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## **Course Handbook**

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Practical Financial Management for NGOs  
– Getting the Basics Right (FM1)

**Taking the Fear Out Of Finance**



**Practical Financial Management for NGOs – Getting the Basics Right**

# **Course Handbook**

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## Glossary

<b>Account</b>	A record of monetary transactions, either written into a book designed for the purpose or entered onto a computer file.
<b>Account code</b>	A code for a specific type of transaction. Transactions are given a code which describes what type of income or expenditure they are, eg 5050 Transport costs, 5600 Office rent etc.
<b>Accounting period</b>	A specified period for recording and reporting financial activity for a given time, eg one year or one month.
<b>Accrual</b>	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.
<b>Accumulated funds</b>	Money, or equipment, that we build up year by year as a result of not spending all our income. Often referred to as our Reserves.
<b>Acid test</b>	The ratio achieved by dividing Current Assets (excl. Stocks) by Current Liabilities. It tells us if the organisation has sufficient funds to pay off its debts immediately.
<b>Apportionment</b>	The sharing of indirect costs between two or more cost centres in proportion to the estimated benefit received.
<b>Asset</b>	Any possession or claim on others which is of value to the organisation. See also Fixed Assets and Current Assets.
<b>Audit</b>	A formal check on the accounts by an independent person (auditor).
<b>Audit trail</b>	The ability to follow the course of any reported transaction through an organisation's accounting systems.
<b>Authorisation</b>	This is the process of approval over transactions, normally the decision to purchase or commit expenditure. Authorisation by a budget holder is a way of confirming that spending is in line with budget and is appropriate.
<b>Back donor</b>	The original source of funds, where a grant is channelled through an agency, such as an international NGO, on to an implementing partner. The agency must report back to the original donor to account for the use of the funds by the local partner.
<b>Balance Sheet</b>	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.
<b>Bank book</b>	A register which records all transactions passing through a bank account. Also known as a cashbook or a Cash Analysis Book.

<b>Bank reconciliation</b>	The process of comparing the entries and ending balance in the cashbook with the bank statement, and identifying any differences. It provides an important check on the completeness and accuracy of the cashbook entries.
<b>Budget</b>	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.
<b>Budget holder</b>	The individual who holds the authority and has the responsibility for managing, a budget for a specified activity, project, programme, department or organisation.
<b>Burn rate</b>	Expressed as a percentage, the amount of a grant or budget used up so far. Also known as the <i>Utilisation Ratio</i> .
<b>Capital expenditure</b>	Expenditure on equipment, property and other fixed assets which will be used to support activities over more than one accounting period.
<b>Capital fund</b>	Accumulated funds and reserves held in the form of equipment and property.
<b>Cashbook</b>	A book or spreadsheet that lists all of the receipts and payments made in to and out of a particular bank or cash account.
<b>Cash reconciliation</b>	Comparing the month end physical cash counted to the expected month end balance in the petty cashbook.
<b>Cashflow</b>	The difference between cash received and cash spent in a period.
<b>Cashflow forecast</b>	A report that shows the expected timing of receipts and payments for the next 3-6 months (or longer).
<b>Chart of accounts</b>	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.
<b>Core costs</b>	Central support costs shared by many projects. Also called overheads or indirect costs.
<b>Cost centre</b>	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.
<b>Creditor</b>	Anyone the organisation owes money to.
<b>Current assets</b>	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.
<b>Current liabilities</b>	Short-term sources of 'finance' (eg from suppliers, bank overdraft) awaiting payment in the next 12 months.
<b>Current ratio</b>	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.
<b>Debtor</b>	Any person or other party who owes money to the organisation.

<b>Depreciation</b>	A proportion of the original cost of a fixed asset which is internally charged as an expense to the organisation in the Income & Expenditure Account.
<b>Designated funds</b>	Unrestricted funds which have been accumulated over time and earmarked for a particular purpose by the Trustees.
<b>Direct cost</b>	A cost which can be specifically allocated to an activity, department or project.
<b>Donation in kind</b>	Where a grant or contribution to a project is made in the form of goods or services, rather than a cash grant or donation.
<b>Double entry bookkeeping</b>	The method of recording financial transactions whereby every item is entered as a debit in one account and a corresponding credit in another.
<b>Exception report</b>	A short narrative report which highlights significant variances and/or areas for concern to accompany the management accounts.
<b>External audit</b>	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.
<b>Financial accounting</b>	Recording, classifying and sorting historical financial data, resulting in financial statements for those external to the organisation.
<b>Fixed asset</b>	An item of high value owed by the organisation for use over a long period. Normally office equipment, vehicles and property.
<b>Fixed assets register</b>	A list of the Fixed Assets of the organisation, usually giving details of value, serial numbers, location, purchase date, etc.
<b>Fund accounting</b>	Used to identify spending according to the different projects or purpose for which the funds were granted.
<b>General ledger</b>	The main accounting record where double-entry bookkeeping is used. See also <i>Nominal Ledger</i> .
<b>General funds</b>	Unrestricted funds which have not been earmarked and which may be used generally to further the organisation's objectives. Often referred to as Reserves.
<b>Imprest</b>	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.
<b>Income &amp; Expenditure Account</b>	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.
<b>Indirect cost</b>	A cost which cannot be specifically assigned to one activity, department or project, eg the fee for the annual audit.
<b>Journal entry</b>	An entry in the books of account which covers a non-monetary transaction – eg for recording a donation in kind or an adjustment for correcting a recording error.

<b>Liabilities</b>	Amounts owed by the organisation to others, including grants received in advance, loans, accruals and outstanding invoices.
<b>Liquidity</b>	The level of cash and assets readily convertible to cash compared to the demands on the available cash., eg to pay bills.
<b>Liquidity ratio</b>	A measure of liquidity obtained by dividing debtors, cash and short-term investments by current liabilities.
<b>Management accounting</b>	The provision of financial information to management for the purposes of planning, decision-making, and monitoring and controlling performance.
<b>Net book value (NBV)</b>	The cost of an asset less its accumulated depreciation to date.
<b>Net current assets</b>	Funds available for conducting day-to-day operations of the organisation. Usually defined as current assets less current liabilities. Also known as working capital.
<b>Nominal account</b>	A 'page' or 'container' in the Nominal Ledger for recording every type of financial transaction likely to occur in an organisation, within a specified time period. A complete list appears in the Chart of Accounts, each with its unique 'nominal code'.
<b>Nominal ledger</b>	A book or computer programme which holds details of each of the nominal accounts. Also known as General Ledger.
<b>Organogram</b>	Organisation chart showing the management and departmental structure of the organisation
<b>Payment voucher</b>	An internal document raised for each payment. It provides a unique reference number and evidence of authorisation. Supporting documents are attached to it.
<b>Petty cash book</b>	The day-to-day listing of petty cash paid out.
<b>Prepayments</b>	Amounts paid in advance at a particular accounting period – eg annual insurance premium.
<b>Procurement</b>	The process of purchasing goods and services. Steps in the process may include requesting, authorising, selecting suppliers, ordering, receiving and paying.
<b>Quarter / quarterly</b>	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.
<b>Receipts &amp; Payments account</b>	A summary of the cash book for the period with opening and closing balances.
<b>Reconciliation</b>	Checking mechanism which verifies the integrity of different parts of an accounting system. Especially balancing the cash book to the bank statement.
<b>Reserves</b>	Funds set aside from surpluses produced in previous years.
<b>Restricted funds</b>	Income which has conditions attached to how used, usually with a requirement to report back to the donor.

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



# Financial Management for NGOs

*An Introduction to Financial Management and Control in the NGO Sector*

This chapter:

- ❑ Explains why financial management is important for NGOs
- ❑ Clarifies financial management and financial control
- ❑ Describes the underlying principles of financial management
- ❑ Explains roles and responsibilities in financial management
- ❑ Outlines the building blocks and tools of financial management

## Why is Financial Management important for NGOs?

In many NGOs financial management is given a low priority. This is often characterised by poor financial planning and monitoring systems.

But NGOs operate in a rapidly changing and competitive world. If their organisations are to survive in this challenging environment, managers need to develop the necessary understanding and confidence to make full use of financial management tools.

Good practice in financial management will:

- help managers to 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 NGO 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!

## So what is Financial Management?

Financial management is not just about keeping accounting records. 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 suffers and it will not run efficiently. If neglected, the vehicle will eventually break down and fail to reach its intended destination.

In practice, financial management is about taking action to look after the financial health of an organisation, and not leaving things to chance. This will involve:

### ■ **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**

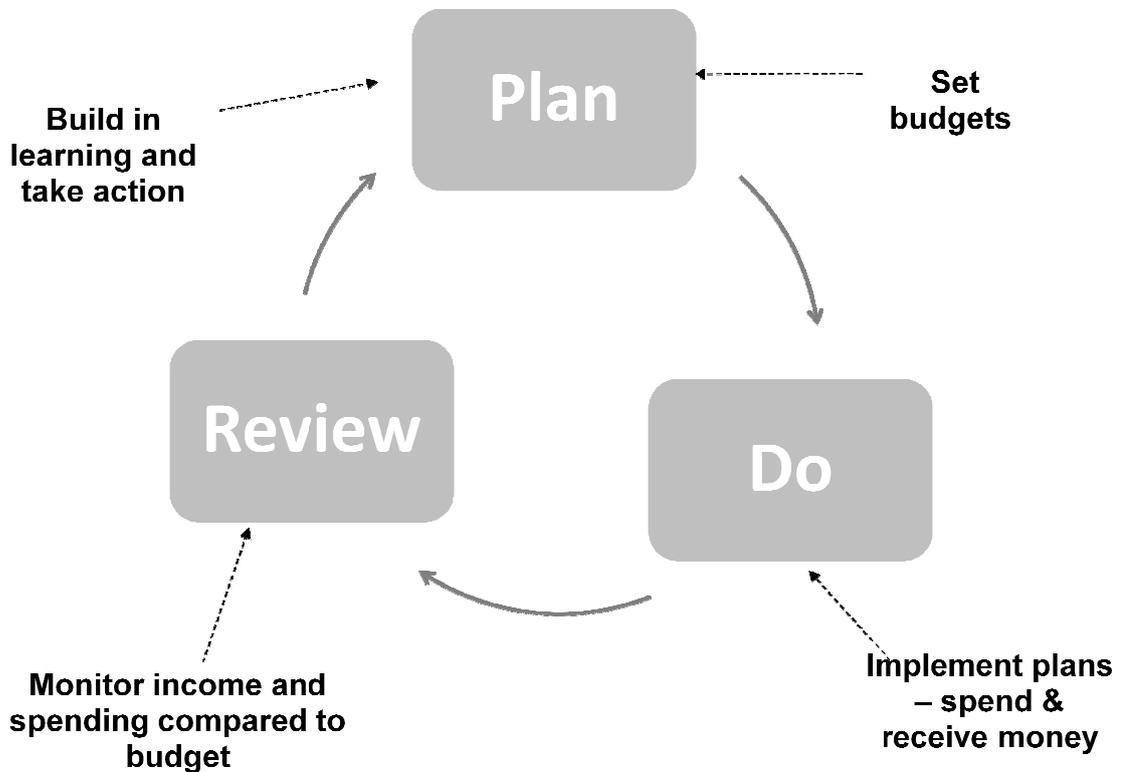
Financial management is part of management as a whole. This means managers must keep an eye on the 'bigger picture' – looking at how the whole organisation is financed in the medium and long term, not just focussing on projects and programmes.

### ■ **Managing by objectives**

Financial management involves close attention to project and organisation objectives. The financial management process – **Plan, Do, Review** – takes place on a continuous basis.

The Plan-Do-Review cycle is illustrated in **Figure 1.1**.

Figure 1.1 – Plan-Do-Review



<b>Plan:</b>	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.
<b>Do:</b>	Having obtained the funds, the programme of activities is implemented to achieve the goals set out in the planning stage.
<b>Review:</b>	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.

## What is Financial Control?

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. And when this happens, managers will sleep soundly at night, beneficiaries will be well served and donors will be happy with the results.

*Financial control occurs when systems and procedures are established to make sure that the financial resources of an organisation are being properly handled.*

With poor financial control in an organisation:

- 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.

## 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.
- They are '**not-for-profit**' (but note that they are still allowed to make surpluses).
- They have many **stakeholders** – an NGO is an alliance of many different interests.
- They are governed by a **committee** of volunteers – the 'Governing Body'.
- They are private autonomous organisations, **independent** of the State.

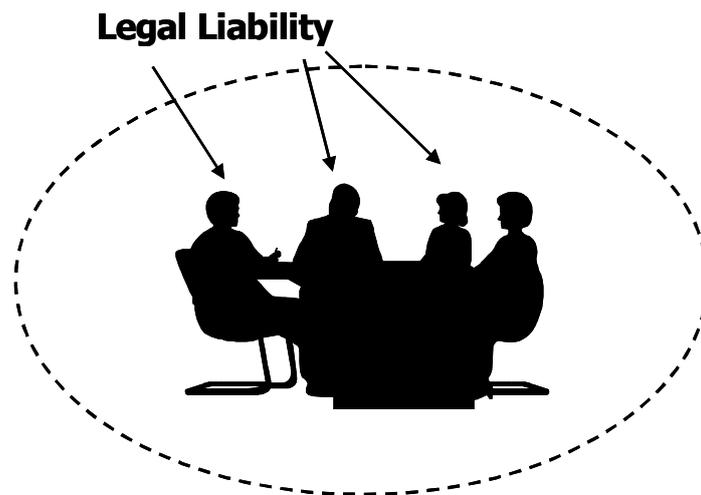
### ■ Legal Status

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' (ie as a group and as individuals) responsible for the affairs of the organisation.

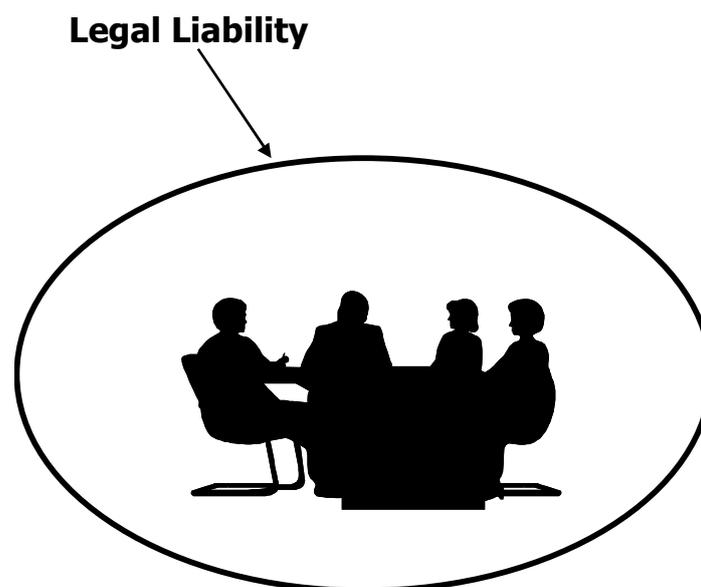
So individual board members could be named in a legal action, as shown by the arrows passing through the organisation's boundaries in **Figure 1.2**.

**Figure 1.2: Unincorporated NGO**



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**).

**Figure 1.3: Incorporated NGO**



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

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**

The way that an NGO is structured and registered will therefore have an impact on its legal status, accountability and transparency. 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;
- the system of accountability – ie who is the governing body, its powers and responsibilities;
- how it raises its funds.

### ■ **The Governing Body**

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

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

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

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

### ■ **Board Members**

Board members 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.

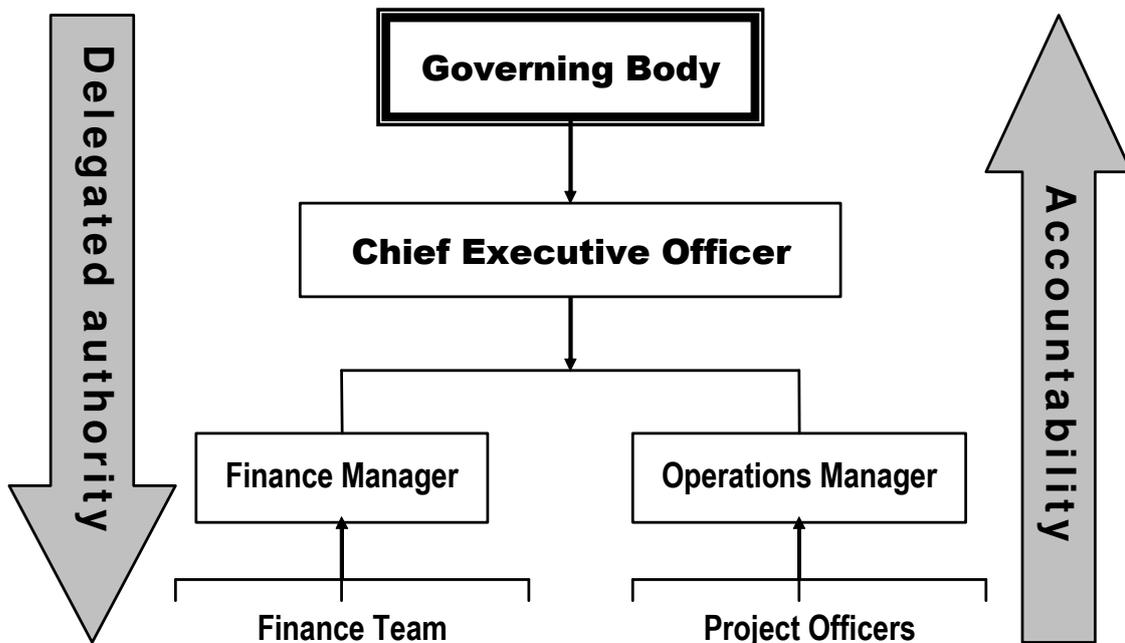
**Honorary Officers** are those who are elected or appointed to specific positions on the board – such as Chair, Treasurer and Secretary. They oversee the execution of board decisions and often sign legal undertakings.

- 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.

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

Figure 1.4: Sample Organisation Chart – How authority is delegated



### ■ Day to day responsibility

As the governing body 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.

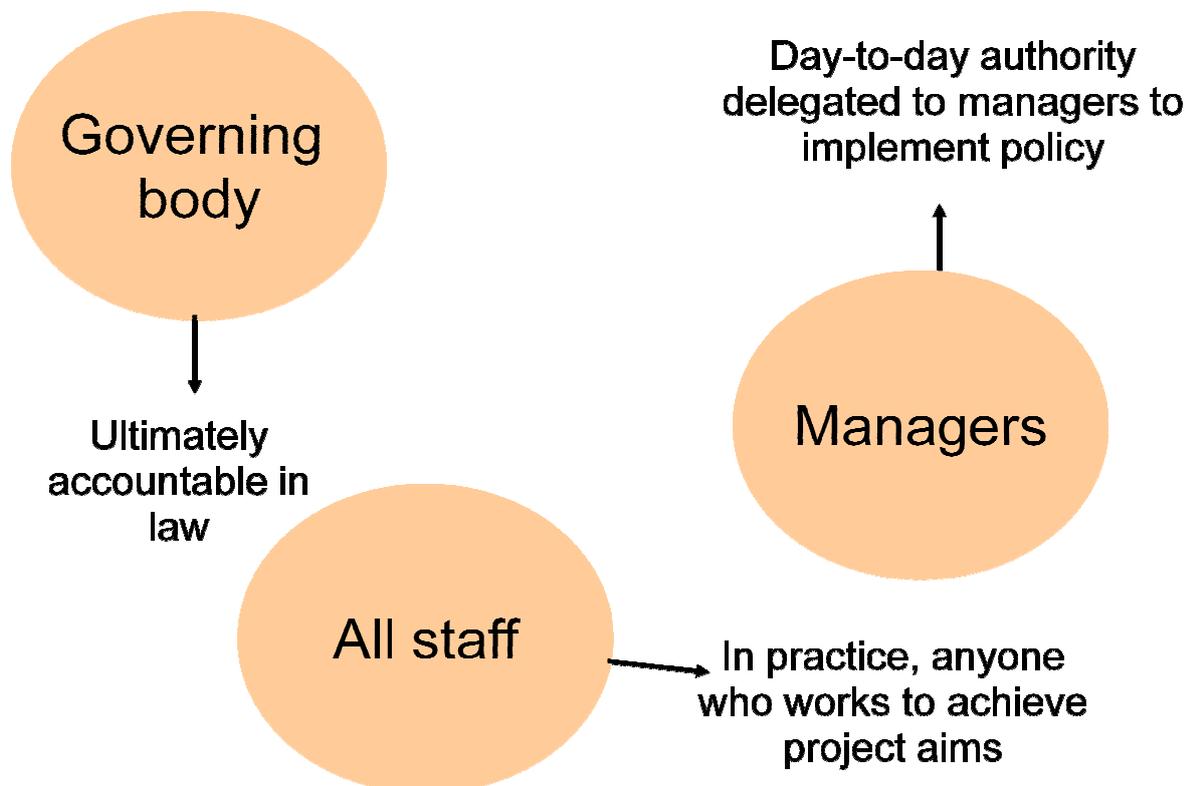
**Figure 1.4** demonstrates how the authority for day-to-day financial management tasks is delegated down through the line management structure. At the same time, the accountability process comes back up through the structure as people report back on progress.

### ■ A Team Effort

In practice, everyone who works to achieve the objectives of an NGO has an important role to play in financial management. Every opportunity must be taken to integrate financial management into the day-to-day operational management of the organisation.

For this to happen, we have to get the basics right. We have to introduce robust systems and procedures and be guided by some important principles which underlie sound financial management.

**Figure 1.5: Who is accountable?**



## The Seven 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 an NGO. 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.

### ■ **Consistency**

The financial policies and systems of an NGO 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.

### ■ **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. NGOs have an operational, moral and legal duty to explain their decisions and actions, and submit their financial reports 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**

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.

### ■ **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 NGO's financial continuity and security. The 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 in the NGO 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.

### ■ **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.

### ■ **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'.*

## **The Four Building Blocks of Financial Management**

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

### ■ **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.

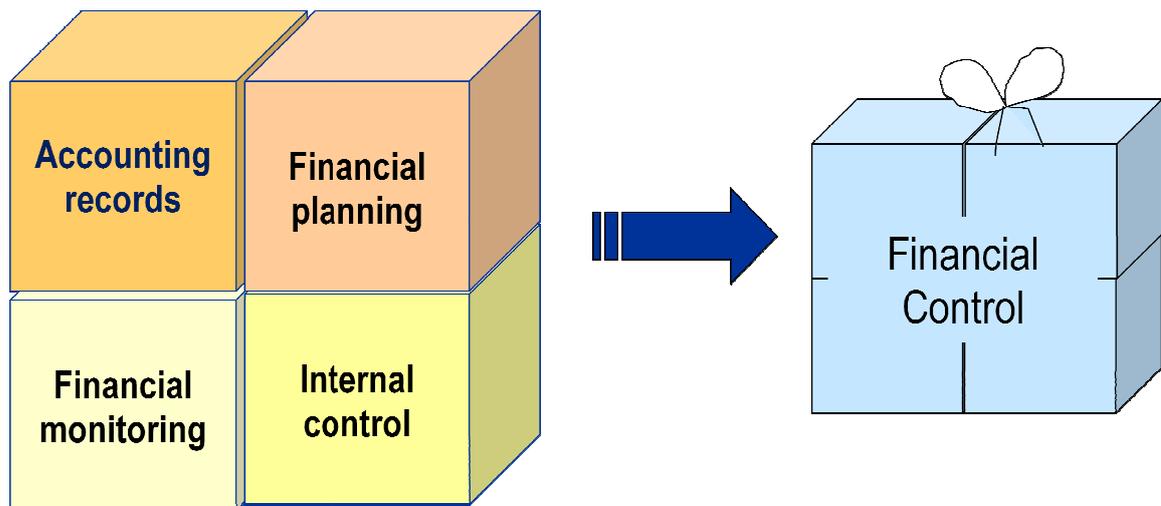
### ■ **Financial Monitoring**

Providing the organisation has set a budget and has kept and reconciled its accounting records in a clear and timely manner, it is then a very simple matter to produce financial reports which allow the managers to assess the progress of the organisation.

## ■ Internal Controls

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 1.6: The Building Blocks of Financial Management – Getting the Basics Right**



**Figure 1.6** illustrates that all of the building blocks must be in place continuously. Effective financial control will not be achieved by a partial implementation.

For example, there is very little point in keeping detailed accounting records if they are not checked for errors and omissions; inaccurate records will result in misleading information, which in turn could wrongly influence a financial management decision.

The building blocks are covered in detail in the remaining chapters. They are also used as the basis for Mango’s Financial Health Check – a self-assessment checklist to help you build your financial management systems. See Appendix 20 and also available for free download here: <http://www.mango.org.uk/guide/resources.asp>

## The 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 highlighted in our working definition of financial management on page 2 of this manual):

### ■ 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 reports...etc..

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

# Getting Organised

*Getting the basics right for your NGO*

This chapter:

- ❑ Explains why it is important to design financial systems which are right for your NGO
- ❑ Describes the two branches of accounting
- ❑ Introduces the Chart of Accounts and Project Cost Centres and their important role in organising the accounts
- ❑ 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

## Systems Design

Systems design is one of the organising aspects of financial management. NGOs are quite different from commercial organisations and state institutions, and financial systems have to be adapted to meet their needs and resources.

The key tools to help to get your systems organised include:

- Organisation chart and job descriptions of staff
- Financial accounts structure – including a Chart of Accounts and Project Cost Centres
- A 'Finance Manual' – or a file of established policies and procedures
- A financial year planner



Financial systems design must also cater for the two distinct, but inter-dependent, branches of accounting: financial accounting and management accounting.

## Financial Accounting vs. 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 which take place inside an organisation. Financial accounting is a system of recording, classifying and summarising information for various purposes.

Financial accounting records can be maintained either using a manual or computerised system (or a combination of both methods). Although it is important to comply with certain accounting conventions and standards, the actual system adopted will depend on:

- the expertise and resources available;
- the volume and type of transactions;
- reporting requirements of managers;
- obligations to donors; and
- the communities NGOs work with.

One output of financial accounting is the annual financial statement, used primarily for accountability to those external to the organisation. The routine output of financial accounting throughout the year 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 reports produced by the management accounting process are therefore primarily for internal use.

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

They must be produced on a regular basis – usually monthly or quarterly depending on the needs of the organisation – and as soon as possible after the reporting period so that figures are relevant to managers' discussions.

## The Right System?

Every NGO is different – there is no such thing as a 'model' finance system. So there are a number of considerations to take into account to find the right approach for your NGO:

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

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

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

## The Chart of Accounts

The Chart of Accounts is probably the most important organising tool for the accounting and reporting processes.

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 income and expense into a series of pre-determined categories or Accounts. These Accounts are listed in the Chart of Accounts and are typically arranged in a logical order: Income and Expenditure, Assets (things we own) and Liabilities (things we owe).

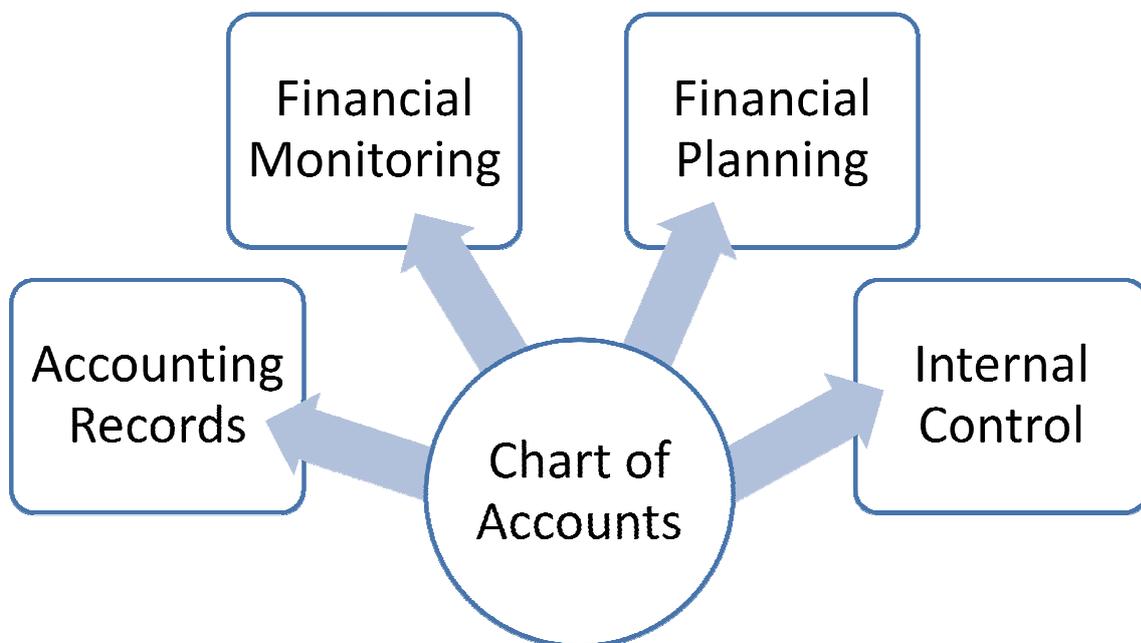
Then, when a transaction takes place, it is recorded in the books of account and categorised according to the guidance held in the Chart of Accounts. The same categories are used in the organisation's budget and financial reports, so promoting consistency and transparency.

Each organisation's Chart of Accounts will be different. Typically, the layout will include account name, reference number and a description for use of the account. An example of a Chart of Accounts can be found in Appendix 1.

Note that the categories have been sorted not only by type of Account, but also into sub-groups under 'family' headings – such as Administration, Personnel and Vehicle Running.

Family headings are especially useful for presenting summarised information. The coding method used (in this case a numerical system but alphabetical systems are also used) follows the same logic using a group of numbers for the same family of items.

**Figure 2.1: The Chart of Accounts in a Finance System**



## Cost Centres

Some grants are given for a specific purpose – these are known as *restricted funds* because they may only be used for a particular activity, rather than for general purposes. Such funds must be accounted for separately 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.

In such circumstances it may be appropriate to identify activities within an organisation by **Cost Centre** (or Activity or Budget Centre). Cost centres are typically applied to projects, functions or departments which have their own budget and funding sources.

The starting point for deciding on a cost centre structure is the organisation chart and donor funding agreements.

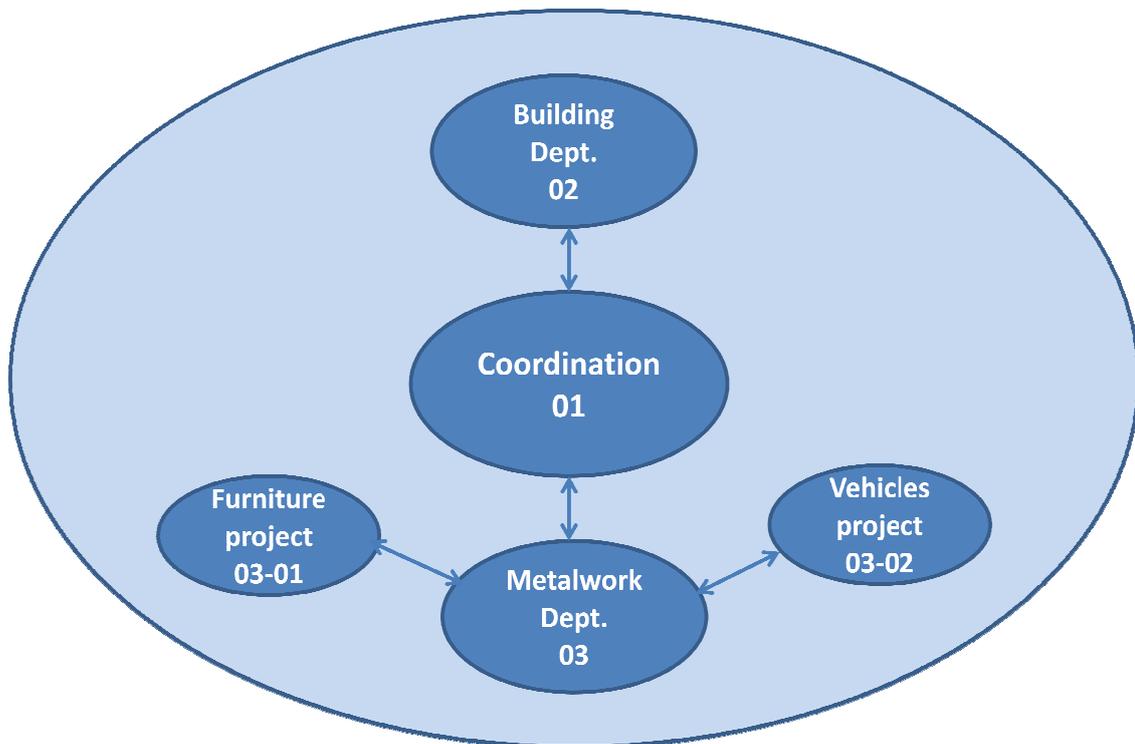
**Example**

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.

A useful way to graphically present cost centres is in the form of an 'egg chart' (see **Figure 2.2** for Milestone's chart).

Their cost centre structure and reference codes are shown in Appendix A1b.

**Figure 2.2: Milestone's Cost Centres**



There is no effective limit on the number of cost centres that can be used especially if a computer accounting program is used. However, it is important to design the cost centre structure carefully to prevent record keeping become burdensome and counter-productive. Each cost centre is given a unique reference or code to identify it within the records.

### ■ How are cost centres used?

With cost centres in place, 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.

## Cost Structures

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

- **Direct costs** are those which are clearly related to a particular activity and can be charged directly to the relevant Cost Centre. 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 more than one activity. 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 their 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 to set down a series of financial policies and procedures to guide operations and avoid misunderstandings.

### ■ What is a policy?

A policy sets out a set of 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.

Policies should stand the test of time – whilst it is important to be flexible, NGOs should not change policies too often.

### **What makes a good policy?**

- It is fair and realistic
- It covers all situations likely to arise
- It meets legal requirements
- It 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. People are more likely to adhere to policies if they had a say in making them.

Here are some ideas for you to consider.

#### **Decide who will be involved in drawing up the policy**

If the policy is to have an impact on how programmes are delivered, it makes sense to include programme staff in the discussions.

#### **Do some background research to gather the information you need to develop the policy**

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

#### **Write the policy document**

Use the following headings as a guide:

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

### **Circulate the draft policy for feedback**

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

## **What is a Finance Manual?**

The Finance Manual brings the financial policies and procedures all together in one document. The manual may also be known as the Financial Regulations or Finance and Office Procedures.

It is generally used by the accounts staff for day-to-day operations but also serves as a reference in case of query by programmes staff.

### **■ What goes in a Finance Manual?**

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
- Ordering and purchasing procedures
- Bank and cash handling procedures
- Management accounting 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

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; and it must be a 'living' manual, used and implemented by everyone and regularly reviewed and updated.

The process of developing policy and procedures together is far more important than the finance manual itself – people need to 'own' and implement them, rather than see them as a 'rule book'.

## Standard Forms

Standard forms are purpose-designed documents used to simplify or facilitate financial administration routines [see Appendix 19 for some commonly used standard forms]. They are one of the best ways to ensure that procedures are followed and understood by those responsible for operating them. Standard forms can be used with almost any procedure but especially where:

- information needs to be supplied by a third party before a transaction can take place;
- a transaction requires to be checked and authorised; or
- financial information is being summarised or reconciled.

**A note of caution** in the use of standard forms: do not overdo the paperwork as too much bureaucracy slows down the accounting process and overloads the authorisation routines.

Some typical uses for standard forms:

- Payment Voucher
- Purchase Order
- Travel and Subsistence Expenses claim
- Assets Register
- Vehicle Log
- Bank Reconciliation
- Journal Voucher
- Staff loan application

## 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 recording, reconciling and trial balance
- **Reporting schedules** – especially to meet donors' requirements
- **Budgeting** process
- **Reviews** – eg assets register, finance manual and insurance cover
- **Year end procedures** – eg preparation for audit



One of the best ways to do this is to use a yearly planning chart. This helps to schedule tasks and allocate tasks to staff so that deadlines can be met. See Appendix 17 for an example.



# Financial Planning

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

This chapter:

- ❑ Describes the planning process and how it links with financial management
- ❑ Highlights different types of budgets and when to use them
- ❑ Describes different approaches to budgeting and how to use a budget worksheet
- ❑ Looks at good practice in budgeting
- ❑ Introduces a tool for managing multiple-donor projects.

## The Financial Planning Process

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

Financial planning does not start with budgets and numbers. Effective budgets can only be produced as a result of good underlying plans. It is impossible to start a financial forecast without a clear idea about what it is you want to do and how you intend to do it.

*"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 as part of their founding documents. 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 period of time.

### **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, realistic and time-bound

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

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

## What is a Budget?

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

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

### ■ Planning

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

### ■ Fundraising

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

### ■ Project implementation

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

### ■ Monitoring and evaluation

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

## Who needs Budgets?

*“A budget tells your money where to go; otherwise you wonder where it went.”*

J. Edgar Hoover

Budgets are used by different people for different purposes.

- The **Board of Trustees** needs the NGO’s overall budget because it has to formally approve it and monitor its progress.
- **NGO Chief Executives** need budgets to keep an eye on progress of the whole organisation and the funding situation.
- **Project managers** need budgets to oversee the implementation of their project activities.
- **Fundraisers** need budgets to accompany funding applications.
- **Finance staff** need budgets to make sure there are enough funds in the bank to cover anticipated expenditure.
- **Donors** need budgets so they can see how an organisation intends to spend its grants.
- **Community partners** need budgets so they can see how an NGO plans to spend and raise funds for their community projects.

## Types of Budget

Essentially, there are three main types of budget:

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

### ■ The Income and Expenditure Budget

The income and expenditure budget sets out the anticipated running costs (also referred to as recurrent costs) of the organisation and shows where the funds will come from to cover the costs [see Appendix 11]. The annual income and expenditure budget is often broken down into shorter periods – quarterly, half yearly or even monthly – to assist with monitoring progress.

### ■ The Capital Budget

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

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

The implications for the income and expenditure budget should be noted – such as running costs for vehicles. A separate capital budget is not required if only one or two capital items are to be purchased. In this case it is sufficient to incorporate the capital items in a separate section of the income and expenditure budget. This is most common in a project budget.

### ■ **The Cashflow Forecast**

For good cash and financial management, cash reserves are essential as there will always be times when grants are delayed or unexpected expenses occur.

The cashflow forecast (or cash budget) helps managers identify those times when cash levels become critical. It predicts the flow of cash in and out of the organisation throughout the year by breaking down the master (or overall) budget into smaller time periods, usually one month.

Whereas the income and expenditure budget shows whether the organisation is covering its costs over the whole year, the cashflow forecast shows whether it has sufficient cash in the bank to meet all of its obligations needs as they arise. [See Appendix 13 for an example.] This then helps to identify likely cash shortages and allows avoiding action to be taken such as:

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

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

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

The cashflow forecast is also useful where the organisation maintains substantial cash reserves which need to be invested wisely to maximise investment income.

### How to prepare a cashflow forecast

To prepare a cashflow forecast, you will need all of the organisation's activity plans and budgets for the year. This exercise is best completed using a computer spreadsheet such as Excel.

For each item of income and expenditure on the budget, you need to predict and plot on the forecast sheet when cash will come in and go out. This is dependent on when activities are planned to take place. Some activity is more predictable than others, eg monthly such as salaries or annual such as insurance and audit fees. Other transactions are unpredictable, eg repairs.

Once the budget has been broken down into each month based on the activity plans, it is possible to calculate the net cash flow: ie whether there is more cash coming in or going out, or vice versa. It is usual to also include an estimate of any bank balances held as reserves as this will help manage our cash flow.

### Tips on Preparing a Cashflow Forecast

1. Cashflow forecasts are not simply the budget broken down into 12 equal instalments - you need to know when specific activities will take place. Eg for a training project, when will the courses take place, when will costs have to be paid and will the course fees be paid in advance?
2. Expenses must be entered on the cashflow forecast when the cash is expected to leave the bank. So an invoice for January's electricity will probably be received in February and paid in March.
3. Some payment are paid monthly, such as salaries. But don't forget that deductions, such as income tax, are often paid to the authorities the month after salaries are paid, or in some cases paid annually.
4. You need to take account of payment terms and income schedules. E.g. in some countries, auditors require a 50% deposit of the audit fee before the audit and the rest follows after the report is filed; so although this is an annual activity the actual cash movement is affected by payment terms. Similarly, grant schedules dictate the inflow of cash from donors.
5. For unpredictable expenses – e.g. equipment repairs – it is best to put a monthly or quarterly sum.
6. Obvious but easily forgotten: you exclude non-cash transactions from the cashflow forecast (eg donations in kind or depreciation) so if these are on the budget, they have to be left off the cashflow.
7. If there is not enough money in the bank to pay for project activities, delays will follow and donors will get upset – so cashflow forecasting is really important!

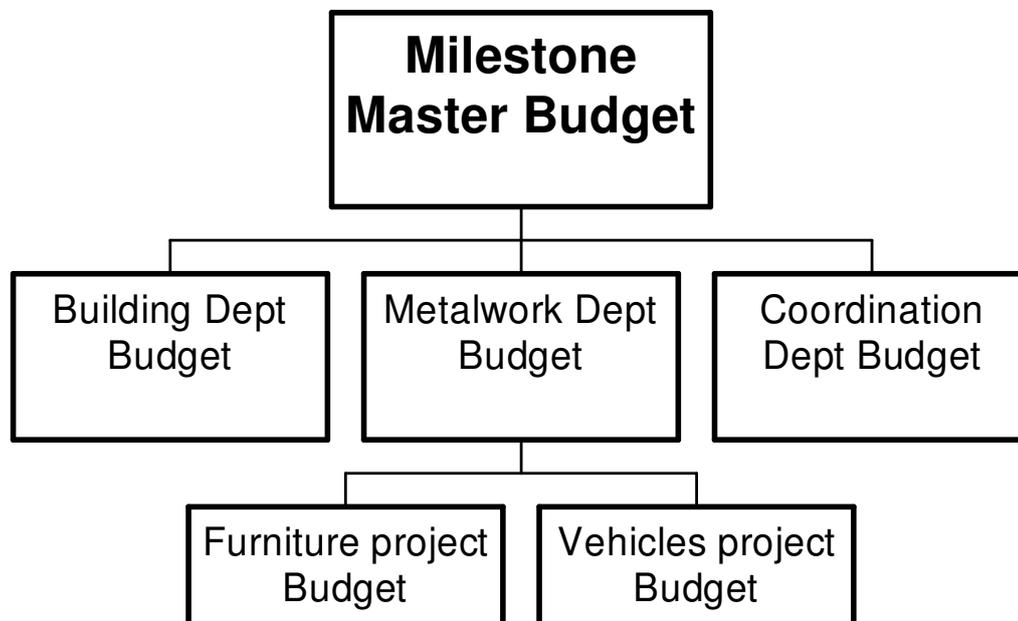
## Budget Structures

To facilitate planning and to enable control to be effective, many organisations try to ensure that the overall structures of their budgets correspond closely to the organisation structure. It is possible to organise budgets at different levels, eg by department, programme or project.

**Figure 3.2** shows Milestone's budget hierarchy. Note that this reflects the cost centre structure that we looked at in the last chapter. The lower level project budgets are consolidated into the departmental budget. Departmental budgets are in turn consolidated into one master budget (see Appendix 11).

This structure allows budgets to be delegated and monitored at the project level, whilst maintaining an overview at department and association level.

**Figure 3.2:** Milestone's budget structure



## Budgeting Techniques

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

### ■ Incremental budgeting

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

A frequent criticism of this approach is that it does not encourage fresh thinking and may perpetuate existing inefficiencies. It also makes it difficult to justify the figures to donors since the original calculations may be long forgotten.

### ■ Zero-based budgeting

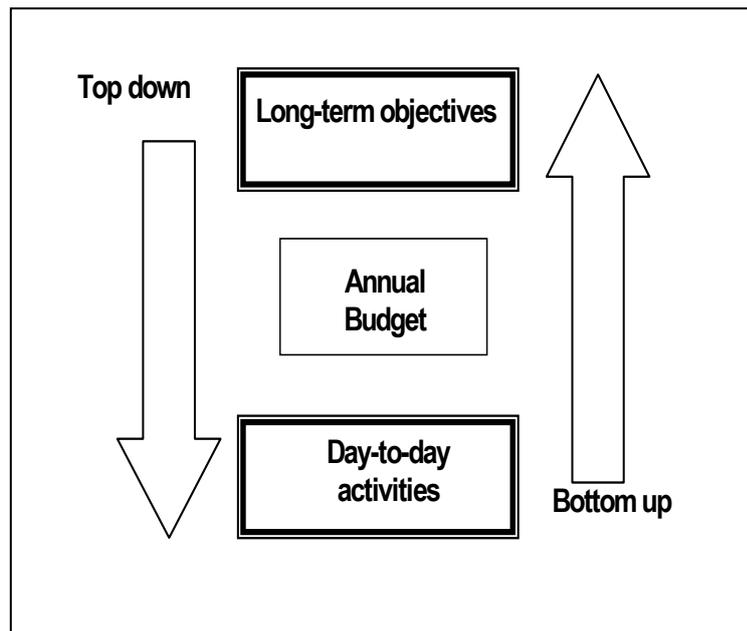
An alternative approach is to start with a clean sheet – a zero base. Zero-base budgeting (or ZBB) ignores previous experience and starts with next year's targets and activities. ZBB requires the writer of the budget to justify all the resource requirements.

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

**Activity-based budgeting** is a special form of ZBB and is frequently used in the NGO sector to create project budgets.

## Top Down or Bottom up?

Figure 3.3: Top Down vs. Bottom up



Since a budget is a financial plan that relates directly to the activities of the organisation, it is important that those who will be responsible for project implementation are closely involved with writing the budget.

If this is not done, the budget will surely be less accurate and the staff less likely to appreciate the need to spend within budget or to reach fund-raising targets.

Where operations staff are involved in setting their budgets it is described as **'bottom up'** budgeting – as opposed to **'top down'** where budgets are imposed by senior managers. Many organisations employ a mix of top down and bottom up approaches.

## Summary of Budget Terminology

MAIN TYPES OF BUDGET	<b>Income &amp; Expenditure</b>	This budget lists all items of incoming funds and recurrent (ie regularly occurring) costs for a specified period.
	<b>Capital</b>	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.
	<b>Cash flow forecast</b>	This budget 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	<b>Balanced</b>	This budget shows that anticipated income is the same as anticipated expenditure
	<b>Deficit</b>	This budget shows that anticipated income is less than anticipated expenditure
	<b>Surplus</b>	This budget shows that anticipated income is more than anticipated expenditure
APPROACHES TO WRITING A BUDGET	<b>Incremental</b>	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-base</b>	This describes an approach to budgeting where the budget is built from 'scratch', and not based on previous budgets or figures.
	<b>Activity based</b>	This describes an approach to budgeting where the budget is built up from a detailed activity plan (a form of zero-base budgeting).
LEVEL OF BUDGET DETAIL	<b>Master</b>	This budget shows overall anticipated income and expenditure for the whole organisation for the year.
	<b>Consolidated</b>	This brings together several project or programme budgets in a table to show a summary of each <u>and</u> the total overall.
	<b>Project or programme</b>	This budget shows income and expenditure for a specified project or programme for the implementation period.
TIME PERIODS	<b>Multi-year</b>	This budget outlines anticipated income and expenditure, or cashflow, for two or more successive years.
	<b>Phased</b>	This describes a budget which has been broken down into smaller time periods – usually monthly or quarterly – to reflect the budget requirements for that period, according to levels of activity.
SPECIALISED BUDGETS	<b>Donor</b>	This budget is produced in the format required by a funding agency and usually accompanies a funding proposal.
	<b>Flexible (or variable)</b>	This budget is regularly reviewed and updated to take account of changes in levels of activity
	<b>Funding grid</b>	This is a special budget which reconciles anticipated income sources to the programme budget, to show which funding source is funding what, and identify funding gaps.
	<b>Rolling</b>	This budget always covers a fixed period of months (eg 12 months). It is updated every month or quarter to include figures for the fixed budgeting period.

## The Budgeting Process

The process of preparing a meaningful and useful budget is best undertaken as an organised and structured group exercise. The budget process involves asking a number of questions:

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

Once the budget has been agreed and the activity implemented, the process is completed by comparing the plan (budget) with the eventual outcome ('actual'), to see if there is anything we have learnt or could do differently next time.

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

### Example: Rudi goes to the Cinema

It is Friday afternoon and a teenage son – Rudi – rushes in from school 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, have a burger and then go to the cinema. 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 burger bar, visit cinema, bus journey home.

**Resources:** Money to cover the costs of bus fares, burger, cinema ticket and popcorn.

	\$	
Travel	1.50	2 x 75c bus fares
Food	3.50	\$3.00 for burger, 50c for popcorn in cinema
Tickets	<u>3.00</u>	
TOTAL	8.00	

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

### **The next day.....**

On Saturday morning, Rudi's mother asks how he enjoyed the evening. He reports that the film was very good 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 burger bar, Rudi and his friends arrived at the cinema to find that all the \$3.00 seats were sold out and they had to spend an extra \$1.00 each on the more expensive seats.

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

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

## **Good Practice in Budgeting**

### **■ Clarity**

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

Clarity and accuracy is key so it is important to keep notes on budgeting assumptions and how calculations have been made.

### **■ Timetable**

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

### **■ Budget Headings**

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

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

## ■ Estimating Costs

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

One of the best approaches is to make a list of all the inputs required and specify the number and unit cost of each item. From this detailed working sheet it is a simple matter to produce a summarised budget for each line item and is very easy to update if units or costs change. **Table 3.1** below provides a simple example of the budget worksheet format.

See below for detailed guidance on how to use the Budget Worksheet and Appendix 12 for a completed project budget worksheet.

## ■ Contingencies

Try to avoid the practice of adding a 'bottom line' percentage for so-called 'contingencies' on the overall budget. As a rule, donors do not like to see this and it is not a very accurate way of calculating a budget. It is better to calculate and include a contingency amount for relevant items in the budget – eg salaries, insurance, and fuel.

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

## ■ Forgotten costs

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

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



## Using a Budget Worksheet

**Table 3.1** shows a typical layout for a budget worksheet as used in activity-based and zero-based budgeting. The extract describes the inputs needed for a 4-day workshop for 20 participants with two tutors.

The table details items required for the workshop, the quantity and the cost per unit. The final column provides the budget for each item.

**Table 3.1 Budget Worksheet**

A	B	C	D	E	F	G [D x E x F]
Ref.	Description	Unit type	No. Unit	Quantity	Unit Cost \$	Total cost \$
1	<b>Workshop costs</b>					
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
	<b>Sub total</b>					<b>2010.00</b>

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

**Table 3.2: Budget Worksheet Columns**

A	<b>Ref.</b>	Line reference – useful if you are discussing the budget and need to draw attention to a particular line in the budget worksheet. An activity-based budget is usually separated into sections, each with a sub total of costs. Each block will have a unique number, as in the above example where all 'workshop' related costs are listed under section 1.
B	<b>Description</b>	A short description of each line in the budget. Try to include different inputs on a line of their own rather than lump similar costs all together.
C	<b>Unit type</b>	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. See below for some further examples of unit types to use for different budget items
D	<b>No. units</b>	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).

E	<b>Quantity</b>	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.
F	<b>Unit cost</b>	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.
G	<b>Total cost</b>	This is calculated by multiplying no. units x quantity x unit cost. So, the cost of lunch and refreshments for 22 delegates on each of 4 days at \$5.00 per delegate costs \$440.00 [22 x 4 x 5]
H	<b>Notes</b>	A notes or comments column is useful to clarify what the item is for and how quantities have been arrived at.
I	<b>Accounts Code</b>	The code used in the organisation's accounting records (ie as listed in the Chart of Accounts)
J	<b>Donor code</b>	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.

### More on Unit Types

Deciding on the unit type requires some careful thought as it is not always so obvious and it does depend on how the items are usually sold or priced. See below for a checklist to help you choose a unit type.

**Table 3.3: Choosing Unit Types**

Typical Budget Items:	Examples of Unit Type:
<b>Personnel Costs</b>	
Salaries, benefits & taxes	Month
Staff recruitment	Advert entry
Staff development	Days, person
Subsistence allowances (eg per diem)	Days, person, trip
Volunteers expenses	Session, person, trip
<b>Transport costs</b>	
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
<b>Programme administration</b>	
Office rent, electricity and water	Month
Office insurance	Month or lump sum per quotation

<b>Typical Budget Items:</b>	<b>Examples of Unit Type:</b>
Telephone & fax	Month
Office stationery	Month (or specify items, eg paper by the box, pens by the piece )
Email subscription	Month or lump sum per quotation
Postage	Month
Repairs & renewals	Month
Bank charges	Month
Audit fees	Lump sum per quotation
<b>Project Costs</b>	
Room hire	Days, month
Publicity costs	advert entry, lump sum per quotation (eg
Publications/reference books	Month or lump sum per quotation
Training materials	Trainee, or specify per item
Professional fees (eg facilitator, consultant)	Days
Printing/photocopy	Copy, delegate, lump sum per quotation
Inputs (eg trees, pipes, tents, tools, cattle)	Piece, according to charging basis
Equipment (eg vehicle, computer, desk etc.)	Piece, according to charging basis or lump sum per quotation
Accommodation	Night
Food	Person, meal, day

### **Summary: What makes a good budget?**

- Anyone could pick it up and use it to manage their activities:
- Easy to read
- Calculations are clear
- Fully-costed, justified and accurate
- Explanatory notes are provided
- Suitable for purpose:
- Appropriate level of detail for the user