

*Taking the fear
out of finance!*

mango

Financial Management Essentials
A Handbook for NGOs



Financial Management Essentials

A Handbook for NGOs

Produced by Terry Lewis for

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Glossary of financial terms

Account	A record of monetary transactions, either written into a book designed for the purpose or entered onto a computer file.
Account code	A code for a specific type of transaction. Transactions are given a code which describes what type of income or expenditure they are, eg 5050 Transport costs, 5600 Office rent etc.
Accounting period	A specified period for recording and reporting financial activity for a given time, eg one year or one month.
Accrual	Adjustment made at the end of an accounting period to recognise expenses that have been incurred during the period but for which no invoice has yet been received.
Accumulated funds	Money, or equipment, that we build up year by year as a result of not spending all our income. Often referred to as our Reserves.
Acid test	The ratio achieved by dividing Current Assets (excl. Stocks) by Current Liabilities. It tells us if the organisation has sufficient funds to pay off its debts immediately.
Allocation	Sharing of direct costs between two or more cost centres in proportion to actual or estimated use, eg the costs of using a shared vehicle for project work. Income can also be allocated.
Apportionment	The sharing of indirect costs between two or more cost centres in proportion to the estimated benefit received.
Asset	Any possession or claim on others which is of value to the organisation. See also Fixed Assets and Current Assets.
Audit	A formal check on the accounts by an independent person (auditor).
Audit trail	The ability to follow the course of any reported transaction through an organisation's accounting systems.
Authorisation	This is the process of approval over transactions, normally the decision to purchase or commit expenditure. Authorisation by a budget holder is a way of confirming that spending is in line with budget and is appropriate.

Back donor	The original source of funds, where a grant is channelled through an agency, such as an international NGO, on to an implementing partner. The agency must report back to the original donor to account for the use of the funds by the local partner.
Balance Sheet	A summary of the financial position of an organisation at a particular date, showing the assets owned by the organisation and the liabilities (or debts) owed to others.
Bank book	A register which records all transactions passing through a bank account. Also known as a cashbook or a Cash Analysis Book.
Bank reconciliation	The process of comparing the entries and ending balance in the cashbook with the bank statement, and identifying any differences. It provides an important check on the completeness and accuracy of the cashbook entries.
Budget	A best estimate of the amount of money that an organisation plans to raise and spend for a set purpose over a given period of time.
Budget holder	The individual who holds the authority and has the responsibility for managing, a budget for a specified activity, project, programme, department or organisation.
Burn rate	Expressed as a percentage, the amount of a grant or budget used up so far. Also known as the Utilisation Ratio.
Capital expenditure	Expenditure on equipment, property and other fixed assets which will be used to support activities over more than one accounting period.
Capital fund	Accumulated funds and reserves held in the form of equipment and property.
Cashbook	A book or spreadsheet that lists all of the receipts and payments made in to and out of a particular bank or cash account.
Cash reconciliation	Comparing the month end physical cash counted to the expected month end balance in the petty cashbook.
Cashflow	The difference between cash received and cash spent in a period.
Cashflow forecast	A report that shows the expected timing of receipts and payments for the next 3-6 months (or longer).

Chart of accounts	A list of all the accounts codes and cost centre codes that are used in an organisation's accounting system, with a description of each.
Core costs	Central support costs shared by many projects. Also called overheads or indirect costs.
Cost centre	A way of distinguishing between different activities or projects to define where costs are incurred or income is 'earned'. Cost centres are closely linked to the concept of budget-holders.
Creditor	Anyone the organisation owes money to.
Current assets	Cash and other short-term assets in the process of being turned back into cash – eg debtors. They can, in theory, be converted into cash within one year.
Current liabilities	Short-term sources of 'finance' (eg from suppliers, bank overdraft) awaiting payment in the next 12 months.
Current ratio	A measure of liquidity obtained by dividing Current Assets by Current Liabilities. It tells us if the organisation is able to pay off its debts within 12 months.
Debtor	Anyone who owes money to the organisation.
Depreciation	A proportion of the original cost of a fixed asset which is internally charged as an expense to the organisation in the Income & Expenditure Account.
Designated funds	Unrestricted funds which have been accumulated over time and set aside for a particular purpose by the Trustees.
Direct cost	A cost which can be specifically allocated to an activity, department or project.
Donation in kind	Where a grant or contribution to a project is made in the form of goods or services, rather than a cash grant or donation.
Double funding	Where a project has funding from more than one source and which exceeds the budget needed to complete the activity.
Double entry bookkeeping	The method of recording financial transactions whereby every item is entered as a debit in one account and a corresponding credit in another.
Exception report	A short narrative report which highlights significant variances and/or areas for concern to accompany the management accounts.

External audit	A review of the year-end financial statements carried out by a professionally qualified and legally registered auditor resulting in an opinion about whether they give a true and fair view.
Financial accounting	Recording, classifying and sorting historical financial data, resulting in financial statements for those external to the organisation.
Fixed asset	An item of high value owned by the organisation for use over a long period. Normally office equipment, vehicles and property.
Fixed assets register	A list of the Fixed Assets of the organisation, usually giving details of value, serial numbers, location, purchase date, etc.
Fund accounting	Used to identify spending according to the different projects or purpose for which the funds were granted.
General ledger	The main accounting record where double-entry bookkeeping is used. See also Nominal Ledger.
General funds	Unrestricted funds which have not been earmarked and which may be used generally to further the organisation's objectives. Often referred to as Reserves.
Good Received Note (GRN)	Supporting document which accompanies deliveries of goods, signed by the person receiving the delivery to acknowledge the goods are received undamaged and as stated on the packing note.
Imprest	A type of cash float, set at an agreed level, which is topped up by the exact amount spent since it was last reimbursed, to bring it back to its original level.
Income & Expenditure Account	Summarises income and expenditure transactions for the accounting period, adjusting for transactions that are not yet complete or took place in a different accounting period.
Indirect cost	A cost which cannot be specifically assigned to one activity, department or project, eg the fee for the annual audit.
Journal entry	An entry in the books of account which covers a non-monetary transaction – eg for recording a donation in kind or an adjustment for correcting a recording error.
Liabilities	Amounts owed by the organisation to others, including grants received in advance, loans, accruals and outstanding invoices.

Liquidity	The level of cash and assets easily convertible to cash compared to demands on the available cash, eg to pay bills.
Liquidity ratio	A measure of liquidity obtained by dividing debtors, cash and short-term investments by current liabilities.
Management accounting	The provision of financial information to management for the purposes of planning, decision-making, and monitoring and controlling performance.
Net book value (NBV)	Cost of an asset less its accumulated depreciation to date.
Net current assets	Funds available for conducting day-to-day operations of the organisation. Usually defined as current assets less current liabilities. Also known as working capital.
Nominal account	A 'page' or 'container' in the Nominal Ledger for recording every type of financial transaction likely to occur in an organisation, within a specified time period. A complete list appears in the Chart of Accounts, each with its unique 'nominal code'.
Nominal ledger	A book or computer programme which holds details of each of the nominal accounts. Also known as General Ledger.
Organogram	Organisation chart showing the management and departmental structure of the organisation
Payment voucher	An internal document raised for each payment. It provides a unique reference number and evidence of authorisation. Supporting documents are attached to it.
Petty cash book	The day-to-day listing of petty cash paid out.
Prepayments	Amounts paid in advance at a particular accounting period – eg annual insurance premium.
Procurement	The process of purchasing goods and services. Steps in the process may include requesting, authorising, selecting suppliers, ordering, receiving and paying.
Quarter / quarterly	Three months of the accounting year, eg Quarter 1 (or Q1) would be 1 January to 31 March where the financial year runs from January to December.
Receipts & Payments account	A summary of the cash book for the period with opening and closing balances.
Reconciliation	Checking mechanism which verifies the integrity of different parts of an accounting system. Especially balancing the cash book to the bank statement.

Reserves	Funds set aside from surpluses produced in previous years.
Restricted funds	Income which has conditions attached to how used, usually with a requirement to report back to the donor.
Signatories	People who are authorised to sign cheques on behalf of the organisation.
Statutory audit	The annual external audit as required by law.
Statutory deduction	Amounts which must be taken from an employee's pay before they receive it, such as income tax or national insurance contributions.
Supporting document	The original documents that describe each transaction. These may include, receipts, invoices, delivery notes, sign sheets etc
Transaction	Any exchange of goods, services or money in return for other goods, services or money. Most commonly receipts and payments.
Trial balance	The list of debit and credit balances on individual nominal accounts from which an income and expenditure statement is prepared.
Trustee	A member of an NGO's most senior governing body, who shares overall responsibility for the NGOs work.
Unrestricted funds	Funds held for the general purposes of the organisation, for spending within the stated objectives.
Variance	The difference between the budget and the actual amount of income or expenditure.
Virement	The ability to transfer from one budget heading to another, for example if one budget line is under-spent, using the spare budget to offset an over-spend on another line.
Working advance	A sum of money entrusted to someone to spend on behalf of the organisation, which needs to be accounted for.
Working capital	See Net Current Assets.
Year-end	The cut-off point for the annual financial accounting period.
Zero-base budgeting	A method of preparing budgets which involves calculating estimates from scratch, by considering each cost area afresh.

Chapter

1

Overview of Financial Management

An Introduction to financial management in the NGO sector

This chapter:

- Sets the context for good practice in NGOs
- Discusses the concept of downward accountability
- Defines financial management and financial control
- Describes the Plan-Do-Review cycle
- Explains why financial management is important for NGOs
- Describes who does what in financial management.

Foundations for effective NGO work

Our goal in the NGO sector is to provide development assistance to 'help people help themselves'.

It is widely accepted that NGOs are most effective when they contribute to people's own efforts to improve their *lives*, organisations or societies – instead of taking a lead in trying to solve other people's problems.

“NGOs deliver quality work when their work is based on a sensitive and dynamic understanding of beneficiaries’ realities, responds to local priorities in a way beneficiaries feel is appropriate, and is judged to be useful by beneficiaries”. **Keystone**

This is important for both short term and long term reasons, including:

- ▶ **Our work should respect people’s right to make their own** decisions about their own lives. We can’t tell people what to think or do. We can help them build up their confidence and abilities, to tackle their own priorities.
- ▶ **NGOs are only one factor in people’s efforts** and we often do not understand local situations and priorities very well. Local situations are complicated and change unpredictably. They always involve local politics: when one social group benefits, another may lose out. People’s priorities are also complicated and change. So our initial analysis may not be right, and our plans are always likely to have to change.
- ▶ **Our work is only sustainable if it is based on local people’s priorities.** It is very unlikely that we can truly ‘persuade’ people to feel a sense of ownership over ‘our’ priorities.
- ▶ **Funds are given to help beneficiaries, not NGOs** – it is not ‘our’ money. We have a responsibility to make sure that it is as useful to beneficiaries as possible.

‘Two Golden Rules’

ONE: *NGOs’ front line staff have to maintain a good quality dialogue with the people they aim to help.*

The first *Golden Rule* requires staff to build up dialogue with all local groups of people, including the poorest and most marginalised. It requires managers to ask two key questions at each stage of the project cycle:

- ▶ Who is making decisions or analysing the situation?

- ▶ Do activities help people build up their self-confidence and ability to tackle their own priorities?

NGOs can choose to make themselves accountable to the people or partners they aim to help, for example managing – and reporting – how their front line staff interact with local people and partners. This can empower local people, allowing them to increase their influence over what the NGOs do. This is sometimes called *Downward Accountability*.

Downward Accountability

Accountability – generally – is the responsible use of power. It means that people can participate in decisions that affect them, 'have a say' in decision-making processes and complain when a decision is made poorly or has unexpected and unwelcome consequences. The Humanitarian Accountability Partnership.

Accountability is a way of influencing other people's decisions. If more powerful people hold less powerful people to account, then it can oppress them. If less powerful people hold more powerful people to account, then it can empower them. This 'empowering' accountability is known as downward accountability because the accountability flows 'down' from more powerful people to less powerful people. It is the same process as citizens holding a powerful government to account.

Interestingly, while NGOs are required to be upwardly accountable to their donors (and spend much time and effort reporting to donors), they do not have to be 'downwardly accountable' to the communities they work with.

TWO: *NGOs depend on their front line staff and have to help them make good judgements – and check whether they do.*

For instance, this could include:

- ▶ Providing front line staff with good quality information
- ▶ Helping front line staff build up their own skills, especially financial

- ▶ Reinforcing the commitment to helping people help themselves
- ▶ Decentralising decision-making, and encouraging flexibility
- ▶ Focusing project delivery on 'customer service'
- ▶ Asking for feedback from beneficiaries and local partners.

Underlying the *Two Golden Rules* is a third idea to keep in mind at all times:

NGOs have to be rigorous and realistic in their proposals, plans and strategies.

This means that NGOs must not claim more than they can realistically achieve. Otherwise donors (and other key stakeholders) will expect unrealistic results, and this can seriously distort work.

These ideas and approaches in many ways challenge how we currently work and relate to key stakeholders and how we measure and monitor effectiveness. For some new ways of looking at NGO accountability and effectiveness, see "Helping People is Difficult" and other papers based on the research by Alex Jacobs, Mango's founder and former Director at <http://www.mango.org.uk/WhoCounts/Resources>.

Both of the Golden Rules point to the importance of financial management in NGO operations. We have to be accountable and able to make good judgements. We can't do that without robust financial management systems in place.

So what is financial management?

Many people have the impression that financial management is just about keeping accounting records. In fact, it is an important part of programme management and must not be seen as a separate activity left to finance staff.

*Financial management entails **planning, organising, controlling** and **monitoring** the financial resources of an organisation to achieve objectives.*

Financial management to an NGO is rather like maintenance is to a vehicle. If we don't put in good quality fuel and oil and give it a regular service, the functioning of the vehicle will suffer and not run efficiently. If neglected, the vehicle will eventually break down and fail to reach its intended destination.

At the heart of financial management is the concept of *financial control*. This describes a situation where the financial resources of an organisation are being correctly and effectively used. This will only happen if strong and relevant financial policies and procedures are put in place.

Poor financial control in an organisation means that:

- ▶ assets will be put at risk of theft, fraud or abuse
- ▶ funds may not be spent in accordance with the NGO's objectives or donors' wishes and
- ▶ the competence of managers may even be called into question.

So it is better to spend some time designing good policies and procedures to help manage your NGO's money.

The financial management process

In practice, financial management is all about actively looking after the financial health of an organisation, not leaving things to chance. This involves:

▷ **Managing scarce resources**

NGOs operate in a competitive environment where donor funds are increasingly scarce. We must therefore make sure that donated funds and resources are used properly, and to the best effect, to achieve the organisation's mission and objectives.

▷ **Managing risk**

All organisations face internal and external risks which can threaten operations and even survival (eg funds being withdrawn, an office fire or a fraud). Risks must be identified and actively managed in an organised way to limit the damage they can cause.

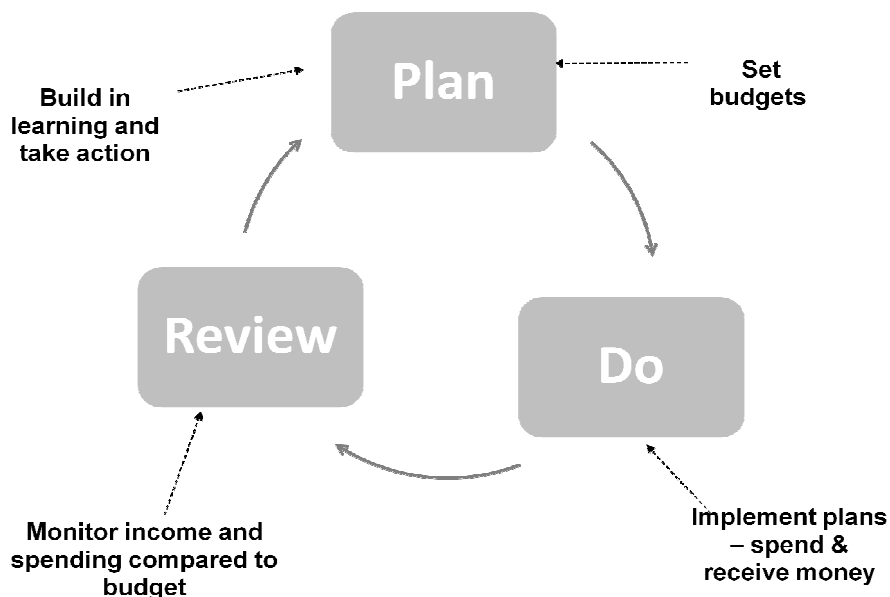
▷ **Managing strategically**

Financial management is part of management as a whole. This means managers must keep an eye on the 'bigger picture' – looking at how the whole organisation is financed in the medium and long term, not just focussing on projects and programmes.

▷ **Managing by objectives**

Financial management involves close attention to project and organisation objectives. The financial management process mirrors the project management cycle – *Plan, Do, Review* – a continuous cycle.

Figure 1.1 – Plan-Do-Review



Plan: When an organisation starts up, it sets its objectives and planned activities. The next step is to prepare a financial plan for the costs involved in undertaking the activities and where to obtain funds.

Do: Having obtained the funds, the programme of activities is implemented to achieve the goals set out in the planning stage.

Review: The actual situation is compared with the original plans. Managers can then decide if the organisation is on target to achieve its objectives within agreed time scales and budget. The learning from the review stage is then taken forward to the next planning phase, and so on.

Why is financial management important?

In many NGOs, financial management has a low priority, characterised by poor financial planning and monitoring systems. But NGOs operate in a rapidly changing and competitive world. If they are to survive in this challenging environment, they need to develop the confidence and skills to manage their financial resources and achieve more with their money.

Good practice in financial management will:

- ▶ help managers make effective and efficient use of resources to achieve objectives and fulfil commitments to stakeholders
- ▶ help NGOs to be more accountable to donors and other stakeholders
- ▶ gain the respect and confidence of funding agencies, partners and beneficiaries
- ▶ give the advantage in competition for increasingly scarce resources
- ▶ help NGOs prepare themselves for long-term financial sustainability.

Some very persuasive reasons for getting it right!

Top Ten Reasons for Good Financial Management:

1. To be accountable to the people who give us money

With good financial reporting systems, it is easier to show donors and supporters that we are using their money for the purpose intended.

2. To be accountable to the communities we work with

We have a moral obligation to show that funds raised in the beneficiary community's name are being used correctly.

3. To be able to produce financial statements for regulatory bodies

As part of the registration process, NGOs are required to be accountable for the money they raise and spend.

4. To minimise fraud, theft and abuse of resources

Good financial management includes internal controls. When these are in place they help to stop fraud and protect the staff as well as the assets.

5. To plan for the future and become more financially secure

We have to plan to make sure we have enough money to carry out our objectives now and in the future. Budgets help us plan for projects and manage cash. Financial information helps us to identify potential financial risks and the need for savings (reserves). We need financial information about where we are now and where we want to be in the future, to help identify our long-term financing needs.

6. To enable staff to make better decisions on the use of funds

Complete, up-to-date and timely project monitoring reports enable project managers to plan their activities according to the budget available and take decisions to fulfil objectives. Good cashflow management enables activities to be planned, items purchased when needed and staff paid on time.

7. To achieve the objectives of the organisation

Good financial management will give the management team and Board the information they need to ensure they are fulfilling the objectives of the organisation and following the strategic plan.

8. To enhance the credibility of the organisation

NGOs that keep good accounts, create great budgets and produce accurate and timely financial reports, inspire confidence and trust in their stakeholders. This gives them an advantage over their competitors.

9. To strengthen fundraising efforts

NGOs that present good budgets and audited financial statements with funding proposals are more likely to receive a favourable response.

10. To get better value for our money

Financial information allows us to compare and assess spending plans to make sure we make efficient, effective and economic use of financial resources.

Who is responsible for financial management?

It is important to understand an NGO's structure and legal status to appreciate who is responsible for what in financial management.

▷ What is an NGO?

The term 'non-governmental organisation' tells us more about what it is not, rather than what it is. NGOs operate in a wide range of fields and come in all shapes and sizes. Whilst each one is unique, most share some common features.

They are:

- ▶ **'values-led'** – their prime motivation is a desire to improve the world in which we live
- ▶ **'not-for-profit'** – but they *can* make surpluses to be set aside for future work
- ▶ an alliance of many different interests, so have many **stakeholders**
- ▶ governed by a **committee of volunteers** – the 'Governing Body'
- ▶ private autonomous organisations, **independent** of the State.

▷ Legal Status

There are a number of different ways of registering as an NGO and this will determine the organisation's legal status. Organisations are recognised either as a separate legal entity (*incorporated body*) or as a loose collection of individuals (*un-incorporated body*).

Most smaller NGOs are un-incorporated. This means that trustees bear full responsibility and are held 'jointly and severally' responsible (ie as a group and as individuals) for the affairs of the organisation. So individual board members could be named in a legal action and have no protection in law. This is illustrated in **Figure 1.2** by the arrows passing through the organisation's boundaries.

When a body is incorporated, it has a separate legal identity and is recognised in law as an 'artificial person' (demonstrated by the thick border protecting the individuals in **Figure 1.3**).

In this situation, individuals serving as board members have some protection in law. They have what is known as *limited liability*. This means that their financial responsibility, if things go wrong, is limited to a token amount (eg USD1.00).

Figure 1.2: Unincorporated NGO

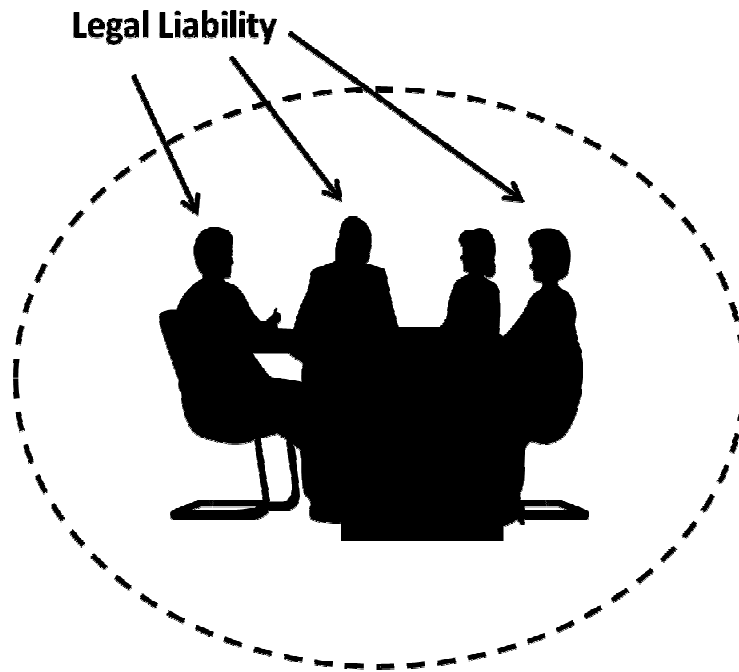
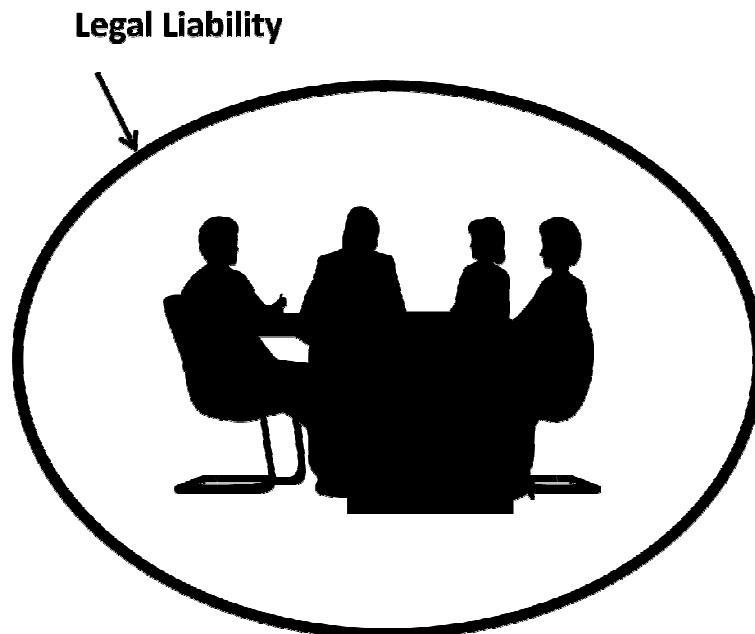


Figure 1.3: Incorporated NGO



Whatever the legal status, the trustees of an NGO together have a statutory duty to see that the organisation is being properly run and that funds are being spent for the purpose for which they were intended.

▷ **The Constitution**

Every NGO should have a founding document such as a *Constitution* or *Memorandum and Articles of Association*. This document describes, amongst other things:

- ▶ the name and registered address of the NGO
- ▶ the objects of the organisation and target group
- ▶ how it raises its funds
- ▶ the system of accountability – ie who is the governing body, its powers and responsibilities.

▷ **The Governing Body**

The governing body or board is **legally responsible** and accountable for the organisation. This means that if anything goes wrong in the NGO then the law holds the members of the governing body responsible.

It has many different names – Council, Board of Directors, Board of Trustees, Executive or Governing Board – and several functions including:

- ▶ responsibility for deciding on policy and strategy
- ▶ custodianship (or safeguarding) of the financial and other assets of the organisation
- ▶ appointing and supporting the Chief Executive and
- ▶ representing the interests of stakeholders.

The governing board is often organised with a series of sub-committees – eg Finance, Personnel or Project sub-committees.

Governing board members – or Trustees – are **volunteers** (ie not paid a salary) and are known variously as trustees, committee members, directors or council members. If board members were to benefit financially from their membership of the board, there could be a conflict of interest.

'Honorary Officers' are those who are elected or appointed to specific positions on the board – such as Chair, Treasurer and Secretary. They oversee the execution of board decisions and often sign legal undertakings.

- ▶ The **Chairperson** is usually the main point of contact for the Chief Executive Officer (CEO), and usually fulfils an important public relations role for the NGO.
- ▶ The **Treasurer's** role is to oversee the finances of the organisation. In a smaller organisation the Treasurer may take on a more active role and act as bookkeeper, but where there are paid staff, the Treasurer assumes more of a supervisory role.

Even if they are not supervising the accounting process and preparing reports themselves, board members must still be sure that everything is in order.

*The governing board members are **ultimately responsible** for the financial affairs of the organisation and they cannot escape this duty except by resigning from the governing body.*

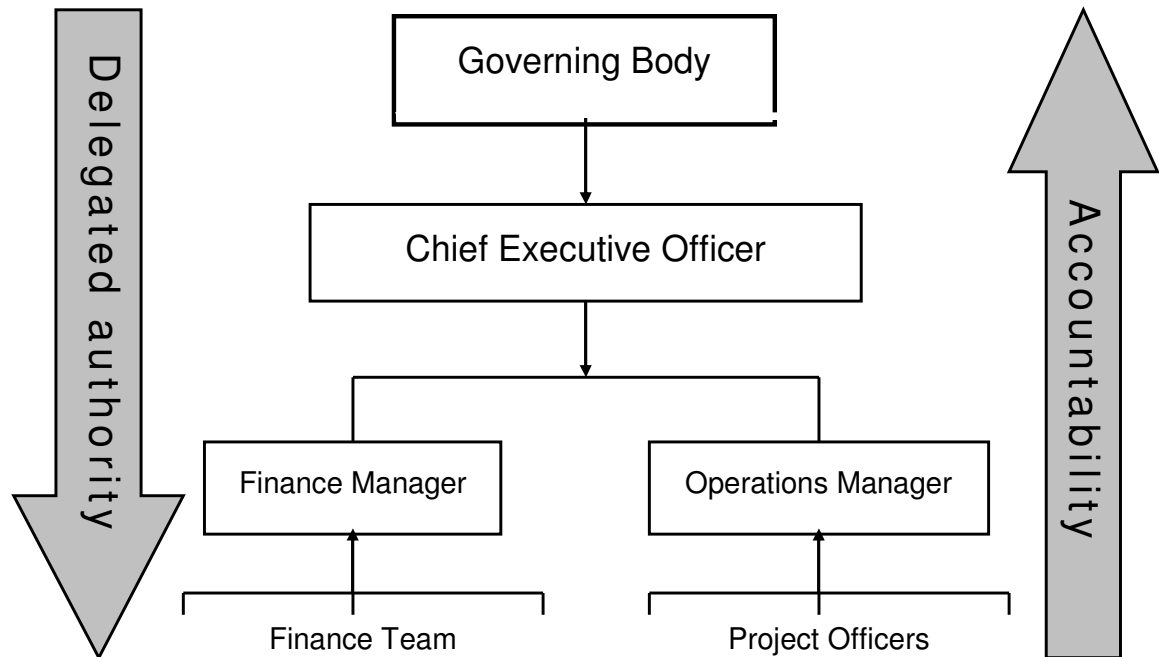
▷ **Day to day responsibility**

As the board is made up of volunteers who meet only a few times a year, it delegates authority for day-to-day management to the CEO, appointed by the board to implement policy. The CEO then decides how to further delegate authority, to share out duties amongst the staff team.

While it is acceptable for the governing body to delegate authority to staff members, *it cannot delegate total responsibility* since ultimate accountability rests with the trustees. Furthermore, authority without accountability is unhealthy – the Board must set up monitoring mechanisms to make sure their instructions are being fulfilled.

Figure 1.4 demonstrates how the authority for day-to-day financial management tasks is delegated down through the line management structure. At the same time, the accountability process comes back up through the structure as people report back on progress.

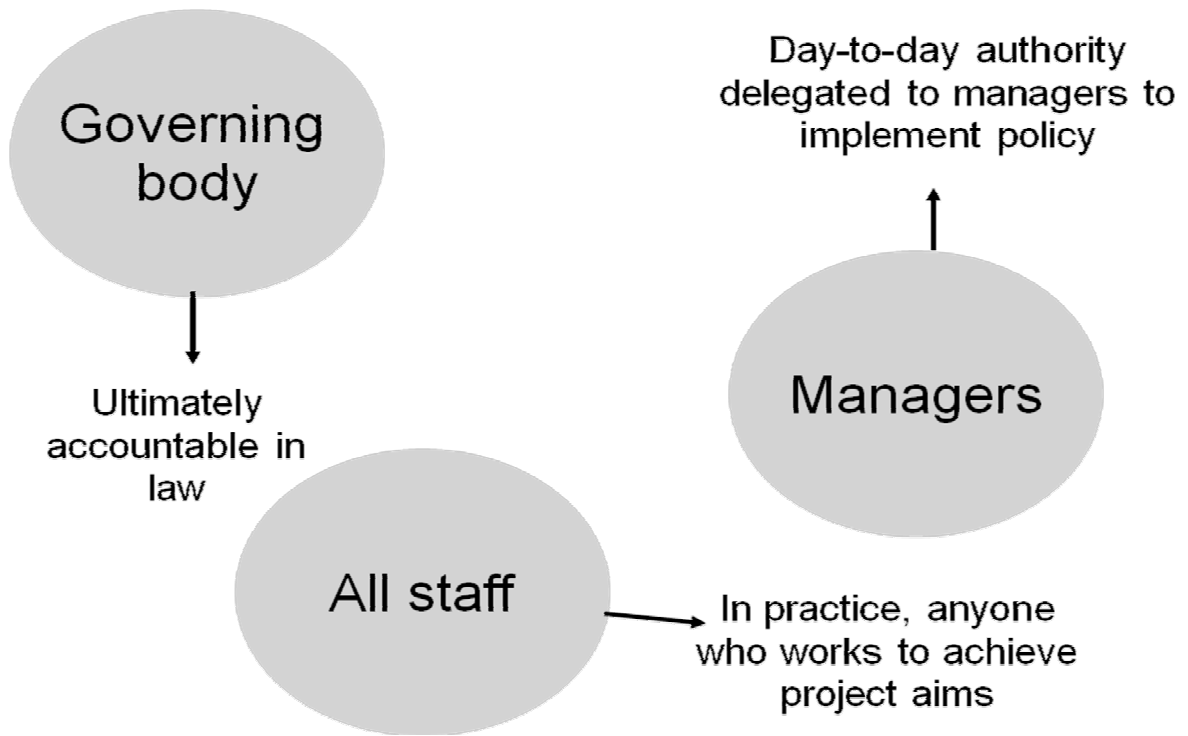
Figure 1.4: Delegated authority



▷ **A Team Effort**

In practice, everyone who works to achieve the objectives of an NGO has an important role to play in financial management. As a team, we must take every opportunity to integrate financial management into the day-to-day management of the organisation.

Figure 1.5: Who is accountable?



Chapter

2

Getting Organised

Getting the basics right for best practice

This chapter:

- Share key principles of financial management
- Outlines the Four Building Blocks of financial management
- Describes the two branches of accounting
- Introduces the Chart of Accounts and Project Cost Centres
- Defines different types of costs
- Looks at the role of financial policies and procedures
- Explains what a finance manual is and what goes in it.

Seven principles of financial management

We begin this chapter on good practice frameworks and systems with a look at a series of guiding principles. Look upon each of the **Seven Principles of Financial Management** as a standard to assess your current practice and goals to aim for.

▷ **Consistency**

Consistent use of financial policies and procedures are important for efficient operations. For example, the Chart of Accounts encourages consistent use of codes in the accounting records, budgets and reports. This assists the financial reporting process and promotes transparency (one of the best ways to hide irregularities is to change the way figures are reported).

▷ **Accountability**

All stakeholders, including beneficiaries, have the right to know how financial and other support has been used to meet objectives. NGOs have an operational, moral and legal duty to explain their decisions and actions, and make their financial reports open to scrutiny.

***Accountability** is the moral or legal duty, placed on an individual, group or organisation to explain how funds, equipment or authority given by a third party has been used.*

▷ **Transparency**

NGOs must be open about their work, providing information about activities and plans to all stakeholders. This includes preparing accurate, complete and timely financial reports. If an organisation is not transparent, it may give the impression they have 'something to hide'.

▷ **Viability**

To be financially viable, an NGO's spending must be kept in balance with money coming in, both at the operational and the strategic levels. Viability is a measure of the NGO's financial continuity and security. Trustees and managers should prepare a financing strategy to show how the NGO will meet all of its financial obligations and deliver its strategic plan.

▷ **Integrity**

On a personal level, individuals must operate with honesty and propriety. For example, managers and Board members must lead by example in following policy and declare personal interests that might conflict with their official duties. The integrity of financial records and reports is dependent on accuracy and completeness of financial records.

▷ Stewardship

Financial stewardship involves taking good care of the financial resources we are entrusted with, to make sure they are used for the purpose intended. The governing body has overall responsibility for this. In practice, managers achieve good financial stewardship through strategic planning, assessing financial risks and setting up appropriate systems and controls.

▷ Accounting Standards

The system for keeping financial records and documentation must observe internationally accepted accounting standards and principles. Any accountant from anywhere around the world should be able to understand an organisation's financial accounting systems.

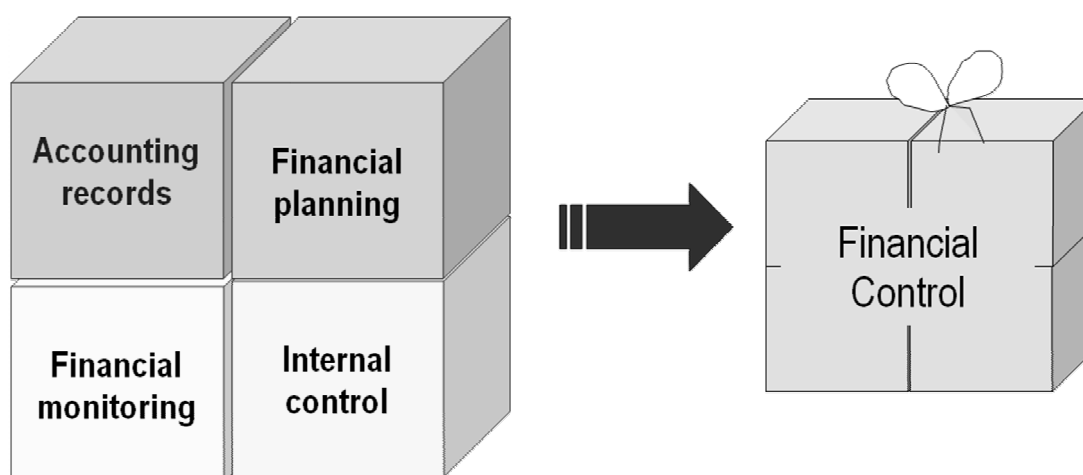
Tip: Use the 7 principles as a checklist to help identify relative strengths and weaknesses in your own organisation. To help you remember, a useful mnemonic formed by taking the first letter of each of the principles is '**CAT VISA**'.



The four building blocks of financial management

There is no model finance system which suits all NGOs. But there are four basic building blocks which must be in place to achieve good practice in financial management.

Figure 2.1: The Four Building Blocks



▷ **Accounting records**

Every organisation must keep an accurate record of financial transactions that take place to show how funds have been used. Accounting records also provide valuable information about how the organisation is being managed and whether it is achieving its objectives.

▷ **Financial planning**

Linked to the organisation's strategic and operational plans, the budget is the cornerstone of any financial management system and plays an important role in monitoring the use of funds.

▷ **Financial monitoring**

Providing the organisation has set a budget and has kept and reconciled its accounting records in a clear and timely manner, it is then possible to produce financial reports for all stakeholders. Internal budget monitoring reports help managers to monitor the progress of projects and annual financial statements provide accountability to external stakeholders.

▷ **Internal control**

A system of controls, checks and balances – collectively referred to as internal controls – are put in place to safeguard an organisation's assets and manage internal risk. Their purpose is to deter opportunistic theft or fraud and to detect errors and omissions in the accounting records. An effective internal control system also protects staff involved in financial tasks.

Figure 2.1 shows how all of the building blocks must be in place continuously to achieve effective financial control. For example:

- ▶ there is very little point in keeping detailed accounting records if they are not checked for errors and omissions (part of internal control)
- ▶ inaccurate accounting records will result in inaccurate reports - which in turn could cause a manager to make a wrong decision.

The four building blocks are covered in detail in the following chapters. They are also used as the basis for Mango's Financial Health Check – a self-assessment checklist to help you build your financial management systems. See Appendix 25.

Tools of financial management



There are many tools, not necessarily financial, which managers can use to help achieve good practice in financial management and control.

We can identify these tools under each of the four functions of financial management (as in our working definition of financial management on page 5).

▷ **Planning**

Planning is basic to the management process and involves looking ahead to prepare as well as possible for the future. In the course of putting a plan together managers will consider several possible alternatives and make a number of choices or decisions. Planning must always precede the doing.

Tools: Strategic plan, business plan, activity plan, budgets, work plans, cashflow forecast, feasibility study...etc.

▷ **Organising**

The resources of the organisation – staff and volunteers, vehicles, property, money – have to be co-ordinated to ensure implementation of the overall plan. It needs to be clear what activities and responsibilities are to be undertaken, when and by whom.

Tools: Constitution, organisation charts, flow diagrams, job descriptions, Chart of Accounts, Finance Manual, budgets...etc.

▷ **Controlling**

A system of controls, checks and balances are essential to ensure proper application of procedures and resources during programme implementation.

Tools: Budgets, delegated authority, procurement procedure, reconciliation, internal and external audit, fixed assets register, vehicle policy, insurance...etc.

▷ **Monitoring**

This involves producing regular and timely information for managers and stakeholders for monitoring purposes. Monitoring involves comparing actual performance with plans to evaluate the effectiveness of plans, identify weaknesses early on and take corrective action if required.

Tools: Evaluation reports, budget monitoring reports, cashflow reports, financial statements, project reports, donor reports, audit reports, evaluation report etc.

Can you identify the common tool that links all of the four functions of financial management?

Systems design



Systems design is one of the organising aspects of financial management. Every NGO is different and financial systems have to be adapted to meet their needs and available resources.

There are a number of considerations to take into account to find the right approach for your NGO:

- ▶ **Structure** – line management number of staff, their functions and where they are based operational structure (eg department, branch, function). *Organograms* are useful here.
- ▶ **Activities** of the organisation – number and type of projects.
- ▶ **Volume and type of financial transactions** – do you pay for your goods and services with cash or with suppliers' accounts or both?
- ▶ **Reporting** requirements and deadlines – how often and in what format do financial reports have to be produced for the different stakeholders in your organisation?
- ▶ **Resources** – what financial, equipment and human resources are available to help manage the finances?

All of these considerations will help to decide the most appropriate:

- ▶ method for keeping accounting records
- ▶ coding structure for transactions
- ▶ financial policies
- ▶ financial reporting routines
- ▶ use of administrative staff.

Financial and management accounting

For the financial management process to take place effectively, financial systems and procedures need to cover two aspects of accounting.

▷ **Financial accounting**

This describes the systems and procedures used to keep track of financial and monetary transactions. Financial accounting is a system of recording, classifying and summarising information for various purposes. Financial accounting records can be maintained using a manual or computerised system (or a combination of both methods).











The main output of financial accounting is the annual financial statements, used primarily for external accountability.

The financial accounts must be accurate and up-to-date if the second area is to be undertaken effectively and with minimum effort.

▷ **Management accounting**

Management accounting takes the data gathered by the financial accounting process, compares the results with the budget and then analyses the information for decision-making and control purposes.

The management accounts are primarily for internal use and should be produced on a regular and timely basis – usually monthly or quarterly depending on the needs of the organisation. The table below summarises the main differences:

Financial Accounting:		Management Accounting:	
	Records transactions		Compares results against goals
	Classifies transactions		Determines reasons for variations
	Reconciles records		Helps identify corrective action
	Summarises transactions		Forecasting & planning
	Presents financial data		Analyses information

The Chart of Accounts

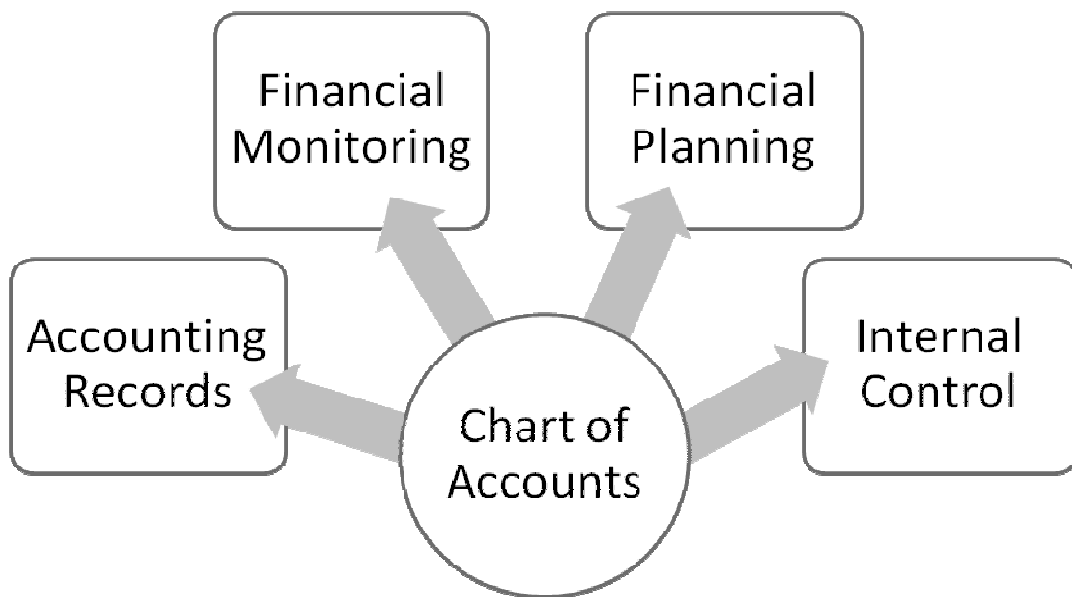
The Chart of Accounts is probably the most important organising tool for the budgeting, accounting and reporting processes. It plays a role in all four building blocks.

There are many different kinds of financial transaction taking place in an NGO. We buy a wide variety of goods and services to help achieve our objectives – from rent for the office to tools for a garden project. And we receive different kinds of income – grants, donations and membership fees, for instance.

To make sense of all of this financial activity, it helps to ‘sort’ the different types of transaction into a series of pre-determined descriptive categories or ‘accounts’. These accounts are listed in the Chart of Accounts and are typically arranged in a logical order:

- ▶ Income
- ▶ Expenditure
- ▶ Assets (things we own)
- ▶ Liabilities (things we owe).

Figure 2.2: The Chart of Accounts in a Finance System



When a transaction takes place, it is recorded in the books of account and categorised according to the guidance held in the Chart of Accounts. The same categories are used in the organisation's budget and financial reports, for consistency and transparency.

Each organisation's Chart of Accounts will be different. Typically, the layout will include:

- ▶ reference number or account code, numerical or alphabetical
- ▶ account name
- ▶ sub-groupings ('family headings')
- ▶ notes on when to use the account.

See an example of a Chart of Accounts in Appendix 1.

Note that the categories have been sorted into sub-groups under 'family' headings – such as Administration, Personnel and Vehicle Running. The coding system follows the same logic using a sequence of numbers for the family group. Family headings are especially useful for presenting summarised information.

Cost centres

It is helpful to further classify financial transactions according to the budget, activity, department or donor that they 'belong' to, so that we can then report and monitor income and expenditure by activity. We use *Cost Centres* (also known as Activity or Budget Centres) to separately identify these transactions in the accounting records.

▷ Fund accounting

It is especially important to identify donor-funded activities in the accounts so that the organisation can demonstrate to the donor how the funds have been utilised. This is known as *fund accounting* and requires care when setting up accounting systems to identify and separate the necessary information. If you have multiple projects, you will need to design a cost centre structure that allows you to meet donor reporting requirements.

▷ Setting up Cost Centres

The starting point for designing your cost centre structure is the organisation chart and donor funding agreements. There is no effective limit on the number of cost centres that can be used especially if you use a computer accounting program. However, do not over-complicate the structure –only include costs centres for activities that you need to report on and monitor.

See the example below for the Milestone Project.

▷ How are cost centres used?

Each cost centre is given a unique reference or code. When financial transactions are entered into the accounting records, not only are they categorised by the type of income or expenditure...

▷ *Which budget line item does this belong to?*

but also classified according to the fund, department or project....

▷ *Which project, donor or department budget does this belong to?*

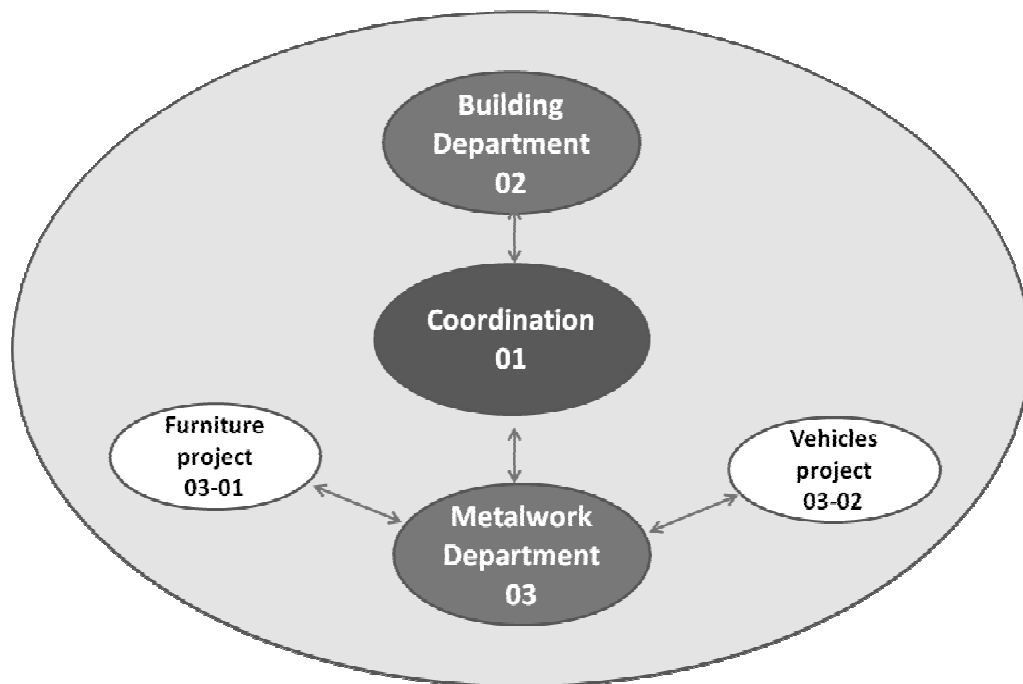
This means that separate financial reports can be more easily produced for each cost centre, helping managers to monitor their own area of responsibility and report to project donors.

Example

Milestone has three departments: *Coordination* (ie management, administration and governance), *Metalwork Department* and *Building Department*. The Metalwork department in turn has two separate activities with their own funding sources: the *Furniture Project* and the *Vehicles Project*.

Their cost centre structure and reference codes are shown in Appendix 1 (page A2) and represented graphically in the 'egg chart' in **Figure 2.3**.

Figure 2.3: Milestone's Cost Centres



Cost structures

As well as identifying the different types of expenditure for your organisation, you also need to classify them as either *Direct* or *Indirect* costs, for budgeting and accounting purposes.

- ▶ **Direct costs** are those which are clearly related to a particular activity and can be charged directly to the relevant Cost Centre(s). For example, in a training project, the costs of room hire for a training event and the trainer's salary.
- ▶ **Indirect costs** are those which are of a more general nature and relate to the organisation as a whole or several activities. For example, head office rent, the audit fee and the Chief Executive's salary. These usually form the bulk of what are known as the 'core' (or overhead or central administration) costs.

We need to distinguish between these two types of cost in the accounts so that managers can properly plan, monitor and control project resources. In particular, core costs have to be shared out – or apportioned – between the different projects in a fair and justifiable way. There are various ways to do this, for example sharing costs according to the size of each project budget (more on this in a later chapter).

Financial policies and procedures

All organisations need a series of financial policies and procedures to guide operations, avoid misunderstandings and encourage consistency.

▷ What is a policy?

A policy sets out principles and guidelines for a key area of activity within an organisation. It removes any questions about how important resources are used. For example, a vehicle policy will clarify who can drive the NGO's vehicles, how they are disposed of and rule on private usage by staff.

Policies are usually written by senior managers and then discussed and agreed by the Board or management team. Once approved, a policy is binding on everyone in the organisation and failure to do so could result in disciplinary action.

A good policy is one that:

- ▶ is fair and realistic
- ▶ covers all situations likely to arise
- ▶ meets legal requirements
- ▶ is affordable for the organisation.

▷ **What are procedures?**

Procedures describe the steps for carrying out the guidelines in a policy. They often include a requirement to complete standard forms to gather data and authorisation for actions. For example, the vehicles procedure might require completion of vehicle requisition forms and journey log-sheets.

***Policies and procedures** are not about being overly bureaucratic. They help to run the organisation smoothly and promote consistency, accountability and transparency. They also facilitate the decentralisation process and help managers make the right decisions*

▷ **Developing financial policies**

It is important to have a structured approach to developing financial policies, to make sure that the policy is fair, realistic and acceptable to those that will be affected. Here is a suggested approach:

Decide who will be involved in drawing up the policy

People are more likely to adhere to policies if they had a say in making them. If the policy is to have an impact on how programmes are delivered, it makes sense to include programme staff in the discussions.

Gather information needed to develop the policy

For example, if you were setting a policy on health-care support for staff, ask around other NGOs to see what they offer and what it costs.

Write the policy document

Use the following headings as a guide:

- The purpose of the policy
- Why we need the policy
- Who the policy applies to
- The policy guidelines
- References (eg to other policies and procedures)

Circulate the draft policy for feedback

It is this stage that will check if the policy is fair and realistic and whether it is likely to be supported (and therefore used).

Review the policy after implementation

After a few months of use, go back and test that the policy is fit for purpose. Policies should stand the test of time – whilst it is important to be flexible and adapt to changing circumstances, do not change policies too often.

What is a finance manual?

The Finance Manual brings the financial policies and procedures all together in one document. The manual may also be known as the Financial Regulations or Finance and Office Procedures. It is generally used by the finance team for day-to-day operations but also serves as a reference in case of query by programmes staff.

Be aware of the limitations of a Finance Manual: it is a major undertaking and it cannot cover everything, to do so would be too bureaucratic. It must be a 'living' manual, used and implemented by everyone and regularly reviewed and updated.

A finance manual might include sections on:

- Financial accounting routines
- The Chart of Accounts and cost centre codes
- Delegated authority rules (ie who can do what)
- The budget planning and management process
- Procurement procedures
- Bank and cash handling procedures

- Financial reporting routines and deadlines
- Management and control of fixed assets
- Staff benefits and allowances
- Annual audit arrangements
- How to deal with fraud and other irregularities
- Code of Conduct for staff and board members.

The manual may also include some reference materials such as:

- Organisation Chart
- Job Descriptions
- Standard forms.

Standard forms

Standard forms are purpose-designed documents used to simplify or facilitate financial administration routines (see Appendices 18-22 for some commonly used standard forms). They help people to follow and administer the procedures and gather information and signatures.

Examples of Standard Forms

- Supplies requisition
- Payment voucher
- Petty cash voucher
- Purchase order
- Advance request
- Travel & subsistence expenses claim
- Assets register
- Vehicle log sheet
- Bank reconciliation form
- Journal voucher

Work planning

Financial management involves many different tasks and routines. It is therefore important to plan tasks involved during the financial year, such as:

- ▶ Financial accounting routines – eg month-end and quarter-end reconciliation, payment runs
- ▶ Critical deadlines – eg payment of government taxes, insurance renewals
- ▶ Reporting schedules – especially to meet donors' reporting requirements
- ▶ Budgeting process – drafting, checking and approving
- ▶ Annual reviews – eg assets register, finance manual, insurance cover
- ▶ Year end procedures – eg closing accounts and annual external audit.

One of the best ways to do this is to create a yearly planning chart and put this up in your office and encourage everyone to keep it up to date. This helps to schedule tasks and allocate tasks to staff so that deadlines can be met.

See Appendix 17 for an example.



Chapter**3**

Financial Planning

'Failing to plan is planning to fail.' (Chinese Proverb)

This chapter:

- Looks at the link between strategic and financial planning
- Highlights different types of budgets
- Describes different approaches to budgeting
- Looks at good practice in budgeting
- Explains how to create an activity-based budget
- Describes the process of budget consolidation
- Introduces a tool for managing multiple-donor funding.

The financial planning process

Financial planning is both a strategic and operational process linked to the achievement of objectives. It involves building longer term funding strategies and shorter-term budgets and forecasts. It lies at the heart of effective financial management.

Financial planning starts with a clear plan about you want to do and how you intend to do it. We can only produce effective budgets if we have good plans to base them on.

"If you don't know where you are going then you are sure to end up somewhere else."

Mark Twain

▷ **The Planning Pyramid**

NGOs exist to achieve certain objectives. It is usual to lay down how the objectives are going to be achieved in a strategic plan. The strategic planning document has several component parts starting with an outline of long term goals – either or both a Vision and Mission – and going into greater and greater detail about how the mission is to be achieved.

Figure 3.1 The Planning Pyramid



As the level of detail increases, the timeframe becomes shorter and participation of staff members in the planning process should increase.

Vision

The vision represents the very long-term goal of the organisation – it is the big problem which the NGO alone cannot solve but strives towards. For example, the United Nations' underlying vision is 'World Peace'.

Mission

Most NGOs have a mission statement. It clarifies the purpose and values of the organisation in a few, general, sentences.

Objectives

Objectives are the building bricks which help an organisation achieve its mission. Objectives (also known as Goals or Strategic Objectives) give focus to the organisation's work and state in clear terms what it is that the organisation hopes to achieve over a given timeframe.

Strategies

Strategies (also known as Specific Objectives) set out how the organisation will achieve each of its core objectives. They outline the actions which will be taken for each objective.

Activity Plans

The strategy may be sub-divided into several, more specific and detailed plans for each activity, function or project. Activity plans have a shorter time focus (about one year) than strategies and objectives and are subject to regular review as progress is made. Activity plans are the basis for budgets so must be very '**SMART**' – specific, measurable, achievable, relevant (or realistic) and time-bound

Once plans are set, the organisation draws up its budgets and cashflow forecast to help implement the plans. During the year financial reports are produced to compare the budget with actual performance.

This review stage is very important to the financial planning process since it will highlight areas where the plans did not happen as expected. This learning process will help to identify revisions which need to be made to the plans. And so the cycle continues... *Plan, Do, Review.*

What is a budget?

*'A budget describes an amount of **money** that an organisation **plans** to raise and spend for a set **purpose** over a given period of **time**.'*

A budget has several different functions and is important at every stage of a project:

▷ **Planning**

A budget is necessary for planning a new project, so that managers can build up an accurate idea of the project's cost. This allows them to work out if they have the money to complete the project and if they are making the best use of the funds they have available.

▷ **Fundraising**

The budget is a critical part of any negotiation with donors. The budget sets out in detail what the NGO will do with a grant, including what the money will be spent on, and what results will be achieved.

▷ **Project implementation**

An accurate budget is needed to control the project, once it has been started. The most important tool for on-going monitoring is comparing the actual costs against the budgeted costs. Without an accurate budget, this is impossible. Because plans sometimes change, it may be necessary to review the budget after a project has started.

▷ **Monitoring and evaluation**

The budget is used as a tool for evaluating the success of the project, when it is finished. It helps to answer the question: 'Did the project achieve what it set out to achieve?'

"A budget tells your money where to go, otherwise you wonder where it went."

J. Edgar Hoover

Who needs budgets?

Budgets are used by different people for different purposes:

- ▶ The **Board of Trustees** needs the NGO's overall budget because it has to formally approve it and monitor its progress.
- ▶ **Chief Executives** need budgets to keep an eye on progress of programmes, operational costs and funding.
- ▶ **Fundraisers** need budgets to accompany funding applications.

- ▶ **Project managers** need budgets to oversee the implementation of their project activities.
- ▶ **Finance staff** need budgets to make sure there are enough funds in the bank to cover anticipated expenditure.
- ▶ **Donors** need budgets so they can see how an organisation intends to spend its grants.
- ▶ **Community partners** need budgets so they can see how an NGO plans to spend and raise funds for their community projects.

Types of budget

Essentially, there are three main types of budget:

- The Income and Expenditure Budget
- The Capital Budget
- The Cashflow Forecast.

▶ The Income and Expenditure Budget

The income and expenditure budget sets out the anticipated running costs (also referred to as recurrent costs) of the organisation and shows where the funds will come from to cover the costs. See Appendix 11 for a *Consolidated Income and Expenditure* budget.

The annual income and expenditure budget is often broken down into shorter periods (or 'phases') – quarterly or monthly – to assist with monitoring progress.

▶ The Capital Budget

A capital budget lists the expenditure you intend to make for the coming years on capital projects and one-off items of equipment that will form part of the organisation's *Fixed Assets*. As these usually involve major expenditure and non-recurrent costs, it is better to list and monitor them separately.



Examples of capital expenditure include:

- Vehicles
- Office furniture and equipment
- Computer equipment
- Building construction or purchase
- Major renovation works.

The implications for the income and expenditure budget should be noted – such as running costs for vehicles.

A separate capital budget is not required if only one or two capital items are to be purchased. In this case it is sufficient to incorporate the capital items in a separate section of the income and expenditure budget. This is most common in a project budget.

▷ **The Cashflow Forecast**

For good financial management, cash reserves are essential as there will always be times when grants are delayed or unexpected expenses occur. The cashflow forecast (or cash budget) helps managers identify those times when cash levels become critical.



Whereas the income and expenditure budget shows whether the organisation is covering its costs over the whole year, the cashflow forecast shows whether it has sufficient cash in the bank to meet all of its obligations needs as they arise. (See Appendix 13 for an example.)

It predicts the flow of cash in and out of the organisation throughout the year by breaking down the master (or overall) budget into smaller time periods, usually one month. This helps to identify likely cash shortages and allows avoiding action to be taken such as:

- ▶ requesting donor grants early
- ▶ delaying payment of certain invoices
- ▶ delaying some activities
- ▶ negotiating a temporary loan facility at your bank.

However, take care as there are likely to be negative consequences if you follow the last three strategies:

- ▶ delaying payments could affect your relationship with suppliers
- ▶ delaying activities will affect the communities you work with and your ability to implement the programme as agreed with your donor
- ▶ borrowing money from the bank will attract interest and bank charges.

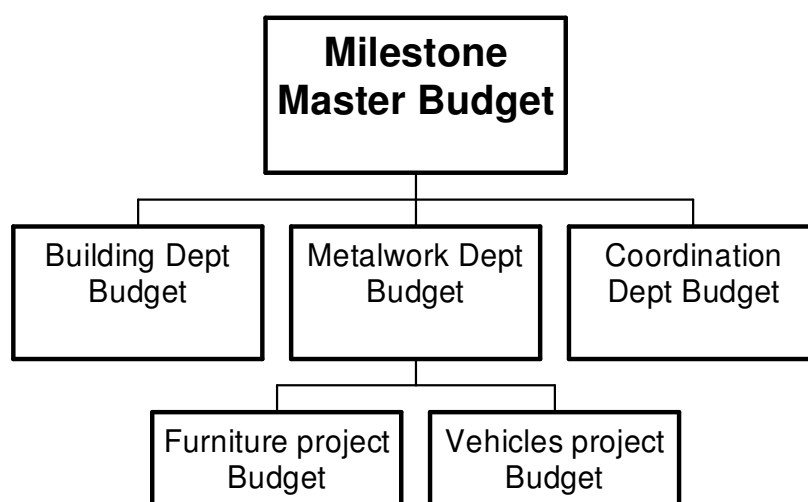
The cashflow forecast is also useful where the organisation maintains substantial cash reserves which need to be invested wisely to maximise investment income. See below for tips on creating cashflow forecasts.

Budget structures

It is practical to organise budgets at different levels, eg by department, programme or cost centre. This allows budgets to be delegated and monitored at the activity level, and summarised overall.

Figure 3.2 shows Milestone's budget hierarchy which reflects their cost centre structure. The lower level project budgets are *consolidated* into the departmental budget. Departmental budgets are in turn consolidated into one master budget (as in Appendix 11).

Figure 3.2: Milestone's budget structure



Tips for preparing a cashflow forecast

- ▶ Set up a cashflow forecast table (a computer spreadsheet will make this easier) with budget items listed on the left and the months of the year along the top (see Appendix 13). Have ready the organisation's activity plans, income schedules and budgets for the year.
- ▶ Based on the income schedule, work out when you will receive cash in the bank for each income item. Plot each expected cash receipt in the cashflow table.
- ▶ Based on the activity plans for the year, work out when cash will actually leave the bank for each expenditure item. For unpredictable expenses – eg equipment repairs – use a monthly or quarterly estimate. Plot each payment in the cashflow table.
- ▶ Take account of payment terms and income schedules. Eg office rent is usually paid in advance, so the rent for April to June would be paid in March. Similarly, a donor's grant agreement might specify 50% of the grant will be paid at the start, then 20 % in months 6 and 9 and the final 10% after receipt of the final report in month 12.
- ▶ You do not need to include *non-cash transactions*, such 'gifts in kind' and depreciation, in the cashflow forecast. This is because these are paper transactions only – there is no actual cash movement.
- ▶ Once the budget has been broken down according to expected cash flow activity, you can calculate the *net cash flow* from the monthly totals on cash in and cash out. This tells you whether there is more cash coming in or going out for each month.
- ▶ Include an estimate of any cash in the bank at the start of the year and add this to the net cash flow to give your monthly cash forecast.
- ▶ When your forecast is complete, you will be able to spot any 'problem' months. For example, in Appendix 13, the figures in brackets on the bottom line indicate that Milestone is predicting cash shortages in several months of the year. This signals that they need an action plan to avoid the cash shortages.

Budgeting techniques

There are two main ways to build a budget – *incremental* and *zero-base*. You should adopt the approach which works best for you, given the skills and time available.

▷ **Incremental budgeting**

This approach bases any year's budget on the previous year's actual, or sometimes budgeted, figures with an allowance for inflation and known changes in activity levels. It has the advantage of being fairly simple and quick to implement. It is most useful for organisations where activity and resource levels change little from year to year.

A frequent criticism of this approach is that it does not encourage fresh thinking and perpetuates existing flaws. It is also difficult to justify these figures to donors since the original calculations are long forgotten.

▷ **Zero-based budgeting**

An alternative approach is to start with a clean sheet – or a 'zero base'. Zero-base budgeting (or ZBB) ignores previous budgets and starts with next year's targets and activities. ZBB requires the writer of the budget to justify all the resource requirements.

This process may suit organisations going through a period of rapid change and those, like NGOs, whose income is activity-based. Zero-based budgets are said to be more accurate since they are based on the detail of planned activities. However, the approach does require more work and time than incremental budgeting.

▷ **Activity-based budgeting**

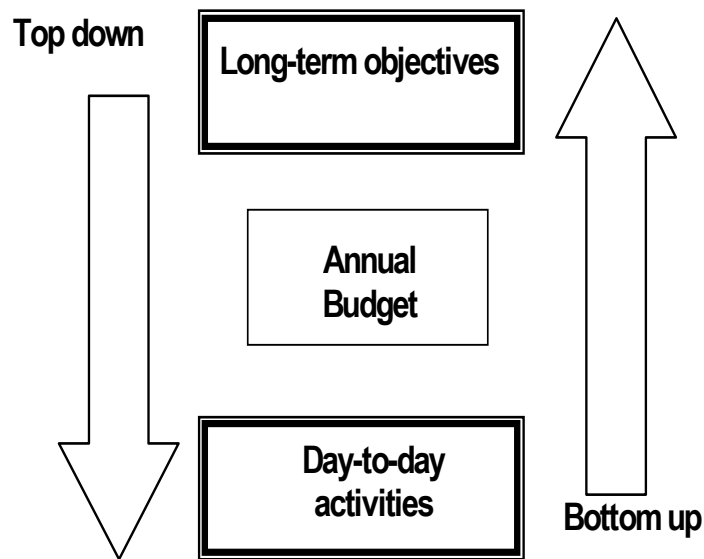
This is a special form of Zero-base budgeting and is frequently used in the NGO sector to create project budgets. It is favoured by many donors. See Appendix 12 for an example.

▷ **Top Down or Bottom up?**

Where operations staff are involved in setting their budgets it is described as 'bottom up' budgeting – as opposed to 'top down' where budgets are set by senior managers.

Since a budget is a financial plan that relates directly to the activities of the organisation, it is important to involve those who will be responsible for project implementation in writing the budget. If this is not done, the budget could be less accurate and staff less likely to appreciate the need to spend within budget or to reach fund-raising targets.

Figure 3.3: Top Down or Bottom up



Summary of budget terminology

MAIN TYPES OF BUDGET	Income & Expenditure	This budget lists all items of incoming funds and recurrent (ie regularly occurring) costs for a specified period.
	Capital	This budget lists one-off expenditure for expensive items such as equipment, property, vehicles, or major building works, which will be used over several years.

	Cash flow forecast	Shows the predicted flow of cash coming in and out of the organisation each month, with the purposes of identifying periods of cash shortages or surpluses.
BUDGET STATUS	Balanced	Where anticipated income is the same as anticipated expenditure
	Deficit	Where anticipated income is less than anticipated expenditure
	Surplus	Where anticipated income is more than anticipated expenditure
APPROACHES TO WRITING A BUDGET	Incremental	Where the calculations are based on previous year's budgeted or actual figures, with adjustments for new activities or known changes
	Zero-base	Where the budget is built from 'scratch', and not based on previous budgets or figures.
	Activity based	Where the budget is built up from a detailed activity plan (a form of zero-base budgeting).
LEVEL OF BUDGET DETAIL	Master	Shows overall anticipated income and expenditure for the whole organisation for the year.
	Consolidated	This brings together several project or programme budgets in a table to show a summary of each and the total overall.
	Project or programme	Shows income and expenditure for a specified project or programme for the implementation period.
TIME PERIODS	Multi-year	This budget outlines anticipated income and expenditure, or cashflow, for two or more successive years.
	Phased	A budget broken down into time periods – usually monthly or quarterly – to reflect the budget requirements according to planned activity for those periods of time.
SPECIALISED BUDGETS	Donor	A budget in the format required by a funding agency, usually accompanies a funding proposal.
	Flexible (or variable)	This budget is regularly reviewed and updated to take account of changes in levels of activity
	Funding grid	A special budget which reconciles anticipated income sources to the programme budget, to show which funding source is funding what, and to identify funding gaps.

	Rolling	A budget that always covers a fixed period of time (eg 12 months). It is updated every month or quarter to include figures for the fixed budgeting period.
--	----------------	--

The budgeting process

It is best to approach the budgeting process as an organised and structured group exercise. The budget process involves asking a number of questions:

- ▶ What are the objectives of the project?
- ▶ What activities will be involved in achieving these objectives?
- ▶ What resources will be needed to perform these activities?
- ▶ What will these resources cost?
- ▶ Where will the funds come from?
- ▶ Is the result realistic?

The budgeting process is one we go through almost on a daily basis without even realising, as the example below demonstrates.

Example: Rudi goes to a football match

It is Friday afternoon and a teenage son – Rudi – rushes in from school and asks his mother for \$10.00 as he'd like to go out with some friends for the evening. His mother asks him to explain what he will be doing and why he needs \$10.00. He says he will take the bus into town, go for some food and then go to watch a football match. His mother then took him through the budgeting process, as follows:

Objective: To have an entertaining evening with friends.

Activities: Bus journey to town, visit a cafe, watch the football match, bus journey home.

Resources: Money to cover the costs of bus fares, food and ticket.

	\$	
Bus fares	1.50	2 x 75c
Food & drink	3.00	Burger and a soda

Tickets	3.00	Standing area
<u>Sweets</u>	<u>0.50</u>	To buy at the match
TOTAL	8.00	

Rudi's mother decides that the plan is a reasonable one but gives him \$8.00, not the \$10.00 he originally asked for.

The next day.....

On Saturday morning, Rudi's mother asks how he enjoyed the evening. He reports that the match was great, his team won and that he and his friends had a very entertaining evening even though it did not go entirely according to plan...After going to the cafe, Rudi and his friends arrived at the football stadium to find that all the \$3.00 tickets were sold out and they had to spend an extra \$1.00 each for a more expensive area.

This meant that Rudi did not have enough money left to buy sweets or to get the bus back home again. Fortunately, he met the parents of some school friends at the match and they offered to give him a lift home, which he gratefully accepted.

So it all ended well, even though his plans did not go *exactly* as intended.

What can we learn from this everyday example?

- ▶ If we talk through the activity, it helps to identify the resources we need
- ▶ Itemising each item we need helps us to arrive at a more accurate estimate of costs
- ▶ It is a good idea to include some contingency for budget items where the price might change or for unforeseen events.

We will return to the process when we look in more details at the *Activity-based Budgeting* approach.

Good practice in budgeting

▷ **Clarity**

Since many different people will need to use the budget for different purposes, they should be able to understand it (and adapt it, when necessary) without any additional explanation beyond what is written down. So keep notes on budgeting assumptions and calculations.

▷ **Get organised**

There are several stages involved in constructing a budget before it can be submitted for approval to the governing body, so it is a good idea to prepare a budgeting timetable and commence the process early. This could be up to six months before the start of the financial year, depending on the size of the organisation and what approach has been adopted.

▷ **Budget Headings**

When setting a budget for the first time or when reviewing a budget, it is important to pay attention to the Chart of Accounts. This is because the budget line items also appear in the books of account and on management reports. If the budget items and accounting records are not consistent then it will be very difficult to produce monitoring reports once the project implementation stage is reached.

One way of achieving consistency is to design a Budget Preparation Sheet for your organisation, which will act as a memory-jogger and prompt staff to include all relevant costs. It will list all of the main types of income and expenditure that a project or department might have in a typical year.

▷ **Estimating Costs**

It is important to be able to justify calculations when estimating costs. Even if you use the incremental method of budgeting, do not be tempted to simply take last year's budget and add a percentage amount on top for inflation. While last year's budget could be very helpful as a starting point, it could also be very misleading and contain historical inaccuracies.

One of the best approaches is to use a budget worksheet (see Appendix 12) to list of all the inputs required and then specify the number and unit cost of each item.

From this detailed working sheet, it is then a simple matter to produce a summarised budget for each line item. It is also easy to then update if quantities or unit costs change. See below for detailed guidance on how to use a budget worksheet.

▷ **Contingencies**

Contingencies are items included in a budget for unforeseen expenses. It is best to include these for the budget lines that might need a 'cushion' (eg salaries, insurance and fuel) rather than adding a 'bottom line' percentage.

Every item in your budget must be justifiable – adding a percentage on the bottom is difficult to justify – and difficult to monitor.

▷ **Forgotten costs**

There is a tendency in the NGO world to under-estimate the true costs of running a project for fear of not getting the project funded. Here are some of the most often overlooked costs:

- Start-up costs (eg publicity, legal costs)
- Central support ('core') costs (eg insurance, utilities)
- Staff related costs (eg recruitment, training, benefits and taxes)
- Vehicle running costs
- Equipment maintenance and repairs (eg for photocopiers and computers)
- Governance costs (eg board meetings, AGM)
- Audit fees.



▷ **Check the figures**

Find yourself a 'budget buddy' to check your draft budget with a critical eye. This could be a work colleague or someone doing a similar role in another NGO.

Ask them to check the figures for accuracy, that you have included all of the resources needed for the activity and if the total cost looks reasonable.

Using a budget worksheet

Table 3.1 shows a typical layout for a budget worksheet as used in activity-based and zero-based budgeting. The extract describes the inputs needed for a 4-day workshop for 20 participants with two tutors. The table details items required for the workshop, the quantities required and the cost per unit. The final column provides the budget for each item.

Other typical columns (not shown in the example above due to space limitations) include 'Notes' and 'Accounts Codes', as described in **Table 3.2**.

Table 3.1 Budget Worksheet

A	B	C	D	E	F	G [D x E x F]
Ref.	Description	Unit type	No. units	Frequ-ency	Unit cost \$	Total cost \$
1	Workshop costs					
1.1	Room hire for workshop	Days	4	1	25	100
1.2	Tutors' fees	Days	4	2	100	800
1.3	Tutors' accommodation	Nights	5	2	50	500
1.4	Lunch & refreshments	Person	22	4	5	440
1.5	Course handbooks	Person	22	1	5	110
1.6	Folders for papers	Trainee	20	1	3.	60
Sub total						2,010

Unit Types

Deciding on the *unit type* requires some careful thought as it is not always obvious. The best way to work it out is to ask yourself:

▷ *"how will the supplier charge for this item?"*

So, for example, a hotel charges for a room for each night, so in this case the unit type is 'night' and the unit cost would be the cost for one night. To arrive at the budget, we would specify the number of rooms or the number of nights – or both.

The checklist in **Table 3.3** will help you select a unit type.

Table 3.2: Budget Worksheet Columns

A	Ref.	Line reference – useful if you are discussing the budget and need to draw attention to a particular line in the worksheet. The budget is often separated into sections for specific activities, each with a number. In the above example all ‘workshop’ related costs are listed under section 1.
B	Description	A short description of each line in the budget. Try to include different inputs on a line of their own rather than lump similar costs all together.
C	Unit type	This is the basis for the costing and calculations. The unit type will vary according to the budget item. For example, in line 1.4 of the table above, the budget for lunches is being costed on a per person basis. See below for some further examples of unit types to use for different budget items
D	No. units	This specifies the number of units required for the project. For example, in the budget above on line 1.4, we need lunches for 22 people (20 trainees plus 2 facilitators).
E	Frequency	This is useful where we need the item described more than once. For example, in line 1.4 in the table above, we need to provide lunches for 22 people on 4 days as it is a 4-day course. In line 1.3, we need to provide 5 nights’ accommodation for 2 tutors. Whereas in line 1.1 we only need to hire a one room.
F	Unit cost	That is, what does each unit cost as defined in column C? So, in line 1.4 we see that it costs \$5.00 for lunch and refreshments for each person.
G	Total cost	This is calculated by multiplying no. units x quantity x unit cost. So, the cost of lunch and refreshments for 22 people on each of 4 days at \$5.00 per person costs \$440.00 [22 x 4 x 5]
H	Notes	A notes or comments column is useful to clarify what the item is for and how quantities have been arrived at.
I	Accounts Code	The code used in the organisation’s accounting records (ie as listed in the Chart of Accounts)
J	Donor code	It is very useful to add another column which details the donor code or line item reference as this makes it easy to transfer the budget figures into the donor budget and reporting formats.

Table 3.3: Choosing Unit Types

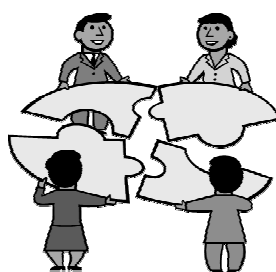
Typical Budget Items:	Examples of Unit Type:
<p><i>Personnel Costs</i></p> <ul style="list-style-type: none"> Salaries, benefits & taxes Staff recruitment Staff development Subsistence allowances Volunteers expenses 	<ul style="list-style-type: none"> Month Advert entry Days, person Days, person, trip Session, person, trip
<p><i>Transport costs</i></p> <ul style="list-style-type: none"> Fuel & lubricants Vehicle insurance Vehicle maintenance Air fares Bus/taxi fares Distribution costs 	<ul style="list-style-type: none"> Kilometre, month Month or lump sum per quotation Kilometre, month Trip/journey Trip, month Kilometre, trip, month
<p><i>Programme administration</i></p> <ul style="list-style-type: none"> Office rent, electricity and water Office insurance Telephone & fax, postage Office stationery Internet subscription Repairs & renewals Bank charges Audit fees 	<ul style="list-style-type: none"> Month Month or lump sum per quotation Month Box, carton, piece or month Month or lump sum per quotation Month Month Lump sum per quotation
<p><i>Project Costs</i></p> <ul style="list-style-type: none"> Room hire/accommodation Publicity costs Publications/reference books Training materials Professional fees (eg, consultant) Printing/photocopy Inputs (eg pipes, tents, tools) Equipment Food 	<ul style="list-style-type: none"> Day Advert entry, lump sum per quotation Month or lump sum per quotation Trainee, lump sum per quotation Days, lump sum per quotation Copy, person, lump sum per quotation Piece Piece, or lump sum per quotation Person, meal, day

The codes columns on the budget worksheet

It is a good idea to include internal accounting codes, and even donor codes, for each item on your activity-based budget worksheet. We can then summarise the budget details into any format required, eg project budgets for internal use or different donor budget to accompany a funding proposal.

The internal codes are detailed on the Chart of Accounts and the donor codes will be found on the donor's budget format or grant guidelines. See the example in Appendix 13 which includes Milestone internal accounts code in the final column.

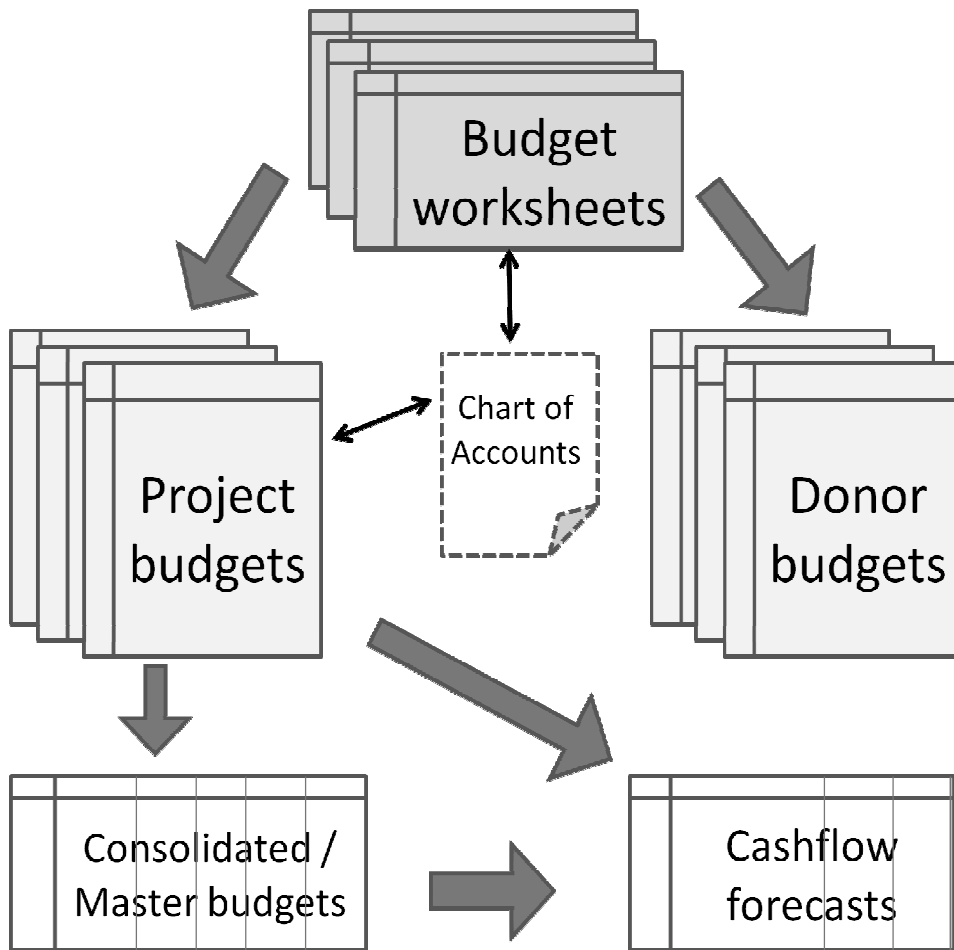
The codes also help with the process of budget consolidation – ie joining together several cost centre budgets into one overall budget.



Budget consolidation

The diagram in **Figure 3.4** demonstrates the process of consolidating budgets into different levels or formats. It shows how budget worksheets are the starting point for all other budgets.

- ▶ They can be summarised into **Project budgets** based on the Chart of Accounts codes. This format allows us to compare the budgets against actual income and expenditure later on.
- ▶ The project budgets can in turn be further summarised into **Consolidated** or **Master** budgets to show information for a programme, department or for the whole organisation. These are ideal for managers and the Board.
- ▶ The internal summarised budgets are then used to create **Cashflow Forecasts**.
- ▶ The budget worksheets can also be used to re-draft the budget into different **donor budget** formats.

Figure 3.4: Consolidating budgets

Budgeting for central support costs

Budgeting is not just about looking at the cost of programme activities. When we create project budgets we must include both the direct project costs *and* a contribution to the Central Support (or 'core') costs to arrive at the true cost of running the project.

The starting point is to write a budget for the Central Support costs so they do not get overlooked and the costs are clear. Typically, Central Support costs include indirect costs such as:

- Office rent, insurance and utilities
- Core staff salaries – CEO, Accountant, Receptionist
- Non-project vehicles and their running costs

- Office stationery and consumables
- Audit fees.

Is it always a Central Support cost?

It is important to keep Central Support costs to a minimum – not only are these costs difficult to finance, they are closely scrutinised by donors, regulatory bodies and the general public.

In some cases, it is possible to *allocate* out some shared costs to project budgets to reduce the central charge. For example:

- ▶ **'Pool' vehicle shared by the CEO and programme staff:** only the CEO usage counts as Central Support costs. Programme staff usage should be included as direct project costs in the relevant project budget.
- ▶ **Photocopier:** charge projects directly for their usage to cover the costs of paper and machine rental.

In both of these cases, you need to set up a usage log to support the charge.

Financing Central Support cost

Every organisation needs a clearly stated policy on how it will pay for its Central Support costs. These costs have to be financed just like any other cost incurred in an NGO.

There are essentially two ways – or a combination of both – to finance your Central Support costs:

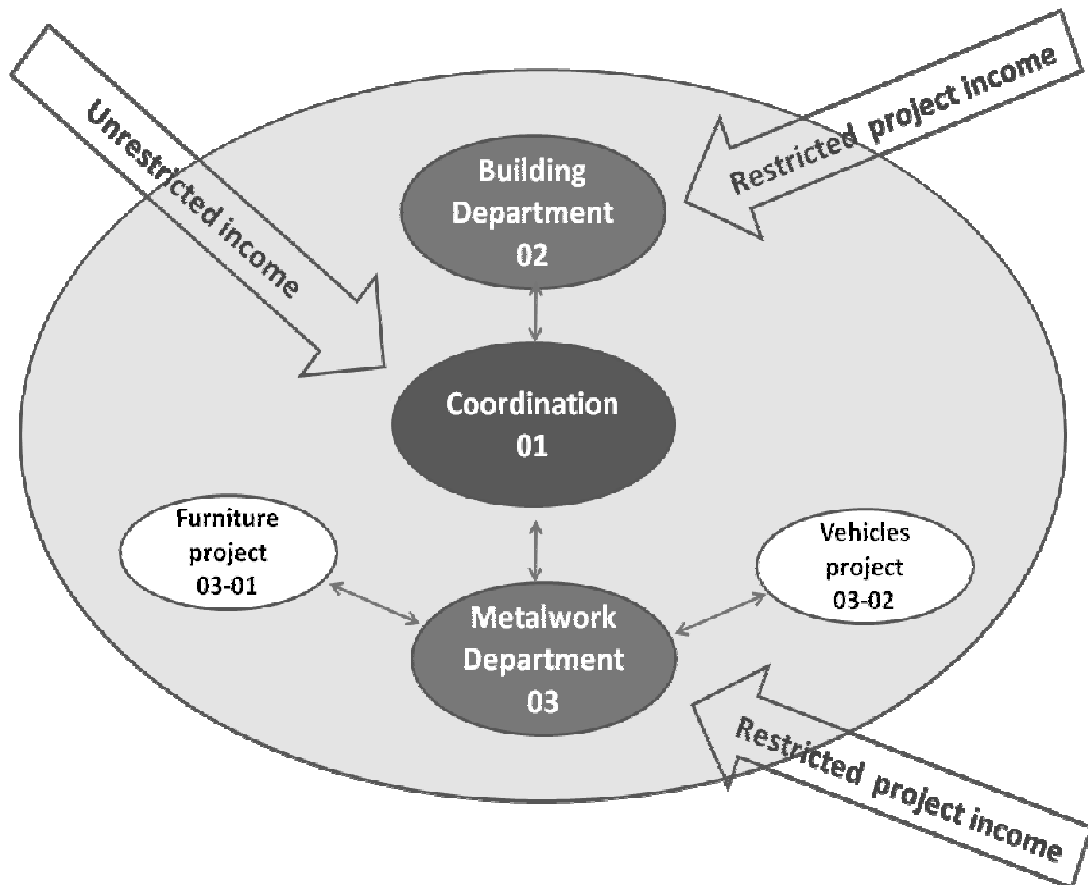
- ▶ Use unrestricted funds (ie money given to the organisation for general purposes)
- ▶ Charge projects a pre-arranged percentage of the costs.

The **Figure 3.5** shows how this works in practice, using Milestone as an example. Unrestricted funds come in centrally ('Coordination') and are used to help pay for some of the Central Support costs. The balance is financed by including a contribution to central support in the project budgets, using an agreed apportionment criteria. (The methods which can be used to apportion costs are covered in a later chapter.)

The projects will then pay their contribution to core costs from their project funds. Note however, that as these are restricted funds, the donors' rules and budgets must be checked to see what is allowed.

As a general principle, you should never accept project funding without a plan to cover the cost of central support – it is just not possible to run a project with direct costs only!

Figure 3.5: Financing Milestone's Core Costs



Multiple donor-funded programmes

When a programme or project has more than one donor, it can present a number of financial planning problems. In particular,

- ▶ Donors have different budget formats and layouts, which they require you to use when applying for funds.
- ▶ Budget line items and descriptions vary, so it is not clear exactly what each category includes or excludes, eg 'Transportation', 'Travel', 'Vehicle Running'.
- ▶ It is not always clear who is paying for what activity or item.
- ▶ Different donors have different policies on Central Support costs. It is not always clear if all the project's internal contribution is covered.
- ▶ Sometimes 'double funding' (ie too much money) occurs on some budget lines and other items are under-funded.

▷ Some Solutions

A detailed Chart of Accounts

If the Chart of Accounts is detailed enough, it will be able to cope with different donor budget lines. For example, the category 'Transportation' is extended in the Chart of Accounts to include:

- Fuel & Lubricants
- Vehicle Maintenance
- Vehicle Insurance
- Public transport
- Air travel
- Distribution costs.

Create budget worksheets for all projects

Because this approach provides a very detailed budget, with donor and internal codes applied to each line, it is possible to transfer the information to any other budget format as required. The worksheet format provides maximum flexibility.

Include some 'indirect costs' as direct project costs

Look to see if it is possible to classify any central support costs as direct costs in the project budget. For example, contributions to office rent and insurance, Accountant's costs and audit fees. But do take care as all costs must be justifiable.

Prepare a 'funding grid'

A funding grid is an internal planning tool which provides an overview of which donor fund is paying for what part of a budget. It is also useful for re-negotiating funding agreements and identifying fundraising needs.

How it works:

- ▶ The overall project or programme budget is detailed in column 1.
- ▶ Donor budgets are entered in the next columns and reconciled to the overall project or programme budget.
- ▶ Unrestricted funds are then entered to 'plug' any gaps.
- ▶ The final column identifies any double funding (surplus) and remaining funding gaps (deficit).

The funding grid must be updated regularly as new information becomes available.

Table 3.4 Example Funding Grid –Milestone Project (extract)

All figures in USD

Budget item	Total Budget	Confirmed Funding				Total expected	Surplus/ (deficit)
		RESTRICTED			UNREST'D		
		DFID	Smile Trust	Vanguard	Dona-tions		
Admin.	38,100	9,000	9,000	0	13,200	31,200	(6,900)
Staff	71,000	18,000	18,000	9,000	26,000	71,000	0
Travel	51,000	11,000	11,000	2,000	6,500	30,500	(20,500)
Training	111,200	52,000	52,000	10,000	0	114,000	2,800
TOTAL	271,300	90,000	90,000	21,000	45,700	246,700	(24,600)

In the example, we can see that:

- ▶ there are some predicted funding gaps for the Admin and Travel budget lines (indicated by the negative figures in brackets);
- ▶ a predicted surplus of funds on the Training budget line of USD 2,800 (indicated by the positive figure); and
- ▶ overall, Milestone *appears* to be USD 24,600 short of the funds it needs.

However, Milestone must not assume that it can keep the 'extra' USD 2,800 on the Training line and use it elsewhere in the budget: these funds are restricted and – strictly speaking – this presents a 'double funding' situation.

In this case, Milestone must contact the donor(s) and make a request to re-allocate the surplus funds on the Training line to other budget lines where there are funding gaps. If the donors refuse, the surplus restricted funds must be given back to the donor.

Summary

Summary of what makes a good budget

The sign of a good budget is that anyone could pick it up and use it to manage their activities. It must:

- Be suitable for the purpose
- Have the right level of detail for the user
- Be easy to read
- Have clear calculations
- Include all costs which are justified and accurate
- Provide explanatory notes.

Chapter

4

Understanding Accounts

An Introduction to the mysteries of accounting

This chapter:

- Discusses why an NGO needs to keep accounts
- Describes the different methods used to keep track of financial transactions
- Outlines which accounting records to keep
- Defines and explains key financial accounting concepts and terminology.
- Describes the financial statements which are prepared from the accounts.

Why keep accounts?

Good financial records are the basis for sound financial management of your organisation.

▷ **Information**

All organisations need to keep records of their financial transactions so that they can access information about their financial position, including:

- ▶ A summary of income and expenditure and how these are allocated under various categories.
- ▶ The outcome of all operations – surplus or deficit, net income or net expenditure.
- ▶ Assets and liabilities – or what the organisation owns and owes to others.

▷ **Credibility**

NGOs especially need to be seen to be scrupulous in their handling of money – keeping accurate financial records promotes integrity, accountability and transparency.

▷ **Legal requirement**

There is often a statutory obligation to keep and publish accounts. Donor agencies almost always require audited accounts as a condition of grant aid.

▷ **Future planning**

Although financial accounting information is historical (ie happened in the past), it will help managers to plan for the future and understand more about the operations of the NGO. With information spanning two or three years, it is possible to identify trends.

Accounting methods

Keeping accounts simply means finding a way to store financial information so that the organisation can show how it has spent its money and where the funds came from. Accounting records can be kept in a manual format – ie hardback books of account – or in a computerised format in one of many accounts packages available.

There are two main methods for keeping accounts:

- Cash accounting
- Accruals accounting.

The two methods differ in a number of ways but the crucial difference is in how they deal with the timing of the two types of financial transaction:

- ▶ Cash transactions which have no time delay since the trading and exchange of money takes place simultaneously.
- ▶ Credit transactions which involve a time lag between the contract and payment of money for the goods or services.

Significantly, the method we choose to record transactions will produce different financial information – as managers we need to know the basis of accounting to better understand financial reports.

▷ **Cash Accounting**

This is the simplest way to keep accounting records and does not require advanced bookkeeping skills to maintain. The main features are:

- ▶ Payment transactions are recorded in a Bank (or Cash) Book as and when they are made and incoming transactions as and when received.
- ▶ The system takes no account of time lags and any bills which might be outstanding.
- ▶ The system does not automatically maintain a record of any money owed by (liabilities) or to (assets) the organisation.
- ▶ The system cannot record *non-cash* transactions such as a donation in kind or depreciation.

When summarised, the records produce a *Receipts and Payments Account* for a given period. This simply shows the movement of cash in and out of the organisation and the cash balances at any given time.

See Appendix 7 for a sample Receipts and Payments Account.

▷ **Accruals Accounting**

This involves '*double entry*' bookkeeping which refers to the dual aspects of recording financial transactions to recognise that there are always two parties involved: the giver and the receiver. The dual aspects are referred to as debits and credits. This system is more advanced and requires accountancy skills to maintain.

- ▶ Expenses are recorded in a *General Ledger* as they are incurred, rather than when the bill is actually paid; and when income is truly earned (ie we are 100% certain it will be paid) rather than when received.
- ▶ By recognising financial obligations when they occur, not when they are paid or received, this overcomes the problem of time lags, giving a truer picture of the financial position.
- ▶ The system can deal with all types of transactions and adjustments.
- ▶ The system automatically builds in up-to-date information on assets and liabilities.

These records provide:

- ▶ an Income and Expenditure Account summarising all income and expenditure committed during a given period and
- ▶ a Balance Sheet which demonstrates, amongst other things, money owed to and by the organisation on the last day of the period.

Table 4.1 Summary of Cash and Accruals Accounting

	CASH	ACCRUALS
<i>Accounting system</i>	Single Entry	Double Entry
<i>Transaction types</i>	Cash only	Cash and Credit
<i>Terminology</i>	Receipts and Payments	Income and Expenditure
<i>Main Book of Account</i>	Bank (or Cash) Book	Nominal (or General) Ledger
<i>Skill level</i>	Basic bookkeeping	Advanced bookkeeping
<i>Non-cash transactions</i>	No	Yes
<i>Assets & Liabilities</i>	No	Yes
<i>Reports produced</i>	Receipts & Payments Report	Income & Expenditure Report with Balance Sheet

▷ **Hybrid Approach**

Many NGOs adopt a 'half-way house' approach. They use the cash accounting basis during the year and then (often with the help of the auditor) convert the summarised figures at the year-end (or more frequently) to an accruals basis for the final accounts and audit.

This includes keeping separate books to record and identify accruals and prepayments (see examples below), unspent grants and capital purchases during the accounting period.

See Appendix 10 Note to the Accounts, Note 3, for a *Schedule of Creditors and Debtors*, identified for Milestone's year-end adjustment process.

Example of an accrual

An electricity bill covering the last month of the financial year is not received until 4 weeks after the year-end. Even though the payment will be made during the new financial year, the expenditure must be recorded in the financial year that the electricity was consumed. It shows up as a liability on the Balance Sheet

Example of a prepayment

Office rent is paid six months in advance. Half of the payment covers the first quarter of the new financial year and is therefore deducted from the office rent account for the current year at the year-end. It is carried forward to the rent account for the financial year when the rent falls due and shows up as a prepayment on the assets list in the Balance Sheet.

Which accounting records to keep

For a small NGO with very few financial transactions, a simple bookkeeping system is all that is needed. As an organisation grows and takes on a number of projects and different sources of funding, its reporting requirements, and therefore its financial systems, will become more sophisticated.

Accounting records fall into two main categories:

- ▶ Supporting Documents
- ▶ Books of Account.

▷ **Supporting documents**

Every organisation should keep files of the following original documents to support every transaction taking place:

- Receipt or voucher for money received
- Receipt or voucher for money paid out
- Invoices – certified and stamped as paid
- Bank paying-in vouchers stamped and dated when money is taken to the bank
- Bank statements
- Journal vouchers – for one-off adjustments and non-cash transactions.

With these documents on file it will always be possible to construct a set of accounts.

Other useful supporting documents include:

- Payment vouchers (PVs)
- Local Purchase Orders (LPOs)
- Goods Received Notes (GRNs).

▷ Books of account

The minimum requirements for books of account are:

- Bank (or Cash) Book for each bank account
- Petty Cash Book.

For organisations with salaried staff, valuable equipment and significant levels of stock, the following records, where relevant, may also be kept as part of a full bookkeeping system:

- General/Nominal Ledger
- Journal or Day Book
- Wages book
- Assets Register
- Stock Control Book.

Supporting documentation

<p>Receipts Explain:</p> <hr/> <p><i>When?</i></p> <hr/> <p><i>How Much?</i></p> <hr/> <p><i>What?</i></p> <hr/> <p><i>Who?</i></p> <hr/> <p><i>Why?</i></p>	<p>It is very important to maintain supporting documents in the form of receipts and vouchers for all financial transactions. These should be cross-referenced to the books of account and filed in date or number order.</p> <p>Apart from being required by the external auditor to support the <i>audit trail</i>, certified receipts also provide protection to those handling the money.</p> <p>Mislaid or incomplete records can result in suspicion of mismanagement of funds.</p>
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Keep separate files for receipts for money coming into the organisation and money going out. Mark invoices 'paid' with the date and cheque number to prevent their fraudulent re-use by an unscrupulous person.

Well maintained files provide invaluable information to the organisation such as the trends in price increases, details of equipment purchased, past discounts, etc.

Bank Book basics

The Bank Book – or Cash Book or Cash Analysis Book – is the main book of account for recording bank transactions (ie ‘cash’ transactions). It is normal to maintain a separate Bank Book for each bank account held as this makes it easier to reconcile each account at the end of the month. See Appendices 3 and 4 for a sample Bank Book.

With a manual (ie paper based) Bank Book, receipts are usually entered on the left side and payments on the right and each page is ruled into columns (see Figure 4.1 for a typical layout). The number of columns required will depend on the type and volume of transactions.

Each transaction is entered on one line of either the Receipts page or the Payments page in date order. The column headings prompt you to enter key information – eg date, cheque number, payee, description, amount, category of transaction, etc. The columns are totalled at the end of each page or accounting period.

Analysis columns

These are what make the Bank Book such a useful record. These columns (numbered 1 to 9 in **Figure 4.1**) include the main categories of income and expenditure as identified in your Chart of Accounts and your budget. They allow you to sort and summarise transactions by budget category which in turn helps to compile financial reports quickly and easily.

Figure 4.1: Typical Bank Book layout

LEFT SIDE										RIGHT SIDE										
<i>Receipts of money into the bank</i>										<i>Payments out of the bank</i>										
Date/details	1	2	3	4	5	6	7	8	9	Date/details	1	2	3	4	5	6	7	8	9	

Bank reconciliation

The Bank Book should be checked with the bank's records – the bank statement – at least once a month, more frequently for very busy bank accounts. This is called the *bank reconciliation*.

*The purpose of a **bank reconciliation** is to make sure that the organisation's own records agree with the bank's records and to pick up any errors or omissions made by the bank or the organisation.*

A bank reconciliation involves taking the *closing bank statement balance* for a particular date and comparing it to the *closing Bank Book balance* for the same date. If there is a difference between these two closing balance figures, the difference must then be explained.








In practice, there will almost always be a difference because of timing delays, such as:

- ▶ Money paid into the bank which is not yet showing in the bank's records
- ▶ Cheques issued to a supplier but not yet banked by the supplier
- ▶ Bank charges and bank interest which get added to the bank statement by the bank periodically
- ▶ Errors either made by the bank or when recording entries in the Bank Book.

See Appendix 6 for a completed bank reconciliation form and Appendix 21 for a blank form to help you with this process.

Table 4.2 summarises the reconciliation process and actions to take when discrepancies are discovered.

Table 4.2 Bank Reconciliation

Item:	In Cash Book	On Bank Statement	Example	Action
Receipt	✓	✗	Cash received in the office, but not yet banked. Cash fraud?	 Monitor bank statement (all cash received must be banked)
Receipt	✗	✓	Bank interest received Donor grant transferred, no advice note sent	 Enter into the Cashbook
Payment	✓	✗	Cheque sent to supplier, not presented to the bank	 Monitor bank statement  Contact supplier if older than two months
Payment	✗	✓	Bank charges or bank interest paid	 Enter into the Cashbook
Cash Book Error	✓	✗	Omission or duplication of a transaction Figures entered incorrectly	 Correct the Cashbook
Bank Statement Error	✗	✓	Bank recording error Cheque fraud	 Contact the bank

Petty cash book

Petty cash records are kept in a similar way to the Bank Book records. As both sets of figures will eventually have to be combined to produce financial reports, it makes sense to set out the books in a consistent manner. A sample Petty Cash book can be seen in Appendix 5.

The Petty Cash Book can either be kept in a loose leaf or bound book format. It does not however, require more than one analysis column on the Receipts side because the only money that is paid into petty cash is the float reimbursement. The Petty Cash Book will also require fewer analysis columns for payments because petty cash will not (usually) be used to pay for larger items such as salaries, office rent, etc.


There are two ways of keeping petty cash:

- fixed float or *imprest* system
- variable or non-*imprest* system.

▷ Fixed float or imprest method

With the *imprest* system you have a fixed float of, say, \$50 and when the cash balance gets low, you top up the float by exactly the same amount that you have spent since the float was last reimbursed.

Example:

Receipts/vouchers for cash spent total:	\$34.60	
Cash remaining in cash box counted:	<u>\$15.40</u>	
TOTAL FLOAT	\$50.00	
Reimbursement cheque written for:	\$34.60	

An advantage of this system is that at any time you count the money plus vouchers in the tin, they should always add up to the fixed float amount. Also, it is much easier to incorporate petty cash spending into the accounts as the reimbursement cheque is entered in the analysed Bank Book.

See how the reimbursement cheque for the petty cash book in Appendix 5 has been written in to the Bank Book in Appendix 4. Look for cheque no. 13583 on 12/01.

▷ **Variable float or non-imprest method**

An alternative is to draw cash from the bank in round sums as required. If you use the non-imprest method you will need an extra column in your Bank Book headed 'petty cash withdrawn'.

When reconciling this float you will have to add up all the petty cash withdrawals since the last reconciliation and add on the cash balance brought forward to get a total of the cash float for the period. This total should then be the same as the total spent since the last reconciliation plus the cash left in the tin. A more complicated and time consuming process!

Full bookkeeping systems

Organisations requiring a full bookkeeping system use a series of *ledgers* (this just means books of account), depending on the activities of the organisation.

▷ **The General or Nominal Ledger**

This is a central record which pulls together basic bookkeeping information from the main working books of account (Bank Book, Petty Cash Book, Sales and Purchase Ledgers).



The General (or Nominal) Ledger is rather like a series of post boxes or 'pigeonholes' used to sort basic financial information. It has one page for each category of income, expenditure, assets and liabilities and information is 'posted' from the other accounting books into each relevant box. This sorting mechanism is especially useful when an organisation has several projects and different donors requiring different reports.

The General Ledger plays a central role in the double-entry bookkeeping system and is the basis for the *Trial Balance* (see below), the starting point for preparation of financial statements.

▷ **Other Ledgers**

Other elements in a full-bookkeeping system include:

- Sales ledger and sales day book (but only if you have sales)
- Purchase ledger and purchase day book
- Stock ledger
- Journal.

These, together with the Bank Book and Petty Cash Book are the day-to-day working accounts books. It is quite possible to set up a General Ledger without these additional ledgers; the choice will depend on the activities of your organisation.

The Journal is used to record unusual, one-off transactions which cannot be recorded easily in other books of accounts. These will include non-cash transactions (such as *depreciation* and donations-in-kind), adjustments and corrections.

A *journal entry* follows the rules of double entry and will always include entries to at least two accounts. For example, a donation-in-kind in the form of rent-free office space would be recorded as income under 'Donations' and expenditure under 'Office Rent'.

▷ **Wages Records**

Employers have a statutory duty to maintain records of all wages paid and deductions made. Failure to keep these records could result in a heavy fine. Be sure to familiarise yourselves with the arrangements of your own Department of Taxes and keep the latest tax deduction tables.

Larger organisations should also keep a separate Wages Book, which brings together all information on staff salaries and deductions. Wages Books can be purchased from stationery suppliers in a pre-printed format or are available as add-ons to accounting software packages.

QB/PSS Pte Ltd		Payment Period: 01-01-2009 - 31-01-2009			
Employee:	Emp. No.	Company ID	Pay Date		
John Tan			30-Jan-2009		
Description	Rate	Amount	Description	Amount	Year To Date Totals
Basic Salary		1,055.00	CPF Employee	291.00	Total Pay 1,055.00
Transport Allowance		400.00			Taxable Pay 1,055.00
					Tax Paid
Employer Contributions				This Period	
(Used / Available / Accrued)					
Holiday hours 0.00 / 0.00 / 0.00					
Personal hours 0.00 / 0.00 / 0.00					
Other 1 : 0.00 / 0.00 / 0.00					
Other 2 : 0.00 / 0.00 / 0.00					
John Tan					
				NET PAY 1,164.00	

What is a trial balance?

The *Trial Balance* (or what accountants often refer to as the 'TB') is simply an arithmetical check on the accounts maintained using the Double Entry method of accounting. It is also the basis for the preparation of accruals-based financial statements.

At the end of an accounting period – usually monthly – all the accounts categories having a balance in the General Ledger are listed on a summary sheet to form a Trial Balance. Providing no errors have crept in during the recording and summarising stages, the total of debit balances on the list will equal the total of the credit balances.

Figure 4.2 illustrates which figures from the Trial Balance end up where in the annual financial statements.

Figure 4.2: Trial Balance leading to financial statements

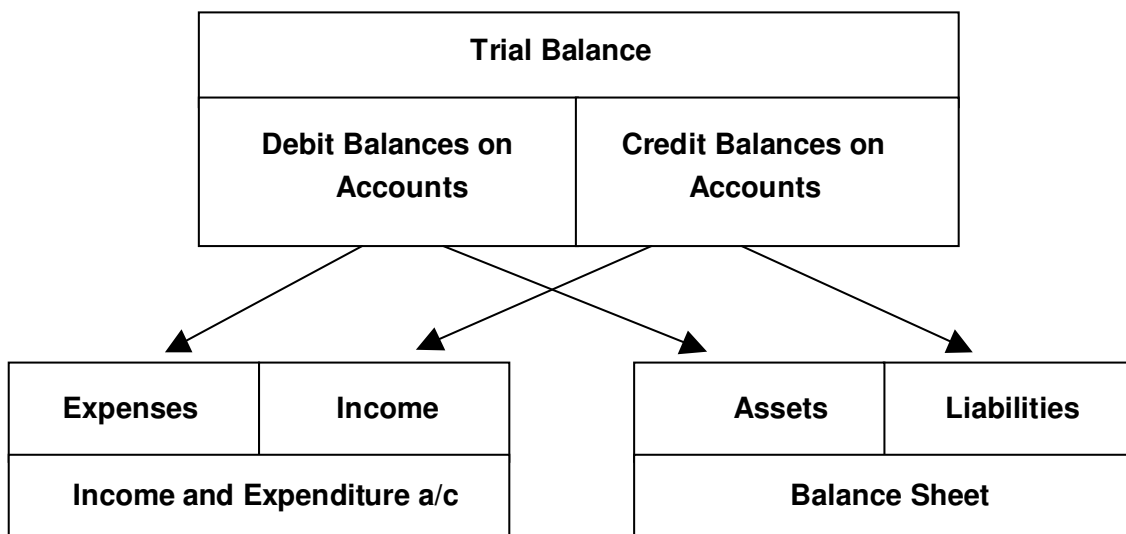
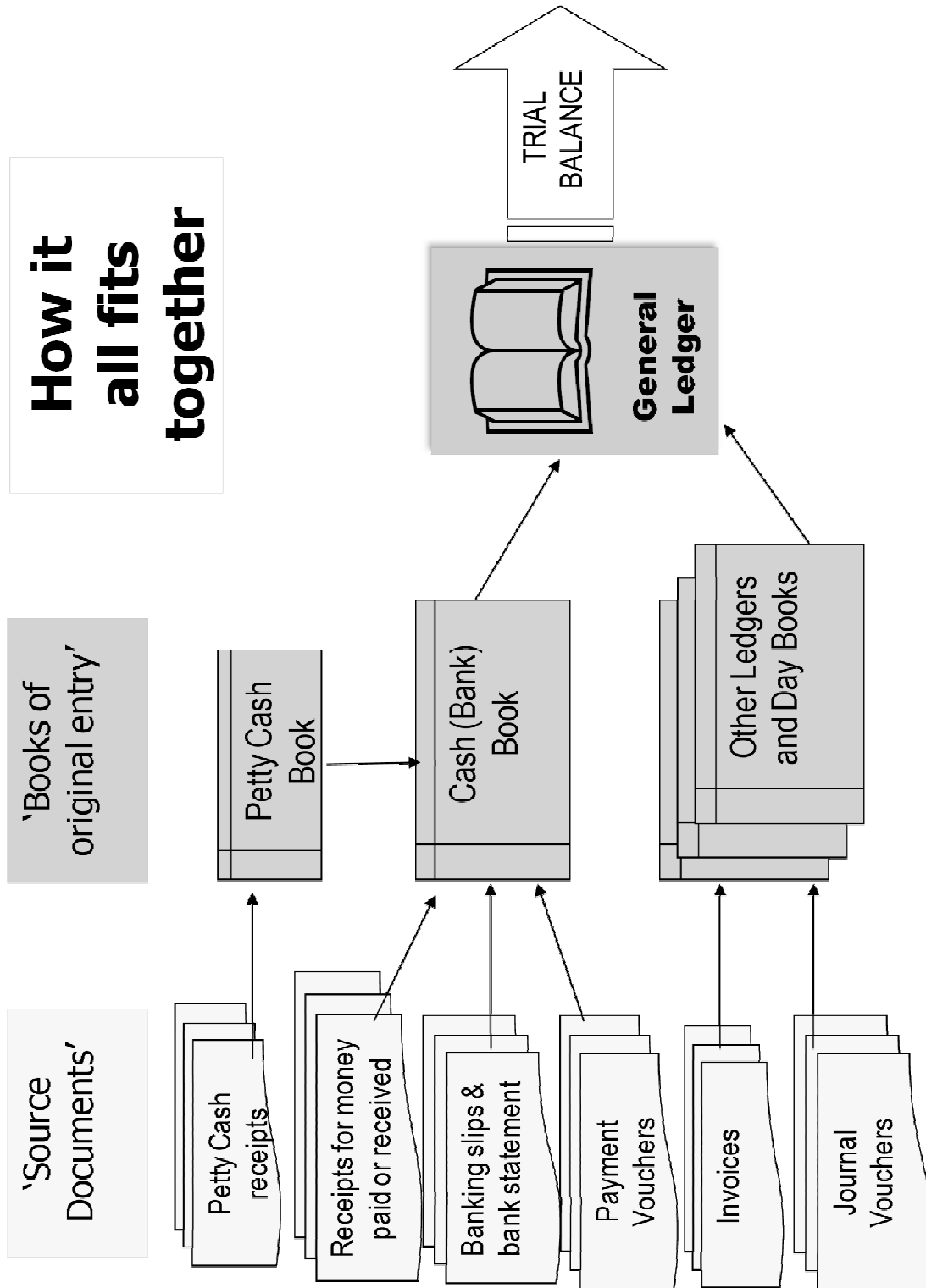


Figure 4.3 shows how the Trial Balance is the final stage of the accounting process – the result of recording, classifying and summarising the many different transactions that take place in an organisation.

Figure 4.3: How it all fits together



What are financial statements?

Financial statements are a product of the financial accounting process. They are a summary of all the transactions for a specified period and show the financial position of an organisation.

Financial statements can cover any period of time – for example, a month, a quarter or one year. The annual financial statements are used as the basis for an annual external audit.

The simplest of all financial statements is the Receipts and Payments report. This is a summary of the Cashbook (see Appendix 7) and includes details of cash balances at the start and end of the reporting period.

The other two main reports relevant to NGOs are:

- ▶ The Income and Expenditure report
- ▶ The Balance Sheet.

Together these contain a lot of useful information. In the chapter on Financial Reports, we look at how to analyse the information in the financial statements.

The Income and Expenditure report

In the not-for-profit sector, the equivalent of the Profit and Loss Account is the Income and Expenditure Report (or Account). See Appendix 8 for an example.

It is either produced from a *Trial Balance* (as described above) where the accruals-based system of accounting is used; or it is based on a Receipts and Payments account with adjustments for 'loose ends'.

It records as a summary:

- ▶ all categories of income and expenditure which belong to that year;
- ▶ all income not yet received but belonging to that financial year; and
- ▶ all payments not yet paid but belonging to that financial year.

Income items usually appear first in a list down the page, followed by the summary of expenditure items. The difference between total income and total expenditure, often called the *outcome*, appears on the bottom line and is expressed either as:

- ▶ 'excess of income over expenditure' where there is a surplus; or
- ▶ 'excess of expenditure over income' where there is a deficit.

This excess figure is then included on the Balance Sheet under the heading Accumulated Funds. Note that there should be an accompanying Balance Sheet for the same date that the Income and Expenditure Account is prepared at.

The Balance Sheet



The purpose of a Balance Sheet is to assess the financial position – or 'net worth' – of an organisation at a given date. If the organisation ceased operating at that date and all of its assets were converted into cash, and all of its debts were paid off, then what was left over would be what the organisation was 'worth'. See Appendix 9.

*The balance sheet is a list of all the assets and liabilities on **one particular date** and provides a 'snapshot' of the financial position of an organisation.*

▶ Components of a balance sheet

The Balance Sheet is in two parts. One part records all balances on assets accounts, the other records all balances on liabilities accounts plus the income and expenditure account balance.

The Balance Sheet will either be presented with the Assets listed on the left and the Liabilities presented on the right of the page, or more commonly nowadays, listed down the page with Assets presented first then Liabilities deducted from them.

Assets

Assets are classified into two parts:

- ▶ *Fixed assets* – tangible long-term assets such as buildings, equipment and vehicles, having a value lasting more than one year. Fixed assets are shown on the balance sheet after an allowance for wear and tear – or *depreciation* – has been made (see an explanation of what depreciation is later in this chapter).
- ▶ *Current assets* - the more *liquid* assets such as cash in the bank, payments made in advance and stocks. These, in theory at least, can be converted into cash within 12 months.

The term *liquidity* is used to describe how easy or otherwise assets can be turned into cash. So money held in a bank account is considered to be very liquid, while money tied up in a building or a vehicle is clearly not liquid at all.

Liabilities

Liabilities are also divided into short and long-term liabilities:

- ▶ *Current or short term liabilities* – including outstanding payments, and short-term borrowings – ie those having to be paid within 12 months.
- ▶ *Long-term liabilities* – such as loans that need to be paid after 12 months. However, for NGOs such borrowings are not common.

Working capital

This is also known as *net current assets*, that is, the short-term assets remaining if all immediate debts were paid off (ie Total Current Assets less Total Current Liabilities). These are the funds that the organisation has available as a cushion or safety net for running the organisation's operations in the short term.

Accumulated funds

Accumulated Funds represent the true worth of the organisation – in the form of capital and/or cash reserves which have been built up from surpluses in previous years.

Accumulated Funds are classified as liabilities. In an NGO the funds are held in trust for the organisation in pursuance of its objectives. If the NGO should close down, any funds remaining after all the debts were paid off would have to either be returned to the original donors (practically quite difficult to do) or passed to another NGO with similar objectives.

Table 4.3 summarises the main components and typical layout of a balance sheet (but do note that terminology does vary from country to country).

Table 4.3 Components of a Balance Sheet

Component:	Description:
FIXED ASSETS:	The less liquid assets – those having a significant value lasting more than one year.
CURRENT ASSETS:	The more liquid assets – can usually be converted into cash within one year.
Cash	Funds held in the bank and as cash.
Debtors	Money owed to the organisation such as loans and unpaid sales invoices.
Prepayments	Value of items paid for in advance such as insurance premiums or equipment rental.
Grants Due	Grants owed to the organisation for projects already started in the reporting period.
Stocks	The value of raw materials or supplies such as publications or T-shirts for sale.
CURRENT LIABILITIES:	Those paid within one year of the year-end.
Creditors & Accruals	Money owed by the organisation at the year-end such as bank overdrafts, unpaid bills.
Grants in Advance	Grants received for a particular purpose but not yet spent, so carried forward to the next financial year.
OTHER LIABILITIES:	Longer term commitments and General Funds.
Reserves	Money set aside for specific purposes, eg replacing equipment. Although designated funds, they form part of the organisation's General Funds.
Accumulated Funds	Accumulated surplus of income over expenditure achieved since the organisation opened.

What is depreciation?

Capital expenditure, such as that on buildings, computer equipment and vehicles, is expenditure which covers more than one accounting period and retains some value to the organisation.

Depreciation is how we account for the cost of wear and tear on fixed assets. It allows the original cost of the item to be spread over its *useful life*. The amount calculated for depreciation is shown as an expense in the accounts and deducted from the previous value of the asset. As a non-cash transaction, depreciation is entered in the accounts using a *journal entry*.

There are several methods used to calculate the cost of depreciating assets, but the two most commonly used are: Straight Line method and Reducing Balance method.

In the **Straight Line method** the amount to be depreciated is spread evenly over a pre-arranged period. For example, a computer purchased for USD 1,000 expected to last for 4 years will be depreciated at USD 250 per year for 4 years. At the end of 4 years the computer will have a zero *net book value* – ie it will have no value as far as the accounts are concerned. In reality, it may have a second hand market value.

The Reducing Balance method fixes a percentage reduction in value so that the item loses more value in the earlier years.

Example:

A car is purchased for USD 10,000. It is decided to depreciate it over 4 years – ie by 25% per year. **Table 4.4** shows how the equipment is depreciated over its useful life (all figures are rounded to nearest dollar).

Table 4.4: Depreciation schedule

Year	Depreciation calculation	Net Book Value
Year 1	$\$10,000 \times 25\% = \$2,500$	\$7,500
Year 2	$\$7,500 \times 25\% = \$1,875$	\$5,625
Year 3	$\$5,625 \times 25\% = \$1,406$	\$4,219
Year 4	$\$4,219 \times 25\% = \$1,055$	\$3,164

Note that when using this method, the asset is never completely written off. At the end of Year 4 it will still have a *residual value*. In this example, the car will be valued in the accounts at USD 3,164. This recognises that the item may have a resale value when it comes to replacing it.

Accounting for shared costs

Some costs cover more than one project or activity. In this case, it is important to identify which activities the costs should be charged to. There are two types of shared costs:

- ▶ Those that are truly **direct costs** and belong to two or more projects
- ▶ Those that are truly **indirect costs** that must be shared across all projects in the organisation.

For truly direct project costs – eg the cost of using a shared vehicle for project activities – these must be **allocated** according to actual use to the relevant project cost centre. It is best to make the allocation when the transaction is entered into the accounting records.

For truly indirect costs – ie central support costs such as the central office running costs or the annual audit fee – these must be **apportioned** in a fair and justifiable way across all cost centres.

Central support costs are often shared out between cost centres in a pre-arranged ratio. This is more commonly entered in the accounting records at the end of the reporting period by making one adjustment entry.

The decision on how to apportion costs between cost centres can be based on different criteria according to what is known as the *cost driver*, eg:

- Full-time equivalent (FTE) staff
- Number of cost centres
- Size of each project budget
- Project staff costs
- Amount of space used by a department.

There is no hard and fast rule for apportioning central support costs to projects. It should however be logical, transparent and consistently applied.

Chapter**5**

Financial Reports

Making sense of the numbers

This chapter:

- Identifies who needs financial reports and why
- Describes the different types of financial report for programme management and stakeholder accountability
- Shows how to interpret financial statements using trend and ratio analysis
- Explains how to use the information in management accounts
- Outlines the important features of donor reports
- Outlines reasons for reporting to beneficiaries.

Who needs financial reports?

As we have seen, one of the main reasons for keeping accounting records is to access information about how the organisation is being run. Having set up accounting systems and budgets, the next step is to produce financial reports to report on and monitor the organisation's financial affairs.

Financial reports are needed primarily by those responsible for managing the organisation and by current and potential donor agencies.

Those responsible for financial management of an NGO also need to 'give an account' of their stewardship to a wide range of stakeholders.

The main reporting outputs include:

- ▶ During the financial year accounting information is summarised and turned into *Management Accounts* for internal monitoring of progress against the budget.
- ▶ At the end of the year, the *Annual Accounts* (ie the Balance Sheet and Income and Expenditure Account) are produced to report on the outcome to external stakeholders.
- ▶ At intervals during the year, an NGO will also be required to complete special *progress reports to donor agencies*.

Providing the accounts are kept in a suitable way and have been checked for accuracy, putting together a financial report is not as time-consuming as you might think.

Financial reports must be timely, accurate and relevant.

Table 5.1 summarises the main users of NGO reports and why they need this information. From this list, we can see that there are many different users of financial reports – both internal and external stakeholders – using financial information for management and accountability purposes.

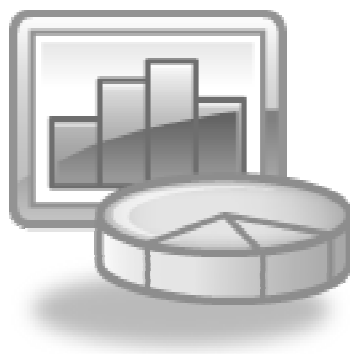


Table 5.1: Who needs financial information?

Stakeholder	Why do they need it?
<i>Project staff</i>	To know how much money and resources are available for their projects and what has been spent so far.
<i>Managers</i>	To keep an eye on how project funds are being used, especially compared to the original plans. To help plan for the future.
<i>Finance staff</i>	To make sure that there is enough money in the bank to buy the things the NGO needs to run its programmes.
<i>Board of Trustees</i>	To keep an eye on how resources are being used to achieve the NGO's objectives.
<i>Donors</i>	To make sure their grants are being used as agreed and that the project's objectives are fulfilled. To consider whether to support an organisation in the future.
<i>Government departments</i>	To make sure that the NGO pays any taxes due and that it does not abuse its status as a 'not for profit' organisation.
<i>Project beneficiaries</i>	To know what it costs to provide the services they are benefiting from and to decide if this is good value for their community.
<i>The general public</i>	To know what the NGO raises and spends during the year and what the money is used for.

It is not surprising, therefore that we need different kinds of reports for different users, as summarised in **Table 5.2**.

Table 5.2: Different Reports for Different Users

	Programme management	Stakeholder accountability
Internal	Budget Monitoring report Cashflow report	Board report
External	Donor progress report (financial and narrative)	Donor report Audited Financial Statements Annual Report Reports to beneficiaries

What are the Annual Accounts?

We return to the Balance Sheet and Income and Expenditure Account. These annual financial statements show in summarised form:

- ▶ where money has come from;
- ▶ for what purpose it has been received;
- ▶ how it has been spent; and
- ▶ what the outcomes of operations are.

They should be prepared as soon as possible after the end of the financial year – for example within six weeks – and made ready for the external audit. The organisation's constitution will often specify the deadline for presentation of accounts to the members.

The Annual Accounts, accompanied by the Annual Report, form the main publicity and information package available and will be of interest to many users. For this reason, the annual accounts should:

- ▶ present the organisation in the best possible light;
- ▶ help to promote its work;
- ▶ meet the needs of those using the accounts; and
- ▶ meet the requirements of auditors.

If an NGO's annual accounts show large accumulated funds, it may give the impression that the organisation is well resourced and donors may be less inclined to give support to new initiatives.

There are however, good reasons why an organisation will have cash reserves – for example, funds put aside to replace equipment or a building appeal fund. An explanation must be provided to reassure potential donors that their support really is needed.

Interpreting financial statements

The aim when reviewing an NGO's financial reports is to assess the health of the organisation and to check that funds are being used as intended – ie to achieve organisation objectives.

Numbers taken on their own don't tell us very much. We need something to measure them against – such as comparing them to similar organisations, standard measures or targets, or previous years' accounts.

When we interpret the Balance Sheet and Income and Expenditure statement we use two types of financial analysis:

- ▶ *Trend analysis* which asks: How are we doing compared with the last period?
- ▶ *Ratio Analysis* which provides a means of interpreting and comparing financial results.

▷ **Trend Analysis**

Trend analysis takes at least two sets of figures compiled using the same accounting techniques and showing information for two consecutive periods, usually year on year. By comparing the figures it may be possible to detect trends and use this information to forecast future trends or set targets.

Trend analysis is more meaningful if also combined with financial ratio analysis.

▷ **Financial Ratio Analysis**

Financial *Ratio Analysis* is used widely in business to assess the profitability and efficiency of companies. Ratio analysis in the not-for-profit sector is less common, but is nonetheless very useful if adapted for the sector.

Ratios allow comparison of reports expressed in different currencies and between organisations of different scale by converting them into a like measure. Donor agencies often use this technique when assessing performance, especially to compare relative costs – such as central administration – between similar organisations or projects.

The importance of ratios is in the clues they may provide to what is going on, not as absolute measures of good or bad performance. Ratio analysis helps Board members and managers answer three important questions:

- ▶ *Financial sustainability* – will our organisation have the money it needs to continue serving people tomorrow as well as today?
- ▶ *Efficiency* – does our organisation serve as many people as possible with its resources for the lowest possible cost?
- ▶ *Effectiveness* – is our organisation doing a responsible job of managing its money?

Analysing the Income and Expenditure Account

You can use ratios on the Income and Expenditure report by converting each line item into a percentage of total income (that means to divide each item by total income and multiply by 100). This gives a guide as to the relative importance of different areas on the statement. For example, the relative costs of administration versus direct project costs. This is useful for drawing attention to the important areas and away from insignificant issues.

This calculation will also give an indication of the level of *donor dependency* – by dividing the total of donor grants by total income and multiply by 100. If your financing strategy is leading you towards less dependence on external aid, the dependency ratio will help to set and monitor your target level.

A further level of analysis can be obtained by comparing the ratios for the current and previous years' figures to detect trends.

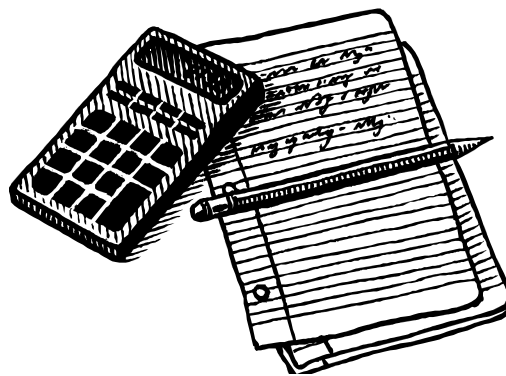
Analysing the Balance Sheet

Again try dividing everything by the total income figure shown on the accompanying Income and Expenditure statement to give an indication of the relative importance of items on the Balance Sheet.

- ▶ A *Survival Ratio* can be calculated by dividing general reserves, sometimes called 'free reserves' (that's the part of the Accumulated Funds which are unrestricted, not held as capital and for general use) by total income (from the accompanying Income and Expenditure statement).

If you then multiply the resulting figure by 365 this will give an indication, in days, of how long the organisation could survive in the coming year if income dried up and levels of activity remain the same. Of course, this is a highly hypothetical scenario as in practice the organisation would contract operations if its income was drastically reduced.

- ▶ The *Acid Test* or *Quick Ratio* asks the question: *Can we pay off our debts now?* It divides Current Assets less the less 'liquid' assets such as stocks and prepayments (in other words, short term debtors and cash balances only) by Current Liabilities (short-term creditors and overdrafts). The resulting ratio should ideally be in the range of 1:1. A ratio of 1:1 suggests an organisation has sufficient cash to pay its immediate debts.
- ▶ The *Current Ratio* asks the question: *Can we pay off our debts within 12 months?* It divides total Current Assets by total Current Liabilities to find a further test of an organisation's (longer term) liquidity. A result of 2:1 is considered satisfactory. Again, convert the figures for both years shown on the Balance Sheet to detect significant trends.



Ratio analysis: quick reference formulas



Ratio:	Formula:
<p><i>1. Donor Dependency:</i></p> <p>Expressed as %</p>	$\frac{\text{TOTAL DONOR INCOME}}{\text{TOTAL INCOME}} \times 100$
<p><i>2. Income Utilisation:</i></p> <p>Expressed as %</p>	$\frac{\text{EXPENDITURE ITEM}}{\text{TOTAL INCOME}} \times 100$
<p><i>3. Survival Ratio:</i></p> <p>Expressed in weeks or days</p>	$\frac{\text{GENERAL RESERVES}^*}{\text{TOTAL INCOME}} \times 52 \text{ or } \times 365$ <p>* these are un-restricted funds for general purposes under Accumulated Funds. Alternatively use Net Current Assets.</p>
<p><i>4. Acid Test or Liquidity Ratio:</i></p> <p>Expressed as a ratio n:n*</p>	$\frac{\text{CURRENT ASSETS} - \text{PREPAYMENTS}}{\text{CURRENT LIABILITIES}}$ <p>*Answer should be in the range of 0.8 to 1.2:1. A result of 1 to 1 means there are sufficient funds to cover immediate debts.</p>
<p><i>5. Current Ratio:</i></p> <p>Expressed as a ratio n:n*</p>	$\frac{\text{CURRENT ASSETS} \dots}{\text{CURRENT LIABILITIES}}$ <p>*A result of 2:1 is considered satisfactory – enough to pay off the debts within 12 months.</p>

Management reporting

Managers need financial information throughout the financial year to monitor project progress and manage budgets effectively. If reports are produced on a timely basis, any problems can be addressed early on and action taken to put things right.

▷ Which reports?

The main reports that will be useful to managers are the:

- Cashflow Report
- Budget Monitoring Report
- Forecast Report.

▷ How often?

Ideally, the management accounts should be produced every month and within a few days of the end of the accounting period (any later and the information becomes out of date and less useful). The minimum frequency for management reports is once a quarter.

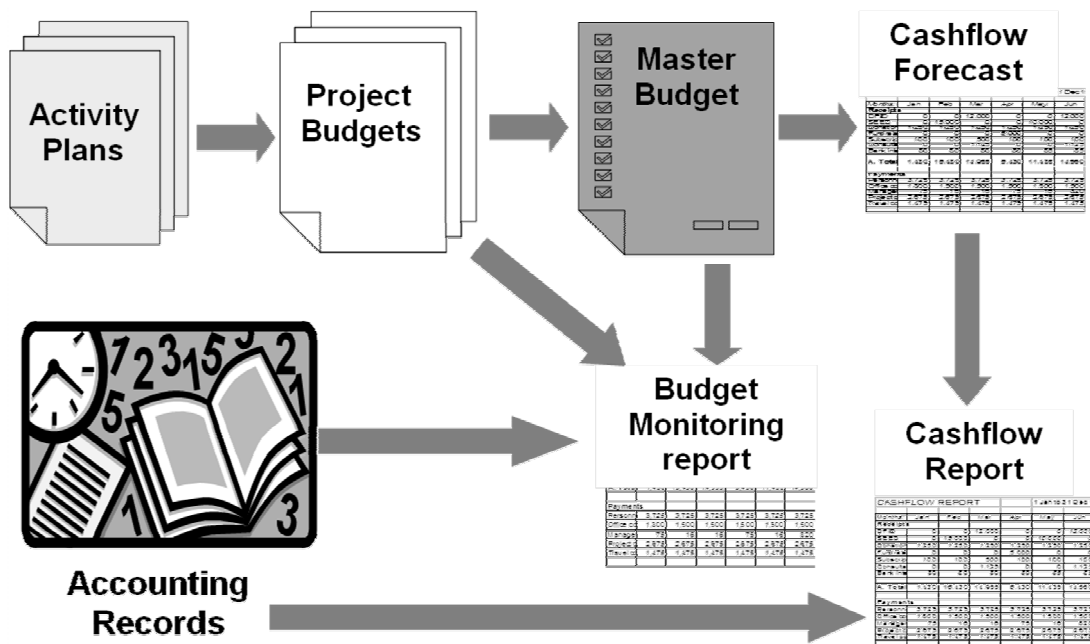
Since the reports are produced so that managers can take decisions about the future management of the organisation, the meetings of the governing body should be set to coincide with the Management Accounts cycle so that the information is still timely.

▷ Where do the figures come from?

Figure 5.1 shows how the financial planning and financial accounting processes come together to produce management reports.

The reports are compiled by taking summarised figures from the main books of account and the budget for the same period. Providing the accounts and budgets have been set up to use the same Chart of Accounts codes and descriptions, this should be a very quick process and no additional work is required.

Figure 5.1: Management Reporting Flow Chart



The cashflow report

The cashflow report is the cashflow forecast updated with actual receipts and payments each month, plus any new information about future spending or fund-raising plans. It allows managers to predict periods when cash balances are likely to be insufficient to meet commitments and make the most of any surplus funds during the year.

Where cash resources are limited, it is important to monitor for the ability to pay creditors on time and to take action when there are early warnings of potential financial difficulty. Options available for managing cashflow include:

- Exercise good credit control – chase debtors for prompt payment
- Review grant schedules– encourage payment in advance rather than in arrears
- Bank all money received daily

- Request special payment terms from major suppliers (and stick to them)
- Pay certain overheads by instalment – eg insurance premiums
- Prioritise major payments
- Defer action that will lead to additional expenditure – eg recruitment, taking on leases, purchasing equipment
- Negotiate an overdraft facility as short term – but expensive – remedy.

The budget monitoring report

This report has several different names (eg Budget Compared to Actual, Budget Variance and Budget Versus Actual) and can take different forms. But as the titles suggest, the reports take the *budget* for the reporting period (preferably the *phased* budget) and compares that with the *actual* income and expenditure for the same period. See a sample report in Appendix 14.

The difference between the budget and the actual result is known as the *variance* and this can tell us a lot about what is happening in a project. Variance figures will be positive, negative or zero, depending on what has happened. Often, budget monitoring reports also show variances as percentages.

For example, the amount of the budget, or grant, used up so far is known as the budget, or grant, *utilisation ratio* or the *burn rate* (see below for how to calculate percentages.)

We can see the *Plan-Do-Review* process in action in Rudi's evening out. He set out his plans for the evening and what each activity would cost (*PLAN*) and then went out with his friends (*DO*). But it did not all go as planned and his actual spending varied as a result.

If we look at the variance column in Rudi's Budget Compared to Actual Report (REVIEW) in **Table 5.3**, it is possible to see the story behind the figures.

Table 5.3 Rudi's Budget Compared to Actual Report

A	B	C	D	E
Budget Item	Budget \$	Actually Spent \$	Variance \$	Budget Utilisation %
Travel	1.50	0.75	0.75	50%
Food	3.50	3.00	0.50	86%
Entrance Fee	3.00	4.00	(1.00)	133%
TOTAL	8.00	7.75	0.25	97%

For example, we can see the effect of Rudi arriving too late to buy the cheaper match tickets: he spent USD 1.00 (or 33%) more than planned on the entrance fee. And because he then didn't have enough money left to buy his bus fare back home (he got a free lift home instead) he under-spent on his Travel budget, using up only 50% of that line.

When we review the figures, and in particular the variance column, it helps us to understand why we did not fulfil the plans and build in that learning to the next cycle.

In Rudi's case, he learnt that he needs to get to the match earlier to buy a cheap ticket (and his mother learnt that it might be a good idea to give Rudi a bit extra for emergencies to make sure he gets home safely.)

▷ How to Calculate Percentages

The budget variance percentage can be calculated in one of two ways. You may use either method but it is important to be consistent:

$$\frac{\text{Budget variance \$}}{\text{Budget for period \$}} \times 100$$

Under-spends will result in a positive % and over-spends will produce a negative %

$$\frac{\text{Actual for period \$}}{\text{Budget for period \$}} \times 100$$

Under-spends will result in a figure less than 100% and over-spends will be more than 100%

To calculate the percentage of the budget utilised (the 'Burn Rate'):

$$\frac{\text{Actual spend \$}}{\text{Total Budget \$}} \times 100$$

A resulting figure of over 100% means the total project budget is overspent.

Forecast reports

Forecast reports are especially helpful from the second quarter onwards for predicting the outcome for the year and helping with the budget process for the next year.

See Appendix 16 for a sample Budget Forecast report.

With a fair degree of accuracy you should be able to tell whether the organisation is going to make a surplus or deficit. This is all-important in your relationship with donors:

- ▶ A large deficit can make the organisation appear to be out of control and poorly managed
- ▶ A small deficit can demonstrate a great need and even a sense of good housekeeping
- ▶ A small surplus can suggest good management
- ▶ A large surplus can indicate a failure to meet needs or inexperience in budgeting.

There are various ways of reducing a surplus at year-end, including purchasing new or replacement equipment, ordering stocks of stationery and office supplies. There is very little that can be done about a large deficit except to provide an early warning and a very good explanation to stakeholders and hope that there are sufficient reserves to cover it.

Analysing budget monitoring reports

Budget monitoring reports help to identify problem areas and provide an early warning when key targets are not being met. They may also help detect fraud and errors in the accounts.

▷ What should we look for?

Key areas to focus on when you pick up a Budget Monitoring Report include:

- ▶ What is the **accounting basis** of the report – is it compiled on the cash or accruals basis? Are there outstanding commitments (see note below)? If so, how does that affect the results?
- ▶ What does the **bottom line** tell you? Overall, is the budget over-spending or under-spending and is it significant at this time in the life of the project or programme? An outcome of plus or minus 10% from the budget is considered to be a reasonable variance.
- ▶ What is the result within budget **'family groups'** (ie budget items in the same area, such as Staff costs or Admin costs)? Is spending overall on target across the group? Again, if the result is within plus or minus 10% from the budget, that is generally acceptable.
- ▶ Look for unusual or **unexpected results** - could this be an indication of a mis-coding or abuse?
- ▶ Are there any **significant variances** in the individual line items? Are the reasons for the differences explained? For example, the Subsistence Expenses budget is substantially and unexpectedly over-spent. Do not just concentrate on over-spending – remember that under-spending is just as critical for an NGO.
- ▶ Do **linked budget line items** (eg activity-related costs) tell the same story or do they contradict? For example, the project materials budget is under-spent suggesting delayed activities but the vehicle running costs are high, which is not logical.
- ▶ Do the budget report figures tell the same story as the **narrative** project report?

Sometimes the figures just do not look right: so trust your instincts and follow up your concerns.

A note on Commitments

Commitments refer to (significant) expenses which have been incurred for a project or organisation in a particular period but haven't yet been accounted for or belong to a future reporting period. Commitments usually occur in a cash accounting system or where there are time delays in reporting all expenditure, eg from field offices.

If significant commitments are not taken into account when compiling budget monitoring reports, the results may under- or over-count the true level of expenditure and give a distorted view when compared to the budget.

It is important to be aware of outstanding commitments when monitoring a budget or grant because decisions are based on the reported variances and balances available. It could appear that there is more (or less) money available to spend than there really is.

Here are two solutions if figures exclude outstanding commitments:

- ▶ Include an extra column in the budget monitoring report to record known commitments
- ▶ Add a note about known commitments in the comments column or covering note.

Variance analysis techniques

Variance analysis involves looking at variations from budget to identify significant or unusual variances and what has caused them to happen. This helps us plan the next phase. The first task is to identify whether the variance is a positive or negative one.

Positive variances are sometimes described as *favourable* (ie generally good news) and negative ones as *adverse* (ie generally bad news). A positive variance happens when:

- ▶ actual income is higher than the budgeted amount, or
- ▶ actual spending is lower than budgeted.

However, note that a budget under-spend is not always 'good news' for an NGO as this could be because activities are not on target and this may be a cause for concern for the donor.

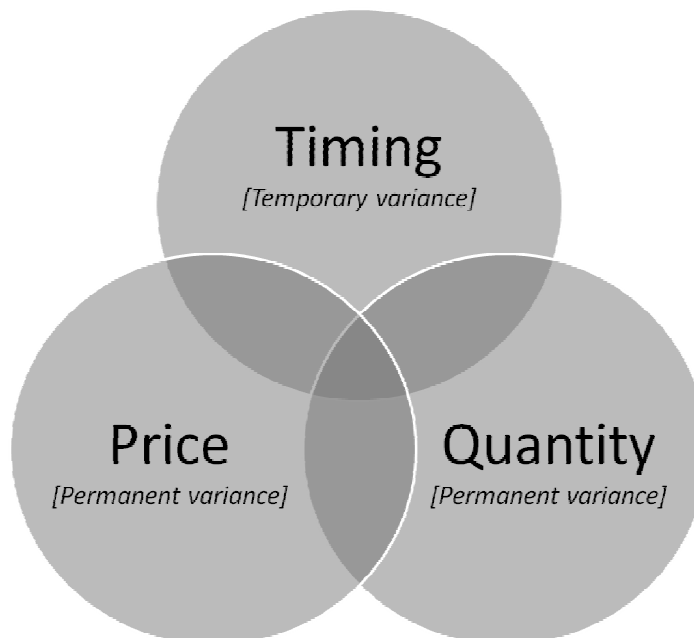
A negative variance happens when:

- ▶ actual income is lower than the budgeted amount, or
- ▶ actual spending is higher than budgeted.

The next step is to understand what has caused the variance to happen. In all cases, a variance represents a change from the original plan but what lies behind it? Generally, we can say that variances will be the result of a change in one or more of:

- ▶ the **timing** of the activity
- ▶ the actual **price** achieved or
- ▶ the actual **quantity** of goods or services taken.

Figure 5.2: What causes variances?



Sometimes a variance may be due to an error in the figures, for instance a mis-coding in the accounting records (which is effectively a change in quantity compared to the plan).

We can classify variances using the three criteria in **Figure 5.2** to highlight if the variance is temporary or permanent – will the variance continue or will it work through the system over time?

Example of a Temporary Variance

The project plans to purchase a vehicle in month 1 but it is held up at the port by Customs. The budget monitoring report will therefore show a big positive variance on the Vehicles line (because the budget has not been used yet). By month 2 the vehicle arrives and is purchased – just a bit later than planned.

The budget monitoring report will no longer show a zero spend on vehicles and the previous large variance will be gone as it was a temporary variance due to a timing issue.

The only action required in this case is to chase up Customs to make sure the vehicle arrives so it can be used for the programme as planned.

Example of a Permanent Variance

The invoice for the vehicle is paid in month 3. The price of the vehicle has increased by 10% due to a fluctuation in the exchange rate.

The budget monitoring report for month 3 now shows a negative variance on the vehicles line equal to the difference between the budgeted price and the actual, higher price paid. This is a *permanent* variance caused by a change of price. A decision has to be made on how to fund the additional 10% on the cost of the vehicle.

Temporary variances

Variances caused by a change in the planned timing of an activity (eg due to delays or rescheduling) are described as *temporary* variances because they will most likely work themselves out during the course of the year. These should be monitored and managed internally, and are generally less of a concern.

Permanent variances

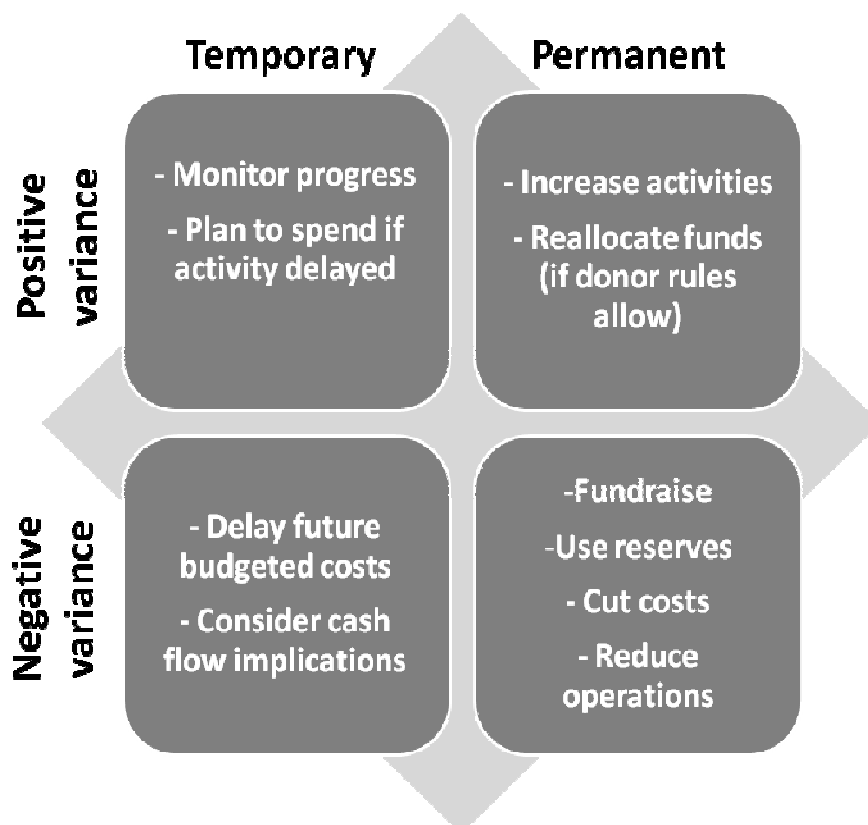
Variances caused by changes in the price or quantity of particular budgeted items fall into the *permanent* variances category because once this has happened, there is no going back. The only way to recover the situation is to make an action plan, eg to reduce spending on future items where lines are overspending or increase activity levels where there are savings.

Permanent variances are therefore generally more serious and management attention and corrective action is required to get back on track.

Action planning

Having analysed the figures in management reports, it is then important to work out appropriate corrective action, if needed. **Figure 5.3** summarises the actions open to managers to take on variances, once analysed using the classifications systems described above.

Figure 5.3: Action to take on budget variances



Deciding on the action to take, will depend on many factors including:

- ▶ knowledge of the project – where it is now and what the activity plans are for the next period
- ▶ awareness of external factors – eg inflationary trends, dependence on other programmes meeting their targets
- ▶ how serious the variance is
- ▶ how controllable, or otherwise, the budget items are
- ▶ what the impact would be to take no action
- ▶ donor rules and conditions.

It is useful to use a *Budget Management Action Planner* table (see **Table 5.4**) to help manage and control your budget. It can be used to discuss action plans with the project team and to monitor progress of the action plan.

Table 5.4: Budget Management Action Planner Format

Budget Management – Action Planner					
1	2	3	4	5	6
Line item	Variance % or £/\$	Var. Type	Controllable?	Impact on project and grant if not corrected	Action required / by
Smile Trust Grant	(\$12,500) 100%	Temp.	Yes	The delay is causing project delays too as we cannot buy vehicle	CEO to contact donor and explain this is causing project delays.
Salaries	\$2,000	Perm't	Yes	Under spend due to vacant post. This is now filled but project activities delayed which could cause problems with donor.	Contact donor to explain why there are delays and request use of under-spend to hire additional staff for a short period to help catch up

Table 5.5: How to use the Budget Management Action Planner

Column heading	What it means
<i>1 Line item description</i>	The budget line that requires some corrective action.
<i>2 Variance % or monetary value</i>	Include items that exceed +/- 10% variation from the budget and which represent a significant sum.
<i>3 Variance Type</i>	Permanent or temporary? Remember that temporary variances will work their way through the system but very large ones might still have an impact, eg on cashflow.
<i>4 Controllable?</i>	To what extent can you control use of the budget, eg to restrict its use or make savings if over-spent or stimulate its use if under-spent.
<i>5 Impact on project & grant management if not corrected</i>	eg Cash flow, achieving targets, meeting timeframes, allowable costs.
<i>6 Action required/by</i>	What should be done (and by who) to minimise the impact and get the project back on target and/or to meet donor requirements? Eg budget reforecast or adjustments; advise donor of delays or request 'no-cost' extensions; request unrestricted funds to cover over-spends; change activity plans; put efforts into reducing costs or stimulate spending; etc.

Reporting to donors

It is worth remembering that donor agencies are themselves accountable to stakeholders (trustees, government, tax-payers, etc.) and they rely on you to provide them with the information they need.

▷ **Accountability**

Financial accountability requires that you demonstrate to the donor that their funds have been used for the purpose for which they were intended. The reference point is the original funding application and guidelines are usually provided with the confirmation of grant aid and the contract or agreement signed by both parties.

It is important to comply with the conditions and meet reporting deadlines to establish credibility and encourage confidence, and to make sure your grant arrives on time.

▷ **Terms and conditions of grant aid**

It is important always to check what you have agreed to do as part of the agreement for funding from each of your donors. Conditions imposed by donors vary enormously but can include:

- ▶ *Progress reports* – frequency, format and style of reports, usually quarterly to coincide with release of grant instalments.
- ▶ *Scope and designation of funds* – what funds may, or may not, be used for; whether funds can be carried forward from one financial year to the next.
- ▶ *Administrative overheads* – the specific items that are allowable or excluded, or a percentage limit based on the total grant.
- ▶ *Budget line items* – specific budget headings/account classifications which correspond with the original grant application.
- ▶ *Virement policy* – ie permission (or otherwise) to transfer surpluses in the budget from one budget heading to another, and within what limits.
- ▶ *Accounting method* – Accruals or Cash accounting.
- ▶ *Bank accounts and interest* – separate bank accounts are required by some donors and/or they do not allow you to keep any interest earned on sums invested.
- ▶ *Depreciation policy* – how to treat fixed assets purchased with a grant.
- ▶ *External Audit* – some donors require a separate external audit.

▷ **The donor report**

Donors require that an NGO is able to demonstrate financial soundness before granting the release of funds. This is why the donor report is so important.

In most cases the report will include a budget compared to actual summary, accompanied by a narrative report on the activities being undertaken. See Appendix 15 for a sample donor report.

Where there are several donors it is important to set up the accounting systems so that the information required by the donor agency can be easily retrieved. Otherwise the organisation will be involved in a tedious information gathering exercise every time a report is required. The use of Cost Centres is particularly useful here.

When putting together a report to donors do:

- ▶ meet reporting deadlines (or request an extension)
- ▶ produce accurate and verifiable figures
- ▶ not conceal under-spends or over-spends
- ▶ explain any significant variations
- ▶ keep the donor informed of any potential problems.

Finally, bear in mind that donors have a lot of experience of working with groups like your own; they will almost always respond positively to requests for advice.

Presenting financial reports

We spend a lot of effort when preparing reports so it is important that they are used and not just put to one side. So do spend some time thinking about who the reader is and what they will find most useful.

▷ **'Exceptions' reporting**

Managers and Board members are busy people and they rarely have the opportunity to read all reports that get sent to them. With financial reports it is good idea to provide an *exceptions report* – a brief cover note that draws attention to key areas or need decisions.

The exceptions report is usually no more than one or two pages long and should avoid using technical jargon. It should be brief and easy to read.

A suggested layout:

- ▶ *Overview of the period being reported* – ie dates covered; how figures have been compiled; what activities are covered by the attached reports; and author of report.
- ▶ *Significant variances* - Highlight the most significant variances from the budget and explain the reasons behind the variances. This should not just concentrate on over-spending of budgets – under-spending can also be a problem, especially when related to donor-funded projects.
- ▶ *Recommendations for action* – ie corrective action required to deal with the key issues identified in the previous section. For example, strategies to avoid a cashflow crisis in future months; revised activity plans to get projects back on target; restricting use of vehicles where running costs are running too far over budget.

▷ **Presentation of figures**

Negative figures in project financial management reports can be represented in two ways: - 1,234 or (1,234)

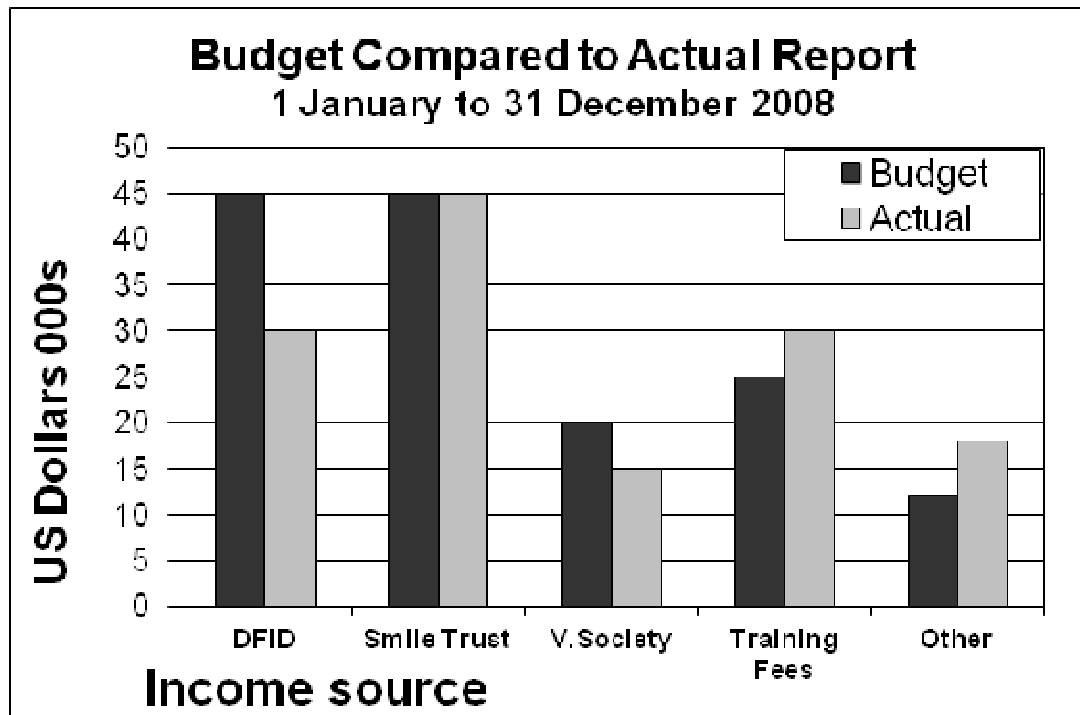
Figures are usually rounded to the nearest whole number – the cents are not relevant to the overall review of the results. The rounding action sometimes results in totals or sub-totals being out by 1.

▷ **Alternative formats**

Graphical formats – for example using a bar chart for a budget compared to actual report (as in **Figure 5.4**) or a pie chart for an income and expenditure report – are a welcome alternative to tables of figures, especially for people who are less confident around numbers.

See also some very interesting ideas on alternative ways to present financial information from Little Fish in Australia: <http://www.littlefish.com.au>

Figure 5.4: Using graphics for financial reports



Similarly, rather than present figures, we might simply present a list of statements such as in this example of an alternative Balance Sheet format (see Appendix 9 for the usual presentation):

Milestone Project Financial position on 31 December 20xx:

- a) Our programme equipment and vehicles – after a deduction for wear and tear – had a value of UC112,091.
- b) We had UC8,095 held as cash and in the bank.
- c) The Smile Trust owed us UC10,000 for the final quarter grant; and we had some outstanding fees and other small amounts owed to us totalling UC2,459.
- d) We owed a total of UC3,262 in unpaid invoices.
- e) This means that if we paid off everything we owe from our available funds, we would have UC17,292 to continue our operations.
- f) Our overall reserves, including the value of our equipment and vehicles, total UC129,383.

Reporting to beneficiaries

Most NGOs recognise the need for downward accountability – ie reporting back to the communities they work with on what they have done with the funds raised in their name. Few NGOs have set up systems to deliver it. Most NGO systems focus on upward accountability, such as reporting to donors, Boards and Head Offices.

To participate fully in an NGO's work, beneficiaries need access to information about the NGO's plans, resources and activities. Increasing transparency and accountability to beneficiaries has many benefits including:

- ▶ Strengthening trust and respect between NGO staff and beneficiaries
- ▶ Improving the quality of programme decisions, as beneficiaries provide feedback on how funds are being spent
- ▶ Empowering beneficiaries to make their own decisions on their own behalf
- ▶ Reducing the risks of inefficiencies and fraud
- ▶ Encouraging finance staff to get more involved with NGO field work.

Introducing this level of financial transparency may naturally hit some obstacles, such as adding to the burden of already busy staff. But if sensitively done, the benefits generally far outweigh the costs.

▷ **How can NGOs provide financial reports to their beneficiaries?**

Financial reports must provide information that is both useful for users and in a style that is easy for users to understand. The following guidelines set out some general principles which can help achieve this when preparing financial reports for beneficiaries.

Content

Content should be relevant to local people, about the specific activities that NGOs have carried out on their behalf. Simple reports – in local currency – showing monthly expenditure compared to budget work well.

Expenditure can be summarised by activity, by geographical area, by budget line or some combination of these. The total budget for each activity, area or budget line should also be included.

As a rule of thumb, each financial report should have no more than 15 lines of information: more lines make reports confusing.

Presentation

Publish reports in local languages and make use of pictures or simple graphs as it is easier for some people to understand visual reports than those just using numbers.

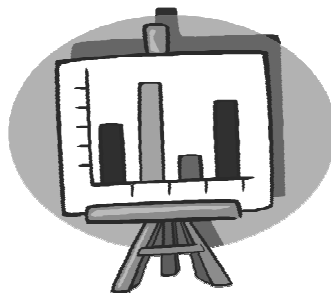
Aim to make financial reports publicly available at the community level. For example:

- ▶ use white-boards or flip-charts to publicly display the results at NGOs' offices, health centres or distribution points, backed up with paper copies of reports at the same places
- ▶ present regular reports to communities at community meetings or to community leaders at project management meetings
- ▶ publish summary reports in newspapers and other local media.

Who provides reports?

Financial reports can be provided either by an NGO's finance staff or by its programme staff. Ideally finance and programme staff should work together. For example, invite finance staff to explain reports at community meetings.

For more ideas on how to report to beneficiaries and information about Mango's "Who Counts?" campaign, please visit: www.whocounts.org.



Summary: Twenty Questions

Here are 20 questions to ask when reviewing financial information:

Auditor's Report on the Annual Financial Statements

1. How long ago was the last audit conducted?
2. What does the Auditor's Opinion say – is it qualified or unqualified?

Balance Sheet

3. Does the organisation have enough ready cash (see 'Cash at Bank' listed under Current Assets) to pay off its immediate debts (see Creditors)?
4. How long could the organisation survive if all of its funding dried up? (Calculate the 'survival ratio') How does this compare to last year?

Income & Expenditure (or Profit and Loss) Account

5. Is income and expenditure broadly in balance? (Look for net income/expenditure)
6. Is there a significant increase or decrease in activity levels from the previous year?
7. What is the balance of direct project costs vs. admin costs? Is it reasonable for the size and nature of the organisation?
8. How 'donor dependent' is the organisation? (Calculate the 'donor dependency ratio')

Budget Monitoring Report

9. Is expenditure broadly in line with the budget? (+ 10%)
10. Is income broadly in line with the budget?
11. Are there any significant variances? If so, have they been satisfactorily explained?
12. What action is being taken to correct significant variances – eg under-spending as a result of delayed activity plans?

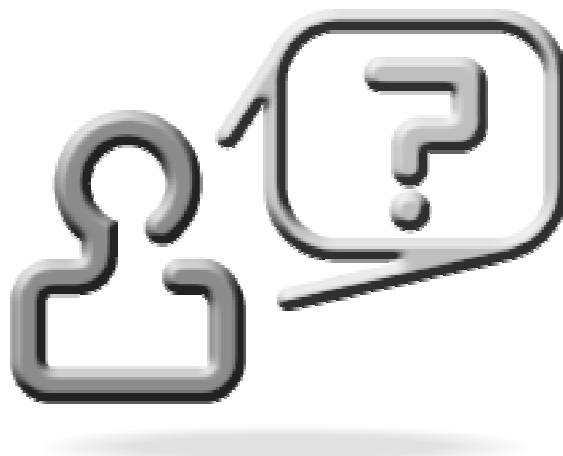
13. Are there any large bills outstanding which could substantially affect the figures shown?
14. Are we owed any large sums of money? What is being done to retrieve them?
15. Are there any un-budgeted expenses which may occur in the rest of the year?
16. What is the projected end-year outcome? Is this outcome satisfactory? If not, what steps can be taken to change the result?

Cashflow forecast

17. Is there enough cash in the bank to fulfil the activity plan in the next six months?
18. What grants are due and are they still expected to come through on time?
19. Are spare cash balances invested to produce the best return?

General

20. What non-financial figures are being produced to show how the programme of activities is progressing?



Chapter**6**

Safeguarding Your Assets

'It is more sensible to establish a system to deter fraud rather than one to discover it.'

This chapter:

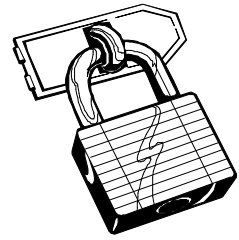
- Explains why we need internal control
- Introduces the Four Actions of internal control
- Introduces delegation of authority and separation of duties
- Highlights the importance of cash control, physical controls and checking routines
- Discusses ways to manage and control fixed assets.

Managing internal risk

This chapter looks at managing the internal risks facing an NGO on a day-to-day basis. We do this by introducing controls, checks and balances to minimise losses and detect errors and omissions in the accounting records.

Controls are also very important in protecting all those who handle the financial affairs of the organisation as they remove any suspicion of, or temptation to, dishonesty.

Four actions for internal control



A good way to think about and set up your internal control systems and procedures is to use the Four Actions approach:

1. DIRECT: to encourage the right action

This means setting policy and giving clear instructions on who does what and what processes to follow. For example, setting a Procurement policy and setting out limits of authority in a delegated authority document.

This action is one we generally take *before* activity takes place.

2. PREVENT: to deter the wrong actions

Sometimes, there will situations where someone fails to follow the guidance in the *Direct* stage. So we need to set up systems that will, as far as possible, minimise the risk of opportunistic theft or loss due to incompetent actions. This includes commonsense physical controls and checking actions during a process.

These actions generally operate *during* implementation.

3. DETECT: identify if and where it has gone wrong

We cannot prevent all incidences of loss, so we then need to have systems in place to pick these up after the process is completed (and learn from it too). For example, cash counts, bank reconciliations and internal audit.

These actions take place *after* the activity has taken place.

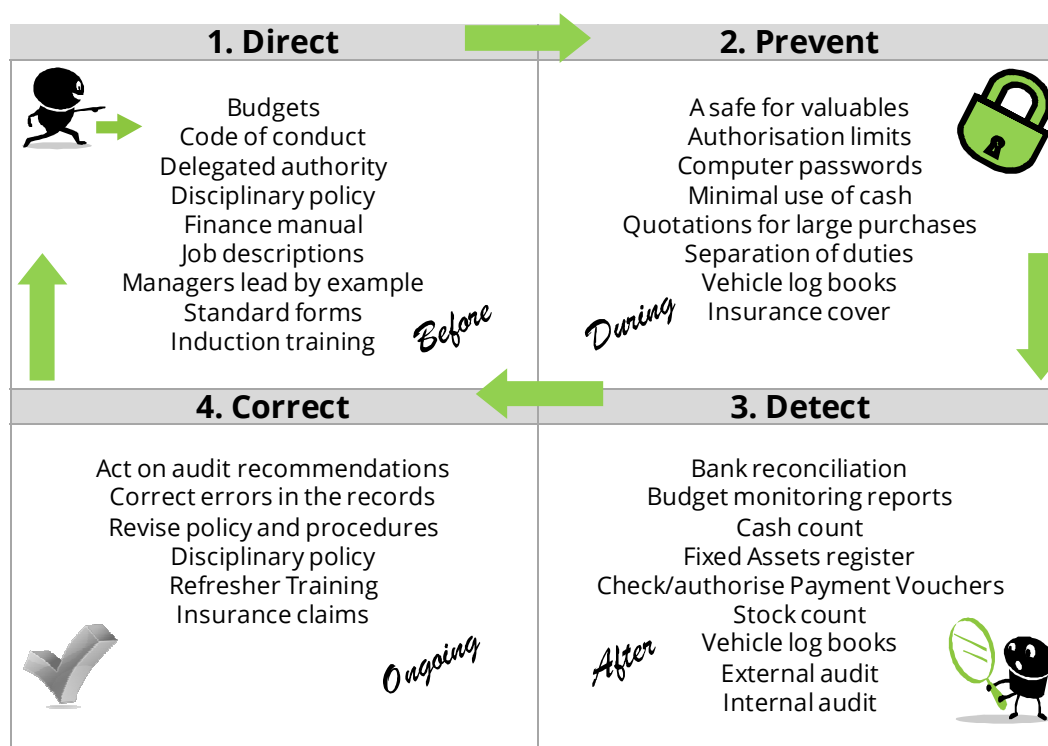
4. CORRECT: put right the errors or losses detected

This includes correcting accounting records, changing policies to reduce the chance of the loss happening again and retraining staff. This process of learning links on to *Direct* as guidance is updated, so completing the cycle.

Where further action is needed, corrections take place on an *ongoing* basis.

Figure 6.1 summarises some of the key internal controls under the Four Actions headings. Some controls can fall under more than one heading as they have multiple effects.

Figure 6.1: The Four Actions process



There are several key internal controls that we will look at through the lens of the Four Actions:

- ▶ Delegated authority and separation of duties
- ▶ Cash control
- ▶ Physical control
- ▶ Checking routines
- ▶ Reconciliation routines.

Delegated authority and separation of duties

Delegated authority falls under the **DIRECT** heading of controls. The Board of Trustees delegates authority through the Chief Executive for the day-to-day running of the organisation. In a large and busy organisation it is not practical (or safe) to allow one person to make all the decisions and authorise all transactions.

The Chief Executive will, therefore, further delegate authority to members of the staff team to relieve the load and to ensure smooth operation during absences of key staff.



▷ **Delegated Authority Document**

Every organisation should decide in advance who should do what in finance procedures. It is good practice to record what has been decided in a *Delegated Authority* document. Its purpose is to clarify who has the authority to make decisions, commit expenditure and sign legal undertakings on behalf of the organisation so that there is no confusion about responsibility. See an example in Appendix 2.

The Delegated Authority Document should include instructions for such duties as:

- Placing and authorising orders for goods and services
- Signing cheques
- Authorising staff expenses
- Handling incoming cash and cheques
- Access to the safe and petty cash
- Checking and authorising accounting records
- Signing legal undertakings.

The Delegated Authority document must be approved by the Board and regularly reviewed to ensure it remains relevant. It should also outline deputising arrangements to cover for absence of key personnel.

▷ **Authorisation rules**

A delegated authority document should observe some basic rules:


- ▶ Define the **lowest level of authority**. Those higher up the management ladder will automatically have the same permissions.
- ▶ Outline **deputising arrangements** to cover for absence of key staff.
- ▶ Prevent anyone from authorising a transaction from which they will **personally benefit**. This would make the individual vulnerable to accusations of improper behaviour.
- ▶ **Avoid staff authorising payments to their managers** – they must be signed by someone who is more senior in the management structure (or the Board).
- ▶ **Limits or conditions** must be clearly defined, eg a project officer may be authorised to commit expenditure up to a specified amount, within certain categories or within budget.

A breach of delegated authority rules is a serious matter and should be dealt with through the organisation's disciplinary procedures.

▷ **A note on authority for bank payments**

Each organisation should have a panel of signatories from which to select the required number of authorising signatures. There should be sufficient people nominated to ensure efficient administration of bank payments. It is usual to have more than one signature on a cheque to help avoid fraud.

Signatories should be regularly reviewed and the list updated when people leave the organisation.

 *NEVER ask signatories to sign blank cheques for future use as this defeats the whole purpose of having more than one signatory.*

▷ **Separation of duties**

This is linked to delegated authority, but falls under the **PREVENT** heading since it aims to remove the opportunity for theft and fraud. By sharing the various duties within a finance procedure around a team, it protects those involved and removes the temptation to mis-use funds. For example, it is risky to allow one person to order some goods, then receive them and also authorise the payment without someone else involved in the process.

Apart from weakening financial control, this puts too much responsibility on one person and if they should leave the organisation or are absent for long periods, then the finances will grind to a halt.

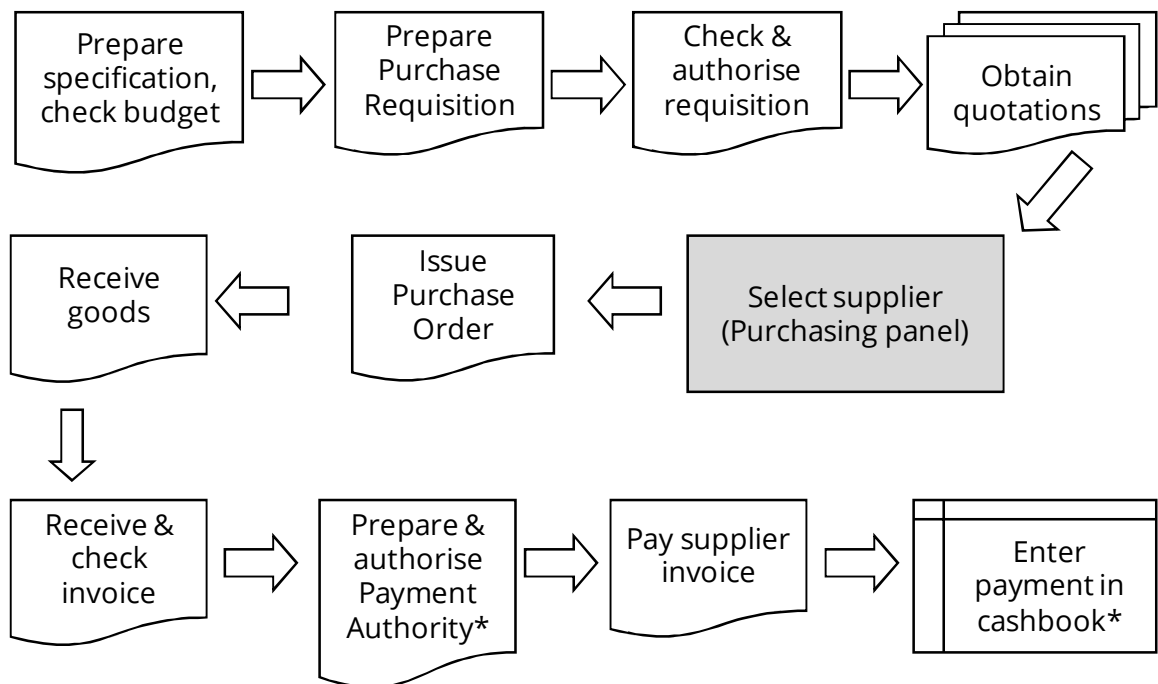
The process for buying goods and services is a very good example of the practical application of delegated authority and separation of duties.

▷ **The procurement procedure**

A *Procurement procedure* sets out the steps and conditions that have to be followed by staff to acquire goods and services so that the objectives of the organisation can be fulfilled efficiently and effectively. This is an example of a typical **DIRECT** control action since it lays down rules to follow when making purchases. But a well written procurement procedure also incorporates the principles of separation of duties so it also encompasses the **PREVENT** action. The procurement procedure:

- ▶ outlines the process and authorities for ordering, receiving and paying for goods and services (see below)
- ▶ clarifies when it is necessary to obtain quotations from suppliers – eg 2 quotations for all expenditure over \$1,000
- ▶ describes which method of payment or acquisition is to be used for different goods and services – eg when it is best to use petty cash, bank transfers (eg salaries) or supplier accounts (eg stationery, fuel)
- ▶ includes a list of approved contractors or suppliers, if used.

Each organisation must design a procurement procedure which suits its own circumstances. **Figure 6.2** shows some typical stages in the process of purchasing a larger item with a supplier account (with the cash accounting systems in place).

Figure 6.2 Typical Procurement Process

A Typical Procurement Procedure

1. Specify goods or services to be purchased, check budget

The standard, quantity and price of goods or services required, as described in the activity plans, is specified clearly. The amount currently available in the budget for the item to be purchased should be checked at the specification stage in case the price has changed since the budget was prepared.

2. Prepare Purchase Requisition

An internal request is prepared – usually on a standard form for that purpose – to formally request the purchase of the goods or services specified. The request will include a description of the purchase and state why it is required.

3. Authorise Purchase Requisition

The purchase requisition will usually be checked and authorised by the budget holder or other nominated person to verify that there is a genuine reason for the purchase. The available budget will usually be checked again at this stage.

4. Obtain Quotations

Quotations from reputable independent suppliers are requested (in accordance with internal procedures and donor rules) to make sure the organisation gets best value for money and to minimise the risk of collusion.

5. Select Supplier

Quotations are reviewed and a supplier is selected based on price, quality, delivery times and 'after sales' terms to ensure value for money. For larger purchases, it is usual to have a Purchasing Panel – a small group of managers who take responsibility for selecting the supplier.

6. Issue (Authorised) Purchase Order (PO)

The authorised Purchase Order is sent to the selected supplier with a copy kept on file with the supplier's quotation. This is a legally binding contract.

7. Receive Goods from Supplier

When supplies are delivered and received, a Goods Received Note (GRN) is usually signed to confirm receipt and a copy filed for later reference.

8. Receive and Check Supplier Invoice

The invoice should be checked and matched up with the GRN, PO and quotation, usually by the finance team.

9. Prepare and Authorise Payment Authority

The Payment Authority is attached to the invoice and all the supporting documents. It includes budget and accounting codes and must be checked and authorised by the budget holder or other nominated person.

10. Pay Supplier Invoice

Payment should be made to the supplier within the specified payment terms, usually 30 days.

11. Enter Payment into Cashbook

The final stage is to record the payment in the organisation's books of account.

Cash control

NGOs often work in environments where cash is the preferred way to pay for goods and services. We have to take special care with cash because it is vulnerable to theft. Cash control is all about **PREVENTING** loss and misuse of cash.



Here are *Seven Golden Rules for Handling Cash*:

1. Keep money coming in separate from money going out

Never put cash received into the petty cash tin, it will lead to error and confusion in the accounting records. All money coming in must be paid into the bank promptly and entered into the records before it is paid out again.

Failure to do this could distort financial information. For example, a training course charges \$25.00 to each of the 10 participants. The cost of food and room hire is \$150.00 and this is paid from the course fees received on the day. The balance of fees – \$100.00 – is paid into the bank as Training Fees.

Why is this a problem? The cost of providing food and room hire has not been recorded in the accounts and so will not appear in the financial report. Similarly, as only the net amount of fees received was paid into the bank, it would appear that only a few people actually attended the course.

2. Always give receipts for money received

This protects the person receiving the money and assures the person handing it over that it is being properly accounted for. Receipts must be written in ink, not pencil, and preferably from a numbered receipt book.

3. Always obtain receipts for money paid out

Sometimes this may not be possible. For example, when purchasing materials from a market stall. In this case the cost of each transaction should be noted down straight away so that the amounts are not forgotten and these can then be transferred to a petty cash slip or internal receipt and authorised by a manager.

Remember – no receipt means there is no proof that the purchase was made.

4. Pay surplus cash into the bank

Having cash lying around in the office is a temptation to a thief and the money would be better managed and earning interest in a bank account. A casual approach to cash on the premises might also lead to people wanting to 'borrow' from it – many a sorry tale of fraud has started in this way. You should always aim to pay cash received into the bank on a daily basis or, at the very least, within three days of receipt.

5. Have properly laid down procedures for receiving cash

To protect those handling money, try to have two people present when receiving cash. Both should count the cash and sign the receipt.

6. Restrict access to petty cash and the safe

Keys to the petty cash box and the safe should be given only to authorised individuals. This should be recorded in the organisation's Delegated Authority document.

7. Keep cash transactions to an absolute minimum

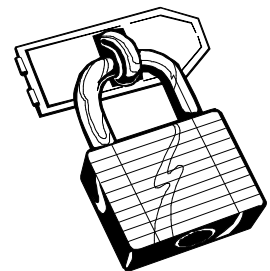
Use cash only when all other methods are inappropriate. Wherever possible, set up suppliers' accounts and pay invoices by cheque or bank transfer. The advantage of paying for most transactions through the bank is that this has the effect of producing a parallel set of accounts in the form of the bank statement. Also, it ensures that only authorised people make payments and it reduces the likelihood of theft or fraud.

Physical controls

Physical controls are additional common sense precautions taken to safeguard the assets of an organisation. They generally fall into the **PREVENT** action heading.

▷ Having a safe

Having a safe – or a safe place – to keep cash, cheques books and legal documents is important for internal control. A proper safe is worth considering especially if your organisation has to keep large sums of money on the premises overnight. Safes are however, expensive and it may be better to improve on banking procedures.



▷ **Safeguarding fixed assets**

Fixed assets may represent considerable wealth held in the form of land, buildings, vehicles, machinery and office equipment and, often over-looked, require special attention to ensure their value is maintained and that they do not disappear through lack of vigilance.

Measures to safeguard these assets include keeping an *Assets Register*, writing a vehicle policy and having a maintenance policy for equipment.

The Assets Register

An Assets Register should be established with an entry or record sheet for each item. Each asset should be tagged with a unique reference number for identification purposes. The register will record important information about each asset, such as:

- where and when the item was purchased and how much it cost
- where it is held or located
- how much it is insured for
- repair history
- serial numbers
- details of guarantees or warranties.
- depreciation rate and method, where relevant.

The record sheet should also state who is responsible for its maintenance and security. The Assets Register should be checked by a senior manager or committee member every quarter and any discrepancies reported and appropriate action taken. See Appendix 19 for a sample Assets Register record sheet.

Building and Equipment Maintenance policy

To preserve the value of buildings and equipment, an organisation must have a pro-active policy of maintenance. For buildings this may require a professional planned maintenance contract for which a realistic budget must be provided.

Office equipment such as photocopiers and electrical equipment should also receive regular services by qualified technicians to ensure they are safe and operating properly.

Insurance cover

Valuable assets should be insured to prevent loss to the organisation as a result of every day risks such as fire, theft and natural disasters.

The decision whether or not to insure property is a good example of managing risk – weighing up the pros and cons of paying for insurance is a common dilemma for managers.

Vehicle policy

Every organisation that owns vehicles should have a vehicle policy. This will set down the policy on a range of issues such as:

- Depreciation
- Insurance
- Purchasing, replacement and disposal
- Maintenance and repair
- Private use of vehicles by staff
- What to do when accidents happen
- Driver qualifications and training
- Carrying of passengers.

The costs of repair and replacement must be also adequately reflected in the budget process.

For each vehicle there should be a log of journeys so that the running costs per KM can be assessed and private use closely monitored. (See Appendix 22 for a sample.) Once you have 12 months information on the costs of running a vehicle, it is possible to calculate its average running costs per kilometre.

See **Table 6.1** for a worked example.

Table 6.1: Calculating Vehicle Running Costs

Vehicle make/model:	Toyota Van	
Date purchased:	26 December 2011	
Purchase price:	\$20,000	
Depreciation period /method:	5 years, straight line method	
Maintenance:	Service every 6,000 km or every 3 months	
KM run	From 1 January to 31 December 2012:	
	KM on clock on 31/12/12	20,601
	LESS KM on clock on 01/01/12	<u>(201)</u>
	Total KM run during year:	20,400
1. Depreciation		\$
	Purchase Price = \$20,000	
	Depreciation period = 5 years	
	Annual depreciation charge = \$20,000 / 5	4,000
2. Fuel consumption		
	Total fuel bills for the year	5,500
3. Maintenance costs		
	Total of invoices for the year for: repairs, service costs, spare parts, tyres, etc	900
4. Insurance and tax		
	Insurance, road tax for the year	3,300
TOTAL VEHICLE RUNNING COSTS:		13,700
<i>Cost per KM calculation:</i>		
	<u>Total costs for the year</u> = \$13,700	\$0.67
	Total no. of KM run 20,400 km	

In conclusion, using the information from our accounts and the vehicle log sheet, we can see that each kilometre run with the Toyota Van cost approximately 67 cents.

The reconciliation process

Reconciliation – a **DETECT** action - involves verifying accounting records to make sure that there are no errors or omissions that have so far gone undetected. Records that should be reconciled at regular intervals are:

- Bank (Cash) Book
- Petty Cash Book
- Stock control records
- Salaries and Deductions schedules.

Once the records have been successfully reconciled, the reconciliation statement must be passed on to be independently checked with the source records by a manager (or Board member in a smaller organisation), as discussed below. The process may also highlight follow up actions, eg actions to **CORRECT** the records.

▷ **Bank (Cash) Book**

The Bank (Cash) Book should be reconciled to the bank statement at least once a month. The purpose of this exercise is to make sure that the organisation's own records agree with the bank's records which are rather like a parallel set of records. This is achieved by taking the closing bank statement balance for a particular date and comparing it to the closing Bank Book balance for the same date, then explaining the differences.

This is an important check not only for accuracy and completeness of records, but also as an early indication of fraud.

▷ **Petty Cash Book**

The petty cash should be counted and reconciled at least weekly. If the imprest system is in use, this is a very easy operation as it is simply a matter of counting up all the payments made since the last reimbursement and counting the cash in the tin. The two totals together make up the total float.

If a discrepancy is found, it must be noted in the petty cash book as either an 'expense – unidentified' or a 'surplus – unidentified' and allocated to an appropriate category. Regular or significant discrepancies must be reported to a manager.

▷ Stock records

Stock records must be checked against the supplies held in the store and receipts from sales to ensure that no errors have crept in (and no stock has crept out).

A **Sample Stock Control Sheet** for some T-shirts is reproduced in **Table 6.2**. It shows the value of the stock the last time it was reconciled. Then it lists new stock purchases and new sales. This gives us an *expected* stock value, on paper at least. Note that the table lists both the cost value (ie what the organisation paid the T-shirts supplier) and the resale value (ie what the organisation expects to sell the T-shirts for).

However, when the T-shirts in the stock room are physically counted and checked, the actual value is less than expected. (The brackets around the bottom line figures indicate the stock value is short.)

What do you think might explain this difference?

Table 6.2 Sample Stock Control Sheet

	Cost Value \$	Resale value \$
Value of stock at 1 Jan 200x	3,000	6,000
Add: Value of purchases between 1 Jan. to 31 Mar.	800	1,600
Deduct: Value of sales during the period	<u>1,300</u>	<u>2,600</u>
EXPECTED STOCK VALUE:	2,500	5,000
ACTUAL STOCK VALUE	2,450	4,900
Difference	(50)	(100)

This difference might be caused by one of several things:

- ▶ The value of new purchases could be wrong – eg the stock delivered was short. This could happen if a delivery is not properly checked against the delivery note and invoice when received from the supplier.
- ▶ The value of sales could be wrong – eg the wrong amount could have been charged or a sale not recorded or coded properly.

- ▶ Stock could have been stolen.
- ▶ Stock could have been given out as gifts or for publicity purposes and not recorded as such in the accounts.

Whatever the explanation, the difference has to be investigated and systems reviewed if necessary. This demonstrates well the importance of regular stock checks.

▷ **Wages Book**

The wages records, and particularly deduction records, are notorious for containing inaccuracies and for abuse in the form of 'ghost employees' (ie people on the payroll who do not exist and where a salary is paid and collected by a fraudster).

Wages records must be reconciled every month to ensure that the correct deductions are being made and passed on to the relevant authority, to avoid severe penalties and interest being imposed.

Checking and authorising accounting records

This is another key **DETECT** responsibility.

▷ **Managers**

Managers, for example the Chief Executive, Programme Director and Financial Controller in a larger organisation or Board members in a smaller one, need to regularly check and authorise records to make sure procedures are being followed correctly and transactions are valid.

Typically, these checks cover:

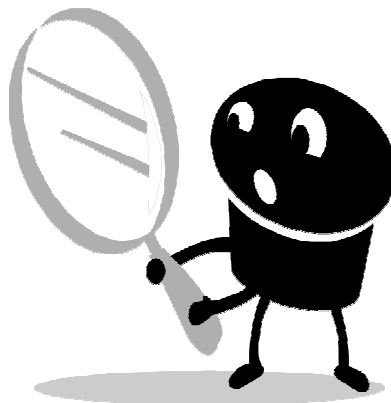
- ▶ authorising staff expenses and receipts, to ensure they are valid
- ▶ reviewing bank records and bank reconciliation statements to ensure they are accurate, complete and up to date
- ▶ counting the cash and checking and authorising the cash reconciliation
- ▶ counting stocks and checking inventory records

- ▶ reviewing order books to ensure delegated authority limits are observed, orders are valid and with approved suppliers
- ▶ signing off vehicle log sheets to verify journeys are valid
- ▶ verifying the Assets Register is complete and accurately records the NGO's assets.

Any evidence of non-compliance with procedures must be followed up by appropriate **CORRECTIVE** action, for example training staff, re-writing procedures or even disciplinary action in the case of improper behaviour.

▷ **Auditors**

In addition to regular checks by management, every organisation should have an annual audit, a more formal **DETECT** action. This topic is covered in more detail in the next chapter.



Chapter

7

Managing Audit

An independent check on accounting records and systems

This chapter:

- ▶ Explains what an audit is
- ▶ Describes the different types of audit
- ▶ Provides an overview of the audit report
- ▶ Gives advice on how to prepare for and manage the external audit.

What is an audit?

An audit is an independent examination of records, procedures and activities of an organisation, resulting in a report on the findings. There are two main types of audit:

- ▶ *Internal Audit* – undertaken for the benefit of those inside the organisation, ie trustees and management.
- ▶ *External Audit* – primarily for the benefit of those outside the organisation, eg stakeholders and funders.

▷ **Why do NGOs need audit?**

Audits are important for NGOs as they demonstrate a commitment to transparency and accountability and bring credibility to the NGO. It is also a legal requirement in most countries to have the financial statements reviewed by an independent auditor once a year.

The audit should be a positive experience and not one to be feared. Use your auditor to discuss ways of improving your accounting systems and procedures.

Internal audit

Internal audit involves a structured review of systems and procedures, as set by the Board and managers, to ensure efficient and effective practices. It is not an internal 'policing' function, rather an opportunity to improve systems and build internal capacity. It may be carried out by someone within or outside the organisation.

The independent review will include a range of checks, including:

- ▶ financial accounting systems and procedures
- ▶ management accounting systems and procedures
- ▶ internal control mechanisms.

The 'Three E's' influence an internal auditor's approach:

- ▶ *Economy*: paying no more than necessary for the resources needed.
- ▶ *Efficiency*: getting the greatest benefit with the fewest resources.
- ▶ *Effectiveness*: how successful we are at meeting objectives or 'doing the right thing'.

The internal auditor's report will highlight their findings to the governing body and management and make recommendations for action, where needed. This could include a more detailed investigation, changing a procedure or training a staff member.

External audit

An external audit is an independent examination of the financial statements prepared by the organisation. It is usually conducted for statutory purposes (because the law requires it). External auditors may also be engaged to do other specific assignments, (eg a fraud investigation).

Being independent means...

The auditor must not have been involved in keeping the accounting records and is not personally connected in any way with the organisation being audited.

Although an auditor's independence must be respected and observed at all times, they are nonetheless providing a service for a fee – you have a right to expect value for money.

▷ **Purpose**

The purpose of external audit is to verify that the annual accounts provide a true and fair picture of the organisation's finances, and that the use of funds is in accordance with the aims and objects as outlined in the constitution.

The purpose of an external audit is NOT:

- To act as a fraud investigation
- To prepare the accounts
- To provide a certificate to say "there are no problems"
- Proof that internal control systems are effective
- Evidence that accounts are 100% error free.

Although it is not the prime role of the audit to detect fraud, this may of course come to light during the checks that take place. Auditors have thus been described as 'watchdogs not bloodhounds'.

▷ **Appointment**

An external audit can be conducted either as part of the annual review of accounts or as a special review by a donor agency. It is conducted by a firm of accountants with recognised professional qualifications.

Auditors are appointed by the Board of Trustees (or Annual General Meeting) or by a donor for a special audit. They are independent of the organisation employing them.

▷ **What is involved?**

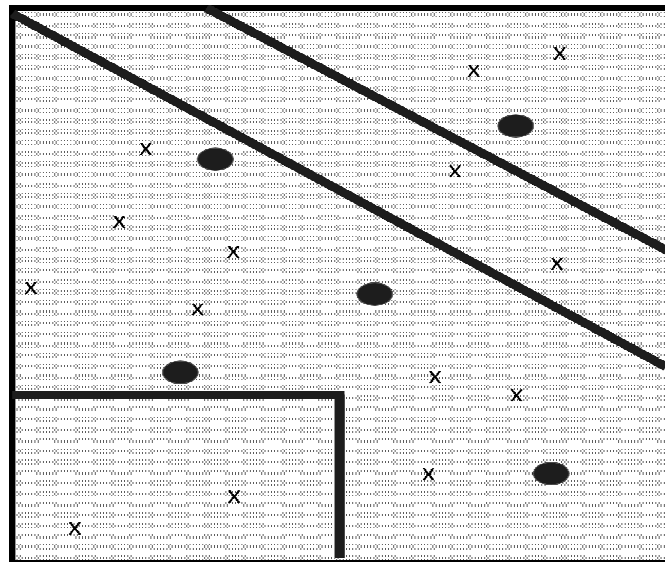
Auditors only have a limited time in which to complete their work, so they concentrate on testing the validity of a sample of transactions and results rather than vigorously checking everything.

Auditor-speak de-mystified:

Material: An item is said to be 'material' if it is considered to be significant to the users of the financial statements.

Test basis: A representative sample, the rest of the transactions are assumed to be similar to the sample tested

Figure 7.1: Sampling



Sampling involves checking a selection of records, for example:

- ▷ a range of high value goods (represented by the 'slice' in the diagram in **Figure 7.1**) or

- ▶ one month's worth of transactions (the 'box' in the diagram) or
- ▶ a random set of transactions (the X marks in the diagram).

Note that if there are errors or fraudulent transactions (as represented by the black dots in the diagram), due to the sampling process, the auditor does not guarantee to detect these.

▷ The audit report

An audit results in a report addressed to members which gives an 'audit opinion' as to the 'true and fair' view given by the financial statements (of the state of affairs of the organisation and operations for the period.)





Auditor-speak de-mystified:

'True' means that the transaction did take place and that an asset exists.

'Fair' means that a transaction is fairly valued and that assets and liabilities are fairly stated.

If the auditors do not agree with the financial results as presented by the organisation, they may issue a report saying that, in their opinion, the accounts are not fine. This could be disastrous for an NGO seeking donor support. **Table 7.1** summarises the types of opinion.

Table 7.1: External Auditor Opinions

Auditor Opinion	Comment
 <i>Unqualified</i>	The accounts do give a true and fair view – a 'clean' audit report.
 <i>Qualified: 'Subject to' or 'Except for'</i>	The accounts are basically OK, apart from specific identified issues, eg an incorrect accounting policy, or specific unsupported expenditure.
 <i>Qualified: Disagreement</i>	There are so many errors that the accounts do not give a true and fair view.
 <i>Qualified: Disclaimer</i>	The auditors are unable to give an opinion because the records are so poor or incomplete. This is very bad indeed.

If the auditors propose any adjustments or changes to the draft financial statements, these must also be approved by the Board. The audit report is addressed to the members and it is usual to formally accept the report at the Annual General Meeting.

Auditors will also often provide a *Management Letter*. This is separate to the audit report and is addressed to management. The report highlights weaknesses identified in the internal control systems and makes recommendations for improvements. Managers have an opportunity to respond to the findings outlined in the management letter and explain what action they will take.

Donor (or project) audit

On occasion, donor agencies may request an independent external audit of records and activities and will appoint a qualified person to undertake a review. The primary purpose of such a review is to check that grants are being used as intended and in accordance with the budget in the original funding agreement.

The auditor may wish to interview staff and committee members and even request to observe the organisation in pursuance of its activities. Every co-operation should be given during such visits and an effort made to be open and honest about organisational strengths and weaknesses.

What does the auditor need?

An auditor will need a quiet place to work where the checks can take place without interruption. If individual staff members are to be interviewed, then a private room where confidential discussions can take place will also be required. Depending on the type of audit taking place, the auditor will usually give advance notification of the records needed.

Do make sure that all the records are up-to-date and properly filed as this will facilitate the routine checks and cause minimal disruption for the organisation. This will also help to save on audit fees.

Here is a checklist of records and other documentation which might be requested by the auditor:

Table 7.2 An Auditor's Checklist

Group of Records	Description of item
<i>A. Primary records of account:</i>	<ul style="list-style-type: none"> ▶ Cash Books completely up to date to the year-end ▶ File of invoices/vouchers for all items of expenditure ▶ File or book of receipts for money received ▶ Bank statements, paying in slips and cheque books ▶ Wages book and records ▶ General Ledger, if kept
<i>B. Summaries and reconciliation statements:</i>	<ul style="list-style-type: none"> ▶ A Trial Balance and/or a summary of all receipts and payments by budget category ▶ Bank reconciliation statements for all bank accounts at the year-end cut-off date ▶ Petty cash reconciliation statement to the year-end cut-off date ▶ Stock sheets
<i>C. Schedules:</i>	<ul style="list-style-type: none"> ▶ Schedule of Creditors (money owed by the organisation) ▶ Schedule of Debtors (money owing to the organisation) ▶ Schedule of Grants Due ▶ Schedule of Grants Received in Advance ▶ Fixed Assets Register
<i>D. Other information:</i>	<ul style="list-style-type: none"> ▶ A letter from bankers to confirm balances [this will be requested by the auditors themselves] ▶ Constitution of the organisation ▶ List of Committee members and staff ▶ Minutes of Board and management meetings ▶ Donor agencies funding agreements and audit requirements

Summary

Table 7.3: Different types of NGO audit

Area:	<i>Internal</i>	<i>External</i>	<i>Donor/Project</i>
Main purpose	Check effectiveness of systems & procedures	Verify the published accounts give a 'true & fair' view	Check that funds used in accordance with the funding agreement.
Focus of review (starting point)	Systems and Procedures manual	Financial statements & underlying records	Grant agreement
Appointed by	Management (but have direct line to the board)	Board (or members)	Donor, but may use normal external auditor if on approved list
Scope	As per planned schedule based on risk assessment. May be for a specific department, grant or period.	All financial transactions in the accounts, whole organisation	Usually limited to the project and related grant funding.
Report includes	Findings and recommendations for improvements	Auditor's opinion and Management letter	Usually, auditor's opinion(s) and recommendations
Employed by	The NGO or external body (outsourced)	External body	External body (sometimes donor themselves)
Qualifications	No formal requirement	Must be qualified & registered accountant	Usually qualified & registered accountant

Chapter

8

Fraud and Corrupt Practices

How to manage when things go wrong

This chapter:

- Defines fraud and its impact
- Explains how to detect and deal with fraud
- Describes corruption and how it manifests itself
- Looks at the risks of bribery on NGOs
- Discusses how to implement a zero tolerance approach to bribery.

What is fraud?

There will be occasions when internal control systems fail to prevent losses through theft, fraud or other irregularities. Fraud includes theft of goods or property, falsifying expenses claims and falsification (or destruction) of records to conceal an improper action.

Fraud is... Intentionally lying or cheating to gain an advantage or to cause someone else to make a loss

Fraud does not include:

- ▶ accounting errors
- ▶ actions condoned by established practice
- ▶ cases where no loss is incurred.

Other 'irregularities' include unauthorised activities for private gain: eg borrowing from petty cash, use of vehicles or abuse of telephones and other equipment for private business. Although these activities are less serious than fraud they must still be taken seriously as they represent abuse of NGO resources.

Fraud has a damaging effect on the organisation with wide-ranging consequences if not properly managed. Imagine a stone falling into a pond: the initial splash is the loss of funds or equipment but it does not stop there, as **Figure 8.1** illustrates.

Figure 8.1: The Ripple Effect of Fraud



Top tips on the warning signs of fraud

Remember: *“Prevention is better than cure!”*

The following ideas *may* be an early indication of fraud or abuse. Use them with care!

▷ **From the accounting records:**

- ▶ Lots of corrections to the manual cashbook – this may include extensive use of white-out or blocked out figures
- ▶ Pristine records – ie a manual cashbook that looks as if they have all been written on the same day in the same hand. Could be an indication of rewritten/duplicate books
- ▶ Delayed banking of cash received – shown up by bank reconciliation. Could be unauthorised ‘borrowing’ of cash.
- ▶ Records not being kept up to date – ie deliberately delayed so managers cannot detect false accounting going on.
- ▶ Missing supporting documents – eg certain bank statements destroyed to cover someone’s tracks, or a project officer who regularly claims to have ‘lost’ receipts.
- ▶ Debtors rising unexpectedly – eg if debtors have paid but the cash is being pocketed. This may occur if there are poor controls in issuing receipt books as someone could take an unused book and issue valid receipts without them ever being entered into the accounting records.
- ▶ Hand written supporting documents with errors and corrections on them. Indicates possible changes made after the goods or services were purchased.
- ▶ Cash counts not reconciling to the accounts but reconciling at the next cash count – possible borrowing of funds by the safe key holder.

▷ **Reports:**

- ▶ Budget monitoring reports showing inconsistent behaviour between line items - eg project-related expenditure is under-spent due to delays – except for fuel which is over-spent. This could indicate abuse of the vehicle.
- ▶ Vehicle log books not maintained in an appropriate level of detail. This could indicate abuse of the vehicle.
- ▶ Budget monitoring reports delayed – to cover up something?

▷ **Non-financial areas:**

- ▶ Working very long hours – first in last out of the office? Could mean that they have to work more to cover their tracks?
- ▶ Never taking holidays – can't afford for someone else to see what they are doing!
- ▶ Change of lifestyle or spending patterns don't match their income (eg designer clothes, social habits, expensive car...)
- ▶ Creating 'smoke screens' – where someone is making a false accusation about another team member to give them time to cover their tracks or make a getaway!

▷ **And some Ideas on fraud prevention:**

- ▶ Make sure you have robust internal control systems in place.
- ▶ Visit projects, and see if the activities carried out roughly match the expenditure.
- ▶ Share financial reports with beneficiaries, and ask if they think they have had value for money.
- ▶ Hold regular meetings with other staff at all levels (eg project and administrative staff, board members, etc) to discuss financial reports, making budgets and reports openly available.
- ▶ Help non-finance staff and managers improve their financial skills, for instance by reading Mango's Guide to Financial Management (available on the CD-Rom in your training pack.)

How to deal with fraud

Incidents of fraud and other irregularities require sensitive handling to minimise the long-term impact. It is important to be prepared to deal with any occurrences of fraud or financial irregularity by having a written procedure which covers steps that need to be taken.

▷ **Deterrence**

The procedure should state clearly that routine controls, checks and balances are in place to safeguard the assets of the organisation. The controls also protect staff from any suspicion of, or temptation to, fraud or other impropriety. Paid staff and volunteers are therefore obliged to co-operate fully with internal control procedures and failure to do so will be dealt with as appropriate within the organisation's disciplinary code.

▷ **Types of irregularity**

The procedure will identify different types of irregularity, how seriously they are viewed, and how they will be dealt with. For example, all instances of theft and fraud will be viewed *as Gross Misconduct* and result in immediate dismissal and loss of terminal benefits. It should include a clear statement on the circumstances in which the Police will be informed. This must take in to account local circumstances and cultural practice.

▷ **Detection**

A procedure for reporting suspicions of irregularities should be made clear to all. This should make it easy for people to report concerns in confidence and without fear of retribution.

When an irregularity is reported or detected, record the details in writing and report it immediately to a manager. Follow up all reports or suspicions immediately, do not allow rumours to spread or let the 'trail' go cold.

▷ **Investigation**

When an incident is reported, it must be dealt with quickly and sensitively. Look for corroboratory evidence before instigating a formal investigation. If all the evidence points to an irregularity, the individual(s) involved should be formally interviewed with a third person present to take notes.

Protect documents and records by either removing access to them by those involved in the irregularity or by suspending the people involved during the investigation. Depending on the nature of the irregularity, an investigation could be conducted by a senior manager or Board member, the internal auditor, the external auditor or, in more serious cases, the Police.

▷ **The 'aftermath'**

Don't under-estimate the long-term and less tangible impacts of fraud. It will involve a lot of a managers' time during the investigation and afterwards. In particular:

- ▶ People will be distressed by the experience and need to be supported. Colleagues will suffer all the mixed emotions of bereavement: anger, guilt, disappointment and loss. They may worry that their jobs are under threat.
- ▶ New staff may need to be recruited and trained.
- ▶ The media may get hold of the story and ask for information
- ▶ Donors will need reassuring that their resources are safe and the project will not suffer.

▷ **Summary**

Keep **RISKS LOW** in mind when managing a fraud or similar incident:

- | | |
|--------------|---|
| <i>DO</i> | R eport the incident to a superior or Board member |
| | I nvestigate incidences, gather the facts |
| | S ecure the assets and records |
| | K eep calm! |
| | S wiftly act |
| <i>DON'T</i> | L ook the other way |
| | O verlook the 'fall out' of a fraud |
| | W ithhold information to protect others |

Above all, remember that prevention is better than cure!

What is corruption?

Corruption happens in all countries of the world and affects all levels in society. But its affects are most severely experienced in the developing world and by the poorest in society – ie the communities that NGOs work with most often.



'Corruption is the misuse of entrusted power for private gain.'

Transparency International

More than \$1 trillion is paid globally in bribes each year. That means \$1 out of every \$30 of GDP is being paid in bribes (*World Bank Institute 2004*).

- ▶ It is estimated (by *The Economist* 2010) that as much as 25% of Africa's GDP is cost of corruption in Africa.
- ▶ Bribery is estimated to raise the average Kenyan family's annual cost of living by 15%. (*Transparency International* 2011).

'Corruption debases democracy, undermines the rule of law, distorts markets, stifles economic growth, and denies many their rightful share of economic resources or life-saving aid.' **Kofi-Annan, former President of the UN**

Corruption appears in many different forms including bribery, fraud, sexual exploitation, cronyism and money laundering.

See **Table 8.1** for definitions of typical corrupt practices.

Table 8.1: Key Definitions

Bribery	The offering, promising, giving, accepting or soliciting of an advantage as an inducement for an action which is illegal, unethical or a breach of trust. Inducements can take the form of gifts, loans, fees, rewards or other advantages.
Collusion	An agreement, usually secretive, which occurs between two or more people to limit open competition by deceiving, misleading or defrauding others. It can involve price-fixing, illicit payments to influence purchasers or misrepresenting the independence of the relationship between the colluding parties (eg resulting from nepotism and cronyism).
Corruption	The misuse of entrusted power for private gain, which can be both personal gain and gain or advantage to a company or organisation.
Cronyism	The appointment of friends and associates to positions of authority, without proper regard to their qualifications.
Embezzlement	Fraudulently acquiring funds or property entrusted to your care but actually owned by someone else.
Extortion	The practice of obtaining something, especially money or property, through force or threats.
Facilitation payments	A form of bribery made with the purpose of expediting or facilitating the performance by a public official of a routine governmental action and not to obtain or retain business or any other undue advantage. Typically demanded by low level, low income officials in exchange for providing services to which one is legally entitled without such payments.
Fraud	Wrongful or criminal deception intended to result in financial or personal gain.
Money laundering	A process whereby the identity and origin of illegally obtained money, such as bribes, are concealed or disguised. The objective is to make illegally obtained money to appear as if it comes from a legitimate source.
Nepotism	The practice among those with power or influence of favouring relatives or friends, especially by giving them jobs.
Sexual exploitation	Where someone uses their position to gain sexual favours.

Bribery and the NGO sector

Bribery is the most common form of corruption affecting poorer communities.

Bribery is

The offering, promising, giving, accepting or soliciting of an advantage as an inducement for an action which is illegal, unethical or a breach of trust.

NGOs are at particular risk of paying bribes due to the nature of their work.

Key risk factors for NGOs:

- ▶ The countries NGOs operate in have high rates of corruption.
- ▶ NGO work involves frequent contact with public officials, eg for licenses, crossing borders.
- ▶ NGOs have regular relationships and often work in partnership with government agencies.
- ▶ The humanitarian nature of NGO work means they need to get things done quickly.
- ▶ NGOs, unlike companies, do not base decisions on where to operate according to the levels of corruption.
- ▶ NGO structures involve working with local partners and Third Party agents.
- ▶ NGO operations are decentralised and field staff make local decisions.

In many countries it is illegal to receive *and* pay a bribe. This is an important risk factor for NGOs and their staff to consider. But NGOs must also recognise that bribery is unethical and they have a moral obligation to fight bribes in their work. Paying bribes embeds and sustains corruption.

Bribery is not victimless: it affects all communities but affects the poor most.

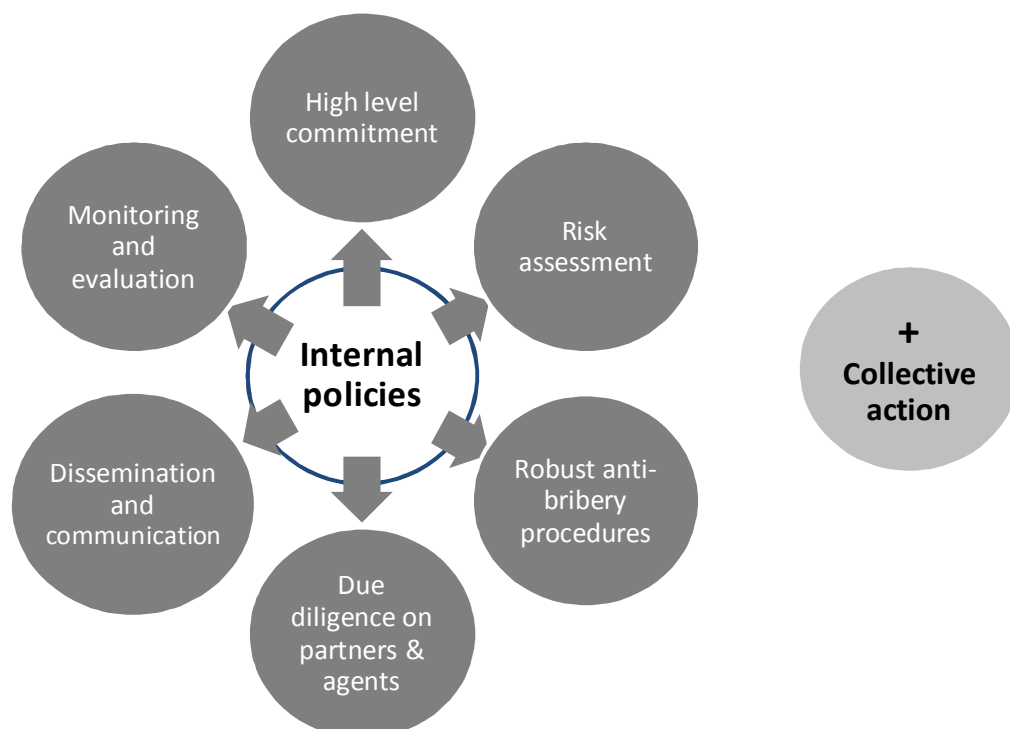
Bribery is always a two-way transaction – there is a payer and the receiver – therefore, if we cut off the flow of bribes, bribery cannot happen. This is the basis for the argument for a zero-tolerance approach to bribes.

Zero tolerance approach to bribes

Mango supports a zero-tolerance approach to bribery. We recommend all NGOs create an anti-bribery policy and train their staff to use it.

The anti-bribery principles put forward by Bond and a group of international NGOs in 2010 provide a strong framework for an anti-bribery policy and action plan. (See *Anti Bribery Principles and Guidance for NGOs* at www.bond.org.uk). The Seven Principles focus on internal policies and practice, plus the principle of collective NGO action:

Figure 8.2 Seven Principles for Zero Tolerance



Seven Anti-Bribery Principles for NGOs

1 High-level commitment

The Board of Trustees and senior management should commit to and oversee the implementation of a policy of zero-tolerance, recognising that bribery is contrary to fundamental values of integrity, transparency and accountability and undermines organisational effectiveness.

2 Risk assessment

Bribery risk assessment should form part of each organisation's overall and ongoing risk management process.

3 Devise and implement robust anti-bribery procedures

Organisations should devise, implement and maintain robust procedures, which are proportionate to the risks and to the size, resources and complexity of the organisation.

4 Due-diligence assessment of partners, agents and contractors

The organisation should assess the bribery risk associated with entering into partnership or contracting arrangements with other entities and then carry out periodic due diligence based on that risk assessment. Partnership or contractual arrangements should check that these organisations have policies and procedures which are consistent with these Principles and Guidance.

5 Dissemination and communication

The organisation should establish effective internal and external communication of its policy and procedures. The organisation should undertake training and awareness programmes to ensure staff, agents and partners are aware of the potential risks, how bribery might affect them, what they should do if they are offered a bribe, and the consequences should they be found to have made or received a bribe.

6 Monitoring and evaluation

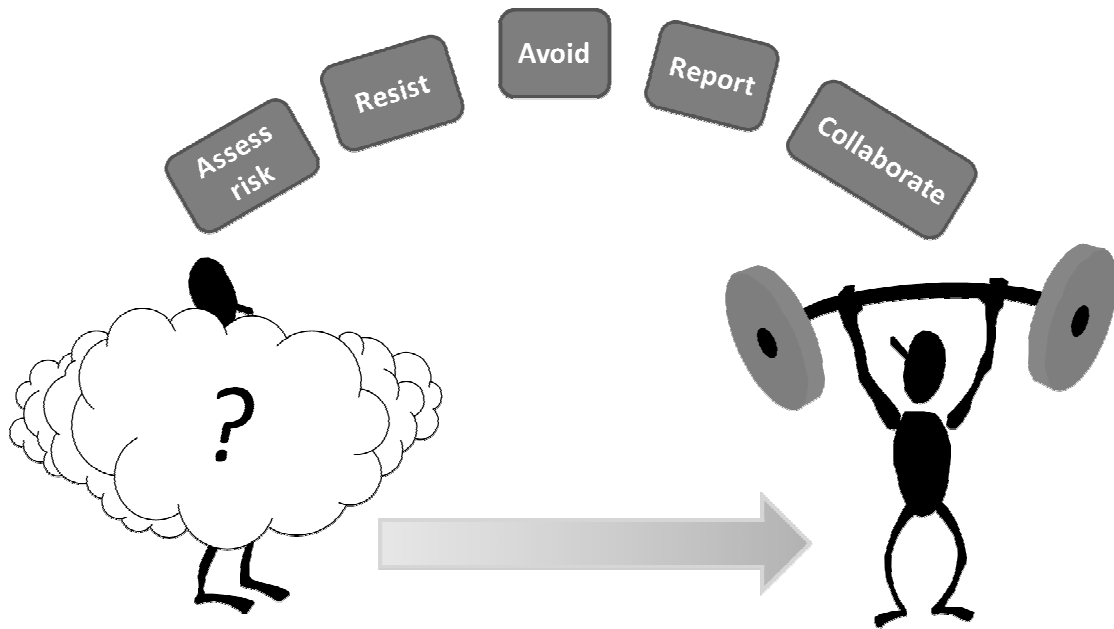
Implementation of anti-bribery procedures should be monitored as part of overall risk management and internal control processes. Periodic reviews of anti-bribery procedures should be made and reported as part of governance and accountability processes. Organisations that are exposed to higher risks should consider external verification and assurance of their anti-bribery procedures.

7 Collective action

The organisation should commit to sharing information and strengthening collective action to prevent bribery.

To implement the zero tolerance approach, there are five key tactics to follow:

Figure 8.3: Five Tactics for Anti-bribery action



▷ **Assess Risk**

The first stage of developing a zero-tolerance to bribery is to identify where your NGO is at risk of encountering bribes:

- ▶ Identify the key risk areas linked to your operations, eg working with partners, procurement, recruitment etc.
- ▶ Identify what the bribery risk is likely to be, eg facilitation payments, jobs for favours
- ▶ Assess the frequency of the bribery risk
- ▶ Assess the consequence if the bribe is not paid, eg delays to projects.

With this information, you can then prioritise action to reduce the risk of bribes now and in the future.

There are many techniques to capture and measure risk and your organisation may already have a preferred approach. **Table 8.2** illustrates an example template.

Table 8.2: Example Risk Assessment template

Risk Assessment Table		Organisation/Dept: <u>Mango - Training Dept.</u>			
Key risk area	What is the bribery risk?	Frequency of bribery risk	Possible consequences if bribe is not paid	Priority for action	
1	Sending training materials by courier	Customs officials want money to release the box.	Monthly (most get through OK)	Customs do not release boxes. Materials don't arrive for the training, affecting quality of service.	H
2	International travel	Officials request bribes at border crossings, for visas on entry, airport departure points, Police checks on roads to airport.	Frequent travel, experience varies but estimate 6 to 10 times a year	Staff delayed; flights could be missed; training services will suffer if trainer does not arrive in time.	H
3	Working with training partners	Potential for money laundering.	Rare, partners are closely vetted and relationship developed over time.	Loss of contract income.	M
4	Working with training partners	Partners may not have zero-tolerance policy	Unknown, will vary according to area of operation	Partners may not fulfil agreed objectives.	M

How to use the risk assessment table

- ▶ **Column 1:** Identify the 'red flag' key risk areas based on where and how you operate, who you work with (eg with partners, using agents, working with government agencies), what projects you run (eg emergencies, construction) etc.
- ▶ **Column 2:** Identify the bribery risks for each key risk area – ie how will bribery manifest itself?
- ▶ **Column 3:** Estimate how often a bribe is likely to be encountered.
- ▶ **Column 4:** What are the consequences if the bribe is not paid – this is to help recognise how serious the risk is and which area to prioritise action.
- ▶ **Column 5:** Rank the risk areas according to those that you need to work on first (eg High, Medium or Low or 1, 2 and 3).
- ▶ **Action plan:** for each item, prepare a response to show options for minimising the risk.

The following pages share some ideas on how to resist and avoid paying bribes.

▷ **Strategies for safely resisting bribes**

It is important to do whatever we can to resist paying bribes until we can find a longer-term solution through techniques to avoid bribes through project design.

All staff should be trained in these techniques to give them confidence to resist bribes safely.

Resisting techniques

Be prepared

- Don't give impression that there is a time pressure
- Learn from NGOs who don't pay
- Have backup – eg witnesses, someone who understands the local language and environment
- Make it clear you don't pay bribes from the outset (eg “it is illegal to pay bribes in my country”).

Find allies

- Eg someone in a position of authority.

Deflect approaches

- Brush it off smilingly
- Play ignorant.



▷ **Strategies for avoiding and reporting bribes**

Avoiding bribes techniques



Active zero tolerance policy

- Identify and mitigate risks of bribery
- Embed into organisation culture, train staff
- Give staff the confidence to say 'no'
- Establish reputation for not paying bribes
- Robust internal controls
- Whistle-blowing procedures.

'Design out' bribes in project design

- Remove urgency, build in longer timescales if starting up in a new country
- Careful selection of agents and partners
- Work around high risk practices, eg don't pay per diems
- Local knowledge, eg which ports and routes are corruption-free?
Which government departments or officials are less corrupt?

Record and report incidence of bribes

- Record and share internally
- Report externally, eg other NGOs, Embassies, anti-corruption agencies, media.

▷ **Consider collective action**

If enough NGOs (and companies) resist paying bribes and share information, some endemic corrupt practices will be forced out. Publicising known regular corrupt practices in the local media – such as the infamous road block on airport roads – could also have a positive impact.

It is also worth contacting the local Transparency International chapters or embassies for advice on local resistance strategies, and to report corrupt practices to them.

'Corruption hits hardest at the poorest in society.'

Mary Robinson, former President of Ireland

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Appendix 1: Milestone's Chart Of Accounts

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Account Description	Code	Comments
INCOME: DONOR		
- DFID	1010	For grants received from this donor
- Smile Trust	1020	For grants received from this donor
- Vanguard Society	1030	For grants received from this donor
INCOME: GENERAL		
- Bank Interest	1110	Interest received on bank accounts
- Donations & fundraising	1120	Fund-raising activities, miscellaneous donations
- Sales	1130	Sales of trainees' work
- Training fees	1140	Course participants' contributions
EXPENDITURE: ADMINISTRATION		
- Audit/accountancy	3010	Audit fees, other accountancy expenses
- Bank charges	3020	Service fees, interest charged on OD balances
- Board meetings	3030	Room hire, refreshments, AGM expenses
- Depreciation	3040	Cost of depreciation of fixed assets
- Postage & stationery	3050	Postage, office and photocopier consumables
- Publicity	3060	Posters, leaflets, advertising training courses
- Rent & utilities	3070	Office rent, insurance and utilities
- Repairs & renewals	3080	Servicing, small items of equipment, office repairs
- Telephones/fax	3090	Telephone accounts, not repairs
EXPENDITURE: PERSONNEL		
- In-service training	4010	Course fees, meals & accommodation
- Recruitment	4020	Recruitment advertising costs, interview expenses
- Salaries & benefits	4030	Gross salaries, housing, medical aid and pensions
- Travel & subsistence	4040	Per diem, meal and overnight allowances, bus fares
EXPENDITURE: VEHICLE RUNNING		
- Fuel	5010	Petrol, diesel and oil costs
- Vehicle insurance/tax	5020	Vehicle Insurance premiums and road tax
- Vehicle maintenance	5030	Service, repairs, tyres, spare parts, car wash
EXPENDITURE: TRAINING		
- Fees & honoraria	6010	Guest speakers' & external trainers' fees/expenses
- Food & accommodation	6020	Room hire, food for trainees
- Training materials	6030	Tools, protective clothing, papers, pens, metal, concrete, etc

FIXED ASSETS:		
- Office Equipment	0110	Computers, printers, desks, chairs, etc.
- Project Equipment	0120	Large tools and training equipment
- Vehicles	0130	Cars, mobile workshop
CURRENT ASSETS:		
- Bank Deposit Account	0210	High interest call account
- Bank Current Account	0220	Cheque account
- Petty Cash	0230	For adjustments to the petty cash Imprest float
- Debtors & prepayments	0240	Money owed to us (eg unpaid training fees) or prepaid amounts for goods/services not yet received
- Advances	0245	Staff loans and working advances
- Grants receivable	0250	Grants due for this year but not yet received from donor
- Stocks	0260	Stocks of raw materials, eg wood and metal
LIABILITIES:		
- Creditors & accruals	0510	Unpaid suppliers' invoices and accrued expenses
- Grants In advance	0520	Donor funds received for future activities
- Reserves	0530	Funds designated for use in future years

PROJECT COST CENTRES

Description	Code	Comments
- Co-ordination	01	Transactions to be allocated to the Co-ordinator's Department
- Building Department.	02	Transactions to be allocated to the Building Trades Department
- Metalwork Dept.	03	Transactions to be allocated to the Metalwork Department as a whole
- Metalwork: Furniture Project	03-01	Transactions to be allocated to the Furniture section of the Metalwork Department only
- Metalwork: Vehicles Project	03-02	Transactions to be allocated to the Vehicle section of the Metalwork Department only

Appendix 2: Delegated Authority Document

AREA OF AUTHORITY:	LIMITS APPLIED:	DESIGNATED PERSONS:
1. Legal documents (where not covered below)		Any <u>two</u> from: Ch, Tr, Se, CE.
2. Leases on property and equipment	Up to \$25,000 Over \$25,000	Any <u>one</u> from: Ch, Tr, Se, CE. Any <u>two</u> from: Ch, Tr, Se, CE.
3. Current Account Cheques	up to \$2,000 Over \$2,000	Any <u>two</u> from: Ch, Tr, Se, CE, one other designated BM Any <u>two</u> from: Ch, Tr, Se, one other designated BM.
4. Bank Account Transfers	Up to \$25,000 Over \$25,000	Any <u>two</u> from: Ch, Tr, Se, CE, one other designated BM Any <u>two</u> from: Ch, Tr, Se, one other designated BM.
5. Staff advances/loans	Max. \$2,000	CE (or in case of CE, Ch or Tr)
6. Staff expenses		LM for all staff below CE level Ch or Tr for CE
7. Board Member expenses		Ch or Tr
8. Orders for Goods & Services	Up to \$1,000 Up to \$5,000 Up to \$25,000 Up to \$50,000 Over \$50,000	SO, providing within budget OM, providing within budget CE, providing within budget Ch or Tr, providing within budget Any 2 BM and minuted by full Board Meeting.
9. Petty Cash expenditure	Up to \$50 (single transaction) Over \$50	AO FC
10. Safe Keys		FC and Tr
11. Receipt of cash & cheques		AO
12. Banking of cash & cheques		AC
13. Annual / sick leave		LM
14. Maternity / Paternity Leave		CE (or in case of CE, Ch or Tr)
15. Contracts of Employment	All staff	Ch, Tr or S

KEY: Ch = Chairperson; Tr = Treasurer; S = Secretary; BM = Board Member
 CE = Chief Executive; OM = Operations Manager; FC = Financial Controller;
 AO; Accounts Officer; AC = Accounts Clerk; SO = Senior Officer; LM = Line Manager.

Appendix 4: Bank Book – Payments Page

MILESTONE PROJECT: Bank Book – Payments January 2009

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Date	Payee/ details of transaction	Cheque or ref. no.	Cost Centre	Amount Paid UC *	Postage & Stat'y 3050	Rent, Ins & Utilities 3070	Repairs & Renewals 3080	Tel/fax 3090	Salary & Benefits 4030	Travel & Subs 4040	Fuel 5010	Food & Accom. 6020	Training Materials 6030	Other [add code]
ANALYSIS OF PAYMENTS CATEGORY														
03/01	SPM Lettings	13571	01	400.00		400.00								
03/01	Petty cash imprest	13572	02	176.54	14.00				15.00		30.00	73.00	44.54	
03/01	Safeway Insurance Co. - office	13573	01	789.00		789.00								
04/01	Newman's Garage - December	13574	03	1362.00							1362.00			
04/01	NGO Assembly - room hire	13575	01	50.00								50.00		
04/01	Pat's Restaurant - deposit	13576	01	150.00								150.00		
04/01	H. Brown - December travel	13577	02	65.35					65.35					
10/01	JS Supplies - December	13578	02	672.34	75.75		288.70						307.89	
10/01	SEB - Electricity December	13579	01	375.21		375.21								
11/01	Pat's Restaurant - balance due	13580	01	675.00								675.00		
11/01	D&J Timber Supplies - stocks	13581	02	1,085.19									1,085.19	
12/01	Office Supplies Ltd, desk/chair	13582	01	1,000.00										1,000.00 [0110]
13/01	Petty cash imprest	13583	01&02	199.15	65.44		20.56			7.50	86.15		19.50	
21/01	Jo Joshi - Nov/Dec. travel	13584	03	135.00						135.00				
25/01	Telecoms - phone bill	13585	01	657.30				657.30						
29/01	J. Joshi - January salary	13586	03	2,300.00					2,300.00					
29/01	H. Brown - volunteer allowance	13587	01	800.00					800.00					
29/01	P. Khan - volunteer allowance	13588	03-02	800.00					800.00					
PAGE TOTAL:				11,692.08	155.19	1,564.21	309.26	657.30	3,900.00	222.85	1,478.15	948.00	1,457.12	1,000.00

* UC = Unit of currency

Appendix 5: Petty Cash Book

MILESTONE PROJECT – PETTY CASH REGISTER

Period covered: 1 to 12 January 2009

Date	PCV No.	Details of transaction or cheque reference	Cash In UC*	Cash Out UC*	Cash Balance UC*	ANALYSIS OF PAYMENTS								
						Postage & stat'y 3050	Repairs & Renewals 3080	Travel & Subs 4040	Fuel 5010	Food & Accom 6020	Training Mats. 6030	Other		
3/1		Cash balance brought forward:	23.46	-	23.46	-	-	-	-	-	-	-	-	-
3/1	-	Top up cheque no. 013572	176.54	-	200.00									
3/1	1	Milk & coffee for office	-	10.57	189.43		10.57							
3/1	2	Calculator batteries	-	9.99	179.44		9.99							
5/1	3	Stamps	-	7.00	172.44	7.00								
6/1	4	Petrol - Jo's van. Bldg dept	-	45.00	127.44				45.00					
7/1	5	Fax paper	-	13.49	113.95	13.49								
10/1	6	OHP materials, pads & pens	-	29.45	84.50	9.95					19.50			
10/1	7	Petrol for Hari's car	-	35.65	48.85				35.65					
11/1	8	Oil for Hari's car	-	5.50	43.35				5.50					
12/1	9	DHL to New York	-	35.00	8.35	35.00								
12/1	10	Lunch/bus fare, Treasurer	-	7.50	0.85			7.50						
		PAGE TOTAL:	200.00	199.15	0.85	65.44	20.56	7.50	86.15	-	19.50	-	-	
			A	B	C									

Total A must = B + C

*UC = Unit of currency

Appendix 6: Bank Reconciliation Form

Milestone Project, Bank Reconciliation

Bank account details:	<i>RNU Bank, Current account no. 00067891</i>
Bank statement date:	31 January 2009
Bank statement sheet number:	37

A. Balance as on bank statement:	12,024.98
Less payments in cashbook, not on statement	
<i>04/01 chq no. 13575 NGO Assembly</i>	(50.00)
<i>25/01 chq no. 13585 Telecomms Co.</i>	(657.30)
<i>29/01 chq no. 13586 J. Joshi</i>	(2,300.00)
B. Total deduction	(3,007.30)
Plus receipts in cashbook, not on statement	
<i>28/01 Course fees</i>	1,500.00
C. Total addition	1,500.00
Less receipts on statement, not in cashbook	
<i>None</i>	
D. Total deduction	0.00
Plus payments on statement, not in cashbook	
<i>Bank charges</i>	35.00
E. Total addition	35.00
F. Balance in Bank Book [A-B+C-D+E]	10,552.68

Reconciliation performed by: **A.D.Ministrator**Signed: **ADM**

Date: 7 Feb 09

Reconciliation checked by: **A. Treasurer**Signed: **AT**

Date: 9 Feb 09

Appendix 7: Receipts & Payments Account

Receipts and Payments Account for the Milestone Project		
1 January to 31 December 2008		
	UC	UC
<u>Opening balance cash and bank</u>		2,880
<u>RECEIPTS</u>		
Donor grants Received:		
– DFID	48,000	
– SMILE Trust	43,000	
Donations & fundraising	750	
Training fees	13,540	
Sales	11,406	
Bank interest	832	
<u>Total receipts</u>		117,528
<u>PAYMENTS</u>		
Personnel costs	46,580	
Training expenses	20,588	
Vehicle running expenses	14,886	
Audit/accountancy	510	
Bank charges	455	
Board meetings	2,156	
Postage & stationery	4,768	
Publicity	396	
Rent & utilities	9,985	
Repairs & renewals	689	
Telephones & fax	9,450	
Office Equipment	1,850	
<u>Total payments</u>		(112,313)
<u>Closing balance cash and bank</u>		8,095

UC = Unit of Currency

Appendix 8: Income & Expenditure Account

Milestone Project

Statement of Income & Expenditure for the year ended 31 December 2008

	UC	UC	2007 UC
INCOME:			
Donor Income:			
-DFID	48,000		45,000
-SMILE Trust	<u>48,000</u>	96,000	45,000
Other Income:			
-Donations & Fundraising	6,750		6,600
-Training Fees	14,640		12,250
-Sales	11,765		6,768
-Bank Interest	<u>832</u>	<u>33,987</u>	<u>698</u>
TOTAL INCOME:		<u>129,987</u>	<u>116,316</u>
EXPENDITURE:			
Personnel Costs		52,580	48,780
Training Expenses		20,588	18,743
Vehicle Running Expenses		15,686	12,670
Depreciation		12,455	13,633
Administration:			
-Audit/Accountancy	587		500
-Bank Charges	455		387
-Board Meetings	2,057		1,480
-Postage & Stationery	4,838		6,776
-Publicity	396		325
-Rent & Utilities	9,994		6,524
-Repairs & Renewals	539		324
-Telephones & Fax	<u>9,341</u>	28,207	<u>6,803</u>
TOTAL EXPENDITURE:		<u>129,516</u>	<u>116,945</u>
EXCESS OF INCOME /(EXPENDITURE) FOR THE YEAR:		471	(629)

UC = Unit of Currency`

Appendix 9: Balance Sheet

Milestone Project
Balance Sheet as at 31 December 2008

	<i>Note</i>	2008 UC	2008 UC	2007 UC
Fixed Assets				
Tangible Assets	1		112,091	122,696
Current Assets				
Cash at bank and in hand		8,095		2,880
Grants Receivable		10,000		5,000
Debtors	2	<u>2,459</u>		<u>1,000</u>
		20,554		8,880
Current Liabilities payable within 12 months				
Creditors and accruals	3	<u>3,262</u>		<u>2,664</u>
Net Current Assets			<u>17,292</u>	<u>6,216</u>
Net Assets			<u>129,383</u>	<u>128,912</u>
<i>Represented by:</i>				
FUNDS	4			
General Purposes Fund			13,292	6,216
Designated Fund – Equipment Replacement			4,000	-
Designated Fund – Fixed Assets			112,091	122,696
Total Funds			<u>129,383</u>	<u>128,912</u>

[UC = Unit of Currency]

Appendix 10: Notes to the Accounts

Note 1 – Fixed Assets

	UC	UC
Value at 1 January	122,696	130,329
Plus: Additions during the year	1,850	6,000
Less: Depreciation for wear & tear	<u>(12,455)</u>	<u>(13,633)</u>
	112,091	122,696

Note 2 – Schedule of Debtors as at 31 December 2008

<u>Description</u>	UC
Training fees due for 2008 courses	2,100.00
Misc. sales invoices	<u>359.00</u>
Total Debtors & Prepayments	2,459.00

Note 3 – Schedule of Creditors & Accruals as at 31 December 2008

<u>Payee</u>	<u>Description</u>	UC
ML Electricity Co.	December electricity bill	375.21
Telecomms Ltd	December telephone a/c	657.30
City Stationers Ltd	Photocopying paper	145.25
Newman's Garage	December petrol, new tyres	1,362.00
J. Joshi	Travel expenses for December	135.00
PWC	Audit fee for 2008 audit (est.)	<u>587.00</u>
	Total Creditors & Accruals	3,261.76

Note 4 – Accumulated Funds

	2008	2007
	UC	UC
Balance at beginning of the year	128,912	129,541
Plus surplus/(less deficit) for period	<u>471</u>	<u>(629)</u>
Balance at the end of the year	129,383	128,912

The designated fund for fixed assets (or Capital Fund) represents the resources invested in the organisation's tangible fixed assets, and which are therefore not readily available for other purposes.

Appendix 11: Consolidated Budget

Milestone Consolidated Budget

1 January to 31 December 2009

		Total Budget	Cost Centre Budgets:		
			01 Co-ordination Dept.	02 Building Dept.	03 Metalwork Dept.
INCOME		UC	UC	UC	UC
DONORS	DFID	90,000	20,000	35,000	35,000
	Smile Trust	90,000	18,000	36,000	36,000
	Vanguard Society	15,000	0	0	15,000
OTHER	Bank Interest	1,000	1,000	0	0
	Donations & fundraising	8,000	2,000	3,000	3,000
	Sales	24,800	0	15,300	9,500
	Training Fees	42,500	100	21,200	21,200
	Total Income:	271,300	41,100	110,500	119,700
EXPENDITURE					
ADMINISTR- ATION	Audit/accountancy	4,500	1500	1500	1500
	Bank charges	600	200	200	200
	Board Meetings	1,200	400	400	400
	Depreciation	6,000	2,000	2,000	2,000
	Postage & stationery	7,500	2,500	2,500	2,500
	Publicity	1,500	500	500	500
	Rent & utilities	9,000	3,000	3,000	3,000
	Repairs & renewals	1,500	500	500	500
	Telephones/fax	6,300	2,100	2,100	2,100
STAFF	Salaries	47,700	0	23,850	23,850
	Housing costs	7,200	7,200	0	0
	Medical insurance	8,600	0	4,300	4,300
	In-service training	4,500	1,500	1,500	1,500
	Recruitment	0	0	0	0
	Travel & subsistence	3,000	1,700	650	650
VEHICLE RUNNING	Fuel	9,000	4,000	2,500	2,500
	Vehicle Insurance	18,000	6,000	6,000	6,000
	Vehicle maintenance	24,000	8,000	8,000	8,000
TRAINING	Fees & honoraria	3,000	0	1,500	1,500
	Food & accommodation	16,000	0	8,000	8,000
	Training Materials	92,200	0	41,500	50,700
Total Expenditure:		271,300	41,100	110,500	119,700
Surplus/deficit		0	0	0	0

Appendix 12: Budget Worksheet

Milestone project: Metalwork Department Budget Worksheet (Direct Project Costs)

Budget Period: 1 January to 31 December 2009

Line ref.	Budget Item	Unit Type	No. Units	Frequency	Unit Cost UC*	Total UC*	Notes	Account code
A	Project Staff Costs					30,300		
A1	Metalwork trainer salary	Month	12	1	1775	21,300	1 x full time post	4030
A2	Government taxes	Month	12	1	212.5	2,550	Approx. 12% of salary	4030
A3	Medical insurance	Lumpsum	1	1	4,300	4,300	20% of salary (rounded up)	4030
A4	Staff training	Day	5	2	150	1,500	2 x 5 days technical training in RSA	4010
A5	Meal allowances	Day	10	12	4	480	Average 10 days per month	4040
A6	Study tour bus fare	Person	2	1	85	170	To Johannesburg	4040
B	Project Inputs					76,700		
B1	Fuel	Kilometer	5,000	1	0.5	2,500	Estimate based on last year	5010
B2	Insurance for project vehicle	Lumpsum	1	1	6,000	6,000	As per quotation	5020
B3	Vehicle maintenance	Quarter	4	1	2,000	8,000	Estimate based on last year	5030
B4	Fees for guest tutors	Day	3	4	125	1,500	4 workshops, 3 days each	6010
B5	Food & accommodation	Participant	20	4	100	8,000	18 trainees plus 2 trainers, 4 workshops	6020
B6	Training materials	Lumpsum	1	4	12,675	50,700	Raw materials and tools as quotation	6030
TOTAL DIRECT PROJECT COSTS						107,000		

* UC = Unit of Currency

Appendix 13: Cashflow Forecast

Milestone Project Summary Cash Flow Forecast: 1 January to 31 December 2009

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Incoming cash												
DFID grant	18,000	0	0	24,000	0	0	24,000	0	0	24,000	0	0
Smile Trust grant	0	0	22,500	0	0	22,500	0	0	22,500	0	0	22,500
Vanguard Society grant	0	0	7,500	0	0	0	7,500	0	0	0	0	0
Bank Interest	40	5	0	0	71	0	0	74	0	26	96	0
Sales income	2,000	2,000	2,000	2,000	2,000	2,000	1,500	1,800	2,000	2,000	2,500	3,000
Donations	0	0	2,000	0	0	2,000	0	0	2,000	0	0	2,000
Training fees	3,500	7,000	0	7,000	3,500	0	0	7,000	3,500	0	7,500	3,500
A. TOTAL CASH IN	23,540	9,005	34,000	33,000	5,571	26,500	33,000	8,874	30,000	26,026	10,096	31,000
Outgoing cash												
Administration costs	2,000	2,000	5,000	2,000	2,000	7,100	2,000	2,000	2,000	2,000	2,000	2,000
Staff costs	5,600	5,600	5,600	5,600	5,600	5,600	6,200	6,200	6,200	6,200	6,200	6,400
Vehicle Running costs	22,000	2,500	2,500	3,000	2,500	2,500	3,000	2,500	2,500	3,000	2,500	2,500
Training programme	1,000	25,000	2,000	2,000	25,000	1,000	2,000	25,000	2,000	1,000	25,000	200
B. TOTAL CASH OUT	30,600	35,100	15,100	12,600	35,100	16,200	13,200	35,700	12,700	12,200	35,700	11,100
C. Net cash flow [A - B]	(7,060)	(26,095)	18,900	20,400	(29,529)	10,300	19,800	(26,826)	17,300	13,826	(25,604)	19,900
D. Cash balance at start of month	8,095	1,035	(25,060)	(6,160)	14,240	(15,289)	(4,989)	14,811	(12,015)	5,285	19,111	(6,493)
E. Cash balance at end of month [C + D]	1,035	(25,060)	(6,160)	14,240	(15,289)	(4,989)	14,811	(12,015)	5,285	19,111	(6,493)	13,407

Appendix 14: Budget Compared To Actual Report

Milestone Project - Budget Compared to Actual Report: 1 January to 31 March 2009

	1 January to 31 March 2009		VARIANCE (adv)/fav UC	VARIANCE %	NOTES
	TOTAL BUDGET UC*	ACTUAL UC			
Income (actual = receipts)					
Donors					
DFID	90,000	25,000	0	0%	
Smile Trust	90,000	25,000	0	0%	
Vanguard Society	15,000	6,350	2,600	69%	Project tools purchased/reimbursed early
Other					
Bank Interest	1,000	205	(45)	-18%	
Donations	8,000	350	(1,650)	-83%	Fundraising strategy to be reviewed
Sales	24,800	5,462	(738)	-12%	
Training Fees	42,500	14,500	333	2%	
TOTAL	271,300	76,867	500	0.7%	
Expenditure (includes commitments)					
Administration					
Audit fees	4,500	0	0	0%	
Bank charges	600	150	105	45	30%
Board Meeting	1,200	150	127	23	15%
Depreciation	6,000	0	0	0	0%
Post & stationery	7,500	1,875	636	1,239	66%
Publicity	1,500	375	200	175	47%
Rent, ins. & utilities	9,000	2,250	2,100	150	7%
Repairs & renewals	1,500	375	327	48	13%
Telephones/fax	6,300	1,575	1,982	(407)	-26%
Staff					
Salaries & benefits	63,500	15,875	15,150	725	5%
In-service training	4,500	1,125	1,000	125	11%
Recruitment	0	0	0	0	-
Travel & subs.	3,000	750	835	(85)	11%
Vehicle Running					
Fuel	9,000	2,250	3,675	(1,425)	-63%
Vehicle Insurance	18,000	17,500	0	0	0%
Vehicle maintenance	24,000	6,000	5,608	392	7%
Training					
Fees & honoraria	3,000	750	500	250	33%
Food & accomm.	16,000	4,000	4,930	(930)	-23%
Training Materials	92,200	23,050	26,450	(3,400)	-15%
TOTAL	271,300	78,050	81,125	(3,075)	-4%
SURPLUS/(DEFICIT)	0	(1,683)	(4,258)	(2,575)	

*UC = Unit of currency

Appendix 15: Donor Report

DFID No.12345
STATEMENT OF ACTUAL EXPENDITURE FOR QUARTER ENDING: 30-Sep-09
AND ESTIMATED EXPENDITURE FOR QUARTER ENDING: 31-Dec-09

Rate applied: 3.75

Budget items:	1	2	3	4 [2 - 3]	5	6	7	8 [7 - 4]	See Report note no.
	Annual Budget GBP	Budget last Qtr GBP	Actual last Qtr GBP	Balance remaining GBP	Spent to date GBP	Spent to date %	Budget next Qtr GBP	Grant claim GBP	
Administration	1,200	0	0	0	1,267	106%	0	0	
	160	40	29	11	91	57%	32	21	
	320	27	23	4	303	95%	27	23	
	1,600	0	0	0	0	0%	1,600	1,600	1
	2,000	500	426	74	1,814	91%	187	113	
	400	100	43	57	189	47%	200	143	
	2,400	600	586	14	1,745	73%	573	560	
	400	100	57	43	212	53%	187	143	
	1,680	420	572	(152)	1,548	92%	415	567	2
	16,933	4,233	4,280	(47)	12,411	73%	4,280	4,327	
Staff	1,200	300	859	(559)	1,170	98%	30	589	3
	0	0	0	0	36	-	0	0	
	800	200	210	(10)	585	73%	195	205	
	2,400	600	773	(173)	2,622	109%	874	1,047	4
	4,800	0	40	(40)	4,720	98%	0	40	
	6,400	1,600	1,297	303	5,087	79%	1,307	1,004	
	800	200	400	(200)	653	82%	147	347	
	4,267	1,067	1,027	40	3,501	82%	1,040	1,000	
	24,587	6,147	6,157	(11)	18,455	75%	6,133	6,144	
TOTAL	72,347	16,133	16,780	(647)	56,409	78%	17,226	17,873	
Total apportioned to DFID:	24,000	5,324	5,537	(213)	18,615	78%	5,385	5,599	
% apportioned to DFID:	33%	33%	33%	33%	33%		33%	31%	

Schedule of DFID grants received/due:

	GBP
Qtr 1	6,667
Qtr 2	5,867
Qtr 3	5,867
Qtr 4	5,599
TOTAL	24,000

Appendix 16: Budget Forecast

Milestone Project Budget Forecast to 31 December 2009

	TOTAL BUDGET		Actual - 1 January to 30 September				TOTAL To 30 Sept		Forecast Quarter 4		TOTAL ANTICIPATED	
	UC		Quarter 1	Quarter 2	Quarter 3	UC	UC	UC	UC	UC	UC	
Income												
DFID	90,000		25,000	22,000	22,000	0	69,000	21,000	90,000			
Smile Trust	90,000		25,000	25,000	25,000	0	75,000	15,000	90,000			
Vanguard Society	15,000		6,350	0	8,500	0	14,850	0	14,850			
Bank Interest	1,000		205	196	226	0	627	200	827			
Donations	8,000		350	895	3,250	0	4,495	800	5,295			
Sales	24,800		5,462	4,670	6,785	0	16,917	7,000	23,917			
Training Fees	42,500		14,500	6,900	11,200	0	32,600	9,500	42,100			
TOTAL	271,300		76,867	59,661	76,961		213,489	53,500	266,989			
Expenditure												
Audit fees	4,500		0	4,750	0	0	4,750	0	4,750			
Bank charges	600		105	125	110	0	340	120	460			
Board Meeting	1,200		127	924	85	0	1,136	100	1,236			
Depreciation	6,000		0	0	0	0	0	6,000	6,000			
Post & stationery	7,500		636	4,568	1,598	0	6,802	700	7,502			
Publicity	1,500		200	350	160	0	710	750	1,460			
Rent, ins. & utilities	9,000		2,100	2,243	2,199	0	6,542	2,150	8,692			
Repairs & renewals	1,500		327	256	213	0	796	700	1,496			
Telephones/fax	6,300		1,982	1,678	2,145	0	5,805	1,558	7,363			
Salaries & benefits	63,500		15,150	15,340	16,050	0	46,540	16,050	62,590			
In-service training	4,500		1,000	167	3,222	0	4,389	111	4,500			
Recruitment	0		0	135	0	0	135	0	135			
Travel & subsistence	3,000		835	569	789	0	2,193	731	2,924			
Fuel	9,000		3,675	3,257	2,900	0	9,832	3,277	13,109			
Vehicle Insurance	18,000		17,500	50	150	0	17,700	0	17,700			
Vehicle maintenance	24,000		5,608	8,603	4,865	0	19,076	4,900	23,976			
Fees & honoraria	3,000		500	450	1,500	0	2,450	550	3,000			
Food & accomm.	16,000		4,930	4,350	3,850	0	13,130	3,900	17,030			
Training Materials	92,200		26,450	19,667	23,090	0	69,207	23,000	92,207			
TOTAL	271,300		81,125	67,482	62,926		211,533	64,597	276,130			
SURPLUS/(DEFICIT)	-		-4,258	-7,821	14,035		1,956	-11,097	-9,141			

AGM costs were under estimated.
 Expect the major event in November
 Expenditure levels are generally on track.
 Major repairs expected in the month of December
 Phone rates were raised by phone company.
 On track
 Last Qtr will not be very busy.
 Estimate based on activity plan
 Estimate based on activity plan
 Estimate based on activity plan
 On track

Appendix 17: Financial Management Work Plan

Financial Management Work Plan

KEY: - - - - = daily X = no. weeks

FINANCIAL ACCOUNTING ROUTINES		JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Banking	Daily												
Payroll	Monthly	X	X	X	X	X	X	X	X	X	X	X	X
Prepare Payment vouchers/cheques	Daily												
Prepare/check Purchase Orders	Daily												
Reimburse/reconcile p.cash / advances	Weekly	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX
Update Cash Book	Weekly	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX
Bank reconciliation	Monthly	X	X	X	X	X	X	X	X	X	X	X	X
Trial Balance	Monthly	X	X	X	X	X	X	X	X	X	X	X	X
Filing	Daily												
Update stock records	Weekly	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX
Reconcile stock records	Monthly	X	X	X	X	X	X	X	X	X	X	X	X
YEAR END													
Year-end reconciliation	Annual												
Prepare financial statements	Annual												
Prepare year-end schedules	Annual												
Auditor's visit	Annual			X									
Income Tax annual return	Annual												
BUDGETING													
Prepare first draft budgets	Annual								XXXX				
Revise budgets	Annual									X	X		
Budget to Board for approval	Annual											X	
REPORTS													
Prepare Budget Monitoring Report	Quarterly	X			X			X			X		
Prepare Cash Flow Report	Monthly	X	X	X	X	X	X	X	X	X	X	X	X
Prepare Donor Reports	Quarterly		X			X			X			X	
- DFID	Quarterly							X			X		
- USAID	Quarterly	X			X								
REVIEWS													
Assets Register	Quarterly	X			X			X			X		
Insurance cover	Six months				X						X		
Chart of Accounts	Annually												X
Delegated Authorities	Six months						X						X
Pay award	Annually			X									
Update Finance Manual	Annually												X

Appendix 18: Sample Expenses Claim Form

Expenses/Cash Advance Claim Form

NAME: _____

POSITION: _____

Date	Details of journey and/or type of allowance being claimed:	Receipt attached ✓	Amount claimed
TOTAL CLAIMED :			

I confirm that the above expenses have been/will be necessarily incurred by me during the course of my duties.*

* Delete as appropriate

SIGNED: _____

DATE: _____

AUTHORISED: _____

DATE: _____

RECEIVED BY: _____

DATE: _____

Appendix 19: Sample Fixed Asset Register

Fixed Assets Register

			REF:
Name of Asset:			
Description:			
Make/Model:		Serial No.:	
Date Of Purchase:		Supplier:	
Purchase Price:		Invoice No:	
Location Of Asset:			
Depreciation Period:		Depreciation Method:	
Depreciation/Repairs/Insurance Schedule:			
Date	Details	Cost / Valuation	

Appendix 20: Sample Payment Voucher

Payment Voucher

Date:		Amount:	
Supplier or payee details		Cheque No. or PCV Reference:	
Invoice No.:		Order No.:	
COST CENTRE Or DEPT. REFERENCE:		BUDGET CATEGORY / CODE:	
<p>DETAILS OF PAYMENT OR REQUEST FOR FUNDS:</p> 			
<p>HAVE ESTIMATES/QUOTATIONS BEEN OBTAINED? YES/NO</p> <p><u>If yes</u>, please attach copies and indicate preferred supplier with reasons.</p> <p><u>If no</u>, please state why not obtained.</p>			
CHECKED BY:			
ORIGINATED BY:		AUTHORISED BY:	
DATE:		DATE:	
ENTERED IN RECORDS BY:		DATE:	

Appendix 21: Sample Bank Reconciliation Form

Bank Reconciliation Form

Bank account details:	
Bank statement date:	
Bank statement sheet number:	
A. Balance as on statement:	
Less payments in cashbook, not on statement (e.g. un-presented cheques)	
B. Total deduction	
Plus receipts in cashbook, not on statement (e.g. unbanked income)	
C. Total addition	
Less receipts on statement, not in cashbook (e.g. income received directly into bank account)	
D. Total deduction	
Plus payments on statement, not in cashbook (e.g. direct debits & bank charges)	
E. Total addition	
F. Balance in Bank Book [A-B+C-D+E]	

Reconciliation performed by:

Signed:

Date:

Reconciliation checked by:

Signed:

Date:

Appendix 23: A Checklist for Good Practice

A. Minimum Requirements	
Standard	Why
<input checked="" type="checkbox"/> A valid supporting document for every transaction, (securely filed and stored for the minimum period required.)	Protection for staff, evidence and details of transaction.
<input checked="" type="checkbox"/> A cash book for every bank account, reconciled every month.	To organise and summarise transaction information; check for errors and omissions.
<input checked="" type="checkbox"/> A Chart of Accounts – used consistently in the accounting records and budgets	Principle of consistency; to facilitate production of financial reports.
<input checked="" type="checkbox"/> A budget detailing costs and anticipated income for all operations.	Planning, fundraising, control and reporting.
<input checked="" type="checkbox"/> Clear delegation of authority – from governing body through the line management structure.	To know who is responsible for what and within what limits.
<input checked="" type="checkbox"/> Separation of duties – sharing finance admin duties between at least two people	To prevent temptation to steal and reduce opportunity to commit fraud; to share the load.
<input checked="" type="checkbox"/> Annual financial statements – preferably audited by an independent person.	Accountability to stakeholders; transparency.
B. Good Practice	
Standard	Why
<input checked="" type="checkbox"/> Additional accounting records when staff employed (wages book) or assets owned (Assets Register).	To meet statutory and audit requirements; for control purposes.
<input checked="" type="checkbox"/> Budgets based on real activity plans, which include the full cost of running a project.	Realistic, more likely to meet targets.
<input checked="" type="checkbox"/> Budgets with clear calculations and notes.	Easy to read and make adjustments. Easy to justify calculations.
<input checked="" type="checkbox"/> Separate core costs budget.	Encourages active management and financing strategy for core costs
<input checked="" type="checkbox"/> Monthly cash flow forecast.	Helps to identify and take action to avoid short-term cash flow problems.
<input checked="" type="checkbox"/> Use of Cost Centres for multiple donors and/or projects.	To separate restricted funds and related transactions to facilitate reporting to managers and donors.
<input checked="" type="checkbox"/> Funding grids for multiple donors situations.	To avoid double-funding situations and identify areas of shortfall.
<input checked="" type="checkbox"/> Budget monitoring reports each month.	To monitor progress; control purposes.
<input checked="" type="checkbox"/> Written policies and procedures	To prevent confusion about organisation rules and expected practice.
<input checked="" type="checkbox"/> Diversified income – mix of restricted and unrestricted funds.	Less vulnerable to financial shocks; helps to build up reserves.
<input checked="" type="checkbox"/> A reasonable level of reserves.	Less vulnerable to financial shocks; helps overcome cashflow problems

Appendix 24: Integrating Financial Management Checklist

Statement of practice	True	Some-times	Not true
1. The Chief Executive takes an active interest in financial management issues.	3	2	1
2. Programme staff's job descriptions set out specific financial management roles and responsibilities.	3	2	1
3. Programme staff receive financial management training, either on formal courses or as 'on-the-job' training.	3	2	1
4. Senior managers lead by example and comply with the financial policies and procedures.	3	2	1
5. Programme staff generally comply with accounting requirements and procedures.	3	2	1
6. Programme staff never complain that financial policies and procedures are too bureaucratic or impractical.	3	2	1
7. If <u>any</u> member of staff does not follow the policies and procedures, this leads to some kind of sanction or warning (as opposed to people getting away with it).	3	2	1
8. Finance policies and procedures written down (for example in a Finance Manual) and circulated to all staff.	3	2	1
9. Non-finance staff are consulted on the practicality and 'user friendliness' of financial paperwork (e.g. vehicle log sheets, payment forms and expenses claims).	3	2	1
10. Finance staff and programme staff meet regularly to discuss programme plans and progress on objectives.	3	2	1
11. Programme staff receive regular budget monitoring reports <u>and</u> use them for managing their programmes?	3	2	1
12. The Chart of Accounts (a list of accounts codes/categories) is made available to programme staff.	3	2	1
13. The finance staff are known to be approachable and willing to discuss queries with programme staff.	3	2	1
14. The finance department 'valued' by the organisation – e.g. it is adequately resourced; it is represented on the management team.	3	2	1
15. Finance staff are involved in the strategic planning process.	3	2	1
16. Budgets are delegated, and managed and implemented at project level.	3	2	1
17. Finance staff are involved in the annual budgeting process.	3	2	1
18. Programme staff are involved in the annual budgeting process.	3	2	1
19. The senior financial officer never complains of being bogged down by day to day paperwork and authorisation duties.	3	2	1
20. Senior programme staff are authorised to sign documentation on behalf of the NGO, within specified limits (e.g. purchase orders, cheques, contracts).	3	2	1

Appendix 25: Mango's Health Check

Mango's Health Check

How healthy is financial management in your
not-for-profit organisation?

Version 3
2009

Contents

Introduction	1
Sections:	
1 Planning & budgeting	3
2 Basic Accounting systems	4
3 Financial reporting	5
4 Internal controls	6
5 Grant management	7
6 Staffing	8
Interpreting your score	9
Additional Resources	10
Glossary	11

About Mango

Mango is a UK based charity which exists to strengthen the financial management of not-for-profit organisations, including NGOs. Mango publishes freely available tools, like this one, as well as running training courses and providing finance staff to work with NGOs. See www.mango.org.uk for more details.

What can Mango's Health Check do?

Mango's Financial Health Check can help you assess the health of your organisation's financial management. It is designed as a self assessment tool so that you can identify the areas where you need to improve.

The Health Check is a set of statements of good practice. They cover all the key areas of NGO financial management. For each statement, you need to consider how well your own organisation is in line with good practice. By the end of the Health Check you will be able to tell if the financial management in your organisation is healthy or sick - and whether you need to call a doctor!

You may like to run the Health Check again after a year or two, to assess and monitor your progress.

What can Mango's Health Check NOT do?

Every organisation is different and financial management systems must reflect this. A 'one size fits all' approach cannot work. But the key aspects of good practice are the same for most organisations most of the time. The Health Check focuses on those key aspects. They are the foundation stones of good practice.

Mango's Financial Health Check only provides a general indication of the health of your organisation's financial management. It is not an exhaustive list of all aspects of financial management.

It is not an audit and it does not describe a standard set of procedures which are relevant in every situation. It is not appropriate to set a score as a 'pass rate' for partner assessment. It is not appropriate to compare scores of two organisations and make conclusions about differences between them.

Who is Mango's Financial Health Check designed for?

It has been particularly designed for small and medium sized not-for-profit organisations (or field offices). This may include Non Governmental Organisations, schools, medical centres, churches etc. It is not designed for the head offices of international organisations.

How to use Mango's Health Check

The Health Check can be run by any member of staff or a trustee. You do not need specialist financial skills to complete it. It includes explanations of each section and a glossary of the financial terms used.

The most useful way to use this tool is to complete it in a 2-3 hour workshop meeting, with input from the Treasurer, Chief Executive Officer, Senior Managers, and a selection of budget holders, finance staff and field staff (ideally 5- 7 people).

Taking each statement of best practice in turn, discuss whether it is true, or is in place, or happens in your organisation. Agree on a score based on what actually happens, not what is supposed to happen, or what is documented in your finance manual. The scores available are 5,4,1 and 0 only.

Explanation	Score
Our practice is totally in accordance with the statement	5
Close to 5, but not quite there	4
Close to 0, but not that poor	1
This is not in place, or is not true or does not happen	0

Clearly a degree of judgement is required to decide between '4' or '1', and it is not an exact science. If you cannot give yourselves a clear cut 5 or 0, you need to decide which one you are closer to.

Often the real value in this exercise is not the score itself so much as the conversations and the details of issues discussed.

Make good notes and keep a list of action points as they come up.

Ring the score for each statement. Add up the total for each section and transfer it to page 9 to get a total. Then interpret the score using the guidance given.

Comments

Mango welcomes comments on its tools and publications. Please send any comments or suggestions you might have on the Health Check to: guide@mango.org.uk. Thank you!

The Health Check is also available in other languages here:

<http://www.mango.org.uk/Guide/HealthCheck>

Section 1	Planning & budgeting
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Budgeting is about working out how much your planned activities are likely to cost. Both programme and finance staff should be involved in setting budgets, to create a foundation for good cooperation and coordination during spending and budget monitoring.

Budgets have a crucial role to play in strong financial management. Budgets should be approved by the Board of Trustees, to check they reflect the planned strategic direction of the organisation. Project managers can use a budget to guide implementation and check on progress. Overhead costs that are shared by many projects also need to be carefully controlled by an assigned budget holder.

The codes used for your budget lines need to correspond to the codes used in your accounting system. Otherwise it will be difficult to track actual spending against expected spending in your budget monitoring reports.

A cash flow forecast is as important as a budget. It constantly looks 3-6 months into the future, starting with the actual cash available now. It helps you to prioritise the timing and scale of planned activities and to spot cash flow problems in good time.

Ref	Statement of best practice	Score			
		5	4	1	0
1.1	Budgets are prepared in good time for all the costs of running the organisation	5	4	1	0
1.2	Both finance and programme staff are involved in setting budgets	5	4	1	0
1.3	Project budgets are based on the costs of planned activities	5	4	1	0
1.4	Budget worksheets include explanatory notes and clear calculations	5	4	1	0
1.5	A separate budget is prepared for core costs (overheads)	5	4	1	0
1.6	Organisational budgets are approved by the Board of Trustees	5	4	1	0
1.7	A named individual (budget holder) is responsible for implementing and managing each budget	5	4	1	0
1.8	Budget codes match (or correspond to) accounting codes	5	4	1	0
1.9	All planned operational costs are adequately funded	5	4	1	0
1.10	A cash flow forecast is prepared every month	5	4	1	0
Total score for planning & budgeting					

Section 2	Basic accounting systems
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Every financial transaction should be backed up by a 'supporting document', e.g. a receipt, invoice or sign sheet (eg for many travel reimbursements). This is the evidence that a specific transaction has taken place.

Every transaction involving paying out or receiving money should be written down in a cashbook. It can be kept in a physical cashbook or petty cashbook, on an Excel spreadsheet or as part of a computerised accounting package. Every entry in the cashbooks should be referenced back to the relevant supporting document.

It is important to check the accuracy of the accounting books at the end of each month by carrying out two essential 'reconciliations'. The bank statement balance is compared to the bank cashbook closing balance. A physical cash count is done to check the closing balance in the petty cash book.

Accounting works by assigning codes to each transaction entered in the cashbooks. The unique list of accounting codes that an organisation uses is called its "Chart of Accounts". Another set of codes can be used to assign transactions to a specific project or donor. These are called 'cost centre' codes.

Ref	Statement of best practice	Score			
		5	4	1	0
2.1	Every payment made has a supporting document providing evidence	5	4	1	0
2.2	All cash or cheques received are recorded on pre-numbered carbon copy receipts (<i>if no cash/cheques received score 5</i>)	5	4	1	0
2.3	All payments and receipts are recorded in cashbooks (date, description, amount)	5	4	1	0
2.4	There is a separate cashbook for each bank and cash account	5	4	1	0
2.5	Every entry in the cashbooks is cross referenced to a supporting document	5	4	1	0
2.6	All cashbooks are updated at least once per month	5	4	1	0
2.7	All cashbooks are written neatly in permanent ink or on computer	5	4	1	0
2.8	A standard Chart of Accounts is used to code (or classify) each transaction in the cashbooks	5	4	1	0
2.9	Transactions are also classified by project or donor using a standard list of 'cost centres'	5	4	1	0
2.10	A bank reconciliation is done each month, for every bank account	5	4	1	0
2.11	A cash count reconciliation is witnessed and recorded each month	5	4	1	0
2.12	The organisation keeps track of amounts owed to others (eg suppliers) and owed by others (eg staff)	5	4	1	0
Total score for basic accounting systems					

Section 3	Financial reporting
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The Board of Trustees need financial reports to oversee the finances of the organisation. Managers need up-to-date figures to monitor projects and make decisions. Donor agencies need reports to check the use of their money, and often as a condition for further funding. Increasingly, organisations are sharing financial information with beneficiaries to increase accountability and build confidence. An annual external audit verifies the accuracy of the financial statements.

The monthly financial reports should include an **Income and Expenditure** report showing money coming into the organisation and how it was spent. If the report compares the amount spent against budget, it is called a **Budget Monitoring Report**. The budget is supposed to be a tool not a straight jacket. Project managers should use financial reports to help make decisions so that the money is used efficiently and effectively to achieve desired outcomes.

It is also important to report on balances held at the end of each month or quarter. Balances includes the amount of money held (cash and bank), as well as amounts owed to the organisation (such as unaccounted working advances) and owed by the organisation (eg to suppliers / tax authorities).

Reports should be produced showing the relevant level of detail according to their use (eg for a single project or donor) or consolidated. Reports should also have the right format for their use, eg donor formats as per grant agreements, standard formats for annual audited accounts, accessible formats for beneficiaries, user friendly formats for managers.

NB: Donor reports are considered in **Section 5: Grant Management**.

Ref	Statement of best practice	Score			
		5	4	1	0
3.1	The board reviews financial reports every quarter	5	4	1	0
3.2	Senior managers discuss financial reports at least once every three months	5	4	1	0
3.3	Reports include details of cash and bank balances, amounts due (eg from staff) and owed (eg to suppliers)	5	4	1	0
3.4	Budget holders receive budget monitoring reports every month	5	4	1	0
3.5	Budget monitoring reports include explanations and comments about differences	5	4	1	0
3.6	Financial reports are used to help make decisions	5	4	1	0
3.7	Financial information is shared with beneficiaries at least once per year, in an accessible way	5	4	1	0
3.8	Annual audits are up-to-date (signed within 6 months of the year end)	5	4	1	0
Total score for reporting					

Section 4	Internal controls
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NGOs use a lot of different internal controls to make sure that:

- Assets are safeguarded
- Accounting records are accurate and up to date
- Fraud and errors are prevented and detected
- Staff are protected

Note: the other sections of the Health Check also include important controls. For instance cash and bank reconciliations are important for checking accuracy of accounting records and identifying fraud.

Ref	Statement of best practice	Score			
		5	4	1	0
4.1	Cash is kept safely in a locked cashbox or safe, in the custody of one individual	5	4	1	0
4.2	All cash received is banked intact, ie without any being spent (if no cash is received, score 5)	5	4	1	0
4.3	All cheques are signed by at least two authorised signatories	5	4	1	0
4.4	Cheques are signed only when all the details have been properly filled in (ie no signatories ever sign blank cheques)	5	4	1	0
4.5	Bank reconciliations are checked by someone who did not prepare them	5	4	1	0
4.6	There is a written policy detailing who can authorise expenditure of different types or value	5	4	1	0
4.7	All transactions are properly authorised	5	4	1	0
4.8	Cash payments are authorised by someone other than the cashier	5	4	1	0
4.9	Different steps in the procurement process, (eg ordering, receiving and paying) are shared among different people.	5	4	1	0
4.10	Expenses claims for staff advances are checked by the same person who authorised the advance	5	4	1	0
4.11	Staff salaries (including advances and loans deductions) are checked each month by a senior manager	5	4	1	0
4.12	Statutory deductions (eg payroll taxes) are properly made and paid on time	5	4	1	0
4.13	All fixed assets (eg vehicles, computers, equipment) owned by the NGO are insured and controlled using a fixed assets register	5	4	1	0
4.14	There is an approved policies and procedures manual in place which is relevant to the organisation, and known by staff	5	4	1	0
4.15	A properly registered audit firm is selected by the trustees	5	4	1	0
Total score for internal controls					

Section 5	Grant management
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Most NGOs get at least some of their funding as grants from donor partners. It is important to have a grant agreement in place that outlines the amounts and timings of funds to be transferred.

Donors tend to fund specific projects with specific budgets which form part of the agreement.

The grant agreement may also contain a number of grant conditions, including procurement rules and reporting requirements. Programme and Finance staff need to work together to ensure consistency between the narrative and financial reports about the same project.

Often NGOs work with several different donors at the same time. It is very important to keep track of which donor is funding which project (or part of a project). It is very bad practice to 'borrow' money received from a donor for a specific project for another purpose.

Ref	Statement of best practice	Score			
		5	4	1	0
5.1	There is a signed grant agreement in place for each grant	5	4	1	0
5.2	Senior Managers check the grant conditions are reasonable before signing agreements	5	4	1	0
5.3	Grant conditions on procurement are known by finance staff, budget holders and procurement officer(s)	5	4	1	0
5.4	There is compliance with the terms and conditions in grant agreements	5	4	1	0
5.5	Donors receive financial reports in the right format and on time	5	4	1	0
5.6	Donor financial and narrative reports are consistent and clearly linked to each other	5	4	1	0
5.7	Donor funds are kept for the activities they are meant for and never 'borrowed' for other activities	5	4	1	0
Total score for grant management					

Section 6**Staffing**

Good financial management is dependent on staff with the right skills, support, and attitude to carry out their responsibilities. All staff have a role to play in financial management. The accounting staff are part of a wider team including the Executive Director, Programme Managers and the Board. Integrating good financial management into programmes involves budget holders and finance staff working hand in hand through all the stages of the financial cycle (plan-do-review).

It may be difficult to assess the technical competence of accounting staff. Good indicators are the timeliness of reports, the neatness of files and records in the accounts office, and auditor's comments or recommendations.

Ref	Statement of best practice	Score			
6.1	The board includes someone with the skills needed to oversee all financial activities	5	4	1	0
6.2	The finance staff have the skills (and qualifications) needed to carry out all financial activities	5	4	1	0
6.3	Managers and programme staff have the financial skills they need to manage budgets and implement controls	5	4	1	0
6.4	Finance staff and budget holders work together well in payments processing and budget monitoring	5	4	1	0
6.5	Different roles within the finance function are clearly defined, known and followed	5	4	1	0
6.6	Senior staff lead by example in following control procedures	5	4	1	0
6.7	Finance staff are recruited freely and fairly on the basis of merit only	5	4	1	0
6.8	All staff receive the training and support they need to carry out their financial management responsibilities	5	4	1	0
Total score for staffing					

Interpreting your score

Record your score for each section in this table. Then compare it to the columns on the right and ring or shade the appropriate risk assessment for each section. Finally add up your total score and see the advice below.

Section	Your Score	High Risk	Medium Risk	Low Risk
1. Planning and budgeting		0 - 25	26 - 40	41 - 50
2. Basic Accounting Systems		0 - 30	31 - 50	51 - 60
3. Financial reporting		0 - 20	21 - 35	36 - 40
4. Internal controls		0 - 40	41 - 60	61 - 75
5. Grant management		0 - 15	16 - 25	26 - 35
6. Staffing		0 - 20	21 - 30	31 - 40
Total Score		0 - 150	151 - 240	241 - 300

Your score is over 240

Well done! Your financial management is in good shape. The risks of not being able to complete your work because of financial problems are low. But do also consider the risk assessment in each section: effective financial management requires strength in all six areas. Use this opportunity to make improvements and further reduce your financial risk.

Your score is between 151 and 240

Not bad! There is clearly some good financial practice in place, but still plenty of room for improvement. There is a risk that financial problems will prevent you from doing your work. Low scoring sections require immediate attention from managers.

Your score is less than 150

Work to be done! You have serious problems. Your financial management is not in good health. There is a high risk that you will face financial problems in the near future: funds may be misused, or donors may withdraw their financial support. Managers and trustees should meet urgently to discuss how the situation can be improved. You should consider calling in assistance as soon as possible. This must be dealt with right now.

Glossary

Account code	A code for a specific type of transaction. Transactions are given a code which describes what type of income or expenditure they are - e.g. 5050 Transport costs, 5600 Office rent etc.
Bank reconciliation	Comparing the month end balance on the bank statement to the month end balance in the cashbook and identifying any differences.
Budget	The best possible estimate of the cost of a set of activities over a given period of time, and of how you are going to pay for those activities
Cashbook	A book or spreadsheet that lists all of the receipts and payments made in to and out of a particular bank or cash account.
Cash reconciliation	Comparing the month end physical cash counted to the expected month end balance in the petty cashbook.
Cash flow forecast	A report that shows the expected timing of receipts and payments for the next 3-6 months (or longer).
Chart of accounts	A list of all account codes, including a description of each code.
Core costs	Costs shared by many projects. Also called overheads or indirect costs.
Cost centre	A label for a group of costs which are looked at together. For instance, different projects are often treated as different cost centres.
External audit	A review of the year-end financial statements carried out by a professionally qualified and legally registered auditor resulting in an opinion about whether they give a true and fair view.
Fixed asset	An item of high value owned by the organisation for use over a long period. Normally office equipment, vehicles and property.
Fixed asset register	A register (list) of the assets owned by the organisation, including details such as: reference number, date bought, purchase price, and location.
Payment voucher	An internal document raised for each payment. It provides a unique reference number and evidence of authorisation. Supporting documents are attached to it.
Petty cash records	The cashbook where cash transactions are recorded, and the supporting documents relating to each transaction.
Procurement	The process of purchasing goods and services. Steps in the process may include requesting, authorising, selecting suppliers, ordering, receiving and paying.
Receipt book register	A register (list) of receipt books as they come from the printers showing dates when each one is issued, finished and returned.
Reconciliation	The process of comparing information held in two sets of records that describe the same transactions.
Supporting document	The original documents that describe each transaction. These may include, receipts, invoices, delivery notes, sign sheets etc
Statutory deductions	Amounts which must be taken from an employee's pay before they receive it, such as income tax or national insurance contributions.
Transaction	Any exchange of goods, services or money in return for other goods, services or money. Most commonly receipts and payments.
Trustee	A member of an NGO's most senior governing body, who shares overall responsibility for the NGOs work.
Working advance	A sum of money entrusted to someone to spend on behalf of the organisation, which needs to be accounted for.