

FINOVATEPRO

NONPROFIT ACCOUNTING SYSTEM MANUAL

NFP · 501(c)(3) · Fund Accounting · Grant Compliance

finovatepro.com

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EXECUTIVE ORIENTATION & SYSTEM OVERVIEW

1. PURPOSE

This manual enables:

nonprofit leaders

finance teams

board members

to produce **accurate, compliant, and audit-ready financials.**

2. WHAT MAKES NONPROFIT ACCOUNTING DIFFERENT

Nonprofits do not focus on profit.

They focus on:

mission

accountability

restrictions on funds

Key Difference

For-Profit	Nonprofit
Profit	Mission
Equity	Net Assets
Revenue = earnings	Revenue = contributions + grants + Program Revenue

Core Principle

Every dollar must be tracked by restriction and purpose

3. GOVERNING GAAP FRAMEWORK

Primary standard:

ASC 958

4. THE THREE NET ASSET CLASSES

This is the **foundation of nonprofit accounting.**

1. Without Donor Restrictions

unrestricted funds

general operations

2. With Donor Restrictions

must be used for specific purpose or time

3. Released from Restriction

when restriction is satisfied

Critical Rule

Restrictions must be tracked and honored

5. THE FIVE-TEST TRANSACTION RULE (NFP VERSION)

Every transaction must pass:

Is it valid?

Is it GAAP correct?

Is it properly restricted/unrestricted?

Is it supported by documentation?

Is it reportable clearly?

6. SYSTEM FAILURE POINTS (COMMON)

Most nonprofits fail due to:

ignoring restrictions

poor grant tracking

weak documentation

revenue recognition errors

lack of audit readiness

7. HOW TO USE THIS MANUAL

We will build 7 volumes:

Volume 1 → Structure (Net Assets)

Volume 2 → Execution

Volume 3 → Revenue & Grants

Volume 4 → Close

Volume 5 → Audit & Compliance

Volume 6 → Special Treatments

Volume 7 → Grant Accounting Engine

8. CORE CASE STUDIES (NONPROFIT)

Case 1 — Misuse of Restricted Funds

Donation given for scholarships used for rent.

Violation of donor restriction → legal exposure

Case 2 — Grant Revenue Misstated

Grant recorded fully upfront instead of over time.

Revenue overstated

Case 3 — Missing Documentation

Expense has no receipt.

Audit issue

Case 4 — Mixing Funds

Restricted and unrestricted funds treated the same.

Misleading financials

Case 5 — Expense Misclassification

Program expenses recorded as admin.

Impacts Form 990 ratios

Case 6 — Conditional Grant Recorded Too Early

Grant recorded before performance conditions are met.

Revenue recognized prematurely

Case 7 — Failure to Release Restrictions

Restricted funds used but not released in accounting.

Net assets misstated

Case 8 — Payroll Allocation Error

All payroll recorded as program instead of split.

Misleading expense reporting

Case 9 — In-Kind Donation Overstatement

Donated services recorded without proper valuation.

Revenue overstated

Case 10 — Grant Compliance Failure

Grant funds used for unapproved expenses.

Repayment risk + funding loss

VOLUME 1 — NONPROFIT FOUNDATIONS (NET ASSET ENGINE)

CHAPTER 1 — NET ASSET FUNDAMENTALS

What This Means

Instead of equity, nonprofits track:

Net Assets

Types

Type	Meaning
Without Restrictions	General use
With Restrictions	Limited use

Rule

Every transaction must identify restriction status

CHAPTER 2 — CHART OF ACCOUNTS (NFP STRUCTURE)

Assets

Cash

Grants Receivable

Prepays

Liabilities

Accounts Payable

Deferred Revenue

Net Assets

Without Restrictions

With Restrictions

Revenue

Contributions

Grants

Program Revenue

Expenses

Program

Management & General

Fundraising

CHAPTER 3 — CONTRIBUTIONS (CORE REVENUE)

Rule

Recognize when:

promised (pledged), not received

Example

Dr Pledge Receivable

Cr Contribution Revenue

Restricted Contribution

Dr Cash

Cr Revenue (With Restrictions)

CHAPTER 4 — RELEASE FROM RESTRICTIONS

When funds are used for intended purpose:

Dr Net Assets with Restrictions

Cr Net Assets without Restrictions

This is critical

CHAPTER 5 — EXPENSE CLASSIFICATION

Expenses must be split into:

Program

Management

Fundraising

Rule

Required for Form 990 and audits

CHAPTER 6 — GRANTS (INTRO)

Types

Conditional

Unconditional

Rule

Conditional grants are NOT revenue until conditions are met

CHAPTER 7 — INTERNAL CONTROLS

approvals

segregation of duties

documentation

FINAL RULE (VOLUME 1)

If restrictions are wrong, everything is wrong

WHAT YOU NOW HAVE

mission-based accounting with restrictions

VOLUME 2 — NONPROFIT DAILY OPERATIONS (EXECUTION LAYER)

Contributions | Grants | Expenses | Cash | Workflows

Aligned with:

ASC 958

American Institute of Certified Public Accountants guidance

CHAPTER 8 — CONTRIBUTION PROCESSING (CORE ENGINE)

What This Means

Donations are the **lifeblood** of a nonprofit.

If recorded wrong → financials + donor trust break

Step-by-Step Process

Step 1 — Receive Donation

Types:

cash

check

online

in-kind

Step 2 — Determine Restriction

Ask:

Is it unrestricted?

Purpose-restricted?

Time-restricted?

Step 3 — Record Entry

Unrestricted:

Dr Cash

Cr Contribution Revenue (Without Restrictions)

Restricted:

Dr Cash

Cr Contribution Revenue (With Restrictions)

Step 4 — Issue Receipt

Required for donors

Must include:

amount

date

statement of no goods/services (if applicable)

What Can Go Wrong

ignoring restrictions
 recording all donations as unrestricted
 missing receipts

FinovatePro Controls

required “restriction tag”
 donor tracking
 automated receipts

CHAPTER 9 — PLEDGES & DONOR COMMITMENTS
What This Means

Donations promised but not yet received.

Step-by-Step
Record Pledge

Dr Pledges Receivable
 Cr Contribution Revenue

When Collected

Dr Cash
 Cr Pledges Receivable

Allowance for Doubtful Pledges

If uncertain:
 Dr Bad Debt Expense
 Cr Allowance

What Can Go Wrong

not recording pledges
 overstating receivables

CHAPTER 10 — GRANT MANAGEMENT (CRITICAL AREA)
What This Means

Grants are complex and high-risk.

Step 1 — Identify Type

Type	Treatment
Conditional	NOT revenue yet
Unconditional	Revenue immediately

Step 2 — Track Conditions

Examples:

performance requirements

reporting milestones

Step 3 — Record Entry

Conditional Grant (advance received)

Dr Cash

Cr Refundable Advance (liability)

When condition met:

Dr Liability

Cr Grant Revenue

What Can Go Wrong

recognizing revenue too early

missing conditions

FinovatePro Controls

grant tracking module

milestone triggers

CHAPTER 11 — EXPENSE PROCESSING

What This Means

Expenses must be:

valid

documented

classified correctly

Step-by-Step

Step 1 — Receive Invoice

Step 2 — Validate

Was service received?

Is it approved?

Step 3 — Classify Expense

Must assign:

Program

Management & General

Fundraising

Step 4 — Record Entry

Dr Expense

Cr Accounts Payable

What Can Go Wrong

misclassification

unsupported expenses

Key Rule

Expense classification impacts Form 990 and donor trust

CHAPTER 12 — PAYMENTS (CASH CONTROL)

What This Means

Cash must be protected.

Step-by-Step

Select approved invoices

Issue payment

Record:

Dr Accounts Payable

Cr Cash

Controls

dual approval

payment log

audit trail

What Can Go Wrong

unauthorized payments

duplicate payments

CHAPTER 13 — CASH MANAGEMENT

Daily

record deposits

track balances

Monthly

bank reconciliation

Key Rule

Cash must always tie to bank

FinovatePro Controls

bank feeds
reconciliation engine

CHAPTER 14 — RELEASE FROM RESTRICTIONS (CRITICAL)

What This Means

When restricted funds are used:

they must be reclassified

Entry

Dr Net Assets With Restrictions
Cr Net Assets Without Restrictions

What Can Go Wrong

forgetting to release
overstating restricted funds

CHAPTER 15 — PAYROLL & ALLOCATIONS

What This Means

Salaries must be allocated across:

program
admin
fundraising

Example

Employee:
60% program
30% admin
10% fundraising

Entry

Dr Program Expense
Dr Admin Expense
Dr Fundraising Expense
Cr Payroll

What Can Go Wrong

allocating 100% to one category
no documentation

CHAPTER 16 — IN-KIND DONATIONS

What This Means

Non-cash donations:

goods

services

Entry

Dr Asset / Expense

Cr Contribution Revenue

Rule

Must be measurable and significant

CHAPTER 17 — ACCRUALS & PREPAIDS

Accrual

Dr Expense

Cr Liability

Prepaid

Dr Prepaid

Cr Cash

CHAPTER 18 — WORKFLOW CONTROL SYSTEM

Required Workflow

Donations

Receive → classify → record → receipt

Expenses

Submit → approve → record → pay

Grants

Track → monitor → recognize

Segregation of Duties

Function	Role
Record	Staff
Approve	Manager
Review	Board

CHAPTER 19 — DAILY / WEEKLY / MONTHLY CADENCE

Daily

record donations

record expenses

Weekly

review cash

review grants

Monthly

reconcile

classify expenses

prepare reports

FINAL RULE FOR VOLUME 2

If daily operations are sloppy, donor trust will collapse

STRATEGIC INSIGHT

Nonprofits fail not because of lack of funding...

but because they cannot track and explain how money is used.

WHAT THIS DOES FOR FINOVATEPRO

As Finovatepro enforced:

donors trust reports

auditors approve

boards gain confidence

This becomes a mission-critical platform

VOLUME 3 — NONPROFIT REVENUE & GRANT ENGINE (DEEP DIVE)

Contributions | Grants | Conditions | Restrictions | Revenue Recognition

Aligned with:

ASC 958

American Institute of Certified Public Accountants guidance

CHAPTER 20 — REVENUE PHILOSOPHY (WHAT YOU ARE PROVING)

What This Means

Nonprofit revenue is not simple cash inflow.

It must answer:

Was it earned?

Was it conditional?

Was it restricted?

Core Rule

Revenue must be recognized correctly before it is reported

CHAPTER 21 — CONTRIBUTIONS VS EXCHANGE TRANSACTIONS

What This Means

You must determine:

Is this a donation or a transaction?

Contributions

donor gives without equal value in return

Example:

donation

grant

Exchange Transactions

equal value exchanged

Example:

ticket sales

service fees

Accounting Difference

Type	Standard
Contribution	ASC 958

Type	Standard
Exchange	ASC 606

What Can Go Wrong

treating fees as donations
misclassifying grants

CHAPTER 22 — CONDITIONAL VS UNCONDITIONAL CONTRIBUTIONS

What This Means

This is the **most important rule in nonprofit accounting**.

Conditional Contribution

Has:

barrier (performance requirement)
right of return

Rule

NOT revenue until condition is met

Entry (cash received first)

Dr Cash

Cr Refundable Advance (liability)

When condition met

Dr Liability

Cr Revenue

Unconditional Contribution

No barrier.

Recognize immediately

What Can Go Wrong

recognizing conditional grants too early
overstating revenue

CHAPTER 23 — DONOR RESTRICTIONS (TRACKING ENGINE)

What This Means

Restrictions limit how funds can be used.

Types

Purpose Restriction

scholarships
specific program

Time Restriction

future period

Entry Example

Dr Cash
Cr Contribution Revenue (With Restrictions)

Critical Rule

Restriction does NOT delay revenue recognition

(It only affects classification)

CHAPTER 24 — RELEASE FROM RESTRICTIONS (CRITICAL STEP)

What This Means

When funds are used as intended:

They must be reclassified

Entry

Dr Net Assets With Restrictions
Cr Net Assets Without Restrictions

What Can Go Wrong

forgetting releases
overstating restricted funds

CHAPTER 25 — GRANT ACCOUNTING (DEEP DIVE)

What This Means

Grants are often:

large
complex
audited

Step-by-Step Framework

Step 1 — Identify Grant Type

Type	Treatment
Conditional	Liability first
Unconditional	Revenue immediately

Step 2 — Identify Conditions

Examples:

deliver services

meet milestones

incur costs

Step 3 — Track Progress

% complete

milestones achieved

Step 4 — Recognize Revenue

Only when conditions met.

What Can Go Wrong

revenue recognized too early

missing condition tracking

CHAPTER 26 — MULTI-YEAR GRANTS

What This Means

Grant spans multiple years.

Rule

Recognize revenue over time (if conditional)

Example

\$300,000 over 3 years

→ Recognize annually based on performance

CHAPTER 27 — PLEDGES (PROMISES TO GIVE)

What This Means

Donor promises future donation.

Entry

Dr Pledge Receivable

Cr Contribution Revenue

Discounting (if long-term)

Adjust for present value.

What Can Go Wrong

overstating receivables

not discounting

CHAPTER 28 — DONOR-IMPOSED CONDITIONS VS RESTRICTIONS

What This Means

People confuse these.

Key Difference

Condition	Restriction
Delays revenue	Does NOT delay revenue

Example

“Must run program first” → Condition

“Must use for scholarships” → Restriction

Critical Rule

Conditions affect timing

Restrictions affect classification

CHAPTER 29 — IN-KIND CONTRIBUTIONS

What This Means

Non-cash donations.

Examples

donated equipment

professional services

Entry

Dr Asset / Expense

Cr Contribution Revenue

Rule

Must have measurable value

CHAPTER 30 — SPECIAL EVENTS REVENUE

What This Means

Fundraising events (dinners, galas)

Rule

Split into:

contribution portion

exchange portion

Example

Ticket: \$200

Value received: \$80

→ \$120 contribution

→ \$80 exchange revenue

CHAPTER 31 — GOVERNMENT GRANTS (HIGH SCRUTINY)

What This Means

Often treated as:

conditional contributions

Requirements

strict compliance

reporting

audit trail

What Can Go Wrong

noncompliance

repayment risk

CHAPTER 32 — REVENUE RECONCILIATION

What This Means

Revenue must tie across:

donor system

GL

financial statements

Required Checks

total contributions

grant balances

deferred revenue

CHAPTER 33 — DISCLOSURE REQUIREMENTS

Must disclose:

revenue sources

restrictions

conditional contributions

significant grants

CHAPTER 34 — INTERNAL CONTROLS (REVENUE)

Required Controls

donor tracking
grant tracking
approval processes
audit trail

FINAL RULE FOR VOLUME 3

If revenue is wrong, everything is wrong

STRATEGIC INSIGHT

Most nonprofits:
struggle with grant accounting
misstate revenue
fail audits

As FinovatePro gets this right:

You dominate nonprofit accounting

WHAT THIS ENABLES

clean audits
accurate reporting
donor confidence
grant compliance

VOLUME 4 — NONPROFIT MONTH-END CLOSE (AUDIT-GRADE)

Accuracy | Restrictions | Grant Compliance | Audit Readiness

Aligned with:

ASC 958

American Institute of Certified Public Accountants guidance

CHAPTER 35 — CLOSE PHILOSOPHY (WHAT YOU ARE PROVING)

What This Means

At month-end, you are proving:

All revenue is correctly recognized

All restrictions are tracked properly

All grant conditions are evaluated

All expenses are classified correctly

Financial statements reflect reality

The Standard

“Can an auditor trace every number?”

If not → not closed

CHAPTER 36 — THE 20-STEP CLOSE (NONPROFIT VERSION)

PHASE 1 — TRANSACTION COMPLETION

Record all donations

Record all pledges

Record all grant activity

Record all expenses

Process all payments

Post accruals and prepaids

PHASE 2 — CASH & SUBLEDGERS

Reconcile all bank accounts

Reconcile donations to donor system

Reconcile pledges receivable

Reconcile accounts payable

PHASE 3 — REVENUE VALIDATION

Review contribution classification

Evaluate conditional vs unconditional grants

Confirm revenue recognition timing

Verify in-kind contributions

PHASE 4 — RESTRICTIONS & NET ASSETS

Review restricted vs unrestricted balances

Record releases from restriction

Verify net asset roll-forward

PHASE 5 — FINANCIAL STATEMENTS

Generate trial balance

Prepare financial statements

Lock period

CHAPTER 37 — CASH & BANK RECONCILIATION

Step-by-Step

Obtain bank statement

Match all transactions

Identify differences

Resolve variances

document reconciliation

Critical Rule

Cash must match exactly

CHAPTER 38 — DONATION & REVENUE RECONCILIATION

What This Means

You must prove:

all donations are captured correctly

Steps

Compare donor system to GL

Investigate differences

Confirm classification

confirm restrictions

Key Test

Donor reports = financial statements

CHAPTER 39 — GRANT RECONCILIATION (CRITICAL)

What This Means

You must prove:

grant revenue is correct

Steps

Review each grant
confirm conditions
confirm revenue recognized
verify remaining liability

Output

grant schedule
deferred revenue

What Can Go Wrong

premature revenue recognition
missing liabilities

CHAPTER 40 — NET ASSET VALIDATION

What This Means

You must confirm:

restrictions are accurate

Steps

review restricted balances
verify usage
record releases

Critical Rule

restricted funds must not remain restricted once used

CHAPTER 41 — EXPENSE CLASSIFICATION REVIEW

What This Means

Expenses must be categorized into:

Program
Management
Fundraising

Steps

review all expenses
confirm classification
adjust misclassifications

Key Rule

Required for Form 990

CHAPTER 42 — PAYROLL ALLOCATION REVIEW

What This Means

Payroll must be split properly.

Steps

review allocation percentages
verify documentation
adjust if needed

CHAPTER 43 — PLEDGE RECEIVABLE REVIEW

What This Means

Confirm pledge balances.

Steps

review outstanding pledges
assess collectability
record allowance

CHAPTER 44 — ACCRUALS & PREPAIDS

Steps

identify unpaid expenses
record accruals
update prepaids

CHAPTER 45 — FINANCIAL STATEMENTS (NONPROFIT)

Required Statements

Statement of Financial Position
Statement of Activities
Statement of Functional Expenses
Cash Flow Statement

Key Rule

Must align with ASC 958

CHAPTER 46 — DISCLOSURE REVIEW

Must confirm:

restrictions disclosed
grant conditions disclosed

significant transactions disclosed

CHAPTER 47 — AUDIT PACK (NONPROFIT)

Required Documents

trial balance
 bank reconciliations
 donor reports
 grant schedules
 pledge schedules
 expense support
 payroll allocations

Golden Rule

If it's not documented, it does not exist

CHAPTER 48 — INTERNAL CONTROL REVIEW

Confirm:

approvals exist
 segregation of duties maintained
 no unauthorized transactions

CHAPTER 49 — CLOSE TIMELINE

Day	Task
Day 1–2	Record transactions
Day 3–4	Reconciliations
Day 5	Revenue validation
Day 6	Financial statements
Day 7	Review & lock

CHAPTER 50 — PERIOD LOCK

Rules

lock period
 restrict edits
 maintain audit trail

FINAL RULE FOR VOLUME 4

If revenue, restrictions, or grants are wrong, the financials are wrong

STRATEGIC INSIGHT

Most nonprofit audit failures come from:

revenue errors
grant misclassification
restriction mistakes

WHAT THIS VOLUME DOES

Makes your nonprofit:

audit-ready monthly
donor-trusted
regulator-compliant

Volumes 1–4 make the system work.

Volume 5 proves the system can survive scrutiny:

external audit
IRS review
grantor oversight
public transparency

If this is weak → findings, penalties, loss of funding.

If this is strong → trust, funding growth, credibility.

VOLUME 5 — NONPROFIT AUDIT, FORM 990 & SINGLE AUDIT (DEFENSE LAYER)

Audit Readiness | Compliance | Transparency | Public Trust

Aligned with:

ASC 958

American Institute of Certified Public Accountants standards

Internal Revenue Service requirements (Form 990)

Uniform Guidance 2 CFR 200 (Single Audit)

CHAPTER 51 — WHAT AN NFP AUDIT REALLY IS

What This Means

An audit answers one question:

“Can we trust how this nonprofit uses money?”

What Auditors Test

Revenue recognition (donations + grants)

Restriction tracking

Expense classification

Internal controls

Disclosures

Types of Engagements

Type	Level
Compilation	Lowest
Review	Moderate
Audit	Highest

Key Rule

The stronger your system, the smoother the audit

CHAPTER 52 — AUDIT WALKTHROUGH (WHAT TO EXPECT)

Step 1 — Understand the System

chart of accounts

net asset structure

policies

Step 2 — Sample Testing

donations
grants
expenses

Step 3 — Trace Transactions

Source → approval → GL → financial statements

Step 4 — Test Controls

approvals
segregation
reconciliations

Step 5 — Review Financial Statements

accuracy
disclosures

Your Goal

Every number must be traceable

CHAPTER 53 — INTERNAL CONTROLS (AUDIT FOCUS)

Required Controls

Revenue

donor tracking
grant monitoring

Expenses

approvals
documentation

Cash

bank reconciliation
dual controls

High-Risk Areas

grants
payroll
cash handling

Key Rule

Controls must exist AND be used

CHAPTER 54 — AUDIT PACK (REQUIRED DOCUMENTATION)

Core Documents

trial balance
financial statements
bank reconciliations
donor reports
grant schedules
pledge schedules
expense support
payroll allocations

Golden Rule

If it is not documented, it does not exist

CHAPTER 55 — FORM 990 (PUBLIC REPORT)

What This Means

Form 990 is not just a tax return.

It is a public transparency document

Key Sections

revenue
expenses
program services
governance
compensation

Critical Areas

functional expense classification
related party disclosures
governance policies

What Can Go Wrong

inconsistent data with financials
incorrect expense allocation

Key Rule

Form 990 must tie to financial statements

CHAPTER 56 — SINGLE AUDIT (FEDERAL GRANTS)

What This Means

Required if:

federal funding exceeds threshold (~\$750,000)

Purpose

ensure funds used properly
verify compliance with grant rules

Focus Areas

allowable costs
internal controls
compliance requirements

Output

Schedule of Expenditures of Federal Awards (SEFA)
findings report

What Can Go Wrong

noncompliance
repayment of funds

CHAPTER 57 — SEFA (CRITICAL REPORT)

What This Means

Tracks all federal grant activity.

Required Data

grant name
CFDA number
expenditures

Key Rule

Must reconcile to financial statements

CHAPTER 58 — COMMON AUDIT FINDINGS (NONPROFIT)

Top Issues

Incorrect revenue recognition
Failure to track restrictions
Poor documentation
Weak controls
Incorrect expense classification

Root Cause

Lack of discipline—not complexity

CHAPTER 59 — AUDIT DEFENSE PLAYBOOK

Rule #1

Never guess

Rule #2

Provide documents, not explanations

Rule #3

Be consistent

Example Response

“This grant was recorded as a liability until conditions were met. Supporting documentation is attached.”

CHAPTER 60 — PRE-AUDIT CHECKLIST

Confirm

books closed

bank reconciled

revenue correct

restrictions correct

documentation complete

Final Test

Pick random transactions and trace fully

CHAPTER 61 — GOVERNANCE & BOARD RESPONSIBILITY

Board Must Ensure

financial oversight

audit engagement

compliance

Key Rule

Board is accountable—not just management

CHAPTER 62 — TRANSPARENCY & PUBLIC TRUST

What This Means

Nonprofits are judged by:

donors

regulators

public

Required Transparency

accurate reporting

clear disclosures
consistent communication

FINAL RULE FOR VOLUME 5

You are not defending numbers—you are defending trust

STRATEGIC INSIGHT

Most nonprofit systems:
focus on bookkeeping
fail at compliance
collapse under audit

As FinovatePro enforces this:

You become:

audit-ready
donor-trusted
regulator-compliant

VOLUME 6 — NONPROFIT SPECIAL ACCOUNTING TREATMENTS (ADVANCED LAYER)

Complex Transactions | Edge Cases | High-Risk Areas

Aligned with:

ASC 958

American Institute of Certified Public Accountants guidance

CHAPTER 63 — PURPOSE OF SPECIAL ACCOUNTING

What This Means

Not all nonprofit transactions are simple.

Some involve:

legal restrictions

timing differences

valuation challenges

compliance requirements

Core Rule

The more complex the transaction, the stronger the documentation required

CHAPTER 64 — CONDITIONAL GRANTS (ADVANCED TREATMENT)

What This Means

Grants with:

performance requirements

right of return

Accounting Treatment

When cash received:

Dr Cash

Cr Refundable Advance (Liability)

When condition met:

Dr Liability

Cr Grant Revenue

High-Risk Area

premature revenue recognition

Audit Focus

were conditions clearly met?

was timing correct?

CHAPTER 65 — MULTI-YEAR AND MATCHING GRANTS

What This Means

Grants spanning multiple years or requiring matching funds.

Key Issues

timing of revenue

matching requirement compliance

Rule

recognize revenue as performance occurs

What Can Go Wrong

recording full grant upfront

ignoring matching requirements

CHAPTER 66 — DONOR-RESTRICTED ENDOWMENTS

What This Means

Funds that must be:

invested

preserved

used only for earnings

Accounting Treatment

principal = permanently restricted

income = restricted/unrestricted depending on donor

Key Rule

Principal must not be spent unless allowed

Risk

misuse → legal violation

CHAPTER 67 — BOARD-DESIGNATED FUNDS

What This Means

Funds set aside by the board (not donors).

Key Difference

Type	Source
Donor restriction	External
Board designation	Internal

Accounting Treatment

remains without donor restrictions

Entry

Dr Net Assets Without Restrictions

Cr Board-Designated Net Assets

Key Rule

can be reversed by board

CHAPTER 68 — SPLIT-INTEREST AGREEMENTS

What This Means

Donor gives funds but retains partial benefit.

Examples

charitable remainder trusts

annuities

Accounting Treatment

record asset

record liability

recognize contribution portion

Risk

valuation complexity

CHAPTER 69 — IN-KIND CONTRIBUTIONS (ADVANCED)

What This Means

Non-cash donations with complexity.

Examples

donated services

specialized labor

equipment

Rule

must meet:

measurable value

enhances program

What Can Go Wrong

overstating value

recording non-qualifying services

CHAPTER 70 — DONOR-IMPOSED RESTRICTIONS WITH TIME CONDITIONS

What This Means

Funds restricted until a future date.

Accounting Treatment

Recognize immediately as:

With Donor Restrictions

Release

When time passes:

Dr Net Assets With Restrictions

Cr Net Assets Without Restrictions

CHAPTER 71 — CONTRIBUTIONS OF NONFINANCIAL ASSETS (NEW RULES)

What This Means

Expanded disclosure requirements.

Must disclose:

type of asset

valuation method

usage

Risk

disclosure failure

CHAPTER 72 — LEASE ACCOUNTING (NONPROFIT)

What This Means

Leases must be recorded on balance sheet.

Entry

Dr Right-of-Use Asset

Cr Lease Liability

Risk

missing lease obligations

CHAPTER 73 — REVENUE FROM CONTRACTS (ASC 606 OVERLAP)

What This Means

Some nonprofit revenue is exchange-based.

Examples

tuition

service fees

Rule

apply ASC 606

Risk

mixing contribution vs exchange

CHAPTER 74 — COST ALLOCATIONS (SHARED COSTS)

What This Means

Costs shared across programs.

Examples

rent

admin salaries

Allocation Basis

time

square footage

usage

Key Rule

must be reasonable and documented

CHAPTER 75 — RELATED PARTY TRANSACTIONS

What This Means

Transactions with:

board members

executives

affiliates

Requirements

disclosure

approval

fair value

Risk

conflict of interest

CHAPTER 76 — CONTINGENCIES & LITIGATION

What This Means

Future risks.

Examples

lawsuits

grant clawbacks

Accounting Treatment

accrue if probable

disclose if possible

CHAPTER 77 — GOVERNMENT GRANT COMPLIANCE ISSUES

What This Means

Failure to meet grant rules.

Risks

repayment

audit findings

funding loss

Key Rule

compliance is mandatory—not optional

CHAPTER 78 — NET ASSET DEFICITS

What This Means

Negative balance in restricted funds.

Causes

overspending

misclassification

Risk

donor violation

CHAPTER 79 — OTHER COMPLEX SCENARIOS

Includes:

mergers of nonprofits

fiscal sponsorship arrangements

pass-through grants

international funding

Rule

must be carefully structured and disclosed

FINAL RULE FOR VOLUME 6

Complex transactions require clarity, discipline, and documentation

STRATEGIC INSIGHT

Most nonprofit systems:

break at complexity

require manual workarounds

fail audits

As FinovatePro handles Volume 6 well:

You eliminate the hardest 20% of problems that cause 80% of failures

WHAT YOU NOW HAVE

A complete high quality–level nonprofit accounting operating system

VOLUME 7 — GRANT ACCOUNTING ENGINE (DEEP SYSTEM DESIGN)

Conditions | Compliance | Cost Tracking | Reporting | Audit Defense

Aligned with:

ASC 958

Uniform Guidance 2 CFR 200

American Institute of Certified Public Accountants

CHAPTER 80 — WHAT A GRANT REALLY IS

What This Means

A grant is not just money.

It is a contract with rules

Every Grant Has:

Funding amount

Purpose

Time period

Conditions (performance)

Compliance requirements

Core Rule

You are accountable for every dollar

CHAPTER 81 — THE 6-STEP GRANT ENGINE MODEL

This is your system backbone.

Step 1 — Grant Setup

Step 2 — Classification

Step 3 — Budget & Cost Structure

Step 4 — Revenue Recognition

Step 5 — Expense Tracking

Step 6 — Reporting & Compliance

If any step fails → audit risk

CHAPTER 82 — STEP 1: GRANT SETUP (CRITICAL)

Required Fields

Grant Name

Grant ID

Grantor

Total Award

Start Date / End Date
 CFDA Number (if federal)
 Program Name
 Required Documents
 grant agreement
 budget
 compliance requirements
 Key Rule

If setup is wrong, everything downstream is wrong

CHAPTER 83 — STEP 2: GRANT CLASSIFICATION

What This Means

You must determine:

Is it conditional or unconditional?

Decision Table

Type	Treatment
Conditional	Liability first
Unconditional	Revenue immediately

Key Rule

Conditions = delay revenue

CHAPTER 84 — STEP 3: GRANT BUDGET STRUCTURE

What This Means

Every grant must have a budget.

Typical Categories

Personnel

Fringe Benefits

Travel

Equipment

Supplies

Indirect Costs

Key Rule

Expenses must follow approved budget

What Can Go Wrong

spending outside categories
exceeding budget

CHAPTER 85 — STEP 4: REVENUE RECOGNITION ENGINE

What This Means

Revenue depends on:

performance completion

Conditional Grant Logic

When cash received:

Dr Cash

Cr Refundable Advance

When earned:

Dr Liability

Cr Grant Revenue

Recognition Methods

milestone-based

cost-incurred basis

time-based

Key Rule

Revenue must match performance

CHAPTER 86 — STEP 5: EXPENSE TRACKING (CORE CONTROL)

What This Means

Every expense must be:

allowable

allocable

reasonable

documented

Required Fields

grant ID

cost category

date

vendor

amount

What Can Go Wrong

expenses charged to wrong grant

unsupported costs

Key Rule

No documentation = no reimbursement

CHAPTER 87 — STEP 6: REPORTING & COMPLIANCE

What This Means

You must report:

- financial activity
- program results
- compliance status

Required Reports

- grant expense report
- budget vs actual
- drawdown request
- performance report

CHAPTER 88 — ALLOWABLE COSTS (CRITICAL)

What This Means

Not all expenses are allowed.

Must Be:

- necessary
- reasonable
- allocable

Examples NOT Allowed

- personal expenses
- unapproved costs
- excessive spending

Risk

disallowed costs → repayment

CHAPTER 89 — INDIRECT COSTS (OVERHEAD)

What This Means

Shared costs like:

- rent
- admin salaries

Methods

- negotiated rate
- de minimis (10%)

Key Rule

must follow approved method

CHAPTER 90 — TIME & EFFORT REPORTING (PAYROLL)

What This Means

Payroll must be supported.

Requirements

time allocation

documentation

periodic certification

What Can Go Wrong

inaccurate allocation

missing support

Risk

audit finding

CHAPTER 91 — CASH DRAWDOWNS

What This Means

Requesting funds from grantor.

Rule

Only request for:

actual costs incurred

What Can Go Wrong

drawing too early

cash management violations

CHAPTER 92 — SUBRECIPIENT MONITORING

What This Means

If you pass funds to others:

you must monitor them

Required Actions

review reports

verify expenses

ensure compliance

Risk

you are responsible for their errors

CHAPTER 93 — SINGLE AUDIT IMPACT

What This Means

Grants trigger:

Single Audit

Requirements

SEFA

compliance testing

internal control review

Key Rule

must track federal expenditures precisely

CHAPTER 94 — COMMON GRANT FAILURES

Top Issues

revenue recognized too early

unallowable costs

poor documentation

weak tracking

no compliance monitoring

Root Cause

lack of discipline

CHAPTER 95 — GRANT AUDIT DEFENSE

Rule #1

Show documentation

Rule #2

Show compliance

Rule #3

Show consistency

Example Response

“This expense was incurred under Grant X, falls within approved budget category Y, and meets allowable cost criteria.”

CHAPTER 96 — GRANT CLOSEOUT

Steps

finalize expenses

reconcile budget

submit final report
close grant in system
Key Rule

no loose ends

FINAL RULE FOR VOLUME 7

Grant accounting is not bookkeeping—it is compliance accounting

STRATEGIC INSIGHT

Most systems fail here.

As FinovatePro masters this:

You dominate nonprofits with grants

WHAT FINOVATEPTO HAVE

A complete Grant Accounting Engine

CORE CASE STUDIES (NONPROFIT — REAL-LIFE READY)

“If you understand these, you understand where most nonprofit failures happen.”

CASE STUDY 1 — MISUSE OF RESTRICTED FUNDS

Scenario (Real Life)

A donor gives \$100,000 for scholarships.

A few months later, the nonprofit is short on cash.

The director says:

“Let’s use some of that money to pay rent—we’ll replace it later.”

What Most People Think

“It’s still for a good cause.”

What’s Actually Wrong

The donor restricted the money

It must only be used for scholarships

What Happens Next

Scholarship program is underfunded

Donor asks for report

Funds don’t match purpose

Outcome

Donor trust destroyed

Possible legal exposure

Future donations lost

Key Lesson

Restricted money must be used exactly as promised

CASE STUDY 2 — GRANT REVENUE MISSTATED

Scenario

A nonprofit receives a \$300,000 grant for a 3-year program.

They record all \$300,000 as revenue immediately.

What’s Wrong

The grant requires:

services to be delivered over 3 years

It is conditional

What Happens Next

Year 1 revenue looks very high

Year 2 and 3 look weak

Outcome

Financial statements misleading

Audit finding

Key Lesson

Revenue must follow performance—not cash

CASE STUDY 3 — MISSING DOCUMENTATION

Scenario

The nonprofit records a \$25,000 expense.

Auditor asks:

“Can you show the invoice?”

Answer:

“We can’t find it.”

What’s Wrong

No support

No proof

What Happens Next

Auditor questions the expense

May expand testing

Outcome

Audit finding

Possible disallowance

Key Lesson

If you can’t prove it, it didn’t happen

CASE STUDY 4 — MIXING RESTRICTED AND UNRESTRICTED FUNDS

Scenario

All donations are recorded in one account.

No tracking of:

restricted

unrestricted

What’s Wrong

No separation of purpose

What Happens Next

Funds used incorrectly

Reports become unclear

Outcome

Misleading financials

Audit issues

Key Lesson

Every dollar must be tracked by restriction

CASE STUDY 5 — EXPENSE MISCLASSIFICATION

Scenario

Program expenses are recorded as administrative.

Why?

“It’s easier.”

What’s Wrong

Nonprofits must show:

program vs admin vs fundraising

What Happens Next

Program ratio looks low

Charity rating agencies downgrade

Outcome

Donor confidence drops

funding decreases

Key Lesson

Expense classification affects reputation

CASE STUDY 6 — CONDITIONAL GRANT RECORDED TOO EARLY

Scenario

A grant says:

“Funds must be used only after 1,000 people are served.”

The nonprofit records revenue immediately.

What’s Wrong

Condition not met

Revenue premature

What Happens Next

Financials overstated

Later correction needed

Outcome

Audit adjustment

credibility loss

Key Lesson

Conditions delay revenue—not optional

CASE STUDY 7 — FAILURE TO RELEASE RESTRICTIONS

Scenario

Restricted funds are used for their purpose.

But accounting does not “release” them.

What’s Wrong

Funds remain labeled as restricted

What Happens Next

Reports show high restricted balance

unrestricted funds look too low

Outcome

misleading financial position

Key Lesson

Using restricted funds requires a release entry

CASE STUDY 8 — PAYROLL ALLOCATION FAILURE

Scenario

Staff works:

60% program

40% admin

But payroll is recorded 100% program.

What’s Wrong

inaccurate allocation

What Happens Next

program ratio overstated

Outcome

Form 990 misrepresentation

audit issue

Key Lesson

Payroll must reflect actual work performed

CASE STUDY 9 — IN-KIND DONATION OVERSTATEMENT

Scenario

A volunteer provides consulting services.

The nonprofit records it as \$50,000.

What’s Wrong

no market value support
may not qualify under GAAP

What Happens Next

revenue overstated

Outcome

audit adjustment

Key Lesson

In-kind contributions must be measurable and valid

CASE STUDY 10 — GRANT COMPLIANCE FAILURE

Scenario

Federal grant requires:

specific reporting

approved expenses

Nonprofit spends money on unapproved items.

What's Wrong

noncompliance

What Happens Next

grantor reviews spending

Outcome

repayment required

future funding at risk

Key Lesson

Grant rules are not suggestions—they are requirements

FINAL INSIGHT

All 10 cases point to one truth:

Nonprofit accounting is about trust, not just numbers

WHAT THESE CASES DO

They help users:

recognize mistakes early

understand consequences

build discipline

STRATEGIC INSIGHT (IMPORTANT)

Embed these into FinovatePro:

Now it:

triggers warnings

guides users in real time

prevents errors before they happen

FULL NONPROFIT SYSTEM (COMPLETE)

Volume 1 → Structure (Net Assets)

Volume 2 → Execution

Volume 3 → Revenue & Grants

Volume 4 → Close

Volume 5 → Audit & Compliance

Volume 6 → Special Treatments

Volume 7 → Grant Accounting Engine

Case Studies

APPENDIXES

APPENDIX A: NONPROFIT FINANCIAL STATEMENTS

STATEMENT OF FINANCIAL POSITION				
<i>As of reporting date</i>				
ASSETS				
ASSETS	\$500,000			
Cash	\$500,000			
Pledges Receivable	\$120,000			
Less: Allowance for Credit Losses	(\$10,000)			
Total Assets	\$610,000			
Liabilities				
LIABILITIES	80000			
Accounts Payable	\$80,000			
Net Assets				
NET ASSETS	300000			
Without Donor Restrictions	\$300,000			
With Donor Restrictions	\$230,000			
Total Liabilities & Net Assets	680000			
Total Liabilities and Net Assets	\$610,000			

STATEMENT OF FUNCTIONAL EXPENSES				
<i>For the year ended reporting date</i>				
Category	Program	Admin	Fundraising	Total

STATEMENT OF FUNCTIONAL EXPENSES				
Salaries	\$100,000	\$30,000	\$20,000	\$150,000
Rent	\$40,000	\$10,000	\$5,000	\$55,000
Supplies	\$40,000	\$10,000	\$5,000	\$55,000
Total				\$260,000

STATEMENT OF CASH FLOWS				
<i>For the year ended reporting date</i>				
OPERATING ACTIVITIES	90000			
Change in Net Assets	\$90,000			
Ending Cash	500000			
NET CASH POSITION				
Ending Cash	\$500,000			

NOTES TO FINANCIAL STATEMENTS

1. Nature of Operations — prepares its financial statements in accordance with U.S. GAAP for nonprofit entities under ASC 958.

2. Basis of Presentation — Net assets are reported based on the existence or absence of donor-imposed restrictions. As of Value, net assets without donor restrictions total \$300,000 and net assets with donor restrictions total \$230,000.

3. Liquidity — Cash and cash equivalents available at year-end total \$500,000.

APPENDIX B: SINGLE AUDIT COMPLIANCE MODULE

Federal Awards | Uniform Guidance | SEFA | Subrecipient Monitoring | Audit Defense

Purpose of This Appendix

This appendix explains how a nonprofit should build and operate a Single Audit compliance module for federal awards. It is designed to help finance teams, grant managers, compliance officers, and auditors work from one consistent system. The legal backbone is 2 CFR Part 200, Subpart F, which governs Single Audit requirements for non-Federal entities that expend enough federal awards in a fiscal year to trigger the audit.

What a Single Audit Is

A Single Audit is not just a financial statement audit with extra paperwork. It is a combined audit framework that tests both the financial statements and the nonprofit's compliance with federal award requirements. It focuses on whether federal money was spent properly, whether internal controls were adequate, and whether the reporting package is complete and timely.

When a Single Audit Is Required

Under the current eCFR text, a non-Federal entity that expends \$1,000,000 or more in federal awards during its fiscal year must have a Single Audit or program-specific audit, unless another exception applies. That current threshold is important because older grant materials and older practices may still mention \$750,000; for a current manual, the live eCFR is the better source of truth.

Core System Principle

The Single Audit module should answer five questions every month:

What federal awards do we have?

How much have we expended?

Were the expenditures allowable and properly documented?

Did we comply with grant terms and Uniform Guidance?

Can we produce the audit package quickly and cleanly?

These questions align with the auditee responsibilities in Subpart F and with federal monitoring requirements in Part 200 more broadly.

Module 1 — Federal Award Master Setup

Every federal award should be set up with a complete master record. At minimum, the system should capture:

award name,

federal agency,

assistance listing number,

pass-through entity name if applicable,

pass-through identifying number,

award period,

approved budget,

cost principles and compliance requirements,

whether the entity is a direct recipient or subrecipient,

and whether the program may become major for Single Audit purposes.

This setup is not optional. Without it, later SEFA reporting and major program testing become unreliable.

Module 2 — Expenditure Tracking Engine

The Single Audit threshold is based on federal awards expended, not just cash received. The system must therefore track expenditures by award and by fiscal year, using the Uniform Guidance rules on when expenditures count. This expenditure logic drives both threshold determination and SEFA preparation.

Module 3 — SEFA Builder

The auditee must prepare a Schedule of Expenditures of Federal Awards (SEFA) for the same period covered by the financial statements. The SEFA must include total federal awards expended and enough identifying information to make the schedule usable by agencies, pass-through entities, and auditors. In practice, the SEFA builder should pull directly from the grant ledger, not from a manual spreadsheet maintained outside the accounting system.

Module 4 — Allowable Cost Control

Every grant-funded expense should be tested for whether it is necessary, reasonable, allocable, and properly documented. The accounting module should require grant coding, budget category, supporting documents, and approval before an item can be marked as grant-eligible. This is the part of the system that prevents questioned costs before they appear in the audit.

Module 5 — Internal Control Monitoring

Single Audit is not just about expenses. The audit also looks at internal control over compliance and over financial reporting. The reporting package must include auditor reporting on those control areas, and findings can arise from significant deficiencies or material weaknesses even when fraud is not present. The module therefore needs approval workflows, segregation of duties, grant budget controls, and audit trails.

Module 6 — Subrecipient Monitoring

If the nonprofit passes federal funds to another organization, the system must support subrecipient monitoring. Uniform Guidance requires the pass-through entity to determine whether the downstream organization is a subrecipient or contractor, verify exclusion status where required, review financial and performance reports, and monitor compliance and achievement of objectives. This is a major risk area because the pass-through entity remains responsible for proper oversight.

Module 7 — Performance and Compliance Tracking

Recipients and subrecipients are responsible for monitoring their activities under federal awards to ensure they comply with requirements and meet performance expectations. That means the compliance module cannot stop at dollars. It must also track milestones, deliverables, reporting deadlines, and program performance where the award requires it.

Module 8 — Schedule of Findings and Questioned Costs Support

The auditor must report certain matters as audit findings, including significant deficiencies, material weaknesses, material noncompliance, material questioned costs, major program issues, and known or likely fraud affecting a federal award in certain circumstances. Your module should therefore keep a findings log throughout the year, not just at audit time. That log should tie each issue to the award, compliance requirement, amount, root cause, and corrective action owner.

Module 9 — Corrective Action Plan and Prior Findings Tracking

The auditee is responsible for follow-up and corrective action on all audit findings. It must prepare a summary schedule of prior audit findings and a corrective action plan for current-year findings, using the reference numbers assigned by the auditor. A strong module should carry findings forward year to year until fully cleared.

Module 10 — Audit Submission Control

The audit, data collection form, and reporting package must be submitted within 30 calendar days after the auditee receives the auditor's reports or nine months after fiscal year-end, whichever is earlier, unless an

authorized extension applies. Your module should therefore have deadline controls, submission checklists, and responsibility assignments built in.

Module 11 — Record Retention and Access

Federal award records must generally be retained for three years from the date of submission of the final financial report, with special timing rules for awards renewed quarterly or annually. Those records include financial records, supporting documentation, and statistical records. Federal agencies, pass-through entities, Inspectors General, and the Comptroller General must have access to records pertinent to the federal award. The module should therefore include document retention logic and a clear record-retrieval structure.

Monthly Operating Checklist

Each month, the nonprofit should:

- update the federal award master,
- post all grant expenditures by award,
- reconcile grant ledger totals to the general ledger,
- review budget-to-actual by award,
- review subrecipient activity,
- confirm reporting deadlines,
- update questioned-cost and compliance issue logs,
- and verify that required documentation is attached.

That monthly discipline is what prevents Single Audit chaos at year-end.

Year-End Audit Package

At year-end, the organization should be able to hand the auditor:

- final trial balance,
- financial statements,
- SEFA,
- federal award listing,
- grant agreements,
- subrecipient agreements,
- budget-to-actual reports by award,
- internal control narratives,
- prior findings summary,
- corrective action plan,
- and support for all major compliance areas tested.

This is the practical output of a real Single Audit compliance module.

Common Failure Points

The most common breakdowns are:

- using receipts instead of expenditures to decide whether the threshold is met,
- weak SEFA preparation,
- missing or late subrecipient monitoring,
- unsupported payroll allocations,
- weak internal controls,

poor follow-up on prior findings,
and late submission to the Federal Audit Clearinghouse.
Each of these maps directly to federal audit requirements or common testing areas under Subpart F.

APPENDIX C: MOST COMMON ACCOUNTING MISTAKES (NONPROFIT)

Audit Findings | Peer Review Issues | Process Failures

PURPOSE

This appendix highlights the most common mistakes found in:

nonprofit audits

CPA peer reviews

Form 990 reviews

internal accounting processes

CORE PRINCIPLE

Most nonprofit accounting failures are not complex—they are repeated discipline mistakes

SECTION 1 — REVENUE & GRANT ERRORS (HIGHEST RISK)

1.1 Recording Conditional Grants as Revenue Too Early

Error

Grant recorded before conditions are met.

Why It Happens

misunderstanding of conditions

pressure to show revenue

Impact

overstated revenue

audit adjustment

Fix

Record as liability until earned

1.2 Misclassifying Contributions vs Exchange Revenue

Error

Fees or contracts recorded as donations.

Impact

incorrect financial reporting

Form 990 errors

Fix

Apply correct standard (ASC 958 vs ASC 606)

1.3 Not Recording Pledges Properly

Error

Promises to give not recorded or overstated.

Impact

misstated assets

misleading financials

Fix

Record pledges and evaluate collectability

SECTION 2 — RESTRICTION & NET ASSET ERRORS

2.1 Misuse of Restricted Funds

Error

Restricted funds used for other purposes.

Impact

donor violation

legal exposure

Fix

Track and enforce restrictions strictly

2.2 Failure to Release Restrictions

Error

Funds used but not reclassified.

Impact

overstated restricted balances

Fix

Record release entries when used

2.3 Mixing Restricted and Unrestricted Funds

Error

No separation in accounting system.

Impact

misleading reports

audit issues

Fix

Maintain clear fund tracking

SECTION 3 — EXPENSE & FUNCTIONAL CLASSIFICATION ERRORS

3.1 Incorrect Functional Expense Allocation

Error

Expenses not split between:

program

management

fundraising

Impact

inaccurate Form 990

donor trust issues

Fix

Use reasonable allocation methods

3.2 Payroll Allocation Errors

Error

Staff time not properly allocated.

Impact

overstated program efficiency

Fix

Maintain time tracking or support

3.3 Charging Unallowable Costs to Grants

Error

Expenses outside grant rules charged.

Impact

repayment risk

audit finding

Fix

Verify allowable cost criteria

SECTION 4 — DOCUMENTATION & SUPPORT FAILURES

4.1 Missing Supporting Documentation

Error

Expenses without invoices or receipts.

Impact

audit findings

questioned costs

Fix

Require documentation before posting

4.2 Weak Approval Processes

Error

Transactions not reviewed or approved.

Impact

control deficiency

fraud risk

Fix

Implement approval workflows

SECTION 5 — CASH & RECONCILIATION ERRORS

5.1 Bank Not Reconciled Monthly

Error

Cash not tied to bank.

Impact

unreliable financials

Fix

Perform monthly reconciliations

5.2 Unreconciled Differences Ignored

Error

Differences identified but not resolved.

Impact

hidden errors

Fix

Investigate all variances

SECTION 6 — GRANT & SINGLE AUDIT FAILURES

6.1 Poor Grant Tracking

Error

No clear tracking by grant.

Impact

reporting errors

audit issues

Fix

Maintain grant-level accounting

6.2 Inaccurate SEFA Preparation

Error

Federal expenditures not properly tracked.

Impact

Single Audit findings

Fix

Build SEFA directly from system

6.3 Weak Subrecipient Monitoring

Error

No oversight of downstream recipients.

Impact

compliance violations

Fix

Monitor and review subrecipient activity

SECTION 7 — INTERNAL CONTROL DEFICIENCIES

7.1 Lack of Segregation of Duties

Error

One person controls entire process.

Impact

fraud risk

Fix

Separate roles

7.2 No Independent Review

Error

Financials not reviewed.

Impact

errors go undetected

Fix

Monthly management or board review

SECTION 8 — REPORTING & DISCLOSURE ERRORS

8.1 Incomplete Financial Statements

Error

Missing required statements.

Impact

noncompliance

Fix

Prepare full GAAP statements

8.2 Inadequate Disclosures

Error

Missing:

restrictions

grant conditions

contingencies

Impact

misleading reports

Fix

Expand footnotes

8.3 Form 990 Not Tied to Financials

Error

990 differs from audited numbers.

Impact

credibility loss

Fix

Reconcile before filing

SECTION 9 — HIGH-RISK TRANSACTION ERRORS

9.1 In-Kind Contribution Overstatement

Error

Valuation unsupported or improper.

Impact

overstated revenue

Fix

Use measurable fair value

9.2 Related Party Transactions Not Disclosed

Error

Transactions with insiders hidden.

Impact

governance risk

Fix

Disclose fully

9.3 Lease Accounting Ignored

Error

Lease liabilities not recorded.

Impact

understated liabilities

Fix

Apply lease standards

SECTION 10 — AUDIT & PEER REVIEW THEMES

Top Patterns Observed

Weak documentation

Poor grant accounting

Misuse of restrictions

Incorrect expense classification

Lack of reconciliation

What This Means

Problems are not technical—they are process failures

FINAL SUMMARY

Root Causes

lack of discipline

lack of structure

lack of review

lack of understanding

Final Rule

If Volumes 1–7 are followed, most of these issues disappear

STRATEGIC INSIGHT

This appendix does one powerful thing:

It shows users what failure actually looks like

And when people clearly see failure:

they avoid it.

WHAT IS BUILT IN FINOVATEPRO

error detection engine

audit readiness system

compliance scoring model

APPENDIX D: COURT & IRS CASES (NONPROFIT ACCOUNTING ISSUES — CITED)

Real Cases | Legal Outcomes | Compliance Lessons

PURPOSE

This appendix highlights actual U.S. court cases and IRS rulings involving:

misuse of funds

tax-exempt violations

governance failures

reporting issues

CORE PRINCIPLE

These are not theories—these are real organizations that failed

SECTION 1 — PRIVATE INUREMENT & EXCESS BENEFIT

Case 1 — United Cancer Council, Inc. v. Commissioner

Issue

Fundraising contract gave excessive benefit to a private company.

What Happened

A third-party fundraiser received a disproportionate share of donations.

Outcome

IRS challenged tax-exempt status (ultimately reversed on appeal, but exposed risk).

Lesson

Even indirect private benefit can trigger IRS action

Case 2 — Church by Mail, Inc. v. Commissioner

Issue

Organization operated for private benefit rather than public purpose.

Outcome

Tax-exempt status denied.

Lesson

Nonprofits must serve public—not private—interests

SECTION 2 — FAILURE TO OPERATE FOR EXEMPT PURPOSE

Case 3 — Better Business Bureau v. United States

Issue

Organization had substantial non-exempt purpose.

Outcome

Denied tax-exempt status.

Lesson

Even one major non-exempt purpose can disqualify a nonprofit

Case 4 — American Campaign Academy v. Commissioner

Issue

Organization primarily benefited a political party.

Outcome

Tax-exempt status denied.

Lesson

Activities must align with exempt mission—not political interests

SECTION 3 — MISUSE OF FUNDS / FRAUD

Case 5 — United States v. Booker T. Washington Foundation

Issue

Misuse and diversion of nonprofit funds.

Outcome

Criminal enforcement and penalties.

Lesson

Weak controls → fraud risk → legal consequences

Case 6 — People v. Grasso (New York Attorney General v. Richard Grasso)

Issue

Excessive compensation in nonprofit setting (NYSE context).

Outcome

Litigation and governance reforms.

Lesson

Compensation must be reasonable and documented

SECTION 4 — IRS REVOCATION & FILING FAILURES

Case 7 — Automatic Revocation of Exemption for Failure to File Form 990

Issue

Failure to file Form 990 for 3 consecutive years.

Outcome

Automatic loss of tax-exempt status.

Lesson

Filing is mandatory—no exceptions

Case 8 — IRS Intermediate Sanctions (IRC §4958)

Issue

Insiders receiving excessive benefits.

Outcome

Excise taxes imposed on individuals and possibly managers.

Lesson

Private inurement triggers penalties—even without revocation

SECTION 5 — GRANT & FEDERAL FUNDING VIOLATIONS

Case 9 — United States ex rel. Marcus v. Hess

Issue

False claims submitted for government funds.

Outcome

Liability under False Claims Act.

Lesson

Misreporting grant activity can trigger federal liability

Case 10 — United States v. Education Management Corp.

Issue

Improper claims tied to federal funding.

Outcome

Large financial settlement.

Lesson

Federal funding comes with strict accountability

SECTION 6 — GOVERNANCE & DISCLOSURE FAILURES

Case 11 — Stern v. Lucy Webb Hayes National Training School

Issue

Board failed fiduciary duties.

Outcome

Court emphasized duty of care and oversight.

Lesson

Boards must actively oversee finances

Case 12 — Rev. Rul. 69-383

Issue

Organization benefiting private individuals.

Outcome

Not eligible for exemption.

Lesson

Private benefit violates nonprofit status

SECTION 7 — COMMON THEMES ACROSS CASES

What Regulators and Courts Focus On

misuse of funds

private benefit

inaccurate reporting

weak governance

failure to comply with IRS rules

FINAL SUMMARY

Most Common Legal Triggers

Private inurement

Misuse of restricted funds
Poor governance
Failure to file or report accurately
Misuse of federal funds
Final Rule

Nonprofit accounting is not just compliance—it is legal accountability

STRATEGIC INSIGHT

These cases prove:

Small accounting failures can become:

IRS penalties
lawsuits
loss of tax-exempt status

WHAT IS BUILT IN FINOVATEPRO

Embedded:
real-case alerts
compliance warnings
governance flags

You become a legal-aware accounting system