PM4NGOs

Finance DPro

Financial Management for Development and Humanitarian Professionals Guide

Publisher

ISBN: 978-1-7345721-7-9

Version information:

Version 1.4 May 17, 2022

Previous Version and History

Pre-release Version A for writing team review September 2016
Pre-release Version B for working group review November 2016
Beta-release version 0.1 February 2017
Version 1.0, May 2017 Version 1.1, June 2017
Version 1.1, June 2017
Version 1.2, August 2017
Version 1.3, February 2018
Version 1.4, May 2022 - rebranded

Acknowledgments

Finance DPro (**FMD Pro**) would not have been possible without the support of many experts who contributed to the creation, review, and editing of the guide. Among these contributors, we extend special thanks to Terry Lewis from Mango (Management Accounting for Non-Governmental Organizations) and Mike Culligan from LINGOs.

The FMD Pro Working Group has informed the scope, content, and management of this initiative, with participants from a diverse range of backgrounds each contributing in unique ways. We give specific thanks to Tim Boyes-Watson, Tom Dente, Chris Proulx, Mark Wagner, Mark Nilles, Tracy Stueve, Adam King, Essam Abdely, Beth Melix-Stanciu, Kevin Young, Gilles Honkpo, Amy Stones, Sarah Armstrong, Nuru Ayiemba, Mohammed Obaidullah, Baraa Bakkar, Ty Dexter, Theodorus Molenbrugge, Christine Howard, Jake McKain, Nicola Kelly, Kate Linde-Kogan, Yasmin Perez, and Lucy Davies.

FMD Pro is a synthesis of Mango's successful global training courses and handbook on Financial Management Essentials for NGOs and is informed by the input of the FMD Pro Working Group. FMD Pro is designed to align with the PMD Pro model of project management for development, relief, and conservation practitioners developed by LINGOs.

The tools and diagrams featured in FMD Pro are a selection of those already used widely in in the development, humanitarian, and environmental sectors. The Fighting Malaria Together case study used for the practical budgeting example is based on materials kindly donated by The Malaria Consortium.

Lastly, this initiative would not have been possible without the contributions of the organizations who supported FMD Pro through their participation on the FMD Pro Working Group.

Notes:

PM4NGOs has decided to rebrand the FMD Pro guide and certification as Finance DPro to align with other DPro methodologies, like the Project DPro and Program DPro. The terminology **FMD Pro** is used in this guide, communications, certificates, exams, and publications solely or along with Finance DPro terminology, without prejudice of its definition or reference.

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1. Introduction

1.1 Financial management: a key contributor to project success

Across the world, every day, organizations are implementing change through development, humanitarian, and conservation projects. Hundreds of millions of people depend on the ability of development organizations to deliver project results effectively and efficiently.

Organizations working in this sector operate in a rapidly changing and competitive world. To thrive and survive in this challenging environment, they need to develop the confidence and skills to manage, and be seen to manage, their projects well.

However, delivering project results effectively and efficiently is a complex challenge. Project teams must work together to produce deliverables and, in the process, deal with issues and tensions that are internal and external to the team. To succeed, the team needs to plan, implement, monitor, and adapt its activities in a number of discipline areas—risk management, time management, stakeholder management, human resources, financial management, and more.

FMD Pro focuses on one of the most critical disciplines needed to ensure project success—financial management. This guide to the FMD Pro focuses on the fundamentals of financial management in the context of projects in development, humanitarian, and conservation sectors. It will give you, the project team member, a firm foundation for managing the finances of your projects. It provides a contextualized, comprehensive, and adaptable resource for anyone managing project finances in these sectors.

Establishing high standards in financial management benefits organizations and projects on many levels. Here are some of the most persuasive reasons for getting it right:

- Enables effective and efficient use of resources to achieve goals and fulfill obligations to all stakeholders
- Promotes accountability to funders and other stakeholders
- Encourages the respect and confidence of funding agencies, partners, and beneficiaries
- Provides an advantage in the competition for increasingly scarce resources
- Prepares the ground for longer-term financial sustainability.

Yet, while there are many reasons why financial management is critical to project success, ultimately one could roll up these benefits into two overarching categories: *accountability* and '*response-ability*'.

- **Accountability**: In a climate of global austerity, when the challenges facing people living in poverty are greater than ever before, it is critical that organizations serving the

world's vulnerable communities can "account" for the use of their resources. Good financial management in projects helps ensure organizations improve accountability in three directions:

- **Upward accountability**: This involves reporting "upward" to funders and stakeholders at a senior level about how their money is being spent.
- **Horizontal accountability:** This involves reporting "horizontally" to project partners—consortia members, ministry-level or implementing partners. It can also involve accountability in internal reporting, for example, sharing information with finance departments and senior leadership teams, which rely on the accuracy and timeliness of financial information to input data into organizational finance systems and make strategic and operational decisions.
- **Downward accountability:** This involves sharing information and updates with beneficiary groups who are the project's primary stakeholders. It includes activities to ensure transparent use of project resources and consultation as to how financial resources should be used for their benefit.

It is important to also recognize that financial management is not just about being accountable. Strong financial management also helps project teams to respond more promptly, more appropriately, and more effectively to the challenges that inevitably arise in all projects. As author Dr. Stephen Covey* says, "accountability breeds response-ability".*

Response-ability: when project teams better understand and manage their financial resources, they make better decisions, respond more effectively to stakeholder needs, and are more agile in adapting to ever-changing environments, risks, and issues.

*Covey, Stephen R. The 7 Habits of Highly Effective People: Restoring the Character Ethic. [Rev. ed.]. New York: Free Press, 2004.

1.2 FMD Pro target audience

This guide to the FMD Pro is written for project team members who are not finance specialists and work in the development, humanitarian, and conservation sector. It is not designed for any specific organization or financial system but instead is intended to provide the fundamental skills that project team members need regardless of the organization or system they use.

This guide will benefit project officers, project administrators, project coordinators, and project managers, as well as other team members. As a project team member, you might ask: "*Am I responsible for financial management? Isn't that why we have accountants, bookkeepers, and financial managers?*"

While it's true that finance teams are key partners and participants in successful projects, good financial management is the responsibility of everyone in an organization. As a project manager or project team member, you should collaborate with your finance department to ensure that your systems are relevant and your data is timely and accurate. This does not mean that you need to be an accountant. But you will need to master the fundamental skills and tools that allow you to contribute to the planning, implementation, monitoring, reporting, and control of the financial resources of your project.

You will not need to do this alone and are likely to seek the advice and support of finance officers through each step of this process. Remember, while finance officers are skilled in managing financial systems, you have the practical knowledge to apply these at a project level. You will understand where systems are strong or weak, and where there are opportunities for improvement. This understanding is rooted in your knowledge of the field context. This practical, pragmatic knowledge is critical to project success.

The good news is that if you are reading this introduction, you have already taken the first step in improving your financial management skills. However, don't expect to be a finance expert after finishing this guide. And that is not a problem! As a project team member, you do not need to be a financial expert to succeed.

Finally, FMD Pro is not envisaged as a guide for non-finance staff who lead organizations or country and regional programs. People in those roles have financial responsibilities that extend beyond those of project team members. While they may benefit from the contents of the guide, they will need to develop additional higher-level skills to deliver more strategic responsibilities.

A final note about audience

Audiences other than project team members will also find FMD Pro Guide helpful.

Managers and mentors can use its tools, techniques, and guidance to enhance the existing skills of their teams. This could involve building the capacity of an individual by introducing the guide and encouraging them to try out new approaches, or to involve them in setting up the building blocks of good financial practice across several teams through a series of workshops.

Trainers and training organizations can use the FMD Pro Guide to inform and structure their curricula, and as a supporting resource for their training activities.

1.3 How the FMD Pro is organized

This FMD Pro Guide is organized into two sections.

Section 1: an overview of key concepts and tools in financial management

This section introduces the key concepts and tools that are referred to throughout the entire guide. It includes models for assessing good practice in financial management and explores the different roles and responsibilities required at a project level.

Financial management is an essential leadership skill for a competent project manager and an approach that should be embedded within the processes and understanding of all project teams. Some staff will have more responsibility than others for managing resources but at a minimum everyone should understand the basics.

Section 2: the four building blocks of financial management

This section is composed of four easy-to-read chapters that cover the essential skills and tools of project financial management. These are:

- Accounting Records
- Financial Planning
- Financial Monitoring
- Internal Control.

FMD Pro has drawn from good practice in both the public and private sectors, making use of tried and tested approaches and adding new tools to enhance ways of working. Most importantly, it offers a model that, once learned and embedded, can be replicated across projects and programs, and from organization to organization, to raise standards across our sector.

However, we recognize that the organizations that use FMD Pro are diverse. So, it is extremely important that they adapt the FMD Pro concepts, practices, and tools to their unique needs. The guide is NOT intended as a template, which can be simply replicated across all organizations and all projects. For example, some organizations will already have well-established policies and procedures in place that set expectations for financial reporting and accountability. Others may not. Whatever the status of your organization, FMD Pro can add value.

Those with more experience of financial management will find tools and techniques that can be tailored for use within existing procedures. And where organizations want to improve internal systems and processes, the guide provides a model that works for all aspects of financial management.

Similarly, just as organizations vary according to the maturity of their systems, they also differ in other ways too. Accordingly, FMD Pro can be adapted and tailored to suit a wide variety of specific contexts:

- **Development and humanitarian emergency responses**: FMD Pro is as adaptable for use in emergencies as it is for long-term development. While it is important not to cut corners and to stick with an overall approach, the timeline for delivering different elements of the model can be reduced and extended depending on the context within which it should be applied.

- **Restricted and unrestricted funding:** Grant funding can be restricted to deliverables and project goals that are set by a funder. Funding may also come from the organizations' own sources, received without any conditions or restrictions attached to their use. The tools and approaches in FMD Pro add value by providing information that can easily be adapted for both reporting to a funder or an organization's own internal reporting.

- **Small and large**: Organizations of any size can make use of FMD Pro. Some of the tools and techniques will be recognizable and already used, others will provide a breakthrough for financial management. The standards set by the overall FMD Pro approach are a benchmark for organizations to assess and monitor whether their financial management processes are as transparent and accountable as they should be.

The use of case studies

In Section 2, we use case studies to demonstrate key financial management tools and concepts. The main case study follows the work of a small technical training organization, Milestone Technical Training Institute (MTTI), using simplified examples of templates, budgets, and reports for illustrative purposes.

2. Key Concepts and Tools

This chapter sets the scene for the course. It introduces you to key financial management terminology and principles and some tools that are used throughout.

By the end of this chapter, you will be able to:

- describe what financial management means in practice
- identify financial management roles and responsibilities at different levels in the organization, including for project staff
- outline the four building blocks of good financial management systems
- describe the purpose and contents of a finance manual.

2.1 What is financial management?

Here is a definition of financial management within an organization. Read it through and think about what this means in practice. Which parts of the statement resonate most strongly as you read them?

Financial management involves…

planning, organizing, monitoring, and controlling the financial resources of an organization to achieve its objectives.

Although the definition is short, several ideas stand out.

- **The aim is 'to help an organization achieve its objectives'.** The last part of the definition is arguably the most powerful part of the statement: if we want to use our organization's money to do the best we can for the communities we work with, we need to manage our financial resources well.

- **Financial management is everyone's responsibility.** Financial staff, accountants, bookkeepers, and auditors are not mentioned in the definition. Although there is a temptation to view financial management as the work of finance officers, in practice,

everyone in the organization is responsible for managing the financial health of the organization.

- **Financial management is carried out at all levels of an organization.** It is conducted from the highest strategic level of the board of the day-to-day operations in the field. That said, this guide focuses on the financial management of projects and the skills required by project team members.

- **Financial management is much more than keeping accounting records.** It requires a broad set of procedures, practices, tools, and skills related to planning, organizing, monitoring, and controlling.

Next, let's explore what we mean by planning, organizing, monitoring, and controlling. Table 1 identifies the purpose of each of those activity areas and tools used in each activity area. **Table 1: Four types of financial management activity**

Planning	Organizing	Monitoring	Controlling
Purpose: To look ahead and build a comprehensive overview of the resources needed to implement activities. The output of this process is a Project Financial Plan, to guide decisions of project teams on how and when to allocate resources.	**Purpose:** To organize project implementation efficiently, such as people, buildings, vehicles, money, and financial paperwork. It also involves ensuring that everyone associated with a project understands his or her role and responsibilities, when to carry them out, and within what limits.	**Purpose:** To track progress with the intent of identifying risks or issues early on and taking corrective action if required. To do this well, it is essential to have up-to-date financial information which compares actual performance with plans.	**Purpose:** To ensure that financial and other resources are used efficiently and effectively. Controls also protect people from false accusation, being manipulated, or the temptation to misuse organizational resources.
Planning tools include: strategic documents (strategic plan, theory of change, and financing strategies) and operational documents (log frames, activity plans, calendars, and, of course, budgets).	**Organizing tools include:** an organization's constitution, organogram, job descriptions, codes of conduct, accounting and coding systems, policies and procedures manuals, forms, and once again, budgets.	**Monitoring tools include:** project evaluation reports, periodic progress reports, audit reports, budget monitoring reports, cash flow reports, reports to funders, and once again, budgets.	**Tools for good control include:** financial policies and procedures, delegated authority document, audits, procurement processes, vehicle policies, insurance, and once again, budgets.

Did you notice that budgets are an indispensable tool of financial management in all four areas of activity? Some financial management tools, like budgets, are used through the entire financial management cycle and are revisited at multiple points through the planning, organizing, monitoring, and controlling process.

2.2 The role of project teams in financial management

Delegation of authority

As stated previously, employees at all levels of an organization are responsible for contributing to strong financial management. However, this does not mean that they all have the same level of responsibility for financial management. In practice, organizations use a model of delegated authority, a formal process by which decision-making is delegated from one party to another. This allows an employee or trustee to represent and act on behalf of an organization within specified instructions and limits (also known as tolerances).

For example, an organization's board delegates authority for running an organization to the chief executive officer (CEO). While it is acceptable for the board to delegate authority to the CEO, it cannot delegate total responsibility since legal accountability rests with the board members (trustees). Delegated authority without accountability is unhealthy, so when authority is delegated it is essential to also set up reporting and monitoring mechanisms to explain decisions and actions, and to make sure instructions are being followed and not abused.

Figure 1 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 moves back up through the hierarchical structure, as people report back on progress.

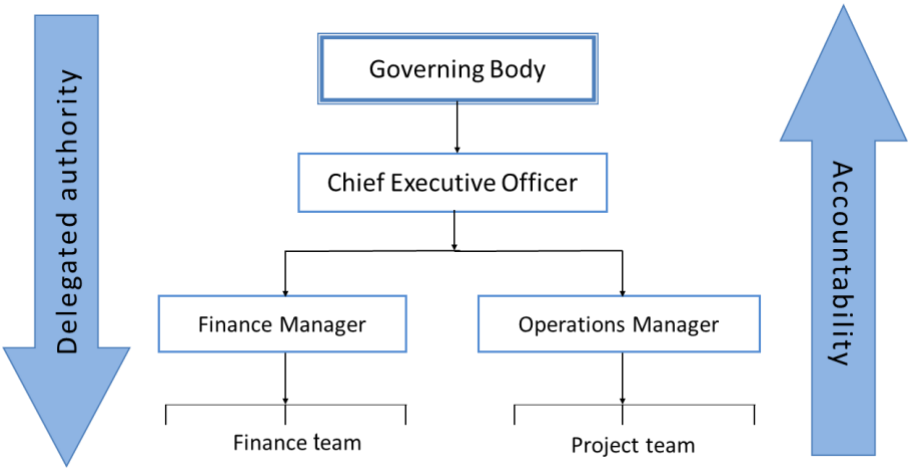


Figure 1: Delegation of authority

This pattern of delegated authority cascades down through an organization, from the board to the executive team, from the executive team to senior managers, and from senior managers to the teams they manage.

Strategic and operational management

As you review the diagram in Figure 1, you will see that stakeholders at the higher end of the delegated authority model are most likely to focus on managing strategically, while staff at other levels of the organization will focus on managing operational objectives.

- **Managing strategically:** All programs and projects must flow from the strategic intent, goals, and mission of an organization, set within a context of the environment in which activities will be implemented. At a senior level, clear strategies are developed to build financially sustainable organizations, including taking measures to diversify income, build up financial reserves (savings), and strengthen stakeholder relationships.

- **Managing operational objectives:** Financial management processes and practices are critical to achieving the shorter-term operational objectives of all programs and projects.

How financial responsibilities are divided will depend on the size of the organization, the work that it does, and how and where the organization is set up legally. Table 2 provides an example of how an organization can delegate its authority for financial management from the board level to the work of the project teams.

Table 2: Financial management roles and responsibilities

Role	Responsibilities
The Board	As stewards of the organization, one of the main responsibilities of a board is to oversee financial accountability and control to make sure that funds are used appropriately to benefit all those they are intended to help. The financial roles and responsibilities of a board include: • Discussing and approving the annual budget • Approving an organization's financial policies, eg delegated authority • Reviewing quarterly and annual summary financial reports, including budget monitoring, cash flow and the balance sheet • Monitoring progress in generating funds to ensure that the organization has adequate resources to carry out its objectives • Reviewing and approving audited financial statements • Ensuring accountability and transparency across the organization • Periodically assessing the financial risks facing the organization.

Role	Responsibilities
Executives	The executive team is responsible for implementing policy that is set by the board and must ensure that key actions take place. They retain overall responsibility for the day-to-day financial management of an organization and must be proactive about keeping themselves informed of progress. Depending on the staff structure and availability of skills, they may delegate authority through the line management structure to distribute financial responsibilities among staff teams. This includes the responsibility to: • Appoint financial staff • Manage the budgeting process • Ensure income is generated as set out in the financing strategy and budget • Make decisions about large expenditures (within the limits set by the board) • Ensure that proper financial records are kept • Ensure that accurate books of account are kept • Ensure that financial reports are produced on time, in the correct format and delivered to the right people • Monitor that program activities are in line with the budget • Check financial reports and draw the attention of staff/board to problems • Ensure control of the organization's cash, stocks, and equipment. *Note*: In practice, executives may delegate some activities needed to fulfill these obligations, e.g. to senior managers, program managers, and the finance team, but the overall responsibility remains with them (hence the use of the word "ensure" in many of the responsibility areas).
Senior/program managers	Senior/program managers are responsible for the overall financial performance and use of resources for the programs that they manage and for each of their constituent projects. This includes closely monitoring program budgets, implementing financial procedures at program level, and ensuring compliance with funder rules, such as checking and authorizing project expenses. Senior/program managers then delegate authority to project managers who are accountable for reporting upward and contributing to the overall program view. Senior/program managers are responsible for ensuring that programs are implemented in line with their organization's goals and strategic intent, and for all related financial management duties, including: • Coordinating the budget-setting process for their programs • Supporting income generation for programs, as required

Role	Responsibilities
	• Managing program budgets within the limits set • Monitoring program budgets against actual income and expenditure and reporting back to senior managers/executives on matters of significance • Reviewing funding agreements to be aware of conditions attached to grants for projects within their program area • Ensuring project staff complete funder reports on time • Implementing appropriate controls and checks to safeguard cash, supplies, and equipment used in their program. *Note*: A program can include multiple projects within one themed area.
Project staff	Project managers and their teams are responsible for the day-to-day financial management of their projects in line with their delegated authority. This typically includes: • Creating budgets for their projects as required by the senior/program manager • Managing project budgets within the limits set • Monitoring project budgets against actual income and expenditure, and reporting to the senior/program manager on matters of significance • Implementing funder rules attached to grants for their project • Preparing narrative progress reports and liaising with finance staff to deliver funder reports on time • Implementing procedures designed to safeguard project cash, supplies, and equipment.

As the table above indicates, project managers and their teams are responsible for the day-today financial management of their projects in line with their delegated authority. This typically includes four areas of operations:

1. **Resource management**: Project teams work in a competitive environment where funds are increasingly scarce. We must therefore make sure that project funds and resources are used properly, and to the best effect, to achieve the project goal and objectives.

2. **Risk management**: All organizations face internal and external risks, which can threaten operations and even survival (e.g. funds being withdrawn, an office fire, or a fraud). Risks must be identified and actively managed to limit the damage they can cause.

3. **Strategic management**: Financial management includes all areas of an organization's work. This means that project team members must keep an eye on the "bigger picture,"

looking at how the whole organization is financed in the medium and long term, not just focusing on project and programs.

4. **Project management**: The project management cycle is based on clear and specific project objectives that are regularly reviewed to monitor progress and outcomes.

Collaborating with the finance team:

The finance team provides support to non-financial staff as they engage in the financial management process. Their support includes:

- Handling an organization's cash, including issuing receipts and banking money
- Administering payment processes to ensure that accounts are paid on time
- Ensuring that financial data from projects is entered into the books of account and reconciled every month
- Ensuring that all financial documents are filed and available for auditors to view

2.3 Plan–Do–Review and the financial planning process

As project teams implement the financial process, all activities should be completed with the aim of continuous improvement of the project, its processes, practices, and activities. The Plan– Do–Review model is a learning cycle that allows your team to learn from experience.

Figure 2: Plan-Do-Review Cycle

Stated simply, the cycle moves through three phases (Plan–Do–Review) and repeats itself when the last phase is complete. Applied to the context of the financial management process, the Plan–Do–Review cycle includes the following activities.

- **Plan**: When we set up a project, we establish clear objectives and activities. We also prepare a series of budgets to estimate the costs of running these activities and to develop proposals to raise the funds.
- **Do**: Having obtained funding, we then implement project activities according to the project plan. This is when we start to spend money and account for the financial transactions that take place.
- **Review**: Throughout the project it is a good idea to monitor progress by comparing what we planned to do with what we actually did, and by comparing the projected budget with actual income and expenditure. The project manager will use this information to decide if actions are needed to keep the project on track. The learning from this review stage is then taken forward to the next planning phase and repeated, in a continuous process of ongoing learning and adaptation.

2.4 Foundations for strong financial management

Financial control: a strong foundation for financial management

As we have seen, the main purpose of financial management is to ensure financial resources are used effectively to fulfill an organization's objectives. This is achieved by creating what is known as financial control, which is achieved through a series of strong and appropriate tools and techniques.

> **Financial control:**
>
> Financial control happens when the financial resources of an organization are used correctly and effectively. Strong and relevant financial policies and procedures must be in place to ensure financial control.

Poor financial control in a project could mean that:

- money and equipment are put at risk of theft, fraud, or abuse,
- funds are not spent according to the project's objectives or the funder's contract, or,
- the competence of project staff is called into question.

The four building blocks of financial management

The foundation of effective financial management is therefore a strong financial system. An organization's financial system is the central pillar for the planning, organizing, monitoring, and controlling of financial resources.

While there is no universal standard for a financial management system, the FMD Pro Guide uses the four building-block model as a framework. The model is composed of four fundamental, interlinked building blocks that must be in place to ensure good practice in financial management.

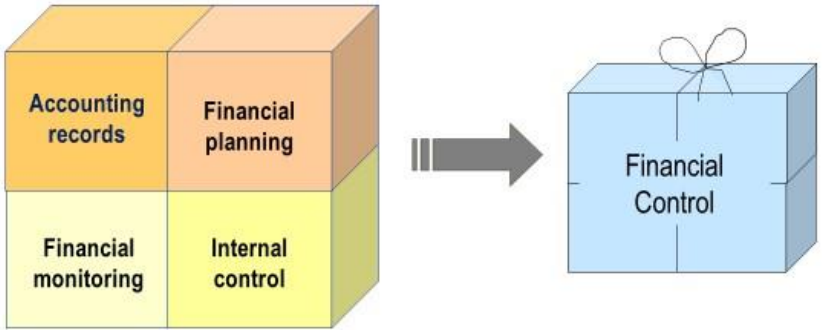


Figure 3: The four building blocks of financial management

Accounting records: Every organization must keep an accurate and complete record of all financial transactions that take place during the financial year so they can show how funds have been used. Accounting records include both the physical paperwork (such as receipts and invoices) and the books of account where the transactions are recorded and summarized.

Financial planning: Linked to an organization's strategic and operational plans, budgets are the cornerstone of any financial management system and play an important role in monitoring the use of funds. The financial planning process includes building longer-term plans, such as a financing strategy, and shorter-term budgets and cash flow forecasts for projects and programs.

Financial monitoring: Providing an organization has kept accurate and timely accounting records and has set its budgets, it is possible to produce financial reports for use by different stakeholders. For example, budget monitoring reports help managers to monitor the progress of their projects, and annual financial statements provide accountability to external stakeholders.

Internal control: Internal control is a system of common sense controls, checks, and balances designed to manage internal risk and safeguard an organization's money, equipment, and other financial resources.

The purpose of internal control is to minimize losses, such as through theft, fraud or incompetence; and to detect errors and omissions in the accounting records. An effective internal control system also protects staff, an organization's most important asset.

It is important to emphasize that the building blocks are integrated and interconnected with each other. For example:

- There is little point in keeping detailed accounting records if you do not complete regular internal control routines to identify errors and omissions.
- It is not possible to monitor the progress of your project compared to the budget if you do not use a consistent coding structure in your budgeting and financial reporting systems.
- If internal controls are not in place to prevent the submission of fraudulent invoices, the accounting records of the project will not be valid.
- Financial monitoring can also be seen as part of an internal control system, as users of financial reports can use the information to spot errors or anomalies.

The four building-block model provides the framework for the remaining chapters. They are also used as the basis for Mango's Finance Health Check, a self-assessment checklist to help you strengthen financial management systems (https://www.mango.org.uk/guide/healthcheck).

2.5 The finance manual

As we have seen, underpinning all financial management systems are a series of financial policies and procedures that guide operations and determine how an organization uses and manages its money. All this information is included in one document: the finance manual.

The manual establishes the framework within which a team manages the finances of a project. It serves as a reference to avoid misunderstandings and encourage consistency. Once approved, the manual becomes part of the hierarchy of regulations that an organization must follow — just as it would be required to follow country legislation, funder regulations, and other organization policies and procedures.

What is a policy?

A policy sets out principles and guidelines for a key area of activity within an organization. It answers any questions about how important resources are used. For example, a vehicle policy will clarify who can drive an organization's vehicles, how they should be disposed of when no longer needed, and outlines the rules on private use by staff.

Policies are usually written by senior managers and then discussed and agreed by the board or management team. Once approved, everyone in an organization must follow the policy, and failure to do so could result in disciplinary action.

What are procedures?

A policy sets out principles and guidelines for a key area of activity within 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 ensure correct authorization for actions. For example, a vehicles usage procedure might require the completion of vehicle requisition forms and journey log-sheets.

The manual establishes the framework within which a team manages the finances of a project. It serves as a reference to avoid misunderstandings and encourage consistency. Once approved, the manual becomes part of the hierarchy of regulations that an organization must follow, just as it would be required to follow country legislation, funder regulations, and other organization policies and procedures.

There is no single template for a finance manual, and yours will depend on the unique needs and structure of your organization. The following content headings are commonly used for each section in a typical financial procedures manual. You can use these as the starting point for your own manual and adapt them to cover the needs and activities of your organization.

- Accounting rules and routines
- Bank and cash handling procedures
- Code of conduct
- Coding structures
- Delegated authority
- Financial planning and budget management processes
- Financial reporting routines
- Fixed assets
- Foreign exchange
- Fraud and other irregularities
- Grant management guidelines
- Insurance
- Procurement procedures
- Staff benefits, allowances, and expenses
- Stock control
- Vehicle management

Your manual may also need to include key elements of external financial regulations and other reference materials such as organization charts, job descriptions, and standard forms/templates.

2.6 Seven principles of financial management

These seven high-level principles (or guiding rules) set a standard of good practice and provide a benchmark for assessing your current financial practices. Use them as a checklist to help identify relative strengths and weaknesses in the financial management of your own organization.

To help you remember these principles, a useful mnemonic, CAT VISA, is formed using the first letter of each principle

Figure 4: The seven principles of financial management

Consistency: Consistent use of financial policies and procedures are important for efficient and effective operations. For example, a clear procurement procedure will help staff to follow the correct process and ensure compliance with funder rules. Consistent use of accounting codes in financial records and budgets makes it easy to produce monitoring reports and promotes transparency (one of the best ways to hide irregularities is to change the way figures are reported).

Accountability: Accountability is the moral or legal duty, placed on an individual, group, or organization to explain how funds, equipment or authority given by a third party, has been used. All stakeholders, including beneficiaries, have the right to know how financial and other support has been used to meet objectives. Organizations have an operational, moral, and legal duty to explain their decisions and actions, and make their financial reports open to scrutiny.

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

Viability: To be financially viable, spending must be kept in balance with money coming in, both at the operational and strategic levels. Viability is a measure of financial continuity and security. Managers should prepare a financing strategy to show how financial obligations will be met and how they will deliver strategic plan and operational objectives.

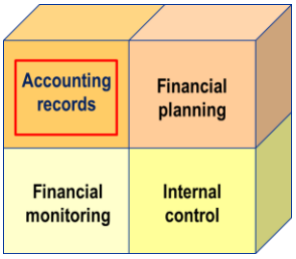
Integrity: On a personal level, individuals must operate with honesty and propriety. For example, managers must lead by example in following organizational policy, or declare personal interests that might conflict with their official duties. The integrity of financial reports is dependent on accuracy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

Stewardship: Financial stewardship involves taking good care of the financial resources that we are entrusted with, to make sure they are used for the purpose intended. An organization's board has overall responsibility for this. In practice, managers and team members achieve good financial stewardship through strategic planning, assessing financial risks, and setting up appropriate systems and controls.

Accounting standards: The system for keeping accurate financial records and documentation must observe internationally accepted accounting standards and principles. An accountant from anywhere in the world should be able to understand an organization's financial accounting records.

3. Accounting Records

In this chapter, we explore the first of the four building blocks of financial management: accounting records, to introduce you to the process of accounting for projects.



It is not designed to turn you into an accountant, but rather to provide an insight into what goes on behind the finance team's door so that you understand your role in the accounting process, and can interpret and use financial reports.

You may find it helpful to refer to the glossary at the end of this guide if you need a definition of any of the terminology used in the following pages.

By the end of this chapter, you will be able to:

- explain why we need to keep accounts and which records to keep.
- describe the difference between financial accounting and management accounting.
- describe how to sort financial transactions using accounting codes.
- outline two different methods used to record financial transactions.
- describe the process used to account for cash advances.
- describe the '3 Ps of procurement': process, people, and paperwork.

3.1 Why do we need to keep accounts?

All organizations, whatever their size, need to keep accurate and complete accounting records for their operations. There are two key reasons for keeping accounts.

Accountability and transparency: It is a legal requirement for all organizations to maintain a record of financial transactions for public scrutiny. Organizations that fail to submit annual accounts with the relevant regulatory bodies can receive penalties such as fines or even the withdrawal of their registration.

Equally important for organizations in our sector is a moral duty to show how donated funds have been used to further their mission. This enhances credibility and trust in an organization's work. Funding agencies almost always require audited accounts as a condition of grant aid.

Management information: All managers need regular updates to help manage their projects and programs. This helps them to understand where they are now and help them plan for the future. Although accounting records provide data on what has happened in the past, when this is compared to the original plan (i.e. the budget), it provides insight into project performance and helps to predict future trends and challenges. We will look at financial reports in more detail in Chapter 5, Financial Monitoring.

3.2 Financial accounting and management accounting

Linked to these two main reasons for keeping accounts are two areas or functions of accounting.

- **Financial accounting**: Financial accounting is the everyday important work of recording, classifying, and summarizing financial transactions for an organization. The main outputs of financial accounting are the annual financial statements: a retrospective view (showing historical data) that is used for external accountability. These financial accounts must be accurate and up-to-date if the second area: management accounting, is to be undertaken effectively and with minimum effort.

- **Management accounting**: Management accounting uses the data gathered by the financial accounting process and analyzes this information (e.g. by comparing it to the budget) for decision-making and control purposes. Management accounting is therefore primarily for internal use and is forward-looking. The table below summarizes the main differences between these two branches of accounting.

Table 3 summarizes the main differences between financial accounting and management accounting.

In this guide, we focus more on management accounting processes because these are critical for project teams to deliver their objectives. However, it is helpful to understand how financial accounting works and feeds into the management accounting process.

Table 3: Comparing financial and management accounting

	Financial accounting	Management accounting
Process	Records, classifies and reconciles all financial transactions, and summarizes transactions for reports	Analyzes data from the financial accounts, compares results with plans, and provides forecasts
Output	Financial statements	Management accounts
Purpose/ audience	External accountability	Internal management
Perspective	Backward-looking, objective	Forward-looking, subjective
Statutory obligation	Yes	No

Both the financial accounting and management accounting processes use accounting codes, so we cover this important area next, as we will refer to them throughout this guide.

3.3 Accounting codes

Every organization needs a list of codes to classify and sort financial transactions, and to summarize internal budgets and create financial reports. There is no universal list of accounting codes, so organizations must create a coding system that suits their operations and reporting needs. There are two key coding tools: the chart of accounts and project cost centers.

The chart of accounts

To run our projects, we need to buy a wide range of goods and services, from paying rent for an office to the purchase of tools for a garden project. We need to receive funds to pay for these from grants, donations, and membership fees, for example. It helps to classify or "sort" the different types of financial transaction into a series of predetermined descriptive categories or accounts. These accounts are listed in a chart of accounts document (its literal meaning is "list of categories").

A chart of accounts is one of the most important organizing tools in accounting and financial management. The coding structure plays a role in all four of the building blocks to:

- Classify financial transactions in the financial accounting records
- Summarize budgets using standard and consistent descriptions
- Create management accounts
- Check accounting records for consistency and accuracy

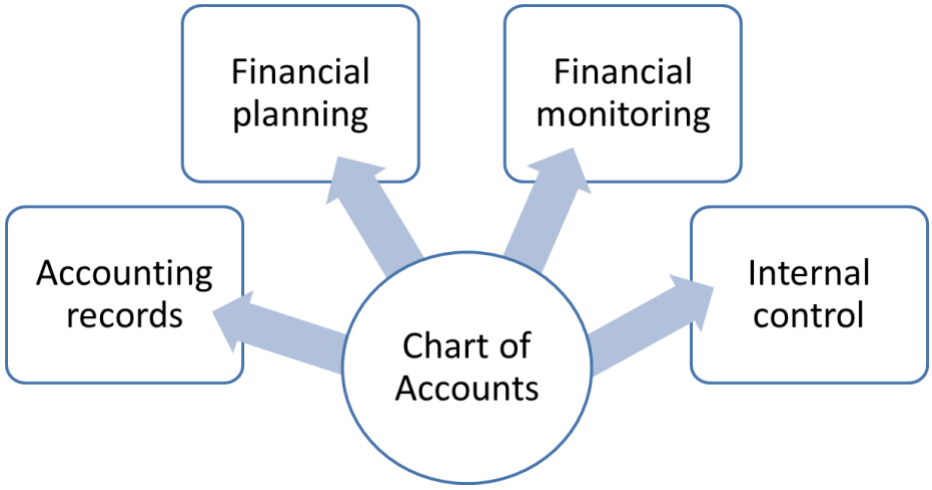


Figure 5. Chart of accounts and the four building blocks

An extract from the chart of accounts document for a small NGO, the Milestone Technical Training Institute (MTTI), is outlined below. You will see that MTTI's chart of accounts document is a table indicating different types of income and expenditure. The columns in this example include the following information.

- **Account code**: A reference number that can be numerical or alphanumerical, applied in a logical sequence.
- **Account name**: A short descriptive term for the category, this should describe a resource item (something you can point to) rather than an activity.
- **Group headings**: 'Family groups' that bring together linked categories, useful for organizing the schedule of categories and for presenting summarized information in reports.
- **Notes**: Provides extra guidance on what to use the account for, to ensures consistency, and avoids coding errors in the accounting records.

MTTI's chart of accounts (in Table 4) is provided as an illustrative example. You should note that your organization's chart of accounts will have its own logic and codes. It is possible to use numbers or letters, or a combination of both. It is important to understand the logic behind the chart of accounts and recognize how it is used in financial planning, accounting, and reporting.

Table 4: The MTTI Chart of Accounts

MTTI - CHART OF ACCOUNTS		
Income & Expenditure codes:		
Code	**Account name**	**Notes**
4000	**INCOME: FUNDER**	
4010	DFID	For grants received from this funder
4020	Smile Trust	For grants received from this funder
4030	Vanguard Society	For grants received from this funder
4100	INCOME: GENERAL	
4110	Bank Interest	Interest received on bank accounts
4120	Donations & fundraising	Fundraising activities, miscellaneous donations
4130	Sales	Sales of trainees' work
4140	Training fees	Course participants' contributions
5000	**EXPENDITURE: ADMINISTRATION**	
5010	Audit & accountancy	Audit fees, other accountancy expenses
5020	Bank charges	Service fees, interest charged on OD balances
5030	Board meetings	Room hire, refreshments, AGM expenses
5040	Stationery	Office and photocopier consumables
5050	Publicity	Posters, leaflets, advertising training courses
5060	Office rent & utilities	Office rent, insurance and utilities
5070	Repairs & renewals	Servicing, small equipment, office repairs
5080	Communications	Telephone, fax, internet, postage, courier
6000	**EXPENDITURE: PERSONNEL**	
6010	Staff training	Course fees, meals & accommodation
6020	Recruitment	Recruitment advertising, interview expenses
6030	Salaries & benefits	Gross salaries, medical aid, pension. Taxes
6040	Travel & subsistence	Per diem, meal/overnight allowances, bus fares
7000	**EXPENDITURE: VEHICLE RUNNING**	
7010	Fuel	Petrol, diesel and oil costs
7020	Vehicle insurance /tax	Vehicle Insurance premiums and road tax
7030	Vehicle maintenance	Service, repairs, tires, spare parts, car wash
7500	**EXPENDITURE: PROJECT INPUTS**	
7510	Consultants fees	Guest speakers', trainer' fees/ expenses
7520	Food & accommodation	Room hire, food for trainees
7530	Training materials	Tools, protective clothing, raw materials
0100	**CAPITAL EQUIPMENT**	
0110	Office Equipment	Computers, printers, desks, chairs, etc.
0130	Vehicles	Cars, mobile workshop

All program staff with responsibility for managing budgets or implementing project activities should have a copy of the chart of accounts document for their organization, so that they can record the correct accounts codes on supporting documentation.

Project cost centers

We use project (or activity) cost centers to separate different activities or functions within the financial accounts and budgets, for example, a project, a program area, a department, a country program, a region, or a funding source. Each cost center is given a unique reference or code.

If a program is made up of multiple projects and is supported by different funding agencies, you need to design a cost center structure that allows you to meet internal and funder reporting requirements. Some coding structures can therefore be quite sophisticated and are many digits long.

Example of a cost center structure

The Milestone Technical Training Institute has three program areas: Central Support (i.e. management, administration, and governance), Metalwork Skills, and Building Trades. The Metalwork Skills Program has two separate projects, a Furniture Design Project, and a Vehicle Repairs Project.

Their cost center structure and reference codes are as follows:

Cost center code	Program/project
01	Central Support
02	Building Trades
03	Metalwork Skills
03-01	Furniture Design Project
03-02	Vehicle Repairs Project

When financial transactions are entered into accounting records, they are categorized as follows:

- **by their type of income or expenditure** - which account code does this belong to?
- **by each project, department, or funder** - which project or activity area does this belong to?

By using cost centers as well as account codes, it is easy to extract data for reports at the required cost center level during the management accounting process. For example, here is a list of transactions that took place at the Milestone Technical Training Institute, with both the cost center code and chart of accounts code added.

Table 5: MTTI cost center structure and reference codes.

Financial transaction description	Cost center code	Account code
Chief Executive salary	01	6030
Program Manager salary (Building Trades)	02	6030
Project Officer salary (Vehicle Repairs Project)	03-02	6030
Office rent	01	5060
Protective clothing for workshop on metalwork skills	03	7530
Vanguard Society grant received (Furniture Design Project)	03-01	4030
Training fees received for Building Trades workshop	02	4140

3.4 Which accounting records to keep

Keeping accounts is about finding a way to store financial information so that the organization can show how it has spent its money and where the funds came from. Accounting records fall into two main categories: **books of account** and **supporting documents**.

Books of account

The books of account are used to keep track of all financial transactions. The main books of account include:

- Cashbook (also known as the bank book or cash analysis book), one for each cash holding or bank account
- Accounts payable and accounts receivable ledgers
- General or nominal ledger
- Journal register or day book
- Salaries or wage records
- Assets register
- Stock register.

While cashbooks are regularly used, not all of the other books of account are required. This will depend on the size of the organization, the number of transactions, reporting requirements and the method of accounting used.

Accounting data is now usually kept on a computer, either in a spreadsheet format or using one of the many accounting software programs available, rather than in physical books or 'ledgers'. The data for the books of account come from supporting documents.

Supporting documents

Supporting documents are the original paper records generated when an organization makes financial transactions, pays for goods or services, or receives income. These paper documents show all the details about the transaction, such as the date, what it was for, the value of the item, who was involved in the transaction, etc. Supporting documents are usually in paper form, but electronic supporting documents are becoming increasingly common. Information is transferred from the supporting documents and recorded in the relevant books of account.

Supporting documents should provide information and evidence to answer the following questions about a transaction.

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

It is important to remember one very simple rule about supporting documents:

> *Every financial transaction MUST be supported by at least one valid supporting document as they provide evidence that the transaction took place.*

However, sometimes it is not possible to get a receipt from a vendor, especially for smaller purchases, such as buying food for a meeting at a market stall. In that case, an organization needs an internal receipting mechanism to create a valid receipt. Usually this will take the form of a 'self-receipt' document where the transaction details are recorded and signed by both parties (payer and receiver). This document will have a standard format and may be in the form of a carbon copy book.

It is best practice to obtain receipts from people your organization pays money to, and in general, the use of self-receipts should be kept to a minimum. Internal or self-receipts should only be used for small cash payments in circumstances where there is no other alternative.

Some funders will not accept internal or self-receipts. It is important for program staff to be aware of the rules of the funder for their project on using internal receipts. An organization should provide a format for a self-receipt and explain when it can be used in the finance manual. This ensures consistency and will minimize challenges on the use of internal receipts from external auditors.

What makes a VALID cash receipt?

- An original document (not a photocopy)
- Dated
- On official stationery and/or
- Stamped and/or
- Signed by at least one party to the transaction

Why are supporting documents so important?

Supporting documents are important for many reasons and that is why we must all make a big effort to obtain valid receipts when we implement projects.

- They are used in the financial accounting process to record details of the transaction in the books of account.
- They are required for the external audit process to prove that the transactions took place as described in the accounting records.
- They provide protection to the project staff handling money. Mislaid or incomplete records can result in suspicion of mismanagement of funds.

Types of supporting documents

The most important supporting documents are the source documents, which are those that originate when the transaction takes place, such as a vendor invoice or a cash register receipt. There are also many other useful secondary documents that support the transaction process, for example, standard forms created by the organization to capture authorizing signatures and accounting codes. See Table 6 for the documents that are most often used in projects.

How long do we keep supporting documents?

All supporting documents must be filed and kept in a safe place so that they are available for cross-reference and audit. It is important to mark invoices as paid to prevent fraudulent reuse.

Each country will have regulations about how long organizations must keep original supporting documents. Typically, it is for the current year plus the previous five years. Funders also include rules about retaining receipts in their grant contracts, which may be different from the local regulations.

Table 6: Supporting documents that are most commonly used in projects.

Document description	Source document	Secondary document
Cash receipt/voucher for money received		
Cash receipt/voucher for money paid out		
Vendor invoice/bill		
Banking slip for cash paid to bank		
Bank statement		
Journal voucher (for adjustments)		
Payment voucher (PV)		
Purchase order (PO)		
Staff expenses claim form		
Goods received note (GRN)		

3.5 The financial accounting process

As we have seen, financial accounting is about recording all the financial transactions that occur on a day- to-day basis. There are many different types of transactions that will need to be tracked and recorded, such as project materials, staff salaries, money received from funders, and many more. These transactions are documented in source documents and entered into the books of original entry, which are, in turn, rolled up into the general ledger. The diagram below shows how the accounting records fit together.

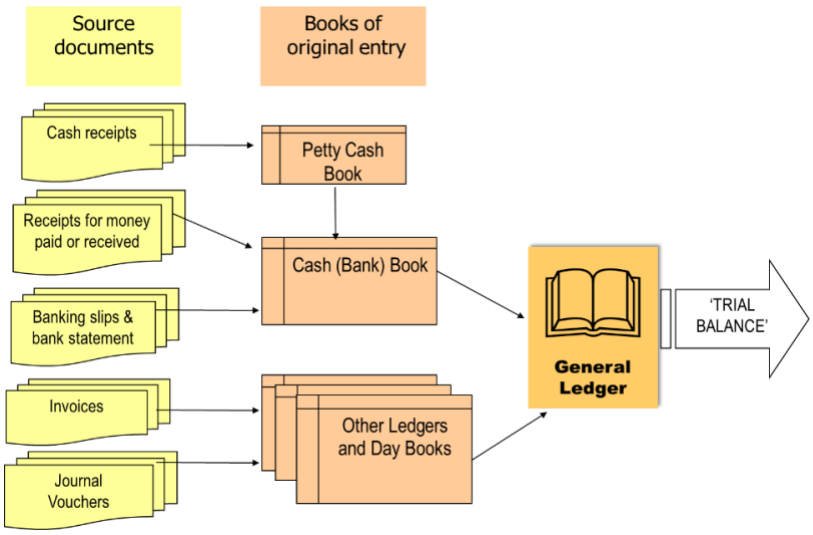


Figure 6: How the accounting records fit together

There are two different approaches to account for financial transactions, either on a cash or accruals basis. It is not necessary for program staff to know the technical details of these two accounting methods but it is important to be aware of the terminology used by each process and the different financial information they produce.

The key difference between cash accounting and accruals accounting is in how they deal with the timing of cash and credit transactions.

Cash and credit transactions: what's the difference?

The only difference between cash and credit transactions is the timing of the payment.

- **Cash transaction**: There is no time delay because the deal and exchange of money take place at the same time, for example, buying bags of cement from a builder's merchant with cash.
- **Credit transaction**: There is a time delay between the receipt of goods or services and payment, for example, signing for bags of cement from a builder's merchant on account or with an organizational credit facility. The actual payment will follow later when the builder's merchant sends an invoice for all the goods purchased that month.

WHEN was it paid not HOW was it paid

A cash transaction is a payment that is settled immediately (using physical money, a check, or a debit/credit card).

Payment for a credit transaction is settled at a later date once an invoice for the transaction has been issued (again using physical money, a check, or a debit/credit card).

A note on non-cash transactions

Some financial transactions involve no physical exchange of cash, having no effect on the inflows and outflows of cash, but they could have an impact on the organization's overall financial position. For example:

- **In-kind donations** of a significant value, such as a donated vehicle, or rice for distribution to beneficiaries during a humanitarian response. For completeness in the accounting records, the transaction is recorded to recognize the value of the donation and in-kind goods.
- **The cost of depreciation** of valuable property or equipment (fixed assets). Depreciation is the internal accounting mechanism used to calculate and record the loss of value of fixed assets over their useful life.

Cash-based accounting system

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

- The main book of account is called the 'cashbook' (which incorporates the petty cash book).
- Incoming cash is called a 'receipt' and cash going out is a 'payment'
- Transactions are recorded in the cashbook on the date they happen.
- There is no record yet of outstanding credit transactions; these only get accounted for when the payment is made.
- This system cannot record non-cash transactions because there is no physical cash transaction.
- When summarized, these records produce a receipts and payments report for a given period. This simply shows the movement of cash in and out of an organization under different categories (accounts) and the cash available at the start and end of the reporting period. It does not show the value of the resources owned by the organization (assets) and the amounts owed to other parties (liabilities).

The table below is an example of a receipts and payments report for MTTI. Note the use of the chart of accounts codes and account names to summarize the report.

Table 7: MTTI receipts and payments report

Milestone Technical Training Institute (MTTI) Receipts and Payments
Report 1 January to 31 December <Year 8>

	Opening balance 1 January <Year 8>		2,880
RECEIPTS		48,000	
4010	DFID grant		
4020	Smile Trust grant	43,000	
4110	Bank interest	832	
4120	Donations & fundraising	750	
4130	Sales	11,406	
4140	Training fees	13,540	
	Total Receipts		117,528
PAYMENTS			
5000	Administration & office equipment Personnel	28,409	
6000		46,580	
7000	Vehicle running	14,886	
7500	Project inputs	20,588	
0100	Equipment	1,850	
	Total Payments		(112,313)
	Closing balance 31 December <Year 8>		8,095

Accruals-based accounting system

This is a more sophisticated and comprehensive approach to accounting that requires a higher level of bookkeeping skills. The main features are:

- It uses double-entry bookkeeping, which recognizes that there are always two sides to every transaction: the giver and the receiver. The dual aspects of each transaction are referred to as debits and credits.
- The main book of account is the general ledger (backed up by other ledgers, such as accounts payable and accounts receivable, as well as cashbook data).
- The terminology used for incoming and outgoing transactions is income and expenditure.
- Income is recorded when it is earned or due, rather than when the cash is received. Expenditures are recorded as they are incurred, rather than when the invoice is paid. This overcomes the problem of time delays with credit transactions.
- The system can deal with all types of transactions, including non-cash transactions.
- Adjustments are included in the accounts, which compensate for the timing delays caused by credit transactions. These adjustments are called accruals (which is how this accounting method gets its name).
- By recognizing financial commitments when they occur, not when they are paid or received, the system automatically builds in up-to-date information on the organization's assets and liabilities.

This process produces a more comprehensive picture of an organization's financial position. The reports produced from a general ledger are described as the financial statements. Financial statements usually include information on the previous year and are required in all countries applying International Financial Reporting Standards (almost all the countries where development practitioners and humanitarians work).

Financial statements include:

- **A balance sheet report** (or the statement of financial position) that shows the value of assets and liabilities on the last day of the reporting period, which is what the organization is worth on that day.
- **A statement of income and expenditure** (or statement of activities) showing all income and expenditure during the reporting period, and the outcome for the year (a surplus or a deficit). In some countries this is also known as: statement of financial activities, statement of financial performance. statement of comprehensive income or income statement. All show the same overall information for an organization.

The two tables below are examples of a balance sheet and a statement of income and expenditure for the Milestone Technical Training Institute.

Table 8: Example balance sheet

Milestone Technical Training Institute (MTTI)

Balance Sheet as at 31 December <Year 8>

	<Year 8> $	<Year 8> $	<Year 7> $
Fixed Assets			
Tangible Assets		112,091	122,696
Current Assets			
Cash at bank and in hand	8,095		2,880
Grants Receivable	10,000		5,000
Debtors	2,459		1,000
	20,554		8,880
Current Liabilities *payable within 12 months*			
Creditors and accruals	(3,262)		(2,664)
Net Current Assets		17,292	6,216
Net Assets		**129,383**	**128,912**
Represented by:			
FUNDS			
General Purposes Fund		13,292	6,216
Designated Fund – Equipment Replacement		4,000	-
Designated Fund – Fixed Assets		112,091	122,696
Total Funds		**129,383**	**128,912**

Table 9: MTTI statement of income & expenditure

Milestone Technical Training Institute (MTTI)

Statement of Income & Expenditure

For the year ended 31 December <Year 8>

	<Year 8> $	<Year 7> $
INCOME:		
Funder Income:		
- DFID	48,000	45,000
- SMILE Trust	48,000	45,000
Other Income: -		
Training Fees	14,640	12,250
- Sales	11,765	6,768
- Donations & Fundraising	6,750	6,600
- Bank Interest	832	698
Total Income	**129,987**	**116,316**
EXPENDITURE:		
Personnel costs	52,580	48,780
Administration	28,207	23,119
Project inputs	20,588	18,743
Vehicle running	15,686	12,670
Depreciation	12,455	13,633
Total Expenditure	**129,516**	**116,945**
Surplus/(Deficit) for the year	**471**	**(629)**

A footnote on accounting methods

Many smaller organizations cannot afford to employ qualified accountants and therefore adopt a "half-way house" approach to accounting. They use the simpler cash accounting basis during the year (which requires basic bookkeeping skills) and then, with the help of an external accounting firm, convert the cash-based figures to an accruals basis at the year-end for the annual accounts and audit.

This is what MTTI has done, hence being able to update the receipts and payment report to the full financial statements shown above. This process requires identifying certain adjusting items

at the year-end, such as expenditure accruals and prepayments (see examples below), unspent grants or grant received early, and significant equipment purchases during the year.

Example of an expense accrual:

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

Example of a prepayment:

Office rent is paid six months in advance. The rent is paid three months before the end of the financial year. Half of the payment covers the first quarter of the new financial year. At the yearend, the three months' rent paid for the next year is deducted from the office rent expenditure account for the current year. It is carried forward to the office rent expenditure account for the next financial year - the period which the rent relates to. This three months' rent shows up as a prepayment on the assets list in the balance sheet.

Example of an income accrual:

A funder's final grant payment for a project is delayed and arrives a few days after the end of the current financial year. As the grant is to cover project expenses already made during this year, it is shown as income in the income and expenditure statement for the current year, and as a current asset (grant receivable) in the balance sheet at the year-end.

Summary of cash vs. accruals

The table below summarizes the differences between cash-based and accruals-based accounting.

Table 10: Cash-based and accruals-based accounting

	CASH	ACCRUALS
Skill level	Basic bookkeeping	Advanced bookkeeping
Transaction types	Cash only	Cash and credit
Terminology	Receipts and payments	Income and expenditure
Main book of account	Cashbook	General ledger
Non-cash transactions	No	Yes
Accounting system	Single entry	Double entry
Assets and liabilities accounted for	No	Yes
Reports produced	Receipts & payments report	Income & expenditure report with balance sheet

3.6 Cash advances

It is common practice to give project staff a cash advance (or cash float) to make cash purchases when implementing projects, especially for trips to the field to cover expenses such as fuel, per diem, accommodation, and meeting expenses. If you are given a cash advance, you must be ready to account for every cent of it. That means:

- keeping an itemized record of every transaction, such as on a staff expenses claim form designed for that purpose,
- providing a supporting document for every item purchased, and
- returning any unspent cash.

Cash advances should be accounted for as soon as possible after a field trip, or at least once a month, so that the expenses can be included in the project accounts as soon as possible.

Cash imprest system

One of the best ways to manage and account for staff cash advances is to use the fixed float or imprest system. It works like this: you are given a cash advance for a fixed sum (let's say $500), and when the time comes to account for the cash advance, you perform a simple reconciliation:

- Add up the total value of the receipts for payments made (Total A).
- Count the cash remaining (Total B).
- Add Total A and Total B together and the result should be the same as the original cash advance (the$500 you started with).
- If the total does not add up to the original cash float amount, then there is either some cash or a receipt missing, which must be accounted for.

Here is a worked example:

Value of receipts for cash spent	346.75	Total A
Remaining cash counted	153.25	Total B
TOTAL FLOAT	**500.00**	**A + B**

The imprest system ensures that every cent is accounted for and makes reconciliation and reimbursement a simple process. This system is often used for managing the petty cash box in an office, which is used to pay for small cash expenditure.

3.7 The 3 Ps of procurement

Most financial transactions take place when we purchase goods and services to implement our projects and programs. We therefore need to be organized about the procurement process to ensure efficient, effective, and economic use of resources.

There are three key aspects of procurement, the 3 Ps: Process, People and Paperwork.

Process

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

We would use a different process to purchase small items of stationery than if buying a vehicle, for example. For larger value items, where the risk is higher, it is normal to obtain two or three quotations from suppliers to find the best deal.

See the flow diagram below (Figure 7) for an example of a procurement process.

People

The procurement process involves a range of people who initiate and/or authorize each stage of the process. The higher the value and risk involved, the more people should be involved to protect the process from fraudulent activity. For example, if purchasing a high value item such as a vehicle, it is usual to include a purchasing panel (purchase committee) to ensure objective supplier selection.

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

The procurement process also builds in checks by line managers to ensure that the rules of delegated authority are followed by those that they manage, e.g. checking that a project officer has not exceeded their authorized limits when ordering goods or services.

Paperwork

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

Steps in the procurement process

Each organization will design a procurement procedure to suit their own operations. The flow diagram below describes steps involved when purchasing higher value items with a supplier account (and where the cash accounting system is in use).

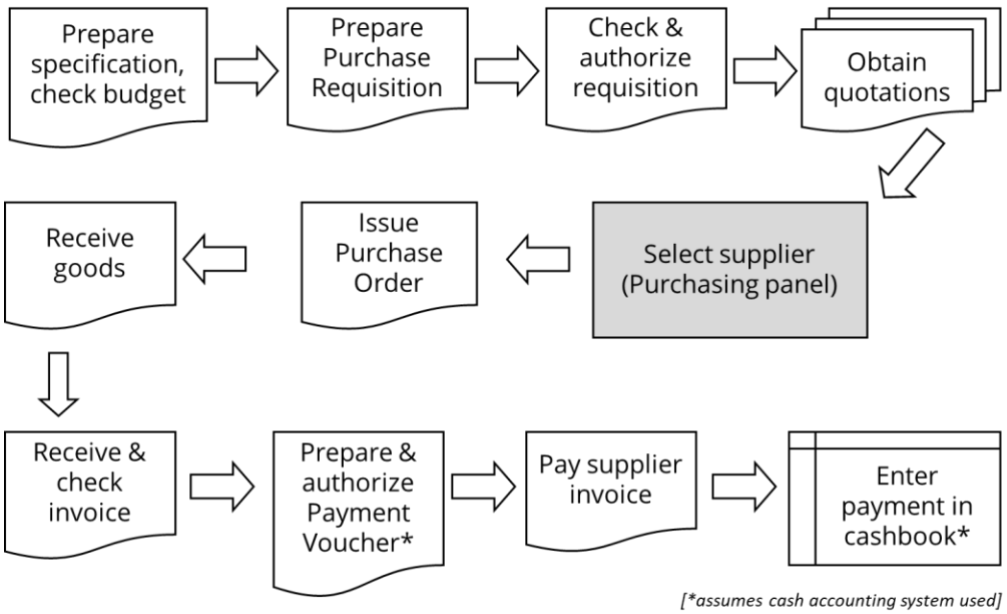


Figure 7: Flow chart of the procurement process

Table 11: Detailed steps in the procurement process

PROCESS	*PEOPLE*	*PAPERWORK*
1. Prepare specification, check budget		
Specify the standard, quantity and price of goods or services required, as described in activity plans. Check how much is available in the budget for the item in case the price has changed since the budget was first prepared.	Budget holder or authorized project staff	Budget Specification note
2. Prepare purchase requisition		
Prepare formal request to purchase the goods or services specified in Step 1, including a detailed description and why it is required.	Budget holder or Authorized project staff	Purchase Requisition form

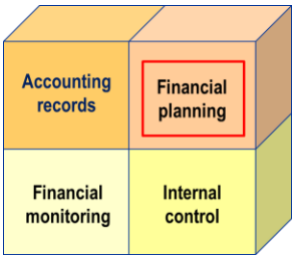
PROCESS	PEOPLE	PAPERWORK
3. Check and authorize purchase requisition		
To verify that there is a genuine reason for the purchase (and budget available for high value items)	Budget holder or Other authorized person	Purchase Requisition form
4. Obtain quotations		
In line with internal procedures and funder rules, request price quotations from reputable independent suppliers to ensure best value for money and minimize the risk of collusion.	Logistician or Other authorized person	Supplier quotations / terms of business
5. Select supplier		
Review quotations and select supplier based on price, quality, delivery times, and 'after sales' terms to ensure value for money. For high value contracts a Purchasing Panel (a small group of managers) will select the supplier.	Budget holder or Other authorized person or Purchasing panel	Supplier quotations/ terms of business Supplier assessment form
6. Issue Purchase Order (PO)		
Send authorized PO to selected supplier and file a copy with the supplier's quotation. This is a legally binding contract.	Budget holder or Other authorized person	Purchase Order Selected supplier quotation
7. Receive goods from supplier		
On delivery, sign Goods Received Note to confirm receipt. Check details and file with PO.	Authorized project staff or Logistician or Other authorized person	Goods Received Note (GRN) Purchase Order
8. Receive and check invoice		
Check the invoice and payment terms, and match up with associated paperwork	Finance staff*	Supplier invoice Supplier quotation PO / GRN
9. Prepare and authorize payment authority		
a) Prepare Payment Authority form and attach all supporting documents and original invoice. *b) Check details, add cost center and account codes, then authorize payment.*	a) Finance staff* b) Budget holder or / and other authorized person (or as specified in delegated authority rules)	Payment Authority form All supporting documents

PROCESS	PEOPLE	PAPERWORK
10. Pay supplier invoice		
Pay supplier as specified by the payment terms, usually within 30 days. Stamp invoice as 'paid' and note payment date and details on Payment Authority form.	Finance staff*	Payment Authority form All supporting documents
11. Enter payment into cashbook		
The final stage is to record the payment in the organization's books of account.	Finance staff*	

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

4. Financial Planning

The second of the four building blocks, financial planning, lies at the heart of effective financial management as it helps organizations to achieve both their longer-term strategic goals and shorter-term project objectives.



By the end of this chapter, you will be able to:

describe how the financial planning process works in programs.

describe different budget formats.

describe the three main types of budgets.

explain how to create an activity-based budget using a budget worksheet.

explain why it is important to budget for central support costs.

describe the '3 Ps of procurement': process, people, paperwork.

4.1 Financial planning in programs

Financial planning lies at the heart of effective financial management and is essential for achieving successful program outcomes. The starting point is clear program objectives and activity plans.

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

There are two key aspects to financial planning for successful programs:

- **Strategic planning:** A long-term view to ensure the financial continuity and security of all operations. Its goal is to achieve an organization's mission and objectives now and in the future. This is a key concern of senior managers and board (trustees), and is captured in a financing strategy and associated policies.

- **Operational planning:** A short-term view aimed at effective program implementation. This includes preparing program budgets and forecasts (based on specific and measurable activity plans), and is the focus for this chapter.

Using budgets in programs

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

A budget is important at every stage of the project financial management cycle.

- **Planning**: Budgets are used to build an accurate picture of what an organization or a new project will cost to run and to help raise funds.
- **Organizing**: When spending money and recording it in the accounts, we use the budgets and the associated codes to organize the costs in our books of account.
- **Monitoring**: Budgets help us to assess the performance compared to the plan. It helps to answer the question, "Has the project achieved what it set out to achieve?"
- **Controlling**: When used for evaluation and learning, budgets help us monitor the use of financial and other resources, ensuring that they are used efficiently and effectively.

Who is involved in the budgeting process?

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

Table 12: The budgeting process: Who does what?

Role	Activity	Notes
Board	Discuss and approve the annual budget (for all programs and operations).	The budget represents a key policy document for an organization and sets limits to authority. Therefore, it must be approved by the board, which is ultimately accountable for the organization's financial affairs.

Role	Activity	Notes
Chief executive (CEO)	Oversee the annual budgeting process.	The CEO may choose to delegate coordination of the budgeting process, e.g. to the finance manager, but it is the CEO's job to make sure it happens and on time.
Senior managers	Set budget guidelines and assumptions, e.g. timetable, inflation rate, salary scales.	They need to give clear direction and advice as needed to those who are developing budgets to ensure consistency and timely completion.
Program team	Produce detailed budgets for their activities/projects.	The program team is in the best position to produce accurate and complete budgets for the activities they work on.
Finance team	Support the budgeting process, e.g. provide data on previous activities, advise on pricing, summarize and consolidate budgets.	The finance team provides important technical support and information for the budgeting process but it is not their job to write project budgets.

In addition, external stakeholders also rely on the budget to understand the work of the organization or project.

- **Funders** require budgets to see how an organization intends to spend its grants and to monitor progress of funded programs.
- **Community partners** use budgets to see how organizations plan to spend money on community projects.

As far as possible, team members who have responsibility for using project budgets should be involved in writing them. This so-called "bottom-up" approach is more likely to produce accurate and well-managed budgets, because not only do program staff know what their projects need, they will feel greater ownership of budgets that they have been involved in creating.

Preparing budgets: two approaches

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

Table 13: Incremental vs. zero-based budgeting approaches

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

As this table shows, the zero-based approach is most suitable for project budgets, especially in the activity-based budget format. This is covered in detail later in this chapter.

Supply-or demand-led budgeting?

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

Supply-led budgeting often results in inaccurate budgets. Critical costs can be both under- and overestimated to make a project fit a specific pot of money. This practice can lead to problems during the project implementation phase and could have a negative impact on funder relationships.

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

4.2 Different forms and types of budgets

As there are a wide range of users and uses for budgets, it is not surprising that they come in many different formats, with different information tailored to users' needs. There is no such thing as a "one-size-fits-all" budget.

The table below highlights some the main differences in content and layout that you are likely to encounter in program budgets.

Table 14: Different content and layout of budget

Activity level	Budgets can be prepared for one activity area, a project (several activity areas), a program (several projects), or the whole organization. (See Figure 8.)
Budget detail	Some users require very detailed budgets (to show how each line is calculated), such as a budget that accompanies a funding proposal. Other users, such as board members or senior managers, prefer to see a summarized version of the budget.
Layout	Most organizations use a standard format to present internal budgets, which will be consistent with the codes and budget descriptions in their chart of accounts (see Chapter 3). Funders usually have their own budget template, using different account codes and budget descriptions, which must be used when applying for funds.
Time frame	A budget always covers a specific time period related to each activity. Budgets typically cover one financial year but they can be prepared for, or broken down into, any period of time: one day, one week, one month, one quarter, or multiple years, depending on the activity or project the budget is for. Budgets used for project monitoring are usually broken down into monthly or quarterly phases.
Currency	Budgets can be prepared in any currency, depending on the requirements of the project, funder, or Head Office. They may include more than one currency – such as the organization's home currency and the funder's operating currency.

Budget hierarchy

The diagram below shows a budget hierarchy for a small organization. The lower level project budgets are summarized (known as consolidation) into the program budget, and program budgets are in turn consolidated into a master, organization-wide budget.

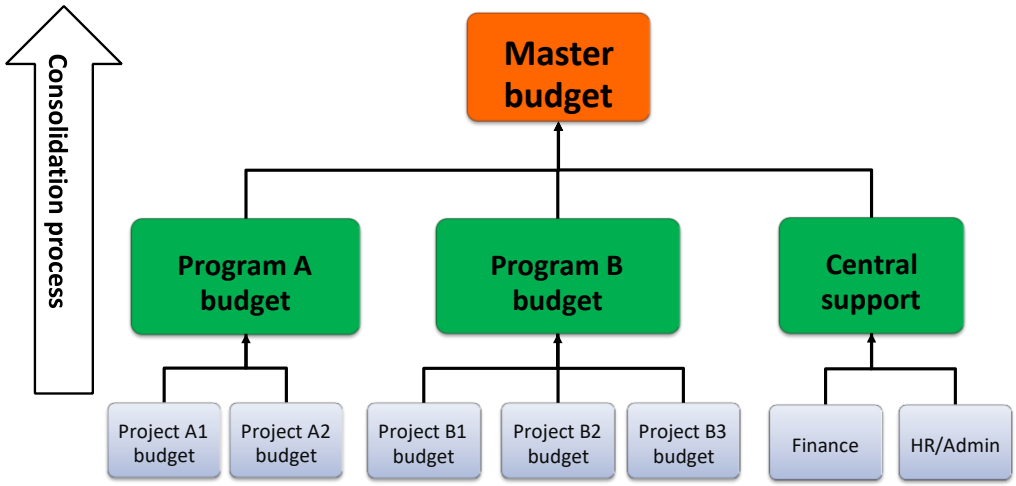


Figure 8: Budget hierarchy

In addition to the range of different budget formats, there are three main types of budget.

- The income and expenditure budget
- The capital budget
- The cash flow forecast (or cash budget).

Income and expenditure budget

This is the budget that you will be most familiar with as it is widely used in project management. Table 15 summarizes its main features.

Table 15: Income and expenditure budget details

What is it?	A budget that shows the estimated costs of running an activity, project, or entire organization, and where the funds will come from to cover the costs for a specified period of time.
What is its purpose?	To summarize income and expenditure information and show the overall position or status of the budget (surplus, deficit, or balanced), which aids project fundraising and monitoring.

How is it compiled?	An income and expenditure budget can be created using either of the two main approaches for budgeting, incremental or zerobased budgeting, but for projects, zero-based is recommended.
Why is it important for	Income and expenditure budgets are important for fundraising at the planning stage of the project life cycle so that sufficient
project planning?	funds can be secured to fulfill its objectives. During implementation, budgets are broken down into shorter time periods (phases), e.g. by month or quarter-year, so that income targets and limits on spending are clear. At the review stage, the phased budget is used to monitor project performance to date.

The 'bottom line'

An income and expenditure budget will present with one of three possible outcomes or statuses:

- **Balanced budget** - where income equals expenditure
- **Deficit budget** - where income is less than expenditure
- **Surplus budget** - where income is more than expenditure.

This is often referred to as the 'bottom line' status of the budget, pointing to the outcome figure which usually appears at the bottom of a budget – i.e. the difference between income and expenditure plans.

Expenses-only budgets

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

Table 16 below, gives a simple illustration of an income and expenditure budget for the Milestone Technical Training Institute (MTTI). Some things to look for:

- The budget is for a 12-month period for the whole organization.
- The account codes and descriptions are identical to those used in MTTI's Chart of Accounts (Table 4). This makes it easy to compare the budget to actual performance when the program is up and running.
- The bottom line shows that this is a surplus budget as there is a small excess of planned income over planned expenditure.
- This budget is in a (relatively) detailed format. It could also be summarized so that it just shows the costs sub-totaled by family group: Funder and General Income, and Admin, Personnel, Vehicle running, etc.

Table 16: MTTI's annual income & expenditure budget

Milestone Technical Training Institute

Annual Income & Expenditure budget

1 January to 31 December <year>

Acct code	Budget description		Total USD
	INCOME		
4010	Funder	DFID	90,000
4020		Smile Trust	90,000
4030		Vanguard Society	15,000
4110	General	Bank Interest	960
4120		Donations & fundraising	8,000
4130		Sales	24,800
4140		Training Fees	42,500
		TOTAL INCOME	**271,260**
	EXPENDITURE		
5010	Admin	Audit & accountancy	4,500
5020		Bank charges	600
5030		Board meetings	1,200
5040		Stationery	7,500
5050		Publicity	1,500
5060		Office rent & utilities	9,000
5070		Repairs & renewals	1,500
5080		Communications	6,300
6010	Personnel	Staff training	4,500
6020		Recruitment	250
6030		Salaries & benefits	83,500
6040		Travel & subsistence	5,522
7010	Vehicle Running	Fuel	4,690
7020		Vehicle Insurance/tax	7,670
7030		Vehicle maintenance	18,240
7510	Project inputs	Consultants fees	8,100
7520		Food & accommodation	8,980
7530		Training materials	92,200
		TOTAL EXPENDITURE	**265,752**
		SURPLUS/(DEFICIT)	5,508

Capital budget

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

- Construction of buildings and infrastructure
- Major renovation works
- Vehicles
- Office furniture and equipment
- Computer equipment
- Medical equipment
- Water and sanitation equipment.

Table 17: Capital budget details

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

Note: Often in our sector, projects need just a few items of equipment. Consequently, in these situations it is not necessary to create a separate capital budget. Instead, these items should be included in a separate section at the end of the income and expenditure budget. However, when projects include significant procurement of equipment, or an organization plans to invest

in replacement of its assets, the option exists to develop a separate capital budget for that purpose.

The cash flow forecast

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

Table 18: Cash flow forecast details

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

An example cash flow forecast is illustrated in Table 19. These are things to look out for in the table:

- It covers the same 12-month period as the income and expenditure budget.
- All anticipated cash income is recorded by the date when it is due to be received at the bank (or cash account where there are no banks). Funder contracts usually include a schedule of installments. Other income streams may necessitate making a best guess.
- All anticipated cash payments recorded by the date when it is due to leave the bank (or cash account). Some payments are regular, such as salaries, while others are irregular (e.g. training costs), reflecting the influence of activity plans.

- The table includes an estimate of cash available in the bank at the start of the year (see Row D for January). The total cash available at the end of the month (Row E) automatically becomes the cash available at the start of the next month (Row D).
- This cash flow forecast predicts a shortfall of cash for six months of the year, including February and March. We know because of the negative figures (in brackets) on the bottom line. Can you identify which other months have cash problems?
- Month 12 shows that there is sufficient funding overall to run the project for the year but money is not getting to the bank when needed to fulfill the project plans.

Table 19: MTTI cash flow forecast

MTTI Summary Cash Flow Forecast

1 January to 31 December <Year>

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Cash received												
DFID grant	18,000	0	0	24,000	0	0	24,000	0	0	24,000	0	0
Smile Trust grant	0	0	22,500	0	0	22,500	0	0	22,500	0	0	22,500
Vanguard Society grant	0	0	7,500	0	0	0	7,500	0	0	0	0	0
Bank interest	80	80	80	80	80	80	80	80	80	80	80	80
Donations	0	0	2,000	0	0	2,000	0	0	2,000	0	0	2,000
Sales income	2,000	2,000	2,000	2,000	2,000	2,000	1,500	1,800	2,000	2,000	2,500	3,000
Training fees	3,500	7,000	0	7,000	3,500	0	0	7,000	3,500	0	7,500	3,500
A. Total cash received	**23,580**	**9,080**	**34,080**	**33,080**	**5,580**	**26,580**	**33,080**	**8,880**	**30,080**	**26,080**	**10,080**	**31,080**
Cash paid out												
Administration	2,000	2,000	5,000	2,000	2,000	7,100	2,000	2,000	2,000	2,000	2,000	2,000
Personnel	7,480	8,072	8,722	7,222	7,222	8,722	7,222	7,222	8,722	7,222	7,222	8,722
Vehicle running	9,590	1,910	1,910	1,910	1,910	1,910	1,910	1,910	1,910	1,910	1,910	1,910
Project inputs	12,520	12,520	6,000	12,520	9,160	6,000	12,520	1,000	6,000	12,520	12,520	6,000
B. Total cash paid	**31,590**	**24,502**	**21,632**	**23,652**	**20,292**	**23,732**	**23,652**	**12,132**	**18,632**	**23,652**	**23,652**	**18,632**
C. Net cash flow [A - B]	(8,010)	(15,422)	12,448	9,428	(14,712)	2,848	9,428	(3,252)	11,448	2,428	(13,572)	12,448
D. Cash available at start of month	8,095	85	(15,337)	(2,889)	6,539	(8,173)	(5,325)	4,103	851	12,299	14,727	1,155
E. Cash available at month-end [C + D]	**85**	**(15,337)**	**(2,889)**	**6,539**	**(8,173)**	**(5,325)**	**4,103**	**851**	**12,299**	**14,727**	**1,155**	**13,603**

Managing cash flow

In situations where the cash flow forecast predicts periods of cash shortages, the project and finance teams need to work together to find a solution, such as:

- negotiating with funders to receive grants early or phased to match the activity plan,
- negotiating with suppliers to delay payment of invoices,
- rescheduling some activities, and/or
- negotiating a temporary loan facility with the bank.

However, there could be negative consequences from some of these actions:

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

Tips for preparing a cash flow forecast for a project

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

4.3 Activity-based budgeting

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

The resources, quantities, and calculations are captured in a detailed table called a budget worksheet (see Chapter 4.4), usually stored as a computer spreadsheet. The budget worksheet is then used to summarize the project budget for use in whatever format is needed, i.e. for internal use or for budgets required by funders.

Useful documentation and information

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

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

The 8 Stages of activity based-budgeting

Figure 9: Eight steps in creating an activity-based budget

Table 20: The eight steps involved in creating an activity-based budget

STEP	What it involves
1. Identify the project objective(s)	Project objectives are set out in the project design documents. It is usual to create one activity-based budget for each objective but sometimes a budget needs to cover more than one objective.
2. List the activities	The project activities (for each separate objective) will also be found in the project design documents and should have clear and quantifiable indicators.
3. Identify and quantify resources	This is probably the most important step in creating your activitybased budget. Each project activity will need to be unpacked, with all the tasks and deliverables listed so that you can identify the resources needed to run it. The project design documents will help with this, but it is a good idea to imagine yourself running each of the various activities to understand what resources will be needed. Be aware of any hidden project resources such as shared vehicles or project staff. A part of any shared resource should be allocated to the project based on an estimate of usage. For example, for a shared vehicle include an estimate of kilometers needed for a project; or for a shared program manager, an estimate of time spent supporting the project. It is helpful to list all the resources and quantities needed for each activity in a separate document or page of the spreadsheet. We call this the activity or project breakdown sheet (see Table 21 below). Note the date or month when the resources will be used, as this information is needed to create phased budgets and forecasts.
4. Research the cost of resources	Using your project breakdown sheet, find out how much each resource will cost at the time when the project will be implement- ed. Wherever possible, get a unit price or base cost for one item. Your finance team may provide a price list for items that are regularly purchased or where there are set amounts for budgets, such as staff allowances or consultancy fees. Don't be tempted to guess the price! Although budgets are a best estimate of costs, they must be based on reliable evidence, not on invented amounts. If you get your unit prices wrong, you will over- or underestimate the costs, jeopardizing the integrity of your budget.
5. Identify known income	Make a list of any known income sources that will be used to support the project. For example, anticipated contributions to costs from services users and communities. Do not include income that is yet to be negotiated.

STEP	What it involves
6. Compile the budget worksheet	You are now ready to complete the budget worksheet. Each activity will be described in a separate section including its required resources, quantities, and unit costs. Each budget line item is assigned a budget code from the chart of accounts and, where relevant, a funder budget code.
7. Review the results	Review the final draft budget to check it is realistic and complete. If possible, get someone else (a budget buddy) to check it. Questions to ask include: • Are the quantities and unit costs reasonable? • Are the costs justified and supported by clear budget notes? • Have any important resources been left out? • Are the calculations correct? Do the totals add up?
8. Summarize the budget	When the budget worksheet is ready, you will summarize the data in whatever format you need for internal or external use, such as in a phased or summary budget format for project implementation, or a budget format used by the funder for fundraising.

The Project Breakdown Sheet

The example project breakdown sheet (Table 21) illustrates the important step in unpacking the project objective into activities and tasks. When completed, the project breakdown sheet contains all the information needed to begin building out the activity-based budget, using a budget worksheet (see section 4.4).

The Milestone Technical Training Institute runs a project that aims to equip young people with metalwork skills to improve employment opportunities. It has identified two activities so far:

A Recruit and train one metalwork skills trainer and

B Deliver four metalwork skills workshops in regional locations, accommodating 18 trainees in each session.

The example project breakdown sheet shows the detailed breakdown for Activity A, which contains three tasks (advertising the new post, appointing the trainer, and organizing their induction).

As well as defining the resources and quantities needed for each activity (in the third column, the table also includes the month when they will be needed (timeframe). This information is then used for cash flow forecasting and creating a phased budget.

Table 21: MTTI project breakdown sheet, partially completed version

Project breakdown sheet

Project title: MTTI Metalwork Dept. - Rural skills training project

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

4.4 Using a budget worksheet in activity-based budgeting

A budget worksheet is a table with preset headings and rows or lines for each item in the budget. It is usually set up in a computer spreadsheet (such as Excel) with formulas to automatically calculate each line and column total. Each project activity area has its own section in the worksheet, with a list of all the resources needed and in what quantities, to calculate the cost of each item needed. This makes it possible to see how much each activity area would cost to deliver.

The table below is an extract from a budget worksheet for MTTI's Rural Skills Training Project. Familiarize yourself with the layout and contents of the budget worksheet (Table 22), and then refer to the table below the worksheet for an explanation of each column and how it works.

Table 22: MTTI budget worksheet (partially completed)

BUDGET WORKSHEET: Metalwork Skills Rural Training Project

Project period: 1 January to 31 December <year>

Currency: USD

Line ref.	Description	Unit type	No. Units	No. times	Unit cost	Total	Notes	A/c code
A	**Recruit and train one metalwork skills trainer**					**29,313**		
A1	Job advertisement in newspaper	Entry	1	2	250	250	1 advert entry for 2 weeks	6020
A2	Metalwork trainer salary	Month	12	1	1,775	21,300	1 x full-time post	6030
A3	Employer's taxes	Month	12	1	213	2,556	Approx. 12% of salary	6030
A4	Medical insurance	Year	1	1	4,260	4,260	20% of gross salary	6030
A5	Technical training course fee	Person	1	1	850	850	5 days, includes food/lodging	6010
A6	Per diem allowance	Day	5	1	15	75	Other expenses during training	6040
A7	Travel to/ from training center	Trip	2	1	11	22	Taxi needed to carry materials	6040
B	**Deliver 4 metalwork skills workshops (5 days duration) in regional locations, for 18 trainees each**					**47,140**		
B1	Fuel for mobile training vehicle	Km	500	4	0.50	1,000	Estimate per previous experience	7010
B2	Insurance for vehicle	Lumpsum	1	1	3,580	3,580	50% shared with Building Dept	7020
B3	Vehicle maintenance / repairs	Quarter	4	1	1,800	7,200	50% shared with Building Dept	7030
B4	Publicity on community radio	Slot	5	6	40	1,200	5 slots per week for 6 weeks	5050
B5	Guest tutor's fees	Day	5	4	180	3,600	One tutor per day, per workshop	7510
B6	Lunch and refreshments	Person	20	4	12	960	18 trainees +2 trainers/ workshop	7520
B7	Workshop supplies/raw materials	Lumpsum	1	4	3,000	12,000	As per supplier quotation	7530
B8	Protective clothing	Person	20	4	130	10,400	18 trainees + 2 spares contingency	7530
B9	Tools set for trainees	Set	18	4	100	7,200	As per supplier quotation	7530
C	**Provide one-to-one post-training support to 40 trainees**					**10,750**		

Column heading	Explanation
Line reference	The line (or row) reference is used to refer to items in the budget. It is not a budget code. It is usual to show each activity in a separate section and to number the sections in a logical way. In our example budget, the two activities shown are denoted by a letter (A, B) and then the resources within each activity are numbered sequentially, e.g. A1, A2, A3, and so on. You can use any numbering system as long as it is logical, consistent, and clear.
Description	This column provides a short description of each activity included in the budget and the resources needed to complete each activity. The description for the resource item should be specific and concise. The resources identified in step 3 of the activity-based budgeting process are listed in the project breakdown sheet (Table 21). It is important to break down resources to the core detail in the budget worksheet as this makes it easier to accurately estimate costs. For example, the staffing costs in the example budget are broken down into salary, employer's taxes, and medical expenses.

Column heading	Explanation
Unit type	This is the basis for calculating the cost of the items listed in the budget. As a general guide, when choosing a unit type it helps to think about how a supplier or vendor would charge you for the item or how often you would pay for the item. For example, a taxi driver could charge for each trip or by the distance travelled, so the unit type would be trip or miles/kilometers. Similarly, if staff are paid on a monthly or weekly basis, the unit type for staff salaries would be month or week. In the example budget, unit types vary according to the item being budgeted for. In line A1, the job advertisement is charged by the advert entry, while in B6, lunch & refreshments are charged per person. See below for more details on the use of lump sum and compound unit types.
Unit type	This is the basis for calculating the cost of the items listed in the budget. As a general guide, when choosing a unit type it helps to think about how a supplier or vendor would charge you for the item or how often you would pay for the item. For example, a taxi driver could charge for each trip or by the distance travelled, so the unit type would be trip or miles/kilometers. Similarly, if staff are paid on a monthly or weekly basis, the unit type for staff salaries would be month or week. In the example budget, unit types vary according to the item being budgeted for. In line A1, the job advertisement is charged by the advert entry, while in B6, lunch & refreshments are charged per person. See below for more details on the use of lump sum and compound unit types.
No. units	This is the first of two columns focusing on quantity and it refers directly to the unit type, i.e. how many of the items described in the unit type column are needed for an activity. So, in our example, in line B9, the unit type is “Set” so we have entered the number of sets we need. The number of units (sets) is 18, one for each trainee. (The unit type could also have been trainee but is more correct as set because that is how the supplier has provided the quotation.)
No. times (or frequency)	The second of the two columns focusing on quantity records the number of times the described resource will need to be used. It is also sometimes called the frequency column. It picks up how frequently you plan to run the activity that it relates to. So, in the example for line B9, the plan is to run the workshops four times, therefore, we need to buy the 18 sets of tools on four occasions.
Unit cost	This is the price of one unit of the unit type. It is important to enter a cost that is as accurate as possible, including an amount for inflation, rather than a random guess.

Column heading	Explanation
	If you get this wrong, it will distort your budget. In our example budget, in line B9 we can see that the cost of a set of tools is $100. This rate has been based on a supplier quotation.
Total	The total for each budget line is calculated by multiplying the two quantity columns and the unit price column: No. units x No. times x Unit cost = Total All the costs for an activity can then be added together for a subtotal. For example, row B shows that the workshop activity will cost $47,140.
Notes	The notes column is useful for adding extra detail to help the reader understand the budget, e.g. explaining how quantities have been used or calculated, such as in rows B2/B3 that explains that these costs are shared with another project. The notes column can also be used to include the assumptions that underpin the estimates for a line item.
Account code	There will be at least one, often more, account codes column. These codes are used to summarize the budget for different budget templates, e.g. internal summary budgets or funder budget templates. Our example above uses MTTI's internal chart of accounts codes.

More on unit types

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

Lump sum: Lump sum is a special unit type used to include a one-off amount or general estimate, often for multiple items or services, that are detailed in a supplier quotation or a separate schedule. In the example budget, we have used a lump sum in line B7 for the workshop supplies as it covers a range of different materials. It is important to be able to justify lump sum amounts, if asked. You should also be sure to consult your funder regulations to ensure that lump sum unit types are permitted as some funders ask that this unit type not be used.

Compound unit types: If you are writing a budget for a large project with multiple activities, you may need to use a more sophisticated unit type that combines two different units. These are known as compound unit types.

Here are some examples of how they are used.

- Three consultants are engaged to run a 5-day training event, 10 times. Compound unit type: consultant/day. No. units: 15 (i.e. 3 consultants x 5 days), No. times: 10, Unit cost: 1 day of consultant time.

- 1,000 sanitation packs are distributed for 6 months to 60 villages. Compound unit type: pack/month. No. units: 6,000 (i.e. 1,000 packs x 6 months), No. times: 60, Unit cost: 1 pack.

It is helpful to use the Notes column to add extra detail to clarify how the figure in the No. units column is calculated. The table below illustrates how compound unit types are used and the related quantities are entered in a budget worksheet (costs are not included in the example).

Table 23: Calculating compound unit types

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

Budgeting for in-kind donations

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

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

Budgeting for contingencies

Sometimes we need to include an extra amount in a budget for so-called contingencies. These are generally used for unforeseen expenses or for items that we think we might need, so it is sensible to add an amount just in case. However, before including contingencies in a budget, check funder regulations allow contingencies in their budgeting guidelines.

An example of this is included in the example budget worksheet above (Table 22). See line B8 where an extra two items of protective clothing have been included.

Tips for including contingencies in your budgets

GOOD PRACTICE

Include a specific (and explained) contingency line for the specific budget lines that need a just-in-case cushion. The actual amount you estimate for the contingency must have a logical basis in the calculation, so that you can justify its inclusion in the budget.

For example, based on your experience of staff turnover, you may decide to include a line for staff recruitment, even though you have no vacancies at the moment.

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

BAD PRACTICE

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

Which currency to use?

The currency that you choose to use for budgeting depends on several factors, in particular where your main sources of income come from and the stability of your home economy.

Here are three possible scenarios to consider (in reality the situation is often more complex):

SCENARIO:		ADVICE:
A	Most of your income comes from external funders, and you operate in a country that experiences rapid inflation and/or erosion of the value of local currency due to exchange rate fluctuations.	Prepare budgets in a 'hard' international currency, such as US dollars, and get the funds paid into a US dollar bank account. This gives you some protection against the impact of inflation and exchange rate losses.
B	Most of your income comes from one or two funders who pay grants in their home currency.	Use the funder currency when creating program budgets for specific donors at the proposal stage, then convert budgets back to your home currency* for internal budget monitoring purposes. This allows you to consolidate the donor-funded budgets with other internal budgets, and to isolate variances caused by exchange rate fluctuations rather than other programmatic causes.

SCENARIO:	ADVICE:
C C. Most of your income comes from sources inside your country of operation	Prepare all budgets in your home currency (building in an allowance for inflation) and include a contingency for exchange rate fluctuations on high value imported goods and services.

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

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

Price inflation

When we write a budget for a project that is going to start in a few months' or a year's time, it is important to include a unit price that includes an allowance for price inflation. If you do not do this, you will not have enough money in your budget to cover the actual costs when the project is implemented.

For example, you are preparing a budget for a conference next year. The cost of accommodation at the conference venue is currently $100 per person. The annual inflation rate is 20%. You must therefore include $120 per person for accommodation in the budget for the conference to cover the likely price increase due to inflation. If you included today's price of $100 per person, you would be short by $20 for each person attending the conference and would not have enough money in your budget for the activity.

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

Budget assumptions

As well as the line-by-line notes on the budget worksheet, it is a good idea to also keep a separate note of key budget assumptions, such as the inflation rate, salary and benefits rates, and standard unit costs.

4.5 Budgeting for indirect project costs

When budgeting for projects, we need to consider both direct and indirect project costs. It is important to include a contribution towards indirect costs in project budgets because:

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

Direct costs: These are incurred as a direct result of delivering a project or activity, for example, the salary for a project officer, materials for a training workshop, or tools and equipment.

Indirect costs: The general, shared costs that support and administer an organization's projects, for instance: the chief executive, office rent, and accountancy costs. These usually form what are commonly called central support costs (or core or overhead costs

Every organization must prepare a budget for their central support costs as part of the annual budgeting process so that it is clear what it costs to support its operations. It is usual to then charge projects that benefit from the support that is provided in a fair, consistent, and justifiable way.

There are a number of different ways to share out (or 'apportion') a project's indirect costs. For example, you might use a ratio based on:

- staff hours (full-time equivalent or FTEs),
- the relative size of project budgets, or
- the estimated use of the relevant resource (for example, space used when apportioning rent, the number of transactions for apportioning finance support).

When setting your budgets, your finance team will provide guidance as to what to include in your budget for indirect costs. Some organizations and funders add a bottom line percentage, for example, 7% of the total cost of direct project costs.

It is usual to create a table to show the apportionment of indirect costs between different project cost centers. This data is then incorporated into the organization's consolidated budget, which we look at next.

4.6 Budgeting for income: restricted and unrestricted funding

Income that organizations use to cover the costs of their planned projects and activities may come from various sources, including external funding agencies, service-user fees, donations to the organization, government agencies, membership fees, sales and other funds self-generated by the organization, corporate sponsorship, etc.

The income that development, humanitarian, and conservation organizations receive falls into two categories from an accounting and legal perspective.

Restricted funds come with conditions about what the funds may or may not be used for. Typically, grants from funding agencies are restricted and can be highly restricted (for example, they may only be used to buy training materials for a specific activity, such as MTTI's Metalwork Skills Rural Training Project) to lightly restricted (for example, can be used for any educationrelated activity). Restricted funds can also be defined as permanently restricted or temporarily restricted in some countries.

Examples of restricted funding include:

- Grants from funding agencies
- Donations from the general public for a specific project, location, or theme
- Donations in-kind (gifts in-kind)
- Sponsorship income for a specific project, individual, or village
- Bank interest on grant income from a funder that specifies the funds must be used for the same project.

Unrestricted funds are exactly what they sound like: funds that come to the organization without a restriction on what they are used for, providing they are used to fulfill the organization's mission. This 'free' money (free in the sense that it is not tied down) brings greater autonomy, flexibility, and security for an organization and is therefore critical to financial sustainability.

Examples of unrestricted funding include:

- General donations to the organization from general fundraising appeals to fulfill its mission
- Membership fees
- Sales of publications
- Rental income received
- Bank interest on the organization's main or general bank accounts
- User fees for a service provided by the organization*.

*In practice, the fees will be applied to cover the costs of the service but surplus fees can be used for any purpose that is within the organization's mission.

When planning for the income that will be incorporated into your budget, it is important to understand and define whether this income is restricted or unrestricted as this will affect how flexible it is.

4.7 Summarizing and consolidating project budgets

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

> *Remember that different users need different levels of detail. This is why we need summary budgets. The budget worksheet is great for the project implementation team, but senior managers and board members prefer a more summarized view.*

The summarizing process

The accounts codes column in the budget worksheet makes it very easy to summarize the budget data into any budget template required. Each line item in the worksheet is allocated a code. For internal format budgets, the code comes from the organization's chart of accounts, for budgets for funding agencies, the code will be as advised by the funder.

The process of adding codes to a budget worksheet is called 'mapping.' As the resources in the budget worksheet are broken down into great detail, it is possible to map the costs to any coding structure, which is what makes the budget worksheet such a flexible and useful budgeting tool.

Here is the summary budget format for the for the Rural Skills Training Project covered by the example budget worksheet, using MTTI's internal chart of accounts codes. It includes direct costs only at this stage.

Table 24: MTTI summary budget

MTTI Metalwork Skills Rural Training Project **Summary Budget** 1 January to 31 December <year>			
Account code	**Budget description**		**Total USD**
5050	**Admin**	Publicity	1,200
6010	**Personnel**	Staff training	850
6020		Recruitment	250
6030		Salaries & benefits	28,116
6040		Travel & subsistence	3,847
7010	**Vehicle Running**	Fuel	2,000
7020		Vehicle Insurance/tax	3,580
7030		Vehicle maintenance	7,200
7510	**Project inputs**	Consultants fees	3,600
7520		Food & accommodation	960
7530		Training materials	35,600
	TOTAL		**87,203**

The consolidated budget

When an organization runs multiple projects and departments, managers need a way to easily combine, or consolidate, multiple, budgets into one table in order to give a useful overview at the program or organization levels.

For example, Table 25 provides the consolidated budget for the Milestone Technical Training Institute. The consolidated budget combines the budgets of the two MTTI departments (Building Department and Metalworks Department) and includes the Central Support cost budgets that supports both departments and includes the organization's indirect costs.

Some things to note about this budget:

- This budget is in the income and expenditure format and includes anticipated income.
- The projects' budgets have first been consolidated into their respective departmental budgets, so the summary budget (Table 24) for the Rural Skills Training Project has been combined with another project in the Metalwork Department.
- The budget includes the apportionment of central support costs so we can see the impact of the charge on the overall project budgets. The organization's policy is that 90% of the central support budget is shared between the two departments, the other 10% being covered by unrestricted fundraising income.
- There is an overall small surplus of $5,508, although the Metalwork Department is predicting a small deficit at this point in the planning process.

Table 25: Program-level consolidated budget

Milestone Technical Training Institute (MTTI) Consolidated Income & Expenditure budget 1 January to 31 December <year>						
A/c. code	**Budget description**		**Central Support**	**Building Dept.**	**Metalwork Dept.**	**Total USD**
	INCOME					
4010	Funder	DFID		50,000	40,000	90,000
4020		Smile Trust		50,000	40,000	90,000
4030		Vanguard Society		15,000		15,000
4110	General	Bank Interest	960			960
4120		Donations & fundraising	8,000			8,000
4130		Sales		16,300	8,500	24,800
4140		Training Fees		25,000	17,500	42,500
TOTAL INCOME			**8,960**	**156,300**	**106,000**	**271,260**
	EXPENDITURE					
5010	Admin	Audit & accountancy	4,500			4,500
5020		Bank charges	600			600
5030		Board meetings	1,200			1,200
5040		Stationery	7,500			7,500
5050		Publicity		300	1,200	1,500
5060		Office rent & utilities	9,000			9,000
5070		Repairs & renewals	1,500			1,500
5080		Communications	6,300			6,300
6010	Personnel	Staff training	700	2,950	850	4,500
6020		Recruitment			250	250
6030		Salaries & benefits	19,875	35,509	28,116	83,500
6040		Travel & subsistence	425	1,250	3,847	5,522
7010	Vehicle Running	Fuel	350	2,340	2,000	4,690
7020		Vehicle Insurance/tax	510	3,580	3,580	7,670
7030		Vehicle maintenance	3,840	7,200	7,200	18,240
7510	Project inputs	Consultants fees		4,500	3,600	8,100
7520		Food & accommodation		8,020	960	8,980
7530		Training materials		56,600	35,600	92,200
		TOTAL EXPENDITURE	**56,300**	**122,249**	**87,203**	**265,752**
9000	Central support	*Central support apportionment % **	*10%*	*54%*	*36%*	*100%*
		Central support re-charge	(50,670)	30,402	20,268	-
		TOTAL AFTER APPORTIONMENT	**5,630**	**152,651**	**107,471**	**265,752**
		OVERALL SURPLUS/(DEFICIT)	3,330	3,649	(1,471)	5,508

* 10% of Central Support costs is covered by unrestricted income; the other 90% is apportioned by relative size of project income

4.8 Creating budgets for funding agencies

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

- Find out what format the funder requires you to submit your budget in. Sometimes they will accept your own internal format, and sometimes they have their own template.
- If they have their own template and account codes, simply map the expense codes to the budget lines in your budget worksheet, then sum the figures using these codes. Enter the sum in the funder budget template.
- Take care to check what the funder will or will not allow to be included as project expenses.
- Follow the funder's guidelines on what is permitted as a contribution toward indirect costs (sometimes referred to as a management fee). Often, they will specify a percentage amount to add somewhere on the template.
- Funders may also ask you to share any known income or to state match funding.
- Finally, be sure to include important budget notes and assumptions, such as inflation rates and exchange rates used.

The budget narrative

When you apply for a grant, a funder will often require that you include a budget narrative to support the budget in the funding proposal. The budget narrative, also known as a budget justification, has two purposes: to explain to the reviewer of the funding proposal how the costs were estimated, and to justify the reason for costs. Budget narratives are especially useful to explain hidden or confusing costs listed in a proposal budget. If you provide a detailed activitybased budget with the funding proposal, most of the calculations will be self-evident so the budget narrative will be shorter. However, you should always check the funder's guidelines to be clear what their specific requirements are for a budget narrative. Some funders provide budget narrative templates to follow.

The table below provides some common cost areas to justify and key considerations when preparing a budget narrative.

As a final check, it is a good idea to ask a colleague to read your proposal budget and budget narrative together to make sure that all costs are clearly explained and justified.

Table 26: Budget narrative – suggested content

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

4.9 The phased budget

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

- to compare the plan with the actual performance of a project during implementation and to check progress (and take action if it is not on target), and
- to advise a funder about how you expect to utilize their grant during project implementation.

The table below shows the phased budget for the MTTI Rural Skills Training Project expenditure. It is summarized by budget heading into the four quarters of the year. The phased budget in this summary format is ready to be used in an internal budget monitoring report (or a report for a funding agency if in the funder format) once the project gets underway.

Table 27: MTTI phased budget

MTTI - Metalwork Skills Rural Training Project
Phased Budget
1 January to 31 December <year>

Account code	Budget description	Q1 Jan-Mar	Q2 April-June	Q3 July-Sept	Q4 Oct-Dec	Total USD
5050	Publicity	600	-	600	-	1,200
6010	Staff training	850	-	-	-	850
6020	Recruitment	250	-	-	-	250
6030	Salaries & benefits	10,224	5,964	5,964	5,964	28,116
6040	Travel & subsistence	847	1,125	750	1,125	3,847
7010	Fuel	450	550	450	550	2,000
7020	Vehicle Insurance/tax	3,580	-	-	-	3,580
7030	Vehicle maintenance	1,800	1,800	1,800	1,800	7,200
7510	Consultants fees	900	900	900	900	3,600
7520	Food & accommodation	240	240	240	240	960
7530	Training materials	8,600	9,200	8,600	9,200	35,600
	TOTAL	**28,341**	**19,779**	**19,304**	**19,779**	**87,203**

How to create a phased budget

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

To create a phased budget, we need to go back to our project budget worksheet (Table 22) and activity plans (or Gantt charts, where used) to allocate the budget according to the plans. It is a similar process to that of creating a cash flow forecast but this time we are looking at when the budget is needed, not when the cash transactions will take place.

4.10 Using a funding grid

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

- Funders have different budget formats and pay grants in different currencies.
- Budget line items and descriptions vary, so it is not clear exactly what each category includes or excludes, e.g. travel-related costs can be described as transportation, travel, vehicle running, distribution etc.
- It is not always clear which funder is paying for what within a project supported by multiple funding agencies.
- Funders have different policies on financing overheads and it is not always clear if a project's obligation to cover indirect costs is met.
- Within the same project or program, it is possible that some budget lines can be 'double-funded' – that means money for the same item from two or more funders – while others can be under-funded, but this will not always be obvious.

The *funding grid* is an internal planning tool that can help to overcome most of these challenges. It provides an overview of who is funding what at project, program, or organization levels. It is presented in table format (Table 28) and matches each anticipated source of income with budgeted expenditure. This reveals where there are gaps in funding, and also any double funding, by budget line.

How the funding grid works

Table 28 shows a summarized funding grid for MTTI, covering all programs, to demonstrate the principle behind the funding grid. In practice, a funding grid may have many more columns for each source of income and detailed rows with funder codes mapped to the internal chart of accounts.

Table 28 MTTI funding grid, partially completed version

All figures in USD			CONFIRMED / EXPECTED INCOME					
			RESTRICTED FUNDS			UNRESTRICTED FUNDS		
A	B	C	D	E	F	G	H	I
Code	Budget group	Total budget	DFID	Smile Trust	Vanguard Trust	Fees & donations	Total anticipated income	Balance surplus/ (deficit)
5000	Admin	32,100	6,750	6,750	0	18,600	32,100	0
6000	Personnel	93,772	21,750	21,750	6,000	44,272	93,772	0
7000	Vehicle running	30,600	9,500	9,500	1,000	10,600	30,600	0
7500	Project inputs	109,280	52,000	52,000	7,000	0	111,000	1,720
TOTAL		**265,752**	**90,000**	**90,000**	**14,000**	**73,472**	**267,472**	**1,720**

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

What do the figures mean?

In the MTTI example, we can see that there are no current funding gaps because the unrestricted funds have been used to plug the gaps, including direct project costs that are normally easier to get a funder to pay for. This is not ideal because it means that their precious unrestricted funds cannot be used for other purposes, including building up their reserves.

We also see that there is a surplus of funds (i.e. too much money) for the project inputs budget line as indicated by the positive figure in column I. This means this line is double funded, as all the income is restricted and the funder has specified what budget lines it can be spent on. MTTI should contact the funder and formally request to re-allocate the surplus funds to other budget lines where there are funding gaps.

Tips on using the funding grid

When building the funding grid table, there are some practical considerations and adjustments to make, especially for a large and complex program.

- **Use exchange rates that correspond to a specified date**. The funding grid can be compiled using the local currency, but it is also common to select the currency of the main source of income.
- **Make sure budgeted expenditure and anticipated income cover the same timeframe**. Funder agreements can start at different times (and rarely coincide with our planning year), so it is important to match income to the period covered by the funding grid. For example, if the funding grid covers expenditure for a year from January to December, and a grant runs for 12 months from March, you must include 10 months of the grant for a full picture (the other 2 months' grant is included in the next funding grid).
- **Map expenditure to internal account codes**. Include donor codes as well as internal chart of accounts codes so that you can see which line items are under- or over-funded.
- **Regularly update the funding grid** as the fundraising situation changes.

4.11 Summary

The diagram below summarizes the budgeting process and illustrates the relationship between the different budgets, as covered in this chapter. Notice that account codes are placed prominently in the center of all the budgets, underscoring their importance in mapping the different budgets to each other.

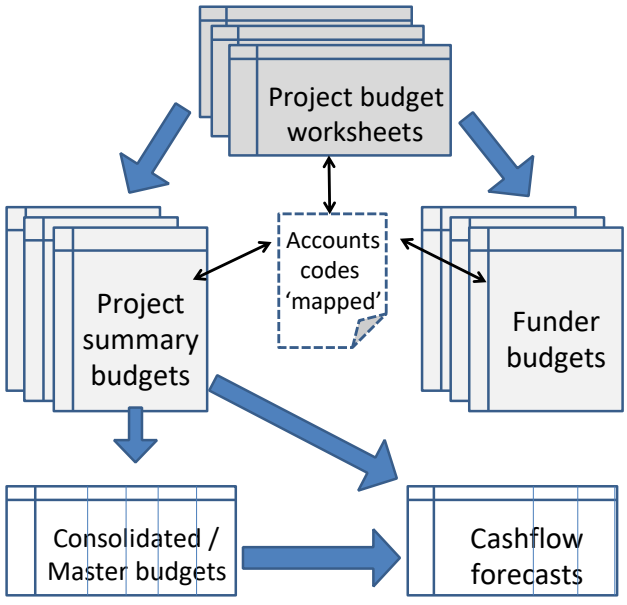


Figure 10: Budgeting process flowchart

5. Financial Monitoring

In this chapter we look at the third building block of financial management, financial monitoring, which builds directly on the previous two areas: accounting records and financial planning. Financial monitoring in projects is all about having regular and up-to-date financial reports to review project progress and make resourcing decisions.

By the end of this chapter, you will be able to:

- identify who needs financial reports and why
- describe the different types of financial reports for program management and stakeholder accountability
- explain how to use the information in budget monitoring and other management reports
- outline the main features and purpose of reports to funding agencies
- explain the benefits of being accountable to project beneficiary communities.

5.1 Overview of financial reports

We cannot have timely and reliable project financial reports without robust accounting records, and we must have good financial planning systems to enable the budget monitoring process. Financial monitoring is also critical to the seven principles of financial management (Chapter 2.6) especially as they relate to:

- **Accountability** and **transparency** - providing all stakeholders with information on how the organization's funds have been used,
- **Stewardship** - helping managers and board members to lead the organization and monitor project performance, and
- **Accounting standards** - ensuring financial statements conform to international accounting standards.

Financial reports are important for both program management and stakeholder accountability. Project teams need to monitor project progress by comparing the budget (i.e. the plan) with what actually happens during implementation. Plans do change when we get in the field, so it is important to spot problems early on, such as changed spending activity, that might impact on project targets or funder rules.

Those responsible for programs also need to give an account of how they have used donated funds to a wide range of stakeholders. Good financial reporting to stakeholders brings credibility and builds trust.

Financial reports must be TIMELY, ACCURATE, and RELEVANT.

Which reports?

The table below lists the key finance reports, outlining who they are aimed at and how they are used for project monitoring and accountability.

Table 29: Financial reports and how they are used

Report type	Used by:	Frequency	Used for:
Budget monitoring report	Project staff, managers, and board members	Monthly	Track the use of project funds compared to budget. Identify any problems early on and plan corrective action for the next phase of implementation.
Cash flow report	Finance staff, managers, and project staff	Monthly	Ensure that there is enough money in the bank to run programs. Find solutions for any periods of cash shortages.
Funder progress report	Funding partners	As specified by funder's rules	Explain how project funds are being used, compared to the original plan and targets.

Report type	Used by:	Frequency	Used for:
			Request changes to the budget or terms of the agreement.
Partner progress report	Community partners and service users	3–6 months	Show how the funds raised for community projects are being used.
Financial statements (audited)	Funding partners (current/potential), government agencies, and the general public	Annual	Be publicly accountable for the organization's income and expenditure, and any assets and liabilities.

Creating financial reports

As we saw in Chapter 3, the data for financial reports is captured and summarized during the financial accounting process. An internal chart of accounts codes ensure consistency and facilitate the reporting process.

The financial statements are the main output of the financial accounting process. The management accounting process then takes the data from the financial accounts to create internal reports to support program management.

Finance teams usually compile financial reports. However, in some field operations or smaller organizations with no dedicated finance support, project staff may need to compile reports themselves. In all situations project staff need to work closely with whomever is responsible for producing the reports, to provide information such as:

- explanations for variations in spending compared to budget,
- predictions of cash needed for the next phase of the project activity, or
- anticipated changes to project plans.

It is especially important for finance and project staff to work together when producing reports to stakeholders where a written progress report is also required, to make sure that the financial data is consistent with the narrative information.

The diagram below shows how the financial planning and financial accounting processes come together to produce internal monitoring reports.

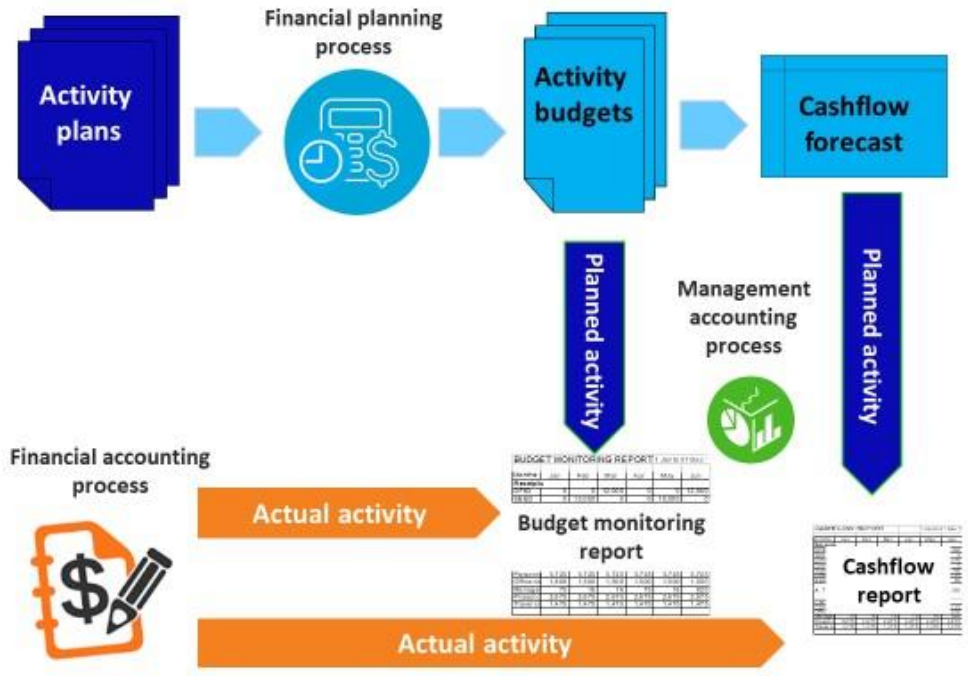


Figure 11: Management reporting flow chart

5.2 The financial statements

FMD Pro focuses on program and project reporting tools and does not cover financial statements in detail. However, it is useful to be aware of the information that they cover as, accompanied by a report on the work of the organization, the annual accounts form the main information package for external stakeholders.

Annual financial statements tell us:

- Where an organization's funds came from during the year (income).
- How the funds were used during the year (expenditure).
- Outcome for the year (surplus or deficit).
- Net worth of the organization at the end of the year (assets less liabilities).

As we saw in Chapter 3, the financial statements are produced from an organization's accounting records. They are a summary of all the transactions for a specified period and show the financial position of an organization.

The two main reports that comprise the financial statements for organizations are:

- **the balance sheet** - or the statement of financial position, and

- **the income and expenditure statement** - in some countries this is also known as the statement of financial activities, statement of activities, statement of financial performance, statement of comprehensive income or Income statement.

Annual financial statements commonly include the previous year's figures for comparison, so you can see what has changed from one year to the next, and whether the financial position is improving or not.

The annual financial statements are also the basis for the annual external audit, an independent examination that assesses an organization's financial accounts, which is covered in the next chapter.

5.3 Budget monitoring report: how it works

Regular and timely budget monitoring reports are an essential resource for project staff. A budget monitoring report is known by many names, including: budget-to-actual comparison report, budget compared to actual report, budget versus actual report (BVA), budget variance report, project budget finance report, and budget management report.

As we saw when we introduced the Plan–Do–Review project planning cycle (see Chapter 2.3), budget holders use ongoing budget monitoring reports to review progress against the original project plan. These reports reveal clues about how well or otherwise the project is going and help to identify actions needed to ensure that plans stay on track.

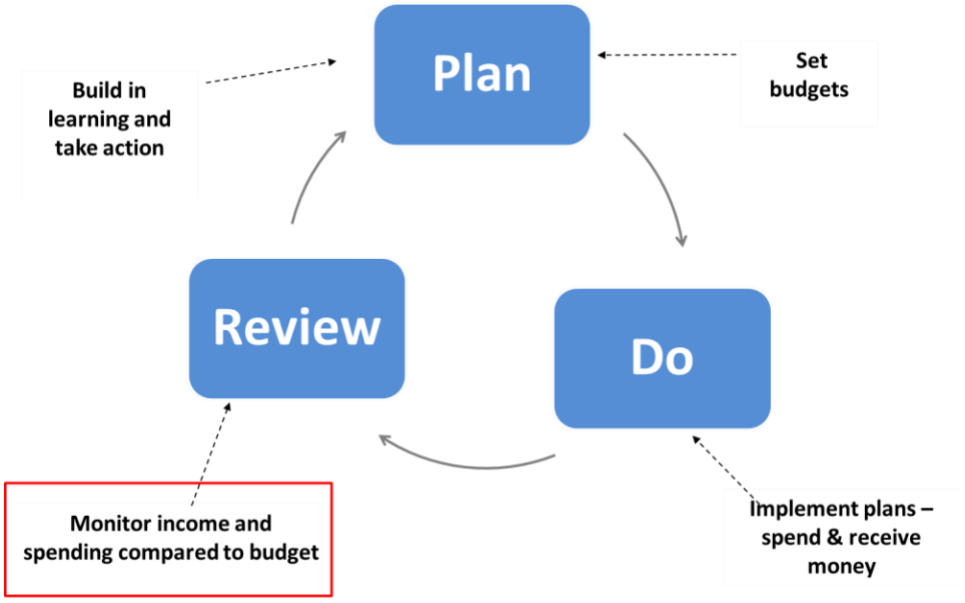


Figure 12: Plan–Do–Review

Managers also use budget monitoring reports to oversee and ensure proper control of project funds. They help to identify problem areas, such as unusual or unexplained expenditure, and provide an early warning sign of key targets not being met.

Layout and content of the report

As well as having several different names, budget monitoring reports also come in a variety of formats. But as its name suggests, the reports take the budget for the reporting period (preferably the phased budget) and compare it with the actual income and expenditure for the same period.

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

The table below is an example of the layout of a budget monitoring report (Table 30). This example uses the budget for Milestone Technical Training Institute (MTTI) as in the financial planning chapter. The table just illustrates expenditure items, but the overall report will also include income items where it is necessary to monitor income lines too.

Table 30: MTTI budget monitoring report

MTTI - Metalwork Skills Rural Training Project
Budget v. Actual comparison report - January to March <Year>

A	B	C	D	E	F	G	H	I
All figures in USD					Q1: January to March <year>			
Code	Budget description	Annual Budget	Budget to date	Actual to date	Variance to date	Variance %	Utilization %	See note
	EXPENDITURE							
5050	Publicity	1,200	600	540	60	10%	45%	1
6010	Staff training	850	850	893	(43)	(5%)	105%	2
6020	Recruitment	250	250	250	0	0%	100%	
6030	Salaries & benefits	28,116	10,224	10,224	0	0%	36%	
6040	Travel & subsistence	3,847	847	305	542	64%	8%	3
7010	Fuel	2,000	450	474	(24)	(5%)	24%	4
7020	Vehicle Insurance/tax	3,580	3,580	3,651	(71)	(2%)	102%	5
7030	Vehicle maintenance	7,200	1,800	940	860	48%	13%	6
7510	Consultants fees	3,600	900	900	0	0%	25%	
7520	Food & accommodation	960	240	216	24	10%	23%	7
7530	Training materials	35,600	8,600	7,400	1,200	14%	21%	8
	TOTAL EXPENDITURE	**87,203**	**28,341**	**25,793**	**2,548**	**9%**	**30%**	

Column heading		Comments
A	*Code*	The internal chart of accounts code.
B	*Budget description*	The account name from the internal chart of accounts code
C	*Annual budget*	The project budget for the whole year, line by line with a total on the bottom row.
D	*Budget to date*	The phased budget, based on the planned activities, for the period covered by the report, in this example for Quarter 1 (January to March), line by line with a total on the bottom row.
E	*Actual to date*	The actual expenditure recorded in the accounting records for the period covered by the report, i.e. the first quarter, line by line with a total on the bottom row.
F	*Variance to date*	The variance is the difference between the phased budget (column D) and the actual recorded expenditure (column E), for the period covered by the report, i.e. the first quarter, line by line with a total on the bottom row. A negative figure (denoted by the brackets around the figure) means the budget is overspent. A positive figure means the budget is underspent.
G	*Variance %*	The figure in the variance column (F) expressed as a percentage of the figure in the phased budget column (D). Again, line by line with a total on the bottom row. A positive figure means there is an underspend compared to the phased budget. A negative figure means there is an overspend compared to the phased budget.
H	*Utilization %*	The figure in the actual to date column (E) expressed as a percentage of the figure in the annual budget column (C). This shows how much of the total project budget has been used up so far, line by line with a total on the bottom row. A figure over 100% means that more than the total budget for the year has been spent at this point in the year.
I	*Note*	This column is used to add notes where needed, e.g. to explain why variances have occurred. The notes are usually provided by the budget holder or project staff responsible for implementing the project. Notes make the report much easier to use and understand.

If we look at the variance figures in the example report in Table 30, it is possible to quickly identify performance compared to budget. Some lines are on budget, some are showing underspends, and some appear to be overspent.

See if you can work out an example of each and then check your conclusions with the chart below.

On budget	Budget underspent	Budget overspent
Recruitment Salaries & benefits Consultants fees	Publicity Travel & subsistence Vehicle maintenance Food & accommodation Training materials	Staff training Fuel Vehicle insurance/tax

By looking at the total row at the bottom of the report, it is possible to get an overall picture of what is happening. In our example for MTTI, we can see that there is a 9% positive variance (meaning 9% underspent compared to the phased budget) and 30% of the total budget has been used so far.

Finally, it is important to be aware that that the content and format of your budget monitoring report will vary depending on the audience. For example, in a project that is supported by multiple funders, the budget monitoring report for one funder can address the financial activities supported by one funder, but not others. Similarly, a report shared with partners might not include overheads or details related to labor costs.

How to calculate variance figures and percentages

When calculating the variance column, the formula that you use will be different, depending on whether you are calculating the variance for expenditure or income.

Table 31: Formula for variance calculations

	D	E	F	Formula used
Item	Budget	Actual	Variance	
INCOME				
Donations	100	50	(50)	E minus D = F
Grant	1,000	1,100	100	E minus D = F
Total	1,100	1,150	50	
EXPENDITURE				

Salaries	2,000	2,100	(100)	D minus E = F
Telephones	250	225	25	D minus E = F
Total	2,250	2,325	(75)	

As the table shows, the formula is a different for income and expenditure calculations. It is therefore easy to see whether there is a positive or negative variance, sometimes also described as favorable (meaning better than expected) or adverse (meaning worse than expected) results.

Negative outcomes are either shown in brackets (as above) or with a standard minus symbol.

NEGATIVE (Worse than expected)	POSITIVE (Better than expected)
Where actual income is LESS than budgeted income	Where actual income is MORE than budgeted income
Where actual expenditure is MORE than budgeted expenditure	Where actual expenditure is LESS than budgeted expenditure

Budget variance percentages can be calculated in one of two ways. You may use either method in your own reports but it is important to be consistent. (Formula option 1 has been used in the MTTI example report above and is more commonly used in budget monitoring reports.)

Calculating variance percentages

Formula	Result
1 Budget variance x 100 Budget for period	Under-spends will result in a positive % and over-spends will produce a negative %
2 Actual for period x 100 Budget for period	Under-spends will result in a figure less than 100% and over-spends will be more than 100%

Calculating the utilization ratio (burn rate)

As you review the budget monitoring report in Table 30, you will also notice that it identifies the amount of the budget, or grant, used up so far. This is known as the utilization ratio or burn rate. Here is the formula to calculate the budget utilization ratio (burn rate):

Formula	Result
Actual spend to date x 100 Total budget	A figure of over 100% means the total project budget is overspent.

Notice that the utilization ratio alone is not enough to determine whether a project is on track with its spending. If 100% of funds for a line item are spent in the first month, and there are significant activities planned for that line item in the future, that is a problem. However, if all the expenses for that line item were planned to take place in month one, there is no problem, even though no additional resources are available for that line item during the remainder of the project life.

Committed expenditure

Commitments (or committed expenditure) refer to significant expenses that have been incurred for a project in a particular period, but haven't yet been accounted for, or which belong to a future reporting period. Commitments are more relevant in a cash accounting system or where there are time delays in reporting some expenditure, e.g. from remotely based field offices.

If significant commitments are not taken into account when compiling budget monitoring reports, the results may under- or overcount the true level of expenditure and give a distorted view when compared to the budget. It is therefore very important to be aware of such commitments when monitoring a budget or grant because decisions are based on the reported variances and balances available. You could find that there is more (or less) money available to spend than there is in reality.

Here are two solutions for situations when figures exclude outstanding commitments:

- Include an extra column in the budget monitoring report to record known commitments.
- Attach a list of known commitments to the report and refer to these in the notes column as needed.

Examples of commitments that might need to be included in a commitments list or column in a budget monitoring report could include:

- Purchase orders issued for significant amounts but goods not yet received or paid for
- Expenditure report from a field office that has not yet been included in the accounting records
- Outstanding bills or payments for goods and services that have been purchased but not yet paid for (in a cash accounting system)
- End of project audit or evaluation that has been contracted but not yet undertaken or not yet invoiced by the audit firm or consultant (in cash accounting system).

5.4 Analyzing budget monitoring reports

The key to making best use of budget monitoring reports for project management purposes is to analyze variances. This involves looking at budget monitoring reports to identify significant or

unusual issues or variances, and to understand what has caused them to happen. This helps us plan the next phase and to take any corrective action.

To get a feel for what this process involves, see below for a useful checklist of what to look at and key questions to ask.

Table 32 budget monitoring checklist:

Item to check	What to look for
1. Check the accounting basis of the report	• Is the report compiled on a cash or accruals basis? • Are there outstanding commitments? If so, how does that affect the results?
2. Look at the bottom line	• Is the overall result (surplus or deficit) within budget? • If not, is the overall variance significant at this stage of the project or program? An outcome of plus or minus 10% is considered reasonable.
3. Look at sub-totals for 'family groups'	• Is spending overall on target across the group? • An outcome of plus or minus 10% is considered reasonable.
4. Check overall expenditure	• Is expenditure broadly in line with the budget, within plus/minus 10%? • Are there any significant outstanding commitments that could substantially affect the figures shown?
5. Check overall income	• Is income broadly in line with the budget? • Are there any large sums of money outstanding or delayed? If yes, what is being done to retrieve them?
6. Look for unusual or unexpected results	• Are there any results that stand out as being unusual or unexplained? • This could be an indication of miscoding, fraud, or misuse of funds so follow up as appropriate.
7. Look for significant variances in line items	• Are the reasons for the variances explained and reasonable? • Do not just concentrate on overspent items. Underspending can also be critical for programs as it suggests delays.

8. Check for consistent results across linked line items	• Do linked budget lines (such as activity-related costs) tell the same story or do the results look illogical?
9. Refer to any supporting narrative reports	• Do the figures tell the same story as the accompanying narrative project report?
SOMETIMES THE FIGURES JUST DO NOT LOOK RIGHT. TRUST YOUR INSTINCTS AND FOLLOW UP YOUR CONCERNS.	

What causes variances to happen?

In all cases, a variance represents a change from the original plan, but what lies behind it? Variances will be the result of one or more of the following three change factors:

- Change in the actual **timing** of the activity
- Change in the actual **price** paid or
- Change in the actual **quantity** of goods or services used.

Figure 13: What causes variances

Alongside these variances, a fourth factor also needs to be considered: sometimes a variance shown in a report is due to an error in the accounting records, for instance, the wrong account code is allocated to a transaction in the accounting records. If this is suspected, it is important to check it out and make the necessary corrections before completing your analysis.

We can further classify the three main causes of a variance to highlight if the variance is temporary or permanent-will the variance work through the system over time, or will it continue?

Temporary variances

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

Example of a temporary variance: An irrigation project planned to purchase water pumps in Month 1 but none of their approved suppliers have the model required due to delays at the port. There is, therefore, a 100% variance on the water pumps budget line in the Month 1 budget monitoring report.

The pumps finally arrive in Month 3 and the budget monitoring report no longer shows a zero balance for the pumps. This was a temporary variance on the project equipment budget due to a change in timing of the activity to purchase the pumps.

Permanent variances

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

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

Example of a permanent variance: When the water pumps were eventually delivered, the price had increased by 18%, partly caused by a deteriorating exchange rate and partly due to limited supply. This results in a large negative variance on the water pumps line in the budget. This is a permanent variance and will require a decision on how to finance the variance.

This example demonstrates how timing issues can have a secondary effect, which is why it is important to monitor temporary variances too.

Are variances always a matter of concern?

A budget is an estimate of what is likely to happen rather than a depiction of reality, so when variances do occur this should not come as a surprise. What we need to look for are the significant variances.

The significance of a variance will depend on factors such as:

- Whether it is positive or negative. Adverse variances (negative) are generally more of a concern, but not always!
- Whether the variance was expected or should have been foreseen.

- How big the variance is in absolute, monetary terms as well as in relative, percentage terms. A variation of plus/minus 10% is generally agreed to be reasonable, but there will always be exceptions to that rule.
- What caused the variance to happen? Was it in your control?
- Whether the variance is temporary or permanent, or the result of a long-term trend.

By highlighting significant variances, the budget monitoring process will focus on activities that require attention and ignore those that appear to be running smoothly.

Are all negative variances bad news and positive variances good news?

The simple answer is: not necessarily. A negative variance might result from some additional spending that is justified or something good that has happened in the project. A positive variance might point to activities not being on target. Here are some examples of different scenarios that can cause a variance.

- The staff recruitment budget is overspent (negative) because the project had to re-advertise an opening for a project team member. But as there has been a vacancy, there is a saving on the salary (positive), which will offset the extra cost of recruitment.
- Workshop costs are higher than budgeted (negative) due to extra people signing up for a course. However, these costs can be offset by additional course fees (positive) received by the trainees' sponsors.
- Project materials for a gardening project are showing a significant underspend (positive). This is caused by the failure of the project to sign up the target number of garden groups, which could result in losing some of the funding (negative).

It is the cause and significance of a variance that matters, not simply whether it is positive or negative.

Variance analysis table

Below is an example of a completed variance analysis table. It is for the MTTI Rural Skills Training Project Quarter 1 budget monitoring report that we looked at earlier. This brings together all the information needed to review variances, including the notes provided by the project team on what caused the variance.

Some things to note on the variance analysis table:

- The table excludes any budget lines that have zero variances.
- The shaded rows are those considered to be significant variances (greater than 10%).
- The notes show that the variances were caused by changes in price, quantity, or timing.
- The overall bottom line variance from budget is 9%, which is within an acceptable level. This would be a lower percentage if the two outstanding invoices (the 'commitments') mentioned in the notes were included in the actual spending figures.

- Although the vehicle maintenance line appears to be underspent by $860 or 48%, the notes tell us that there is an outstanding invoice for new tires of $1,000, so the current variance is a timing issue. If we take that $1,000 outstanding bill into account, this budget line is overspent by $140, which is a price issue (due to higher import duties). This demonstrates why it is important to be aware of expenditure commitments when reviewing project budgets.

- The largest percentage variance is 64% for travel and subsistence caused by a delay in implementing the follow-up visits. The absolute underspend of $542 is not a huge sum, but the delay is a concern because this is a key activity area. It is important that the project staff get this activity back on track as soon as possible.
- The last two rows, food and accommodation and training materials, are examples of linked budget items as they support the same project activity. The notes give the same reason for their underspending (fewer trainees than planned), which is both logical and reassuring. The training materials budget also has an unpaid bill, which would bring the underspend variance percentage to 10%.
- The final column gives a conclusion on what further action is needed as a result of carrying out the variance analysis on the budget monitoring report.

Table 32: Variance analysis table

Budget	Variance		Note	Reason for the variance	P/Q/T	Follow up action?
EXPENDITURE						
Publicity	60	10%	1	Discount negotiated	Price	None required
Staff training	(43)	(5%)	2	Supplier increased price after quotation obtained	Price	None required
Travel & subsistence	542	64%	3	Delay in introducing follow-up visits for first trainees	Timing	Reschedule activity
Fuel	(24)	(5%)	4	Variance is not significant	n/a	None required
Vehicle Insurance /tax	(71)	(2%)	5	Premium a little higher than expected	Quantity	None required
Vehicle maintenance	860	48%	6	Unpaid bill $1000 for tires (cost more due to higher import duties)	Timing (& Price)	Monitor closely
Food & accommodation	24	10%	7	16 trainees, not 18 as planned	Quantity	Monitor future bookings
Training materials	1,200	14%	8	Fewer trainees than planned, Unpaid bill USD 310.	Quantity	Monitor future bookings
TOTAL	**2,548**	**9%**				

5.5 Taking action on variances

Having analyzed the figures in the budget monitoring report, the budget holder must next create an action plan to get the budget, or more importantly, the project, back on track. They must discuss recommended actions with their manager and the project funder where relevant. Deciding on which actions to take will depend on many factors, including:

- **Knowledge of the project:** Where it is now and what the activity plans are for the next period?
- **Awareness of external factors:** What are the inflationary trends? What dependencies exist with other programs that influence our ability to meet project targets?
- **Internal policies:** e.g. rules on budgetary control and flexibilities (or tolerances)
- **Funder rules:** e.g. for budget variances and flexibility on over- or under-spending budget lines.
- **Significance**: How serious is the variance and how urgently does it need to be resolved?
- **How controllable:** Is it possible to control future spending on the budget items under pressure?
- **Impact:** What would the impact be if we take no action?
- **Availability of unrestricted funds:** e.g. to finance over-spends.

This diagram summarizes possible actions to take for different categories of variance, according to whether they are positive or negative, temporary, or permanent.

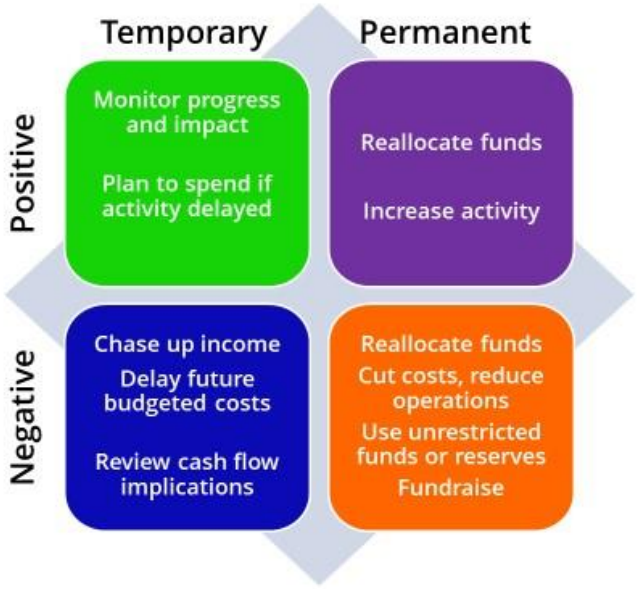


Figure 14. Action to take on budget variances

Temporary positive variances

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

Temporary negative variances

These variances are often caused by a delay in planned income, e.g. grants arriving later than scheduled. This could cause cash flow problems for the project.

In such cases, it is important to chase up the income or resolve the issue that is causing the delay. For example, a common cause of delayed grants is that the organization has not submitted a funder report on time. It may be necessary to delay some big expenses until the issue is resolved.

Permanent negative variances

These variances are often the most difficult to resolve. The first option is to check if it is possible to reallocate funds from elsewhere in the budget, are there any permanent positive variances that can be used? Many organizations and funders allow transfers between lines within 'family groups' of costs providing the overall subtotal for the group of costs does not exceed the 10% rule. That means that budget holders only need to request formal approval where the transfer exceeds 10% of the budget line.

Budget transfers that exceed the 10% rule or involve transfers between family groups, for example, making use of a positive variance on the salaries budget to fund a negative variance on the transportation budget, will require authorization by the line manager and/or funder, where relevant.

Example of a budget transfer

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

Other options to manage permanent negative variances include:

- Controlling or cutting costs in future months' activities
- Finding additional sources of income.

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

Additional income? Options for additional financing include requesting additional funding from project funders, requesting top up funds from central pots of unrestricted funds, and fundraising for new support. Just as it is difficult to control some costs, it is not always feasible to replace lost income.

For example, a fundraising campaign to bring in 50 individual supporters for a girls' education program only manages to recruit 25 supporters after 6 months, the chances of recovering the lost income for the first half of the year are highly unlikely. Or a funder pledges to support an activity but the money never materializes, making it difficult to find last minute alternative funds. In these situations, it helps if the organization has its own money in the form of unrestricted income or cash reserves.

Permanent positive variances

The options for managing the final category are either:

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

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

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

Returning to the example above, where surplus funds in the salaries budget are used to fund the extra recruitment advertising, the budget lines remain the same and the invoice for the adverts are coded as usual to the recruitment advertising account, NOT the salaries account. This will show up as a permanent negative variance on the recruitment advertising budget line, but that is OK as it has been authorized and falls within the rules of acceptable budget transfers within a family group.

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

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

Budget management meetings

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

Budget monitoring action planner

The budget monitoring action planner table (Table 33) and related explanatory notes will help you to monitor and control your budget, and is useful when discussing action plans with the project team.

Table 33: Budget monitoring action planner

MTTI Budget Monitoring Action Planner					
1	2	3	4	5	6
Budget item	Variance % or $	Variance type	Level of control over budget	Impact if not corrected	Action required/by
Travel and subsistence	64%	Temporary	High	May not fulfill targets in grant agreement.	Trainer to set up a revised schedule for April/May. Review again next month.
Vehicle maintenance	($140) including commitments	Permanent	Medium	Budget could be overspent and MTTI must cover costs from unrestricted funds.	Program manager to monitor vehicle logs; obtain at least two quotations for future repairs.

Column 1, Budget item: The budget line that requires some corrective action.

Column 2, Variance % or monetary value: Only include significant variances here.

Column 3, Variance type: Is this permanent or temporary? Remember that temporary variances will work their way through the system but very large ones might still have an impact, e.g. on cash flow or activity targets

Column 4, Level of control over budget: To what extent do you have control over the budget (low, medium, or high)? For example, can you restrict its use or make savings if overspent or stimulate its utilization if underspent?

Column 5, Impact on project and grant if not corrected: Examples of this include weakened cash flow, delays achieving targets, missed deadlines, and allowable costs and tolerances exceeded.

Column 6, Action required/by: What should be done (and by whom) to minimize the impact and get the project back on track and/or to meet funder requirements? Examples include budget reforecast or adjustments, advise funder of delays or request a no-cost extension, request unrestricted funds to cover overspends, change activity plans, put efforts into reducing costs or stimulate spending, etc.

When budgets become out of date

Budgets are an estimate of costs for future project activities based on the plans and information available at the time they are prepared. When we get into the field, plans can and do change for important and justified reasons, and that means that some budgets will become out of date. This is especially evident during the budget monitoring process, where budget variances are traced back to changes in activity plans or major price changes.

Budgets that have become out of date are difficult to work with because there will be a mismatch with revised activity plans and spending needs, and we need to take action to resolve this. There are two ways to manage budgets or budget lines that have become out of date:

- Managing budget variances using transfers of budgeted funds (as described above), or
- Revising the budget.

Revising the budget

Sometimes changes to activity plans or project operating context affect multiple lines in a project budget making a project budget substantially out of date and therefore more difficult to manage. In this situation, it may be better to rework the whole budget, re-budgeting for the project activities using current plans and information, and request a budget modification approval from the organization's management team and project funder(s). This is often called a budget revision.

For projects supported by an external funding agency, you must first check the relevant funder's guidelines and rules on requesting budget revisions (also known as "change in scope" request) before taking action.

Things you need to check on include:

- What constitutes a significant funds reallocation? For example, cost modifications that exceed 25% of the approved budget or $250,000, whichever is less.
- What format to use to present the revised budget?
- What costs can and cannot be included in a revised budget?
- What supporting evidence is needed?
- Any deadlines for budget revision requests?

In all cases, the reasons for submitting a revised budget, or revised budget lines, must be explained and the revised costs justified. Some funders will require a new budget narrative to be completed (see Chapter 4.7) as part of the budget revision process. It is important to demonstrate that the original project objectives will still be met by the revised plan. The revised budget is more likely to be approved if the total budget does not exceed the amount covered by the original funding agreement.

5.6 Budget forecast reports

Some budget monitoring reports also include a budget forecast column that predicts income and/or expenditure for a future period, such as the next quarter, six months, or to the end of the planning year.

Why is it needed?

A forecast report combines the actual figures for previous months with an estimate of income and expenditure for the forecasting period. From the forecast figures, project staff can then identify trouble spots and take necessary action, re-budget, or undertake fundraising in good time.

Budget forecast reports are especially useful for projects where there is a risk of a shortfall in funding, significant over- or underspending, or where an organization has few unrestricted funds or reserves to top up overspent projects.

As the project year nears its close, it is also important to be aware of the likely outcome for your project so that you can manage your relationship with key stakeholders. For example, a large deficit can make the project appear to be out of control and poorly managed, but a large surplus can indicate a failure to meet objectives or poor budgeting. A small deficit or surplus suggests good overall budget management.

How to create a forecast report

A forecast is based on current knowledge and past trends, not simply the project budget for the forecast period. Knowledge of the project is essential. It would be difficult to prepare a forecast for a project you are not involved in!

Information that will be useful when preparing a forecast includes:

- Income and expenditure for the year so far
- Commitments, i.e. outstanding bills or payments for goods and services that have been purchased or received but not yet paid for
- Historical data and trends for previous periods
- Activity plans, including any changes or additions for the forecast period
- Current pricing information (have any budget items been hit by unexpected price increases?).

Using all the available information and your knowledge of the project, you then need to estimate how much is needed for each budget line item for the forecast period. It is important to be as realistic as possible and explain any assumptions that lie behind the estimates. See Table 34 for a sample forecast report.

When the forecast figures are complete, identify any areas of concern and create an action plan to mitigate the risks presented.

What does it look like?

See Table 34 below for an example budget forecast report for MTTI. Look at the layout and content of the report, and then note these key points.

- The report includes the *actual* income and expenditure for the first three quarters (January to September) of the year, and then an estimate for the final three months.
- When the actual figures are added together with the fourth quarter, this gives a total forecast for the year (see the final shaded column). This is sometimes referred to as an out-turn report as it is forecasting what the final position will be at the end of the year.
- The *forecast percentage for the year* column tells us at a glance how much of the budget will be received (income) or used up (expenditure) by the end of the year. If the figure is less than 100%, it means it is under budget, if it is over 100%, that means it is over budget.
- If you run your eye down the percentage figures, it will help you identify problem lines, such as communications and vehicle maintenance.
- Overall, the budget is forecast to be USD $4,510 or 3% overspent. This is not excessive but the managers will have to address the areas of overspending and work out a plan to finance those extra costs.

Table 34: Example budget forecast report

MTTI - Budget Forecast Report to 31 December <Year>

All figures in USD

Code	Budget description	TOTAL BUDGET	Actual - 1 January to 30 September			TOTAL to 30 Sept	Forecast Oct-Dec	Forecast for year	Forecast % for year	
			QTR1	QTR2	QTR3					
	INCOME									
4010	DFID	90,000	25,011	22,086	21,727	68,824	21,000	89,824	100%	Net exchange rate loss
4020	Smile Trust	90,000	22,500	22,500	22,500	67,500	22,500	90,000	100%	
4030	Vanguard Society	15,000	7,395	0	7,976	15,371	0	15,371	102%	Net exchange rate gain
4110	Bank Interest	960	219	197	231	647	240	887	92%	
4120	Donations & fundraising	8,000	350	895	3,250	4,495	3,400	7,895	99%	Estimate based on pledges received and previous year.
4130	Sales	24,800	5,462	4,670	6,785	16,917	7,300	24,217	98%	
4140	Training Fees	42,500	14,500	6,900	11,200	32,600	8,500	41,100	97%	
	TOTAL	**271,260**	**75,437**	**57,248**	**73,669**	206,353	**62,940**	**269,293**	**99%**	
	EXPENDITURE									
5010	Audit & accountancy	4,500	0	4,750	0	4,750	0	4,750	106%	Additional costs incurred due to unannounced funder audit
5020	Bank charges	600	140	135	145	420	140	560	93%	
5030	Board meetings	1,200	127	924	85	1,136	100	1,236	103%	
5040	Stationery	7,500	636	4,568	1,598	6,802	800	7,602	101%	Annual report printing costs were more than expected
5050	Publicity	1,500	400	350	400	1,150	350	1,500	100%	
5060	Office rent & utilities	9,000	2,145	2,243	2,195	6,583	2,200	8,783	98%	
5070	Repairs & renewals	1,500	327	256	213	796	700	1,496	100%	Major repairs expected in the month of December
5080	Communications	6,300	1,982	1,678	2,145	5,805	1,200	7,005	111%	Restrictions on phone usage introduced
6010	Staff training	4,500	1,000	167	3,222	4,389	111	4,500	100%	
6020	Recruitment	250	250	0	0	250	0	250	100%	
6030	Salaries & benefits	83,500	20,875	20,875	20,875	62,625	20,875	83,500	100%	
6040	Travel & subsistence	5,522	1,108	1,190	2,305	4,603	1,500	6,103	111%	
7010	Fuel	4,690	942	1,020	1,434	3,396	1,200	4,596	98%	
7020	Vehicle Insurance/tax	7,670	7,600	0	70	7,670	0	7,670	100%	
7030	Vehicle maintenance	18,240	5,608	8,603	6,865	21,076	3,900	24,976	137%	Major repairs during year; new tires in Qtr 4
7510	Consultants fees	8,100	2,625	1,800	2,000	6,425	1,500	7,925	98%	
7520	Food & accommodation	8,980	1,954	2,150	2,540	6,644	2,500	9,144	102%	
7530	Training Materials	92,200	26,450	19,667	23,090	69,207	23,000	92,207	100%	
	TOTAL	**265,752**	**74,169**	**70,376**	**69,182**	**213,727**	**60,076**	**273,803**	**103%**	
	SURPLUS/(DEFICIT)	**5,508**	**1,268**	**(13,128)**	**4,487**	**(7,374)**	**2,864**	**(4,510)**		

5.7 The cash flow report

The cash flow report is used to predict any periods when cash balances are likely to be critical cash shortages may potentially hamper the project implementation plans. Does that sound familiar? It should, because it looks exactly like the cash flow forecast that we looked at in the financial planning chapter (Chapter 4.2 and Table 19).

The cash flow report is different, however, because it includes the actual receipts and payments each month, plus any new information about future spending or income plans. So, it is partly a report on what has actually happened, and partly a forecast for the future, including the most up-to-date data available.

Cash flow reports are especially important where operations are highly dependent on cash, such as humanitarian responses or projects operating in remote areas. In these cases, a cash flow report is needed on a weekly basis rather than the more typical monthly report.

Project staff and finance teams should work together to discuss options for overcoming predicted cash flow problems.

How to manage cash flow problems

- Review grant schedules: encourage funders to pay in advance rather than in arrears.
- Get reports to funders on time to avoid delays in grant payments.
- Bank all cash received within two days, or daily if large sums are received.
- Request special payment terms from major suppliers (and stick to them).
- Negotiate to pay large expenses by installment, e.g., insurance premiums.
- Delay non-urgent actions that will lead to additional expenditure, e.g., recruitment, taking on leases, purchasing equipment.
- Negotiate an overdraft facility as a short-term (but expensive) remedy.

5.8 Reporting to funding partners

Funding agencies require evidence of how their funds are being used before approving the release of funds. Periodic and annual financial reports fulfill that role. It is important to comply with the funder's reporting conditions to establish credibility and to make sure your grant arrives on time!

Accountability to funders

Financial accountability requires funding partners to demonstrate that funds have been used for the purpose for which they were intended. It is worth remembering that funder agencies are themselves accountable to stakeholders (board, government, tax payers, etc.) and they rely on you to provide them with the information they need, on time.

Project accounting systems

Where multiple funders are supporting a project or program, it is important to set up appropriate project accounting systems and coding structures so that the information required by each funder can be easily retrieved. Setting up separate cost centers for each funding source is particularly useful here.

It is also important to map the funder's accounting codes referenced in the budget to your internal chart of accounts codes, adding new codes where needed.

Funder terms and conditions

When creating financial reports for funders, it is important to check the funding agreement to be aware of reporting requirements and any budget restrictions. The following checklist will help you keep things on track.

Things to check in funding agreements	
Reporting requirements	What frequency and format are required?
Exchange rates and currency	What currency and exchange rate to use for reporting purposes
Timeframe	Are there any specified dates within which the funds must be used? Can funds be carried over from one financial year to the next?
Scope and designation of funds	What can the project budget be used for? Are there restrictions on where goods may be purchased from? What is allowed for central support costs?
Budget flexibility (tolerances) policy	Is it possible to transfer surpluses from one budget line to another? How should a request for budget transfers be made?
Bank interest	Can you retain any interest earned on grant funds held in the bank?

Reporting formats and frequencies

The frequency of reports can vary from monthly to quarterly or even just once a year. Reports are typically required to coincide with release of grant installments, so it is important to meet the reporting deadlines. Most funders require some form of a budget compared to actual report and/or a grant utilization (burn rate) report, based on the project budget that accompanied the original funding application.

See Table 35 below for an example of a funder report using the grant utilization format. Things to note in this report:

- The funder requires the organization to provide data on their whole budget and the amount of grant and spending allocated to the funder.
- It is a summary report prepared in the funder's home currency, British Pounds (GBP), so the figures have been converted using an agreed exchange rate, which is noted on the funder report.
- The report format includes a budget compared to actual variance report for the reporting period (columns 2, 3, and 4), as well as the total spend to date, i.e. grant utilization and burn rate (see columns 5 and 6).
- The report also includes a forecast for the next reporting period, quarter four (see column 7, which is used as the basis to calculate the grant request in column 8).
- The amount requested takes into account the variance in quarter three (to adjust for any under- and over-spending) and, as this is for the final quarter, the claim made cannot exceed the total grant for the year.
- There is no phased budget for the period to date, so it is not possible to tell from these figures if the project is on target according to the activity plan. But this is a funder report, and their main interest is to see if the funds are being spent on time.

Table 35: Example report to a funder

Funder X Project No.Y12345

STATEMENT OF ACTUAL EXPENDITURE FOR QUARTER ENDING: 30 Sept <Year>

AND ESTIMATED EXPENDITURE FOR QUARTER ENDING: 31 Dec <Year> *Exchange rate:* **1.5**

	1	2	3	4 [2 - 3]	5	6	7	8 [7 - 4]
Budget items:	TOTAL BUDGET GBP	Last quarter Budget GBP	Last quarter Actual GBP	Variance GBP	Total spent GBP	%	Budget next quarter GBP	Grant request GBP
Administration	21,400	4,287	4,521	(234)	18,295	85%	3,660	3,894
Staff	62,515	17,440	17,601	(161)	47,911	77%	14,991	15,152
Vehicle Running	20,400	4,300	5,579	(1,279)	21,428	105%	3,400	4,679
Project inputs	72,853	16,745	18,420	(1,675)	54,851	75%	18,000	19,675
TOTAL	177,168	42,772	46,121	(3,349)	142,485	80%	40,051	43,400
Funder X grant:	60,000	14,485	15,620	(1,134)	48,254	80%	13,564	14,118
% apportioned to funder X	*34%*							

Schedule of grants received/due:

	GBP	
Qtr 1	16,674	Received
Qtr 2	14,724	Received
Qtr 3	14,485	Received
Qtr 4	14,118	Due
TOTAL	60,000	*[This total must not exceed original budget agreed in contract]*

The narrative or progress report

In most cases, a report to a funder will include financial data accompanied by a short, written progress report. The narrative report will include comments on the following:

- Activities and targets achieved during the reporting period, compared to the plan
- Any challenges experienced and lessons learned
- Plans for the next period
- Requests for budget realignment and transfers.

It is important that the narrative report refers directly to the financial report for the same period. For instance, a narrative report might say, “work has gone ahead well and two wards have been built at the hospital”, but the financial report shows no expenditure on construction materials. Either the narrative report is wrong or the financial report does not include all expenses. If this is not explained, it is a sure way of undermining funder confidence in your project or organization.

The impact of exchange rates

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

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

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

Case Study: Exchange rate losses

A local organization prepares a budget in its local currency, LCs, and submits the budget to a funding agency, who requires the budget to be prepared in USD. The exchange rate at the time of preparing the budget was 2 LCs to 1 USD. The budget is approved and the funder sends USD 500 to the local organization. This is converted into LCs but the exchange rate has changed to 1.5 LCs to 1 USD.

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

The difference between the budget and what was actually received in local currency is 250 LCs. As this amount is less than budgeted, it represents an exchange rate loss. This could create a problem for the organization if the funder still expects the project to be delivered to plan. The organization now has 250 LCs less than it budgeted for.

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

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

- A monthly average rate
- The rate on the first day of the month
- The daily rate provided by your bank
- The rate on internet websites
- The rate provided by funders on their websites.

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

Top tips for reporting to funders

- DO meet reporting deadlines (or request an extension).
- DO produce accurate and verifiable figures.
- DO NOT conceal underspends or overspends.
- DO explain any significant variations.
- DO keep the funder informed of any potential problems.
- DO remember that staff from funding agencies will have a lot of experience of working with groups such as yours. They will almost always respond positively to requests for advice.

5.9 Reporting to partner communities

Most organizations recognize the need for 'downward accountability', which means reporting back to communities about what has been achieved with funds that were raised on their behalf. However, only a few organizations have set up systems to make sure that this happens. Instead, most reporting processes focus on achieving upward accountability, such as reporting to funders, boards, and head offices.

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

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

Often downward accountability focuses on updating communities on programmatic, not financial, data. This programmatic data might include how many beneficiaries have been served, how many activities completed, how many deliverables put in place, etc. However, opportunities to share information about financial progress should also be considered for true transparency and accountability.

Introducing this level of financial transparency may naturally meet obstacles, including adding to the burden of busy staff. But if sensitively done, the benefits generally far outweigh the costs.

How can organizations provide financial reports to the communities they work with?

Financial reports must provide information that is useful and easy for service-users and communities to understand. The following guidelines set out some general principles that can help achieve this when preparing financial reports for beneficiaries.

Content: Content should be relevant and relate to specific activities that organizations have carried out with and on behalf of local communities. Simple reports, in local currency, showing monthly expenditure compared to budget, work well.

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

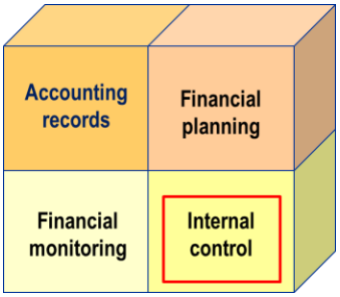
As a general rule, each financial report should have no more than 15 lines of information: more lines make reports confusing.

Presentation: Publish reports in local languages and include pictures or simple graphs, as it is easier for some people to understand visual reports than those that just use numbers. Aim to make financial reports publicly available at a community level. For example:

- Use whiteboards or flip-charts to publicly display the results at an organization's offices, health centers, or distribution points, backed up with paper copies of reports at the same places.
- Present regular reports to communities at community meetings or to community leaders at project management meetings.
- Publish summary reports in newspapers and other local media.

6. Internal Control

The final block in the four building block model of financial management is internal control. Simply stated, internal control systems help deter opportunistic theft or fraud, and detect errors and omissions in the accounting records.



By the end of this chapter, you will be able to:

- explain how the four-actions model of internal control protects projects against the risk of losses due to errors, theft or fraud, ,
- use procedures and practices from each of the categories of the four-actions internal control model,
- define corruption and list illicit actions that contribute to corrupt practice,
- identify warning signs of potential fraud in your projects,
- employ strategies to counter bribery in project implementation.

You may find it helpful to refer to the glossary at the end of this guide if you need a definition of any of the terminology used in the following pages.

6.1 Why internal control matters

Internal control systems are designed to protect an organization's financial resources from everyday internal risks. Internal controls use practical and common-sense checks and balances to ensure an organization's resources are used for the purposes intended, and to the best effect.

A strong system of internal control benefits all stakeholders who are involved in a project and its operations:

- **Project level:** Actively manage the risk to project resources with appropriate policies, procedures and checks, to minimize losses and detect errors in accounting records.

- **Organization level:** Improve the reliability of financial information and reports with timely feedback, and compliance with rules and regulations.
- **Funder/contributor level:** Increase accountability and transparency for donated funds, and ensure sure funds entrusted to a project or organization are used effectively.
- **Community level:** Help to ensure that scarce project resources go where they are most needed, where they can be most effective, and to those who need them most
- **Individual level:** Finally, and arguably most important of all, internal control systems protect staff involved in the financial affairs of a project or organization. They can prevent the temptation or opportunity to misuse resources, and protect staff from misplaced suspicion of abuse of funds.

6.2 The four-actions model for internal control

A strong system of internal control is intended to minimize the everyday risks to financial resources, such as errors and omissions in accounting records, or theft and fraud. To manage these risks in your projects, you need to set up systems to support day-to-day operations.

One model for establishing an internal control system is the four-actions model (see Table 36 and Figure 15), which acts as a good practice framework to minimize risk before it happens, and during implementation, and then to check for correct losses, should they occur.

Table 36: The Four Action model explained

Action type	What this means in practice
DIRECT	Set clear guidance, policies, and expectations for good financial practice. These actions generally take place before project activity begins.
PREVENT	Establish systems that remove the opportunity for theft and minimize the risk of losses due to errors and incompetence. These actions take place during the implementation of the project.
DETECT	Implement processes and procedures that identify if and where activities have gone wrong. These actions identify problems after the improper activity has taken place.
CORRECT	Update and improve internal control systems as the project team learns from experience. These actions are ongoing and aim to provide continuous improvement to the system.

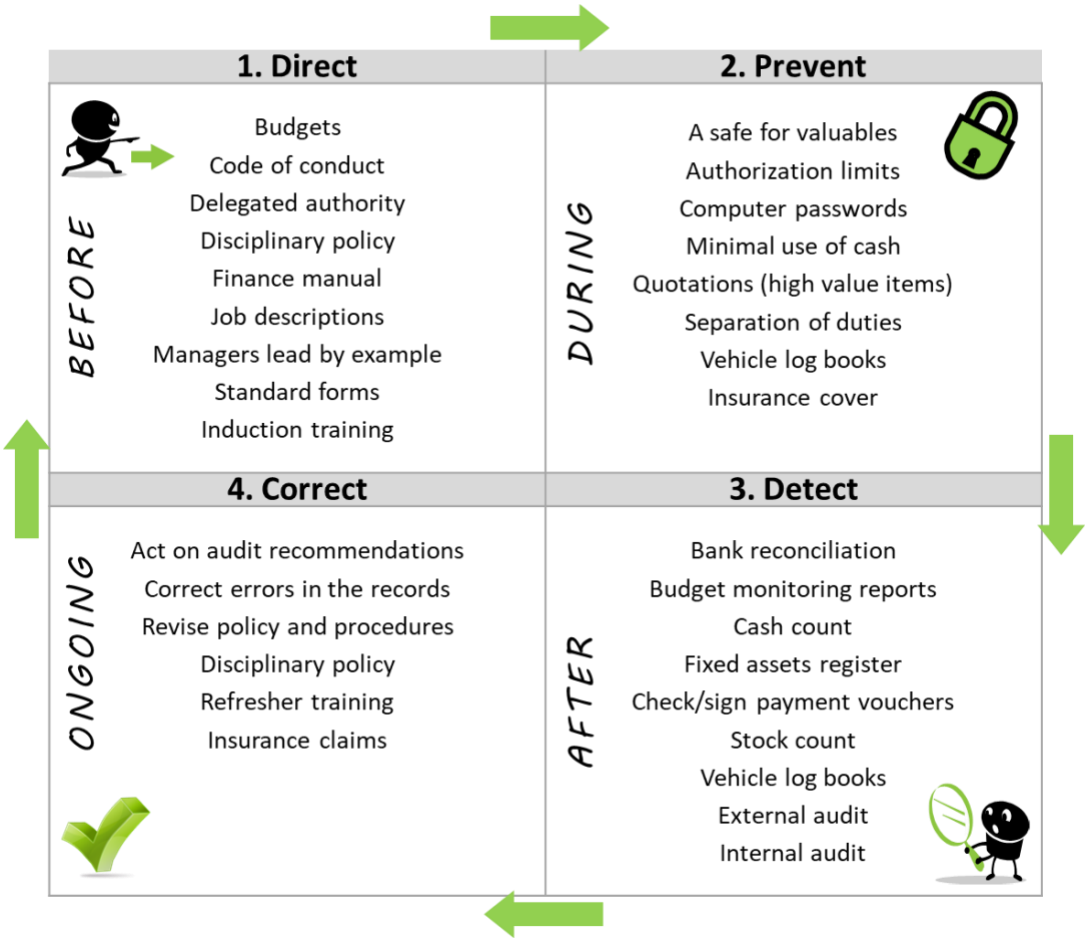


Figure 15: The four-actions model

In the following sections, we will look more closely at each of the four-action categories and explore some of the key tools, procedures, and practices a project team can use to minimize losses due to errors, theft and fraud.

6.3 Direct actions

Direct actions include setting clear guidance, policies, and expectations. These actions generally take place before an action occurs. For example, standard forms are created before the project activities begin to help ensure that all staff on the project are held to the same level of accountability when managing project processes.

There are many actions that fit into the direct category. All of them are intended to encourage the right action (and discourage errors, fraud, and theft). Some illustrative examples that fall into this category include:

- Finance manual
- Budgets
- Code of conduct
- Delegated authority
- Disciplinary policy
- Job descriptions
- Standard forms
- Training

While all the tools, policies, and actions in the direct category are important, there are several that are especially relevant to the work of project teams. These are explored more closely below.

Finance manual

An organization's finance manual is the first document to review when identifying direct actions that guide the work of a project team. The purpose of the manual was discussed in Chapter 2.5. Simply stated, it sets out principles, policies, and practices on matters that affect the operations of an organization. It includes guidance on 'HOW to do it', as well as 'WHY we do it'.

Policies outline the reasons why things are done the way they are, and the procedures explain how things are done on a day-to-day basis.

Delegated authority document

Every organization should decide in advance who is responsible for what financial procedures and what level of authority they have. These decisions are recorded in a delegated authority document, sometimes called the authorization matrix or the map of authority. This document's purpose is to clarify who has the authority to make decisions, commit expenditure, and sign legal undertakings on behalf of the organization so that there is no confusion about responsibility (see also Chapter 2.2).

The delegated authority document should include instructions for such duties as:

- Placing and authorizing orders for goods or services
- Signing checks
- Authorizing staff expenses
- Accessing to the safe and petty cash
- Handling incoming cash and checks
- Signing legal undertakings
- Checking and authorizing accounting records

Members of the project team should familiarize themselves with the delegated authority document and follow its guidance when managing the project. Occasionally, there might be a conflict between the delegated authority document and the funder's conditions for a project. In this scenario, the issue should be taken to a senior manager for clarification and guidance, and possibly to establish a temporary change to the delegated authority tolerances for implementation within the project supported by that funder.

> ***Remember:*** *The delegated authority document is usually approved by the Board (the highest level of an organization). A breach of delegated authority rules is a serious matter and should be dealt with through the organization's disciplinary procedures.*

Table 37 below, shows a sample of a delegated authority document. Review this document and pay special attention to how the format of the document observes these standard rules:

- **It clearly defines limits and conditions:** for example, a project officer may be authorized to commit expenditure within specified budgets, or up to a certain amount.
- **It defines the lowest level of authority:** those higher up the management ladder will automatically have the same permissions.
- **It prevents individuals from authorizing transactions they would personally benefit from**: this would make the individual vulnerable to accusations of improper behavior.
- **It avoids staff authorizing payments to their managers**: they must be signed by someone who is more senior in the management structure (or by a Board member).
- **It outlines deputizing arrangements:** this will allow for cover during absence of key staff.

Adapting delegated authority for emergency response projects

It is not unusual in emergency response projects to find that standard procedures for cash management, procurement, and employment decisions are unrealistic, due to the urgency, scale and complexity of the operating environment.

For example, teams working in the immediate wake of rapid on-set emergencies need to make large purchases, often in cash, and with limited access to vendors. In those situations, the delegated authority document may be exceptionally revised to give increased levels of authority to implementing team members.

Exceptional revisions to the delegated authority document must be formally requested, authorized and documented. Remember that any exception should be temporary, monitored, and revisited as the situation evolves.

Table 37: Example delegated authority document

KEY: to the designated persons referred to in the delegated authority document below					
BM	Board member	FO	Finance Officer	PO	Project Officer
CH	Chairperson	LM	Line Manager	T	Treasurer
CE	Chief Executive	PM	Program Manager	VC	Vice Chairperson
FM	Finance Manager				

Area of authority:	**Limits applied:**	**Designated persons:**
Legal documents (where not covered below)		CE CH VC T
Leases on property and equipment	Up to $25,000	CE FM CH VC T
	Over $25,000	CE CH T
Bank account	Up to $500	One from: FM CE PM, any designated BM
	From $501 to $5,000	Two from: FM CE PM, any designated BM
	$5,001 to $25,000	One from: FM CE Plus any one designated BM
	Over $25,000	CE plus any designated BM
Staff advances/loans	Max. $2,500	CE (in case of CE CH or T)
Staff expenses	As defined by the budget	LM for all staff below CE level CH or T for CE
Board member expenses		CH or T
Orders for goods & services	Up to $1,000	PO providing within budget
	Up to $5,000	PM providing within budget
	Up to $25,000	CE providing within budget
	Up to $50,000	CH/T providing within budget
	Over $50,000	Any two BM, and minuted at full board meeting
Petty cash expenditure	Up to $50 Over $50	FO FM
Safe keys		FM and T
Receipt of cash & checks		FO
Banking of cash & checks		FO
Annual/sick leave		LM
Maternity/Paternity Leave		CE (or in case of CE: CH / T)
Contracts of employment	All staff	CH T or VC

6.4 Prevent actions

While the direct actions are intended to encourage people to do the right thing, prevent actions are intended to remove or limit opportunities to misuse resources or commit theft. Prevent actions, like direct actions, are proactive and address risks before they become an issue that needs to be corrected. Prevent actions generally operate during implementation of project activities.

Some illustrative actions that fall into the prevent category include:

- A safe or strong box
- Cash management policy
- Insurance policies
- Authorization limits
- Procurement policies
- Vehicle log books
- Separation of duties
- Computer passwords
- Bank reconciliation

While all the tools, procedures, and actions in the prevent category are important, there are several that are especially relevant to the work of project teams and which are explored more closely below.

Separation of duties

The concept of separation (or segregation) of duties is to share around, to as many people as possible, the responsibilities for: authorizing transactions, receiving goods, custody of assets, entering transactions into the accounting records, reconciling, and verifying transactions.

Separation of duties means ensuring that these functions are undertaken by separate individuals within an organization, so that no one person should have responsibility to complete two or more of these key responsibilities. By sharing the various duties in a finance procedure around a team, it protects those involved and removes the temptation and opportunity to misuse funds.

In the context of development, humanitarian, and conservation organizations, the process for buying goods or services is a good example of the practical application of separation of duties. Imagine a scenario that allows one person to order goods, receive them, authorize the payment, and register the transaction in the financial system. If a single person could do all these four tasks, they could conspire with vendors (this is known as 'collusion') to obtain a financial gain, at the expense of the organization.

Delegating too much authority to a single person weakens internal control due to the opportunity it creates for theft or fraud. It also runs the risk of the financial system grinding to a halt if that person were to leave the organization, or were absent for long periods.

Separation of duties matrix

A 'separation of duties matrix' helps a team to structure the sharing out of duties in a practical and robust way, and helps to identify areas where separation is weak. The table below provides an example of what a procurement duties matrix could look like. Similar matrices could be developed for other processes such as cash management, payroll, inventory, and accounting.

Table 38: Separation of duties matrix, procurement example

Task	Name 1	Name 2	Name 3	Name 4	Compensating controls
Initiate purchase order	Y				
Approve requisition			Y		
Prepare purchase order				Y	
Manage inventory records		Y			
Approve vendor payments				Y	

Note that in smaller organizations, staff limitations may make a complete separation of duties impractical. This is when 'compensating controls' must be considered. For example, in an ideal situation no individual project staff member should undertake all of the following tasks: approve the requisition, approve vendor payments, and manage the inventory records.

However, if this arrangement is unavoidable, a compensating control could be that a line manager would closely review the work of that person to make sure that they were not abusing their responsibility. This should be noted in the separation of duties matrix for procurement.

Cash control

Organizations working in the development and humanitarian sector often work in environments where cash is used extensively or is the preferred, or the only, way to pay for goods and services. Some common scenarios where the use of cash is unavoidable include projects that collect cash receipts in the form of community contributions, charge fees for services, or manage revolving loan funds.

Project teams must take special care with cash because it is especially vulnerable to theft and misuse. Cash control is all about preventing loss and misuse of cash. The 'seven golden rules' for handling cash include practical guidelines to help reduce the risk to cash in projects.

Seven Golden Rules for Handling Cash

1. Keep money coming in separate from money going out.

Never put cash received in with the office cash float, as it could lead to error and confusion in the accounting records, and distort financial information. All cash coming in must be paid into the bank and entered in the records, before it is paid out again.

2. Always give receipts for money received.

This protects the person receiving cash and assures the person handing it over that it is being properly accounted for. Receipts must be written in ink, not pencil, and preferably from a numbered receipt book. It is good practice for receipt books to have three carbon copies: one for the payer, one for the accounting records, and one which stays in the receipt book.

3. Always obtain receipts for money paid out.

No receipt means there is no proof that the purchase was made. If it is possible to obtain a supplier receipt, the details of the transaction should be noted down straight away so that it is not forgotten. The details can then be later transferred to a cash voucher or internal receipt, and authorized by a manager.

4. Pay surplus cash into the bank.

You should aim to pay all cash received into the bank on a daily basis or, at the very least, within three days of receipt. Having cash lying around an office is a temptation to a thief. The cash is safer and could be earning interest in a bank account. A casual approach to cash might lead to people wanting to 'borrow' from it.

5. Have properly laid down procedures for receiving cash.

To protect those handling cash, ensure that there are proper procedures in place, and people know how to use them. Procedures vary depending on the organization and context, but could include steps such as: whenever cash is received have two people present, if possible; count the cash in the presence of the depositor; and keep the cash in view until it is verified and the transaction is complete.

6. Restrict access to petty cash and the safe.

Keys to the petty cash box and the safe should be given only to authorized individuals. This should be recorded in an organization's delegated authority document.

7. Keep cash transactions to an absolute minimum.

Use cash only when all other methods are inappropriate. Set up vendor accounts to for monthly supplies, and pay invoices by check or bank transfer. Paying for transactions through the bank increases control, and provides evidence of the transaction on the bank statement.

Physical controls

Physical controls include many common sense prevent actions intended to safeguard project assets. Physical controls apply to all of the valuable assets used by your project: from cash to building supplies, from valuable documents to vehicles, and everything in between.

Use a safe: Having a safe/strong box, or a safe place, to keep cash, checkbooks, and legal documents is important for internal control. A proper safe is worth considering, especially if your organization must keep large sums of money on the premises overnight. Safes are expensive, however, and it may be better to improve on banking and cash handling procedures.

Keep fixed assets secure: Fixed assets may represent considerable wealth held in the form of land, buildings, vehicles, machinery, and office equipment. Often overlooked, fixed assets require special attention to ensure their value is maintained, and that they do not 'disappear' through lack of vigilance.

Measures to safeguard these assets include:

- **Maintain an asset register.** An assets register should be set up with an entry or record sheet for each item. Each asset should be tagged with a unique reference number for identification purposes. The register will record important information about each asset: Where and when was it purchased? How much did it cost? Where is it located? How much it is insured for? Repair history? Serial numbers? Details of guarantees or warranties?

- **Document a building and equipment maintenance policy.** To preserve the value of buildings and equipment, an organization must have a proactive policy of maintenance. For buildings, this may require a professional planned maintenance contract for which a realistic budget must be provided.

- **Obtain insurance cover.** Valuable assets should be insured to prevent loss to the organization because of every day risks such as fire, theft, and natural disasters. The decision whether to insure property is a good example of managing risk: weighing up the pros and cons of paying for insurance is a common dilemma for managers.

- **Establish a vehicle policy.** Every organization that owns vehicles should have a vehicle policy. This will set down the policy on a range of issues, such as depreciation, insurance, purchasing/replacement/disposal, maintenance and repair, who can drive the vehicles, private use of vehicles by staff, accident procedures, and passenger rules.

- **Maintain vehicle logs.** For each vehicle, there should be a log of journeys so that the running costs per kilometer or mile can be assessed and private use closely monitored. Once you have 12 months' information on the costs of running a vehicle, it is possible to calculate its average running costs per kilometer or mile. Regular monitoring of average running costs over time for each vehicle is a good way to prevent misuse of the vehicles.

6.5 Detect actions

Regardless of investment in direct and prevent actions, they cannot stop all problems before they occur. Detect actions implement procedures and practices designed to identify if and where things have gone wrong. These actions take place after the activity has taken place.

All detect activities are intended to identify irregularities, errors, fraud, and theft. Some illustrative actions that fall into the detect category include:

- Audits
- Budget monitoring
- Cash counts
- Fixed asset register check
- Payment vouchers
- Reviewing records
- Stock counts
- Vehicle log books
- Bank Reconciliation

While all the tools, policies, and actions in the *detect* category are important, there are several that are especially relevant to the work of project teams. These are explored more closely below.

Reviewing records

All managers need to regularly review and authorize records to make sure procedures are being followed correctly and transactions are valid. This is just as relevant for project managers it is for other managers, including executives, senior managers, financial controllers, and board members.

At the project level, these reviews might include, but are not limited to, the following:

- Confirming expenses and receipts are authorized properly, to ensure they are valid
- Counting stocks and checking inventory records
- Reviewing order books to ensure delegated authority limits are observed, orders are valid and with approved suppliers
- Signing off vehicle log sheets to verify journeys are valid
- Verifying whether the assets register is complete and accurately records the project's assets.

Any evidence of non-compliance with procedures must be followed up by appropriate corrective action, such as re-training staff, re-writing procedures, or even disciplinary action in the case of improper behavior.

The audit process

In addition to regular checks by management, every organization should have audit processes in place, a formal detect action. Audits are important for organizations as they demonstrate a commitment to transparency and accountability and bring credibility.

What is an audit?

An audit is an independent examination of records, procedures, and activities of an organization, resulting in a report on the findings. There are three main types of audit: internal, external, and funder (or donor).

Table 39: Types of audit

	Internal audit	External audit	Donor (or funder) audit
Main purpose:	Check effectiveness of systems & procedures	Verify published accounts give a true & fair view	Check funds used in accordance with the funding agreement
Focus of review (starting point):	Systems & procedures manual	Financial statements & underlying records	Project funding agreement
Intended for:	Internal audiences, including board & management	External audiences, including funders & government agencies	Funders & other external audiences
Scope:	As per planned schedule based on risk assessment; may be for a specific department, grant, or period	All financial transactions in accounts, whole organization	Usually limited to project and related funding
Report includes:	Findings & recommendations for improvements	Auditor's opinion and management letter	Usually, auditor's opinion(s) & recommendations

The role of project staff in the audit process

Generally, the role of project staff in the audits process is as follows:

- **Internal audit:** It is at the discretion of the internal auditor whether the scope of the audit requires connecting with a project team. If the auditor is reviewing specific project processes or grant management procedures, they might ask to review project team practices. The degree to which internal audits focus on the programmatic operations will depend on the organization.
- **External audit:** Project staff are unlikely to meet the external auditor or be involved in the audit process.

- **Donor (or funder) audit:** The auditor may wish to interview project staff and partner agencies. Sometimes they may request to observe project activities and speak with beneficiary communities. Always do your best to cooperate during such visits, and to be open and honest about organizational strengths and weaknesses.

6.6 Correct actions

Correct actions aim to provide continuous improvement to the internal control system. Correct actions update and improve internal control systems as the team learns from experience, to reduce the chance of the loss happening again. Illustrative actions in the correct category include:

- Acting on audit recommendations • Revising policies and procedures • Conducting refresher training
- Correcting errors in the • Taking disciplinary actions • Processing insurance claims records

Perhaps the most interesting component of correct actions is that they create learning links to the other three internal control actions. For example:

- Errors found when reviewing accounting records during the *detect* phase are fixed during the *correct* phase.
- Policies created in the *direct* phase that are vague or incomplete are updated during the *correct* phase.
- Audit recommendations finalized during the *detect* phase are addressed during the *correct* phase.

These connections and interconnections underpin a learning cycle that continuously improves the project controls.

6.7 Deterring and detecting corrupt activities

One of the areas where internal controls are especially helpful is in deterring and detecting corrupt activities. Corruption takes place all over the world and affects all levels of society. But it is most severely experienced in the developing world and by those who are poorest in society – these are the communities where most organizations in our sector work.

> *"**Corruption** is the misuse of entrusted power for private gain."*
> **Transparency International**

The most common types of corruption that we encounter at the project level include fraud and bribery. However, in practice, corruption includes a wide span of improper and illicit activities (see table below).

Table 40: Forms of corrupt practice

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

While corruption in any form poses significant risk, and should be actively managed, the remainder of this chapter focuses on two corrupt activities that are especially common in the development, humanitarian, and conservation sector: fraud and bribery.

6.8 Addressing fraud

Fraud is defined as 'intentionally lying or cheating to gain an advantage or to cause someone else to make a loss'. These are serious and illegal offenses and include the theft of goods or property, falsifying expenses claims, or the falsification (or destruction) of records to conceal an improper action.

Fraud has a damaging effect on an organization with wide-ranging consequences if not properly managed. These range from extra work for staff and delays in project activities, to a high level of reputational risk to both an organization and the entire sector. Imagine a stone falling into a pond: the initial splash is the loss of funds or equipment, but it does not stop there. **Figure 16: The ripple effect of fraud**

As money is diverted for unofficial or illegal activities that line the pockets of the powerful, there is less to spend on social services and support for people living in poverty. The prevention of fraudulent activities is therefore a critical part of internal control.

Some ways to take action to prevent fraud before it happens include:

- ensure that robust internal control systems are in place
- establish schedules for regular project visits, so that the project team can monitor project expenditures and check they are in line with implemented activities

- share financial reports with beneficiaries, and ask if they think the project is achieving value for money
- hold regular meetings with staff at all levels (project and administrative staff, board members) and with partners, to discuss financial reports and make budgets and reports openly available to ensure transparency
- take time to help non-finance staff and managers to improve their financial skills.

The list below identifies some of the warning signs that may be an early indication of fraud or abuse. Use them with care! While these signs help identify irregularities, there may be valid reasons for some of these scenarios.

Warning signs of fraud in accounting records:

- Lots of corrections to accounting records. This may include extensive use of white-out or blocked-out figures.
- Pristine documents (e.g. vehicle logs or attendance records) that look as if they have all been written on the same day in the same hand could be an indication of rewritten or duplicate books.
- Delayed banking of cash received discovered by bank reconciliation could be unauthorized 'borrowing' of cash.
- Records are not kept up to date, or are deliberately delayed, so managers cannot detect incidences of false accounting.
- Supporting documents are missing, e.g. bank statements destroyed to cover someone's tracks, or a member of the project team regularly claims to have lost receipts.
- Payments have been made but are not accounted for on a budget line. The cash must have gone somewhere and could have been stolen. A possible cause of this could be poor controls, e.g. if valid receipts are not entered into the accounting records.
- Handwritten supporting documents that include errors and corrections could indicate changes made after goods or services were purchased.
- There is a cash shortfall in a safe or cash box, but the next time you count it, the amount is reconciled. This could indicate possible borrowing of funds by the safe key holder.

Warning signs of fraud in reports:

- Budget monitoring reports reveal inconsistent behavior between line items, e.g. if project-related expenditure is underspent due to delays, but the budget for fuel is overspent. This could indicate abuse of the vehicle.

- Vehicle logbooks are not maintained in an appropriate level of detail. This could indicate abuse of the vehicle.
- Budget monitoring reports are delayed, with potential for covering up unauthorized activities.

Warning signs of fraud in non-financial areas:

- Look out for irregular work patterns, e.g. if someone is first in, last out of the office. This could mean that a staff member is working longer hours to compensate for other activities.
- If a staff member never takes holidays, it could be because they need to cover up irregular activities.
- A significant change in lifestyle or spending patterns that doesn't match a person's income (e.g. designer clothes, social habits, expensive car may indicate irregular activities).
- Creating a smoke screen by making a false accusation about another team member. This may be intended to divert attention or help make a quick getaway.

If you suspect fraud

If you suspect that fraud or other irregularities are taking place, think before you act so that you can deal with the situation appropriately and confidentially. You may need to raise the issue with your line manager or your finance team if you suspect fraudulent activity. This usually depends on the level of authority that you have in your organization. Your organization may have a fraud policy or whistle-blowing (speaking up) procedures that you need to follow. If unsure, it's important to involve your line manager.

You won't be able to spot everything, so take time to ensure that the people you work with (staff and partners) understand the need to be vigilant.

When an incident is reported, it must be dealt with quickly and sensitively. Look for corroborative evidence before starting a formal investigation. If all the evidence points to an irregularity, the individual(s) involved should be formally interviewed with a third person present to take notes. Depending on the nature of the irregularity, an investigation could be conducted by a senior manager or board member, the internal auditor, the external auditor or, in more serious cases, the Police.

Finally, don't underestimate the long-term and less tangible impacts of fraud. It will involve a lot of management time during the investigation and afterwards. In particular:

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

6.9 Managing the risk of bribery

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

Bribery, like fraud, is a form of corruption, and is an everyday experience for many project staff across the development and humanitarian sector. Our sector is at particular risk of paying bribes due to the nature of our work.

- Bribery is often endemic in the countries where we operate.
- Our programs often work in partnership with government agencies and involve frequent contact with public officials, e.g. those issuing operating licenses, border guards, and customs officials.
- Humanitarian programs require quick responses. Delays can cost lives and corrupt officials know this.
- Programs often work collaboratively with other implementing partners, consortia, and third party agents whose actions are more difficult to monitor.

The payment of bribes in the sector, most commonly in the form of 'facilitation payments', results in a huge diversion of funds to corrupt officials, adversely affecting the impact and potential of programs. Facilitation payments are made with the purpose of expediting or facilitating the performance of a public official for a routine governmental action. Typically demanded by low-level, low-income officials in exchange for providing services, which you are legally entitled to receive without such payments.

In many countries, it is illegal to receive and pay a bribe, with severe penalties applied to successful prosecutions. It is therefore important for project teams to be aware of where the bribery risks occur in their programs and to have a strategy for minimizing the risk and cost of bribery. Furthermore, project teams should also recognize that bribery is always a two-way transaction: there has to be both a payer and a receiver. Therefore, if we cut off the flow of bribes, bribery cannot happen. This is the basis for the argument for a zero-tolerance approach to bribes.

Zero-tolerance approach to bribery

In 2010, a group of international NGOs convened to establish a framework of seven principles for a zero -tolerance approach to bribery. The anti-bribery principles (Figure 17) provide a framework for organizations wanting to establish a culture to confront and control bribery. While these principles and guidance were written specifically for NGOs, they apply equally well to all organizations working in the development, humanitarian, and conservation sector.

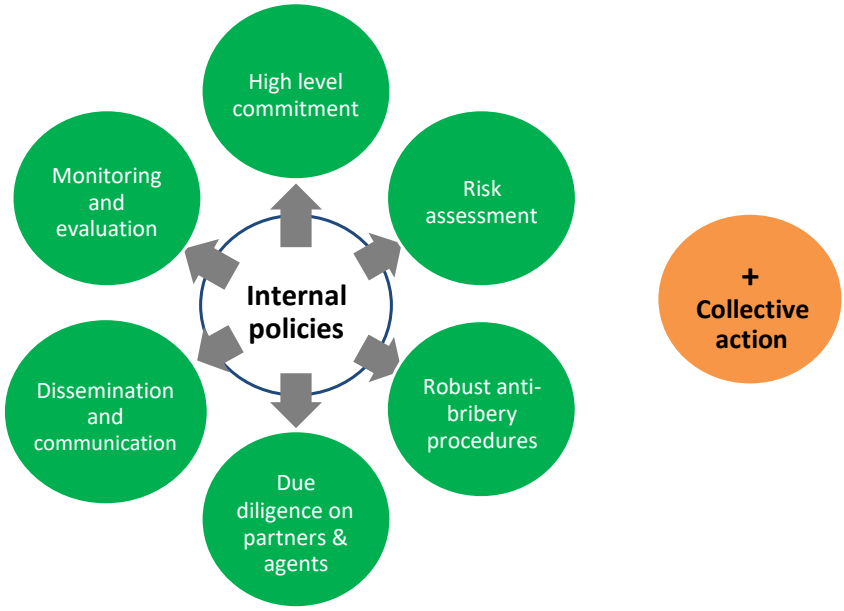


Figure 17: Seven principles for zero tolerance to bribery (BOND 2010)

Seven principles of zero tolerance

1. High-level commitment

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

2. Risk assessment

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

3. Devise and implement robust anti-bribery procedures

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

4. Due-diligence assessment of partners, agents, and contractors

The organization should assess the bribery risk associated with entering into partnership or contracting arrangements with other entities and then carryout periodic due diligence based on that risk assessment. Partnership or contractual arrangements should check that these organizations have policies and procedures that are consistent with these principles and guidance.

5. Dissemination and communication

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

6. Monitoring and evaluation

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

7. Collective action

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

Five key tactics to resist bribes

To put these principles into practice, there are five key tactics that organizations should follow at the program level to minimize the risk and cost of paying bribes. (Source: Mango/Transparency International 2010.)

1. Assess risk

Assess the risk of encountering bribes in your projects and programs. For example:

- Key risk areas, e.g. working with partners, procurement, recruitment, etc.
- The types of bribery risks, e.g. facilitation payments, jobs for favors, etc.
- The frequency of the bribery risk.
- The consequence if the bribe is not paid, e.g. delays to projects.
- From your assessment, create an action plan to reduce the risk of bribes now and in the future.

2. Resist paying bribes

An immediate, short-term strategy to train staff to give them confidence to resist bribes safely. Here are some top tips:

- Make it clear you don't pay bribes from the outset, e.g. "It is illegal to pay bribes in my country."
- Don't give the impression that there is time pressure.
- Deflect approaches: brush it off with a smile, play ignorant, halt a meeting if it looks as if a bribe will be requested.
- Have backup, e.g. witnesses, someone who understands the local language and environment.
- Find an ally, e.g. someone in a position of authority.
- Learn from others who don't pay.

3. Avoid paying bribes

This is a long-term strategy to 'design out' bribes in your project design using the following actions:

- Remove urgency by building in longer timescales for start-ups.
- Carefully select agents and partners.
- Work around high-risk practices, e.g. don't pay per diems.
- Use local knowledge: Which government officials are less corrupt?
- Embed into organization culture.
- Support staff in saying 'no' to bribes, e.g. budget for delays and additional costs incurred.
- Set up and implement robust internal controls.
- Define whistle-blowing procedures.
- Establish local reputation as an organization that does not pay bribes.

4. Report:

- Share information about corrupt practices and officials with other organizations, local media, and embassies

5. Collaborate:

- Work with other organizations to publicize and fight against well-known corrupt practices, e.g. 'import duties' for supplies and equipment during a humanitarian crisis.
- Support 'NGOs don't pay bribes' campaigns.

Further reading

Here are some resources that we have used in developing this chapter. You may also find some of these useful to help you develop your own policies and procedures to fight fraud, bribery, and corruption.

- Anti-bribery Principles and Guidance for NGOs, Bond 2010, www.bond.org.uk
- Corruption Perceptions Index, Transparency International, www.transparency.org
- Preventing Corruption in Humanitarian Operations, Transparency International, www.transparency.org/whatwedo/publication/preventing_corruption_in_humanitarian_operations
- Download the free Transparency International app Preventing Corruption in Humanitarian Operations (for Apple/Android): http://achttp://ac-hum.lucid.berlin/app/overview.htmlhum.lucid.berlin/app/overview.html

APPENDICES

APPENDIX 1: GLOSSARY OF TERMS

These are some accounting terms that you are likely to come across in financial management (not all of which are referred to specifically in the guide).

Account	A record of monetary transactions, either written into a book designed for the purpose or entered on a computer file.
Account code	A number that is used to classify a transaction in the accounting records. It describes the type of income, expenditure, asset or liability that is being logged. Examples: 7070 (fuel costs) or 5060 (office rent and utilities).
Accounting period	A specified period for recording and reporting financial activity for a given time, e.g. one year or one month.
Accrual	Adjustment made at the end of an accounting period to recognize expenses that have been incurred during the period but for which no invoice has yet been received.
Accumulated funds	Money or equipment that is built up year-on-year as a result of not spending income. Often referred to as an organization's reserves.
Activity-based budgeting	A method of preparing budgets that involves calculating the costs of each item from scratch based on a detailed activity plan.
Allocation	The process of sharing direct costs between two or more cost centers in the accounts, in proportion to actual or estimated use. The costs of a shared vehicle could be split into different project activities by the number of miles or kilometers travelled. Income can also be allocated to various activities.
Apportionment	Process for sharing indirect costs between two or more cost centers in proportion to the estimated benefit received, e.g. splitting a director's salary on the basis of full-time equivalent staff numbers.
Asset	Something that is owned, or claimed to be owned, and is of value to an organization. Examples include cash, equipment, and loans to staff. Also see fixed assets and current assets.
Audit	A formal check on the accounts by an independent person (auditor).

Audit trail	The ability to follow the journey of any reported transaction through an organization's accounting systems.
Authorization	The process of approving transactions, normally the decision to purchase or make expenditure. Authorization by a budget holder is a way of confirming that spending is in line with budget and is appropriate. See delegated authority document.
Authorization matrix	See delegated authority document
Back donor	The original source of funds when a grant is channeled through another organization, onto an implementing partner. The agency must report back to the original donor to account for the use of funds by a partner.
Balance sheet	A summary of the financial position of an organization at a particular date, showing the assets owned by the organization and the liabilities (or debts) owed to others. The difference between the assets and liabilities is what the organization is worth on that date.
Bank book	An accounting register that records all transactions passing through a bank account. Also known as a "cashbook" or a "cash analysis book," it can be in a physical book format or on computer.
Bank reconciliation	A monthly process that involves checking the end-of-the-month bank statement and comparing it to the cashbook activities to identify and explain any differences.
Budget	The best possible estimate of the cost of a set of activities over a given period of time, with an indication of how these activities will be paid for.
Budget holder	An individual who has authority and responsibility for managing a budget for a specific activity, project, program, or department.
Burn rate	Expressed as a percentage, the amount of a grant or budget used up so far. Also known as the "utilization ratio".
Capital expenditure	Expenditure on equipment, property, or other fixed assets that will be used to support activities over more than one accounting period.
Capital fund	Accumulated funds and reserves held in the form of equipment and property.
Cashbook	An accounting record that lists all of the receipts and payments made into and out of a bank or cash account. A cashbook is usually kept in a book, a spreadsheet or using specialist accounting software.
Cash reconciliation	A formal count of the physical cash held, which is compared with the records in the related cashbook or petty cash book. Any differences must be investigated and accounted for.
Cash flow	The difference between cash received and cash spent over a given period.

Cash flow forecast	A planning tool that shows the expected timing of receipts and payments over a fixed period of time, 3-6 months or longer.
Chart of accounts	A list of all account codes and account descriptions used in the accounting records.
Comparative bid analysis	A formal comparison of different quotations received from vendors/suppliers. The supplier is selected based on a range of criteria including: price, quality, delivery and 'after sales' terms, to ensure value for money.
Core costs	Costs that are shared by many projects. Also called "central support costs", "overheads" or "indirect costs".
Cost center	A label for a group of costs that are looked at together, for example for a project, program, department or donor.
Current assets	Balance sheet accounts that show the amount of cash and all assets that can be converted into cash, usually within a year. These include bank balances, staff advances and prepayments.
Current liabilities	Amounts that are owed to others (e.g. unpaid suppliers or a bank overdraft) that should be paid back within a year.
Debtor	Anyone who owes money to an organization.
Delegated authority document	A document which clarifies who in an organization has the authority to make decisions, commit and approve expenditure and sign legal undertakings on behalf of the organization so that there is no confusion about responsibility. It also specifies levels of authority or up to what limits the persons can act. Also referred to as the authorization matrix or map of authority.
Depreciation	A proportion of the original cost of a fixed asset, representing the loss in value due to wear and tear, which is internally charged as an expense to the organization. This is a non-cash transaction.
Designated funds	Part of the unrestricted general reserves of an organization that have been set aside for a particular purpose at the discretion of the board.
Direct cost	A cost that can be specifically allocated to an activity, department, or project.
Donations in-kind	Where a grant or contribution to a project is made in the form of goods or services, rather than a cash grant or donation. Also called gifts in-kind. This is a non-cash transaction.
Double funding	Where a project or activity has been funded from more than one source and exceeds the budget needed to complete an activity.
Double-entry bookkeeping	The method of recording financial transactions whereby every item is entered twice (once as a debit entry and once as a credit entry) to recognize that there are always two sides or parties in every transaction, a giver and a receiver.

Exceptions report	A short narrative report that highlights significant variances or areas for concern to accompany management accounts.
External audit	A review of the annual financial statements of an organization, program, or project. Usually carried out by an independent and legally registered auditor, resulting in an opinion about whether the financial statements give a true and fair view of the financial position and associated records.
Financial accounting	Recording, classifying, and summarizing historical financial data, resulting in financial statements.
Fixed asset	Item of significant value that is owned and used by an organization over a long period of time, such as buildings, vehicles, or office equipment.
Fixed asset register	A list of the assets owned by an organization, including details such as reference number, date purchased, price, and location.
Fringe benefits	An extra benefit which an employer provides to an employee, supplementing an employee's money wage or salary. Examples include private health care, housing allowance, pension contributions.
Fund accounting	Accounting for spending on projects according to the source of the donated funds.
Funding grid	An internal planning tool that provides an overview of which funder is paying for what part of a project budget, and where gaps in funding or double funding exist.
General funds	Unrestricted funds that have not been set aside for a particular use and which may be used to support an organization's objectives.
General ledger	The main accounting record where double-entry bookkeeping is used. See also 'nominal ledger'.
Goods received note (GRN)	Supporting documents that accompany deliveries of goods, signed by the person receiving the delivery to acknowledge that the goods have arrived, are undamaged, and are as stated on the packing note.
Imprest	A type of cash float, set at an agreed level, that is topped up by the exact amount spent since it was last reimbursed to bring it back to its original level.
Income and expenditure statement	Summarizes income and expenditure transactions for the ac- counting period, adjusting for transactions that are not yet complete or took place during a different accounting period.
Indirect cost	A cost that cannot be specifically assigned to one activity, department, or project, e.g., the fee for an annual audit, which is later apportioned to projects on a fair and justifiable basis.

Journal entry	An entry in the books of account that covers a non-monetary transaction, e.g., for recording a donation in-kind or an adjustment to correct a recording error.
Liabilities	Amounts owed by an organization to others, including grants received in advance, loans, and outstanding invoices.
Liquidity	The level of cash and assets that are easily convertible into cash compared to demands on the available cash, e.g. to pay bills.
Management accounting	Providing financial information to managers for the purpose of planning, decision-making, and monitoring performance.
Map of authority	See delegated authority document.
Net book value (NBV)	Cost of a fixed asset less the total cost of depreciation to date.
Net current assets	Funds available for conducting an organization's day-to-day operations, defined as current assets less current liabilities. Also known as 'working capital'.
Nominal account	A page or container within a nominal ledger for recording every type of financial transaction likely to occur in an organization. A complete list appears in the chart of accounts, each with its own unique nominal code.
Nominal ledger	A book or of account that holds details of every income, expenditure, asset and liability account used by the organization. Also known as the general ledger.
Organogram	Organizational chart showing the management and departmental structure of an organization.
Out-turn report	A forecast of the final position at the end of the year or planning period for a project. This combines the actual income and expenditure to date with the current forecast of expected income and expenditure to the end of the planning period/year.
Payment voucher	An internal document that is raised for every payment to an external supplier. It provides a unique reference number and evidence of authorization. Supporting documents are physically attached.
Petty cash book	A separate cashbook kept as a record for small cash transactions, such as small office expenditure on coffee, tea or cleaning materials. All transactions are supported by a receipt or voucher.
Prepayments	Amounts paid in advance during a particular accounting period, e.g. office rent paid for the next three months.
Procurement	The process of purchasing goods and services. Steps may include requesting, authorizing, selecting suppliers, ordering, receiving, and paying.

Quarter/quarterly	Three months of the accounting year, e.g. quarter 1 (or Q1) would be from 1 January to 31 March where the financial year runs from January to December.
Receipts & payments report	A summary of the cashbook or bankbook for a defined period with opening and closing cash balances.
Receipt book register	A register (list) of receipt books as they come from a printer showing the date on which each was issued, finished, and returned.
Reconciliation	Process of comparing information in two sets of records that describe the same transactions, e.g. bank, cash or stock reconciliation.
Reserves	An organization's savings, funds that are set aside from surpluses produced over the years.
Restricted funds	Income that has conditions attached to how it is used, usually with a requirement to report back to the funding agency.
Signatories	People who are authorized to sign documents on behalf of an organization, e.g., bank transactions or purchase orders.
Statutory audit	The annual external audit as required by law.
Statutory deductions	Amounts that must be taken from an employee's pay before they receive it, such as income tax.
Stipend	An amount of money that is paid regularly to someone, especially for work or training that is usually unpaid
Supporting document	Original documents that describe a financial transaction, such as cash receipts, invoices, delivery notes, sign sheets, bank statements.
Transaction	Any exchange of goods, services, or money in return for other goods, services, or money. Most commonly receipts and payments.
Trial balance	List of (debit and credit) balances for each nominal account, used to prepare financial statements.
Trustee	A member of an organization's most senior governing body, who shares overall responsibility for its work.
Unrestricted funds	Income and reserve funds that can be used to support any of an organization's objectives as received without conditions attached.
Utilization ratio	Expressed as a percentage, the amount of a grant or budget used up so far. Also known as the 'burn rate'.
Variance	The difference between the budget and the actual amount of income and expenditure.
Virement	The ability to transfer from one budget heading to another, e.g., if one budget line is underspent, using the spare budget to offset overspend on another line.

Working advance	A sum of money entrusted to someone to spend on behalf of an organization, which needs to be accounted for. Also known as a staff advance or cash float.
Working capital	See net current assets.
Year-end	Cut-off point for the annual financial accounting period.
Zero-based budgeting	A method of preparing budgets that involves calculating the costs of each item from scratch, rolling these up into an overall budget.

These are explanations and processes that are often used in our sector.

Development organization	A spectrum of organizations that fall within a wide continuum of humanitarian and development in their projects and practices, including those that facilitate sustainable development programs in areas such as environmental, health, education, and agriculture, and the direct implementation of emergency and development projects for people in critical need because of sudden natural disasters or conflict.
Gantt chart	A bar chart that graphically represents the schedule of program and project activities.
Goal	The highest-level desired end result or impact (transformation, sustainability, livelihood, well-being etc.) to which a project contributes, or the ultimate objective in any logical framework (logframe).
Impact	The significant effect or longer-term result of an activity (identified with the outcome or goal levels in many logical frameworks).
Inputs	The resources that a program or project must mobilize and apply to activities (human and financial resources, and equipment, etc.).
Issue	A risk that has now occurred. It can take the form of an unresolved decision, situation, or problem that will significantly impact on a project.
Iteration	The act of repeating a process for a second, third or more times to achieve the desired goal, target or result. This is sometimes called 'rolling wave' planning.

Logistics	The process of planning, implementing and controlling the efficient and cost-effective flow and storage of raw materials, in-process inventory, finished goods and related information from point of origin to point of consumption for the purpose of conforming to customer requirements.
Outcomes	The end result or consequence of the activities of a project that help to bring about the accomplishment of an organization's goals.
Outputs	The tangible deliverables of a project including products, goods, services and changes (e.g. people gain knowledge and skills or a road built) that contributes to enabling an organization's desired outcomes.
Procurement	Planning and implementing all aspects of resource acquisition, including specifications development, supplier research, negotiations, buying, contract administration and inventory control.
Program	A group of related activities (projects) managed in a coordinated way to obtain benefits and control greater than if projects were managed individually.
Project	A set of activities meeting agreed objectives in a specified period of time with an agreed set of resources.
Project charter	A document that describes a project at a high level and which is used authorize the project manager to begin work.
Project control	The process of measuring and reporting on progress and taking corrective action to ensure that project objectives are met.
Project implementation plan	A comprehensive and logical presentation of the detailed project model to help ensure that it will be delivered on time, on scope and on budget.
Project management	Planning, organizing and managing resources to bring about the completion of project goals, outcomes and outputs.
Project manager	A professional in the field of project management who has the authority to plan, implement and close projects to bring about the successful completion of project goals, outcomes and outputs.
Project proposal	A clear and concise offer that seeks approval from a potential funder for the delivery of products and/or services in response to funder request or anticipated need.

Project scope	All of the work that is required to deliver a project successfully, and how different elements fit together.
Risk	The potential effect of uncertainty on project activities with potential to cause harm if they are not controlled and resolved.
Theory of change	A comprehensive description of the high-level goals of an organization or program illustrating how and why a desired change is expected to happen in a specific context. The goals and objectives of projects should all be led by their organization's strategic intent.
Top-down estimating	A technique that relies on a relatively small group of experts who establish an overall sense of costs (that can then be broken down into smaller work packages).
Work breakdown structure (WBS)	A hierarchical task list created by breaking a project down into its core components and detailed tasks.

FMD PRO LEARNING OUTCOMES

The FMD Pro Learning Outcomes Table maps the contents of the Guide to the FMD Pro to Bloom's Taxonomy's four learning outcomes levels (knowledge, comprehension, application and analysis.) The FMD Pro certification examination bases its questions on the learning outcomes found in the table, providing FMD Pro certification candidates (and training organizations) an outline of what will be assessed in the FMD Pro exam.

Bloom's Taxonomy Learning Outcome Levels				
	1 Knowledge	**2 Comprehension**	**3 Application**	**4 Analysis**
Bloom's Taxonomy Definition	Know key facts, terms and concepts from the guide	Understand key concepts from the guide	Apply key concepts when provided a scenario	Analyze and distinguish between appropriate and inappropriate use of the concepts in the guide

Syllabus Area		**Financial Management Key Concepts**
Topic	**Code**	
Know facts, terms and concepts related to Financial Management		
KC	KC–1	List the 4 actions involved in managing financial resources to achieve an organization's objectives
	KC–2	List the seven principles of financial management
	KC–3	Provide examples of the benefits of strong financial management
Understand Financial Management key concepts		
KC	KC–4	Describe the Plan–Do–Review cycle and how the financial management process fits within it
	KC–5	Describe the four building blocks of financial management and how they are interconnected
	KC–6	Identify practical tools for each of the four building blocks of financial management
	KC–7	Explain how the seven principles of financial management are used to ensure good practice
	KC –8	Explain the importance of the finance manual in establishing the policies, practices and procedures for financial management.
	KC–9	Describe the importance of accountability and transparency in development, relief and conservation organizations
	KC–10	Explain what financial control means and how to achieve it
	KC–11	Describe financial management roles and responsibilities at different levels in the organization

Syllabus Area		Accounting Essentials
Topic	Code	
Know facts, terms and concepts related to Accounting Essentials		
AE	AE−1	Identify the two key reasons why it is important to keep accounts
	AE−2	Differentiate between the purpose, process and outputs of financial accounting and management accounting
Understand Accounting Essentials key concepts		
AE	AE−3	Describe the role of the Chart of Accounts in financial planning and accounting systems
	AE−4	Describe the role of cost centers in project management
	AE−5	Explain the link between budgets, accounting records and financial reports
	AE−6	Explain best practices for keeping and maintaining accounting records
	AE−7	Describe what makes a valid supporting document
	AE−8	Explain the relationship between supporting documents and the books of account.
	AE−9	Explain the key differences between cash and accruals accounting methods
	AE−10	Compare the purpose and process of cash−based accounting to accruals based accounting
	AE−11	Explain the process to account for cash advances
	AE−12	Describe the 'Three Ps' (process, paperwork and people) of procurement.
	AE−13	Give examples of non−cash transactions and how they are treated in the accounting system.
Apply and tailor Accounting Essentials key concepts to a scenario		
AE	AE−14	Navigate the steps of an illustrative procurement process flow chart.

Syllabus Area		Financial Planning
Topic	**Code**	
Know facts, terms and concepts related to Financial Planning		
FP	FP–1	List the eight steps involved in the activity–based budgeting process
	FP–2	List at least 4 challenges that come with managing projects with multiple sources of income
Understand Financial Planning key concepts		
FP	FP–3	Identify the budget roles and responsibilities of different stakeholders in an organization
	FP–4	Identify the advantages and disadvantages of incremental budgeting as compared to zero–
	FP–5	Describe different types of budget and how they are used in project management
	FP–6	Describe how project budgets fit into an organization's budget hierarchy
	FP–7	Describe the purpose and structure of an income and expenditure budget
	FP–8	Describe the purpose and structure of a capital budget
	FP–9	Describe the purpose and structure of a phased budget
	FP–10	Describe the purpose and structure of a consolidated program budget
	FP–11	Describe how cash flow forecasts are used during project implementation
	FP–12	Describe the purpose and structure of a budget worksheet
	FP–13	Identify unit types for different budget items
	FP–14	Explain the importance of codes in budget worksheets to create summary budgets in different templates (internal and external)
	FP–15	Describe the purpose and key components of a budget narrative that accompanies a funding
	FP–16	Identify why it is important to include a contribution to central support costs in every project
	FP–17	Describe the purpose and structure of a funding grid
Apply and tailor Financial Planning key concepts to a scenario		
FP	FP–18	Interpret a project cash flow forecast and identify actions to address project cash shortfalls
	FP–19	Interpret a funding grid and identify actions to address double–funding and under–funding

Syllabus Area		Financial monitoring and reporting
Topic	**Code**	
Understand Financial Monitoring and Reporting key concepts		
FMR	FMR–1	Identify the different types of financial reports that are produced in organizations for program management and stakeholder accountability
	FMR–2	Describe the key components of a typical budget monitoring report
	FMR–3	Compare the uses of the budget variance percentage and the utilization ratio (burn rate)
	FMR–4	Describe the purpose and structure of a cash flow report
	FMR–5	Describe the purpose and structure of the variance analysis table
	FMR–6	Describe the purpose and structure of the budget monitoring action planner
	FMR–7	Describe the purpose and structure of budget forecast reports
	FMR–8	Describe the options and process for managing and updating budgets that have become out of date due to changes in project plans or context.
	FMR–9	Describe the purpose and structure of a typical report to a funding partner.
	FMR–10	Explain why it is important for program staff and finance staff to work together when creating internal and funder reports for projects
	FMR–11	Explain the impact of exchange rate fluctuation on a project supported by a funding agency.
Apply and tailor Financial Monitoring and Reporting key concepts to a scenario		
FMR	FMR–12	Interpret budget variances, variance percentages and income utilization ratios
	FMR–13	Classify budget variances according to whether they are caused by a change of price, quantity or timing, and if a permanent or temporary variance.
	FMR 14	Identify areas of concern based on the review of project budget monitoring reports
	FMR–15	Propose possible actions to address budget variances
	FMR–16	Explain how to address outstanding commitments in budget monitoring reports.

Syllabus Area		Internal control
Topic	**Code**	
Know facts, terms and concepts related to Internal Control		
IC	IC–1	Define internal control
Understand Internal Control key concepts		
IC	IC–2	Describe how internal control systems and procedures are used to minimize internal risk
	IC–3	Describe the four internal control actions and identify examples of controls in each
	IC–4	Describe the purpose of delegated authority and separation of duties
	IC–5	Explain how the delegation of authority may change in a emergency context
	IC–6	Explain how to minimize the risk to project cash and physical assets
	IC–7	Explain the purpose and process of reconciliation in internal control
	IC–8	Compare the purpose and processes of the three main types of audits
	IC–9	Define the concepts of fraud, corruption and bribery
	IC–10	Give examples of the most common types of corruption
	IC–11	Define the seven principles that underpin a zero–tolerance approach to bribery
	IC–12	Recommend actions to strengthen internal control to prevent loss to project resources
	IC–13	Explain the importance of having internal controls to minimize the risk and impact of fraud and other irregular activity
	IC–14	Identify the five practical tactics to deal with bribery in project environments.
Apply and tailor Internal Control key concepts to a scenario		
IC	IC–15	Recognize typical warning signs that fraud may be occurring in a project