

NONPROFIT CONTROLS PROJECT



The Misericordia University Internal Controls and Federal Tax Exemption Basics for All Volunteer Organizations Resource Manual

A nonprofit organization typically obtains financial resources from a variety of sources to carry out the purpose for which it exists. If those financial resources disappear through even honest mistakes let alone purposeful misuse, everyone suffers. When an officer or member steals from the organization he or she swore to serve, would-be volunteers steer clear of it; donations decline; services are negatively affected, and, in worst-case scenarios, sometimes it is shuttered. It goes beyond the person, the organization, and people who benefit from the organization. It hurts all nonprofits because of the violation of trust.

All Volunteer Organizations (AVOs), in particular, suffer the most as nearly all do not have paid staff to oversee bookkeeping and day-to-day operations, and therefore are reliant upon people from the community who may or may not possess the particular skillset needed to monitor operations.

Steps can be taken by volunteer fire companies, churches, parent-teacher organizations, youth athletic leagues, student clubs, and other nonprofit entities to mitigate their risk of errors and exposure to the theft of funds and/or services. Any lack of oversight is not fair to the organization, the community members it serves and, actually even the person who has volunteered to be the sole guardian of the organization's money. It is vitally important for nonprofits – no matter the size – to implement some simple internal controls.

What you will find inside:

The faculty and the students of the Business Department at Misericordia have put together this resource entitled the ***Misericordia University Internal Controls and Federal Tax Exemption Basics for All-Volunteer Organizations Resource Manual***. As much as possible, the information, guidelines and recommendations contained in this resource are provided and explained in language designed for those with little or no background in accounting or finance. Examples and templates are included where appropriate. You will find information on how to access additional resources available on the Web and in print.

The first section of the Resource Manual is entitled *Basic Internal Controls that every All Volunteer Organization should have*. The controls covered in this section represent the bare minimum that an organization should strive to implement and maintain. Many of these are general in nature and encompass the entity as a whole, such as having more than one person involved in any activity that involves cash, other assets and debts. There is also disclosure of simple controls specific to particular activities, such as collecting cash. In most cases, expansion of what can be done to provide additional checks and balances will be available in later sections of the resource and links to those will be embedded in this first section. This first section on basic internal controls represents a

manageable starting point for any organization no matter how small or large. Please read the *Basics* section first:

[Basic Internal Controls that every All Volunteer Organization should have.](#)

The other sections and subsections of this Resource Manual delve more deeply into specific internal controls for particular activities. They are as follows:

[Cash and Bank Accounts](#)

- Collecting and depositing cash
- Payments made by check and cash
- Bank accounts
 - Bank account reconciliation

[Internal reporting](#)

- The treasurer's report
- Other internal reports

[External reporting](#)

- Internal Revenue Service reporting
 - Reporting unrelated business income
 - Maintaining exempt status
- Pennsylvania reporting

[Event Management](#)

[Tax Exempt Status](#)

- Applying for a Tax ID number
- Incorporating as a nonprofit
- Registering as a charitable organization
- Applying to the IRS for tax-exempt status
- Applying to Pennsylvania for exemption from paying sales tax

[Audits](#)

- External audits and reviews
- Internal audits

Note: This site is intended for the use of All Volunteer Organizations (AVOs) that have no employees and typically have no physical office space available for exclusive use. The controls recommended have been designed for AVOs and in some cases would not be appropriate for larger nonprofit organizations. It is strongly recommended all nonprofits in Pennsylvania consider joining the [Pennsylvania Association of Nonprofit Organizations \(PANO\)](#) that makes available to its members numerous excellent resources and training. The cost of membership in PANO is determined on a sliding scale based upon the size of the organization.

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Fred Croop is available to speak to All Volunteer Organizations or other groups about the importance of implementing internal controls and safeguards in AVOs. Contact him at fcroop@misericordia.edu or (570) 674-6327.

Basic Internal Controls that every All Volunteer Organization (AVO) Should Have

Establish Joint Responsibility: More than one person should be involved in every activity and transaction that involves cash, other AVO assets, and liabilities/debts. This can be accomplished in a variety of ways based upon the specific activity or transaction and the officers and volunteers available to help. This will typically entail a modest level of extra effort and/or inconvenience but the commitment is almost always worth the increased prevention of honest errors and deliberate abuse that can damage the organization, its officers/members/volunteers, its benefactors, the beneficiaries, its work and the community it serves. Be creative to reduce the burden; there are many ways to implement this basic control with little imposition and recommendations on specific activities and transactions are included in relevant sections of this resource.

Adopt and Publish the Rules: Written policies and procedures for the AVO should be developed and made readily available to all officers, members and volunteers. In addition, responsibilities and specific levels of authority and authorization for everyone involved should be defined to which all must adhere. New officers, members and volunteers should be informed of all policies, procedures and limits of authority by providing and explaining the written documents as soon as possible after they join the work of the AVO. All internal controls, such as the ones found in this resource, that have been adopted should be included in the written policies and procedures of the AVO.

Live by a Budget: The AVO should adopt an annual budget. The treasurer should include in his or her monthly report to the board how much has been collected or earned toward budgeted receipts and revenues along with how much has been spent or committed to be spent toward each budgeted expense. At the

end of the year, a final tally of budget versus actual should be produced and presented to the board at the first board meeting of the next year.

Require a Treasurer's Report at every Meeting: The Treasurer should provide a written report to the secretary for the minutes at each board meeting. The report should be read to all in attendance and if someone wants a written copy arrangements should be made to provide it. The report should include at minimum: year-to-date receipts/revenues and payments/expenses compared to budgeted amounts; the balances in all bank accounts; the balance of cash on hand; and any bills that have been received but not yet paid. In essence, the format of the report should communicate the year-to-date profit and loss of the AVO in addition to the receipts and disbursements since the previous treasurer's report, not just the latter.

Prepare Monthly Bank Reconciliations: A monthly bank reconciliation on each bank account *should be prepared by someone other than the treasurer, anyone who handles cash receipts and bank deposits (if different from treasurer) and anyone who pays bills by writing checks (if different from treasurer)*. This could possibly be another officer or a volunteer. The Treasurer should provide transaction details (deposits & checks) to the person who will reconcile the account and the bank statement should be mailed by the bank directly to the person who will prepare the reconciliation (or that person should have electronic access to the bank statement). The person who reconciles the account should report on the most recent reconciliation at each board meeting. An explanation of how to prepare a bank reconciliation and a template to do so are included in the section of this resource entitled [Bank Account Reconciliations](#).

Have the Financial Records Audited: Audits by Certified Public Accountants are expensive and most AVOs will not have the resources to afford an audit by a CPA. However, this is one of the best protections against undiscovered honest

errors and deliberate misuse of AVO resources and if at all possible an audit by a CPA should be arranged. In a case where an audit by a CPA is not feasible, the AVO should have a yearly internal audit done by a small group of members or volunteers (a two- or three-person audit committee) of the AVO who are not officers and do not have any significant responsibilities for handling cash, other assets, liabilities, making payments or deposits, etc. Recommendations on how to perform an internal audit are included in section [Audits](#) of this resource.

Sometimes an AVO cannot afford an annual audit by a CPA but can manage to pay for one every few years (for example, every third year). If this is possible the AVO can combine both approaches to audits, an independent audit by a CPA every few years and internal audits by an audit committee in the intervening years. If and whenever a CPA audit is performed, the CPA should report the results to the audit committee who can then inform the board of the findings.

The Treasurer should not have Conflicting Authority: The Treasurer of an AVO should never at the same time hold another office (such as President) of the board, even temporarily.

Rotate the Treasurer Responsibility: If at all possible, the Treasurer should have a term limit of no longer than three years and, if reelected, should have at least a two-year period between terms.

Never have only one Person Count Cash: All cash receipts should be immediately counted in presence of at least two people and the tally should be signed by all present. Cash should be deposited in a bank account as soon as possible.

Have Mail Opened by Two People: If at all possible, all mail to the AVO should be opened in the presence of two or more people. This is quite often difficult but should be seriously considered if donations or other receipts are routinely received by mail.

Endorse all Checks upon Receipt: All checks received should immediately be endorsed on the back "For Deposit Only" to the AVO name with the bank account number of the AVO.

Make all Payments by Check: All payments made by the AVO should be by check. Never pay bills with cash taken out of the receipts of an event.

Require Two Signatures on Checks: Checks should require the signatures of two officers. This may not always be practical but should be the case as much as possible. In order to handle smaller expenditures a checking account with a small balance that is never exceeded can be established where only one signature is needed. Also, a small petty cash fund can be utilized. The policies, procedures and processes for single-signature checking accounts and petty cash accounts are presented in the [Payments Made by Check and Cash](#) section of this resource.

Avoid the use of Credit and Debit Cards: The use of credit/debit cards is rife with the potential for abuse. If at all possible, the issue of credit cards for use by an AVO should be avoided. If there is an unavoidable need for the issuance and use of a credit card, a provider (bank/credit card company) should be secured that will send an email notice to an AVO member who does not have access to the card when: a transaction in an amount above a prescribed limit has occurred; a number of transactions in a day exceeds a prescribed number; and unusual transactions (for example, payments to a clothing store) have occurred. Monthly statements should be sent to someone without access to the card and should be reconciled just like bank statements.

Two Rules of Internal Controls that Help: Each AVO is unique in one or more ways. This resource will not be able to address every situation and circumstance that may be a part of the activities and operations of an AVO. Therefore, in conclusion to this list of basic controls that every AVO should have, it is suggested that the leaders of an organization adopt as a mindset two general rules of internal control used by accountants and auditors that can guide the development of checks and balances in unique situations.

- **Segregation of Duties** – This is a variation of the "more than one person should be involved in every transaction" basic control described earlier in this section. This states that the recording of the transaction (typically the Treasurer) should be separate from the authorization for the transaction (typically the President or a committee of the AVO) and both should be, if possible, separate from the handling of the transaction itself (typically a volunteer or group of volunteers).
- **Safeguarding of Physical Assets** – Typically this means limiting access to assets so that only authorized individuals have access for only those responsibilities specifically approved for them per AVO policies. Examples would include: keeping the checkbook and blank checks locked up; keeping the keys to vehicles, buildings and rooms under specific control; keeping credit/debit cards in the hands of only those who are authorized to use them and preferably locked up when not in use; and keeping titles to vehicles, buildings and similar assets locked up.

Internal Controls for Cash and Bank Accounts

Cash in the form of currency and coin represents the most vulnerable of resources available to an AVO in carrying out its mission and purpose. There does not have to be intentional actions in order for the AVO to suffer losses of cash; honest individuals make mistakes, poor recordkeeping and documentation lead to cash unaccounted for, and the lack of strict procedures to keep AVO cash separate from other cash (volunteers' personal cash) risks losses. Of course, though, unfortunately sometimes easy access to cash is just too much of a temptation for some individuals.

Money received into an AVO in the form of checks, while less prone to loss through honest mistakes, and safer than currency, is still subject to the risk of loss by individuals intent on relieving the AVO of some of its money.

Access to the funds the AVO has in the bank can be had through using AVO checks and AVO credit/debit cards. Controls to prevent inappropriate use of these are critical and procedures to detect errors (so that they can be corrected) or abuses (so that they can be stopped) as quickly as possible need to be designed carefully and implemented without fail. While corporations, larger non-profits, and even small businesses, having the advantage of employees and stable physical locations, can create strong internal controls over cash on hand and cash in the bank, AVOs have no employees and typically no designated physical location. Recommended controls in this resource to protect cash have been specifically designed for an AVO with no employees and no dedicated physical location and would not be appropriate for nonprofit organizations with employees and/or an office location.

Collecting and Depositing Cash

Money Received through the Mail:

-Stress with those who make donations, pay membership fees, or any other payments to the AVO that they should send only checks or money orders payable to the exact name of the organization. This should be a prominent statement in all materials and communications.

-Use a post office box as the address for the organization. Provide keys to only a limited number of people (preferably only two) who can pick up the mail on a regular basis.

-The person who picks up the mail from the P.O. box should not open it but instead keep a tally of how many pieces of mail have been picked up.

-The mail is taken to a person designated in the AVO's policies and procedures (a strong control would be that it would not be the Treasurer, if practical). The two

should open the mail together and complete a list of what is received. (If the mail can only be opened by the second person, the tally by the first person becomes the compensating control as will be evident in a later step in the process.) All checks are immediately endorsed for deposit only to the AVO. A list of the mail handled including the checks and any money received is completed as the mail is opened. It can be as simple as the example listing that can be found [here](#).

-The checks and money (not the list) is then delivered to the Treasurer for recording, preparation of a deposit slip in duplicate, and deposited in the bank. Other mail that did not contain money is delivered to the appropriate person in the AVO.

-The tally of the number of pieces of mail picked up by the first person, the listing of mail opened and the deposit slip are all turned over to the person who will prepare the bank reconciliation (see [Bank Account Reconciliations](#)) to ensure that all match and mail is accounted for.

Money Received by Hand Delivery:

Admittedly, this is very difficult to track and control. The AVO should specify in its policies and procedures that all money received by any officer, member or volunteer should immediately be turned over to a designated person, typically the Treasurer. The AVO should adopt and make known to all that every person who donates or pays money to the AVO will receive a receipt and that such receipt will only be issued by the Treasurer, no one else.

Money Received for Food or Merchandise at an Event:

Very often AVOs will have food and merchandise stands or booths at events. The key controls are to have more than one person involved at all times, to count

starting and ending cash on hand in the presence of two people, to safeguard all cash while at the stand and in transit in the most secure manner available (lockbox or safe), and to immediately deposit the receipts in the bank. See recommended internal control procedures for events in the section of this resource entitled [Event Management](#). **The following are actual procedures for handling cash receipts followed by a youth athletic AVO in Northeastern Pennsylvania (Courtesy of Linda Murphy, Misericordia Accounting Major):**

- **Registration Fees:** Before the season starts the youth athletic organization has several open registration sessions in which board members and volunteers collect necessary documents and fees. All fees collected at each meeting are logged and counted by at least two people with one being a board member. The money is then turned over to the treasurer to be deposited in the bank. The log for all registrants reflecting the total collected is attached to the bank deposit slip and the amount is recorded in the bank ledger.
- **Fundraiser conducted through the mail:** A significant fund raiser is soliciting for team sponsors and advertising on the field. These receipts are opened at a board meeting, logged into a spreadsheet, verified by two individuals, and deposited in the bank.
- **Receipts at sporting events:** It is impossible for a board member to be present at all games as they go on everyday for six to ten hours. The AVO relies heavily on volunteers to work the snack stand which includes paying the referees. All referee fees in sealed envelopes are provided to the volunteers working the stand by the treasurer. The envelopes are marked according to the specific game date and time and kept at the snack stand on a daily basis. At the start of the day, two volunteers must verify the starting cash drawer and sign off on a daily sheet. All sales are recorded in a cash register to keep track of sales and control inventory. At the end

- of their shift, two volunteers must count the drawer back to the starting point, put all proceeds in the shift envelope, and drop it in a safe.
- Board members take turns emptying the safe each day, closing out the register, and counting the receipts with a second board member or volunteer present. The funds are deposited and logged in the ledger with the deposit slip being attached to the daily report.

Payments made by Check and Cash

As stated in the [Basic Controls](#) section, the best system involves making all payments by checks that requires two signatures.

All large commitment of funds (anything above a predesignated dollar amount per the established policies and procedures of the AVO) should be approved in advance by the full board at a board meeting. Other smaller payments and purchases can be made prior to board approval by the designated co-signers of checks. All payments should be listed in the Treasurer's Report that is submitted for approval at each board meeting.

All payments to vendors should be made based only on invoices or bills, not monthly statements. The co-signers of the check should sign it only after matching the invoice/bill to the check amount, verifying correct payee is listed on the check and confirmation by an officer, member or volunteer that goods or services have been received in good order.

- If it is impractical to pay small amounts by getting the signatures of two people, consider two alternatives: A second checking account can be established that requires only one signature, has a present maximum balance (such as \$200 or \$500) and has printed on the checks: "This check is not valid for amounts over \$200." The designated person who makes small payments with this account keeps receipts for what he or she

has spent. At a board meeting, or before if the balance in the account gets too low, he or she compiles all the receipts and submits them as evidence for the issuance of a check from the main two-signature bank account to deposit back into the small single-signature account that will bring the balance of the account back up to its preset maximum (again, such as \$200 or \$500).

- A lockable petty cash box that contains a preset amount of currency and coin (such as \$100) can be given to a designated officer, member or volunteer who uses the cash from the box to pay for small purchases and puts in the box receipts/bills for anything paid out of it. At any point in time the cash left in the box and the receipts/bills should total the preset amount (such as \$100). At a board meeting, or before if the balance in the account gets too low, he or she compiles all the receipts and submits them as evidence for the issuance of a check from the main two-signature bank account to the petty cash person who can then cash the check and put the cash back into the box to bring the total currency and coin back up to its full preset amount (such as \$100).

Never pay for items out of the cash taken in at a food/merchandise stand. Always pay bills using a checking account or the petty cash box.

Never sign blank checks.

Never make checks out to cash.

Keep unused checks under lock and key.

Keep cash on hand under lock and key.

Account for any voided checks. These should be given to the person preparing the bank reconciliation.

The following are actual procedures for handling purchases/payments followed by a youth athletic AVO in Northeastern Pennsylvania (Courtesy of Linda Murphy, Misericordia Accounting Major):

In preparation for the season opening the AVO needs to issue checks for the uniforms, equipment, and signage. The bills are reviewed and approved by all board members with the checks requiring two signors. To supply the snack stand, checks are issued after the invoices are reviewed and approved. All snack stand replenishment invoices and utility bills are reviewed and approved by the board and checks are issued with two signatures.

Bank Accounts

All money collected and all payments made should go through a checking account. This provides a separate duplicate set of records maintained by an independent bank for the AVO as a back up to the records kept by the treasurer.

Any decision to open new accounts or investment (interest-bearing savings, certificates of deposit, brokerage/mutual fund accounts, etc.) should be approved by the full board at a board meeting. Part of the approval process should be the specification of responsible officers with regard to access and decision-making power over the new account(s).

Signature cards should be updated immediately whenever signatories change.

The supply of unused checks should be given immediately to the new officer responsible for checks when responsibilities change. The new custodian of checks needs to ensure all unused checks are accounted for.

It is at the time that new officers are chosen and responsibilities change that mistakes and unfortunate discrepancies are more likely to occur so the immediate reconciling of accounts and frequent monitoring of activity during this time is recommended.

Bank Reconciliations

The purpose of a bank reconciliation is to account and adjust for any differences between the financial records of checking account transactions kept for a month by the treasurer of an AVO and the transactions recording by the bank for the checking account. There will almost always be differences. Without tracking down those differences to know exactly what they are, the leaders of an AVO will never have confidence that they have control of exactly where the AVO stands with its cash resources. Contrary to popular belief by individuals with their own personal checking accounts, bank reconciliations are not difficult to complete if they are done on a monthly basis and the differences are nailed down month by month.

However, the real reason that the topic of a bank reconciliation is included in a resource on internal controls for AVOs isn't that it represents basic good accounting and bookkeeping, which it definitely does. The reason that it is so important for AVOs is that the preparation of a monthly bank reconciliation by a person who does not handle the day to day management of a checking account represents the single most important control in protection of the most vulnerable resource of an AVO, its cash. Bank reconciliations need to be prepared monthly and completed (reconciled) within a short period (preferably ten days) after the bank statement day by a person who does not handle the checking account or the financial records of the AVO. Period. So, the leaders of the AVO should reconcile themselves to setting up policies and procedures that are followed to the letter to ensure that this is accomplished.

Policies and Procedures:

The bank reconciliation should not be prepared by the Treasurer. It is most practical that the President of the AVO prepare the monthly reconciliation. It would be preferable that it not be one of the signatories on the checking account but if it is (such as the President) it is imperative that each check require two signatures.

The President or whoever prepares the bank rec (accounting slang) reports that it has been completed and all differences accounted for at the first board meeting that occurs after the ten-day period to complete it has passed and that it reconciles to the balance of checking reported by the Treasurer.

The bank should be instructed to send the bank statement directly to the home address of the person who will prepare it; not to the address of the Treasurer or some other address where mail is accessible by any member of the AVO other than the person preparing the bank rec. If there is online access to the bank statement the person preparing the bank rec should have that access.

The reconciliation will sometimes reveal adjustments that need to be made in the financial records of the AVO (such as interest earned posted by the bank, an NSF check deducted, a mistake by the Treasurer in recording the amount of a check, fees deducted by the bank). The adjustments that need to be made should be communicated to the Treasurer as soon as practical.

Preparation of a Bank Reconciliation

What is Needed:

The Bank statement for the month that includes a listing of the deposits and other credits to the checking account and the listing of checks that were processed by the bank along with any other debits (charges) to the account

The up-to-date checking account ledger or "checkbook" that is kept by the Treasurer

The bank reconciliation prepared for the previous month

A template for the format of the bank reconciliation (One example is provided [here](#).)

Steps in Preparing a Bank Reconciliation:

1. Head up the template of the bank rec with the AVO name, the checking account number and the ending date of the bank statement.
2. At the top of the bank rec template write down the ENDING BALANCE found on the bank statement (Note, make sure it is the ending balance and not the beginning balance or some other subtotal on the statement.).
3. Check off all the deposits on the bank statement matching them to the ones recorded in the Treasurer's checkbook. There may be one deposit in the checkbook (There really should never be more than one if any at all.) made at the very end of the month that did not get to the bank in time for it to appear on the bank statement. This is called a deposit in transit and if there is one, it should be entered on the template as an addition to the ending bank balance.
4. Look at the bank rec completed for the prior month and check if there was a deposit in transit listed on it. If there was, make sure it appears as a deposit on

the bank statement for the current month (If there was a deposit in transit last month it should appear as the first deposit on the statement for this month.).

5. Next, the checks deducted on the statement by the bank must be compared to the checks recorded in the Treasurer's checkbook. If there are a lot of checks written care must be taken to match up the exact check numbers and amounts; this is very important. Check off in the checkbook each check that is deducted by the bank on the bank statement (There is usually a place for a checkmark in a checkbook for just this purpose.). Any checks that have been written and recorded in the checkbook that are not deducted on the bank statement are ones that the people to whom the checks were written have not cashed yet. These are called outstanding checks. List the outstanding check numbers, dates they were written and the amounts on the back of the template for the bank rec. Now, what is in these instructions next should actually be done before what was just stated but it would not have made sense until grasping the concept of outstanding checks. Again, look at the bank rec for the prior month and make sure that all outstanding checks were deducted by the bank this month. If there are any that weren't cashed, then they are still outstanding and should be listed again with the new outstanding checks found this month. This should probably be done before determining the new outstanding checks of this month because of the prior month's checks having earlier check numbers making sense that they should be listed before the new ones.

6. Total the outstanding checks and insert that total as a subtraction from the ending bank balance on the bank rec template.

7. Draw a line on the template under the outstanding check total and compute a subtotal taking the numbers entered on the template so far: the ending bank balance plus the deposit in transit (which may be 0) minus the outstanding checks. Enter the subtotal on the bank rec template.

THIS IS THE ACTUAL (REAL) BALANCE OF THE CHECKING ACCOUNT AT THE END OF THE MONTH.

8. If the bank recorded transactions on the bank statement that the Treasurer did not list in the checkbook (because he or she did not know about them such as interest earned or fees deducted) they must be added or subtracted next on the template. This is confusing but if one rule is followed it will always be done correctly. The rule: If the item was added by the bank (like interest earned) it will be subtracted on the bank rec template. If the item was deducted by the bank (like fess charged) then it will be added on the bank rec template. This seems the opposite of what it should be, and it is, but there is a good and logical reason for it. When these items are subtracted and added on the template, the total should be the ending balance per the Treasurer's checkbook. The Treasurer did not know about these when he or she computed the balance so his or her balance is out of date and you are "backing into" that out of date balance just to ensure that everything reconciles.

9. So, draw a line on the template and subtract and add any items recorded by the bank from the "REAL" account balance arrived at in step 7 and enter the "bottom line" amount on the template.

THIS IS THE NUMBER THAT SHOULD MATCH THE ENDING BALANCE IN THE TERASURER'S CHECKBOOK. IF THE NUMBERS DO NOT MATCH, THE DIFFERENCE NEEDS TO BE TRACKED DOWN AND RECONCILED.

10. Once any differences are reconciled let the Treasurer know if he or she needs to make any adjustments to the checkbook for items the bank had processed like interest earned or fees charged.

11. Keep the bank rec so that it is available to prepare the bank rec for the next month.

Reports to the Board and Members of the AVO

Written and oral reports to the board and/or general membership of the AVO at meetings document the activities of the organization and establish a shared understanding of and/or agreement to plans for the future. The reports that should be made at every meeting and those that need to be made at a specific meeting, such as the meeting designated for budget approval, need to be specified in the written policies and procedures of the AVO. Also, it should be specified which reports must be in writing such as the Treasurer's Report. Some reports can be made orally, such as those made by individuals assigned a specific short-term task like finding a potential location for an upcoming event. However, it is important to ensure that the secretary can capture all the facts of any oral reports; otherwise the reports should be committed to writing. The Treasurer's Report and the minutes of the previous meeting represent the items that are most critical in regard to strong internal controls for the AVO. These must be in writing and preserved in a safe location at all times. Action taken on all reports presented should be recorded in the minutes. Typically, this means a vote to accept the report itself and/or recommendations included in the report. All decisions and actions of the of the organization must be documented in the minutes.

Treasurer's Report

As noted in the Basics section of this resource, a comprehensive Treasurer's Report presented at every board meeting is essential to maintaining an acceptable level of protection regarding the most vulnerable asset of the AVO, its cash. The Treasurer's Report should be understandable to all, signed by the treasurer, and submitted for inclusion in or attachment to the minutes of the meeting. The report must: start with the ending balance of the previous report; include all the financial activity that transpired since the last report (including a detailed listing of all donations received and checks/payments made); be

mathematically correct (This should never be assumed; the report should be double-checked.); end with the balance to be carried forward to the next report; and include a year-to-date comparison of actual receipts and expenses to the budget of receipts and expenses adopted by the AVO. A [Sample Template of a Monthly Treasurer's Report](#) that includes all of these important elements can be found [here](#).

Other Internal Reports

Minutes of Meetings: The written minutes of meetings should include: action taken on the minutes of the last meeting held; the Treasurer's Report and the action taken on it; results of the most recent bank reconciliation; summaries of committee reports; and all decisions made and actions taken by the board and/or voting members. The officers and recognized visitors present at the meeting should be listed and others in attendance should at the very least be counted (if practical listed) and the number recorded.

The Results of the Most Recent Bank Reconciliation should be presented.

A Report by each Committee should be made.

A Report by each Individual who had Accepted or was Assigned a Specific Task should be made.

A Report-Out on any Event held should be made.

A Report on any Regulatory or Tax Filing submitted for the AVO should be reviewed and, if appropriate, a copy of the filing should be provided to those in attendance.

A Report on the Results of an Audit should be made, if one had been completed recently .

External Reporting

Caution and Disclaimer: This resource is designed to be a primer on external reporting for small AVOs without complex activities. It should not be used as an authoritative reference and is by nature unable to cover comprehensively all possible reporting requirements that may be dictated by the specific activities of each unique AVO. The Internal Revenue Service and the departments of the Commonwealth of Pennsylvania recognize small nonprofits often need assistance in determining what reporting needs to be addressed and these government bodies are willing to and can provide significant help. If there is any question by an AVO on what external reporting needs to be accomplished, contacting these agencies or consulting with a CPA or attorney is strongly suggested.

Overview: Depending upon the size (in dollars of gross receipts and assets) of and the activities conducted by an AVO, filing reports with government agencies or regulatory bodies may be required. This resource will present the basic requirements universal to most small AVOs based upon "the letter of the law." Many small AVOs do need to file reports but are unaware and do not. It is often the case that a government agency will not discover this because the AVOs are so small and, quite frankly, in most of these cases the reports if submitted would just be filed away by the agency and no action is taken or needed in any way. However, technically the AVO is not meeting its responsibilities in these instances and at least on paper consequences do exist. This resource must take the approach of presenting what is required based upon absolute adherence to government agency requirements and cannot take the approach of presenting "short cuts" that often in reality work out for the AVO in the end.

Federal: Most AVOs do need to submit a simple annual online filing with the IRS only; some AVOs need to complete an annual tax return. If an AVO is conducting activities that unfairly compete with tax-paying businesses, depending upon the

money made, a tax return might need to be filed and tax paid. These requirements will be covered in this section of our resource.

Pennsylvania: Some AVOs must file reports with the Commonwealth of Pennsylvania. These requirements will be covered in this section of our resource.

Internal Revenue Service Reporting

It needs to be established right up front in this coverage of meeting the reporting requirements of the IRS that per strict interpretation of regulations, **the only AVOs that do not have to file something annually are: churches are integrated auxiliaries, conventions and associations of churches and AVOs that are part of larger organizations that file group IRS returns. All other AVOs** no matter their size or whether they have applied for tax-exempt status or not by IRS regulations **must submit an annual filing.**

In order to complete the annual filing an AVO must have a Tax ID Number. Technically, this is called an Employer Identification Number (EIN) but don't let the word Employer throw you as the AVO needs the EIN in spite of by definition having no employees. This is what the IRS and other government bodies use as the unique identification number for the AVO. If one needs to be obtained, the process to do so is covered in the [Obtaining a Tax ID Number for an AVO](#) section of this resource.

AVOs that have not Filed for Tax-Exempt Status: As covered in the Applying to the IRS for Tax-Exempt Status section of this resource, charitable (per the IRS) AVOs that do not normally take in more than \$5,000 in annual gross receipts do not have to formally apply and pay a fee for obtaining tax-exempt status; these AVOs are automatically deemed exempt until such time as they exceed the \$5,000 limit. However, even though an AVO has not needed to file an application to be tax exempt, it is still, by the letter of the law, required to file annually with the IRS. So, please bear in main that the next discussion of filing an

e-Postcard version of IRS form 990-N applies to AVOs even if they have never applied for tax-exempt status.

The IRS 990 Tax Return: AVOs whose annual gross receipts are normally \$50,000 or less have the advantage of satisfying the annual IRS filing requirement by doing it online through what is called an e-Postcard. The e-Postcard is actually the IRS form 990-N. IRS form 990 is the annual tax return that must be filed by nonprofits analogous to the IRS form 1040 that is filed annually by individuals. There are three versions of the 990: long form 990 itself that complex and/or large nonprofits must use; 990-EZ that is a four-page return that smaller nonprofits without complex transactions can use; and the 990-N that really is as simple as it gets for small nonprofits (that would include most all AVOs) where only a few questions need to be answered online. Therefore, this resource will focus on the e-Postcard filing.

Due Date of the e-Postcard: The e-Postcard must be completed online by the 15th of the fifth month after the end of the fiscal (tax) year of the AVO. For example, if the AVO ends its year on December 31, then the e-Postcard needs to be filed by May 15 of the following year. However, for example, if the AVO ends its year on June 30, then the e-Postcard needs to be filed by November 15 of that same year. The IRS is very flexible, to a certain point, with regard to late filings; there is a penalty. However, if an AVO fails to submit its annual filings for three consecutive years, it loses its tax exempt status. The consequences of this are burdensome (filing back-dated corporate tax returns, etc.) and expensive (paying taxes as if the nonprofit were operating as a business).

Information to be submitted on the e-Postcard: There are only eight pieces of information that must be entered on the e-Postcard:

1. The Employer Identification Number (EIN) of the AVO

- 2.The tax year for which the filing is being made
 - 3.The official legal name of the AVO and its mailing address
 - 4.Any unofficial names the AVO uses
 - 5.The name and address of the principal officer (usually the president)
 - 6.If the AVO has a Web site, the address must be provided
 - 7.Confirmation that the AVO had \$50,000 or less in gross receipts for the tax year
 - 8.Notification if the AVO intends to go out of business
- It is that simple. The e-Postcard, of course, has to be filed online. If for some reason the AVO cannot, or chooses not, to file online it can complete the four-page 990-EZ form which would be more burdensome, but manageable.

Reporting Unrelated Business Income (UBI)

Per the IRS: "Unrelated business income is the income from a **trade or business regularly conducted** by an exempt organization and not substantially related to the performance by the organization of its exempt purpose or function." It is difficult at times to determine if what an AVO is doing to raise money is a trade or business. The common sense interpretation is that if it takes business away from a profit-making tax-paying business, it is a trade of business. However, even if it is, to be UBI it must be conducted regularly; it would be OK if it is just conducted one time or very rarely. Also, to be UBI, it must be related to the purpose of the AVO only in that it provides profits to be used by the AVO; if it related to the purpose (for example, food stand at athletic events) then again it is

OK and not UBI. This can get tricky and once again, we recommend if there is any doubt whether an activity of an AVO represents UBI, a CPA should be consulted.

An AVO needs to file a tax return (990-T, due the 15th of the fifth month after the end of the AVO's tax year) and pay tax on Unrelated Business Taxable Income (UBTI) only if it has gross income (Revenue from UBI activities minus Cost of Goods Sold, if any, but not reduced by other expenses) in a year in excess of \$1,000. Many AVOs are small enough to never exceed this threshold and do not have to file. However, one thing to note is that an AVO regularly conducts gaming activities to support its purpose but not related to its purpose, it is the gross money collected, not the net profit that is used to determine if the \$1,000 gross income has been exceeded and, of course, this may impact some AVOs. However, the AVO does get to deduct expenses in arriving at taxable income. So, an AVO may taxable income of less than \$1,000 and pay tax on it (Tax is assessed from the first dollar of taxable income.) because it had to file due to exceeding the \$1,000 **gross** income limit. The tax on UBTI small AVOs is 15%.

Note: Having UBI does not in and of itself jeopardize an AVO's tax-exempt status. The only consequence is that the AVO may have to pay tax on the UBTI.

Maintaining Tax-Exempt Status

Unfortunately, some nonprofits lose their tax-exempt status by not following the rules and regulations. This topic is covered here because more often than not it is due from failure to file IRS reports. There are other situations, though, that also jeopardize the tax exempt status of nonprofits, including AVOs.

According to the IRS your Tax-exempt AVO will jeopardize its status if it ceases to be operated exclusively for one of the exempt purposes identified under section 501(c)(3) of the Code. But what exactly does this mean? In its [Life Cycle](#)

[of a Public Charity](#) publication, the IRS explicitly lists the actions in which an AVO may or may not engage and the obligations it is responsible for upholding.

According to the IRS's compliance guide, a 501(c)(3) organization:

must absolutely refrain from participating in political campaigns of candidates for local, state, or federal office;

must restrict its lobbying activities to an insubstantial part of its total activities;

must ensure that its earnings do not inure to the benefit of any private shareholder or individual;

must not operate for the benefit of private interests such as those of its founder, the founder's family, its shareholders, or persons controlled by such interests;

must not operate for the **primary purpose** of conducting a trade or business that is not related to its exempt purpose, such as a school's operation of a factory;

may not have purposes or activities that are illegal or violate fundamental public policy;

must satisfy annual filing requirements.

Besides the preceding, it should be noted that failing to file an annual return (e-Postcard, or other 990) or notice for three years consecutively results in the automatic loss of tax exemption for an organization. As discussed in a preceding section, the loss of tax exemption means that you will have to begin paying corporate income tax on your annual revenue; you may even be subject to back taxes and penalties if your remitted payment is not calculated based on the effective revocation date of your tax-exempt status. Additionally, loss of this

federal classification may result in the revocation of any other tax exemptions (such as PA sales tax) that have been awarded to your organization by the state. This also means that donors will not be able to receive a tax deduction for any contributions they make to your organization after the revocation date.

If you still have questions regarding compliance rules and procedures, please consult [IRS Publication 557, Tax-Exempt Status for Your Organization](#) and the [Life Cycle of a Public Charity](#). The IRS provides through its Website invaluable information to your group regarding any other questions you may have including the following: [Educational Products, Workshops and Seminars for Exempt Organizations](#) offered; [How to Stay Exempt](#) tutorial; and [StayExempt.IRS.gov](#) companion Website. The IRS also offers a newsletter for exempt organizations called *EO Updates* specifically geared toward tax-exempt organizations; this free publication can help you stay current on the latest developments in tax law that affect charities and non-profits, so take advantage of it if you can. You can subscribe to [EO Update here](#).

Finally, for additional assistance, please consult a tax adviser. Tax-exempt status and tax law compliance are not matters that should be regarded lightly. If you are unsure of something, ask a professional; the loss of your organization's status should not be a risk you are willing to take. Good luck!

Pennsylvania Reporting

Pennsylvania does not require AVOs to file tax returns or any other submissions similar to the 990-N the IRS requires.

If there has been a change in the officers of the AVO during a year, Pennsylvania requires the AVO to file a one-page Annual Statement – Nonprofit Organization form DSCB 15-5110 by April 30 of the following year. There is no fee for this

statement. The [DSCB 15-5110 form and instructions are available for download from this resource here](#).

By the year 2021 every AVO is required to file a Decennial Report and pay a fee of \$70 with it. However, if the AVO has filed at least one Annual Statement – Nonprofit Organization form DSCB 15-5110 before then it is not required to file the Decennial Report. Therefore, PANO urges every nonprofit in Pennsylvania to file at least one Annual Statement – Nonprofit Organization form DSCB 15-5110 (that requires no fee) before 2021 in order to save the \$70 cost of filing the Decennial Report.

If the AVO has had to file an initial Charitable Organization Registration Statement PA form BCO-10 (See the discussion of this in the [Registering as a Charitable Organization](#) section of this resource.) then it is required to file a [BCO-10](#) Statement by May 15 of each year and pay the applicable fee. Many AVOs, unless they are raising more than \$25,000 in contributions per year and/or hiring someone to fund raise for them, do not need to file these registrations forms.

All AVOs are required to file an annual Institutions of Purely Public Charity Registration Statement unless exempted as a religious institution and such separate groups or corporations which form an integral part of a religious institution and are exempt from filing an annual IRS 990 Return. AVOs that raise less than \$25,000 per year need only to complete the first three lines of the form and check that they are exempt because of that and mail in the form by May 15. (See the discussion of this in the [Registering as a Charitable Organization](#) section of this resource.) There is no fee for filing this form. The [Purely Public Charity Registration Statement is available for download from this resource here](#).

Event Management

Prescribed Procedures developed in Advance covering all aspects of the conduct and management of the event with designated responsibilities and limits of authority for all officers, members, and volunteers involved should be

committed to writing. This is especially critical with regard to handling cash collections and processing them after collection right up until they are deposited in the bank.

Thoroughly Go over the Event Procedures with Everyone Working the Event in advance of the start of the event. Place written copies of the procedures in key locations such as inside cash boxes, at stands, at the door, etc.

Establish One Cash Collection Point for Events that have Multiple Stands. Have patrons buy tickets at a centralized ticket stand to be used at the other stands for the event; no cash is collected at the other stands. This type of set up limits the number of people with access to cash (However, there should still be at least two working the ticket stand.) and by centralizing the handling of cash there is greater assurance that established procedures will be followed without exception.

Use a Cash Register, if affordable.

Strict Inventory Procedures for Tickets must be Employed when tickets are used by patrons for the purchase of food and other items, to buy chances on winning a prize, etc. This includes: a beginning count of tickets in the presence of at two people that is written down and signed off by both; physical safeguarding of the inventory of tickets at all times with only authorized access per established procedures; the recording of all tickets issued with the signing of a receipt by the officer, member or volunteer who accepts them; an ending count of the tickets remaining (ending ticket inventory) in the presence of two people and signed off by both; and a reconciling of the tickets used to the cash collected.

Cash Boxes/Drawers should be Safeguarded at all Times. The beginning cash balance in the drawer should be counted in the presence of the person accepting the drawer and the person handing it over with both signing in

agreement to the tally of the count which should be a predetermined amount per the procedures. At the end of the event or at any shift change there should a count of the money taken in and verification that what remains in the drawer is equal to the beginning balance; this should be documented in writing in the presence of two people.

Cash Collected at Events should be Counted and Deposited in the Bank as soon as Possible. Of course, the count should be in the presence of two people and the cash should be safeguarded until deposited; if possible employ the use of bank bags that can be locked, fireproof boxes, or best yet a safe in combination with the bank bags. An actual set of procedures used by a youth athletic league for sporting events can be found near the bottom of the page in the [Collecting and Depositing Cash](#) section of this resource.

With Long Events, Count and Deposit Cash at Set Intervals. This is a worthwhile approach for a long single-day event, but is a critical procedure with events that span more than one day.

Tax Exempt Status

It is strongly advised that an AVO should consult with an attorney and CPA in dealing with applying for tax exempt status and whether it is required for very small AVOs. The resources provided here serve only as background in being prepared to ensure that discussions with these professionals are effective and efficient. Also, the explanations provided are designed to be understandable to all reading them, even without a law or tax background, but in being so may be as authoritative as necessary to deal with tax exempt status. The publications of the IRS that are referenced in this resource should be consulted to for exact interpretations.

The first question to answer is: Does the AVO want to apply for tax-exempt status or, more importantly, is it required to apply?

Per the U.S. regulations and laws enforced and interpreted by the Internal Revenue Service:

- Established churches and groups that are a part of established churches DO NOT need to apply for tax exempt status but are automatically considered tax exempt; donations to them are tax deductible to the contributors. (See IRS Publication 1828, [*Tax Guide for Churches and Religious Organizations.*](#))
- A chapter, or similar sub-unit, of a larger nonprofit organization that is tax exempt and the chapter uses the blanket exemption with permission of the parent organization DOES NOT need to apply for tax exempt status; donations to it are tax deductible to the contributors.
- Nonprofits with annual gross receipts that "normally" are less than \$5,000 DO NOT need to apply for tax exempt status but are automatically considered tax exempt; donations to them are tax deductible to the contributors. Please consult IRS Publication to determine if the \$5,000 test is met with brand new nonprofits and in cases where the gross receipts in some years are \$ 5,000 or higher and in other years fall below \$5,000.
- Virtually ALL OTHER NONPROFITS MUST APPLY FOR TAX EXEMPT STATUS or risk being taxed as a profit-making entity where donations to them would not be tax deductible to the contributors. This includes nonprofits that previously met the less than \$5,000 gross receipts test but have now exceeded that threshold with what they take in.

Even if an AVO is not required to apply for tax exempt status, sometimes it is still may be to its advantage to do so anyway. Many sources of grant funding require it and donors sometimes look more favorably on an AVO that is tax exempt.

To apply for tax exempt status under the IRS, the AVO must be: 1) organized (in almost all cases as a corporation); 2) created for an acceptable tax exempt purpose; and 3) be operated primarily for the tax exempt purpose with no

political activity, no substantial lobbying activity, no profit going to anyone involved, and not operate a business activity that competes in a significantly unfair way with taxable businesses.

The steps in applying for federal tax exempt status include:

1. Apply for an Employer Identification Number (EIN) even when no employees are going to be hired. This is the identification number for the AVO, again, needed for that purpose even if there are no employees. The process to do this is covered in the section of this resource entitled [Obtaining a Tax ID Number for an AVO](#).
2. Incorporate in a state or commonwealth if not already incorporated. The process for incorporating a nonprofit organization in the Commonwealth of Pennsylvania is laid out in the section of this resource entitled [Incorporating as a Nonprofit](#).
3. Register as a Charitable Organization in Pennsylvania. The explanation for when this is required and how to register is covered in the section of this resource entitled [Registering as a Charitable Organization](#).
4. Make application to the IRS for tax exempt status utilizing IRS form 1023 Application for Recognition of Exemption or form 1023EZ including all required attachments and fee. The process to do this is covered in the section of this resource entitled [Applying to the IRS for Tax-Exempt Status](#).
5. Wait for a response from the IRS that usually takes a few months. Answer any questions from the IRS, if there are any, and eventually, if all is acceptable to the IRS, the AVO will receive an IRS letter of determination that grants tax exempt status. This letter serves as proof of exemption.

Note: you will also find a page and resources on applying for exemption from paying sales tax in Pennsylvania [here](#).

6. Meet all annual and other filing requirements in a timely manner to maintain tax exemption status. The filing requirements are covered in the section of this resource entitled *External Reporting*.

Obtaining a Tax Identification Number for the AVO

You must begin the application process for tax-exempt status by obtaining an Employer Identification Number (EIN). Note: Do not let the word "Employer" throw you off. Even though AVOs by definition will have no employees, the EIN still represents the identification number used by the Internal Revenue Service (IRS) and by the Commonwealth of Pennsylvania (PA) as the unique identifying number for a nonprofit organization, even when it does not have any employees. The EIN can be obtained by filing through a fax submission or by mail an IRS Form SS-4, *Application for Employer Identification Number* (A pdf version of the form can be found here: <http://www.irs.gov/pub/irs-pdf/fss4.pdf>) or by calling the IRS toll-free at (866) 816-2065. However, the most convenient method for AVOs would be to submit all required information in an online version of the form that can be found at: <https://sa.www4.irs.gov/modiein/individual/index.jsp> If using the online version first click on the button "Begin Application" at the bottom of the first screen. Be sure to click "View Additional Types, Including Tax-Exempt and Governmental Organizations" and "Other Non-Profit/Tax-Exempt Organizations" as choices on the screens where this is requested. The application must be completed in one session.

Forming a Nonprofit Organization in the Commonwealth of Pennsylvania

After obtaining an EIN for your group, your next step is to form a corporation with nonprofit status. Nonprofit corporations are defined by the Pennsylvania Department of Revenue as those whose members or shareholders may not receive any of the pecuniary (i.e., financial) profits of the organization. The

procedure to form a corporation with nonprofit status in the Commonwealth of Pennsylvania requires two forms to be filed with the state Bureau of Corporations and Charitable Organizations: an Articles of Incorporation document and a docketing statement (PA form).

The Articles of Incorporation form ([link to PA form DCSB 15-5306-7102B](#)) requires the following information (items 1 to 10 labeled as such on the form):

- **1.**The name of the corporation. The name chosen for the organization must be available for use, meaning that it has not already been taken by another business or nonprofit in the Commonwealth. To determine if the name you want to use for your AVO is already taken and therefore not available, you can enter it into Pennsylvania's database of names that have already been reserved
at:<https://www.corporations.state.pa.us/corp/soskb/csearch.asp>
- **2.**The address of the corporation. The initial registered address requires the street and number. A post office box alone is not acceptable. Of course, many AVOs do not have a physical location with a mailing address. There are two options in this case: 1) use the home or business address of one of the organizers; or 2) use a Commercial Registered Office Provider's (CROP). A CROP can be used by an AVO to provide a registered address in any document filed in the Department of State in lieu of providing a registered office address. Info on obtaining a CROP can be found
at:<http://www.portal.state.pa.us/portal/server.pt/community/corporations/12457/xxx-commercial-registered-office-provider/571862>
- <http://www.portal.state.pa.us/portal/server.pt/community/corporations/12457/xxx-commercial-registered-office-provider/571862>**3.**The purpose of the non-profit corporation. You will need to provide a stated purpose of the nonprofit corporation that is one of the approved purposes allowed by

the state. Section 5301 of the Pennsylvania Code lists the following or similar lawful purposes: Athletic; A lawful business purpose to be conducted on a not-for-profit basis; Beneficial; Benevolent; Cemetery; Charitable; Civic; Control of fire; Cultural; Educational; Encouragement of agriculture or horticulture; Fraternal; Health; Literary; Missionary; Musical; Mutual improvement; Patriotic; Political; Prevention of cruelty to persons or animals; Professional, commercial, industrial, trade, service or business associations; Promotion of the arts; Protection of natural resources; Religious; Research; Scientific; and Social. Note: In Pennsylvania, an AVO corporation must be able to fulfill its purpose without any financial benefit to the members except for reimbursement of reasonable expenses incurred in the performance of approved AVO activities.

- **4.** A statement is included on the PA form indicating that the corporation is one that does not contemplate a pecuniary gain or profit, incidental or otherwise. Signing the form acknowledges the applicant agrees to this requirement.
- **5.** The AVOs will be organized on a non-stock basis and there is a place on the form to check that this is so.
- **6.** There is a place on the form to strike out one of the following statements that will not apply to the AVO: "The corporation shall have no members." or "The incorporators constitute a majority of the members of the committee authorized to incorporate by the requisite vote required by the organic law of the association for the amendment of such organic law." The AVO must decide whether there will be members or not. If not the AVO is governed solely by the board of directors. Most AVOs do not decide to have members but this is a complex issue and you should consult an attorney if there is any doubt.
- **7.** Item 7 on the form does not typically apply to AVOs. It is for coops.
- **8.** The names and addresses of the incorporator(s) must be listed. Note: These individuals do not have to be on the board of the AVO but must be

authorized to file the articles of incorporation by the AVO. You can determine the first directors before the application or defer to a future election at the initial organizational meeting of the AVO after incorporation.

- **9.**The date that the AVO wants the incorporation to be effective needs to be specified.
- **10.**In addition to the preceding 9 items required by the Commonwealth of Pennsylvania, the AVO can include additional provisions of the articles of incorporation. **At minimum, the following three provisions must be included, per the IRS,** for the AVO to be considered for tax-exempt status:
 - "Said corporation is organized exclusively for charitable, religious, educational, and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future federal tax code.
 - No part of the net earnings of the corporation shall inure to the benefit of, or be distributable to its members, trustees, officers, or other private persons, except that the corporation shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth in Article Third hereof. No substantial part of the activities of the corporation shall be the carrying on of propaganda, or otherwise attempting to influence legislation, and the corporation shall not participate in, or intervene in (including the publishing or distribution of statements) any political campaign on behalf of or in opposition to any candidate for public office. Notwithstanding any other provision of these articles, the corporation shall not carry on any other activities not permitted to be carried on (a) by a corporation exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code, or the

corresponding section of any future federal tax code, or (b) by a corporation, contributions to which are deductible under section 170(c)(2) of the Internal Revenue Code, or the corresponding section of any future federal tax code.

- Upon the dissolution of the corporation, assets shall be distributed for one or more exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future federal tax code, or shall be distributed to the federal government, or to a state or local government, for a public purpose. Any such assets not so disposed of shall be disposed of by a Court of Competent Jurisdiction of the county in which the principal office of the corporation is then located, exclusively for such purposes or to such organization or organizations, as said Court shall determine, which are organized and operated exclusively for such purposes."

To complete the Pennsylvania **Articles of Incorporation-Nonprofit** form DCSB 15-5306-7102B, the incorporators must sign their names. Finally, publication of either the intent to file or the actual filing of the Articles of Incorporation must be made in two newspapers of general circulation, one a legal journal if possible. You need to advertise your corporation's name, statement that the corporation will be or already has been incorporated, a summary of your corporation's purpose, and a date that you either did file or intend to file for incorporation. If there is only one local paper, that will be sufficient. To determine publications that are legal journals, consult the geographic listing of legal journals found on the Pennsylvania Department of State's website that can be found at:http://www.portal.state.pa.us/portal/server.pt/community/corporations/12457/x_geographical_listing_of_legal_publications/571893Proofs of publication must be filed with the meeting minutes of the corporation.

The completed Articles of Incorporation should be accompanied by one copy of form DSCB: 15-134A, *Docketing Statement*. Form DSCB: 15-134A requires a replication of some of the information provided in the Articles of Incorporation form: the entity name, the name and mailing address of the individual responsible for initial tax reports, a description of business activity, a specified effective date, the EIN, and the date of the entity's fiscal year end. The link to form DSCB: 15-134A

is: https://www.portal.state.pa.us/portal/server.pt/document/488546/134a_pdf

Once the Articles of Incorporation and Docketing Statement have been completed, they are submitted with the filing fee of \$125 payable to the Commonwealth of Pennsylvania. The address to which to submit the documents is:

- Department of State
- Bureau of Corporations and Charitable Organizations
- P.O. Box 8722
- Harrisburg, PA 17105-8722

Registering as a Charitable Organization

There are nonprofit organizations operating in Pennsylvania that must register with Pennsylvania Department of State's Bureau of Charitable Organizations and file annual reports. The determination of whether an AVO must register is essentially made based upon not being a type of organization specifically exempted from the requirement per two Acts of legislation: the Solicitation of Funds for Charitable Purposes Act or the Institutions of Purely Public Charity Act.

Those groups exempt from registration on the Solicitation of Funds for Charitable Purposes Act include: an organization that does not hire and pay a person to solicit contributions and receives less than \$25,000 of contributions in a year; volunteer fire and ambulance companies and auxiliaries; organizations of individuals who protect the public safety (police, firefighters, emergency

management personnel, etc.); religious institutions and such separate groups or corporations which form an integral part of religious institutions; educational institutions; groups that operate directly under the supervision of education institutions; parent/teacher organizations; hospitals; hospital foundations; nonprofit libraries; and active living centers. The complete list with additional information can be found in the [PA Department of State's Exclusions and Exemptions Chart](#). If the AVO is not included in this list, it must file a [Charitable Organization Registration Statement PA form BCO-10](#) for its most recently completed fiscal year within 30 days of receiving more than \$25,000 in gross national contributions or prior to compensating someone to solicit contributions from Pennsylvania residents. Complete information on filing this form, the filing fees required that range from \$15 to \$250, and other associated solicitation of funds reporting requirements can be found on the [PA Department of State's Information for Charitable Organizations Web page](#).

An AVO that is exempt from filing a Charitable Organization Registration Statement may still be required to file an annual [Institutions of Purely Public Charity Registration Statement](#) unless it is exempted as one of two types of organizations: religious institutions and such separate groups or corporations which form an integral part of a religious institution and are exempt from filing an annual IRS 990 Return; or institutions of purely public charity which receive contributions of less than \$25,000 per year provided that the institution's program service revenue does not equal or exceed \$5,000,000.

Applying to the IRS for Tax-exempt Status

Caution and Disclaimer: This resource is presented as an introductory guide to applying for tax-exempt status with the IRS. It is meant as a primer for small AVOs to educate on the aspects of seeking tax-exempt status for the AVO. It

cannot cover all of the many complexities and nuances of becoming exempt from federal income tax and therefore should be used with that in mind. It is strongly suggested that a Certified Public Accountant with experience in applying for tax-exempt status be engaged by an AVO to handle the application process.

Some AVOs are automatically tax-exempt without applying: Churches, interchurch organizations of a church, conventions and associations of churches, integrated auxiliaries of a church (such as a youth group) and any AVO (that is not a private foundation; a private foundation has very few contributors of large amounts of money) that normally have annual gross receipts of \$5,000 (*See explanation below.) or less do not need to formally file an application if the organizations meet all the IRS requirements of being what is called a 501(c)(3) nonprofit entity. Many small AVOs will be automatically exempt because gross receipts do not normally exceed \$5,000. The label 501(c)(3) refers to the section of the Internal Revenue Code (IRC) that defines the requirements for this type of organization to be eligible for exempt status. This term, 501(c)(3), is used by most people in referring to a tax-exempt organization.

So, what makes an AVO eligible for exemption under section 501(c)(3) of the IRC? There are three key components:

1. The AVO must state that its purpose(s) is one or more of the following: charitable, educational, religious, scientific, literary, fostering of national or international sports competition, preventing cruelty to children or animals, or testing for public safety.
2. The AVO must be incorporated with articles of incorporation that must state its purpose(s) is one or more listed in section 501(c)(3) (from the list given in item 1 above) to which all activities will be dedicated to that purpose while its assets will be permanently dedicated to exempt purposes.

3. The AVO must not participate in political campaigns of candidates for public office, must have insignificant political lobbying activities if any at all, must ensure earnings do not benefit a private individual, must not operate in the interest of its founder, must not operate a business unrelated to its exempt purpose, and must not violate the law or public policy.

*There is some flexibility in meeting the "normally have annual gross receipts of \$5,000 or less" test. An AVO is deemed to have met the \$5,000 or less requirement if:

1. During its first tax year it received gross receipts of \$25,000 or less,

2. During its first two tax years it received a total of \$12,000 or less in gross receipts,

3. During its last three tax years it received a total of \$15,000 or less in gross receipts

An AVO that at any point fails to meet the \$5,000 or less gross receipts test must formally file for tax-exempt status within 90 days after the end of the tax year that caused it to fail the test.

The Application Process for Tax-exempt Status: Once it is decided or required to apply formally to the IRS for tax-exempt status, there are three application forms for that purpose: form 1024, form 1023, and form 1023EZ. It would be extremely rare that an AVO would need to use form 1024 so that document will not be covered in this resource. The 1023EZ form is a simplified version of the much longer and more complex form 1023. The IRS created form 1023EZ several years ago to make the application process more manageable for small nonprofits and 70% of all nonprofits are able to use the 1023EZ instead of

the much more complicated form 1023. Virtually all AVOs are included in the 70% that can use form 1023, so that will be the application form covered in this resource.

AVOs still must document that they meet the criteria to use the short form 1023EZ and do so by answering "no" to 26 questions on the [Form 1023-EZ Eligibility Worksheet](#) (available for download in this resource by clicking on it). The Worksheet is included in the [IRS instructions for form 1023EZ](#) (The entire instruction publication is available through the link to it on the IRS site which you can access by clicking on it.). All answers to the questions must be "no" to qualify for use of the short form; not one answer can be "yes." The completed Worksheet does not need to be submitted to the IRS but is required to be kept in the files of the AVO to document its eligibility to use form 1023EZ.

Form 1023EZ must be completed online; it cannot be submitted by mailing or faxing. There is a fee for the application process and that also must be made online; it cannot be made by mailing a check to the IRS. For virtually all AVOs the fee will be \$400; larger nonprofits pay a higher fee.

The IRS instructions for form 1023EZ are easy to understand and follow. While the form itself must be filed online, a [pdf copy of it for reference and advance preparation is available here](#). The following are some points that may be helpful in completing some of the items on the form:

Make sure you check the box at the very top of the first page of the form indicating that you have completed the Eligibility Worksheet and that the AVO is eligible to use form 1023EZ.

Item 4 in Part I: "Person to Contact if more Information is Needed" needs to be someone authorized to represent the AVO. If the person is authorized per the

bylaws of the AVO, such as the president or other officer, nothing special needs to be done. However, if that person is not authorized in the bylaws, such as a CPA or attorney, then an additional form must be filed: [IRS form 2848 Power of Attorney and Declaration of Representative](#) (Click on name to be linked to form 2848.). Form 2848 is short and simple and it will not be covered here because if you have someone like a CPA or attorney representing the AVO, that professional is very familiar with completing the form.

Item 2 in Part II: You must check this box to indicate that you have articles of incorporation that have been accepted by Pennsylvania.

Items 5,6, and 7 in Part II: You must check this box to indicate that you have included the three provisions in the AVO's articles of incorporation that were described as IRS required provisions in the [section of this resource on how to incorporate](#).

Most of the information requested in Part II of the form relates to detailed discussions of what is to be included in articles of incorporation and qualifying for 501(c)(3) status sections of this resource that you would have read before starting the application. However, item 9 in Part III relevant to Unrelated Business Income (UBI) is discussed in the External Reporting section of this resource. Please refer to the explanation of UBI there to determine if the AVO has or will have \$1,000 or more annually in what is classified as UBI.

The items you check in Part IV are designed to ensure that your AVO is not a private foundation, but indeed is a public charity type AVO. Unless the AVO was formed to benefit and is supported by a very limited number of individuals, it is not a "private" foundation. If there is any doubt, the AVO should definitely consult a CPA or attorney.

It is assumed that an AVO using this resource did not previously have tax-exempt status that was revoked. Therefore, Part V of the form does not need to be completed.

The IRS will contact the authorized representative if additional information is needed. When the IRS reaches its decision on tax-exempt status, it will send a letter of determination to the AVO. If the letter is negative there is an appeal process but if all requirements have been met and all processes followed in compliance, the determination should be positive. Congratulations.

Maintaining Tax-exempt Status: Once granted, tax-exempt status continues indefinitely unless something changes in the AVO that would make it no longer eligible for exemption. Also, the IRS can revoke exempt status for violating policies or not adhering to prescribed reporting. What to watch and be careful of in order to not jeopardize exemption status is covered in the external reporting section of this resource.

Applying for Exemption from Sales Tax in Pennsylvania

Nonprofit organizations, including AVOs, can apply for exemption from paying sales tax in Pennsylvania. The application is long and requires a number of attachments, such as the articles of incorporation and bylaws, but there is very little information requested that is difficult to understand and compile. Also, there is no fee to apply. If the application is approved the Commonwealth will issue to the AVO a tax number that can be given to businesses from which goods and services are obtained, authorizing the vendors to not collect sales tax from the AVO. The form used to apply to the PA Department of Revenue is PA REV-72.

Audits

An audit of the financial records of the AVO should be performed once a year. Few internal controls represent a more powerful deterrent to financial abuse and an effective tool to detect a problem before it gets any larger than it already has grown to that point.

Audits can be external or internal. External audits represent a much stronger internal control as they are performed by trained professionals independent of the AVO, usually CPAs. These audits, though, are expensive. Internal audits by volunteers involved in the AVO represent a more cost effective alternative (virtually zero cost), however, the tradeoff is a loss of confidence that the work is performed by independent individuals with audit experience. Still, at the very least, the AVO should have an internal audit performed at least once a year.

Both types of audits are discussed in the next two segments of this section.

External Audits and Reviews

Independent External Audits: If the AVO can afford the cost, having an annual audit performed by a CPA is the best protection with regard to the occurrence of unfortunate errors or purposeful misrepresentations/financial abuses. The knowledge that a CPA will be auditing the AVO is a strong deterrent to those who might be tempted to misuse the assets of the AVO. An annual audit by a CPA therefore is a powerful preventative control. However, in the event that errors or financial abuse do occur the audit also serves as a detection control that can minimize losses.

The audit by a CPA is very expensive, and rightfully so, as the CPA must perform a lot of work and tests to meet generally accepted auditing standards and if he or

she misses something (Everything is done on a sample basis and as stringent as auditing standards are there is still a chance that a problem will still go undiscovered.) the cost of the possibility of mounting a legal defense must be built into the audit fee. If an AVO cannot afford an annual audit (and most will not be able to bear the cost), as suggested in the [Basic Internal Controls that every All Volunteer Organization \(AVO\) Should Have](#) section of this resource, the AVO should consider whether it can pay a CPA for an audit every few years and have internal audits performed for the years where there is not an external audit by the CPA.

Independent External Review: Another approach that many AVOs (and larger nonprofits and small businesses take, for that matter) may consider if the cost of an external audit is not possible, is to have a review of the financial statements performed by a CPA. A review is not an audit. There is less work involved for the CPA and therefore the cost is lower. The tradeoff is that while an audit provides what is called "reasonable assurance" that the financial statements are fair, a review provides only "limited assurance." Sometimes those who are familiar with how audits work, assume that if the work is done by a CPA, it is in fact an audit. AVOs should be careful to determine exactly what level of assurance the CPA is providing. Unfortunately, there is sometimes similar confusion regarding the performance of a "compilation" by a CPA. A "comp," as it is often called in business circles, provides no assurance and even if done by a CPA does not represent a preventative or detective control at all. If there is any question on what level of assurance is being provided by a CPA, just ask him or her. He or she will be glad to explain exactly what they are doing and what it means, or doesn't mean, to the AVO. The CPA never wants any misunderstanding.

Of course, many AVOs cannot afford an external audit or review by a CPA at all, in any year. So, the alternative that should be implemented is an internal audit discussed on the next page.

Internal Audits

This primer on internal auditing needs to be studied in concert with the internal controls, operating procedures, and reporting requirements covered in the following sections of this resource: [Basic Internal Controls that every All Volunteer Organization \(AVO\) Should Have](#); all three segments of [Cash and Bank Accounts](#); both segments of [Internal Reporting](#); and both segments of [External Reporting](#), especially the sub-segment [Maintaining Tax-Exempt Status](#). The internal auditors need to confirm controls that have been adopted are in place and operating effectively, operating procedures are being followed to the letter, and required reports are accurate and being filed on time.

Every AVO that does not have an external audit conducted in a year should have an internal audit. The fundamentals of establishing an internal audit function are as follows:

- The audit process and expectations (like what reports should be provided by the auditors to who and when) should be part of the bylaws of the AVO and/or in the policies and procedures manual.
- The internal auditors should be volunteers, members, board members, or officers who have no responsibility for recording, physically handling, or approving financial transactions, etc. These internal auditors are sometimes configured as an audit committee. There should be more than one auditor and the membership of the audit committee should be changed frequently but preferably in such a way as there is always still one member with experience who was on the committee the year before. If possible at least one member of the audit committee should have some business experience, preferably in bookkeeping or accounting. **Note:** If there is another AVO of the same type and size, it should be considered asking for a reciprocal audit arrangement; have the auditors of the first AVO audit the records of the second while the auditors of the second are

auditing the records of the first. This arrangement greatly increases the credibility of the internal audits because the auditors are truly independent of the records they are auditing, yet there is no cost like there would be with an external audit.

- The auditors should report the results of their work at a board meeting which should formally accept the report and a signed written version of the audit report should be given to the secretary to include in the minutes of that meeting.
- The audit committee should obtain a receipt from the treasurer that all records have been returned to him or her intact.
- Every account and every financial component of the AVO should be audited; none should be left out "because it is so small," or "we did nothing with it last year," or "I just can't find those papers right now." The auditors don't have to look at every single transaction in every account, but they should look at every account in one way or another.
- The auditors should never assume that the totals, subtotals and numbers carried over from one area to another are correct. The auditors should re-add, recompute, and trace all numbers.
- The auditors should write a simple plan of what they plan to do ahead of time and then follow it. This also can make the audits conducted in subsequent years easier to do.
- The audit should be performed as soon after the year end as possible.
- An internal audit should be performed whenever there is a change in the treasurer.

The details of the what should be done in the audit itself are difficult to cover in this resource because each AVO is unique with its own set of bylaws, policies, procedures, financial transactions, exempt purpose, etc. What is listed here is not to be considered a complete list of audit steps and procedures and some mentioned may not be applicable to a specific AVO. Even if an AVO cannot

afford an external audit by a CPA, it should consider engaging one to design an internal audit program for the AVO. This would not be too costly and would represent a one-time investment. None-the-less, presented here is a list of some of the audit steps and procedures that would be appropriate and in most cases necessary for internal audits of AVOs:

- The auditors should ensure that they have access to articles of incorporation, bylaws and/or policies and procedures manual, list of all officers and other responsible individuals with their titles, list of authorized signatories on bank accounts, copies of all minutes for the year, copy of the minutes for the last meeting of the year preceding the audit, copy of the minutes for the first meeting held after the year of the audit if one has been held, a list of all bank accounts, reports filed with regulatory agencies (like the IRS), all correspondence from regulatory agencies and any letters from attorneys.
- The auditors should ensure that they obtain all credit card statements, treasurer reports, bank statements, and bank reconciliations for the year, and as with the minutes, the last one of each for the preceding year and the first one of the subsequent year.
- The auditors should obtain all checkbooks and canceled checks. The invoices and other supporting documentation for payments should also be obtained.
- The auditors should obtain documentation of cash collections and bank deposits (like deposit slips).
- The auditors should obtain any books of financial records like journals and ledgers.
- Test a few of the treasurer reports to ensure they are mathematically correct and all the numbers match those in other records (deposits, balance brought forward from previous report, balance forward to the next report, bank reconciliation, etc.).

- Test a few bank reconciliations to ensure they are mathematically correct and all the numbers match those in other records especially the treasurer reports and the bank statements.
- Ensure that all check numbers for the period are accounted for, including any voided checks which need to be examined to ensure they have been voided. Ensure there are no missing check numbers.
- Examine the largest checks written in the year, a sample of checks that appear to be written the same every month, and any that appear unusual. Verify that the amounts recorded in the other records (like the bank statement and treasurer report) match those on the checks, the dates match (make sure timing is not delayed or post-dated), the payees are who they should be, and the endorsements on the back of the checks appear to be legitimate.
- Match the largest checks written in the year, any that appear unusual, and a random sample of others to the supporting documentation for the payments: invoices (not vendor statements), sign offs that goods or services have been received, etc.
- Ensure the signatures on the checks are by the correct signatories and if two are required that there are indeed two "different" signatures on the checks.
- Examine the credit card statements and examine supporting documentation of any large and unusual charges.
- The auditor should sign in the checkbook where the final entry is for the year so that no additional entries can be made after the audit is completed. This signature should be checked the next year to ensure no additional entries had been made for the previous year.
- Examine all bank statements looking for any unusual transactions.
- Verify that established procedures for handling cash collected and bank deposits made have been followed to the letter.

- Verify that all other internal controls established in the bylaws and/or policies and procedures manual have been implemented and carried out correctly by the correct authorized individuals.
- Always pay attention to the timing of work done (deposits, reports, payments, etc.) to ensure that there are not long delays or post-dated work.
- Count the petty cash fund if there is one.
- Verify the list of, or make a list if one is not already prepared, outstanding bills unpaid at the end of the year.
- Ensure that all donations have been handled correctly and that receipts have been sent out to individuals who contributed \$250 or more.
- If the AVO has any equipment or similar assets, ensure that the list of assets matches what is in existence; examine the assets to ensure they are present and in good condition.
- Review all reports to external agencies (IRS, etc.) to ensure they are accurate and filed on a timely basis. Review all correspondence received from external agencies.
- Include in the auditors' report:
 - o Any exceptions found
 - o Confirmation of all that is found to be correct
 - o Signatures of all auditors

AVO Name _____
Listing of Mail Opened
Date _____

Item Number	Date Opened	Sender	Directed to:	Cash Enclosed (✓)	Check Enclosed (✓)	If Cash or Check Enclosed - Dollar Amount

Signature of Person Opening the Mail _____

Signature of Person Opening the Mail _____

BANK RECONCILIATION TEMPLATE

ENDING Balance per the Bank Statement
(Make sure it is the ending not the beginning balance.)

ADD: Deposits in Transit
(This would be any deposit that per the date on the deposit slip is on or before the ending date of the bank statement but does not appear on the bank statement.)

SUBTRACT: Outstanding Checks Total per attached list
(These would be checks per the Treasurer's records dated on or before the ending date of the bank statement that have not been cashed per the listing of checks deducted on the bank statement. Include any checks outstanding on the last bank reconciliation that were not in the listing of checks cashed per the listing this month; therefore still outstanding.)

THIS IS THE UPDATED "REAL" ENDING BALANCE OF THE CHECKING ACCOUNT

SUBTRACT: Anything added on the bank statement that is not in the treasurer's records such as interest earned (The Treasurer needs to make this adjustment to his or her records.)

ADD: Anything deducted on the bank statement not in the Treasurer's records such as bank fees or checks that have bounced (The Treasurer needs to make this adjustment to his or her records.)

THIS BALANCE SHOULD EQUAL THE ENDING BALANCE OF CASH PER THE TREASURER'S RECORDS

(If you do not get the Treasurer's balance you need to investigate until you find the difference.)

LISTING OF OUTSTANDING CHECKS

Check Number	Date Issued	Amount
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TOTAL OF OUTSTANDING CHECKS

BANK RECONCILIATION EXAMPLE

ENDING Balance per the Bank Statement (Make sure it is the ending not the beginning balance.)	\$1,200.20
ADD: Deposits in Transit (This would be any deposit that per the date on the deposit slip is on or before the ending date of the bank statement but does not appear on the bank statement.)	\$0.00
SUBTRACT: Outstanding Checks Total per attached list (These would be checks per the Treasurer's records dated on or before the ending date of the bank statement that have not been cashed per the listing of checks deducted on the bank statement. Include any checks outstanding on the last bank reconciliation that were not in the listing of checks cashed per the listing this month; therefore still outstanding.)	\$345.60
THIS IS THE UPDATED "REAL" ENDING BALANCE OF THE CHECKING ACCOUNT	<hr/> \$854.60
SUBTRACT: Anything added on the bank statement that is not in the treasurer's records such as interest earned (The Treasurer needs to make this adjustment to his or her records.)	\$0.53
ADD: Anything deducted on the bank statement not in the Treasurer's records such as bank fees or checks that have bounced (The Treasurer needs to make this adjustment to his or her records.)	\$5.00
THIS BALANCE SHOULD EQUAL THE ENDING BALANCE OF CASH PER THE TREASURER'S RECORDS (If you do not get the Treasurer's balance you need to investigate until you find the difference.)	<u>\$859.07</u>

LISTING OF OUTSTANDING CHECKS

Check Number	Date Issued	Amount
1011	1/2/2015	\$100.00
1015	1/6/2015	\$200.00
1016	1/15/2015	\$45.60

TOTAL OF OUTSTANDING CHECKS \$345.60

AVO Name
Treasurer's Report
For the Month ended _____

Cash Balance at end of Last Month \$ -
 Adjustments per Bank Rec \$ -
 Corrected Cash Balance Beginning \$ -

	Year to Date	Annual	Difference	
Receipts:	for Month of _____	Actual	Budget	Actual to Budget

Donations	-		
Food Stand			
Fundraiser #1			
Fundraiser #2			
Interest Earned			
Other Receipts			
<i>(List all categories of receipts and revenues in the budget and any that additional that were not planned)</i>			

Total Receipts	\$ -		
-----------------------	-------------	--	--

	Year to Date	Annual	Difference	
Expenses:	for Month of _____	Actual	Budget	Actual to Budget

(List all categories of expenses and expenditures in the budget and any that additional that were not planned)

See attached listing of checks and payments for month.

Total Expenses	\$ -		
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Cash Balance at end of Current Month	\$ -
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Treasurer Signature: _____

AVO Name
Listing of Checks Issued and Payments Made
For the Month ended _____

Date	Check #	Payee	Purpose	Amount
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