarily on financial statements to execute their oversight responsibilities. Well prepared financial statement should have following characteristics:

· Comprehensible

· Concise

· Comparative

· Complete

· Current

The readings for this week will help you understand how these different financial reports can be analyzed to bring clarity and understanding to even the most complicated nonprofit organizations.