Aim and purpose
The purpose of this module is to help the small scale contractors build a working vocabulary of the financial world and to understand the basic computations used by analysts working in the corporate finance field. The terms and ideas covered in this module will provide the background necessary for small scale contractors to understand concepts of financial management.

Learning outcomes
On completion of this module a learner should:

a) Understand the basics of financial markets that provide short and long term financial requirements of the business
b) Understand the requirements of various banks that provide facilities to small scale contractors
c) Understand the basic concepts of the three main financial statements
d) Recognize the significance of the time value of money in the financial planning process
e) Identify techniques used by financial planners to evaluate, compare, and select investment alternatives
f) Recognize the basic valuation concepts and calculations that apply to corporate valuation
g) Identify fixed income securities that may be included in an investment portfolio and derivative securities that are used to manage risk.

Module Overview
Financial management serves as an introductory mode for students beginning their study of finance and financial markets. The ideas and calculations presented in this module serve as the foundation for continued study in the areas related to corporate finance and the capital and derivative markets. The purpose of this module is to help the learner build a working vocabulary of the financial world and to understand the basic computations used by people working in the corporate finance field. The terms and ideas covered in this module will provide the background necessary for the learner to understand concepts presented in financial management for contractors.

Designed for: Owner/Managers, Administrators, Sole Trader, Partnerships, Small Company Structures
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1 OVERVIEW
Financial Management Components Financial management is an important part of programs management and must not be seen as a separate activity left to finance staff. There is no model finance system which suits all organizations. But there are some basic components which must be in place to achieve good practice in financial management.

Planning and Budgeting - Linked to the firm’s strategic and operational plans, the budget is the cornerstone of any financial management system and plays an important role in monitoring the use of funds. It is essential for any business firm to plan and budget.

Accounting Records - Every firm must keep an accurate record of financial transactions that take place to show how funds have been used. Accounting records also provide valuable information about how the organization is being managed and whether it is achieving its objectives.

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

Internal Controls - A system of controls, checks and balances – collectively referred to as internal controls – are put in place to safeguard an organization’s assets and manage internal risk. Their purpose is to deter opportunistic theft or fraud and to detect errors and omissions in the accounting records. An effective internal control system also protects staff involved in financial tasks.

2 PRINCIPLES OF FINANCIAL MANAGEMENT
It is useful to identify a series of good practice principles, which can be used as a standard in developing proper financial management systems. These principles provide a high-level guide for firm owners to help them make sure that their firm is using funds effectively and that staff are working appropriately.

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

2.2 ACCOUNTABILITY
The firm must explain how it has used its resources and what it has achieved as a result to all stakeholders (Clients, Tax Authority, Bankers etc). All stakeholders have the right to know how their funds and authority have been used. A firm must have an operational, moral and legal duty to explain their decisions and actions, and submit their financial reports to scrutiny.

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

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

2.5 INTEGRITY
Individuals in the firm must operate with honesty and propriety. For example, managers and Board members will lead by example in following policy and procedures and declare any personal interests that might conflict with their official duties. The integrity of financial records and reports is dependent on accuracy and completeness of financial records.

2.6 STEWARDSHIP
A firm must take good care of the financial resources it is entrusted with and make sure that they are used for the purpose intended – this is known as financial stewardship. The governing body (e.g. the Board of Directors) has overall responsibility for this. In practice, managers achieve good financial stewardship through careful strategic planning, assessing financial risks and setting up appropriate systems and controls.

2.7 ACCOUNTING STANDARDS
Accounting standards is a term used to refer to the standard framework of guidelines for financial accounting. These include conventions and rules accountants follow in recording and summarizing transactions, and in the preparation of financial statements. The system for keeping financial records and documentation should be in line with the internationally accepted accounting standards and principles.

3 TOOLS OF FINANCIAL MANAGEMENT
There are many tools, not necessarily financial, which managers can use to help achieve good practice in financial management and control. We can identify these tools under each of the four functions of financial management.

3.1 PLANNING
Planning is basic to the management process and involves looking ahead to prepare for the future. In the course of putting a plan together managers will consider several possible alternatives and make a number of choices or decisions. Planning must always precede the doing. Tools: Strategic plan, business plan, activity plan, budgets, work plans, cash flow forecast, feasibility study…etc.

3.2 ORGANIZING
The resources of the firm – staff, vehicles, property, and money – have to be co-ordinated to ensure implementation of the overall plan. It needs to be clear what activities and responsibilities are to be undertaken, when and by whom. Tools: Constitution, organization charts, flow diagrams, job descriptions, Chart of Accounts, Finance Manual, budgets, etc.

3.3 CONTROLLING
A system of controls, checks and balances are essential to ensure proper application of procedures and resources during program implementation.
Tools: Budgets, delegated authority, procurement procedure, reconciliation, internal and external audit, fixed assets register, vehicle policy, insurance...etc.

3.4 **MONITORING**

This involves producing regular and timely information for managers and stakeholders for monitoring purposes. Monitoring involves comparing actual performance with plans to evaluate the effectiveness of plans, identify weaknesses early on and take corrective action if required. Tools: Evaluation reports, budget monitoring reports, cash flow reports, financial statements, project reports, audit reports, evaluation reports…etc.

4 **FINANCIAL MANAGEMENT RESPONSIBILITY**

It is important to understand firm’s structure and legal status to appreciate who is responsible for what in financial management.

*The Governing Body:* The governing body is legally responsible and accountable for governing and controlling the organization. This means that if anything goes wrong, then the law holds the members of the governing body responsible. The Governing body could have many different names depending on the organization – Board of Directors, Executive or Governing Board – and several functions including:

- Responsibility for deciding on policy and strategy;
- Custodianship (or safeguarding) of the financial and other assets of the organization;
- Appointing and supporting the Chief Executive; and
- Representing interests of stakeholders.

*The Chairperson*

Is usually the main point of contact for the Chief Executive Officer (CEO), and usually fulfils an important public relations role.

*The finance manager* oversees the finances of the organization. In smaller businesses the Finance Manager may take on a more active role and act as bookkeeper, but where there are paid staff the finance manager assumes more of a supervisory role.

Even if they are not supervising the accounting process and preparing reports themselves, board members must still be sure that everything is in order.

*Chief Executive Officer (CEO):* As the governing body is made up of part-time who meet only a few times a year, it delegates authority for day to day management to the CEO, appointed by the board to implement policy. The CEO then decides how to further delegate authority, to share out duties amongst the staff team. While it is acceptable for the governing body to delegate authority to staff members, it cannot delegate total responsibility since ultimate accountability rests with the board members. Furthermore, authority without accountability is unhealthy – the Board must set up monitoring mechanisms to make sure their instructions are being fulfilled.

5 **PLANNING AND BUDGETING**

Planning and budgeting involves all the procedures necessary to ensure that the firm’s activities are carried out effectively and in particular the financial information needed is provided in an efficient and timely manner. Planning is the process of determining how an
organization will afford to achieve its strategic goals and objectives. Budgeting is the process of planning income and expenditure for a specific time or project. It is an essential component of the planning process.

Budgets are used to:

1. Plan and implement a firm’s objectives
2. Calculate estimated income and expenditure
3. Co-ordinate activities
4. Communicate plans
5. Set clear targets
6. Quantify the resources and people needed to achieve them
7. Monitor, review and evaluate actual performance
8. Be accountable to shareholders

5.1 THE BUDGETING PROCESS

The process should be a well-coordinated and consultative exercise. The budget process involves asking a number of questions:

- Objectives - What are the firm’s objectives?
- Activities - What activities are to be carried out in achieving these objectives?
- Resources - What resources will be required in carrying out these activities?
- Cost - What is the estimated cost of resources?
- Funding - What will be the financing resources
- Outcome - Is the expected outcome realistic?

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

Summary of key budgeting steps

1. Identify project or organizational objectives Involve a range of staff and stakeholders in this.
2. Decide on limitations Identify any limits to resources and funds available at the start.
3. Gather data For example:
   - Previous year’s budget and latest information on actual income and expenditure
   - Estimates of running costs, income and grants
   - External factors influencing income and expenditure (such as exchange rates, predicted inflation)
4. Decide how much will be received (income) Be as realistic as possible. Show lower estimates of donations and charges. Only include guaranteed grant income.
5. Decide how much will be spent (expenditure) Separate items into types. This may need to follow your own organization’s and/or your donor’s standard list of budget headings.
6. Construct the budget
   - List the budget item by item, making sure that income is at least as much as expenditure. Provide a note of calculations to justify them.
7. Obtain approval
   - Obtain approval from your own firm board of directors.
5.2 GOOD PRACTICE IN BUDGETING

5.2.1 Clarity
Since many different people will need to use the budget for different purposes, they should be able to understand it (and adapt it, when necessary) without any additional explanation beyond what is written down. Clarity and accuracy is key so it is important to keep notes on budgeting assumptions and how calculations have been made.

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

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

5.2.4 Estimating Costs
It is important to be able to justify calculations when estimating costs. Even if you use the incremental method of budgeting, do not be tempted to simply take previous year’s budget and add a percentage amount on top for inflation. While last year’s budget could be very helpful as a starting point, it could also be very misleading and contain historical inaccuracies. One of the best approaches is to make a list of all the inputs required and specify the number and unit cost of each item. From this detailed working sheet it is a simple matter to produce a summarized budget for each line item and is very easy to update if units or costs change.

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

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

Things to keep in mind

- Involvement of field staff, community representatives and all the stakeholders in the preparation of the budget.
- The administrative costs verses total program costs. For instance, the administrative costs may be a percentage of the total program costs or may be based on the actual costs to be incurred in support of the program activities
- Budget and price increases and provision for unforeseen or abnormal expenditure.
Budget should be prepared in a draft form, the draft budget should be placed before the decision making body, where the feasibility of various individual budgets is discussed upon and a decision is made. On the basis of approval, the final budget should be prepared.

**Good practices in budgeting**

- Always start with the objectives for the organization/activity and involve other people. Ask the person responsible for each activity to prepare a budget.
- Use finance staff to provide technical advice, but not to decide priorities (unless it is their own budget).
- Be as realistic as possible. Add notes to the budget to show how calculations were made. Show whether income is ‘guaranteed’ or ‘not yet confirmed’.
- Allow plenty of time and get approval from the management before the start of the period/year.
- Show the agreed budget (and any alterations) to staff. Tell them what they have to do to keep within the budget.
- Provide detailed budget-monitoring reports for those with day-to-day management responsibility, and a summarized report for the management committee.
- Monitor the budget against actual income and expenditure regularly. Take any necessary action. The management committee, leader, and managers should review these reports regularly.
- Add notes to budget-monitoring reports, to explain major differences between the budget and actual income and expenditure.

Budgets are used by different people for different purposes.

- The *Board of Directors* needs the organization’s overall budget because it has to formally approve it and monitor its progress.
- *Chief Executives* need budgets to keep an eye on progress of the whole organization and the funding situation.
- *Project managers* need budgets to oversee the implementation of their project activities.
- *Finance staffs* need budgets to make sure there are enough funds in the bank to cover anticipated expenditure.

**5.2.6 Cash-flow Forecasting**

The cash flow forecast (or cash budget) is based on the income & expenditure and capital budgets for the firms. It is used by managers to monitor the availability of cash. Whereas the income and expenditure budget shows whether the firm is covering its costs over the whole year, the cash flow forecast shows whether it has sufficient cash in the bank to meet all of its payments needs as they arise.

The cash flow forecast attempts to predict the flow of cash in and out of the firm throughout the year by breaking down the budget into smaller time periods, usually one month. This then helps to identify likely cash shortages and allows avoiding action to be taken such as:

- requesting for payments from clients early
- delaying payment of certain invoices
- delaying some activities; or
- negotiating a temporary overdraft facility

**How to Prepare a Cash flow**
Cash flow forecast will show:

a) When the money will be received and paid
b) Whether there will be a positive or negative bank/cash balance over each month of the period
c) If you need to plan to cover a shortfall, or invest a surplus
d) To compile a cash flow forecast you need to:
   e) Use the organization’s budget
   f) Decide when each budget item will be received or paid. Some may be received in a single amount, others may be paid equally each month (for example salaries)
g) Write down each item, and enter each item when you expect it will be received or paid, regardless of when it is due
h) Include the expected bank and cash balance at the beginning of the period as your starting point
i) Calculate the amount for each month by taking:
   i) The opening balance for the month
   ii) Plus the money estimated to come in during the month
   iii) Less the money estimated to go out during the month
   iv) This equals the balance left at the end of the month (and the opening balance for the next month)
j) Improve your cash flow by considering whether any ‘money coming in’ can be received earlier, or any ‘money going out’ can be paid later
k) Update the forecast as new information becomes available

5.2.7 Accounting Records

Good financial records are the basis for sound financial management of any firm.

i) Importance of Records

Information All firms need to keep records of their financial transactions so that they can access information about their financial position, including:

- A summary of income and expenses and how they are allocated under various categories.
- The outcome of all operations – surplus or deficit, net income or net expenditure.
- Assets and Liabilities – or what the firm owns and owes to others.

ii) Credibility: keeping accurate financial records promote integrity, accountability and transparency and avoid suspicion of dishonesty.

iii) Legal Requirement: There is often a statutory obligation to keep and publish accounts.

iv) Future Planning: Although financial accounting information is historical (i.e. happened in the past), it will help managers to plan for the future and understand more about the operations of the firm. With information spanning two or three years, it is possible to detect trends.

5.2.8 Accounting Methods

Keeping accounts simply means devising appropriate methods for storing financial information so that the organization can show how it has spent its money and where the funds came from. Accounting records can be kept in a manual format – i.e. hardback books of account – or in a computerized format in one of many accounts packages available.
There are two main methods for keeping accounts:

- **Cash accounting**
- **Accruals accounting**

The two methods differ in a number of ways but the crucial difference is in how they deal with the timing of the two types of financial transaction:

- *Cash transactions which have no time delay since the trading and exchange of monies takes place simultaneously.*
- *Credit transactions which involve a time lag between the contract and payment of money for the goods or services.*

Significantly, this produces different financial information so we need to know the basis of accounting to better understand of financial reports.

### 5.2.9 Cash Accounting

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

1. **Payment transactions are recorded in a Bank (or Cash) Book as and when they are made and incoming transactions as and when received.**
2. **The system takes no account of time lags and any bills which might be outstanding.**
3. **The system does not automatically maintain a record of any money owed (liabilities) or to (assets) of the organization**
4. **The system cannot record non-cash transactions such as depreciation.**

### 5.2.10 Accruals Accounting

This involves ‘double entry’ bookkeeping which refers to the dual aspects of recording financial transactions to recognize that there are always two parties involved: the giver and the receiver.

The dual aspects are referred to as debits and credits. This system is more advanced and requires accountancy skills to maintain.

- **Expenses are recorded in a ‘General Ledger’ as they are incurred, rather than when the bill is actually paid; and when income is earned rather than when received.**
- **By recognizing financial obligations when they occur, not when they are paid or received, this overcomes the problem of time lags, giving a truer picture of the financial position.**
- **The system can deal with all types of transactions and adjustments.**
- **The system automatically builds in up-to-date information on assets and liabilities.**

These records provide an Income and Expenditure Account summarizing all income and expenditure committed during a given period; and a Balance Sheet which demonstrates, amongst other things, money owed to and by the firm on the last day of the period.

**Key Records**

Examples of key records include the following

- Cash/Bank book
- Vouchers (Receipts, Payments and Journal)
- Imprest / Advances Register
- Bank Statement/Bank Reconciliation
5.2.11 The Cash Book
This is the analysis book used to keep track of the monetary transactions, which take place in a firm. In this book the firm’s inflows (or deposits) and cash outflows (or withdrawals) are recorded.

A cashbook is used for recording, classifying and summarizing an organization’s cash transactions in such a manner that would enable anyone interested in the information contained therein to make an informed decision. When the cashbook is well kept, then as one looks at it one should be able to tell the amount of money an organization had (if any) at the beginning of a given period, how much money has come in (deposits) or how much has been paid out (or withdrawn) and the remaining or available balance as at a given period of time.

5.2.12 Vouchers
A voucher is a documentary evidence to support transactions. There are three types of vouchers.

- Payment Voucher – used to record payments/expenses
- Receipt Voucher – used for recording receipts whether by cash or cheque
- Journal Voucher – used to record transactions other than those involving cash.

i) Imprest/Advances Register
This is a record that shows sum advanced, repaid, accounted for or still outstanding. Office imprest is a fixed amount of cash available in an office designated to be used for incidental and miscellaneous expenses, such as office milk, coffee, tea, nuts, bolts, plugs, casual labor wages, some stationery and the like.

Cash is advanced from the office imprest by first using an approved requisition form. The various expenses incurred by using office imprest are entered and coded on a “petty cash expenses voucher”. These expenses get to be entered in the cash book when replenishing the office imprest.

Travel imprest or advance is an amount requested by and availed to an individual to be used for an authorized and scheduled field trip. The cash for the scheduled trip is availed using a “Travel imprest or advance request form”. This is a onetime imprest or advance and must be requested for every time a field trip is scheduled. The imprest or advance must be accounted, using a “Travel expenses voucher” which should be filled, signed, submitted and approved as soon as the individual returns from the field trip and must also surrender the cash balance if any.

5.2.13 Bank Statement
A bank statement is a detailed record of one’s financial transactions maintained by the bank, available to the customer on request. Besides the customer’s deposits and withdrawals, the bank statement contains a record of such items as:

- Charges made by the bank for keeping the account
- Interest on loans and overdrafts
- Standing order payments made by the bank on the customer’s behalf, as per the customer’s written instructions
- Direct collections made by the bank on behalf of the customer
- Unpaid cheque for whatever reason.
5.2.14 Bank Reconciliation Statement

The bank reconciliation is a record agreeing differences between the bank statement and the cash book. It serves the following purpose;

- To check the accuracy of the cashbook and the bank statement before preparation of financial statements and reports.
- It is a tool of internal control for bank transactions, which allows the account holder to investigate and settle any differences arising between the account holder’s cashbook and the bank statement.
- Ensures that undue delays are not occurring between cheque disbursements, deposits and their clearance by the bank.
- To ascertain the correct balance of cash to be reported in the financial report.
- To check for any errors committed in the recording of banking transactions, either by the account holder or the bank.
- To update the account holder’s cash records as regards payments made and items received by the bank, which appear only in the bank statement but not in the account holder’s records.

EXAMPLE - The Cash Book On 1 January 2010, Chileshe ltd had K200 cash in hand and K200,000 in the bank. During the month the following transaction took place.

a) Receipt of cash from a client into the bank k100,000 on 5 Jan 2010

\[
\begin{align*}
\text{Dr} & \quad \text{Bank} \quad K100,000 \\
\text{Cr} & \quad \text{Income} \quad K100,000
\end{align*}
\]

b) Withdrawal from Bank to Petty cash – k 2,000 on 10 Jan 2010

\[
\begin{align*}
\text{Dr} & \quad \text{Petty cash} \quad k2,000 \\
\text{Cr} & \quad \text{Bank} \quad k2,000
\end{align*}
\]

c) Payment of expense from Bank – Salaries paid k20,000 on 15 Jan 2010, Cheque 001

\[
\begin{align*}
\text{Dr} & \quad \text{Expense} \quad k20,000 \\
\text{Cr} & \quad \text{Bank} \quad k20,000
\end{align*}
\]

d) Payment of advances from Petty cash – k 500 each to James, Mike and Mary on 20 Jan 2010

\[
\begin{align*}
\text{Dr} & \quad \text{Advance to James} \quad k500 \\
\text{Cr} & \quad \text{Petty cash} \quad k500
\end{align*}
\]

\[
\begin{align*}
\text{Dr} & \quad \text{Advance to Mike} \quad k500 \\
\text{Cr} & \quad \text{Petty cash} \quad k500
\end{align*}
\]

\[
\begin{align*}
\text{Dr} & \quad \text{Advance to Mary} \quad k500 \\
\text{Petty cash} & \quad k500
\end{align*}
\]

e) Retirement/Liquidation of travel advance k 500 on 25 Jan 2010

i) James – Expense k500 in full

\[
\begin{align*}
\text{Dr} & \quad \text{Expense} \quad k500 \\
\text{Cr} & \quad \text{Petty cash} \quad k500
\end{align*}
\]
5.3 FINANCIAL REPORTING

Financial reports are needed primarily by those responsible for managing the firm and by current and potential financiers; but those responsible for financial management of a firm also need to ‘give an account’ of their stewardship to a wide range of stakeholders.

- **Project staff**: To know how much money and resources are available for their projects and what has been spent so far.
- **Managers**: To keep an eye on how project funds are being used, especially compared to the original plans. To help plan for the future.
- **Finance staff**: To make sure that there is enough money in the bank to buy the things the firm needs to run its business.
- **Government**: To make sure that the organization pays any taxes due and that it does not abuse its status as a ‘not for profit’ organization.
- **Project beneficiaries**: To know what it costs to provide the services they are benefiting from and to decide if this is good value for their community.
- **The general public**: To know what the organization raises and spends during the year and what the money is used for.

5.3.1 Budget Status and Advance

Request On periodic basis (monthly or quarterly) depending on the reporting requirements, a report that combines the budget, expenses in the cashbook, cash flow statement and a reconciliation of cash balance at hand may be required. This report is divided into the following main sections:-

**I. Budget section**

a) Account code - this is a listing of budget line items in line with the firm’s chart of accounts. Some firms may not have a comprehensive chart of accounts; in this case the existing cost classification can be applied.

b) Budget line items - this is the description of the account code in (a) above.

c) Approved budget - this is the consolidated approved budget for the year.

**II. Expenses section**

a) Previous cumulative expenses - these are the sum total of expenses for the previous periods excluding those for the period being reported.
b) Current expenses - these are expenses for the period being reported as reflected in the cashbook for the current reporting period.

c) Total spent to date - this is the sum total of previous cumulative expenses plus current expenses

III. Cash projection section

This is the projected cash flow to meet the planned expenditure for the subsequent periods. This can be monthly, quarterly or any other period as may be agreed. It is a good practice to limit cash flow projection to a period of 3-6 months as it may be difficult to accurately project cash flow requirements beyond 6 months.

IV. Fund balance reconciliation section

This is a summary reconciliation of total receipts net of total payments, projected cash requirements, cash at hand and the expected additional cash requisition.

5.3.2 Annual Accounting Statements

Most firms, even small ones, produce a statement at the end of their financial year, to report what they have done with the funds given to them. These are presented in two main ways:

i) Receipts and payments account

The receipts and payments account (sometimes called a ‘cash account’) shows a summary of all cash and bank money coming in (receipts) and going out (payments) over the last year. It is the simplest form of accounting statement. Items bought for longer-term use, for example vehicles or computers, are listed alongside the day-to-day items such as rent and salaries. All the information for a receipts and payments account comes from the organization’s own records. It shows:

- The amount held in cash and bank at the beginning of the year
- Plus money received (receipts)
- Less money paid (payments)
- The amount held in cash and bank at the end of the year.

It does not show whether a surplus or a deficit has been made, only what money is left. The receipts and payments account is usually produced by small groups with a single purpose or activity and few staff. Its main advantage is that it can be prepared by someone who has not been trained in technical accounting.

ii) Income and expenditure account

The income and expenditure account is an annual accounting statement to show what has happened over the last year. It shows the cash and bank amounts, but also additional items. For example, an amount due for payment in the year (for example the outstanding end-of-year telephone charge) will be included, even though it has not yet been paid. This means that the account shows a full 12 months’ income and expenditure, and can be compared with the budget and previous year’s accounting statements.

4.4 Reporting to Government The government will require full disclosure of information related to taxes as well as development activities supplementing government efforts.

iii) Reporting to Beneficiaries
Most firms recognize the need for downward accountability. To participate fully in an organization’s work, beneficiaries need access to information about its plans, resources and activities. Increasing transparency and accountability to beneficiaries has many benefits including:

- Strengthening trust and respect between organization’s staff and beneficiaries;
- Improving the quality of program decisions, as beneficiaries provide feedback on how funds are being spent;
- Empowering beneficiaries to make their own decisions on their own behalf; and
- Reducing the risks of inefficiencies and fraud.

Introducing this level of financial transparency may naturally hit some obstacles, such as adding to the burden of already busy staff. But if sensitively done, the benefits generally far outweigh the costs. Some good practice ideas on how to practically report to beneficiaries include:

- Making information easier to understand by using graphical presentations
- Using whiteboards outside offices to display budgets, the amounts of funds available for each area and a monthly update of expenditure.

5.3.3 **Qualities of Good Accounting Information**

*Relevance:* The information provided should satisfy the needs of information users. In the case of company accounts, clearly a wide range of information will be needed to satisfy a wide range of users.

*Completeness:* An organization’s accounts should present a rounded picture of its activities.

*Comprehensibility:* Information may be difficult to understand because it is skimpy (not large enough in amount or size) or incomplete; but too much detail is also a defect, which can cause difficulties of understanding.

*Reliability:* Information will be more reliable if it is independently verified. It is a good practice that the auditors who verify accounts be independent of the organization and hold an approved qualification.

*Objectivity:* Information should be as objective as possible. This is particularly the case where conflicting interests operate and an unbiased presentation is needed.

*Timeliness:* The usefulness of information is reduced if it does not appear until long after the period to which it relates. What constitutes a long interval depends on the circumstances: management may need frequent information on cash flows to run the firms efficiently.

**Questions to answer when developing a budget**

- Does the budget reflect the organizations priorities?
- What are the fundamental assumptions upon which the budget has been approved (ex. inflation rates)?
- Who is responsible for monitoring and controlling budget expenditures?
- What are the boards’ budget policies that govern the preparation and control of the budget?
5.4 **INTERNAL CONTROLS**

Financial (or internal) controls are essential for any FIRM. They help an organization to prevent errors and the possibility of theft. Most importantly, financial controls help to protect reputations. The leadership team and managers are responsible for making sure that there are good financial controls in place.

What are financial controls? Financial controls are the financial and management systems that aim to protect the firm’s property and minimize the risk of error and theft.

5.4.1 **Cash control principles**

Cash is the most liquid of assets, and is therefore most likely to be misappropriated. For this reason, establishing basic internal controls over cash receipt, maintenance of cash and cash disbursement is critical. Risks with cash are theft or loss of cash, disbursement of cash without proper document or authorization, incorrect charging of receipts/disbursements, (incorrect source codes or accounts), disbursements that do not comply with donor regulations.

a) Keep the minimum amount of cash needed for you to operate efficiently.

b) Record all cash items received or paid in a cash book as soon as possible after the transaction has taken place.

c) Issue pre-printed numbered receipts, with the organization’s name, for any cash received, and keep a copy.

d) Request a receipt and keep it when money is paid out in cash.

e) Keep cash in a secure place – preferably in a lockable tin which is kept in a safe. If not, use a locked cupboard or drawer.

f) A senior person should count the cash regularly and check that it agrees with the cash book. This person and the cashier should sign the cash book to confirm that the count has been made.

g) Someone other than the cashier should authorize any large or unusual payments. Set a limit above which the cashier must obtain the approval of a manager.

h) The person responsible for cash (the ‘cashier’) should not (ideally) be the one dealing with other accounting records.

i) The cashier should check regularly how much cash is left and tell a senior person if there is not enough for day-to-day operations.

j) Make one person responsible for the control of cash at any one time. When a new person takes over, both people should agree and sign the cash balance.

5.4.2 **Bank control principles**

a) Register bank accounts in the name of a firm – never in the name of an individual.

b) Tell the bank that all requests for withdrawals (cheques, for example) should be signed by two people. Sometimes it is more practical to require ‘any two signatories from three named individuals’.

c) Never sign blank cheques, or expect others to do so.

d) Each time that the bank statement is received (or the pass book is updated), check that the organization’s own bank records in the cash/bank book agree with it.

e) Write cheques for as many payments as possible, to avoid holding large amounts of cash.

f) Transfer large amounts directly through the bank from one account to another.

g) Pay money into the bank as often as practical, to avoid keeping large sums of cash on the premises. In rural locations, this cannot be done very often. Make use of people going to the town where the bank is, to pay money in. Cheques can sometimes be...
requested to avoid large amounts of cash building up. If cash is held, it must be kept securely.

h) The person who is involved in the preparation of cheques should not also sign them.

i) Keep cheque books in a safe, locked cupboard or drawer.

j) Keep the fewest possible separate bank accounts, although some donors will insist that you keep a separate bank account for their funds.

5.4.3 Budgeting and accounting controls

a) Prepare the budget in line with organizational objectives before the start of the year, and get the management committee to approve it.

b) Produce the budget and actual reports as soon as possible after the end of the period.

c) Add notes to explain large differences in the budget and actual statement.

d) Compare regular summaries of income and expenditure with the budget. Make sure that the management committee and managers monitor the summaries.

e) Prepare a cash-flow forecast to show when shortages may occur.

f) Record everything, keeping accurate and up-to-date accounting records.

g) Make sure that there is a supporting document (an invoice, for example) for every transaction, and file the documents in order.

h) Keep a system to alert you when money is still owed to you.

i) Record ‘restricted’ donor funding separately in the accounting system.

j) Provide financial reports when required and include them in work plans.

5.4.4 Purchase and authorization controls

a) Make sure there is a budget for goods and services ordered.

b) Allow only nominated people to place orders.

c) Ask for at least three quotes for goods and services valued at more than a certain amount.

d) Check goods and services received for quality before paying for them.

e) Match invoices against original orders, and pay on original invoices only.

f) Keep clear records of money owing and paid to other people.

g) Do regular stock-takes of goods held, and check that they agree with stock records.

h) A senior person should authorize expenditure before it is made.

i) Cheques should be authorized by a different person from the one who signs them.

5.5 Management controls

a) Allocate responsibilities to staff.

b) Write job descriptions for staff.

c) Recruit suitably qualified staff: check their references and qualifications.

d) Identify and deal with staffs that are not performing adequately.

e) Make sure that everyone knows the policies and procedures. Write them down and talk about them regularly, for example in staff meetings.

f) Develop staff, for example through induction and training for new staff.

6 EXTERNAL AUDIT
An audit is an independent examination of records, procedures and activities of an organization, resulting in a report on the findings. There are two kinds of audit:

a) Internal audit

b) External audit
As the name implies, an external audit is primarily for the benefit of those outside the organization, e.g. stakeholders and funders. Internal audit is undertaken for the benefit of those inside the organization, i.e. trustees and management.

The audit should be a positive experience and it is an opportunity to receive feedback on strengths and weaknesses of organizational systems.

6.1 Importance of Audits
Audits are important to organizations as they demonstrate a commitment to transparency and accountability and bring credibility. It is also a legal requirement in most countries to have the financial statements reviewed by an independent auditor once a year.

6.1.1 Internal Audit
An internal audit review is undertaken at the request of the management of the organization. It focuses on reviewing compliance with systems and procedures as set by the Board/management. The internal auditor’s report will highlight findings and make recommendations for action, where needed. It may be carried out by someone within the organization, or an outsider may be engaged to carry out an ‘internal audit’ through an outsourcing arrangement.

An internal audit will include a range of checks as part of the independent review, including:
   i) Financial accounting systems and procedures;
   ii) Management accounting systems and procedures;
   iii) Internal control mechanisms.

The internal auditor reviews the adequacy of the design of the systems of procedures, and checks that they are being properly implemented. A report is presented to the governing body and management, who respond by taking corrective action, perhaps changing a procedure, or further training, restructuring among other recommendations. The following are factors that influence internal auditor’s approach:
   i) Economy – paying no more than necessary for the resources needed.
   ii) Efficiency – getting the greatest benefit with the minimum resources.
   iii) Effectiveness – describes how successful we are at meeting objectives or ‘doing the right thing’

6.1.2 External Audit
An external audit is an independent examination of the financial statements prepared by the organization. It is usually conducted for statutory purposes (because the law requires it). External auditors may also be engaged to do other specific assignments, (e.g. a fraud investigation). The purpose of external audit is to verify that the annual accounts provide a true and fair picture of the firm’s finances; and that the use of funds is in accordance with the aims and objects as outlined in the constitution.

The purpose of an external audit is NOT:
   • To act as a fraud investigation
   • To prepare the accounts
   • To provide a certificate to say “there are no problems”
   • Proof that internal control systems are effective
   • Evidence that accounts are 100% error free
a) **Appointment of external auditors**

An external audit can be conducted either as part of the annual review of accounts. It is conducted by a firm of accountants with recognized professional qualifications.
# 8 Appendices

**Appendix 1 – Sample Cashbook Format**

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(*) An analysis of advances should be prepared and presented in the advances schedule (appendix 2)

Prepared by: ................................................ Signature: ................................................ Date: ............................................

Approved by: ................................................ Signature: ................................................ Date: ............................................
### Appendix 2 - Sample Advances Schedule Format

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### Appendix 3 - Sample Budget Status & Advance Request Format

**XYZ NGO**

**BUDGET STATUS & ADVANCE REQUEST FORM FOR THE MONTH XXXXXX (Amount in xxxx)**

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### Appendix 2 - Sample Advances Schedule Format

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Total

Prepared by: ___________________________  Signature: ___________________________  Date: __________

### Appendix 3 - Sample Budget Status & Advance Request Format

**XYZ NGO**

**BUDGET STATUS & ADVANCE REQUEST FORM FOR THE MONTH XXXXXX (Amount in xxxx)**

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