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Sierra Leone Urban Research Centre (SLURC)

Financial Management Workshop

Workshop Manual

13 – 15 September2017

Freetown, Sierra Leone

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Manual Index

References

1. Financial Management Essentials – A handbook for NGOs *By Terry Lewis of Mango*
2. Successful Grant Management – How to keep your donors happy *By Terry Lewis and Rob Hayes of Mango*
3. ACLAIM Africa Limited – Finance for Non-Finance Managers' Training.

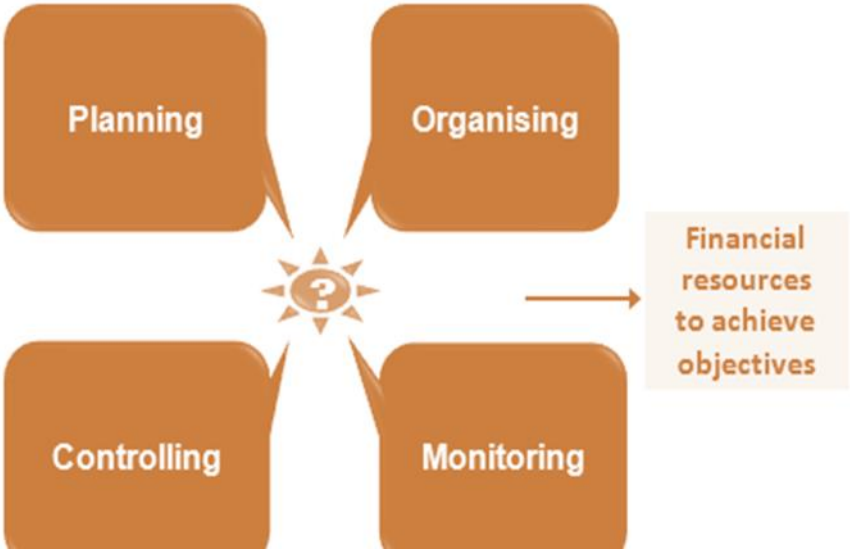
1.What is Financial Management?

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 to a not-for profit is rather like maintenance is to a vehicle. If we don't put in good quality fuel and oil and give it 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.

With effective financial management, the financial resources of an organisation are correctly and effectively used.

Financial Management is:



a) **Planning** includes making forecasts and decisions on the financial resources. This is also called Budgeting and Forecasting for the short term and Financing Strategy for the longer term financing needs of the organisation.

b) **Organising:** as programme staff are implementing activity plans, they carry out financial transactions, for example paying for a hall for a mobilization workshop. Financial management involves organising these transactions to enhance production of financial reports which guide decision-making. This is also called Accounting.

c) **Monitoring** involves the preparation and Review of Financial Reports such as those comparing actual performance to budget and taking corrective action.

d) **Controlling** involves establishment of checks and balances that are key to ensure that resources are applied for the right purpose. This is also referred to as Internal Controls.

2. Why is Financial Management important?

In a donor funded organisation, effective financial management is very important:

- to enable **Accountability** to various stakeholders;
- to enable **Continuity and security** of the organisation – for example, cash flow forecasts ensure that the entity meets its obligations and financing strategy that ensures funding over 3-5 years;
- to build **Confidence and trust** in the organisation – for example, from donors and beneficiaries; and
- consequently, results in **Achievement of organisational objectives** – for example a budget provides limits to ensure spending is within objectives.

3. Who is responsible for Financial Management?

The Board or Governing Body has ultimate responsibility legally, but they delegate day to day responsibilities to Management. The staff in the Finance Department have an important role in Financial Management, but all staff (Programme, Operations, etc) at every level, have a role to play.

The table below lists the key tasks in financial management with some guidance for who should take lead responsibility and provide additional support when required.

Programme Staff Roles	Finance Staff Roles
Planning (Budgeting)	
❖ Develop planning and budgeting timetable together with finance staff. ❖ Develop detailed phased annual work plans showing the months when activities are to be carried out. ❖ Prepare phased Activity Based Budgets in accordance with the annual work plans ❖ Insert Budget Codes in draft budgets	❖ Develop planning and budgeting timetable together with programme staff. ❖ Communicate budget preparation guidelines and templates. ❖ Guide programme staff in how to prepare Activity Based Budgets including unit type, unit cost, number of units, frequency, amount and notes. ❖ Prepare Chart of Accounts including Budget Codes and communicate them to programme staff. ❖ Consolidate project budgets.
Organising (Accounting)	
❖ Requisition for payment ❖ Approval of payment from budget ❖ Insertion of appropriate budget codes on payment requisition to ensure appropriate recording. ❖ Implementing activity on which funds are spent. ❖ Preparing supporting documentation to account for operational advances. ❖ Reviewing accountability to ensure activity carried out as planned.	❖ Verification of accuracy and adequacy of supporting documents. ❖ Assessment of cash availability for payment. ❖ Releasing the funds for an activity ❖ Record transactions in accounting system ❖ Appropriately filing the payment and accountability documents. ❖ Arithmetic review of accountability to ensure that supporting documents are adequate and appropriate. ❖ Expensing accountability in the accounting system.

Programme Staff Roles	Finance Staff Roles
	❖ Receiving, recording and banking returned cash after activity.
Monitoring (Report preparation and review)	
❖ Prepare programme monitoring reports showing planned performance vs actual performance. ❖ Reviewing budgeting monitoring reports with finance staff and comparing consistence with programme monitoring reports. ❖ Preparing donor programmatic report ❖ Reviewing donor programmatic and financial report for congruence.	❖ Prepare budget monitoring reports showing budgeted expenditure vs actual expenditure. ❖ Reviewing programme monitoring reports with programme staff and comparing consistence with budget monitoring reports. ❖ Preparing donor financial report. ❖ Reviewing donor programmatic and financial report for congruence. ❖ Preparing financial statements

4. How to attain effective Financial Management?

The "Face of Effective Financial Management" model has been used to explain this better. The Core financial management system processes (eyes, nose and mouth) are supported by other "softer" elements as shown below.

a) Budgeting

This includes budget preparation and cash flow planning.

b) Bookkeeping and Accounting

This includes: classifying and summarising transactions; maintaining cashbooks for different bank and cash accounts; tracking funds flow from the donors; ordering, receiving and paying for supplies and services; and maintaining financial records in an organised filing system.

c) Reporting

This includes preparation of accurate and timely financial reports; preparation of budget monitoring reports; preparation of donor reports; and preparation of annual financial statements.

d) Internal controls

This includes adequate internal control procedures occurring in a conducive internal control environment. (Covered later in the handbook).

e) Culture and values

Values including integrity, accountability, transparency etc have an impact on the financial management system. A culture of genuine emphasis on proactively creating impact for beneficiaries is a plus for financial management as well.

f) Enabling environment

The environment in the organisation should support effective financial management. This may include: having a clear and appropriate organisational structure; management meetings reviewing financial matters; management who lead by example; proper integration between finance and non-finance department; suitable equipment and working environment.

g) Staff

There is need for motivated and competent staff, especially in finance department. All other staff with a role to play in financial management need to be financially literate.

5. The Principles of Financial Management

It is useful to identify a series of good practice principles, which can be used as a standard in developing proper financial management systems in a not-for profit. These principles provide a high-level guide for trustees and senior managers to help them make sure that their organisation is using funds effectively and that staff are working appropriately.

Look upon each of the Seven Principles of Financial Management as goals to work towards.

a) Consistency

The financial policies and systems of a not-for profit must be consistent over time. This promotes efficient operations and transparency, especially in financial reporting. This does not mean that systems may not be refined to cope with a changing organisation. Inconsistent approaches to financial management could be a sign that the financial situation is being manipulated.

b) Accountability

The organisation must explain how it has used its resources and what it has achieved as a result to all stakeholders, including beneficiaries. All stakeholders have the right to know how their funds and authority have been used. Not for profits have an operational, moral and legal duty to explain their decisions and actions, and submit their financial reports to scrutiny.

c) Transparency

The organisation must be open about its work, making information about its activities and plans available to relevant stakeholders. This includes preparing accurate, complete and timely financial reports and making them accessible to stakeholders, including beneficiaries. If an organisation is not transparent, then it may give the impression of having something to hide.

d) Viability

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

e) Integrity

On a personal level, individuals in the organisation must operate with honesty and propriety. For example, managers and Board members will lead by example in following policy and procedures and declare any 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.

f) Stewardship

An organisation must take good care of the financial resources it is entrusted with and make sure that they are used for the purpose intended – this is known as financial stewardship. The governing body (eg the Board of Trustees) has overall responsibility for

this. In practice, managers achieve good financial stewardship through careful strategic planning, assessing financial risks and setting up appropriate systems and controls.

g) 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 the organisation's system for keeping financial records.

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

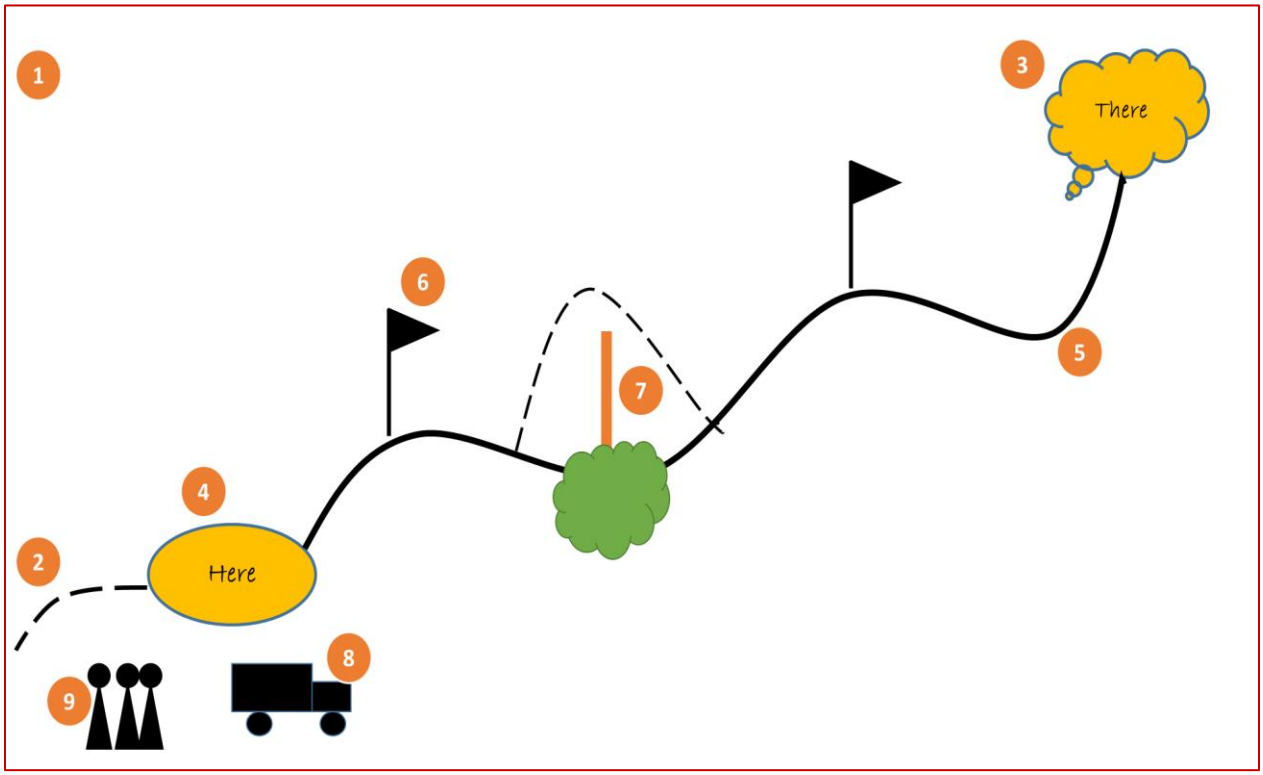
6. Minimum requirements and good practices in Financial Management

Minimum Standards	
Standard	**Why**
☑ A valid supporting document for every transaction, (securely filed and stored)	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 emergency projects.	Planning, fundraising, control and reporting.

☑ Budget monitoring reports – possibly produced weekly at onset, moving to monthly later depending on grant length and value.	So programme staff know how much they have left to spend.
☑ 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 administration duties between at least two people	To reduce opportunity to commit fraud; to share the load.
☑ Written policy on transferring cash to the field	To manage the risks to cash and protect staff
☑ A clear and straight forward procurement process	To avoid collusion and comply with donor regulations without hindering implementation
B. Good Practice	
Standard	**Why**
☑ Accounting records for staff employed (payroll) and assets owned (Assets Register).	To meet donor 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 budget for overheads	Encourages active management and financing of overheads
☑ Regular cash flow forecast.	Helps to identify and take action to avoid short-term cash flow problems.
☑ Use of Cost Centres where multiple donors and/or projects.	To separate restricted funds and related transactions; to facilitate reporting to managers and donors.
☑ Funding grids for multiple donor situations.	To avoid double-funding situations and identify areas of shortfall.
☑ Clear, written policy on asset security and physical controls	To minimise risks and abuse of NGO assets during an emergency response

7.Strategic Planning Refresher

Before conducting short-term or long-term financial planning, it is important for the organisation to have a comprehensive strategic plan. One simple model in developing a strategic plan is to consider strategic planning as a journey.



Using the journey metaphor, the organisation would need to answer questions such as:

i. Who are we? (Identity, Values, Nature of entity)

ii. Where are we coming from? (Historical Analysis)

iii. Where are we going? (Vision, Mission, Strategic Objectives)

iv. Where are we now? (Situational Analysis – Internal and External)

v. How do we get there? (Strategies, Service Delivery Models, Partners as well as supporting Structures, Systems and Staff)

vi. How do we know we are on the right path? (Measures of Success)

vii. What could go wrong and how would we respond? (Risk Management)

viii. What must we have done right to ensure success (Key Success Factors)

ix. Who can we go with along the journey (Strategic Partners)

"More important than the strategic plan is the strategic planning process".

8. Financing Strategy

Once the not-for profit has established a Strategic Plan, there is need to develop a Financing Strategy to ensure that the mission is funded. A key outcome of developing and implementing an effective Financing Strategy is the achievement of Financial Sustainability. This is attained when an NGO is assured of continuity in serving its beneficiaries in the long term, even when donor funding is withdrawn.

The key elements of achieving Financing Sustainability that a not for profit should aspire to are as shown below:

- **Income Diversification**: Having different sources of income such that withdrawal of one does not have significant effect on the organisation.
- **Unrestricted Funds**: Availability of funds to the NGO to allocate according to its own priorities rather than the restrictions of the funding source.
- **General Reserves**: Availability of resources put aside by the NGO to meet unplanned eventualities.
- **Strong Stakeholders**: Maintaining good relationships with the different stakeholders leading to growth in funds or reduction in costs.

The sources of financing that a not-for-profit may consider all fit along the "Ask – Earn" continuum below:

Donors	Community financing	Self-Financing
More Restricted ←	→	Less Restricted
E.g. Institutional donors, trusts & foundations, embassies	E.g. Corporate sponsorship, fundraising events, rotary clubs	E.g. Membership fees, business income, consultancy fees.

In order to implement the Financing Strategy, it is important that it is outlined in an implementation plan as shown in the table below.

Strategy/ Activity	Measure	Target	Responsible	Timelines
A. DONOR FINANCING				
A1. Obtain Funding From New Donors. A.1.1 Receive proposal writing training A1.2 Hire Resource Mobilization staff				
B. COMMUNITY FINANCING				
C. SELF FINANCING				

9. What is a Budget?

> An amount of money that an organisation plans to raise and spend for a set purpose over a given period of time.

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 if 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 should also be carefully controlled by an assigned budget holder.

10. Why is Budgeting Important?

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

a) 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.

b) 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.

c) 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.

d) Monitoring and evaluation

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

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

11. Top Tips for a Good Budget

a) Be organised

Meaningful and useful budgets are best prepared as an organised group exercise with beneficiaries, programme and finance staff all working together. Have ready all of the information that you need such as prices and activity plans.

b) Set up a timetable

Start the budgeting process early and set out a timetable for everyone to follow. This could be up to six months before the start of the financial year.

c) Write down all your notes and assumptions

Different people will use the budget for different purposes so they should all be able to pick it up and understand it without any additional explanation. Keep notes on budgeting assumptions and attach them to the budget.

d) Use consistent budget headings

If the budget line items and accounting records use the same descriptions and headings, then it will be much easier to produce regular budget monitoring reports.

e) Estimate costs

It is important to be able to justify your calculations when estimating costs, so use detailed budget worksheets (showing units and quantities) whenever possible. Last year's budget can be very helpful as a starting point; but it might also be misleading and contain inaccuracies.

f) Take care with contingencies

Try to avoid adding a 'bottom line' percentage for so-called 'contingencies' on the overall budget. Generally, donors do not like to see this and it is not an accurate way of calculating a budget. It is better to calculate and include a contingency amount for separate items in the budget – eg a salaries contingency or fuel contingency, if needed.

Remember that every item in your budget must be justifiable. Adding a percentage at the bottom is difficult to justify – and also difficult to monitor.

g) Forgotten costs

Don't forget the forgotten costs! There is a tendency in NGOs to under-estimate the true costs of running a project for fear of not getting a project funded, eg audit fees, staff recruitment costs, board expenses, social security contributions, etc. If you don't include them in the budget, how will you pay for these real costs?

h) Check the figures

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

12. Approaches to Budgeting

a) Incremental Budgeting

This describes an approach to budgeting where the calculations are based on previous year's budgeted or actual figures, with adjustments for new activities or known changes.

b) Zero-Based Budgeting

This describes an approach to budgeting where the budget is built from 'scratch', and not based on previous budgets or figures. Activity Based Budgeting (ABB) is a form of Zero-based budgeting. The work plans are drawn up according to activities (e.g. 'train 16 groups of community development workers'). Budgets are drawn up in terms of the chart of account descriptions, which should remain consistent from one year to the next.

c) Hybrid Budgeting

This describes an approach to budgeting that combines Incremental Budgeting for some transactions and Zero-Based Budgeting for others. In practice, for a continuing organisation, this is the approach adopted.

13. Activity Based Budgeting

It is best to approach the budgeting process as an organised and structured group exercise. An Activity Based Budgeting process is recommended for budgeting for NGOs as it has a logical flow. It involves asking the following questions:

a) What are the objectives of the project?

b) What activities will be involved in achieving these objectives?

c) What resources will be needed to perform these activities?

d) What will these resources cost?

e) Where will the funds come from?

f) Is the result realistic?

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Activity Based Budgeting Worksheet

Here is a typical layout for the main columns in a budget worksheet. The extract below describes the inputs needed for a 4-day workshop for 20 participants with 2 trainers.

	A	B	C	D	E	F [C x D x E]
Ref.	**Description**	**Unit Type**	**No of Units**	**Quantity/Freq**	**Unit Cost ($)**	**Total Cost**
1	**Workshop costs**					
1.1	Room hire for workshop	Days	4	1	25.00	100.00
1.2	Tutors' fees	Days	4	2	100.00	800.00
1.3	Tutors' accommodation	Nights	5	2	50.00	500.00
1.4	Lunch & refreshments	Delegate	22	4	5.00	440.00
1.5	Course handbooks	Delegate	22	1	5.00	110.00
1.6	Folders for papers	Trainee	20	1	3.00	60.00
						2,010.00

A	**Detail**	A short description of each line in the budget. Try to include different inputs on a line of their own rather than lump similar costs all together.
B	**Unit type**	This is the basis for the costing and calculations. The unit type will vary according to the budget item. For example, in line 1.4 of the table above, the budget for lunches is being costed on a per delegate basis.
C	**No. units**	This specifies the number of units required for the project. For example, in the budget above on line 1.4, we need lunches for 22 delegates (20 trainees plus 2 facilitators).
D	**Quantity/ Freq.**	This is useful where multiple items are required. For example, in line 1.4 in the table above, we need to provide lunches for 22 delegates on 4 days as it is a 4-day course. In line 1.3, we need to provide accommodation for 2 tutors. Whereas in line 1.1 we only need to hire one room.
E	**Unit cost**	That is, what does each unit cost as defined in column C? So, in line 1.4 we see that it costs $5.00 for lunch and refreshments for each delegate.

F	**Total cost**	This is calculated by multiplying no. units x quantity x unit cost. So we can see that the cost of lunch and refreshments for 22 delegates on each of 4 days at $5.00 per delegate costs US$440.00 [22 x 4 x 5]
G	**Notes**	A notes or comments column is useful to clarify what the item is for and how quantities have been arrived at.
H	**Acct Code**	The code used in the organisation's accounting records (i.e. as listed in the Chart of Accounts)
I	**Donor code**	It is very useful to add another column which details the donor code or line item reference as this makes it easy to transfer the budget figures into the donor budget and reporting formats.

Activity Based Budgeting – Unit Type examples

Below are examples of unit types that could be used for different cost 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

Typical budget items:	Examples of unit type:
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

14. Accounting Records

Every organisation must keep an accurate record of all 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.

Accounting records fall into two categories:

a) **Supporting documents** – these are the paper-work, such as receipts and invoices, which provide evidence, or proof, that a transaction took place. There should be at least one supporting document for every transaction taking place.

b) **Books of Accounts** – these are the books or 'ledgers' where information of financial transactions are recorded and summarised. They can either be kept as special books with lots of columns or on a computer accounts program designed for that purpose.

There are two main approaches to keeping accounts:

a) **Cash accounting** – a simple bookkeeping system which is relatively easy to use. This uses a *Cashbook* to record the date that payments are made and cash is received. It also gives a summary of cash available in the bank.

b) **Accruals accounting** – a more advanced system requiring knowledge of 'double entry' bookkeeping techniques. This uses a *General Ledger* (in addition to the Cashbook) to capture financial transactions when they are actually committed or due. This system provides a more comprehensive view of the financial status of the organisation, including information on assets (things we *own*) and liabilities (things we *owe* to others).

c) There is also a **'hybrid' approach** used by many NGOs. This is where the cash accounting system is used during the year and summary figures are adjusted at the year-end on an accruals basis.

15. Accountability

In order for the stakeholders of the organisation (management, staff, beneficiaries, implementing partners, donors) to work and relate effectively together, there needs to be inter-dependence among and between them. Interdependent relationships are more mature than other dependent or independent ones, and are a pre-requisite to team work or partnership. Such relationships may only grow and remain healthy where there is accountability between people.

There are several definitions for the term accountability, however, for this purpose, we shall define it as follows:

> *"Having been entrusted with **resources** and a **purpose**, there is an **obligation** to **honestly** give an **account** of **how** and **when** the resources have been used and the **tasks accomplished**."*

a) Managerial Accountability:

There are many forms of accountability ranging from political, personal, managerial, etc. The focus herein is *Managerial Accountability*. This is the obligation of those who have received delegated authority to explain and justify how they used it. Managerial accountability requires managers to carry out their tasks according to agreed criteria and with satisfactory results. It includes the following:

- **Financial** accountability is the obligation to ensure that money (financial resources) has been spent as agreed and according to set rules and procedures.
- **Effectiveness** (programme) accountability is the obligation to ensure that intended outcomes have been achieved; the desired impact has been made.
- **Efficiency** (process) accountability is the obligation to ensure that value for money has been achieved and that the output/input ratio is as favourable as possible.
- **Legal** accountability is the obligation to ensure that the nation's statutory requirements and all contractual obligations have been observed by the organisation. For example, while being efficient and effective, the organisation should, at the same time, fulfil its statutory requirements such as Pay As You Earn, Social Security, etc.
- **Professional** accountability is the obligation to ensure that professional ethics are observed in rendering service and in the way we conduct ourselves. Some professional bodies have a professional code of conduct which is binding on all members.

b) Financial Accountability:

To be financially accountable, it is key to answer the following questions.

- *What is involved in requesting for working advances?* i.e. the people involved at all levels and documents filled in should be known by staff. For instance the budget holder of the requesting department needs to approve an advance request form after ascertaining that all the relevant documents are attached and that the item requested for is within their budget.
- *What is involved in preparing financial accountability after spending?* Staff should be clear about the steps one has to go through to prepare good accountability. Good accountability should be *complete* (the entire amount taken accounted for including evidence of deposit of funds remaining unspent), *accurate* (free of error), *timely* (within the agreed timelines, to ensure timely review and reporting) and *consistent* (aligned the request made).
- *What is involved in reviewing financial accountability?* Many times budget holders are involved at the stage or approving an advance but leave the review of the accountability to finance staff only. It is important that the initial approver of the transaction, who is aware of the activity that was going to be carried out reviews the accountability first before submission to finance. The finance office should guide other staff in how to prepare good accountability and notify them timely in the event any gaps are identified during review.
- *How long after spending should financial accountability be submitted?* Management should establish the maximum number of days that staff should take before submission of accountability. This should be enforced by putting measures in place to reprimand individuals that fall short. Management should lead by example in this area. On a weekly and/or monthly basis, information should be extracted from the accounting software and shared our regarding staff with outstanding accountability.
- *What are the effects of not submitting complete, accurate and timely financial accountability?* Many times, non-finance staff do not put in adequate effort to submit complete and accurate financial accountability because they do not know the effect on the all-round cash flow position of the organisation. For example: without liquidating, finance would not expense an advance and therefore may give misleading financial reports; the organisation may be blacklisted by donors; the organisation's cash flows could be affected adversely where the donors only remit disbursements based on evidence of proper spending of prior disbursements; etc.

16. Financial Monitoring

Providing the organisation has kept and reconciled its accounting records in a clear and timely manner, it is possible to produce a variety of financial reports for those with an interest in the work of the organisation. There are several kinds of reports, used by different stakeholders – both inside and external to the NGO. The main types are:

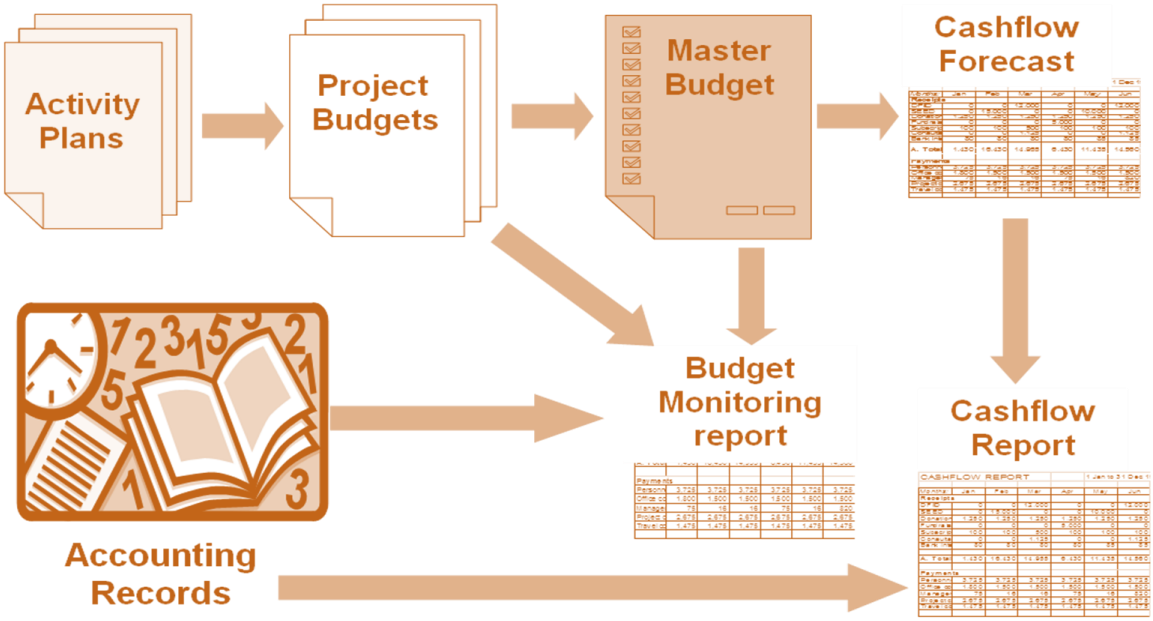
a) **Financial statements** – produced at least once a year to give a summary of operations and the financial status of the organisation. These are usually comprised of an Income & Expenditure Statement and a Balance Sheet. The annual financial statements form part of the audited annual accounts and mainly for use by those external to the organisation.

b) **Donor reports** – it is usual to provide an account to donors on how their funds are being used. Often accompanied by a narrative report, this financial report will usually be in the form of a budget monitoring report, the required frequency and format specified by each donor.

c) **Budget monitoring report** – this report compares the budget with actual income and expenditure for a specified period. Managers need this report to monitor progress of projects and programmes, and to help make decisions about future action. It should be produced at least once every quarter.

17. Management Reporting Flowchart

Below is a typical flow from activity plans to budgets, to accounting records and to reporting.



18. Budget Monitoring Reports

Management reports should normally include budget monitoring reports, which show the expected or budgeted income and expenditure against the actual achieved income and expenditure for a period.

a) Favourable and adverse variances:

The difference between the budgeted figure and the actual figure is called a **Variance**. If there is underspend, the variance is said to be **favourable**. If there is overspend, the variance is said to be **adverse**. Favourable does not necessarily mean good. For instance, the underspend could be a result of not conducting a major activity – that is not a good thing. Management should take appropriate action.

b) Temporary vs. Permanent Variances:

Some variances are permanent, for example if the budget for buying a vehicle was US$10,000 but it actually cost US$11,000. That US$1,000 will remain as a variance on that asset account for the whole year – it is permanent. Other variances are temporary, for example if a training event was supposed to happen in March, but it got pushed to April. In March it will show an under-spend, but that variance will have vanished by the end of April.

c) Variance Analysis:

Assuming that transactions have been correctly recorded, and no off-budget items are purchased, variances are caused by either a change in ***Quantity***, ***Price*** or ***Timing*** from the initially planned. It is important to know what the cause is to be able to address it effectively. Understanding the different types of variances on the budget monitoring report is important because there are different options for management action or decisions.

19. Risk

a) What is Risk?

The Chinese have two characters for risk: "风 险". One signifies "*Threat*" while the other signifies "*Opportunity*". Risk is, therefore, the possibility that an event will occur that will impact (positively or negatively) the achievement of objectives.

b) What is Risk Management?

Risk Management is a process for identifying, measuring, and prioritizing risks and creating responses to minimise or eliminate the negative impact of events.

c) Why manage risks?

There are several reasons why an organisation should invest time and resources in managing risks. Some of them include:

- **Avoid adverse surprises:** Effective risk management enables an organisation to anticipate what could go wrong and take decisions now about what should be done in case anything went wrong. An organisation that has anticipated a potential risk is usually better prepared to prevent or deal with a risk than one that may not have invested in assessing "what could go wrong?"
- **Ensure continuity**: An organisation that has anticipated risks such as loss of a major donor may take appropriate measures to widen the funding base. Loss of the donor due to funding priorities would, therefore, not significantly affect the continuity of the operations.
- **Staff confidence**: A risk conscious organisation provides confidence to staff of a secure working environment. For example, if staff of an organisation are aware that the organisation takes measures to insure their health, they are more likely to have confidence in their employer.
- **Donor confidence**: Donors have more confidence in an organisation that has put in place risk management procedures as this would give reasonable assurance that resources are well safe-guarded.
- **Exposure to legal suits:** An organisation that does not have risk management practices is more likely to face legal suits. With effective risk management, potential suits are anticipated and measures put in place to mitigate them. For example, an organisation that is aware of the threat of potential non-compliance with the tax acts would ensure that it has the appropriate advice to prevent that.

"Hope for the best, prepare for the worst".

d) What is involved in risk management?

Risk management involves asking the following questions:

- What could happen that would affect our ability to meet our objectives?
- How likely is it to occur?
- What would be the impact if it did?
- What should we do to reduce the risk to acceptable levels?

Risks that an organisation faces can affect it in differing ways depending on their likelihood of occurrence and consequences. There is, therefore, need to ensure that the risks with

high likelihood and impact are given priority to ensure that they are reduced to an acceptable level (also known as risk appetite).

In response to the risks identified, an organisation can adopt one of the 4 strategies below:

- **Accept risk**: If a risk is very low and no action needs to be taken or if the cost of responding to the risk is greater than the benefit, the organisation could opt to accept the risk.
- **Transfer risk**: The organisation may opt to transfer the risk to another party for instance insuring a building against fire and theft.
- **Reduce risk**: The organisation could put measures in place to reduce the likelihood and/or severity of risks to an acceptable level. For example, backing up data reduces the risk of loss of information.
- **Avoid risk**: The entity might opt to abandon the strategy or discontinue a project because risk outweighs potential benefits.

20. Internal Controls

Processes put in place by an organisation to provide reasonable assurance regarding the achievement of objectives.

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

a) Four Actions for Internal Control

i. 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.

ii. Prevent: to deter the wrong actions

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

These actions generally operate *during* implementation.

iii. 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.

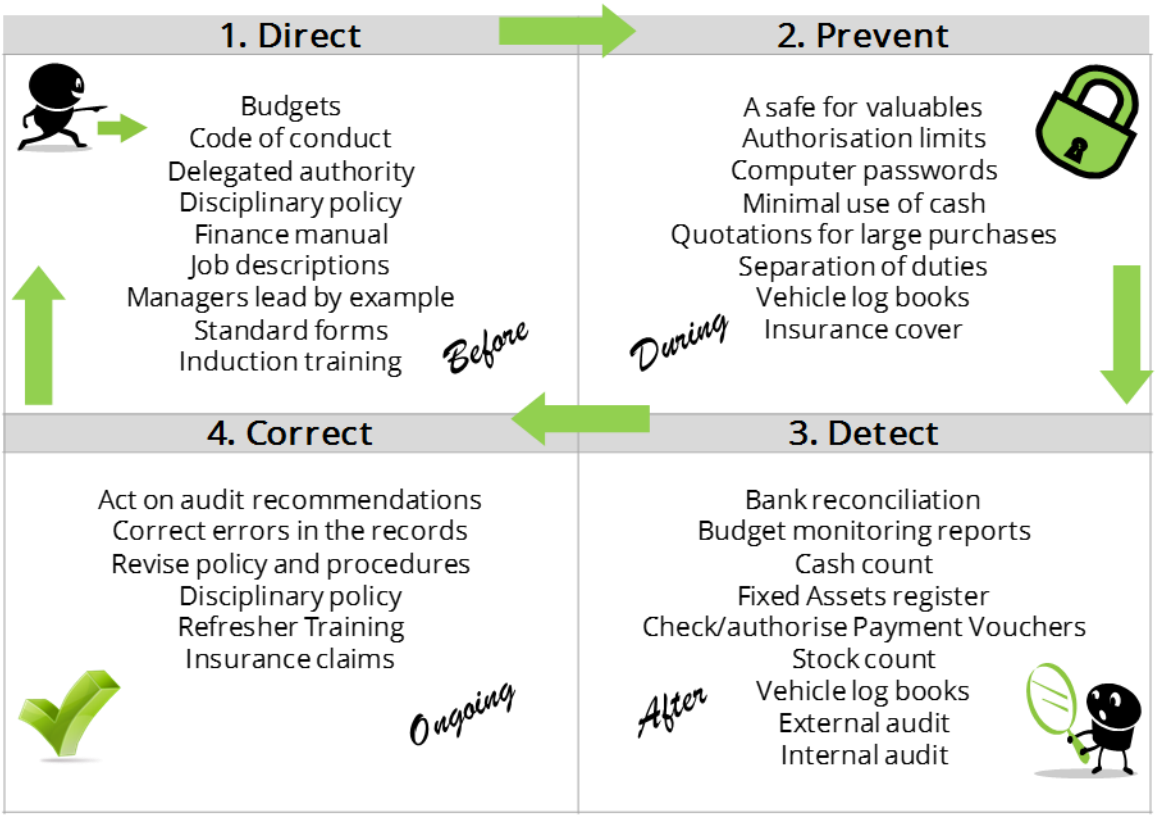
These actions take place *after* the activity has taken place.

iv. 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.

In the table below are examples of the four actions for internal control.



b) Types of Internal Controls

The types of internal control procedures include the following:

- **Checks by management:** There is need for management to carry out a number of checks for example reviewing receipt books to ensure that all the money in the receipt book is banked, reviewing the records in the accounting system to ensure that they are accurately recorded, reviewing reports prepared to detect any anomalies, etc.

- **Access limits:** Measures are put in place to ensure that information or assets are not accessed by unauthorized persons. E.g. using lock and key, using passwords.
- **Reconciliation:** This involves comparing two positions that are supposed to read the same thing for any unexplained differences. For example, one needs to compare their bank statement to their cashbook records to ensure that any differences are not related to error or fraud.
- **Physical verification:** Carrying out physical stock counts, cash counts, asset verification are examples of physical verification which give visual evidence of the existence of assets.
- **Approval or Authorisation:** This control involves a person higher in ranking, expertise and responsible for a particular area giving a go ahead for an activity to be carried out. For instance, before inventory is removed from a store, the storekeeper would request for authorization from someone with the required authority.
- **Standard documents:** Use of standard documents and records in an organisation are a major control to prevent fraud. For instance if a company does not have standard receipt books with a stamp, any staff member could pick cash from a client without evidence to the company that this has been done.
- **Segregation of duties:** In carrying out a number of steps for a particular transaction, it is important for a number of individuals to be involved. For example, it would not be advisable to have one person looking for a supplier, contracting them, raising a purchase order, preparing the cheque, receiving the item, recording the item etc. Segregating duties, therefore, involves sharing out the duties to different people to prevent fraud or error.

An easy way to remember the Internal Control Procedures is **"CAR PASS".**

c) Limitations of Internal Controls:

It is important to note that even with the best of internal controls, it is still possible for some risks to remain sip through. Internal controls may have limitations in the following areas:

- **Low Staff Numbers**: In very small organisation, it may not be possible to put in place certain internal controls effectively for example segregation of duties. The numbers of staff available may be too few to segregate duties.
- **Cost of Controls**: In some cases, it may be more costly to implement an internal control procedure than the benefit derived. An extreme example: it may not make sense to hire a guard to watch over a pen.
- **Management Override:** In some cases, high level personnel in an organisation may use their positions to override the controls for their personal gain. For instance where a

control requires a requisition to be raised before any payment is made, a senior personnel could override that control by ordering the cashier to give them cash without a requisition.

- **Human Error:** As a result of misunderstanding, stress, fatigue or pressure, staff may not implement internal controls as required. For example, a cashier at a bank may be required to count cash in the presence of the customer but may forget due to fatigue.
- **Collusion:** It is said that the weakest link in any control system are people. Staff are responsible for implementing internal controls and supervising one another. It is possible for staff to work together to defraud the organisation.

21. Internal and External Audit

a) An External Audit is…

A process by which an auditor forms and expresses an independent professional opinion as to whether the financial statements give a true and fair view and whether they have been properly prepared in accordance with relevant legislation and accounting standards.

As well as the **audit report**, the organisation should get a **management letter** giving information and advice about weaknesses noted, implications, root causes and recommendations.

An external audit is not…

- A certificate guaranteeing there are no problems;
- A fraud investigation, or assurance that there is no fraud;
- A witch-hunt; and
- Assurance that the internal controls system is adequate.

Audit team on the premises

When the audit team visits, the organisation should ensure there is enough space for them, and that staff are available to answer questions or provide documents. Auditors are legally allowed to ask any question or look at any document necessary for forming their opinion.

The organisation should anticipate the questions that auditors are likely to ask with respect to documents supporting the assertions in the financial statements, and have these ready before the audit commences.

Before the audit team comes to the premises, there should be an inception meeting to agree upon the necessary information needed, staff availability, logistics, etc. At the end of the field

work, there should be a closing meeting where the auditors present their preliminary findings to the organisation to allow for validation.

b) Internal audit

The objective of internal audit function is continuous improvement of internal control systems and risk management strategies.

Activities with a high risk associated should be adequately controlled, through the design of appropriate control procedures. Internal checks are done to ensure that the procedures are followed. Where controls are not followed, this is brought to management attention and appropriate action taken, and later to the Board Audit Committee, for oversight. Where the controls are found to be inadequate, recommendations are made for improvements. This gives management timely information for corrective action.

Internal audit should not be part of the systems themselves! They should be independent from what they audit.

c) Internal vs. External audit

Category	External auditor	Internal auditor
Prime objective	Form opinion on financial statements	Improvement of internal control system
Frequency	Annual	More frequent, say, quarterly
Qualification requirement	ACCA, CPA, etc.	None required, but ACCA, CPA, CIA better placed
Staff	Definitely not staff	May be staff or outsourced.

22. Overhead Cost Allocation & Absorption

It is important to have a clearly stated policy on how the organisation will cover its overhead costs (also referred to as Indirect Costs or Shared Costs or Core Costs or Administrative Costs). These are costs that cannot be directly attributed to a specific project. These costs have to be funded just like any other cost incurred in the organisation. The starting point is to produce a separate budget for overhead costs so they do not get overlooked.

There are essentially two ways – or a combination of both – to fund overhead costs: use unrestricted funds (i.e. money that the organisation has for general purposes) to cover all or part of the overhead costs; or charge core costs out to projects using a pre-arranged apportioning ratio.

Overhead Allocation:

There are costs which, though initially overheads, could be allocated to a specific project if the organisation has established mechanisms to fairly identify them. For example:The salary of the Finance Manager that is handling various projects could be construed as overhead costs, initially. However, to a certain extent, it may be possible to allocate that salary to a project if proper timesheets are maintained showing the time spent on a specific project.

Overhead Absorption:

The remaining costs that cannot be allocated to the different projects may would need to be absorbed by the projects according to a pre-agreed justifiable ratio. The ratio for apportioning the overhead costs among the various projects is dependent on the Cost Driver. Assuming that the total value of overhead costs is US$ 100,000 and of that $80,000 is salaries. The predominant cost or Cost Driver, in this case, would be salaries. The organisation may consider the project with most staff to take on the biggest chunk of the $100,000 overhead costs. Other criteria that could be considered according to the Cost Driver may include:

- Size of each project budget;
- Amount of space used by project;
- Number of clients/beneficiaries;
- Actual consumption, eg. kilometres travelled etc.

There is no hard and fast rule for apportionment of overheads to projects; rather logic should be applied and the criteria chosen should be fair, justifiable and applied consistently.