

CHAPTER 2

FINANCIAL MANAGEMENT

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LEARNING TO...

OBJECTIVES

- UNDERSTAND WHAT FINANCIAL MANAGEMENT INVOLVES.
- CONTROL COSTS AND SAVE MONEY.
- ASSURE THAT A NATIONAL SOCIETY'S FUNDS ARE RAISED FAIRLY.
- MAKE SURE THAT FUNDS ARE ADMINISTERED HONESTLY.
- UNDERSTAND THE CONNECTION BETWEEN A NATIONAL SOCIETY'S REPUTATION AND SOUND FINANCIAL MANAGEMENT.

1. WHAT IS FINANCIAL MANAGEMENT

Financial management concerns all aspects of a national society's work dealing with money. This means:

- Checking that the plans and budget of the national society are financially sound and that the budget balances;
- Reviewing the budget and financial situation monthly, noting variances, providing explanations and taking action;
- Pursuing all possible savings on purchases;
- Controlling expenditures and keeping within agreed budgets;
- Overseeing how money is raised, and ensuring that no methods are used which could damage the reputation of the national society;
- Establishing and following an effective accounting procedure;
- Regulating how money is collected, counted, handled, deposited and accounted for - making certain of the integrity of the process at every step;
- Arranging for adequate internal and external checks and audits;
- Presenting the financial position of the national society regularly and clearly to internal and external constituents. This is discussed further in section 7 of this chapter, financial marketing.

Many Financial Management functions are integral to the work of resource development. The way these functions are carried out can have a great impact on the effectiveness of resource development.

2. THE IMPORTANCE OF PLANNING AND BUDGETING

Chapter 1 of this handbook discusses the process of planning and budgeting. This process is critical to the success of any operation and is a vital element of financial management. Careful planning and budgeting will help ensure that a National Society has well defined and realistic programmes and a clear understanding of how those programmes are to be funded.

The role of Financial Management in planning and budgeting is:

- To check that the proposed budget is financially sound -that the targets and costs are realistic, and that the budget balances;
- To ensure that raising money and spending money are coordinated so as to minimize the possibility of cash flow problems;



- To regularly review the financial situation and take corrective action to tackle problems identified in the reviews;
- â To make sure that all costs are kept at a reasonable level and that the income/expense ratios of the National Society are acceptable to both the National Society and to public scrutiny (See **Chapter 1, Section 12: Ratios**);
- To be aware of the possible effects of "earmarked" income (i.e., income designated by the donor for a specific purpose) on cash flow and on the amount of funds available for core support;
- To ensure that sufficient non-earmarked income is raised to provide for the ongoing work of the National Society;
- To ensure that realistic costs are applied to raising earmarked income;
- To ensure that the costs of large capital items are depreciated (i.e., apportioned in the budget over a number of years, depending on expected life span) and that the cost of this depreciation is included in each year's expenditure budget.

3. COST CONTROL



National Societies of the Red Cross and Red Crescent Movement are a channel through which funds made available by governments, trusts, companies and individuals are directed to help those who are most vulnerable. Controlling all costs of the National Society is therefore a major element of resource development because it helps guarantee that the greatest possible amount of donated money is used to help the most vulnerable.

Controlling costs does not mean that projects or activities should suffer because inadequate resources are available to them. It means **applying the optimum amount of money to the programmes of the National Society**. It means avoiding waste and it means **keeping all expenditures under review** to achieve the most cost-effective operation possible.

DOING**TO DO****Checklist of Ideas for Controlling Costs and Saving Money**

- Remember to look at fixed costs as well as variable costs when controlling expenses (See **Chapter 1** for explanation of fixed and variable costs). It is much easier to alter variable costs, but in the long term, firm control of fixed costs will bring most benefit.
- Make sure someone is accountable for all costs. This person must approve all expenditure incurred for his/her area of responsibility and will be personally responsible for ensuring that all expenditures are within the agreed budget.
- Monitor costs, and compare actual expenditures regularly with those forecast in the budget. Examine any significant variances and take steps to bring them into line.
- Before agreeing to the cost of a fundraising or income generating activity, make sure that it is justifiable by asking:
 - Does the ratio of income to costs comply with the ratio level agreed by the National Society, or will it comply at some point in the future?
 - If the ratio does not fall within the acceptable level, do other benefits justify the extra cost?
- Ensure large items of capital work, purchases and other contracts are tendered for (put out to bid) and obtain at least three estimates before awarding a contract.
- Ask suppliers to give discounts.
- Request tax exemption from the government.
- Ask for donations of goods and services that you might normally pay for.
- Consider low-cost alternatives when purchasing or renting equipment, vehicles, office space.
- Suggest volunteers may wish to donate their expense reimbursements back to the Society.

4. REGULATING HOW MONEY IS RAISED



DOING



TO DO



Fundraising and income generation should be more than just cost-effective. It is also important, particularly to non-profit organizations like Red Cross and Red Crescent Societies who rely on donor support, that money be raised in a fair, moral and honest way. One of the most precious assets of the Red Cross and Red Crescent is its reputation. Nothing must be done in fundraising, or in any other activity, to threaten this.

In financial management this means:

- Ensure that all activities involving money fall within the laws of the country concerned, and that they are sensitive to cultural or religious beliefs.
- Ensure that all gaming activities, such as lotteries, raffles and competitions, are fair, and are seen to be fair, to all who participate in them.
- Ensure that adequate systems are in place for receipt and safe keeping of funds, in order to protect both the funds and the reputations of the people handling them.
- Record receipt of all money donated to the National Society and, whenever possible, provide the donor with a receipt.
- Ensure that proper accounting procedures are carried out promptly after receiving money.
- Use funds as promised or as the donor requests.
- Avoid donations from non-reputable sources.
- Take appropriate steps to ensure the reliability and honesty of all those who raise money on behalf of the National Society.

5. ACCOUNTING PROCEDURES

In order to keep track of its financial situation, a National Society must have an appropriate and reliable accounting system.

This system should:

- Record all financial transactions in an orderly and comprehensive way.
- Set procedures for handling money to safeguard it from theft or misappropriation, and protect those who are responsible for it from suspicions and accusations as to their honesty and integrity.



TO DO
WHO?
WHEN?



- Arrange audits to ensure that all the procedures are adhered to (See below).
- Any accounting system should adhere to the following basic principles:
- Each transaction should be accompanied by a supporting document, e.g., donation receipt for monies contributed or invoice/receipt of purchase for monies spent.
 - Use pre-numbered standard forms and records for accounting purposes.
 - Wherever possible, cash should be handled by two people working together.
 - No two consecutive stages of the accountancy procedure should be completed by the same person and, preferably, every stage should be completed by a different person.
 - It must be made clear who has the authority to sanction a transaction, and authorization must be obtained before any transaction takes place.
 - All cheques and other appropriate documents should be signed by two people. If the cheque is for more than a certain amount of money, one of the signatories should be a staff member and the other an Executive Committee member.
 - Accounting records must be kept up to date, and transactions should be recorded as soon as possible after they have been made.
 - All accounts should be audited annually.
 - Accounts should be made available for inspection by anyone who has good reason to view them.
 - All monies should be banked as soon as possible after receipt, and a secure facility should be available to keep money safely until then.
 - Once a project is established that will receive contributed income, it should be coded and a separate bank account should be opened so that there can be accurate financial control.
 - A National Society should have a system by which staff or volunteers who are concerned about any aspect of financial procedure may raise the matter" with a senior Executive Committee member and/or the Secretary General.

6. AUDITING

Every National Society has an obligation to its donors, staff, volunteers and beneficiaries to safeguard funds and handle them in a responsible way.

External Audits

As a general rule, an independent qualified accounting firm should conduct an audit of the financial statements on a yearly basis. The purpose of the audit is to obtain an opinion on the financial statements to confirm that they present fairly the project's receipts, payments, movement of funds and fund balances for the period audited. In addition, the auditors will report whether in their opinion the statement of income and expenditures and the fund balance are in accordance with the books and records kept by the National Society.

The Federation's Internal Audit Department organizes the audit of funds transferred by the Federation to the National Societies. In case your project received funds transferred from the Federation, these will be audited by external auditors appointed by the Federation's Internal Audit Department. These auditors will belong to an internationally recognized audit firm to ensure the same level of quality worldwide.

The same may apply to money received from other external sources. Check carefully the contracts and regulations covering such grants.

Internal Control

A proper accounting system will incorporate internal control systems (see above). In addition to the elements mentioned, under Accounting Procedures, it should be noted that an independent local audit firm (preferably part of an internationally recognized audit firm) can advise on how best to structure these.



Recommendations on financial management and internal controls can be found in **Strengthening Financial Management, a Manual for National Societies** by Malka Dharmaratne (HDI Studies on Development, No. 5, 1990, Revised September 1992, Henry Dunant Institute).

7. FINANCIAL MARKETING

Financial Marketing is the way of presenting the National Society's financial position to appropriate constituents.

These include:

- The Executive Committee of the National Society, which is ultimately responsible for the Society's affairs;
- Staff and volunteers of the National Society, who need to be clear about the financial situation;
- Donors and members, who need to be assured that money they have given is being used in the most efficient and effective way;
- Any official bodies in the country who check the accounts of non-profit organizations;
- The general public, particularly those who are being asked to contribute in some way to the work of the National Society. Like those who are already donors, potential donors among the general public must be satisfied that any donations will be used to best effect.



The reputation of each National Society is vital to gain and maintain the support of the public. Like it or not, many people will judge a National Society by the way it conducts its financial affairs. Furthermore, a single instance of bad publicity over an item of expenditure can seriously damage a National Society's image for years to come.

There is a positive side to this, however. Demonstrating how efficiently a National Society raises and uses its money can be an important "selling feature" for a resource development programme.

For example, consider issuing an annual "public disclosure statement" through a newspaper advertisement, a billboard or a flyer. The purpose would be to thank and educate the public by presenting charts showing sources and use of funds. A public thank you message from the Chairman and photographs of your service activities will strengthen the report and can help encourage future donors.



Points to Remember when Presenting the Financial Picture

- Accounts can be a mystery to those who are not used to seeing them. It is important to make the information appropriate to its intended audience. The Executive Committee may need to know about things in intricate detail. For donors, you might present a simplified version, perhaps in diagram form, such as the example in Attachment C.
- Make sure the information given is honest and factual.
- Be open about financial matters. Trying to hide things will only make people suspect the worst. If there has been a problem, it is better not to hide it but to explain what is being done to resolve it.
- Produce financial marketing material as soon as possible after the annual audit.
- Indicate clearly the period to which the figures refer.
- Make a comparison with previous years, especially when there are clear improvements.
- Report or comment on major changes from previous years. Explain why they have happened and indicate if they are likely to happen again.
- Comment on any significant event that may have influenced the figures substantially.
- Point out any trends or indicators that may have an effect on finances in future.

8. STEWARDSHIP

The staff and volunteers of a Red Cross/Red Crescent Society are fundamental to achieving the aims of the Movement in serving the most vulnerable throughout the world.

Red Cross and Red Crescent workers at all levels carry a serious responsibility as stewards of the funds and other resources from all sources - individuals, trusts, governments, businesses. Those involved in resource development are especially accountable to donors and to beneficiaries to see that funds are used honestly and effectively.

Financial stewardship is not to be taken casually. A National Society should put procedures in place to move funds as directly as possible from the donor to the beneficiary.

Good stewardship means:

- Compliance with moral and legal financial requirements;
- Meeting professional standards for organizational management;
- Providing staff and volunteer job satisfaction;
- Reporting to donors how funds are used in order to build donor confidence and encourage repeat gifts;
- Ensuring the next generation will have a strong Red Cross or Red Crescent Society.



CONCLUSIONS...

SUMMARY

- FINANCIAL MANAGEMENT ENTAILS SETTING UP SOUND PROCEDURES FOR PLANNING AND BUDGETING AND MAKING SURE THEY ARE CARRIED OUT.
- AVOIDING WASTE AND REVIEWING EXPENDITURE HELP ACHIEVE A COST-EFFECTIVE OPERATION.
- FUNDS SHOULD ALWAYS BE RAISED FAIRLY, HONESTLY, OPENLY AND WITH RESPECT FOR LOCAL CUSTOMS.
- A NATIONAL SOCIETY NEEDS RELIABLE ACCOUNTING WITH BOTH INTERNAL CONTROLS AND EXTERNAL AUDITS.
- DONORS GIVE MORE READILY WHEN THEY KNOW A NATIONAL SOCIETY'S FINANCES ARE COMPETENTLY HANDLED.

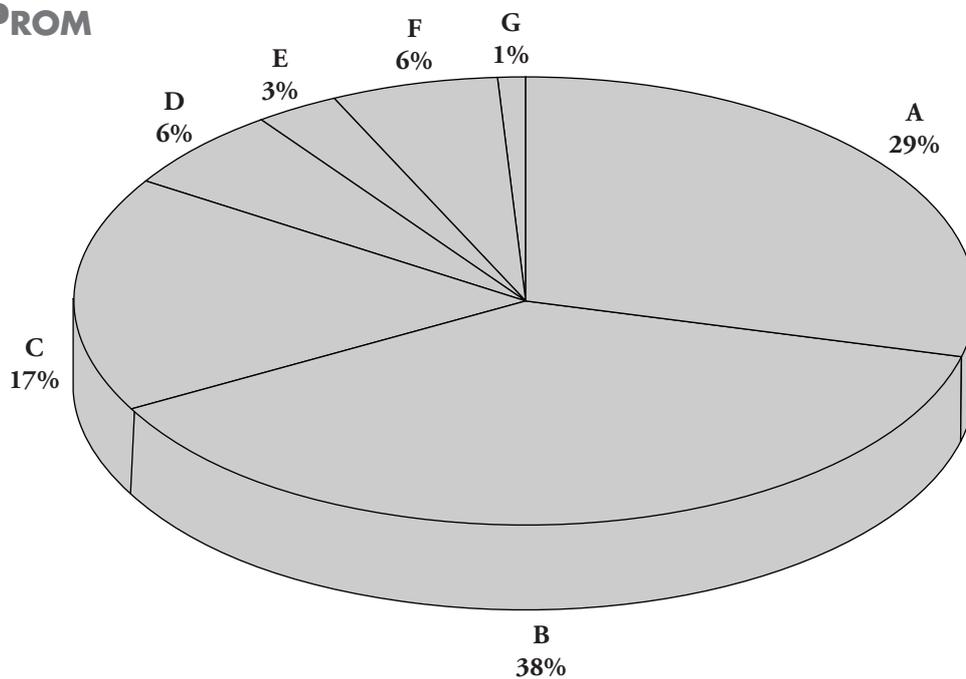
ATTACHMENT D

Sample Income/Expense Diagrams For Donors



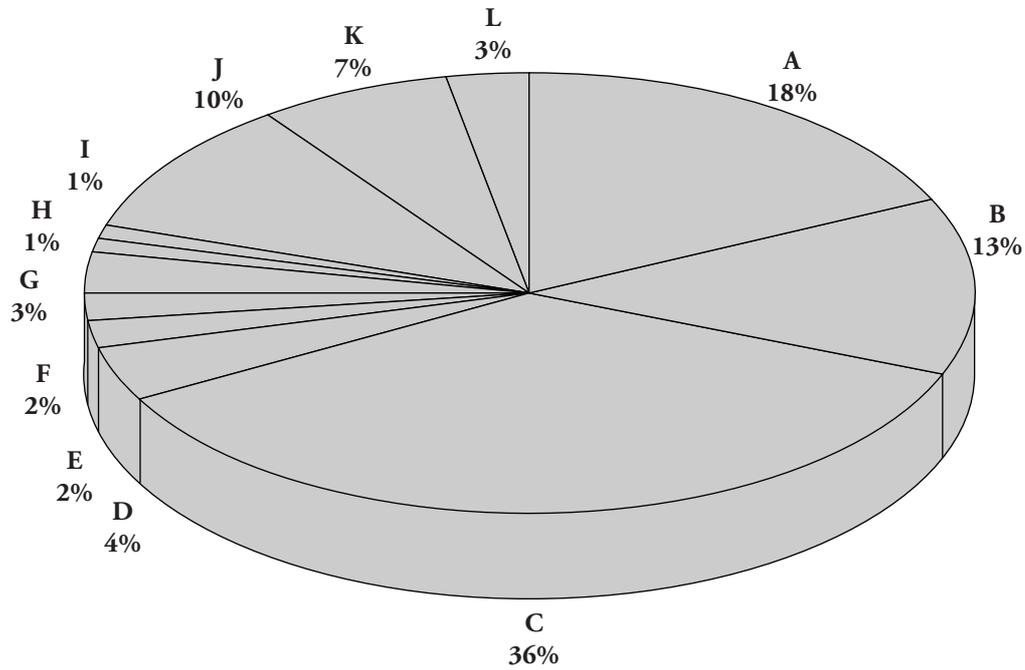
N.B. Typically, would be part of Annual Report or "Public Disclosure Statement".

INCOME - WHERE IT CAME FROM



A. Annual Fundraising Campaign	21,349,761	29%
B. Donations For Disaster Relief Operation	28,106,437	38%
C. Property Rental Income	12,514,067	17%
D. Handling And Processing Of Blood	4,209,696	6%
E. Charity Sweepstakes	2,580,000	3%
F. Collection Of Previous Years Fund Campaign	4,551,936	6%
G. Red Cross Youth Enrollement Fees	778,809	1%
Total	74,090,710	100%

EXPENSE - WHERE IT WENT



A. Chapter Operations	13,506,091	18%
B. Blood Programme	9,435,251	13%
C. Disaster Relief Operations	26,750,688	36%
D. Red Cross Youth	2,647,907	4%
E. Disaster Preparedness & Relief Service	1,645,822	2%
F. Social Services	1,833,545	2%
G. Health, Nursing & Safety	1,982,918	3%
H. International Obligation & RC Conferences	839,478	1%
I. Miscellaneous Programmes	1,048,354	1%
J. General Management, Planning & Administration	7,062,776	10%
K. Fundraising	4,868,293	7%
L. Public Information	2,469,587	3%
Total	74,090,710	100%