mango

Helping NGOs do more with their money

Financial Management Essentials

A Handbook for NGOs

Financial management essentials

A handbook for NGOs

Produced by Terry Lewis for

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Mango is an award-winning UK-based charity which provides financial management training, consultancy and free resources for humanitarian and development non-profit organisations.

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Glossary of financial terms

Account	A record of monetary transactions, either recorded in a book designed for the purpose or entered onto a computer file.
Account code	A unique numerical code or short name assigned to each type of financial transaction, to separately identify them in accounting records. Also used in budgets and financial reports
Accounting period	A specified time period for recording and reporting financial activity, eg one year, one quarter 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 reserves.
Acid test	The ratio achieved by dividing Current Assets (excluding stocks) by Current Liabilities. It tells us if the organisation has sufficient funds to pay off its debts immediately.
Allocation	The process of sharing direct costs between two or more cost centres in the accounts in proportion to actual or estimated use. Eg where the costs of using a shared vehicle for project work are allocated according to the number of kilometres travelled. Income can also be allocated.
Apportionment	The process of sharing indirect costs between two or more cost centres in proportion to the estimated benefit received. Eg sharing Director salary on the basis of full time equivalent staff numbers.
Asset	Something we own or have a claim on others which is of value to the organisation. Examples include cash, equipment and loans to staff. See also Fixed Assets and Current Assets.
Audit	A formal check on accounting records by an independent person (auditor).

Audit trail	The ability to follow the journey of any reported transaction through an organisation's accounting systems.
Authorisation	The process of approving transactions, normally the decision to purchase or make expenditure. Authorisation by a budget holder is a way of confirming that spending is appropriate and in line with the budget.
Back donor	The original source of funds channelled through an agency (such as an international NGO) to an implementing partner. The agency must report back to the original donor to account for the use of the funds by the 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. Also known as *Statement of financial position*.
Bank book	An accounting register which records receipts and payments transactions passing through a bank account. Also known as a cashbook or a cash analysis book. Can be held in a physical book format or in a computer file.
Bank reconciliation	The process of comparing the entries and ending cash balance in the cashbook with the bank statement for the same period, for the purpose of spotting 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 Grant or Budget Utilisation ratio.
Capital expenditure	Expenditure on equipment, property and other fixed assets of high value 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.

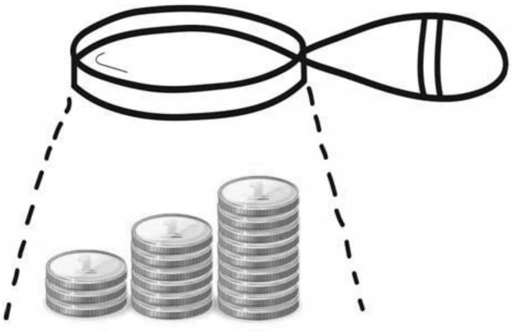
Cashbook	An accounting register which records receipts and payments transactions passing through a bank or cash account. Also known as a bank book or a cash analysis book. Can be held in a physical book format or in a computer file.
Cash reconciliation	Comparing the physical cash count to the expected balance in the petty cash book on a particular date.
Cashflow	The difference between cash received and cash spent in a period.
Cashflow forecast	A report that shows the expected timing of cash 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 known as operating overheads.
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	Amounts owed to others (eg unpaid suppliers' bills, bank overdraft) which should be paid 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, representing the loss in value due to use, which is internally charged as an expense to the organisation.
Designated funds	Part of the unrestricted general reserves which have been set aside for a particular purpose at the discretion of the Board.
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 donation.
Double funding	Where a project or activity has restricted 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 twice (once as a debit entry and once as a credit entry) to recognise there are always two sides or parties in every transaction – a giver and a receiver.
Exceptions report	A short narrative report which highlights significant variances or areas for concern to accompany management reports.
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 of the financial position and associated records.
Financial accounting	The process of recording, classifying and summarising historical financial data, resulting in financial statements.
Fixed asset	An item of high value owned by the organisation for use over a long period, eg office equipment, vehicles and buildings.
Fixed assets register	A schedule of an organisation's equipment and property, recording details of purchase date, value, location, etc.
Fraud	Intentionally lying or cheating to gain an advantage or to cause someone else to make a loss.
Fund accounting	Accounting for spending on projects according to the source of the donated funds.
Funding grid	An internal planning tool which provides an overview of which donor fund is paying for what part of a project budget.
General ledger	The main accounting record where double-entry bookkeeping is used. See also *Nominal ledger.*
General funds	Unrestricted reserves which have not been set aside for a particular use and which may be used to support any of the organisation's objectives.

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. Also known as *Statement of financial performance, Profit and Loss account* or *Income Statement.*
Indirect cost	A cost which cannot be specifically assigned to one activity, department or project, eg the fee for the annual audit. Usually shared out (apportioned) between projects on a pre-agreed basis.
In-kind donation	See Donation in kind.
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 to correct a recording error.
Liabilities	Amounts owed by the organisation to others, including outstanding invoices, unspent restricted grants and loans.
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	Providing financial information to managers for the purposes of planning, decision-making and monitoring performance.
Net assets	Total assets minus total liabilities, the net worth or equity of an organisation.
Net book value (NBV)	Cost of a fixed asset less the total cost of depreciation to date.
Net current assets	Funds available for conducting day-to-day operations of the organisation, 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. A complete list appears in the Chart of Accounts, each with a unique nominal code.
Nominal ledger	A book or computer programme which holds details of each of the nominal accounts. Also known as the *General ledger*.
Organogram	Organisation chart showing the management and departmental structure of the organisation.
Payment voucher	An internal document completed for each payment to capture payment information and evidence of authorisation. Supporting documents are attached to it.
Petty cash book	The day-to-day listing of petty cash (ie small cash amounts) transactions.
Prepayments	Amounts paid in advance at a particular accounting period, eg office rent paid for the next three months.
Procurement	The process of purchasing goods and services including requisition, supplier selection, purchase order, receiving goods and payment.
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 cashbook (or bank book) for a defined period with opening and closing cash balances.
Reconciliation	Checking mechanism which verifies the integrity of different parts of an accounting system, for example balancing the cashbook to the bank statement.
Reserves	The organisations savings, funds that are set aside from surpluses produced over the years.
Restricted funds	Income or reserves which have conditions attached to how used, usually with a requirement to report back to the donor.
Signatories	People who are authorised to sign documents on behalf of the organisation, eg bank transactions, purchase orders.
Statement of financial position	Another name for the *Balance Sheet.*
Statement of financial performance	Another name for the Income and Expenditure statement.
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.
Supporting document	The original documents that provide evidence of a transaction, eg receipts, invoices, bank statements.
Transaction	Any exchange of goods, services or money in return for other goods, services or money.
Trial balance	List of (debit and credit) balances for each nominal account, used to prepare an Income & Expenditure report.
Trustee	A member of the governing body who shares overall responsibility for the NGO's work.
Unrestricted funds	Income and reserve funds which can be used to support any of the organisation's objectives as received without conditions attached.
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 overspend 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	Cut-off point for the annual financial accounting period.
Zero-base budgeting	A method of preparing budgets which involves calculating costs for each item from scratch.



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, on Mango's website.

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 your organisation's financial health, 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.

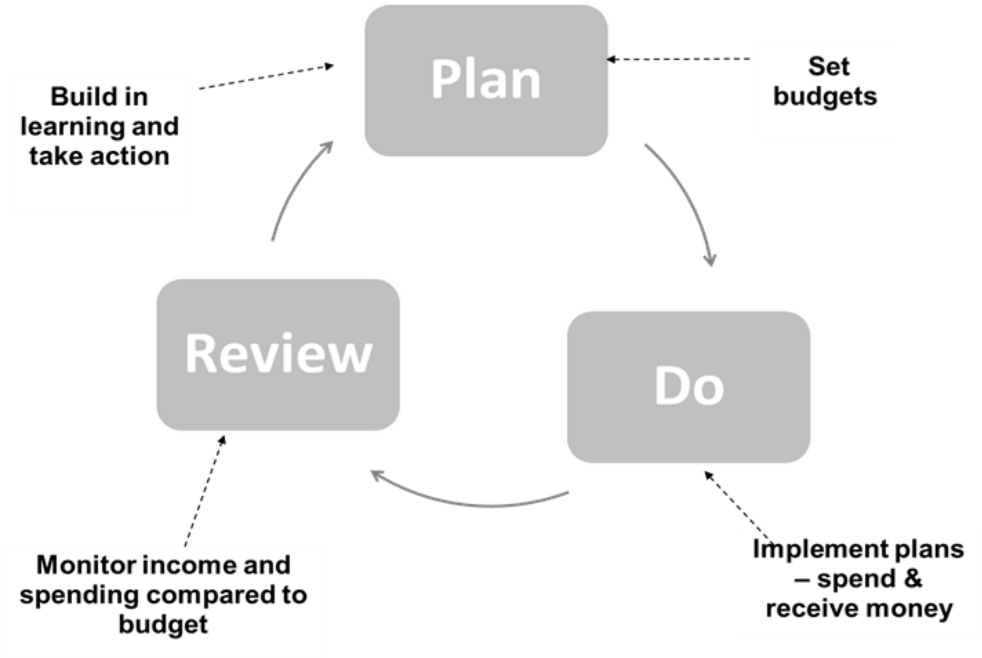
▷ **Managing strategically**

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 need to plan to finance our objectives now and in the future. Financial information helps identify financial risks and long-term financing opportunities.

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

Timely and complete budget monitoring reports enable managers to monitor performance so far, and take decisions on using resources going forward.

7. To achieve the objectives of the organisation

The management team and Board need financial information to ensure they are meeting the goals of the organisation, and following the strategic plan.

8. To enhance the credibility of the organisation

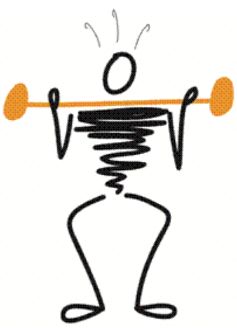
If you demonstrate financial accountability and transparency, this will inspire confidence and trust in stakeholders, and give you an advantage over competitors.

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* which means that if things go wrong, their financial responsibility, is limited to a token amount (eg USD 1.00).

Figure 1.2: Unincorporated NGO

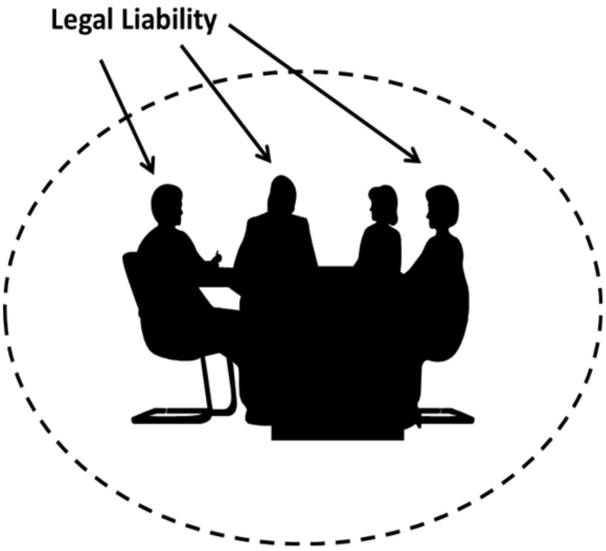
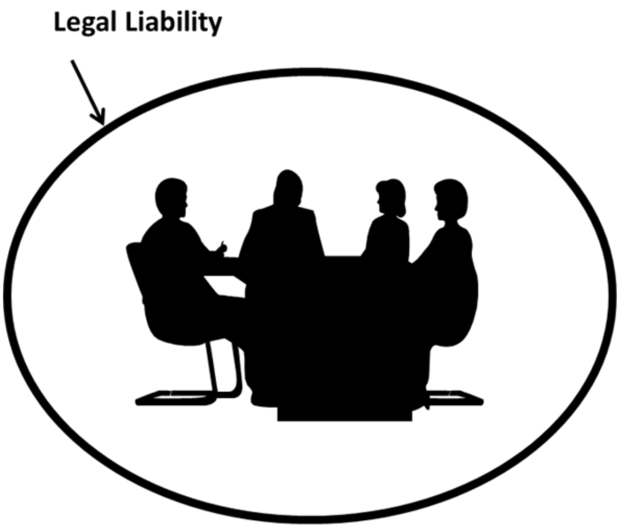


Figure 1.3: Incorporated NGO



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
- representing the interests of stakeholders.

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

Governing body 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.

> *Governing body members are* ***ultimately responsible*** *for the financial affairs of the organisation. They cannot escape this duty except by resigning from the governing body.*

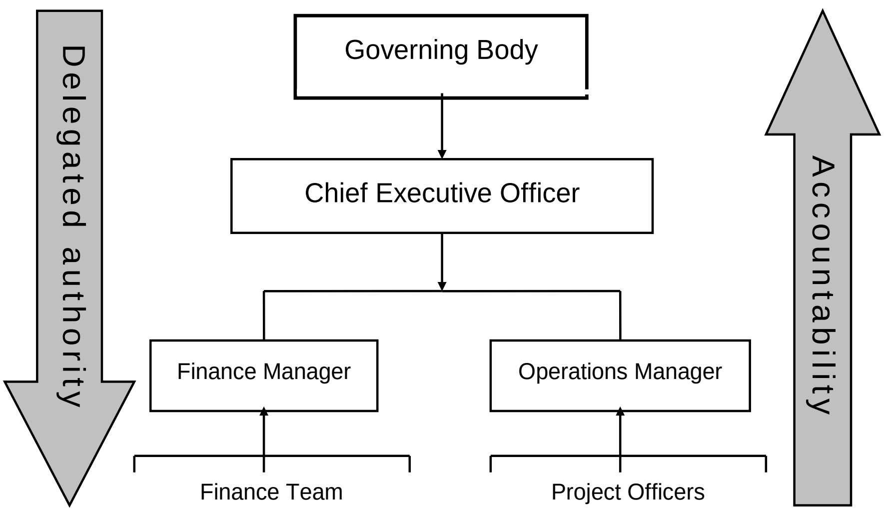
▷ Day to day responsibility

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.

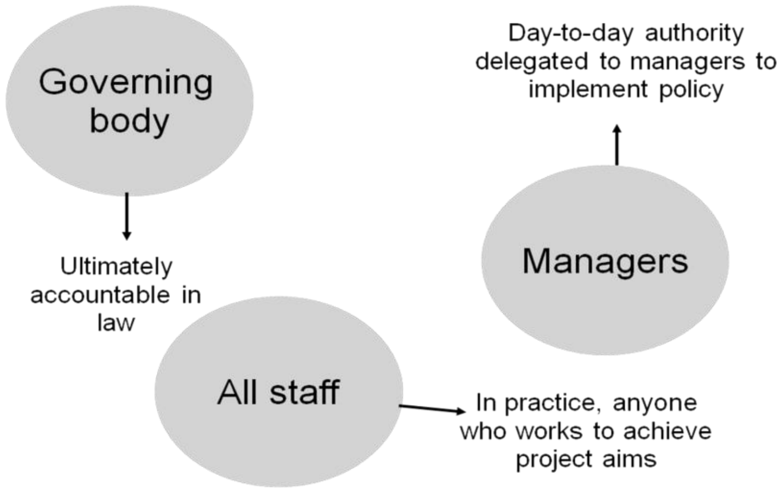
Figure 1.4: Delegated authority



▷ 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:

- Shares 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 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 to aspire to.

▷ **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**

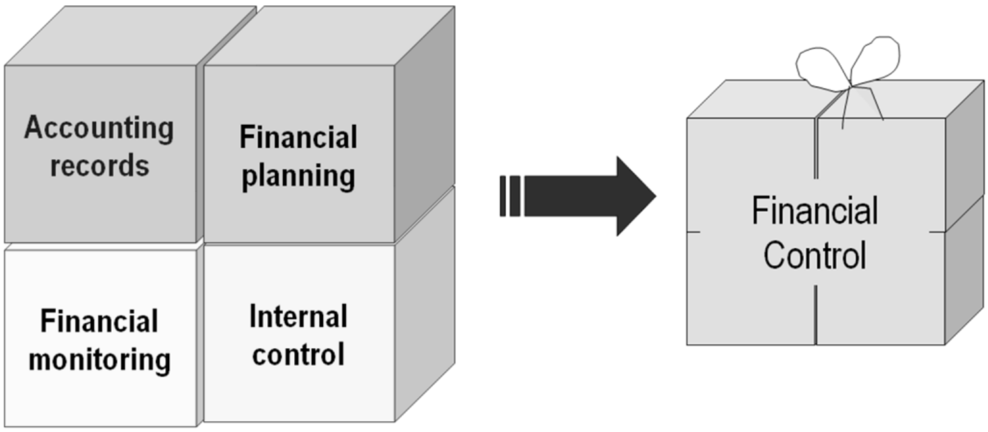
The system for keeping financial records and documentation must observe internationally accepted accounting standards and principles. Any accountant from anywhere around the world should be able to understand an organisation's financial accounting systems.

Tip: Use the seven 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'**.

Four building blocks of financial management

There is no model finance system which suits all organisations. 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 *Finance Health Check* – a self-assessment checklist to help you build your financial management systems (see Appendix 26).

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.

Did you notice the common tool that links all of the four functions of financial management? Yes, it is the budget.

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 things to consider to find the right approach for your NGO:

- **Structure** – 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 have a supplier accounts that you settle each month, or a mix of the two?
- **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 money, equipment, people and skills 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.

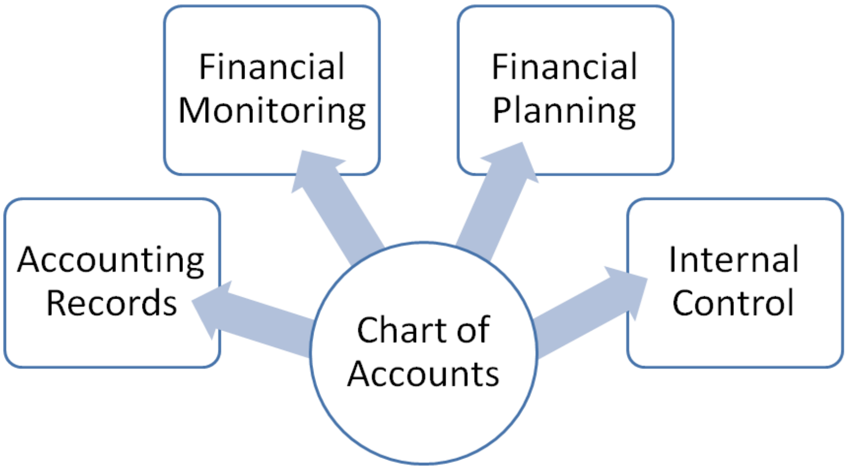
The management accounts are primarily for internal use and should be produced on a regular and timely basis – usually monthly or quarterly depending on the needs of the organisation. The table below summarises the main differences:

	Financial accounting:		Management accounting:
	Records transactions	☹ ☺	Compares results against goals
	Classifies transactions		Determines reasons for variations
☑	Reconciles records		Helps identify corrective action
=	Summarises transactions		Provides forecasts
	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.

Figure 2.2: The Chart of Accounts in a finance system



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).

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:

- account code numbers, letters or both)
- account name
- sub-groupings ('family' groups)
- 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' group 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?'*

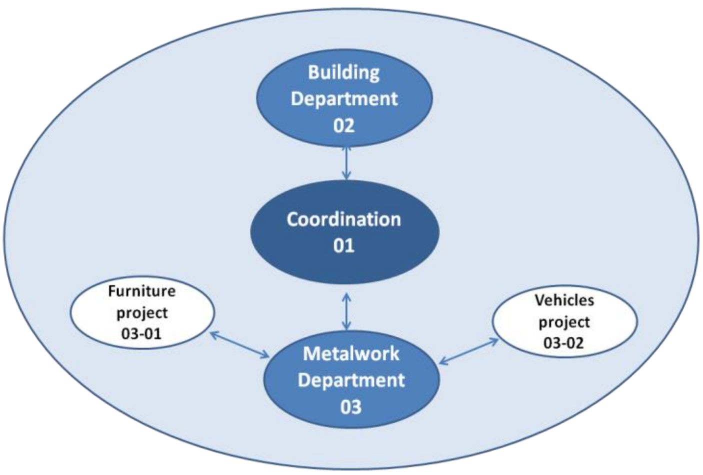
This means that separate financial reports can be more easily produced for each cost centre, helping managers to monitor their own area of responsibility and report to project donors.

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:

- Purpose of the policy

- Why we need the policy
- Who the policy applies to
- 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.

The finance manual

A *Finance manual* brings together all the financial policies and procedures 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 other teams.

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.

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 20 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
- 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.

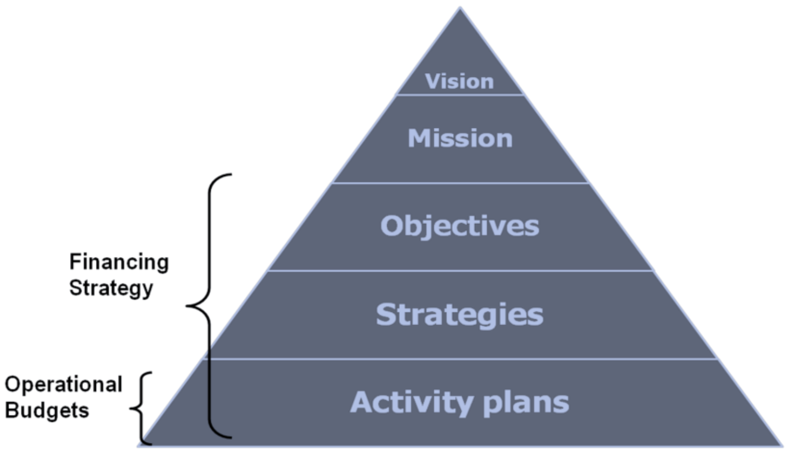
Financial planning starts with a clear plan about you want to do and how you intend to do it. We can only produce effective budgets if we have good plans to base them on.

> *"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

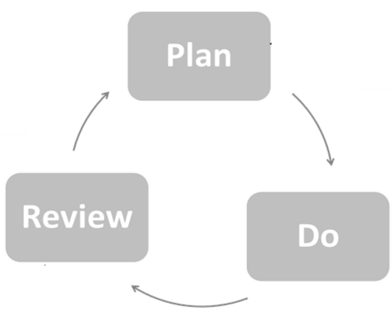
Strategies (also known as specific objectives) set out how the organisation will achieve each of its core objectives. They outline the actions which will be taken for each objective.

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 is a key tool in financial management. It has a number of 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?'

What makes a good budget?

The sign of a good budget is that anyone who needs to, could pick it up and use it to fulfil their budget management responsibilities.

A good budget is…

✓ *Fit for purpose*

- The right level of detail for the user
- Includes all relevant income and expenditure items
- Costs are clear, justified and accurate.

✓ *Easy to use*

- Calculations are clear
- Explanatory notes provided where needed.

Who is involved in the budgeting process?

The budgeting process involves a range of people, each with a specific role to play, including organising the process, providing information, writing budgets, and checking and approving budgets. The table below outlines who does what in the budgeting process.

Table 3.1: The budgeting process: who does what?

Role	Activity	Comments
Board of directors	Discuss and approve the annual budget (ie all programmes and operations)	The budget represents a key policy document for an organisation, and sets limits to authority. It must be approved by the board, which is ultimately accountable for the organisation 's financial affairs
Chief Executive (CEO)	Oversees the annual budgeting process	The CEO may choose to delegate coordination of the budgeting process, eg to the finance manager, but it is the CEO's job to make sure it happens and on time

Role	Activity	Comments
Senior managers	Set budget guidelines and assumptions, eg timetable, inflation rate, salary scales	They need to give clear direction and advice to those who are developing budgets to ensure consistency and timely completion
Programme team	Produce detailed budgets for their activities/projects	The programme team is in the best position to produce accurate and complete budgets for the activities they work on
Finance team	Support the budgeting process, eg provide data on previous activities, advise on pricing, summarise and consolidate budgets	The finance team provides important technical support and information for the budgeting process but it is not their job to write project budgets

In addition, external stakeholders also rely on budgets to understand the work of the project.

- **Funding agencies** require budgets to see how an organisation intends to spend its grants, and to monitor progress of funded programmes
- **Community partners** use budgets to see how organisations plan to spend money on community projects.

Preparing budgets

There are two main approaches to creating budgets: incremental and zero-based-budgeting.

Table 3.2: Incremental vs. zero-based budgeting approaches

	Incremental budgeting	**Zero-based (including Activity-based) budgeting**
Most suitable for:	▪ Projects where activity and resource levels change little from year to year	▪ New and one-off projects, or those that experience a lot of change year on year
How it works:	▪ The new budget is based on the previous year's actual, or sometimes budgeted, figures with an allowance for inflation and known changes in activity levels.	▪ Starts with a clean sheet (a 'zero base') and builds the budget according to planned activities and targets. ▪ The resources are listed, quantified and individually costed
Advantages:	▪ Relatively simple and quick to create	▪ Generally, more accurate ▪ Costs are easy to justify ▪ Easy to update with new information ▪ Favoured by many donors
Disadvantages	▪ Risks carrying over historical errors ▪ Difficult to justify the figures as the original calculations may no longer be available ▪ Reduces innovation by encouraging teams to deploy the same plan and resources year after year	▪ Takes more time to compile ▪ Need a lot of information before you create the budget

As **Table 3.2** shows, the zero-based approach is most suitable for project budgets – especially in the *Activity-based budget* format - which is covered in detail later in this chapter.

▷ Supply or demand-led budgeting?

Whatever approach you use to set project budgets, it can be tempting to make a project budget 'fit' a specific pot of money. But it is important to work out the 'true' costs of running a project (ie what the project demands) before you look at possible funding options, and not be influenced by the supply of funds.

Supply-led budgeting often results in inaccurate budgets. Critical costs can be both under- and over-estimated to make a project fit with a specific pot of money. This practice can save up problems at the project implementation phase and could have a negative impact on donor relationships.

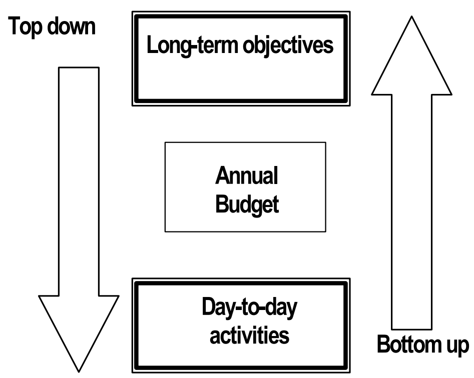
A well-constructed budget with clear and justified costs will enhance your fundraising plans and be welcomed by potential funding partners.

▷ 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 3.2: Top down or bottom up



What does the budget show?

There is no such thing as a 'one-size-fits-all' budget. As there are a wide range of users and uses for budgets, it is not surprising that they come in many different formats, with different information tailored to users' needs. Here are some of the main differences in content and layout that you are likely to encounter in budgets:

Activity level	Budgets can be prepared for one activity area, a project (ie several activity areas), a programme (ie several projects) or the whole organisation. See the budget hierarchy diagram below.
Budget detail	Some users, eg donors, require very detailed budgets to show how each line is calculated. Other users, such as board members or senior managers, prefer to see a summarised version, to see the headline figures.
Layout	Most organisations use a standard format to present internal budgets, which will be consistent with the codes and budget descriptions in their Chart of Accounts. Donors usually have their own budget template, with their own codes and budget descriptions, which must be used when applying for funds.
Timeframe	A budget always covers a specific time period related to each activity. They typically cover one financial year but can be prepared for, or broken down into, any period of time: one day, one week, one month, one quarter or multiple years, depending on the activity. Budgets used for project monitoring are usually broken down into monthly or quarterly 'phases'.
Currency	Budgets can be prepared in any currency, depending on the requirements of the project, donor or Head Office. They often include more than one currency – eg the organisation 's home currency and the donor's operating currency.

Three key budgets

There are three main types of budget:

- Income and Expenditure budget
- Capital budget.
- Cashflow forecast (or cash budget).

▷ **Income and Expenditure budget**

This is the budget that you will be most familiar with as it is widely used in project management.

What is it?	A budget that shows the estimated costs of running an activity, project or entire organisation, and where the funds will come from to cover the costs, for a specified period of time. The 'bottom line' shows whether there is enough income to cover the expenditure – surplus or deficit?
What is its purpose?	To summarise income and expenditure information and show the overall position or status of the budget – surplus, deficit or balanced – to aid project fundraising and monitoring.
How is it compiled?	It can be created using either of the two main approaches for budgeting – incremental or zero-base budgeting – but for projects, zero-based is recommended.
Why is it important?	Income and Expenditure budgets are important for fundraising at the planning stage of the project life cycle so that sufficient funds can be secured to fulfil its objectives. During implementation, budgets are broken down into shorter time periods (phases) – eg for each month or quarter-year – so that income targets and limits on spending are clear. At the review stage, the phased budget is used to monitor project performance to date.

The 'bottom line'

Balanced budget: when income equals expenditure

Deficit budget: when income is less than expenditure

Surplus budget: when income is more than expenditure.

Some organisations (eg international NGOs with country programmes) manage their projects using an expenses-only budget format – and do not include an income section in their budgets. When using an expense-only budget, the total budget of a project is based on an amount organised by the head office for the project – which corresponds to the income section of an income and expenditure budget.

See Appendix 11 for an example of an Income and Expenditure budget for Milestone. Some things to look for:

- The budget is for a **12-month period** for the whole organisation
- The **account codes and descriptions** are identical to those used in Milestone's chart of accounts *(*Appendix 1*)* – this makes it easy to compare the budget to actual performance when the programme is up and running.
- **The bottom line** shows that this is a balanced budget as anticipated income equals planned expenditure.
- This budget is in a (relatively) **detailed format**. It could also be summarised so that it just shows the costs sub-totalled by 'family group' – eg Donor and Other income, and Admin, Personnel, Vehicle Running, etc.

▷ Capital budget

The *Capital budget* is similar in format to, and complements, the Income and Expenditure budget but as its name suggests, it is only used for 'capital' projects. The term 'capital' refers to items of equipment or investments that will be used over several years, such as:

- construction of buildings and infrastructure

- major renovation works
- vehicles
- office furniture and equipment
- computer equipment
- medical equipment
- water and sanitation equipment.

See an example Capital budget in Appendix 12, which is a budget put together for a funding proposal.

What is it?	A budget that lists one-off expenditure for expensive items such as equipment and construction works, which will be used over several years and form part of the organisation 's fixed assets.
What is its purpose?	To separately list, and be able to monitor, the major investment and one-off costs involved in capital projects.
How is it compiled?	As the Capital budget includes one-off expenditure, it is only possible to use the zero-based budgeting approach to create it. It is usual to include a contingency for unpredictable variations to the budget, such as exchange rate fluctuations that could affect the cost of imported goods. It is also important to pick up related costs in the Income and Expenditure budget, eg as vehicle running costs, insurance and storage for equipment.
Why is it important?	Capital projects represent a higher risk to an organisation due to the significant sums of money and valuable assets involved, so it is important to list and monitor them separately.

Often, projects need just a few items of equipment so it is not always necessary to create a separate capital budget. Instead, these items should be included in a separate section at the end of the Income and Expenditure budget. However, when projects have significant procurement needs, the option exists to develop a separate capital budget for that purpose.

▷ The Cashflow forecast

Whereas the Income and Expenditure budget shows whether a project has enough income to cover its anticipated costs over a whole year, the Cashflow forecast (or cash budget) helps to identify times during the year when cash levels may become critical.

The cashflow forecast is also useful if the organisation has substantial cash reserves which need to be invested wisely to maximise investment income. See an example in Appendix 13.

What is it?	A financial planning tool that shows the predicted flow of cash in and out of a project or organisation each month, to show periods of cash shortages or surplus.
What is its purpose?	To predict any months where there may not be enough cash available to pay for planned activities, so that corrective action can be taken.
How is it compiled?	The process uses the income and expenditure budget (and capital budget if used), project activity plans and schedules of anticipated income, to predict when incoming and outgoing cash transactions will take place.
Why is it important?	Project teams need to be confident they have sufficient cash to buy goods and services when needed to implement activities. This is especially relevant where donors choose to pay grants in arrears, and require an organisation to pre-finance project activities (ie pay for project activities up-front and get reimbursed later).

Tips for preparing a project cashflow forecast

1. You will need: a project's timed activity plan, income schedules, Income and Expenditure budget and Capital budget (if used) for the year.
2. Set up a cashflow forecast table (a computer spreadsheet will make this easier) with the budget items listed on the left and the months of the year along the top.
3. Based on the income schedule, plot each expected cash receipt in the cashflow table. Take account of payment schedules in donor agreements, for example: 50% of the grant to be paid in month 1; 20 % in month 6 and month 9; and 10% after receipt of the final report in month 12.
4. Based on the activity plan, plot each payment in the cashflow table according to when the cash will leave the bank. For unpredictable expenses – eg equipment repairs – estimate a monthly or quarterly average. Take account of payment terms, such as office rent paid in advance, so the rent for April to June would be paid on 1 April.
5. Do not include non-cash transactions (such as *in-kind donations* and *depreciation*) in the cashflow forecast. This is because these are 'paper' transactions only – there is no actual cash movement and or impact on cash balances.
6. Include any cash balances available at the start of Month 1. For new projects this will probably be zero.
7. Calculate the cash movement (Total Receipts – Total Payments) for each month, and then add in any cash available at the start of the month. The result is the *Net cashflow* for the month. A positive figure means there is cash left over after paying for the planned activity. A negative figure means there is a forecast cash deficit – ie not enough cash is available that month to pay for the planned activity.
8. When your forecast is complete, you will be able to spot any 'problem' months. This signals a need for an action plan to avoid further cash shortages.
9. Where cash levels are likely to become critical it is important to update the cashflow forecast every month with the latest information.

Here are some things to look out for in the example in Appendix 13:

- It is based on and covers the same 12-month period as the Income and Expenditure budget.
- The table includes an estimate of cash available in the bank at the start of the year (see Row D for January). The total cash available at the end of the month (Row E) automatically becomes the cash available at the start of the next month (Row D).
- This cashflow forecast predicts a shortage of cash for six months of the year, including February and March. We know because of the negative figures (in brackets) on the bottom line. See if you can identify which other months there are cashflow problems.
- Month 12 shows that there is sufficient funding overall to run the project for the year – but money is not getting to the bank in time to when needed to fulfil the project plans.

How to use the cashflow forecast

If the cashflow forecast predicts periods of cash shortages, as in our example, the project and finance teams need to work together to find a solution. For example:

- negotiate with donors to receive grants early or phase them to match activity plans
- negotiate with suppliers to delay payment of invoices
- reschedule some activities
- arrange a temporary loan facility with the bank.

However, there could be negative consequences from some of these actions, so it is important to take action with an eye on the associated risks:

- delaying payment could affect your relationship with suppliers
- delaying activities could adversely affect the project and relationships with stakeholders
- borrowing money from the bank will attract bank charges.

Activity-based budgeting

Activity-based budgeting is a form of zero-base budgeting and is widely used in the development and humanitarian relief sector. It is ideal for creating accurate and complete project budgets. The technique systematically lists, quantifies and costs all the resources (eg people, materials and equipment) that are needed to run the activities described in a project plan.

The resources, quantities and calculations are captured in a detailed table called a *Budget Worksheet* – usually as a computer spreadsheet. The details are then summarised in whatever format is needed – eg for internal use or for donors' budgets.

It is best to approach the budgeting process as an organised and structured group exercise. There are eight steps involved in creating an activity-based budget.

Figure 3.3: The 8 steps

We will look at each of these steps in detail, but first let's look at an everyday example of budgeting – a process that we go through almost on a daily basis without even realising. As you read through the example, think about how Rudi and his mum follow the activity-based budgeting process, and what we can learn from this.

Budgeting 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
Sweets	0.50	To buy at the match
TOTAL	**8.00**	

They review the summary figures together. Rudi's mother decides that the plan is a reasonable one and 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.

The key learning from this example is that it helps a lot to describe everything that is involved in the activity you want to write a budget for, and to break down the component parts as much as possible. Also, it is important to think about possible risks, and build in a 'safety net' contingency if possible.

▷ Useful documentation and information

It is important to be well organised and have everything ready before you get started on the activity-based budgeting process, including:

- Clear and measurable project plans – key documents include the project proposal, log-frame and timed activity plan (Gantt chart)
- Budgeting policies and guidance, such as for staff salaries and benefits, indirect costs contribution and inflation rates
- Price list for commonly-used resources
- Budget worksheets and templates
- Latest Chart of Accounts
- Timetable for submitting budgets for approval.

▷ The 8 steps

The table below explains the eight steps involved in the activity-based budgeting process.

Table 3.3: The activity-based budgeting process

Step	What it involves
1. Identify the project objective(s)	The project objective(s) are set out in the project design documents. It is usual to create one activity-based budget for each objective (or area) but sometimes a budget needs to cover more than one objective.
2. List the activities	The project activities (for each separate objective) will also be found in the project design documents and should have clear and quantifiable indicators.
3. Identify and quantify resources	This is probably the most important step in creating your activity-based budget. Each project activity must be 'unpacked' to list the tasks and deliverables, so that you can identify the resources needed to run each task.

Step	What it involves
	The project design documents are useful here, but it helps to imagine yourself running each of the activities to understand what resources are needed. Be aware of any 'hidden' project resources such as shared vehicles or project staff. A part of any shared resources should be allocated to the project based on an estimate of usage. For example, for a shared vehicle, include an estimate of kilometres travelled; or for a shared Programme Manager, an estimate of time spent supporting the project. It is helpful to list all the resources and quantities needed for each activity in a separate document or page of the spreadsheet. We call this the *Activity or Project Breakdown Sheet* (see below). Note the month when the resources will be used, as this is needed to create phased budgets and forecasts.
4. Research the cost of resources	Using the Activity Breakdown Sheet, find out how much each resource will cost when a project will be implemented. Wherever possible, get a unit price or base cost for one item. Your finance team may provide a price list for items that are regularly purchased or where there are set amounts for budgets, such as staff allowances or consultancy fees. Don't be tempted to guess the price! Although budgets are a best estimate of costs, they must be based on reliable evidence, not on invented amounts. If you get your unit prices wrong, you will over- or under-estimate the costs, jeopardizing the integrity of your budget.
5. Identify known income	Make a list of any known income sources that will be used to support the project. For example, anticipated contributions to costs from services users and communities. Do not include income that is yet to be negotiated.
6. Compile the budget worksheet	You are now ready to complete the budget worksheet. Each activity is described in a separate section to show required resources, quantities and unit costs. Each budget item is assigned a budget code from the chart of accounts and, where relevant, a donor budget code.

Step	What it involves
7. Review the results	Review the final draft budget to check it is realistic and complete. If possible, get someone else (a 'budget buddy') to check it. Questions to ask include: • *Are quantities and unit costs reasonable?* • *Are costs justified and supported by clear budget notes?* • *Have any important resources been left out?* • *Are the calculations correct? Do the totals add up?*
8. Summarise the budget	When the budget worksheet is ready, you will summarise the data in whatever format you need for internal or external use, eg for project implementation in a phased or summary budget format or for fundraising using a budget format used by the donor.

We will now look more closely at steps 2 top 6 using Milestone as a worked example, and two important budgeting tools: the project breakdown sheet and the budget worksheet.

Two important budgeting tools

▷ **Project breakdown sheet tool**

The project breakdown sheet supports steps 2 and 3, to 'unpack' project objective into activities and tasks, and listing out the resources needed to implement the activities. When completed, the project breakdown sheet has all the information we need to build the activity-based budget.

Example

Milestone is preparing a budget for a project that aims to equip young people with metalwork skills to improve employment opportunities. It has identified two activities:

A. Recruit and train one metalwork skills trainer
B. Deliver four metalwork skills workshops in regional locations, for 18 trainees each.

The project breakdown sheet (see **Table 3.4**) shows the details for Activity A, which contains three tasks:

1. Advertising the new post
2. Appointing the trainer
3. Organising their induction.

Table 3.4: Example project breakdown sheet

Project breakdown sheet

Project title: MTTI Metalwork Dept - Rural skills training project

Ref.	Objective level:	Description of objective, activity or task	Rresources and quantities needed	Timeframe
	Objective:	***Equip rural unemployed people with metalwork skills to improve employment opportunities***		
A	**Activity:**	**Recruit and train one metalwork skills trainer**		
1	TASK	Advertise the new post	Job adverisement in national newspaper - 1 advert entry for 2 weeks	Complete before Month 1
2	TASK	Appoint trainer	Metalwork trainer salary, 12 months, full time post	Month 1 to 12
			Employer's taxes, 12% of gross salary	Month 1 to 12
			Medical insurance premium, 20% of gross salary	Month 1
3	TASK	Provide induction and technical training to new trainer	Technical training course (5 days)	Month 2
			Meals/accommodation (5 days)	Month 2
			Travel to/from training - 2 bus trips	Month 2
			Per diem allowance (5 days)	Month 2
B	**Activity:**	**Deliver 4 metalwork skills workshops in regional locations, for 18 trainees each**		

Once the tasks are identified, the resources and quantities needed for each are entered into column 4 – for example, to advertise the new post, they plan to put an advertisement in a national newspaper for two weeks. The table also includes the month when the resources will be needed (see *Timeframe* column). The timing information is used for cashflow forecasting and creating a phased budget.

▷ The budget worksheet tool

The next step is to transfer the detail in the project breakdown sheet to the *budget worksheet*. This is a table with rows to enter each resource item in the budget, and pre-set headings to help do the calculations. It is usually set up in a computer spreadsheet (such as Excel) with formulas to automatically calculate each row and column totals.

Each project activity area has its own section in the worksheet, with a list of all the resources needed, and in what quantities, to calculate the cost of each item needed. This makes it possible to see how much each activity area would cost to deliver.

Table 3.5 is part of the budget worksheet for Milestone's Rural Skills training project. Familiarise yourself with the layout and contents, and then read the explanations for each column, and how it works in **Table 3.6**.

Table 3.5: Budget worksheet – example

BUDGET WORKSHEET: Rural Skills Training Project
Project period: 1 January to 31 December [year]

					Currency:	USD		
Line ref.	**Description**	**Unit Type**	**No. Units**	**No. times**	**Unit Cost**	**Total**	**Notes**	**Account code**
A	**Recruit and train one metalwork skills trainer**					**15,195**		
A1	Job advertisement in newspaper	Entry	1	2	250	250	1 advert entry for 2 weeks	4020
A2	Metalwork trainer salary	Month	12	1	888	10,650	1 x half-time post	4030
A3	Employer's taxes	Month	12	1	107	1,278	Approx. 12% of salary	4030
A4	Medical insurance	Year	1	1	2,130	2,130	20% of gross salary	4030
A5	Technical training course fee	Person	1	1	850	850	5 days, includes meals/accommodation	4010
A6	Per diem allowance	Day	5	1	5	25		4040
A7	Travel to/from training centre	Trip	2	1	6	12	Bus fare	4040
B	**Deliver 4 metalwork skills workshops (5 days duration) in regional locations, for 18 trainees each**					**41,140**		
B1	Fuel for mobile training vehicle	Kilometer	500	4	0.50	1,000	Estimate based on previous experience	5010
B2	Insurance for vehicle	Lumpsum	1	1	3,580	3,580	50% as shared with Building Trades Dept	5020
B3	Vehicle maintenance/repairs	Quarter	4	1	1,800	7,200	50% as shared with Building Trades Dept	5030
B4	Publicity on community radio	Slot	5	6	40	1,200	5 slots per week for 6 weeks	3050
B5	Guest tutor's fees	Day	5	4	180	3,600	One guest tutor per day, per workshop	6010
B6	Lunch and refreshments	Person	20	4	12	960	18 trainees plus 2 trainers, per workshop	6020
B7	Workshop supplies/raw materials	Lumpsum	1	4	1,780	7,120	As per supplier quotation	6030
B8	Protective clothing	Person	20	4	35	2,800	18 trainees plus 2 spares as contingency	6030
B9	Tools set for trainees	Set	18	4	190	13,680	As per supplier quotation	6030
C	**Provide one-to-one post-training support to 40 trainees**					**5,210**		

Table 3.6: Budget worksheet – how it works

Column	Description
Line reference	The line (or row) reference is used to refer to items in the budget. It is not a budget code. It is usual to show each activity in a separate section and to number the sections in a logical way. In our example budget, the two activities show are denoted by a letter – A and B – and then the resources within each activity are numbered sequentially, eg A1, A2, A3 and so on. You can use any numbering system as long as it is logical, consistent and clear.
Description	This column provides a short description of each activity included in the budget, and the resources needed to complete each activity. The description for the resource item should be specific and concise. The resources are identified in Step 3 of the activity-based budgeting process are listed in the Project Breakdown Sheet It is important to break down resources to the core detail in the budget worksheet as this makes it easier to accurately estimate

Column	Description
	costs. For example, the staffing costs in the example budget are broken down into salary, employer's taxes and medical expenses.
Unit type	This is the basis for calculating the cost of the items listed in the budget. As a general guide, when choosing a unit type, it helps to think about how supplier would charge you for the item or how often you would pay for the item. Eg a taxi driver could charge for each trip or by the distance travelled – so the unit type would be Trip or Kilometres. Similarly, if staff are paid on a monthly or weekly basis, the unit type for salaries would be Month or Week. In the example budget, unit types vary according to the item being budgeted for. In line A1 the job advertisement is charged by the advert entry, while in B6, Lunch & refreshments are charged per person. See below for more details on the use of lump sum and compound Unit Types.
No. units	This is the first of two columns focussing on quantity and it refers directly to the Unit Type – ie how many of the items described in the Unit type column are needed for an activity. So, in our example, in line B8 the Unit Type is Set so we have entered the number of sets we need. The number of units (sets) is 18, one for each trainee. (The unit type could also have been Trainee but is more correct as Set because that is how the supplier has provided the quotation).
No. times (or Frequency)	The second of the two columns focussing on quantity records the number of times the described resource will need to be used. It is also sometimes called the Frequency or Quantity column. It picks up how frequently you plan to run the activity that it relates to. So, in the example for line B9 Tools, the plan is to run the workshops four times. Therefore, we need to buy the 18 sets of tools on 4 occasions.
Unit cost	This is the price of one unit of the Unit Type. It is important to enter a cost that is as accurate as possible, including an amount for inflation, rather than a random guess. If you get this wrong, it will distort your budget. In our example budget, in line B8 we can see that the cost of a set of tools is $190. This rate has been based on a supplier quotation.
Total	The total for each budget line is calculated by multiplying the two quantity columns and the unit price column: ***No. Units x No. Times x Unit cost = Total***

Column	Description
	All the costs for an activity can then be added together for a sub-total. For example, row B shows that the workshop activity will cost $46,780.
Notes	The notes column is useful for adding extra detail to help the reader understand the budget – eg explaining how quantities have been used or calculated, such as in rows B2/B3 which explains that these costs are shared with another project. The notes column can also be used to include the assumptions that underpin the estimates for a line item.
Account code	There will be at least one, often more, account codes column. These codes are used to summarise the budget for different budget templates, eg internal summary budgets or donor template budgets. Our example above uses Milestone's internal Chart of Accounts codes.

More on unit types

Unit types are critical to the understanding and successful completion of the budget worksheet. If you get this right, the data columns are much easier to complete.

LUMP SUM

Lump sum is a special unit type used to include a one-off amount or general estimate, often for multiple items or services, which are detailed in a supplier quotation or a separate schedule. In the example budget we have used lump sum in line B7 for the workshop supplies as it covers a range of different materials.

It is important to be able to justify lump sum amounts, if asked. You should also be sure to consult your donor regulations to ensure that lump sum unit types are permitted – as some donors ask that this unit type not be used.

COMPOUND UNIT TYPES

If you are writing a budget for a large project with multiple activities, you may need to use a more sophisticated unit type, which combines two different units. These are known as compound unit types. Here are some examples of how they are used:

Three consultants are engaged to run a five-day training event, ten times. Compound unit type: *Consultant/day*. No. Units: 15 (ie 3 consultants x 5 days), No. Times: 10, Unit cost: one day of consultant time.

1,000 sanitation packs are distributed for six months to 60 villages. Compound unit type: *Pack/month*. No. Units: 6,000 (ie 1,000 packs x 6 months), No. Times: 60, Unit cost: one pack.

It is helpful to use the notes column to add extra detail to clarify how the figure in the No. Units column is calculated.

Table 3.7 illustrates how compound unit types are used and the related quantities are entered in a budget worksheet (costs are not included in the example).

Table 3.7: Calculating compound unit types

Item	Unit type	No. units	No. times	Notes
Consultants fees for workshops	Person-day	15	10	3 consultants for each 5-day workshop, delivered 10 times
Sanitation packs for villages	Pack-month	6,000	60	1,000 packs delivered for 6 months to 60 villages

For a useful quick reference guide to selecting unit types, see **Table 3.8** below.

Table 3.8: Choosing unit types

Typical budget items:	Examples of unit type:
Personnel Costs	
Salaries, benefits & taxes	Month
Staff recruitment	Advert entry
Staff development	Days, person
Subsistence allowances	Days, person, trip
Volunteers expenses	Session, person, trip
Transport costs	
Fuel & lubricants	Kilometre, month
Vehicle insurance	Month or lump sum per quotation
Vehicle maintenance	Kilometre, month
Air fares	Trip/journey
Bus/taxi fares	Trip, month
Distribution costs	Kilometre, trip, month
Programme administration	
Office rent, electricity and water	Month
Office insurance	Month or lump sum per quotation
Telephone & fax, postage	Month
Office stationery	Box, carton, piece or month
Internet subscription	Month or lump sum per quotation
Repairs & renewals	Month
Bank charges	Month
Audit fees	Lump sum per quotation
Project Costs	
Room hire/accommodation	Day
Publicity costs	Advert entry, lump sum per quotation
Publications/reference books	Month or lump sum per quotation
Training materials	Trainee, lump sum per quotation
Professional fees (eg, consultant)	Days, lump sum per quotation
Printing/photocopy	Copy, person, lump sum per quotation
Inputs (eg pipes, tents, tools)	Piece
Equipment	Piece, or lump sum per quotation
Food	Person, meal, day

Budgeting for contingencies

Sometimes we need to include an extra amount in the budget worksheet for *contingencies*. These are for unforeseen expenses or for items that we think we might need, so it is sensible to add an amount *'just in case'*.

However, before including contingencies in a budget, be sure to ensure that any donor regulations you need to follow permit contingency line items in their budgeting guidelines. An example of this is included in the example budget worksheet above – see line B8 where extra two items of protective clothing have been included.

✓ It is good practice to include a specific (and explained) contingency line for the specific budget lines that needs a just in case 'cushion'.

For example, based on your experience of staff turnover, you decide to include a line for staff recruitment costs, even though you have no vacancies at the moment. The actual amount you estimate for the contingency must have a logical basis to the calculation, so that you can justify its inclusion in the budget.

When you create a Capital budget, it is often necessary to add a percentage to a family group of costs as a general contingency – eg 20% for imported equipment as a contingency against exchange rate fluctuations and extra import duties.

✗ Avoid the practice of adding a percentage to the overall budget for contingencies on the bottom line. This is difficult to justify, as not every line in your budget truly needs a contingency. It is also difficult to monitor because it is not possible to allocate bottom line contingencies to an account code.

Unit cost and price inflation

When we write a budget for a project that is going to start in a few months' or a year's time, it is important to include a unit price in the budget worksheet that includes an allowance for price inflation.

If you do not do this, you will not have enough money in your budget to cover actual costs during implementation.

For example, imagine you are preparing a budget for group conference next year. The cost of accommodation at the conference venue is currently $100 per person. The annual inflation rate is 20%. You must therefore include $120 per person for accommodation in the budget for the conference to cover the likely price increase due to inflation. If you included today's price of $100 per person, you would be short by $20 for each person attending the conference.

Sometimes, prices increase at different rates due to other economic or policy reasons. For example, the government announces a new 10% sales tax on fuel, so the unit price in the budget must take account of both the general inflation rate and the extra 10% sales tax.

Which currency to use?

The currency that you choose to use for budgeting depends on several factors, in particular where your main sources of income come from and the stability of your home economy. See **Table 3.9** for three possible scenarios to consider (in reality the situation is often more complex):

Table 3.9: Which currency?

Scenario	Advice
A. Most of your income is from external donors. You operate in a country that experiences rapid inflation and/or weak local currency.	Prepare budgets in a 'hard' international currency, such as US Dollars, and get the funds paid into a US Dollar bank account. This gives you some protection against the impact of inflation and exchange rate losses.
B. Most of your income comes from one or two donors who pay grants in their home currency.	Use the donor's currency when creating programme budgets for specific donors at the proposal stage, then convert budgets back to your home currency for internal budget monitoring purposes. This allows you to consolidate the donor-funded budgets with other internal budgets, and to isolate variances caused by exchange rate fluctuations rather than other programmatic causes.
C. Most of your income comes from sources inside your country of operation.	Prepare all budgets in your home currency (building in an allowance for inflation) and include a contingency for exchange rate fluctuations on high value imported goods.

When deciding which exchange rate to use to convert local costs to the chosen base currency, you should make a reasonable judgment based on information available. Some donors will tell you what rate to use, others are more flexible – in which case select a rate that looks reasonable for the period the budget covers. Always note the exchange rate and effective date on the budget.

As there can be a significant time lag between the initial submission of a proposal to a donor and a project starting, before you sign a grant contract, do review the exchange rate assumptions in the budget and re-negotiate the rate with the donor if it is significantly different.

Budgeting for 'In-kind donations'

In-kind donations are where resources are donated to a project as materials and equipment rather than funds, for example vehicles or computer equipment. When you budget for a project using activity-based budgeting, you will automatically include all the resources needed to run your project. If you know that some of these resources will be donated in kind once the project starts, you can then include the value of the item as known income.

You should only include in-kind donations in your budget, if the item is essential to the success of the project (ie you would have to buy it anyway) and it is something that you can put a tangible value on. Community contributions in the form of donated labour, and some non-essential donated materials can fall outside of this rule.

Budget assumptions

Finally, as well as the line-by-line notes on the budget worksheet, it is a good idea to also keep a separate note of key budget assumptions, such as the inflation rate, salary and benefits rates and standard unit costs. This is especially important if you are preparing a budget to accompany a funding proposal and the donor requires a budget narrative (discussed later in the chapter).

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.

It is important to include a contribution towards indirect costs in project budgets because:

- Projects cannot operate without central support services
- We need to calculate the true, full cost of running project activities
- Central support costs should be financed somehow.

Central support budgets are needed too

The starting point is to write a budget for the central support costs so they do not get overlooked, and the costs are clear. It is usual to then 'charge' projects that benefit from the support that is provided in a fair, consistent and justifiable way. There are a number of different ways to share out (ie 'apportion') a project's indirect costs. For example, using a ratio based on:

- Staff hours ('full time equivalent' or FTEs)
- The relative size of project budget
- Estimated use of the relevant resource (eg space for apportioning rent, number of transactions for apportioning finance support).

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.

Central support costs policy

Every organisation needs a clearly stated policy on how it will finance its central support costs. These costs have to be covered by income 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:

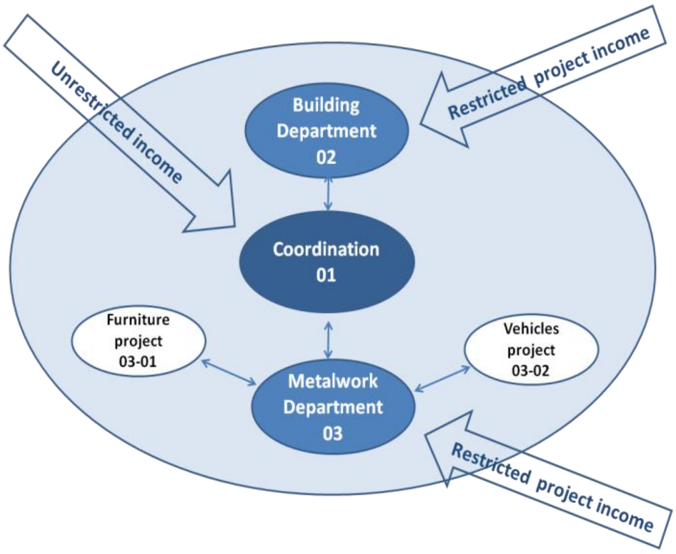
- Use unrestricted funds (ie money given to the organisation for general purposes)
- Charge projects a pre-arranged percentage of the costs.

Figure 3.4 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 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 3.4: Financing Milestone's core costs



Summarising and consolidating budgets

When the project budget worksheet is completed, the final stage is to summarise the data into different format budgets as required – eg for internal budget management purposes or to create a donor budget to accompany a funding proposal.

Remember that different users need different levels of detail so that is why we need to create summary budgets. The budget worksheet is great for the team implementing the project, but it is too detailed for senior managers and board members who prefer more of an overview.

▷ The summarising process

The accounts codes columns in the budget worksheet make it very easy to summarise the budget data into any budget template required. Each line in the worksheet is allocated a code – for internal format budgets, the code comes from the organisation 's chart of accounts, for donor format budgets the code will be as advised by the donor. The process of adding codes to a budget worksheet is called 'mapping'.

As the resources in the budget worksheet are broken down into great detail, it should be possible to map the costs to any coding schedule, which is what makes the budget worksheet such a flexible and useful budgeting tool.

Table 3.10 show the summary budget format for the for the Rural Skills training project covered by the example budget worksheet, using Milestone's internal chart of accounts codes. It includes direct costs only at this stage.

This budget will in turn be joined together with other projects in the Metalwork Department to create a summary budget for the whole department – as in Appendix 15.

Table 3.10: Milestone Summary budget

MTTI Metalwork Dept - Rural skills training project

Summary budget

1 January to 31 December [year]

Account code	Budget description		Total USD
3060	Admin	Publicity	1,200
4010	Personnel	Staff training	850
4020		Recruitment	250
4030		Salaries & benefits	14,058
4040		Travel & subsistence	3,247
5010	Vehicle Running	Fuel	1,000
5020		Vehicle Insurance/tax	3,580
5030		Vehicle maintenance	7,200
6010	Project inputs	Consultants fees	3,600
6020		Food & accommodation	960
6030		Training materials	25,600
	TOTAL		**61,545**

▷ The Consolidated budget

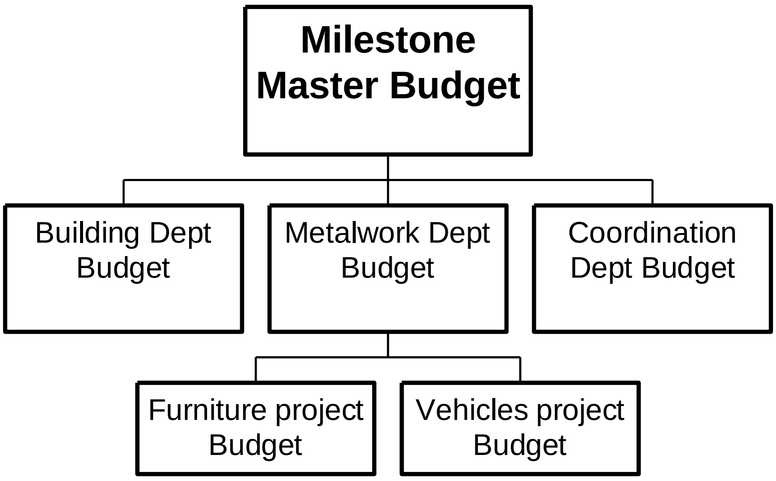
When an organisation runs multiple projects and departments, managers need a way to easily combine - or consolidate – multiple budgets into one table, to give a useful overview at the programme or organisation levels.

See the Consolidated budget for Milestone in Appendix 16. The Consolidated budget combines the budgets of the two departments (building department and metalworks department) and includes the central support costs.

This budget is in the income and expenditure format so includes anticipated income.

Figure 3.5 shows Milestone's budget hierarchy and the process of consolidation. The lower level project budgets are rolled up into the departmental budget, then the departmental budgets are in turn consolidated into one master budget (as in Appendix 16).

Figure 3.5: Milestone's budget structure



The Phased budget

A phased budget breaks down the project budget into time periods (ie phases), usually by month or quarter-year, to show when the budget will be used up during project implementation, according to the activity plan. There are two key purposes of a phased budget:

- To compare planned with actual performance of a project, to check progress, and take action if it is not on target
- To advise a donor about how we expect to utilize their grant during project implementation.

▷ How to create a phased budget

To create a phased budget, we need to go back to our project budget worksheet and activity plans (eg Gantt charts, if used) to allocate the budget according to the plans. It is a similar process to that of creating a cashflow forecast but this time we are looking at when the budget is needed, not when the cash transactions take place.

A phased budget is NOT the total budget divided by 12 months or 4 quarters. It must mirror the activity plan.

Table 3.11: Milestone Phased budget

MTTI Metalwork Dept - Rural skills training project
Phased budget
1 January to 31 December [year]

Account code	Budget description	Q1 Jan-Mar	Q2 April-June	Q3 July-Sept	Q4 Oct-Dec	Total USD
3060	Publicity	600	-	600	-	1,200
4010	Staff training	850	-	-	-	850
4020	Recruitment	250	-	-	-	250
4030	Salaries & benefits	5,112	2,982	2,982	2,982	14,058
4040	Travel & subsistence	572	535	1,070	1,070	3,247
5010	Fuel	250	250	250	250	1,000
5020	Vehicle Insurance/tax	3,580	-	-	-	3,580
5030	Vehicle maintenance	1,800	1,800	1,800	1,800	7,200
6010	Consultants fees	900	900	900	900	3,600
6020	Food & accommodation	240	240	240	240	960
6030	Training materials	6,250	6,250	6,600	6,500	25,600
	TOTAL	**20,404**	**12,957**	**14,442**	**13,742**	**61,545**

Table 3.11 shows a quarterly phased budget for Milestone's Rural Skills training project expenditure, summarised by budget heading. In this summary format, it is ready to be used in an internal budget monitoring report (or a donor report if in donor budget format) once the project gets underway.

Creating budgets for donor agencies

To create a budget for a donor agency, you will follow the same process described above for internal budgets, starting with an activity-based budget worksheet, the project will need to follow these steps:

- Find out what format the donor requires you to submit your budget in. Sometimes they will accept your own internal format, and sometimes they have their own template.
- If they have their own template and account codes, simply match up ('map') the expense codes to the budget lines in your budget worksheet, then sum the figures using these codes. Enter the sum in the donor budget template.
- Take care to check what the donor will or will not allow to be included as project expenses.

- Follow the donor guidelines on what is permitted as a contribution towards indirect costs (sometimes referred to as a Management Fee). Often, they will specify a percentage amount to add somewhere on the template.

Donors may also ask you to complete a *budget narrative*.

▷ **What is a budget narrative?**

When applying for a grant, a donor will often require you to include a budget narrative to support the budget in the funding proposal. The budget narrative, also known as a budget justification, has two purposes:

- to **explain** how the costs were estimated, and
- to **justify** the reason for costs.

Budget narratives are especially useful to explain hidden or confusing costs listed in a proposal budget. If you provide a detailed activity-based budget with the funding proposal, most of the calculations will be self-evident so the budget narrative could be briefer.

However, not all grants officers will be familiar with activity-based budgeting, and may not even look at the budget attached to a proposal, so it is better to include more detail, to be sure.

Here are some tips on preparing a budget narrative

- Always check the funding agency's guidelines to be clear what their specific requirements are for a budget narrative. Some donors helpfully provide a budget narrative template for you to follow.
- Remember that the reviewer of your funding application will not be familiar with your local context, prices or practices, so you must clearly explain how budget lines are calculated, and in as much detail as possible. One good 'rule of thumb' is to see if the narrative could be used to re-construct the budget line it refers to.
- Ask around other organisations that have successfully won funding, for any tips on preparing budget narratives for specific donors - eg what costs did they scrutinise most or least closely, were there any costs that they rejected?
- Ask a colleague to read your proposal budget and budget narrative together to check that all costs are clearly explained and justified.

- The table below provides some of the most common cost areas that you may need to explain or justify, and some key considerations when preparing a budget narrative.

Table 3.12: Budget narrative guidance

Costs to justify	**Points to consider:**
All personnel	• Describe the need for ex-patriate, local and Head Office staff • How does each individual contribute to the project? • How much time will each individual spend on the project? • What are the necessary qualifications for project staff? • What staff 'fringe' benefits or allowances are provided, and why? • Explain and justify annual increases in salaries and benefits • Explain and justify the cost of staff training and how it relates to meeting project expenses
Consultants and outside contractors	• Describe the qualifications and duties of the outside specialists that need to be hired • Explain the amount of time they will spend on the project • Refer to specific donor guidelines on use of outside contractors
Supplies and equipment	• Include cost estimates/descriptions of quotes obtained for any specialized supplies or equipment, including capital equipment such as vehicles • Describe why the supplies and equipment are needed, and which objective they relate to • Explain how the supplies and/or equipment will be used in your project to complete project objectives • Justify any costs for the security and insurance of supplies and equipment • Refer to donor guidelines on procurement and depreciation of capital equipment, and explain any variations to their rules, if relevant
Travel and accommodation	• Explain the purpose of trips and justify those travelling. • Explain the lodging and per diem/stipend rates used.

	• Refer to donor guidelines on the use of specific air carriers and explain any variations to their rules, if relevant
Indirect costs and management fees	• Explain and justify indirect cost recovery rates and/or management fees

Multiple donor–funded programmes

When a programme or project has more than one source of income, it can present a number of planning challenges. In particular:

- Donors have **different budget formats** and pay grants in different currencies
- **Budget descriptions vary**, so it is not always clear what each category includes or excludes, eg Transport, Travel, Vehicle running
- It is not always clear **which donor is paying for what** within a multiple-donor funded project
- Donors have **different policies on financing central support** and it is not always clear if a project's obligation is met
- Within the same project, it is possible for some budget lines to be **'double-funded'** (ie funds awarded for the same item by multiple donors), and others to be **under-funded**, but this is not obvious.

▷ **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 & oil
- 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, accounting costs and audit fees. But do take care as all costs must be justifiable.

Prepare a funding grid

The *funding grid* is an internal planning tool that can help to overcome most of these challenges. It provides an overview of who is funding what at project, programme or organisation -wide levels, and depending on the level you wish to monitor. It is presented in table format and matches each anticipated source of income source with budgeted expenditure.
This reveals where there are gaps in funding, and also any '*double funding*', by budget line.

▷ Using the funding grid

Table 3.13 is a summarised example for Milestone covering all programmes to demonstrate the principle behind the funding grid. However, in practice, a funding grid would have more columns for each source of income, and detailed rows with donor codes mapped to the internal chart of accounts.

Table 3.13: Example funding grid –Milestone Project (summary) Example funding grid

All figuresin USD			CONFIRMED / EXPECTED INCOME					
			RESTRICTED FUNDS			*UNRESTRICTED FUINDS*		
A	B	C	D	E	F	G	H	I
Code	**Budget group**	**Total budget**	**DFID**	**Smile Trust**	**Vanguard trust**	**Fees & donations**	**Total anticipated income**	**Balance Surplus/ (deficit)**
3,000	Admin	32,100	6,750	6,750	0	18,600	32,100	0
4,000	Personnel	93,772	21,750	21,750	6,000	44,272	93,772	0
5,000	Vehicle running	30,600	9,500	9,500	1,000	10,600	30,600	0
6,000	Project inputs	109,280	52,000	52,000	7,000	0	111,000	1,720
	TOTAL	**265,752**	**90,000**	**90,000**	**14,000**	**73,472**	**267,472**	**1,720**

The table below explains how the funding grid table works.

Table 3.14: Explanation of example funding grid

Columns A, B and C:	This is the summary budget with internal account codes and description.
Columns D, E and F	These are the sources of funding from confirmed donors. The funds are restricted and must be used according to the donor's contracts and agreed budgets. The funds are allocated to the budget lines according to the donor agreement.
Column G	These are the general, unrestricted funds that can be used for any mission-related purpose. Unrestricted funds are used here to fill any gaps not covered by donor funds, based on priorities set by the managers. Fortunately, Milestone has enough unrestricted funds to cover the funding gaps.
Column H	This is the total income expected at the time of completing the funding grid. This is now compared to the total budget in Column C.
Column I	The difference between columns C and H. Any gaps in funding shows as a negative figure while 'double funding' – ie a surplus on that line – shows as a positive figure.

Tips on using the funding grid

When building the funding grid table, especially for a large and complex programme, here are some practical considerations:

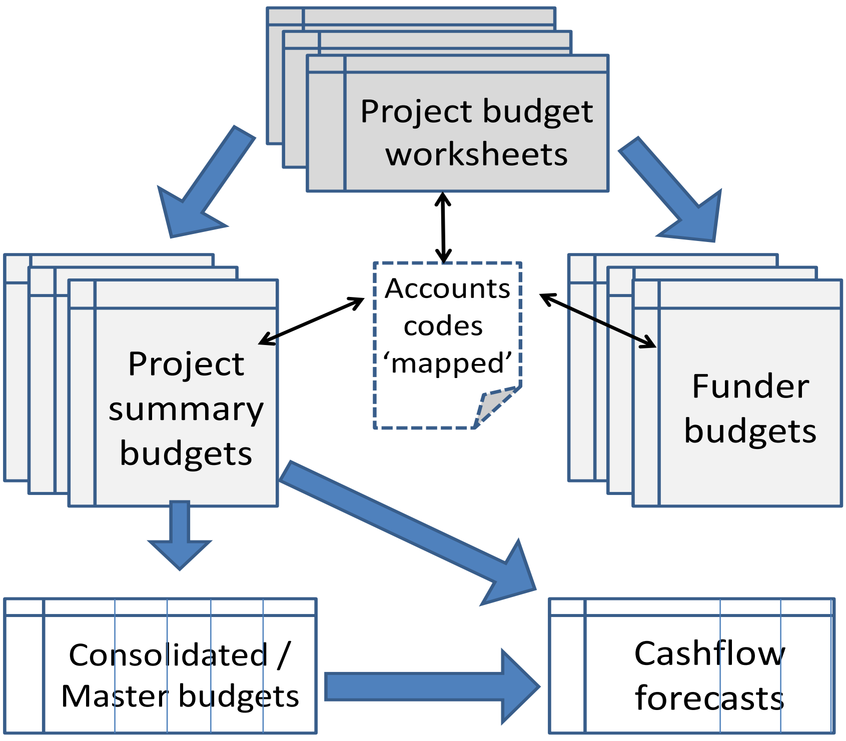
- **Use exchange rates that correspond to a specified date.** The funding grid can be compiles using the local currency, but it is also common to select the currency of the major source of income.
- **Make sure the budgeted expenditure and anticipated income cover the same time period.** As donor agreements can start at different times (and rarely coincide with our own planning years), income and expenditure must be matched to the period covered by the funding grid. For example, if it covers expenditure from January to December, and a donor grant runs for 12 months starting in March, you will just include 10 months of the grant – the remaining two months' grant will be the next year's funding grid.

- **Map expenditure to internal account codes**. Include the donor codes as well as the internal Chart of Accounts codes so that you can see which line items are under- or over-funded.
- **Regularly update the funding grid** as the fundraising situation changes.

Summary

The diagram below summarises the budgeting process and illustrates the relationship between the different budgets. Notice that the account codes images is placed prominently in the centre of all the budgets – underscoring their importance in mapping the different budgets to each other.

Figure 3.6: Flowchart- budgeting process



The table below summarises the different types of budget and approaches.

Table 3.15: Summary of budgeting terminology

	BUDGET TYPE OR STATUS	DEFINITION
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.
	CASHFLOW 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	**ACTIVITY BASED**	Where the budget is built up from a detailed activity plan (a form of zero-base budgeting).
	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.
	BOTTOM UP	Where the budget is developed by team members who have responsibility for using the budget during implementation of the activities.
	TOP DOWN	Where budgets are developed by senior managers, without involving the staff who will implement the activities.
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.

	BUDGET TYPE OR STATUS	DEFINITION
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.

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 & 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
Accounting system	Single entry	Double entry
Transaction types	Cash only	Cash and credit
Terminology	Receipts and payments	Income and expenditure
Main book of account	Bank (or cash) book	Nominal (or general) ledger
Skill level	Basic bookkeeping	Advanced bookkeeping
Non-cash transactions	No	Yes
Assets & liabilities	No	Yes
Reports produced	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

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.

Receipts explain:

- ✓ *Who?*
- ✓ *When?*
- ✓ *How much?*
- ✓ *What?*
- ✓ *Why?*

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

Other useful supporting documents include:

- Payment voucher (PV)
- Local purchase order (LPO)
- Goods received note (GRN).

▷ 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

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.

Apart from being required by the external auditor to support the *audit trail*, certified receipts also provide protection to those handling the money.

Mislaid or incomplete records can result in suspicion of mismanagement of funds.

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 *cashbook* 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 Receipts of money into the bank										RIGHT SIDE Payments out of the bank									
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.

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

Table 4.2: Bank reconciliation

Item:	In cashbook	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
Cashbook 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:	$15.40
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.

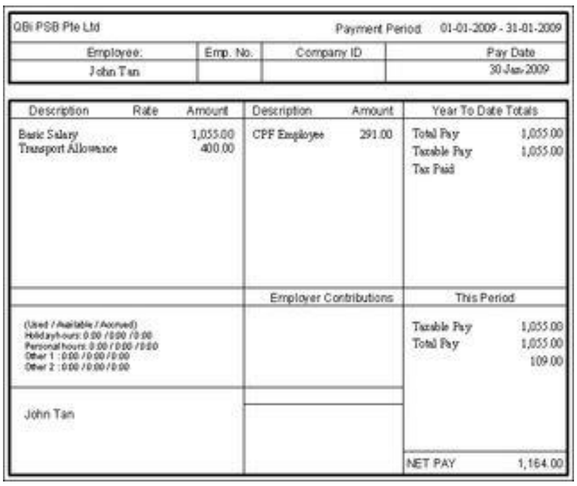
The Journal is used to record unusual, one-off transactions which cannot be recorded easily in other books of accounts. These will include non-cash transactions (such as *depreciation* and donations-in-kind), adjustments and corrections.

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.


QBi PSB 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

Taxable Pay 1,055.00
Total Pay 1,055.00
109.00

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

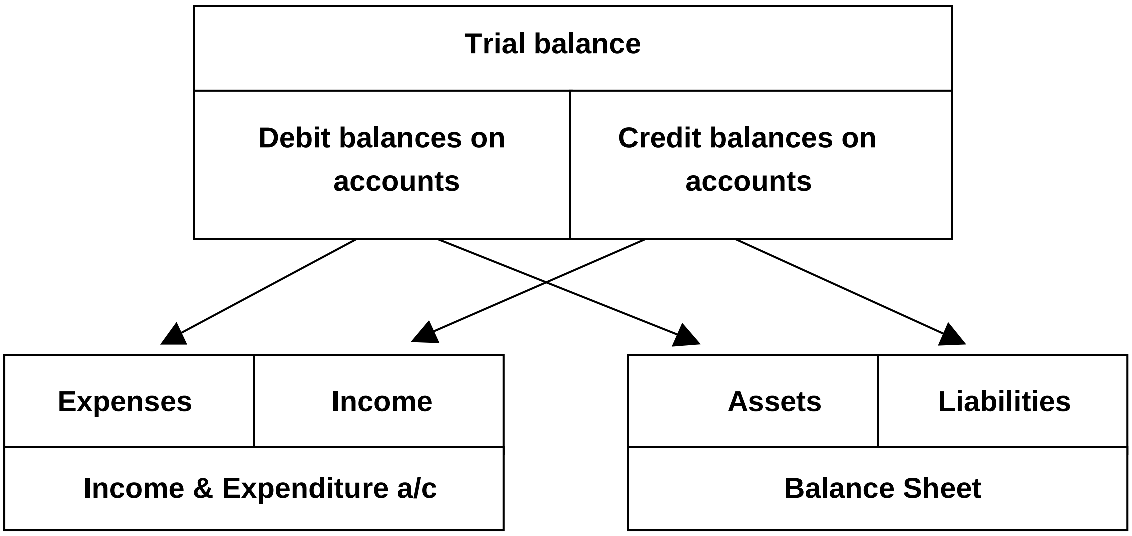
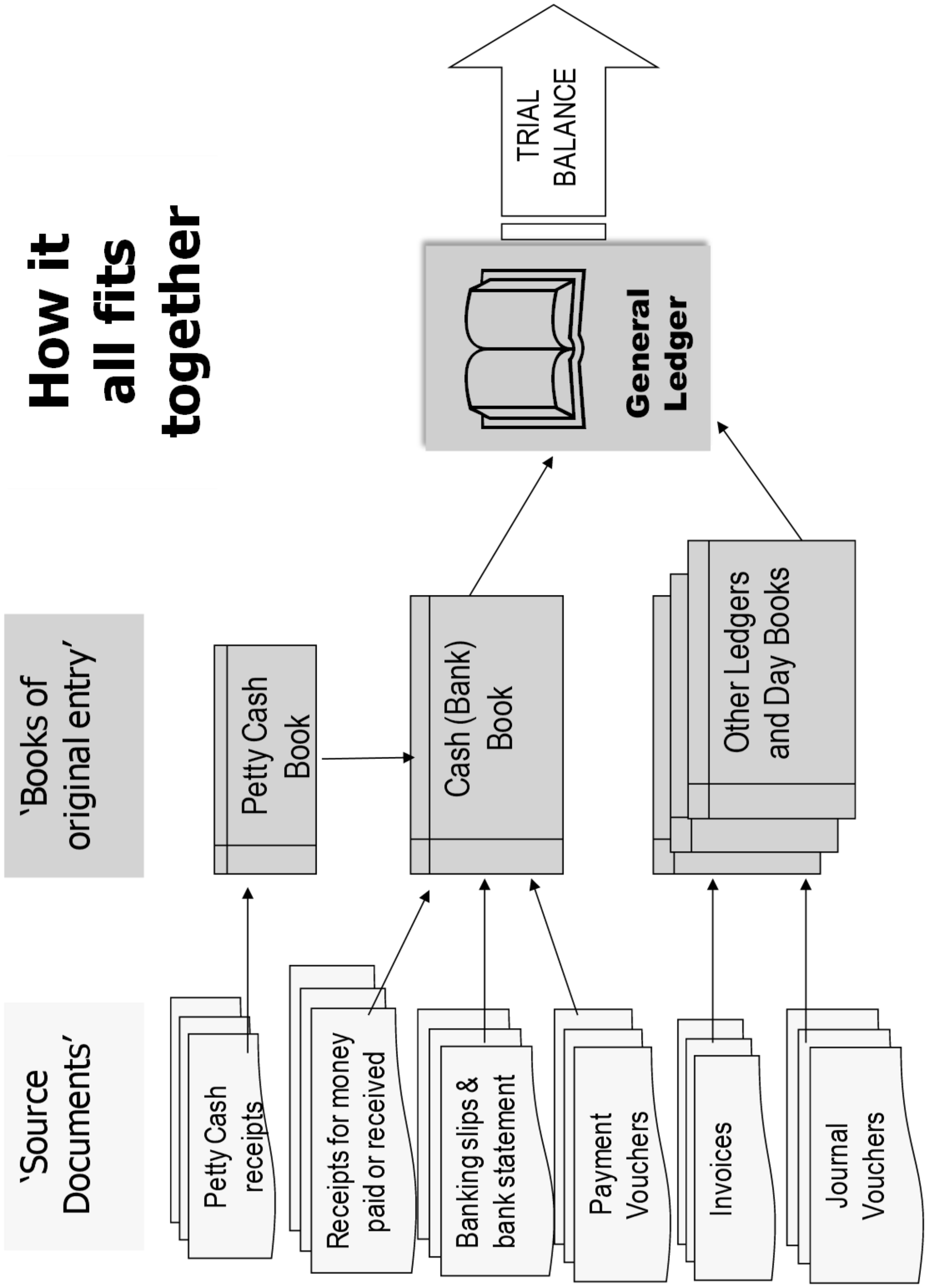


Figure 4.3 shows how the trial balance is the final stage of the accounting process – the result of recording, classifying and summarising the many different transactions that take place in an organisation.

Figure 4.3: How it all fits together



What are financial statements?

Financial statements are produced from the organisation's accounting records. They are a summary of all the transactions for a specified period of time and show the financial position of an organisation. In particular, the financial statements tell us:

- where the organisation's money came from
- how the money was used up
- the outcome for the period, ie a surplus or deficit
- what the organisation is worth (on paper).

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 the annual accounts and external audit.

It is common for the annual financial statements to include the previous year's figures for the purpose of comparison - so you can see what has changed from one year to the next. Is it getting better - or worse?

The simplest of all financial statements is the Receipts & 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 & 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 & 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
- 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 of accumulated funds. There should be an accompanying Balance Sheet for the same date that the Income & Expenditure report 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 & 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 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

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.

Also known as *net current assets*, they are calculated by deducting immediate debts (current liabilities) from short-term funds (current assets).

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).

Table 4.3: Components of a Balance Sheet

Component:	**Description:**
FIXED ASSETS:	*Less liquid assets, those having a significant value lasting more than one year, eg cars, office equipment, property.*
CURRENT ASSETS:	*The more liquid assets – can usually be converted into cash within one year.*
Cash	Money held in the bank and as cash.
Debtors	Money owed to the organisation, such as loans and unpaid invoices.
Prepayments	Value of items paid for in advance such as insurance premiums or office rent.
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 and 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 reserves.*
Accumulated funds	The total of all accumulated surpluses and deficits achieved since the organisation started. The funds are held as cash and/or equipment and can be restricted or unrestricted.

Component:	**Description:**
General funds	These are the part of the accumulated funds that are unrestricted and available for general use - the organisation's 'safety net' money. Also called General purposes fund.
Designated funds	Part of the General funds, money set aside for specific purposes, eg replacing equipment.
Long-term loans	Any loans to others that have to be repaid in more than 12 months' time, eg a mortgage on a building or a capital loan from a donor.

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 x 25% = $2,500	$7,500
Year 2	$7,500 x 25% = $1,875	$5,625
Year 3	$5, 625 x 25% = $1,406	$4,219
Year 4	$4,219 x 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 to 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 & 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?
Project staff	To know how much money and resources are available for their projects and what has been spent so far.
Managers	To keep an eye on how project funds are being used, especially compared to the original plans. To help plan for the future.
Finance staff	To make sure that there is enough money in the bank to buy the things the NGO needs to run its programmes.

Stakeholder	Why do they need it?
Board of Trustees	To keep an eye on how resources are being used to achieve the NGO's objectives.
Donors	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.
Government departments	To make sure that the NGO pays any taxes due and that it does not abuse its status as a 'not for profit' organisation.
Project beneficiaries	To know what it costs to provide the services they are benefiting from and to decide if this is good value for their community.
The general public	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?

In the previous chapter we looked at the Balance Sheet and Income & Expenditure account – ie the financial statements. When these are produced at the end of the financial year, they become the *annual accounts*.

Accompanied by a report on the work of the organisation, the annual accounts form the main information package for external stakeholders. 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
- 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 & Expenditure statement we use two types of financial analysis:

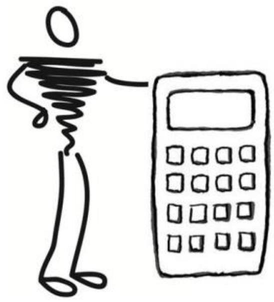
- *Trend analysis* which asks: how are we doing compared with the last period?
- *Ratio analysis* which provides a means of interpreting and comparing financial results.

▷ 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 statement

You can use ratios on the Income & 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

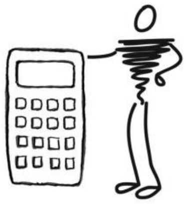
Again, try dividing everything by the total income figure shown on the accompanying Income & Expenditure statement to give an indication of the relative importance of items on the Balance Sheet.

- The S*urvival 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 & 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.

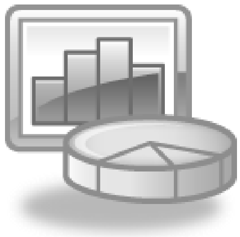
- The *Acid Test* or *Quick Ratio* asks the question: *Can we pay off our debts now?* It divides Current Assets less the less 'liquid' assets such as stocks and prepayments (in other words, short term debtors and cash balances only) by Current Liabilities (short-term creditors and overdrafts). The resulting 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:
1. Donor Dependency: Expressed as %	$\frac{\text{TOTAL DONOR INCOME}}{\text{TOTAL INCOME}} \times 100$
2. Income Utilisation: Expressed as %	$\frac{\text{EXPENDITURE ITEM}}{\text{TOTAL INCOME}} \times 100$
3. Survival Ratio: Expressed in weeks or days	$\frac{\text{GENERAL RESERVES*}}{\text{TOTAL INCOME}}$ X 52 or X 365 * these are un-restricted funds for general purposes under Accumulated Funds. Alternatively use Net Current Assets.
4. Acid Test or Liquidity Ratio: Expressed as a ratio n:n*	$\frac{\text{CURRENT ASSETS – PREPAYMENTS}}{\text{CURRENT LIABILITIES}}$ *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.
5. Current Ratio: Expressed as a ratio n:n*	$\frac{\text{CURRENT ASSETS....}}{\text{CURRENT LIABILITIES}}$ *A result of 2:1 is considered satisfactory – enough to pay off the debts within 12 months.

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.

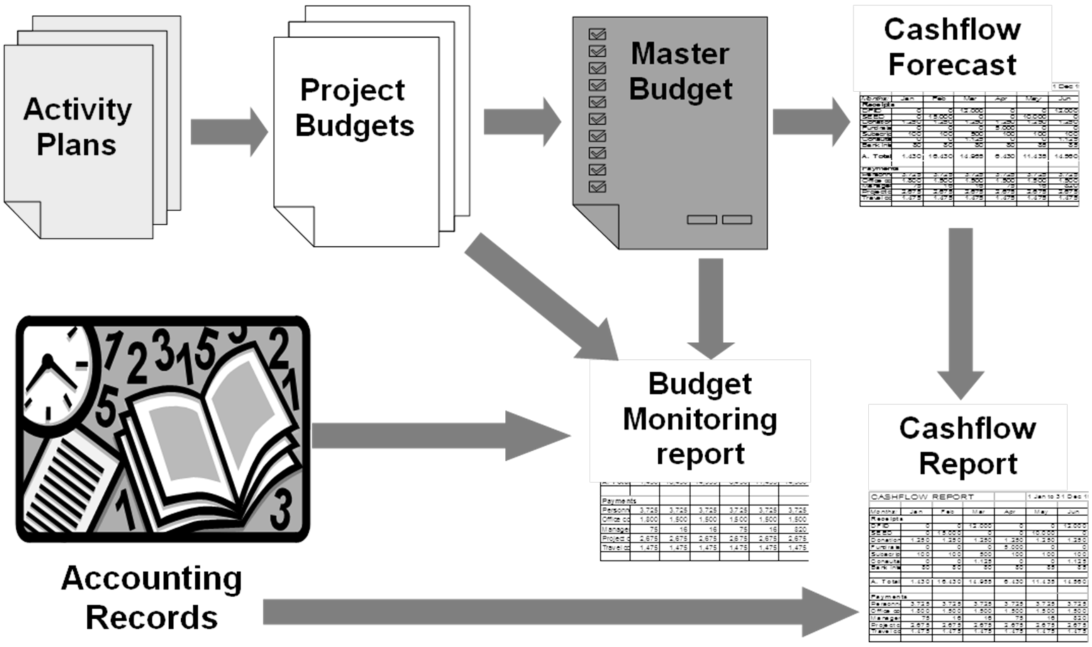
Since the reports are produced so that managers can take decisions about the future management of the organisation, the meetings of the governing body should be set to coincide with the management reporting cycle so that the information is still timely.

▷ 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 17.

The difference between the budget and the actual result is known as the v*ariance* 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.

Table 5.3: Rudi's budget compared to actual report

A	B	C	D	E
Budget item	**Budget $**	**Actual spend $**	**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%

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.

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:

Budget variance $ x 100 Budget for period $	*Under-spends will result in a positive % and over-spends will produce a negative %*
Actual for period $ x 100 Budget for period $	*Under-spends will result in a figure <u>less</u> than 100% and over-spends will be <u>more</u> than 100%*

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

Actual spend $ x 100 Total Budget $	*A resulting figure of over 100% means the total project budget is overspent.*

Forecast reports

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

See Appendix 19 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:

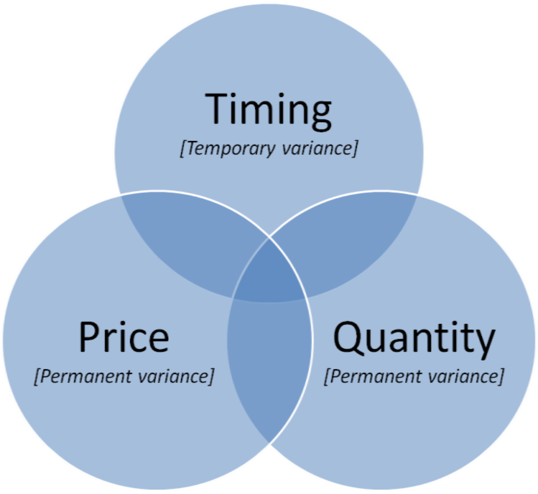
- actual income is lower than the budgeted amount, or
- actual spending is higher than budgeted.

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.

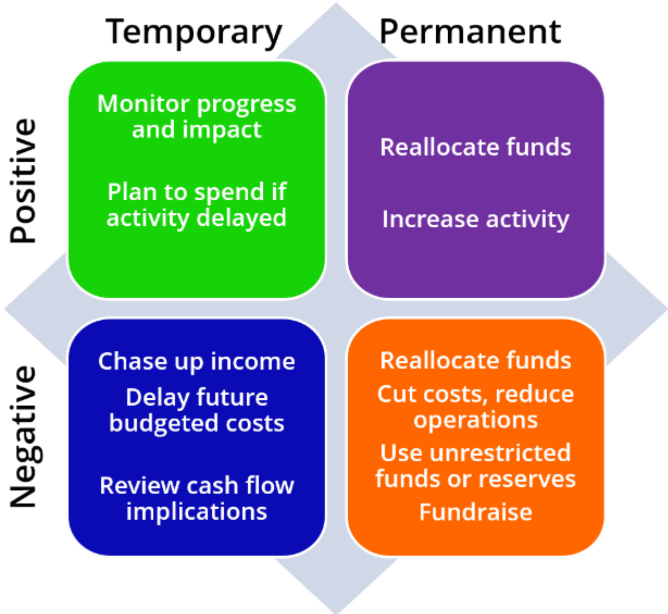
Permanent variances are therefore generally more serious and management attention and corrective action is required to get back on track.

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, according to whether they are positive or negative, temporary or permanent.

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
- the donor's rules and conditions.



1. Temporary positive variances

The key here is to be aware of what is causing the variance and whether it will have a knock-on effect elsewhere (as in our example of the water pumps). If the variance is due to delays in project implementation, it is important to make a plan to get the project back on track.

2. Temporary negative variances

These variances are often caused by a delay in planned income, e.g. grants arriving later than scheduled. This could cause cash flow problems for the project. In such cases, it is important to chase up the income or resolve the issue that is causing the delay. For example, a common cause of delayed grants is that the organization has not submitted a donor report on time.

It may be necessary to delay some big expenses until the issue is resolved.

3. Permanent negative variances

These variances are often the most difficult to resolve. The first option is to check if it is possible to reallocate funds from elsewhere in the budget – are there any permanent positive variances that can be used?

Many organizations and donors allow transfers between lines within 'family groups' of costs providing the overall sub total for the group of costs does not exceed the 10% rule. That means that budget holders only need to request formal approval where the transfer exceeds 10% of the budget line.

Example of a budget transfer

There is a staff vacancy which has resulted in a permanent positive variance on the Salaries budget. The Recruitment advertising budget is already used up from previous recruitment activities. The budget holder can authorize further spending on advertising as there is flexibility within the Personnel family group due to the under-spend on salaries. This is known as a budget transfer (or 'virement').

Budget transfers that exceed the 10% rule or involve transfers between family groups, e.g. making use of a positive variance on the Salaries budget to fund a negative variance on the Transportation budget, will require authorization by the line manager and/or donor, where relevant.

Other options to manage permanent negative variances include:

- control or cut costs in future months' activities
- finding additional sources of income.

Cost control?

It is not always possible to control or cut costs, especially if it would affect the project's ability to meet key performance indicators. Also, some budget lines are less 'controllable' than others, e.g. office rent, government taxes, and others are fixed or essential, e.g. vehicle insurance.

Additional income?

Options for additional financing include:

- requesting additional funding from project donors
- requesting 'top up' funds from central pots of unrestricted funds
- fundraising for new support.

Just as it is difficult to control some costs, it is not always feasible to replace lost income.

For example, a fundraising campaign to bring in 50 individual supporters for a girls' education program, only manages to recruit 25 supporters after 6 months – the chances of recovering the lost income for the first half of the year are highly unlikely.

Or a donor pledges to support an activity but the money never materializes, making it difficult to find last minute alternative funds. In these situations, it helps if the organization has its 'own money' in the form of unrestricted income or cash reserves.

4. Permanent positive variance

The options for managing the final category are either:

- reallocating funds to other budget lines that may be under pressure, or
- increasing activities within the project.

In both cases, it is important to discuss plans with the project donors. If it is decided to increase the level of activity to use up surplus funds on certain budget lines, take care not to incur costs in other budget lines where there are no spare funds.

In summary, permanent variances need more attention, however, we must not ignore temporary variances because they can cause cashflow problems - and may be an early warning of project delays.

WARNING! The budget transfer process

If you use budget transfers (virement) to manage variances, remember that it is a budget management technique: the budget and transactions coding process remain unchanged.

Returning to our example above, where surplus funds in the Salaries budget are used to fund the extra recruitment advertising:

- the budget lines remain the same; and
- the invoice for the adverts are coded as usual to the Recruitment advertising account – NOT the Salaries account.

This will show up as a permanent negative variance on the Recruitment advertising budget line, but that is OK as it has been authorized and falls within the rules of acceptable budget transfers within a family group.

The budget transfer process simply manages the negative and positive variances within the overall budget – the permanent variances will always be evident on the budget monitoring report as nothing else has changed.

▷ Budget management meetings

It is good practice to hold monthly budget review meetings, with both program and finance staff, to discuss results, and make action plans to resolve any 'red flag' issues. Recommended actions should then be discussed with managers and project donors, where relevant.

Budget monitoring action planner

It is useful to use a *Budget monitoring 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 monitoring action planner

Budget monitoring action planner					
1	2	3	4	5	6
Line item	Variance % or £/$	Var. Type	Controll-able?	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 monitoring action planner

Column heading	What it means
1. Line item description	The budget line that requires some corrective action.
2. Variance % or monetary value	Include items that exceed +/- 10% variation from the budget and which represent a significant sum.
3. Variance Type	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.
4. Controllable?	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.
5. Impact on project & grant management if not corrected	eg Cash flow, achieving targets, meeting timeframes, allowable costs.
6. Action required/by	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 18 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.

▷ The impact of exchange rates

Donors often disperse funds in their home currency, not the project's local currency, and require budgets and reports to be prepared in this currency. However, the organization may have converted these funds into other currencies to pay for goods and services and must have a system to re-convert for reporting purposes.

Exchange rates between currencies fluctuate. It is very unlikely that the rate that the organization got from its bank when converting funder money into another currency, will be the same rate it used when preparing the original project budget for the funding agency. The difference between what the organisation receives in local currency and what it had budgeted for is known as an *exchange rate gain* or *loss*.

Exchange gains and losses are a natural product of operating in different currencies. These gains and losses need to be tracked for the purpose of reporting to funding agencies. The example below demonstrates how an exchange rate loss can occur.

Example: Exchange rate losses

A local NGO prepares a budget in its local currency, LCs, and submits the budget to a funding agency, who requires the budget to be prepared in USD. The exchange rate at the time of preparing the budget was 2 LCs to 1 USD.

The budget is approved and the funder sends USD 500 to the local NGO. This is converted in LCs but the exchange rate has changed to 1.5 LCs to 1 USD.

	LCs	Exchange rate	USD
Budget	1,000	2 : 1	500
Actually received	750	1.5 : 1	500

The difference between the budget and what was actually received in local currency is 250 LCs. As this amount is less than budgeted, it represents an exchange rate loss.

This could create a problem for the organisation if the donor still expects the project to be delivered to plan; the organization now has 250 LCs less than it budgeted for.

An exchange rate gain would occur if the actual exchange rate were greater than 2 LCs to 1 USD. When using the case of US dollars – generally most countries have a weaker currency than the USD, leading to currency gains.

There is no single 'right' approach to managing and reporting on exchange rate gains and losses. Exchange rates are complex and there are many different ways of converting the money spent back into the donor's required currency for reporting purposes. This can be done using one of the following:

- A monthly average rate
- The rate on the first day of the month
- The daily rate provided by your bank

- The rate on internet websites
- The rate provided by funders on their websites.

The key to exchange rates is to be aware of, and report on, the impact that losses have on a project. It is also important to be aware of any gains, which if agreed by the funder, could be used for enhancing project activities or for building reserves.

▷ Budget no longer relevant?

When project plans change significantly some budgets will become 'outdated' – they no longer fit the purpose they were written for. This becomes evident during the budget monitoring process.

Budgets that have become out-of-date are difficult to work with because there will be a mis-match with revised activity plans and spending needs. There are two ways to manage budgets or budget lines that have become outdated:

- Manage budget variances using transfers between budget lines
- Revise the budget.

We covered budget transfers earlier in this chapter so we will now focus on what to do when you need to completely revise the budget.

▷ Revise the budget

When changes to activity plans affect multiple lines in a project budget, making a project budget substantially outdated, it may be better to re-draft the budget using current plans and information. You can either do that by starting from scratch for the period the revised budget will cover, using your usual budget-setting process, or you can use budget forecasting tools and techniques.

For internal budgets, the revised budget will have to be approved by the organisation's management team who will consider implications for financing the proposed changes.

▷ Budget modification requests to donors

For donor-funded projects, it is important to check the donor's guidelines for requesting a budget modification or major reallocation of funds. You need to find out:

- What constitutes a 'change of scope' requiring funds reallocation, eg cost modifications that exceed 25% of the approved budget
- What format the revised budget should be presented in
- What costs can and cannot be included in a revised budget
- What supporting evidence is needed
- Any deadlines for budget revision requests.

The reasons for submitting a revised budget or funds reallocation must be explained, and the revised costs justified. Some donors will require a budget narrative report to be completed as part of the budget revision process (as they do when first applying for a grant).

Tips for successful donor budget revision

- The sooner you alert the donor to the need to revise the budget, the better.
- Do not assume your donors will approve budget revisions and risk losing funds by making unauthorised expenses.
- It is important to demonstrate that the original project objectives will still be met by the revised plan.
- The revised budget is more likely to be approved if the total budget does not exceed the amount covered by the funding agreement.

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**

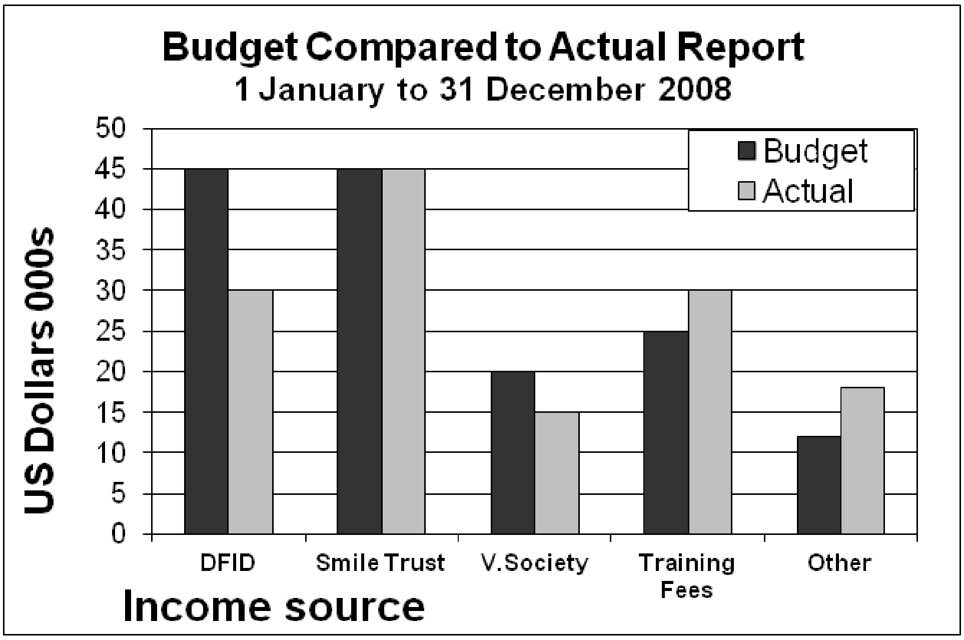
Negative figures in project financial management reports can be represented in two ways: – 1,234 or (1,234)

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 & Expenditure report – are a welcome alternative to tables of figures, especially for people who are less confident around numbers.

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.

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 common-sense 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.

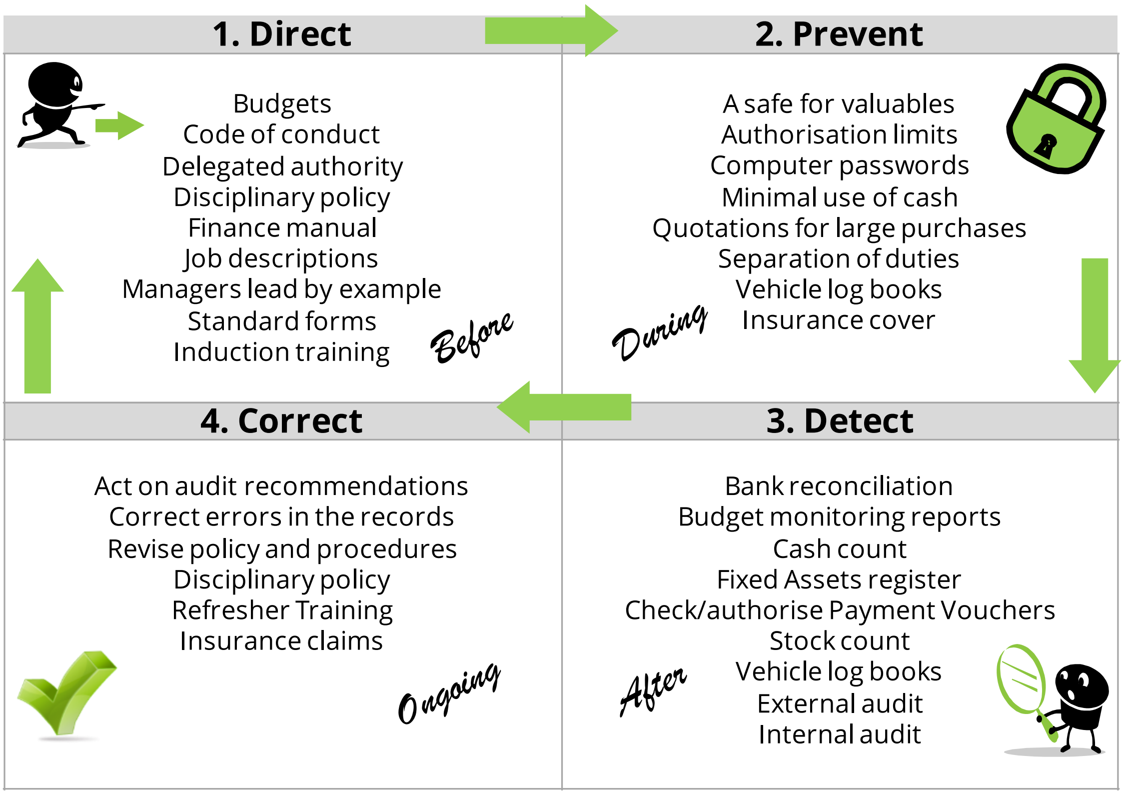
4. CORRECT: put right the errors or losses detected

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.

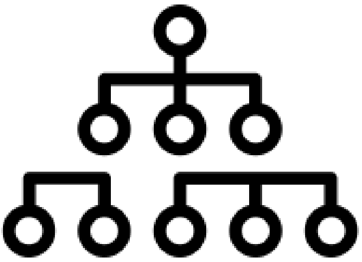
Figure 6.1: The Four Actions process



We will now look at some key internal control policies and procedures through the lens of the four internal control actions:

- Delegated authority
- Procurement procedure
- Cash control
- Physical control
- Checking routines
- Reconciliation routines.

Delegated authority



The practice of *delegated authority* falls under the **DIRECT** action. The Board of Trustees delegates (ie gives) 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.

Every organisation should decide in advance who should do what in finance-related procedures to manage the different levels of risk. 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, expenditure and sign on behalf of the organisation, so that there is no confusion about responsibility. See an example in Appendix 2.

The delegated authority document must be approved by the Board and regularly reviewed to ensure it remains relevant. It should include instructions for such duties as:

- placing and authorising orders for goods and services
- signing cheques
- approving staff expenses
- handling incoming cash and cheques
- access to the safe and cash box
- checking accounting records
- signing legal documents and contracts.

▷ 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.

▷ Adapting a delegation of authority for emergency responses

When responding to a humanitarian emergency, we often find standard procedures for cash management, procurement, and employment decisions are unrealistic. This is because we need to respond on a large scale, moving quickly to save lives, and the operating environment is often complex and changing fast.

Teams responding to a humanitarian emergency often need to make large purchases, sometimes in cash, and with a limited choice of suppliers. In those situations, we can make an *exceptional revision* to the delegated authority document so that implementing team members are given increased levels of authority. However, these exceptional revisions to the delegated authority document must be formally requested, authorised and documented.

Remember that any exceptional change to the delegated authority document is only temporary. The project management should monitor the changes to authority levels and amend the revised authority levels as the situation changes.

Where there is a high risk of humanitarian emergency, organisations can have a ready -prepared delegation of authority specifically for emergency responses. This saves time when an emergency response begins: the organisation only needs to approve that the operating environment meets certain criteria and the implementing team can immediately start using the emergency delegated authority scheme.

▷ 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

Separation (or segregation) of duties is closely 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 of people, it protects those involved and minimises the temptation to mis-use funds.

For example, it is risky to allow one person to order some equipment, then receive it, and also authorise the payment, without someone else involved in the process. As well as increasing the risk of theft or fraud, this puts too much responsibility on one person.

▷ Separation of duties matrix

A *separation of duties matrix* helps a team to organise an effective and practical sharing of duties, and identify areas where separation is weak. The table below provides an example of what a procurement duties matrix could look like.

Table 6.1: Separation of duties matrix – purchasing supplies example

Task	Name 1	Name 2	Name 3	Name 4	Compensating controls
Initiate purchase request	x				
Approve purchase request			x		Check budget
Prepare purchase order				x	
Update inventory records		x			
Approve vendor payment	x			x	Two signatures, must include budget holder

Note that in smaller organisations, staff limitations may make a full separation of duties impractical. This is when additional measures should be put in place – referred to as *compensating controls* – to protect those involved in the process. Examples of additional controls include:

- having two people authorise a stage in the process
- checking with a third party or a supporting document
- having a line manager or Board member to periodically review the work of individuals involved in a process.

The *procurement procedure* is a very good example of the practical application of delegated authority and separation of duties, so we return to this later in the chapter.

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**

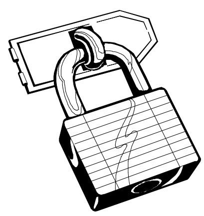
Keys to the petty cash box and the safe should be given only to authorised individuals. This should be recorded in the organisation's Delegated Authority document.

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 set up 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 22 for a sample Fixed Assets Register.

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 24 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 6.2** for a worked example.

Table 6.2: Calculating vehicle running costs

Vehicle make/model:	Toyota Van	
Date purchased:	26 December 2015	
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 2016: KM on clock on 31 Dec 2016 LESS KM on clock on 1 Jan 2016 Total KM run during year:	 20,601 (201) 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
Cost per KM calculation: Total costs for the year = $13,700 Total no. of KM run 20,400 km		 $0.67

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 6.3: 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	1,300	2,600
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 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.

The 3 Ps of Procurement

Every organisation needs a *Procurement procedure*. It clearly sets out the steps, responsibility areas, paperwork and safeguards needed to buy goods and services to implement projects and programmes, and ensure effective use of funds.

The procurement process embodies the four internal control actions:

- **DIRECT** – it lays down rules about who is authorised to do what, and the steps to follow when making purchases
- **PREVENT** – it includes separation of duties principles to share the workload, and to minimise the risk of theft or fraud
- **DETECT** – it builds in checking routines to ensure procedures are followed and the correct paperwork exists
- **CORRECT** – it allows a review of the process and actions taken so far, and the chance to put things right before proceeding to the next stage.

Each organisation will design a procurement procedure which suits its own circumstances – eg the number of people available to support the process, the level of risk involved, and the type of purchases needed. There are three key aspects to consider –the *3 Ps of Procurement* – Process, People and Paperwork.

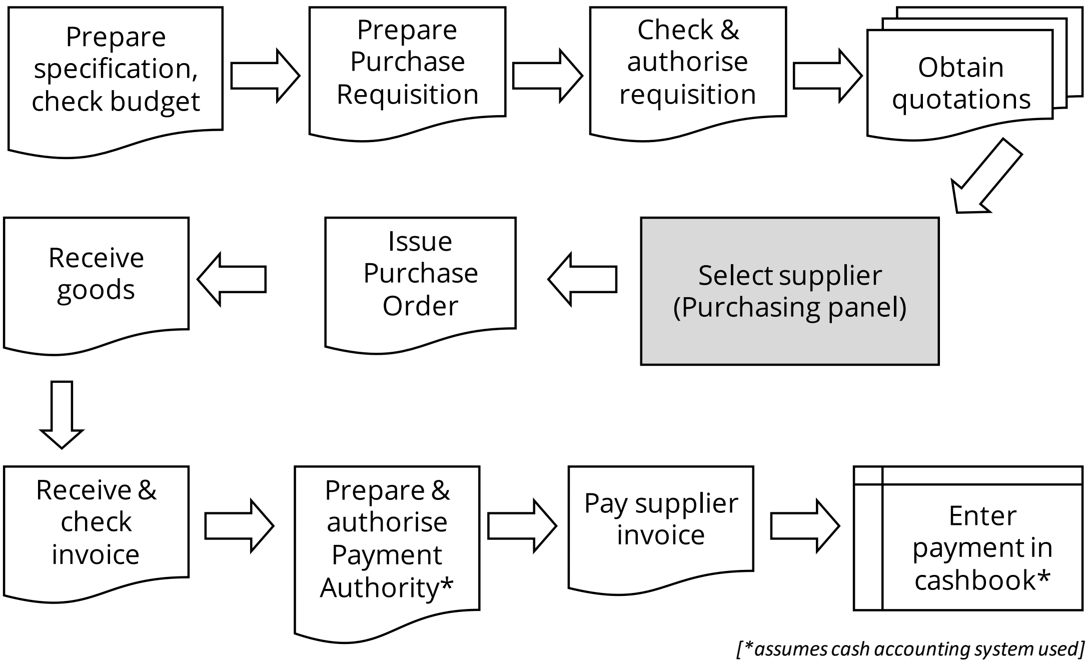
▷ Process

The procurement process describes the steps and rules that need to be followed to order, receive and pay for goods and services. The process itself will vary from organisation to organisation, and for different types of purchase.

The higher the value of goods or services, the higher the risk, and the more steps we need to follow. So, we use a different process to purchase small items of stationery to the one we use to buy a vehicle. For example, for higher value items, it is normal to obtain two or three quotations from suppliers to find the best deal.

Figure 6.2 shows an example of the steps in the process when purchasing a high value item (where there is a cash accounting system in place).

Figure 6.2: Procurement process flow chart - example



*[*assumes cash accounting system used]*

▷ People

The procurement process involves a number of people who will initiate or check and authorise each stage of the process. The higher the value and risk involved, the more people should be involved to protect the process from fraudulent activity.

For example, if purchasing a high value item such as a vehicle, it is usual to include a purchasing panel to ensure objective supplier selection.

The procurement process is built on the principle of separation of duties, and applies formal delegated authority rules, to ensure proper control. Sharing out responsibility between different people, and incorporating a range of checks, protects those involved and minimises the opportunity for fraud or collusion with suppliers.

The procurement process also builds in checks by managers to ensure that the delegated authority rules are followed by those that they manage, for example to check that a project manager has not exceeded their authorised limits when ordering goods or services.

▷ **Paperwork**

As you can see from the flow diagram above, each stage of the process generates paperwork and supporting documentation, such as purchase requisitions, purchase orders, quotations, invoices and payment vouchers. All the documentation should be checked at each stage of the process, then filed together for each transaction, and for later reference and audit purposes.

The table below summarises the 3 Ps of Procurement for our example flow chart above.

Table 6.4: The 3 Ps of Procurement

PROCESS	PEOPLE	PAPERWORK
1. Prepare specification, check budget		
Specify the standard, quantity and price of goods or services required, as described in activity plans. Check how much is available in the budget for the item in case the price has changed since the budget was first prepared.	Budget holder or Authorised project staff	Budget Specification note
2. Prepare purchase requisition		
Prepare formal request to purchase the goods or services specified in Step 1, including a detailed description and why it is required.	Budget holder or Authorised project staff	Purchase Requisition form
3. Check and authorise purchase requisition		
Verify that there is a genuine reason for the purchase (and budget available especially for high value items)	Budget holder or Other authorised person	Purchase Requisition form
4. Obtain quotations		
In line with internal procedures and donor rules, request price quotations from reputable independent suppliers to ensure best value for money and minimise the risk of collusion.	Logistician or Other authorised person	Supplier quotations / terms of business
5. Select supplier		
Review quotations and select supplier based on price, quality, delivery times, and 'after sales' terms to ensure value for money. For high value contracts a Purchasing Panel (a small group of managers) will select the supplier.	Budget holder or Other authorised person or Purchasing panel	Supplier quotations/ terms of business Supplier assessment form
6. Issue Purchase Order (PO)		
Send authorised PO to selected supplier and file a copy with the supplier's quotation. This is a legally binding contract.	Budget holder or Other authorised person	Purchase Order Selected supplier quotation
7. Receive goods from supplier		
On delivery, sign Goods Received Note to confirm receipt. Check details and file with PO.	Authorised project staff, Logistician or Other authorised person	Goods Received Note (GRN) Purchase Order

PROCESS	PEOPLE	PAPERWORK
8. Receive and check invoice		
Check the invoice and payment terms, and match up with associated paperwork	Finance staff*	Supplier invoice Supplier quotation PO / GRN
9. Prepare and authorise payment authority		
a) Prepare Payment Authority form and attach all supporting documents and original invoice. *b) Check details, add cost centre and account codes, then authorise payment.*	a) Finance staff* b) Budget holder or / and other authorised person (or as specified in delegated authority rules)	Payment Authority form All supporting documents
10. Pay supplier invoice		
Pay supplier as specified by the payment terms, usually within 30 days. Stamp invoice as 'paid' and note payment date and details on Payment Authority form.	Finance staff*	Payment Authority form All supporting documents
11. Enter payment into cashbook		
The final stage is to record the payment in the organisation 's books of account.	Finance staff*	

*It is common practice to separate these duties between different finance team members to strengthen the process and minimise opportunity for collusion and fraud.

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 donors.

▷ **Why do NGOs need audits?**

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?

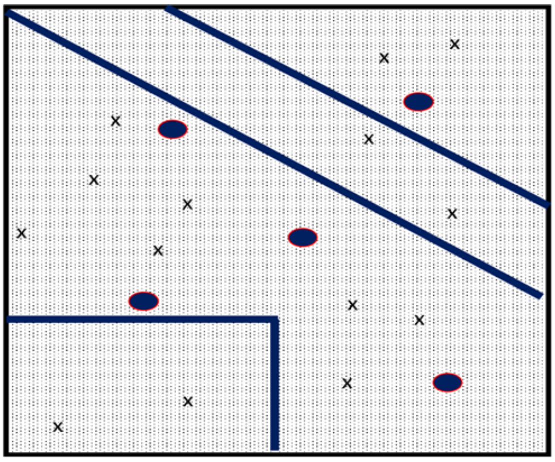
Auditors only have a limited time in which to complete their work, so they concentrate on testing the validity of a sample of transactions and results rather than vigorously checking everything.

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 if 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 external audit results in a report addressed to members, usually presented and approved at the annual general meeting. The report gives an audit opinion on 'the state of affairs of the organisation and operations for the period'.

If you have an opportunity to review your own or a partner's financial statement, it is worth looking closely at the auditor opinion to see what it says. Everyone hopes for a 'clean' audit report – that is where the auditor confirms that the financial statements fairly represent or give a 'true and fair' view of the organisation's financial statements.

> 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.*

Modified audit opinions

The auditors do not always agree with the financial results presented by the organisation. This could result in the auditor issuing what is known as a 'qualified' or 'modified' opinion. There are two reasons why an auditor would consider giving a modified audit opinion:

- they conclude that the financial statements as a whole have significant inaccuracies
- they have not been able to find enough evidence to conclude that the financial statements as a whole are free from significant errors.

There are various degrees of modified opinion, depending on the seriousness of the disagreement or concern with the financial statements and records, as summarised in **Table 7.1**.

Where a modified opinion is given, the auditor must explain their reasons in a 'Basis for Modification Paragraph' in the audit report. This paragraph is normally placed before the opinion paragraph and details the significant issues and errors they found during the audit.

If the auditors propose any adjustments or changes to the draft financial statements, these must also be approved by the Board.

Table 7.1: External auditor opinions

Auditor opinion	What it says and means
 Unqualified opinion	*"The financial statements present fairly, in all material respects… (or show a true and fair view of…)"* Unmodified opinion. A 'clean' audit report.
 **Unqualified opinion:** with 'emphasis of matter'	*"The financial statements present fairly, in all material respects… (or show a true and fair view of…)"* Unmodified opinion. Still a clean audit opinion but followed by a note on something that the reader needs to be aware of, eg an outstanding legal action or a major catastrophe.
 **Qualified opinion:** 'subject to' or 'except for'	*"Except for the matters described above… the financial statements present fairly (or give a true and fair view of) …"* Modified opinion. The accounts are basically OK, apart from specific identified issues described, eg an incorrect accounting policy, or specific unsupported expenditure.
 Adverse opinion	*"…the financial statements do not present fairly (or give a true and fair view of)…"* Modified opinion. There so many significant errors that the accounts do not give a true and fair view. This is serious.
 Disclaimer of opinion	*"…because of the significance of the matter described above … we do not express an opinion on the financial statements."* Modified opinion. The auditors are unable or unwilling to give an opinion because the records are so poor or incomplete. This is very bad indeed.

▷ Management letter

Auditors often provide a *Management Letter* after the audit is completed. 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:

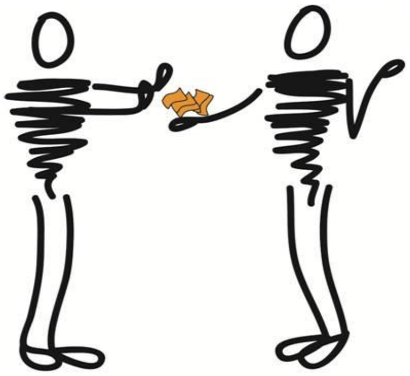
Table 7.2: An auditor's checklist

Group of Records	Description of item
A. Primary records of account:	▸ Cashbooks 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
B. Summaries and reconciliation statements:	▸ 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
C. Schedules:	▸ 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
D. Other information:	▸ 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:	***Internal***	***External***	***Donor/Project***
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.

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:

DO

- **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

DON'T

- **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 General Secretary 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.

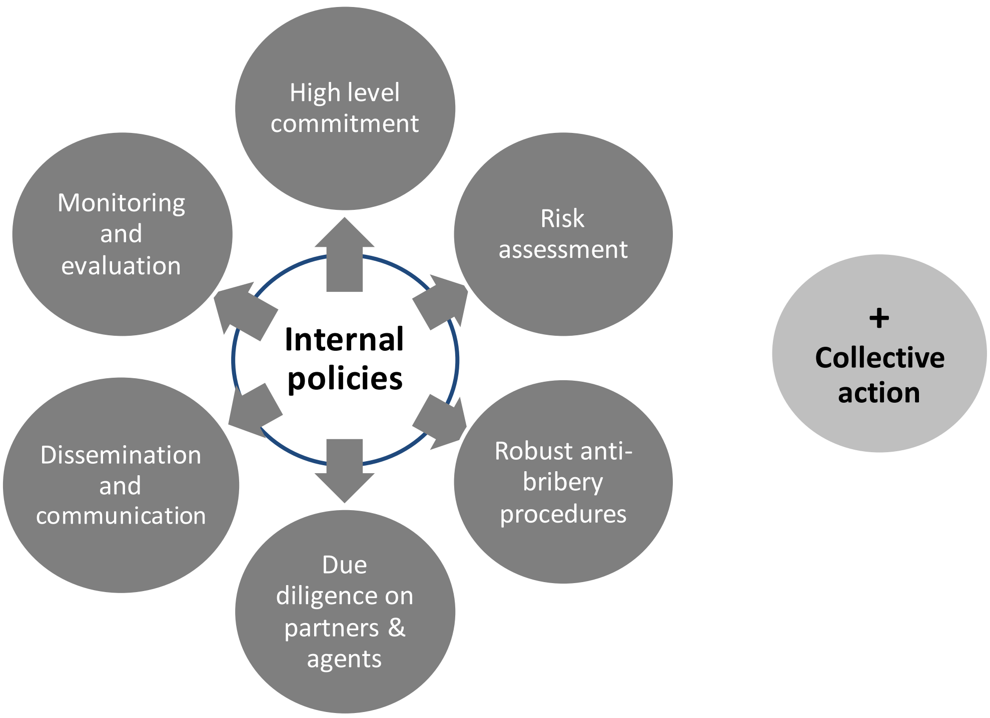
Remember that bribery is always a two-way transaction – there is a payer and the receiver – therefore, if we cut off the flow of bribes, bribery cannot happen. This is the basis for the argument for a zero–tolerance approach to bribes.

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.

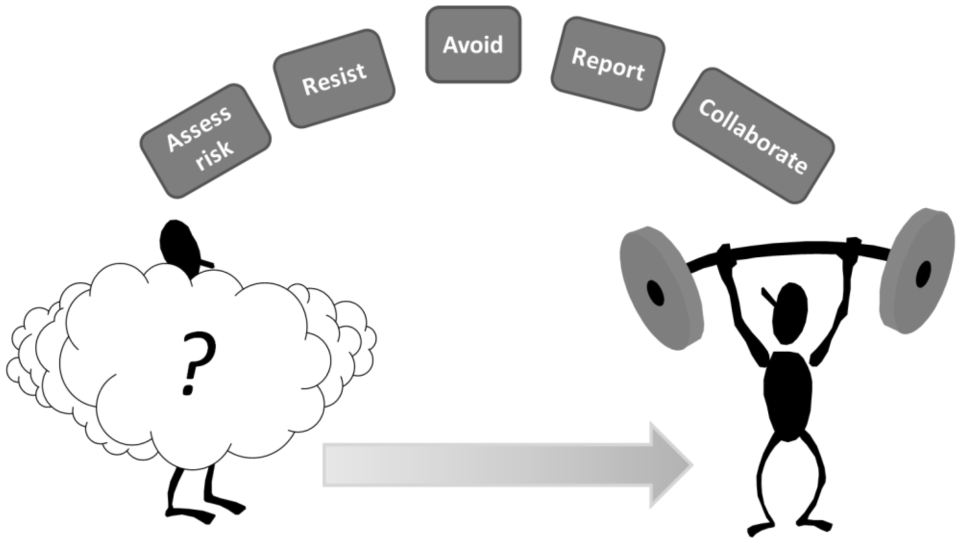
Organisations that are exposed to higher risks should consider external verification and assurance of their anti-bribery procedures.

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:** Mango - Training Dept.

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 helps recognise how serious the risk is and where 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

▷ 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

▷ **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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Appendices

Appendix 1: Example Chart Of Accounts –Milestone (MTTI)

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: Example Delegated Authority Document

AREA OF AUTHORITY:	LIMITS APPLIED:	DESIGNATED PERSONS:
1. Legal documents (where not covered below)		Any two from: Ch, Tr, Se, CE.
2. Leases on property and equipment	Up to $25,000 Over $25,000	Any one from: Ch, Tr, Se, CE. Any two from: Ch, Tr, Se, CE.
3. Current Account Cheques	up to $2,000 Over $2,000	Any two from: Ch, Tr, Se, CE, one other designated BM Any two from: Ch, Tr, Se, one other designated BM.
4. Bank Account Transfers	Up to $25,000 Over $25,000	Any two from: Ch, Tr, Se, CE, one other designated BM Any two 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 3: Bank Book – Receipts Page

MILESTONE PROJECT: Bank Book – Receipts January Year 9

1	2	3	4	5	6	7	8	9	10	11
					ANALYSIS OF RECEIPTS CATEGORY					
Date	Details of transaction	Recpt. No.	Cost Centre	Total UC*	Grant DFID 1010	Grant SMILE 1020	Donations & fundr'g 1120	Sales 1130	Training Fees 1140	Other [add code]
03/01	*Cash received for sales goods*	*46m*	*03*	*250.00*				*250.00*		
10/01	*Donation from Mrs Dlamini*	*21c*	*01*	*100.00*			*100.00*			
21/01	*Course fees*	*03b*	*02*	*2,000.00*					*2,000.00*	
23/01	*Misc. sales*	*04b*	*02*	*500.00*				*500.00*		
28/01	*Course fees*	*47m*	*03-01*	*1,500.00*				`	*1,500.00*	
30/01	*4th qtr, SMILE grant*	*05b*	*01*	*10,000.00*		*10,000.00*				
			PAGE TOTAL	*14,350.00*	-	*10,000.00*	*100.00*	*750.00*	*3,500.00*	
			Plus: Balance brought forward from last month:	*7,894.96*						
			Less: Total Payments for the month:	*(11,692.08)*						
			Balance carried forward to next month	*10,552.68*						

*UC = Unit of currency

Appendix 4: Bank Book – Payments Page

MILESTONE PROJECT: Bank Book – Payments January Year 9

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
					ANALYSIS OF PAYMENTS CATEGORY									
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]
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 BOOK

Period covered: *1 to 12 January Year 9*

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 A	199.15 B	0.85 C	65.44	20.56	7.50	86.15	-	19.50	

*UC = Unit of currency

Total A must = B + C

Appendix 6: Bank Reconciliation Form

Milestone Project, Bank Reconciliation

Bank account details:	*RNU Bank, Current account no. 00067891*
Bank statement date:	31 January Year 9
Bank statement sheet number:	37

A. Balance as on bank statement:	12,024.98
Less payments in cashbook, not on statement	
04/01 chq no. 13575 NGO Assembly	(50.00)
25/01 chq no. 13585 Telecomms Co.	(657.30)
29/01 chq no. 13586 J. Joshi	(2,300.00)
B. Total deduction	(3,007.30)
Plus receipts in cashbook, not on statement	
28/01 Course fees	1,500.00
C. Total addition	1,500.00
D. Adjusted bank balance	10,517.68
E. Balance in bank book	**10,552.68**
Plus receipts on statement, not in cashbook	
None	
F. Total addition	0.00
Less payments on statement, not in cashbook	
Bank charges	(35.00)
G. Total deduction	(35.00)
H. Balance in Bank Book [after adjustments]	**10,517.68**

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

Signed: ***ADM*** **Date**: 7 Feb Y9

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

Signed: ***AT*** **Date**: 9 Feb Y9

Appendix 7: Receipts & Payments Account

Receipts and Payments Account for the Milestone Project (MTTI)

1 January to 31 December Year 8

	UC	UC
Opening balance cash and bank		**2,880**
RECEIPTS		
Donor grants Received:		
– DFID	48,000	
– SMILE Trust	43,000	
Donations & fundraising	750	
Training fees	13,540	
Sales	11,406	
Bank interest	832	
Total receipts		**117,528**
PAYMENTS		
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	
Total payments		**(112,313)**
Closing balance cash and bank		**8,095**

UC = Unit of Currency

Appendix 8: Income & Expenditure Account

Milestone Project (MTTI)

Statement of Income & Expenditure for the year ended 31 December Year 8

			Year 7
INCOME:	UC	UC	UC
Donor Income:			
-DFID	48,000		45,000
-SMILE Trust	48,000	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	832	33,987	698
TOTAL INCOME:		**129,987**	**116,316**
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	9,341	28,207	6,803
TOTAL EXPENDITURE:		**129,516**	**116,945**
EXCESS OF INCOME /(EXPENDITURE) FOR THE YEAR:		**471**	**(629)**

UC = Unit of Currency`

Appendix 9: Balance Sheet

Milestone Project (MTTI)

Balance Sheet as at 31 December Year 8

	Note	Year 8 UC	Year 8 UC	Year 7 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	2,459		1,000
		20,554		8,880
Current Liabilities payable within 12 months				
Creditors and accruals	3	3,262		2,664
Net Current Assets			17,292	6,216
Net Assets			**129,383**	**128,912**
Represented by:				
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			**129,383**	**128,912**

[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	(12,455)	(13,633)
	112,091	122,696

Note 2 – Schedule of Debtors as at 31 December Year 8

Description	UC
Training fees due for Year 8 courses	2,100.00
Misc. sales invoices	359.00
Total Debtors & Prepayments	**2,459.00**

Note 3 – Schedule of Creditors& Accruals as at 31 December Year 8

Payee	Description	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 Year 8 audit (est.)	587.00
Total Creditors & Accruals		**3,261.76**

Note 4 – Accumulated Funds

	Year 8	Year 7
	UC	UC
Balance at beginning of the year	128,912	129,541
Plus surplus/(less deficit) for period	471	(629)
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: Income & Expenditure budget

Milestone (MTTI) Income & Expenditure Budget

1 January to 31 December Year 9

	Account code	Budget item	Total budget UC
INCOME			
DONORS	1010	DFID	90,000
	1020	Smile Trust	90,000
	1030	Vanguard Society	15,000
OTHER	1110	Bank Interest	1,000
	1120	Donations & fundraising	8,000
	1130	Sales	24,800
	1140	Training Fees	42,500
		Total Income:	**271,300**
EXPENDITURE			
ADMINISTRATION	3010	Audit/accountancy	4,500
	3020	Bank charges	600
	3030	Board Meetings	1,200
	3040	Depreciation	6,000
	3050	Postage & stationery	7,500
	3060	Publicity	1,500
	3070	Rent & utilities	9,000
	3080	Repairs & renewals	1,500
	3090	Telephones/fax	6,300
STAFF	4010	In-service training	4,500
	4020	Recruitment	0
	4030	Salaries & benefits	63,500
	4040	Travel & subsistence	3,000
VEHICLE RUNNING	5010	Fuel	9,000
	5020	Vehicle Insurance	18,000
	5030	Vehicle maintenance	24,000
TRAINING	6010	Fees & honoraria	3,000
	6020	Food & accommodation	16,000
	6030	Training Materials	92,200
		Total Expenditure:	**271,300**
		Surplus/ (deficit)	0

Appendix 12: Capital budget

Milestone (MTTI) Capital Budget

Funding request to ABC Philanthropy Foundation
Submitted 22 September <Year 9>

Budget item		UC
0110	**Office equipment**	**21,900**
	Computers	5,600
	Printers	800
	Desks & chairs	13,100
	Smart phones	2,400
0120	**Project equipment**	**44,900**
	Generators	18,500
	Tooling machinery	26,400
0130	**Vehicles**	**114,900**
	Mobile workshop lorry	82,000
	Conversion works	14,600
	Motorcycles	18,300
SUB-TOTAL		**181,700**
	Contingency 10%	18,170
GRAND TOTAL		**199,870**

Appendix 13: Cashflow Forecast

Milestone Project Summary Cash Flow Forecast: 1 January to 31 December Year 9

	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 Worksheet

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

Budget Period: 1 January to 31 December Year 9

Line ref.	Budget Item	Unit Type	No. Units	Frequ-ency	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 15: Summary budget

Milestone Summary Budget - Metalwork Dept.

Direct project costs, 1 January to 31 December Year 9

	Code	Budget item	Total UC
	INCOME		
DONORS	1010	DFID	35,000
	1020	Smile Trust	36,000
	1030	Vanguard Society	15,000
OTHER	1120	Donations & fundraising	3,000
	1130	Sales	9,500
	1140	Training Fees	21,200
	Total Income:		**119,700**
EXPENDITURE			
STAFF	4010	In-service training	1,500
	4030	Salaries & benefits	28,150
	4040	Travel & subsistence	650
VEHICLE RUNNING	5010	Fuel	2,500
	5020	Vehicle Insurance	6,000
	5030	Vehicle maintenance	8,000
TRAINING	6010	Fees & honoraria	1,500
	6020	Food & accommodation	8,000
	6030	Training Materials	50,700
	Total Expenditure:		**107,000**
	Surplus/(deficit) before overheads		**12,700**

Appendix 16: Consolidated Budget

Milestone (MTTI) Consolidated Budget

1 January to 31 December Year 9

		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 17: Budget Compared to Actual Report

Milestone Project - Budget Compared to Actual Report: 1 January to 31 March Year 9

		TOTAL BUDGET	1 January to 31 March BUDGET	ACTUAL	VARIANCE (adv)/fav	VARIANCE %	NOTES
		UC*	UC	UC	UC	UC	
Income (actual = receipts)							
Donors	DFID	90,000	25,000	25,000	0	*0%*	
	Smile Trust	90,000	25,000	25,000	0	*0%*	
	Vanguard Society	15,000	3,750	6,350	2,600	*69%*	Project tools purchased/reimbursed early
Other	Bank Interest	1,000	250	205	(45)	*-18%*	
	Donations	8,000	2,000	350	(1,650)	*-83%*	Fundraising strategy to be reviewed
	Sales	24,800	6,200	5,462	(738)	*-12%*	
	Training Fees	42,500	14,167	14,500	333	*2%*	
	TOTAL	**271,300**	**76,367**	**76,867**	**500**	***0.7%***	
Expenditure (includes commitments)							
Administration	Audit fees	4,500	0	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%*	Year end book adjustment
	Post & stationery	7,500	1,875	636	1,239	*66%*	Delay in printing the annual report
	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%*	Aware of problem, making efforts to
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%*	Error on our original budget – request
	Vehicle Insurance	18,000	17,500	17,500	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%*	Costs for April course incurred in this
	Training Materials	92,200	23,050	26,450	(3,400)	*-15%*	Costs for April course incurred in this
	TOTAL	***271,300***	***78,050***	***81,125***	***(3,075)***	***-4%***	
	SURPLUS/(DEFICIT)	0	(1,683)	(4,258)	(2,575)		

Appendix 18: Donor Report

DFID No.12345
STATEMENT OF ACTUAL EXPENDITURE FOR QUARTER ENDING: 30 Sept Year 9
AND ESTIMATED EXPENDITURE FOR QUARTER ENDING: 31 Dec Year 9

Rate applied: 3.75

		1	2	3	4 [2 - 3]	5	6	7	8 [7 - 4]	
Budget items:		Annual Budget GBP	Budget last quarter GBP	Actual last quarter GBP	Balance remaining GBP	Spent to date GBP	Spent to date %	Budget next quarter GBP	Grant request GBP	See note
Administration	Audit fees	1,200	0	0	0	1,267	106%	0	0	
	Bank charges	160	40	29	11	91	57%	32	21	
	Board Meeting	320	27	23	4	303	95%	27	23	
	Depreciation	1,600	0	0	0	0	0%	1,600	1,600	
	Post & stationery	2,000	500	426	74	1,814	91%	187	113	1
	Publicity	400	100	43	57	189	47%	200	143	
	Rent, ins. & utilities	2,400	600	586	14	1,745	73%	573	560	
	Repairs & renewals	400	100	57	43	212	53%	187	143	
	Telephones/fax	1,680	420	572	(152)	1,548	92%	415	567	2
Staff	Salaries & benefits	16,933	4,233	4,280	(47)	12,411	73%	4,280	4,327	
	In-service training	1,200	300	859	(559)	1,170	98%	30	589	3
	Recruitment	0	0	0	0	36	-	0	0	
	Travel & subs.	800	200	210	(10)	585	73%	195	205	
Vehicle Running	Fuel	2,400	600	773	(173)	2,622	109%	874	1,047	4
	Vehicle Insurance	4,800	0	40	(40)	4,720	98%	0	40	
	Vehicle maintenance	6,400	1,600	1,297	303	5,087	79%	1,307	1,004	
Training	Fees & honoraria	800	200	400	(200)	653	82%	147	347	
	Food & accomm.	4,267	1,067	1,027	40	3,501	82%	1,040	1,000	
	Training Materials	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 19: Budget Forecast

Milestone Project - Budget Forecast to 31 December Year 9

	TOTAL BUDGET	Actual - 1 January to 30 September			TOTAL to 30 Sept	Forecast Q4 Oct-Dec	TOTAL ANTICIPATED	
		Q1	Q2	Q3				
Income	UC	UC	UC	UC	UC	UC	UC	
DFID	90,000	25,000	22,000	22,000	69,000	21,000	90,000	
Smile Trust	90,000	25,000	25,000	25,000	75,000	15,000	90,000	
Vanguard Society	15,000	6,350	0	8,500	14,850	0	14,850	
Bank Interest	1,000	205	196	226	627	200	827	
Donations	8,000	350	895	3,250	4,495	800	5,295	
Sales	24,800	5,462	4,670	6,785	16,917	7,000	23,917	
Training Fees	42,500	14,500	6,900	11,200	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	4,750	0	4,750	
Bank charges	600	105	125	110	340	120	460	
Board Meeting	1,200	127	924	85	1,136	100	1,236	
Depreciation	6,000	0	0	0	0	6,000	6,000	
Post & stationery	7,500	636	4,568	1,598	6,802	700	7,502	AGM costs were under estimated
Publicity	1,500	200	350	160	710	750	1,460	Expect the major event in November
Rent, ins. & utilities	9,000	2,100	2,243	2,199	6,542	2,150	8,692	Expenditure levels are generally on track.
Repairs & renewals	1,500	327	256	213	796	700	1,496	Major repairs expected in the month of December
Telephones/fax	6,300	1,982	1,678	2,145	5,805	1,558	7,363	Phone rates were raised by phone company
Salaries & benefits	63,500	15,150	15,340	16,050	46,540	16,050	62,590	On track
In-service training	4,500	1,000	167	3,222	4,389	111	4,500	Last Qtr will not be very busy
Recruitment	0	0	135	0	135	0	135	
Travel & subsistence	3,000	835	569	789	2,193	731	2,924	Estimate based on activity plan
Fuel	9,000	3,675	3,257	2,900	9,832	3,277	13,109	Estimate based on activity plan
Vehicle Insurance	18,000	17,500	50	150	17,700	0	17,700	
Vehicle maintenance	24,000	5,608	8,603	4,865	19,076	4,900	23,976	Estimate based on activity plan
Fees & honoraria	3,000	500	450	1,500	2,450	550	3,000	On track
Food & accomm.	16,000	4,930	4,350	3,850	13,130	3,900	17,030	
Training Materials	92,200	26,450	19,667	23,090	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)**	

Appendix 20: Financial Management Work Plan

Financial Management Work Plan

KEY: - - - - - = daily x = no. weeks		JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
FINANCIAL ACCOUNTING ROUTINES													
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													
- DFID	Quarterly		x			x			x			x	
- USAID	Quarterly	x			x			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 21: 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 22: 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 23: 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:	
DETAILS OF PAYMENT OR REQUEST FOR FUNDS:			
HAVE ESTIMATES/QUOTATIONS BEEN OBTAINED? YES/NO If yes, please attach copies and indicate preferred supplier with reasons. If no, please state why not obtained.			
CHECKED BY:			
ORIGINATED BY: DATE:		AUTHORISED BY: DATE:	
ENTERED IN RECORDS BY:		DATE:	

Appendix 24: Sample Vehicle Log Sheet

Vehicle Log sheet

Vehicle Log Sheet

Vehicle registration no:______________

DATE OF JOURNEY	DESTINATION/JOURNEY DETAILS	DEPT.	KM READING START	KM READING FINISH	FUEL PURCHASED COST	FUEL PURCHASED # LITRES	DRIVER SIGNATURE
Total KMs run / petrol purchased this month							

Appendix 25: A Checklist for Good Practice

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

Appendix 26: 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 any 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 and 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

Instructions

Go through the 20 questions and answer them as honestly as possible, circling the number which most closely reflects the situation in your NGO.

Add up your scores. Then use the table below to assess the level of integration of financial management in your NGO, and the impact that might have on your work.

Scores:

20-30 Your organisation has a low level of integration of financial management. This could lead to misunderstandings and conflict between programme and finance staff teams; inefficient procedures; and ineffective use of resources. Staff may waste time, and not feel confident about finances. Plan a strategy to raise the profile of financial management in the organisation so that it eventually becomes second nature for everyone, and embedded across the organisation.

31-49 Your organisation has a reasonable level of integration of financial management. But you could easily improve matters with some careful planning. Further improvements may be very useful, helping prevent misunderstandings and conflict; making procedures more efficient; helping staff do their jobs better and more efficiently; and making more effective use of resources. For instance, a good first step might be to review the findings of the self-assessment with some of your managers and discuss what you can do better.

50-60 Congratulations! Your organisation has a high level of integration of financial management. But don't be complacent – make sure that the culture of financial management stays embedded in your organisation. Use every opportunity to keep financial management issues on the agenda. For example, make sure that new staff and Board members receive regular training and financial information. And make sure finance staff keep up their friendly and hard working attitude!

Appendix 27: Mango's Health Check

Mango's Health Check

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

Version 3

2009

Contents

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

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			
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

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			
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 (*if no cash/cheques received score 5*)	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

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			
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

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			
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

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			
5.1	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.