CPA Services

BUDGETING & CONTROL SYSTEM

MODULE-3

CERTIFICATE COURSE IN FINANCIAL MANAGEMENT & ACCOUNTABILITY

CONTENTS

CHAPTER-1

PLANNING

1.1 INTRODUCTION

Planning is an instrument that provides the aim for the future. It is an activity by which the objectives are defined and specific goals and targets are formulated to be achieved. When one is planning for the organization's future one has to fund the plans. Budgeting is planning in financial terms. It is important that plans are translated into financial terms. Budgeting is the most effective way to facilitate this process, it is the tool to monitor cash flows, provide the direction for prioritizing deployment of funds for appropriate developmental activities and to ensure that programmes are completed on time. Budget is an important tool whereby you can remain on top of the funds flowing in and on the nature and quantum of expenditure. Planning and budgeting are correlated.

"Planning", in simple terms is:

(i) an act of formulating a program for a definite course of action or

(ii) the act or process of drawing up plans or layouts for some project or an organization as a whole.

However, planning is defined differently according to contexts. It is said to be the "deliberate social or organizational activity of developing a strategy of future action to achieve a desired set of goals for solving different problems in complex context. This is underpinned by the power and intention to commit resources to act as necessary to implement the chosen strategy".

In recent times, planning has come to be seen as a much broader set of human activities, encompassing the provision of physical infrastructure as well as public and social services, including health, education, sanitation, shelter, and transport among others. Besides the technical, analytical and design components, planning is seen intensely as a value-laden activity. Planning is a prelude to budgeting.

A budget is a plan to:

(i) Manage your finances

(ii) Ensure that you can continue to fund your current commitments

(iii) Enable you to make confident financial decisions and meet your objectives

(iv) Ensure you have enough money for your future projects and programmes.

A budget outlines where the money will be spent and how that spending will be financed. It must be remembered that a budget is not a forecast. A forecast is a prediction of the future whereas a budget is a planned outcome of the future, defined by the plan that the organization desires to achieve. As a comparison, there is a 'weather forecast' but never a 'weather budget'.

1.2 ADVANTAGES OF PLANNING

Planning helps in:

- Focusing on the goal.
- Anticipation of risk and elimination of waste
- Allocating appropriate resources to the project
- Reducing cost
- Facing future challenges
- Managing activities and funds effectively
- Improving decision making
- Providing direction and in formulating specific strategies
- Improving efficiency
- Introducing various systems in the organization
- Identifying problems in advance and providing timely warning about deviations

- Enhancing staff motivation
- Facilitating the assessment of performance

1.3 LIMITATIONS OF PLANNING

- Planning process is quiet costly and time consuming
- Internal and external inflexibilities
- It depends on the reliability of information
- Difficulty of accurate premises as the future is not known
- Planning can minimize risk but cannot eliminate the risk
- As the saying goes "Planning on paper is as good as no planning" so the success of the planning depends upon implementation
- It depends on internal and external variables which are beyond the control of the planner

1.4 ESSENTIALS OF A GOOD PLAN

- Planning is a continuous process
- Planning must be creative
- Planning process must be communicated to the lowest possible level
- Planning should be time bound
- Planning should exist at all levels in the organisation
- Planning must motivate people towards its implementation
- Planning should not be rigid, rather should be flexible to respond to sudden changes in internal and external environment.
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- Planning must coordinate the efforts of all the departments
- Planning must have an inbuilt controlling process
- People are the essence of planning as the success of every plan depends upon people, so this factor must be kept in mind while framing plans

1.5 PROCESS OF PLANNING

The planning process needs to:

(i) Ensure that the programme plan is towards achieving the overall vision, mission and goal of the organization.

➤ Clarity of vision, mission and goals are of paramount importance.

(ii) Ensure that the programme plan is relevant to meet the needs of the target group.

➤ Identification of ground realities, the population that the institution is to serve, the geographical location, local customs must have a practical approach.

(iii) Ensure that the projected plan is converted into a concrete action plan.

➤ Identify the logical steps or activities that will be implemented and these must be linked to a time line to achieve the objects.

(iv) Ensure that the action plan is converted into a cost plan with effective budgeting.

➤ Allocate a monetary value to each activity and components of each activity as close as possible to the ground reality. Financial resources are to be put to optimal use in an efficient and effective manner.

1.6 TYPES OF PLANS

Though basically, planning implies a view of the future activities and the course of action, the main types of plans that are practiced by the development organizations are:

1. Focus Area Plans
2. Time Based Plans

1.6.1. Focus Area Plans: These plans are related to the organization as a whole and can be categorized as:

- Organizational Planning
- Programme Planning
- Strategic Planning
- Action Planning

- **Organizational Vs Programme Planning:** Planning is based on the programmes of the organization. The organizations carry out several programmes at various locations. The overall plan of the organization consisting of several programmes is known as organizational planning. This facilitates the organisation to have a bird's eye view of the plan consisting of several programmes. Hence organizational planning is crucial in which the programme plan shall fall in place.

- **Strategic Planning:** Strategic Planning is a conscious effort to identify the broad perspectives, vision, mission, goals and objectives for the organization. Strategic planning works out the methodologies and tactics for the effective achievement of the organizational goals and objectives. The focus of strategic planning is on the long term rather than on short term plan. It is the overall approach, based on an understanding of broader context in which one can function, one's own strengths and weaknesses, and the problem one is attempting to address. A strategy gives a framework within which to work, it clarifies what one is trying to achieve and the approach one intends to use. It gives one clarity about what one actually wants to achieve and how to go about achieving it, rather than a plan of action for day-to-day operations.

- **Action Planning:** Action planning is an effort to concretely identify the programmes and activities within the framework of the goals and objectives already evolved in the process of strategic planning. The above programmes and activities are meant to effectively realize the vision and mission of the organization. This is the plan for day-to-day operations.

1.6.2. Time Based Plans: These plans are based on the time period and are categorized as:

- Long Term Plans
- Medium Term Plans and
- Short Term Plans

Long Term Plans:

Long term plans provide security for the continuity of the mission of the organization. This demonstrates a sense of foresight and wisdom. These plans also keep the goals and objectives of the organization in focus. Long term plans normally have a tenure of at least five years.

Medium Term Plans

Medium term planning is a more practical exercise and normally has a time horizon of two to five years. It is more practical because the closer we are to the present day, the fewer assumptions have to be made, and the probability of the plan reflecting, what actually happens is much greater. The medium term plan will reflect the outline strategies developed in the long-term plan, but concentrate on the major decisions over the next two to five plans.

Short Term Plans

While long term planning is essential, it is equally important to plan for the short term in order to carry out the activities and realize the vision of the organisation. Short term planning or budgeting, normally covers a period of one year, and unlike the others, may be subject to revision within that year. Because it deals with the immediate future, it is subject to much more certainty and can provide a detailed statement of intent. Short term plans are therefore produced in much more details than others.

1.6.3. Barriers in the Planning Process:

Some of the barriers that come across in the planning process are:

- Lack of knowledge as to how to plan
- Lack of adequate time
- Difficulty in getting the right people together
- Uncertainty about the availability of resources

The following table gives the questions that need to be asked during the planning process to ensure that the barriers are overcome:

Planning Element	Key Managerial Decisions
Objectives	•What objective will be sought? •What is the relative importance of each objective? • What is the relationship among the objectives? •When should each objective be achieved? •How can each objective be measured? •What person or organizational unit should be accountable for achieving the objective?
Actions	• What important actions bear on the successful achievement of objective? • What information exists regarding each action? • What is the appropriate technique for forecasting the future state of each import and action? • What persons or organizational units should be accountable for the action?
Resources	•What resources should be included in the plan? •What are the inter-relationships between the various resources? •What budgeting technique should be used? •Which person or organizational unit should be accountable for the preparation of the budget?

Planning Element	Key Managerial Decisions
Implementation	•Can the plan be implemented through authority? •What policy statements are necessary to implement the overall plan? •To what extent are policy statements comprehensive, flexible, coordinative, ethical and clearly written? •Who or what organizational units would be affected by the policy statements?

CHAPTER-2

BUDGETING

2.1. INTRODUCTION

A budget is a document that translates plans into money - money that will need to be spent to get your planned activities done (expenditure) and money that will need to be generated to cover the costs of getting the work done (income). It is an estimate, or informed guess, about what you will need in monetary terms to do your work.

Non-Profit organizations exist to achieve certain objectives and hence a budget is the translation of a objective plan in financial terms. The budgeting process is one of the most important aspects of an NGO. Planning and budgeting are two important functions in project management. They are like two sides of the same coin. It is often misunderstood that planning and budgeting are very essential to profit-making organizations and not to not-for-profit organizations, but this is not correct. However, the fact is that these aspects are very critical in a non- profit organization.

Once the plans are set, the organization draws up budgets to help implement the plans. Budgeting is nothing but the financial planning which includes the cost element to the planned actions. Financial Planning is an integral part of the total planning. For the successful implementation of any mission, however noble it might be depends a lot on financial resources. As the focus in non-profit organizations is service to the community, economic resources are only a means. Hence, the challenge in a non-profit organization is to put the limited financial resources to the best use to achieve the maximum benefit.

Budget is also a significant document for any organization with the donors. The budget sets out in detail what the organization will do with the grant, including where the money will be spent on and what results are to be achieved. Thus, during a given time frame, these plans and budgets enables the organization to compare it with actual performance.

Hence a budget is an essential management tool, without, which one is like a pilot navigating in the dark without instruments.

- The budget brings to focus how much money is required to carry out the activities.
- It channelizes the thought process through the implications of the activity planning. There are times when the realities of the budgeting process force a rethink of action plans.
- The budget through the cash flow statement brings out when certain amounts of money is required to carry out the activities and when will the funds be available.
- The budget enables monitoring of income and expenditure. In the process problems can be identified.
- The budget is a basis for financial accountability and transparency.
- Donors use the budget as a basis for deciding whether what you are asking for is reasonable and well-planned.

A budget is NOT:

- Written in Stone – A budget can be modified from time to time provided steps are taken to deal with the implications of the changes
- A Mark up of 10% Above the Previous Year's Expenditure: The budgeting process needs to assess in real terms what is really required and not repeat the previous expenses.
- Just a Donor Requirement: The budget should not be prepared as part of a funding proposal and then taken out and dusted when it is time to do a financial report for the donor. It is a living tool that must be consulted in day to day work, checked monthly, monitored constantly and used creatively.
- An Optimistic And Unrealistic Picture Of What Things Actually Cost: Costs should never be under-estimated or camouflaged. You will be surprised how quickly all the hidden costs appear

2.2. WHO SHOULD BE INVOLVED IN BUDGETING?

Budgeting is a serious and responsible activity. Your organisation's ability to do what it has planned to do and to survive financially depends on the budgeting process. It is always advisable to have a small budgeting team. This may only mean that one person does a draft budget which is then discussed and commented on by the team. Where staff is competent to take full responsibility for the financial side of the organisation or project, the following would normally be involved in the budgeting process:

- The Finance Manager and / or Accountants
- The Project Manager and Senior Programme Staff
- Director of the organisation or department.

The members of the Board / Governing Body / Trustees should also be involved in the process since the ultimate responsibility vests with them. They can constitute a Finance Committee comprising of experts to assess the budget and make recommendations.

Where an organisation has branches and/or regions, or several departments, then each branch, region or department should draw up the budget for its own work. These budgets then need to be consolidated (put together) in an overall budget for the organisation. Financial monitoring works best when those closest to the spending take responsibility for the budget.

2.3. GOOD PRACTICES IN BUDGETING:

- **Clarity:** Some of the areas where clarity is required are the following:

1. Name of the Project
2. Nature of Programme

3. Geographical Area
4. Approach to be Followed for Implementation
5. Budget Components
6. Time Period:

• **Time frame:** There are generally several stages before a budget is finally approved by the Governing Body of an organization. Hence the process needs to start early and therefore needs to be prepared well in advance, say atleast six months in advance, before the start of the respective period for which it is being prepared. However, this time frame may vary from organizations to organization depending on its size, structure etc.

• **Budget items:** Adequate care is to be given while setting the budget items. It is these budget items on which the program activities will be carried out and it is these budget items that will also appear in the financial reports. If the budget items and the accounting records are not consistent, then it will be difficult if not virtually impossible to produce the required reports.

• **Estimating the Costs:** An organization may follow any method for preparing the budgets, but the cost estimation made has to have adequate justification. It will be always helpful to make a list of all the inputs required along the number and unit cost of each item of such inputs. From this detailed work sheet, it will be quite easy to prepare a summarized budget for each line item of the budget. In the case of foreign donations the rate of exchange should be specified as this will affect the finance plan.

• **Contingencies:** Contingencies are generally provided for unforeseen expenditure and also for meeting any cost escalation of a given item. There are different methods of providing for contingencies. Many organizations provide a line at the bottom of the budget items for “contingencies” and a percentage of the overall budget is shown as the estimated amount of it. Some may add an

• **Program and Administrative Cost:** Generally, most of the organizations prepare Program Cost separately and the Program Support cost i.e. the Administrative Cost separately. Program Support Cost represents the recurring expenses relating to administration in implementation of a program. It is important to clearly define what will constitute programme cost and what will form administrative cost. As an example, salaries are normally taken as administrative cost but in a hospital the salary paid to the doctors, the nurses, ward boys would be programme cost as it is not possible to run the the hospital without these persons. The salaries paid to the office staff in the hospital can be classified as Administrative Cost. Similarly travel is taken as administrative cost but travel to field locations for programme implementation and monitoring should form part of Programme Cost.

2.4 CHARACTERISTICS OF A BUDGET

Hence, the following are the important characteristics of a budget:

a) It is a financial and/or quantitative statement;
b) Prepared well in advance;
c) For a definite period;
d) For the attainment of objectives and measures agreed upon.

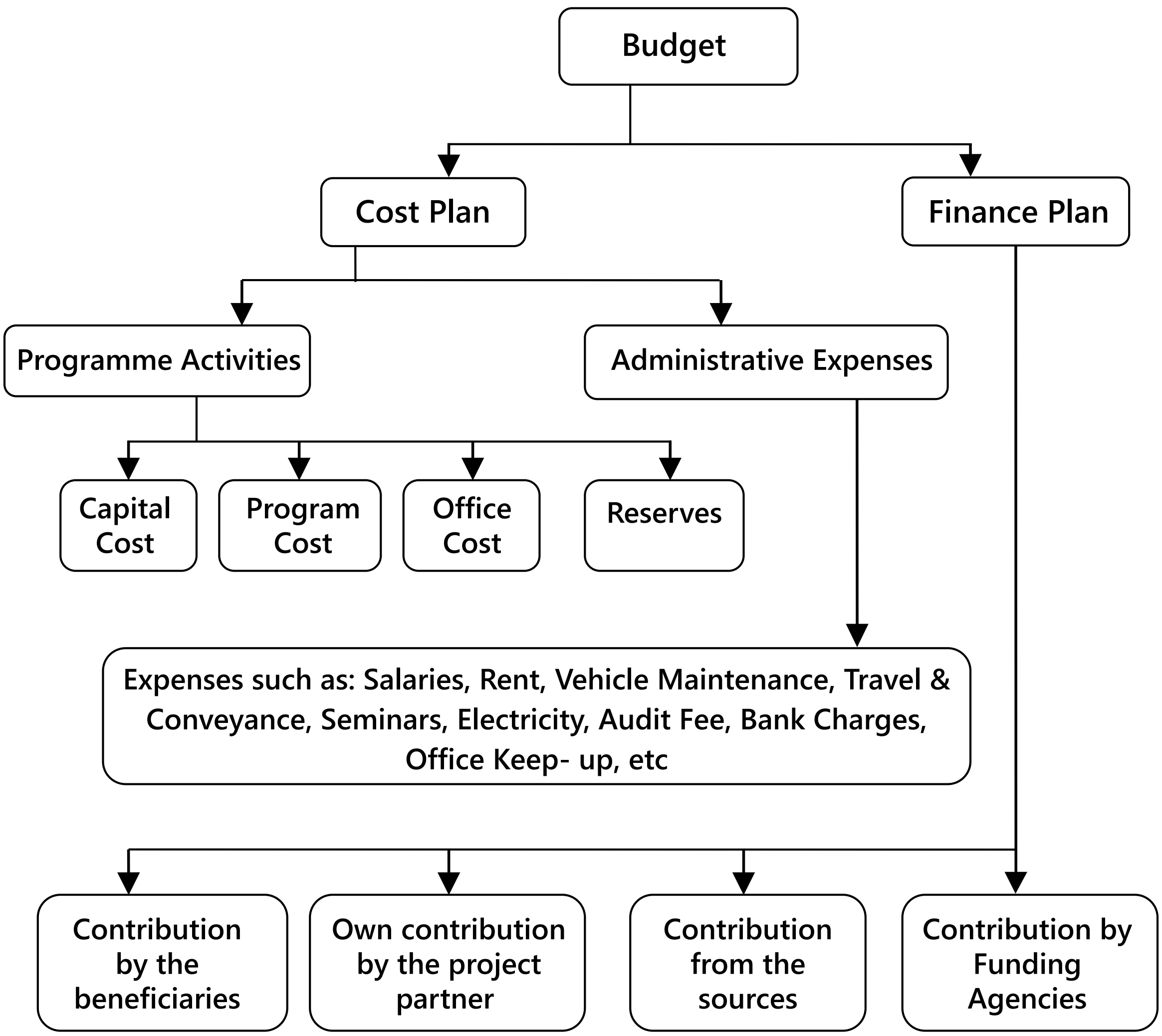
It would therefore be advisable for every organization to prepare a budget since this would enable it to plan out the activities of the ensuing year/s. This also helps in planning the commitments and to activate resource mobilization to meet such commitments.

2.5. BUDGET PLANS:

An organization would normally prepare the following plans to budget their activities for the ensuing year(s) in foreign currency and in national currency:

- Cost plan
- Finance plan

Flowchart showing various aspects of budgeting is as under:



Cost plan and Finance Plan are the two sides of the same coin. In cost plan all the expenditures and payments of the project are anticipated and provided for in advance. In the Finance Plan all the possible/expected sources of income are mentioned.

2.6 OWN MEANS CONTRIBUTION

"Own Means Contribution" is the commitment or contribution of various stakeholders to the project other than from the funding agency. Technically only the contribution by the NGO and the beneficiaries should be taken as own means contribution, since that is the actual contribution by them. However very often in the context of the funding agency, they look at funding provided by them and that raised by the NGO as the two broad sources in the finance plan. In this context the funds raised by the NGO is taken as own means. This could include funds raised from other agencies, the government, donations from other parties including individuals and funds raised through fund raising events or campaigns. It should be ensured that the contributions are directly relevant to the project.

For Example: You need Rs. 100 to run a project. Where the donor says he/she can raise the funds for Rs.90 only i.e. 90% of the expenditure is funded by the donor or funding agencies but 10% you have to raise the funds on your own. Here this 10% i.e. Rs. 10 is the own means contribution.

2.6.1. Rationale for Own means Contribution: There are good reasons for the Project Implementing Organization to participate in the expenditure (upto a certain percentage) to be incurred on a program/ project.

- ➤ Strengthening of responsibility and decisions making; as all the stakeholders play a proactive role rather than doing the job only of implementation.
- ➤ Motivation and a sense of ownership for the beneficiaries to contribute to their project/ program.
- ➤ Better cooperation between beneficiaries and credit institutions in case of bank financing.
- ➤ Creating conditions for the contribution of the project (project sustainability) after contribution from the funding agencies have been exhausted.

2.6.2. Types of Own Means Contribution: Own Means Contribution can be of two types:

(i) In cash or investments

(ii) In kind.

When the contribution is to be received in the form of cash or investments like bank fixed deposits or mutual funds, the budgeting is done on the basis of the value so expected. However where the own means contribution is to be received in kind then the basis for valuation needs to be built in the budget. The documents that would be required for accounting for each contribution item in kind should also be specified so that there is no arbitrary valuation or at a later time in the accounting for such own means in kind. Separate books need to be maintained since they cannot be accounted for alongwith the financial books of account. These would be subsidiary registers duly supported by vouchers and documents to evidence that the own means in kind was actually contributed and used for the project. The own means in kind at no stage should be arbitrary or notional figures.

Own means must not be that expenses are inflated and paid for and that the supplier returns some amount as a contribution. This would be wrong and against the principle or concept of own means. Own means must be voluntary contribution by a stakeholder.

Own means in kind would include the following, which are not paid for:

- Labour
- Supply of agricultural produce or seeds
- Supply of transportation e.g. bus or tractor for ferrying the beneficiaries or use of tractor for carrying material e.g. mud, cement, stones etc.
- Material for the Programme e.g. wood, stones, mud, cement, teaching aids such as copies and books, medicines,

- Use of Equipment or Facilities e.g. hall or room for training programme, computers for teaching, electricity etc.
- Food and Physical Arrangements such as tents, durries for a rally or campaign.

In the budgeting process, the issue to be addressed is how to value the own means in kind. The basis for valuation must be clearly defined and based on reality. Notes must be given to the budget clearly specifying the basis for valuation and the rationale. Examples for the basis of valuation are given below:

Own Means Contribution in Kind	**Basis For Valuation**
Labour	The daily wage rate that the labour would normally earn in that particular area. If there are different rates for men and women; between mason and ordinary labour, then those should be taken into account for computing the value. At times the government specifies the wages to be paid and that rate could form the basis. However often the local labour is not able to get the government rate and normally work for a lower rate. In such a case the lower rate should be taken as the basis since that is the reality.
Supply of agricultural produce or seeds	Cost of the produce or seeds if purchased at say the wholesale price or retail price, whichever would have normally be availed of had on to buy it.

Supply of transportation e.g. bus or tractor for ferrying the beneficiaries or use of tractor for carrying material e.g. mud, cement, stones etc.	Cost of hiring of the bus or the tractor. This could be based on a daily rate or per trip basis or distance traveled.
Material for the Programme e.g. wood, stones, mud, cement, teaching aids such as copies and books, medicines,	Cost of the material had one to buy it. The value could be a wholesale or bargained rate or the retail price depending on the reality of the situation.
Use of Equipment or Facilities e.g. hall or room for training programme, computers for teaching, electricity etc	Cost of hiring such hall or the price at which the concerned agency would normally hire out the premises. Hire of computers and other equipment would be at a market rate or a negotiated rate, which is reasonable. Expenses like electricity can be accounted for at taking the value given in a bill. If a generator is used then the cost of diesel and marked up for the hire of the generator.
Food and Physical Arrangements such as tents, durries for a rally or campaign.	Cost of cooking or a per person rate for food. Cost of hiring tents, durries, chairs, generator that one would pay.
Teachers Honorarium / Coach	Persons voluntary teaching or providing coaching then the fee that would normally be paid to such teacher or coach.

2.7 TECHNIQUES FOR BUDGETING

The two main techniques for budgeting are incremental budgeting and zero based budgeting.

a. **In zero based budgets**, past figures are not used as the starting point. The budgeting process starts from "scratch" with the proposed activities for the year. The result is a more detailed and accurate budget, but it takes more time and energy to prepare a budget in this way. This technique is essential for both new organisations and projects and ongoing programmes. It is probably the best route to go in a dynamic organisation that is proactive in taking on new challenges.

b. **Incremental budgets** are budgets in which the figures are based on those of the actual expenditure for the previous year, with a percentage added for an inflationary increase for the new year. This is an easy method that saves time but it is the "lazy" way and is often inaccurate. This budgeting technique is only suitable for organisations where each year is very similar to the previous one in terms of activities. Very few dynamic organisations or projects are so stable that this budgeting technique really works for them.

2.8 BUDGET PROCESS:

Getting Ready

The above has dealt with what the various requirements are but there is a need to begin the process, so how does one begin in simple terms:

1. List the items on which you spend money. You will know what these are from your action planning process. After that group the items under headings or cost centres.
2. Estimate the unit cost of the line items and then the annual costs.
3. List your likely sources of income or revenue. Then group them under suitable budget heads. This is the basis of your income budget.

Now you are ready to begin putting your budget into a budget format. The remaining steps are:

Budget Preparation

4. Prepare the budget format.
5. Do the addition and multiplication based on unit costs.
6. Add in notes to explain items that may not be clear.
7. Get feedback on your budget.
8. Finalise the budget.

The budget can be prepared on the computer using the excel programme. If a computer is not availble then it can be prepared manually.

Feedback

Once the budget is ready , duly checked and the explanatory notes are incorporated, it is time to get feedback.

From whom should feedback be obtained:

- From the people who worked on drawing up the budget.
- From others in the project or department.
- From the finance department and accountants
- From the Director (unless you are the Director).
- From the Board or the Finance Sub-Committee or Budgeting Sub-Committee of the Board.

What should be done with the feedback?

- On the categories and line items – has everything that needs to be included been included?
- Consider the suggestions and taken an informed decision.
- On the notes – do they explain everything that needs a special explanation?
- On the addition – is it right?

Finalization

Once the feedback obtained is considered, amendments made, if they were required and calculations and dates checked, the budget is fanalized. Finalising the budget does not mean filing it away and never looking at it again. Once the budget is finalised, it is time to implement it – both in terms of generating the necessary income and carrying out the activities that incur expenses. The budget gives the basis for monitoring the programme / organiztion financially.

CHAPTER-3

STATEMENT OF CASH FLOWS

3.1. INTRODUCTION

The Cash Budget reflects projected cash and bank receipts and payments and cash / bank equivalents such as short term fixed deposits with the bank and the balance being the cash and bank balance in hand. Essentially the cash budget shows future cash inflows and cash outflows. Cash budgets usually include both operating and non-operating transactions. It includes outflow on recurring and capital items. A cash budget identifies possible cash shortages and overages. Shortages may require borrowing. Overages may mean there is extra money available to invest for a return. The cash budget also indicates if anticipated cash resources are adequate to finance operations. If not, external financing may be needed for which the budget estimates the amount and timing.

The cash budget focuses on short-term cash flows including receipts, disbursements, loans, repaying debt, and purchases. Expenditures may be timed to match cash receipts or cash availability.

Cash flow management refers to the need to have cash come in -- flow in -- at the right times, so that it is available to flow out as needed. Everyone knows that if an organization has more expenses than income, sooner or later it will find itself in trouble. However, even if income matches or exceeds expenses in a given year, the cash from the income may not arrive in time to pay the bills as they come due. A cash shortage can be very disruptive to your ability to carry out your mission. To avoid disruptions of business or to take advantage of temporary cash surpluses, cash flow can and should be projected, monitored, and controlled.

3.2. CASH FLOW PLANNING IN PROJECT FINANCIAL MANAGEMENT

The importance of cash flow planning and proper budgeting in non-profit sector is immense. NPOs usually operate on project based funding with different donors having specific budget and compliance requirements. As the non-profit sector relies primarily on donations and grants, planning and budgeting of funds is all the more important to effectively utilize any incoming funds and identify the timelines for raising of such funds.

Effectively managing finances for the non-profit sector is always important, but even more so when times are uncertain. A Cash Flow forecast can help an organization respond and adapt to immediate financial challenges. Equally important, cash flow forecasts are a vital tool for ensuring that a non-profit organization (NPO) stays viable in the long run.

In this article, we will look at the various aspects of cash flow planning in an NPO, some important points to consider while forecasting, and steps to prepare a cash flow statement.

3.3. WHAT IS CASH FLOW PLANNING?

A budget is basically a financial expression of project plan and it activities. However, cash flow plan is an estimation of cash requirement based on the activity schedule of the project.

In an NPO, the major sources of income are grants from various donors, general donations or receipts from any of the development activities. Similarly, NPOs have a wide range of expenses primarily programmatic as well as administrative expenses such as salaries, rent, audit fees, etc.

A Cash Flow plan determines the cash requirement on a periodic basis – monthly or quarterly. While a budget gives an overview of the financial plan for a project/ program, it is when the budget is broken down into activity schedule, the cash requirements can be determined.

3.4. IMPORTANT POINTS TO CONSIDER WHILE PREPARING A CASH FLOW STATEMENT

For a sound cash flow management within the organization, it is advisable to reflect on the following points in the planning process:

1. Know the timing of activities

Cash flow forecasts are not simply the budget broken down into twelve equal instalments – but an important exercise to know when specific activities will take place. For example, for a training project, when will the courses take place, when will costs have to be paid and will the course fees be paid in advance etc.

2. Record the expected timing of payments

Expenses must be entered on the cash flow forecast when the cash is expected to leave the bank. For example, the amount payable towards Provident Fund of employees for the month of March needs to be paid before 15th of next month. Even though it is accrued in the month of March but is actually paid in April. Therefore, it should be accounted accordingly for the outflow in the cash flow statement.

3. Salary payments

Salaries are usually paid monthly. But do not forget that deductions, such as income tax, are often paid to the authorities the month after salaries are paid, or in some cases paid annually.

4. Grant schedules

Every donor has a different grant schedule which cannot be ignored while anticipating cash requirement. For example, a particular donor may have a six-monthly payment schedule. This needs to be considered while preparing the cash flow statement as it will directly influence the timing of recording the inflow.

4. Exclude non-cash transactions

Obvious but easily forgotten! Exclude non-cash transactions from the cash flow forecast (e.g. donations in kind or depreciation). So if these are on the budget, they have to be left off the cash flow.

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6. Unforeseen expenses

There are always some expenses which are unforeseen or uncontrollable in nature for e.g. equipment repairs. It is best to put a monthly or quarterly estimated sum for these kind of expenses. The estimates can be taken from past experiences.

7. Budget to be kept as a Base

For preparing a cash flow plan, budget should be kept as base. Budget is an expression of activities in financial terms and based on the activity schedule of the project, the budget is determined. For instance, a budget depicts the total finances required for an activity, say workshop. However, when one breaks down the sequence of activities required to hold that workshop, the timing of cash flow requirement can be ascertained.

8. Separate Bank Account

Dedicating a separate bank account for a project is highly important from cash management point of view. The more segregated project funds are, the easier it becomes to determine the real time cash position. Often times, intermixing of project funds leads to difficulty in separating transactions with a common source. For example, it becomes a tedious task to segregate interest income for each project

3.5. HOW TO PREPARE A CASH FLOW STATEMENT?

In order to prepare a cash flow statement, it is advisable to follow a step wise approach. As it is clear now on what to consider while preparing a cash flow statement, following basic steps that can be followed to prepare one:

Step 1: Break down the Budget

The very first step in preparing a cash flow statement is analyzing the project budget and breaking it down into smaller segments. For instance, a budget indicates the fund planned for the workshops to be held during Year 1 of the project duration. However, it does not indicate the precise timing of implementation. Therefore, before building the cash flow forecast, one needs to determine the timing of the planned activities during the period.

Step 2: Prepare Activity Schedule

NPOs operate on project based funding and to ensure that the project is timely, it is essential to determine the timeline of each and every activity. That is why it is so important to prepare an Activity Schedule.

While the fixed costs remain constant, the programmatic part may be discussed with the Program team to ascertain the timeline of activities. Once the activity schedule is prepared, the monthly or quarterly cash requirement can be ascertained. Ideally, it is a good idea to undertake cash flow planning monthly. Some of the examples of sources of cash inflow and outflow are as under:

Anticipated Cash Inflow	Anticipated Cash Outflow
Project grant	Salary to program and administrative staff
Donations	Office rent
Fee from service revenue	Audit fee
Interest income on project balance	Procurements
Exchange rate gains	Program expenses for e.g., training expenses, workshop expenses, travel costs, etc.

Note: It is very important to keep donor's policies in mind while estimating cash inflow and outflow. Since project funds are usually restricted in nature, the utilization needs to be planned carefully. For instance, organization's common costs should be duly allocated project wise as per the existing Common Cost Allocation policy. Similarly, decisions like investment of project funds should be checked with the donor's policy.

Step 3: Determine Grant Schedule

After preparing the activity schedule, the next step is raising the required funds. Every donor has a different grant schedule and cash inflow is highly dependent on that. The cash flow forecast should take into consideration the anticipated timing of cash inflow and plan activities in such a manner that no implementation delay occurs due to non-payment. The biggest benefit of building cash flow forecasts for the non-profit sector is that, it can be used to identify and respond to cash deficits and cash surpluses in advance.

In order to avoid the situations of Surplus/ Deficit (Excess/ Shortfall of Income over expenditure) in the project, it is important to analyse the cash flow status with the actual implementation status.

However, this must first be discussed with the different funding agencies, which may have their own set of unique and independent principles for grant management.

Conclusion:

Preparing a cash flow statement is not a one-time activity. Projections should be updated and reviewed regularly. The frequency will depend on how closely the organization's cash flow needs to be monitored.

Managing cash flow for NPOs can be an ongoing challenge. Thankfully, cash flow forecasts are an effective way to avoid running out of cash unexpectedly. By understanding cash flow and planning ahead, one can avoid unexpected shortage of funds in the project, provide stability to our organizations and build organizational capacity.

CHAPTER-4

BUDGETARY CONTROL

4.1 VARIANCE DETERMINATION AND ANALYSIS

Budgeted revenue and costs are what they should be. Actual revenue and costs are what they are. A variance is the difference between the two. Such difference must be investigated as to cause and who is responsible, if controllable. Sometimes the variance is due to incorrect forecasting (e.g., outdated standards, deficient planning), other times it is due to poor performance. Budget figures should be adjusted when circumstances have changed (e.g., increased competition, new technology). For example, if actual spending is below planned amounts, this may be due to laggard program performance. Variances may be determined and evaluated by program, service, cost center, or department.

Variances are interrelated, so an unfavorable variance in one responsibility unit may result in a favorable one in another segment. Insignificant variances need not be considered unless they recur repeatedly and/or reflect potential problems. For example, even a variance below a cut-off rupee or percent amount may need analysis if the variance is continually unfavorable because it indicates a problem (e.g., poor supervision). The cumulative effect of a repeated minor unfavorable variance may be just as harmful as an occasional one. Variances should be thorough and as detailed as needed. It may be expressed in aggregate monetary terms, per unit fee, per unit cost, service units, volume, and percentages. It may be computed yearly, quarterly, monthly, daily, or hourly depending on how important it is to identify the problem.

Variance analysis shows whether resources (physical and human) have been effectively used. It may result in rearranging resources to result in cost savings and efficiencies. The objective of cost control is to result in the least possible cost based on predetermined quality standards.

Variances indicating cost overruns can be a problem in contracts because the excess costs may not be reimbursable. If responsibility for a variance is joint, corrective steps should also be joint. If correcting for an unfavorable variance conflicts with organizational policy, the policy should be reappraised and perhaps changed. If the policy is not changed, the variance should be considered uncontrollable.

Budgets should be realistic. Standards are based on the situation being evaluated. For example, a "tight" standard should be set for cost reduction. A "perfection" standard should be used for high quality services. However, tight standards may discourage workers while loose standards may cause inefficiency.

4.2. REVENUE VARIANCES

Revenue variances examine the difference between actual revenue and budgeted revenue in aggregate monetary value terms, per unit fee, and service units. If actual revenue exceeds expected revenue, a favorable variance arises. In the opposite case, there is an unfavorable variance. Such unfavorable variance points to a need for corrective steps such as increasing user fees, increasing membership, etc. Membership and fund raising quotas may be set.

4.3. COST VARIANCES

Cost variances look at the difference between actual cost and budgeted cost and may be expressed in total rupees, per unit cost, and service units. If actual cost exceeds budgeted cost, an unfavorable variance arises. Identification of the problem is needed, including whether the variance is controllable or uncontrollable. If controllable, corrective actions must be implemented and if necessary appropriate administrative action maybe called for.

4.4. FUND RAISING COSTS

Some fund raising costs can be standardized, such as presentations for which a standard time call can be established. Calling up frequency should be determined. If percentages are tied to charitable contributions obtained, standards can be based on a percentage of those contributions. Actual funds raised may not be the best measure of fundraisers' performance. They do not take into account different territory potentials. Also, a high volume fundraiser may have to cover a high promotion cost.

An evaluation should be made of whether fund raising expenses are realistic taking into account contributions generated. Are excessive costs (above limits set) due to the failure of controls or deficient management?

4.5. VARIANCE ANALYSIS REPORTS

Variance analysis reports include examining the difference between actual and budget figures for:

(1) Revenue

(2) Costs

(3) Quality, and

(4) Growth.

Variance analysis reports may be expressed in rupees, ratios, graphs, percentages, and narrative, e.g. revenue volume may be declining because of inadequacy in fund raising. Variance analysis reports should be broken down between that resulting from providing more or less services than initially budgeted and that due to efficiency (inefficiency) or unplanned changes in input prices.

An evaluation should be made of whether fund raising expenses are realistic taking into account contributions generated. Are excessive costs (above limits set) due to the failure of controls or deficient management?

4.6. BUDGETARY CONTROL AND DECISIONS REQUIRED

Budgetary control should exist over revenue and expenses. Cost controls should be established. Spending limits may be placed on personnel, time, funds, and assets. Any expenditure above the preset amount must be authorized. A cost containment report should be prepared identifying above average costs.

Budget cuts, when needed (e.g., poor economy, political factors) should be in the areas of least importance and/or having the least severe consequences (e.g., on quality of service performed). Some programs may be downgraded, where the same level of service or comparable results are sought through less expensive ways. The community may be invited to give their input to program cuts.

Managers preparing program or department budgets must have operating authority over their responsibility units and be accountable for performance. Otherwise, there is deficient planning and control.

CHAPTER-5

MONITORING

5.1 MEANING OF MONITORING:

Monitoring is a process by which people who are connected in various capacities to the organizations ensure that the project or activity is carried out in accordance with the planned objective.

It is the systematic collection and analysis of information as a project progresses. It is aimed at improving the efficiency and effectiveness of a project or organization. It is based on targets set and activities planned during the planning phases of work. It helps to keep the work on track, and can let management know when things are going wrong. If done properly, it is an invaluable tool for good management, and it provides a useful base for evaluation. It enables you to determine whether the resources you have available are sufficient and are being well used, whether the capacity you have is sufficient and appropriate, and whether you are doing what you planned to do.

Monitoring can be associated with both program perspectives as well as with the finance perspective. However, our primary focus at present is from finance perspective, although all along we will find the interlinkage between program and finance. In the absence of regular monitoring and control, the system however effective, may not yield the desired results. Monitoring is the process that is geared towards learning from what you are doing and how you are doing it, by focusing on:

- Efficiency
- Effectiveness
- Impact

Efficiency tells you that the input into the work is appropriate in terms of the output. This could be input in terms of money, time, staff, equipment and so on. When you run a project and are concerned about its replicability or about going to, then it is very important to get the efficiency element right.

Effectiveness is a measure of the extent to which development programmes or projects achieve the specific objectives it set.

Impact tells you whether or not what you did made a difference to the problem situation you were trying to address. In other words, was your strategy useful? Before you decide to get bigger, or to replicate the project elsewhere, you need to be sure that what you are doing makes sense in terms of the impact you want to achieve.

5.2. NEED FOR MONITORING

Monitoring as we have seen is very important because it is a check on how the project activities are progressing. It involves giving feedback about progress of the project to the donors, implementers and beneficiaries of the project.

In many organizations," monitoring" is something that that is seen as a donor requirement rather than a management tool. Donors are certainly entitled to know whether their money is being properly spent, and whether it is being well spent. But the primary (most important) use of monitoring should be for the organization or project itself to see how it is doing against objectives, whether it is having an impact, whether it is working efficiently, and to learn how to do it better. It is also very important in project planning and implementation. At the same time monitoring provides information that will be useful in:

- Analyzing the situation in the community and its project ;
- Determining whether the inputs in the project are well utilized ;

- Identifying problems faced by the community and their causes;
- Suggest possible solutions to problems;
- Ensuring all activities are carried out properly by the right person and in right time;
- Identify problems in planning and/or implementation;
- Determining whether the way the project was planned is the most appropriate way of solving the problem at hand;
- Raise questions about assumptions and strategy;
- Push you to reflect on where you are going and how you are getting there;
- Provide you with information and insight;
- Encourage you to act on the information and insight;
- Increase the likelihood that you will make a positive development difference.
- Review progress;
- Make adjustments so that you are more likely to "make a difference"

5.3. TYPES OF MONITORING

Compliance Monitoring: Organization is under certain legal obligations to comply with various formalities. Such compliances can be towards the Government, Legal Authorities, Donor/ Funding agency, etc. Whether the organization is fulfilling such obligation or not, is the whole purpose of compliance monitoring. Such types of monitoring are usually done by the higher official of the organization, like Executive Director, Secretary, etc.

Performance Monitoring: The organization is expected to provide optimal service to its beneficiaries. The performance of the organization depends upon various factors, one, being the performance of its employees. Infact, the organizational performance is directly proportional to the performance of its employees. The management is therefore entrusted with the responsibility of regularly monitoring the performance of its employees. In the macro-level the performance of such organizations is again monitored by various agencies, like funding agencies, Government,

Financial Monitoring: As the term suggests, financial monitoring refers to the monitoring of the financial aspects of the program. By means of financial monitoring, it is seen, whether the expenditure is made as per the budget plan. By means of financial monitoring, we assess the variance between the budget plan and the actual expenditure. Financial monitoring, however, should not be viewed in isolation as it is very much, part and parcel of the program.

Program Monitoring: Program Monitoring is undertaken to fulfill the following purposes:

- To provide the information required for improving the selection, performance and cost-effectiveness of projects.
- To provide the information required by the funding agencies and local level agencies interested in the project.
- To ensure effective vertical and horizontal information flows between different levels and agencies associated with the projects.

The major components of program monitoring are as follows:

1. Project Progress Reports.

- Summary
- Progress of physical implementation compared to targets.
- Financial performance compared to targets.
- Performance of principal inputs and services.

2. Special Diagnostic Studies
3. Project Completion Reports.
4. Project Sustainability

Practically, every development program provides for monitoring of both the achievements of its physical and financial targets, and the benefits actually accruing to its target. Usually, a family-based approach is used for the monitoring the impact of a program on its clientele.

5.4. LEVELS OF MONITORING

Broadly, the various Levels of Monitoring are as follows:

- De-jure Monitoring
- Board Level Monitoring
- Administration Monitoring

• **De-jure Monitoring:** It is usually the highest level of monitoring. For instance, an organization is supposed to fulfill certain legal and taxation formalities, now it becomes the responsibility of the Government and taxation authority, to see whether the organization is complying with such regulations. Similarly, the governing body also monitors the overall performance of the organization, which again is de-jure level monitoring i.e. actions and compliances exist because of laws.

• **Board Level Monitoring:** As stated earlier the board is entrusted with the responsibility of sound functioning of an organization. It is their duty to see whether the organization is able to discharge its duties effectively or not. Whether the organization is complying with the legal formalities, is undertaking internal control measures, and to see whether the organization is adhering to the rules and regulation of the organization, are some of the responsibility of the Board.

- **Administration Monitoring:** The management of the organization is entrusted with the responsibility of sound functioning of the organization. The management looks after the general administration of the affairs of the organization, and sees whether the organization is able to discharge its responsibilities effectively or not. This requires regular monitoring of the activities of the organization.

5.5. AREAS OF MONITORING

The areas of monitoring are as follows:

- Status of the program/ project vis-à-vis the plan
- Budgetary control
- Cash & Bank balances control
- Fixed assets control
- Investment
- Financial Statements
- Compliance of laws of the land
- Compliance of requirement of the funding agency

Monitoring helps to ensure that systems are in place and it facilitates taking corrective measures. It also facilitates in achieving successful implementation of a development project.

5.6 PROCESS OF MONITORING

Let us now discuss the various things that go to facilitate the process of monitoring.

Monitoring is an internal function in any project or organization. It involves:

- Establishing indicators of efficiency, effectiveness and impact;
- Setting up systems to collect info rmation relating to these indicators;
- Collecting and recording the information;

5.7. INDICATORS

Indicators are an essential part of a monitoring and evaluation system because they are what you measure and/or monitor. They are measurable or tangible signs that something has been done or that something has been achieved. The indicators vary from each organisation or project.They may be set to suit to the needs of the organisation or project but they should give some idea for measuring impact of a particular project.

5.8. INFORMATION

Information used in monitoring can be classified as:

- Quantitative; or
- Qualitative.

Quantitative measurement tells you "how much or how many". Quantitative measurement can be expressed in absolute numbers or as a percentage. It can also be expressed as a ratio. One way or another, you get quantitative (number) information by counting or measuring.

Qualitative measurement tells you how people feel about a situation or about how things are done or how people behave. One can get qualitative information by asking, observing, interpreting.

Some people find quantitative information comforting – it seems solid and reliable and "objective". They find qualitative information unconvincing and "subjective". It is important to realize that when speaks of quality of life, it is the qualitative indicators that provide the appropriate indication. The same holds good when one assesses 'happiness'. It is a mistake to say that "quantitative information speaks for itself". It requires just as much interpretation in order to make it meaningful as does qualitative information.

In order to gather information it is needed to go out and ask questions – to get qualitative information. Choice of indicators is also subjective, one can use quantitative or qualitative methods to do the actual measuring

The monitoring requires a combination of quantitative and qualitative information in order to be comprehensive.

How Do We Get Information?

The information you collect must mean something and then make sure that you store the information in such a way that it is easy to access.

Usually one can use the reports, minutes, attendance registers, financial statements that are part of the work as a source of monitoring and evaluation information.

However, sometimes it becomes essential to use special tools that are simple but useful to add to the basic information collected in the natural course of work. Some of the more common ones are:

- Case studies
- Recorded observation
- Diaries
- Recording and analysis of important incidents (called "critical incident analysis")
- Structured questionnaires
- One-on-one interviews
- Focus groups
- Sample surveys
- Systematic review of relevant official statistics.

Who Should Be Involved?

Almost everyone in the organisation or project will be involved in some way in collecting information that can be used in monitoring. This includes:

- The administrator who takes minutes at a meeting or prepares and circulates the attendance register;

- The fieldworkers who writes reports on visits to the field;

- The accountant who records income and expenditure.

In order to maximise their efforts, the project or organisation needs to:

- Prepare reporting formats that include measurement, either quantitative or qualitative, of important indicators.

- Prepare recording formats that include measurement, either quantitative or qualitative, of important indicators.

- Record information in such a way that it is possible to work out what you need to know. For example, if you need to know whether a project is sustainable financially, and which elements of it cost the most, and then make sure that your bookkeeping records reflect the relevant information.

Analyzing Information

At some point during the monitoring a large amount of information is collected and it has to be decided as to how to make sense of it or to analyze it.

Analysis is the process of turning the detailed information into an understanding of patterns, trends, interpretations. The starting point for analysis in a project or organisational context is quite often very unscientific. It is based on ones intuitive understanding of the key themes that come out of the information gathering process. Once you have the key themes, it becomes possible to work through the information, structuring and organising it.

Taking Action

Monitoring has a little value if the organisation or project does not act on the information that comes out of the analysis of data collected. Once you have the findings, conclusions and recommendations from the monitoring process, you need to:

- Report to your stakeholders;
- Learn from the overall process;
- Make effective decisions about how to move forward; and, if necessary,
- Deal with resistance to the necessary changes within the organisation or project, or even among other stakeholders.

Now let us discuss the various stages of Monitoring

5.9 STAGES OF MONITORING

Monitoring of a development project can be classified into the following stages:

Stage I: During Planning and Approval
Stage II: During Implementation
Stage III: During Finalization of the project

I) Monitoring during Planning and Approval:

The framework for planning needs to facilitate a clear linkage between the activities and finance.

The time frame for implementation of each activity is to be laid in clear.

The following tasks provide the broad frame work for effective monitoring during the planning and approval stage:

• Ensure that the project or program plan is towards achieving the overall vision, mission and the goal of the organization.
• Ensure that the program plan is relevant to meet the needs of the target group.
• Ensure that the projected plan is converted into a concrete action plan.
• Ensure that the action plan is converted into cost plan by effective budgeting. Budgeting is planning in financial terms. It is important that the plans are translated into financing terms.
• Ensure that the budget includes a clear time plan, remittance schedule and reasonable matching contribution, wherever possible, from the partner organization in addition to the quantum of funding expected from the donor. (It needs to be remembered that the budget sets a framework for reporting and analysis)
• Ensure that finance plan is clearly and realistically drawn as to:
• The local sources of funds
• The funds to be sought from the funding agencies abroad.]

Once the above framework is followed during the planning and approval stage, it paves a clear concrete path for effective implementation and monitoring of the project concerned.

II) Monitoring during Implementation:

Monitoring during implementation is a very crucial aspect for the successful completion of the project.
The frame work for monitoring during implementation depends largely on the preparation of regular periodical reports and analysis.

The frequency of monitoring could be monthly, quarterly, half-yearly or annually depending on the size of the organization, funds handled, and the geographical area of operation.

Strategy of Monitoring During Implementation

Reports are the most important tools for monitoring during implementation of a program/project. They are:

- Budget Variance Report
- Periodical Financial Report
- Annual Audited Financial Report
- Periodical Activity Report
- Investment Status Report
- Legal Compliance Status Report
- Funding Partners Status Report

The above various reports help in effective monitoring of a project.
Analysis and conclusions made during studying of these reports can be recorded in a "Periodical Monitoring Sheet".
This will enable not only to observe deviations in the cost incurred at the time of implementation, but also facilitate effective follow–up for the future during implementation of the project.

III) Monitoring During Finalization

Final audited financial and the progress reports are the key instruments to monitor and justify the completion of a project as per the planned activities:

Check-List:

- Ensure if the project has been completed within the planned time frame. If not analyze and justify the reasons for deviation.
- Ensure if the total fund received from the funding agency has been utilized for the approved purposes.
- Ensure if the agreed funding ratio has been adhered to.
- Ensure if the total expenditure incurred on any individual cost items has not exceeded the budget amount beyond the permissible limit. If so, obtain the reasons for such excess costs and include the same as part of the closing reports.
- Ensure necessary relevant photographs are obtained about the program completed.
- Ensure if any additional measures not foreseen in the approved budget have been undertaken. If so, ensure necessary approvals have been obtained.
- Ensure if any specific reporting or program requirements of the funding agency have been duly adhered to

CHAPTER-6

REPORTING

6.1. INTRODUCTION

A sound Management System in any organization has two important elements:

- Program Management
- Finance Management

According to one author,

Performance measured gets better fast.

Performance measured and reported gets better faster.

Performance measured, reported and managed gets better fastest.

6.2. MEANING OF REPORTING

Reporting is a process through which the organizations are able to document, seek information, analyze the results, and make suitable decisions for managing the organization performance in the best manner.

6.3. SIGNIFICANCE OF REPORTING

Reports reflect the organization's present financial situation. It is an important tool through which the organization's stakeholders are able to judge the performance to know whether or not the organization has carried out the activities as per the plan or has there been any deviation.

Reporting is, thus, very crucial to enhance the accountability and transparency of the organization.

We also know that one of the important functions of accounting is that it serves as a means of information/ communication to the management. This function is mainly performed through generation of reports.

Whether you are monitoring or evaluating, at some point, or points, there will be a reporting process. This reporting process follows the stage of analyzing information.

6.4. WHY IS THERE THE NEED FOR REPORTING?

Effective reports are critical organisational documents because they:

- Communicate information and ideas about your work, and that of your organisation
- Reflect and explain progress with work – and lack of progress.
- Make it easier for your organisation to assess progress and plan anew.
- Promote accountability.
- Promote discussion and informed decision-making.
- Emphasize problems and make recommendations.
- Share information, learnings and experiences.
- Provide analysis and offer insights into the way forward.
- Help with effective and strategic planning.
- Help members to participate in the democratic processes of your organisation.

6.5. WHO DO WE WRITE REPORTS FOR?

Who you write reports for varies from organisation to organisation. Depending on the purpose of your report, your audience could include:

- staff
- members

- executive committee
- board
- funders
- other organisations
- members of the public

It is important to be completely clear about why you are writing your report.

6.6. TYPES OF REPORTS

There are many different kinds of reports – we are sure you are familiar with them. They include:

- External reports
- Internal reports
- Financial reports
- Non-financial reports
- Annual reports
- Committee reports
- Staff reports
- Membership reports
- Research reports
- Special reports
- Progress reports

Some of these reports are discussed below:

- **External Reports:** The external reports are generated primarily, to comply with the requirement of the government, legal and tax purposes, donor, etc.

- **Internal Reports:** The internal reports are generated, and oriented towards the management to enhance the internal control and monitoring measures and thereby enable it to periodically analyze the performance and take corrective measures wherever applicable and make plans for the future accordingly.

- **Committee reports:**
    - A committee member is usually delegated to write a committee report.
    - Committee reports are progress reports, and are written more frequently than annual reports. They are short reports to explain progress.

- **Financial reports:** The financial reports submitted must be transparent and clear with supporting schedules. For example, the overall financial statement should reflect the fund status of each project and the expenditure incurred must be in accordance with budget line items of the project approved. The reporting must be in such a manner that the report to a funding agency relating to that project must be clearly reflected in the overall financial statement of the organization. This integrated approach will facilitate to read and understand the financial statement better.

- **Non-Financial Reports:** They primarily consists of narrative reports which details about the activities carried out during the specific period of reporting. In fact, these reports are generally prepared to comply with the funding partners' requirement and secondly for the monitoring and analytical purpose of the organization carrying out the said activities. In fact there are certain key aspects which needs to be taken care of while preparing such reports which is not only a requirement of the funding partner but will also enhance the review and improvement process of the organization implementing the activities. The report needs to be prepared in such a way that it is possible to compare the actual achievement of the project with the planed measures.

6.7. DIFFERENT WAYS OF REPORTING

The following are some of the ways of reporting in a development organization:

1. Reporting to the Board/ Governing Body.
2. Reporting to the Executive Committee/ Director.
3. Reporting to the Government.
4. Reporting to the Funding Partner/ donor agency.
5. Reporting to the public at large/ community.

Reporting To The Governing Structures

The following reports are generally submitted to the Governing structures:

a) Quarterly or Half-Yearly Reports
b) Annual Audited Financial Reports
c) Legal Compliance Status Reports
d) Budget Comparison Reports
e) Investment Status Reports
f) Funding Partner Status Report.

a) Quarterly or Half-Yearly Reports: Boards of the non-profit organisations could meet every quarter during the financial year. In the quarterly meetings the following reports should be presented to the board for review of the Board:

- Receipts and Payments Accounts
- Income and Expenditure Accounts
- Balance Sheet
- Financial Report on Project(Donor's requirement)
- A report of the Key Financial Ratios

- Legal Compliance Status Report
- Annual Budget Comparison Report
- Investment Status Report

b) Annual Financial Report: Normally it is a requirement that every non-profit organisation should present its audited financial statement in the Board meeting after the end of the financial year and adopt the same before filing it with the appropriate Governmental Authorities.

The Board may review the following reports:

i) Audited financial statements including –

a. Receipts and Payments Accounts

b. Income and Expenditure Accounts

c. Balance Sheet

ii) A report of the Key Financial Ratios

iii) Legal Compliance Status Report

iv) Annual Budget Comparison Report

v) Investment Status Report

c) Legal Compliance Status Report: This is a report that informs the board whether the organisation has complied with the necessary laws e.g. filing the Income Tax returns, reporting to the Ministry of Home Affairs under FC(R) A etc. If there is any action against the organisation by the government it should be reported to the Board. Information should not be purposely concealed from them. If there is any violation of the laws, it will have serious implications causing immense damage to the organisation.

i. Project status Report: An organisation often implements many projects simultaneously. Therefore it is important for the Chief Functionary as well as the board to understand the Status or the Stage of completion of each project. This report therefore gives complete details about each project at any particular point of time.

ii. Budget Comparison Report: Unless the plan is reviewed regularly any deviation from it can be rectified in a timely manner. A budget is a financial plan and hence it needs to be compared with the actual Financial Statements (monthly, quarterly, half yearly or annually) periodically wherein every deviation can be identified. After analyzing the deviations, corrective measures must be taken immediately. A Budget Comparison Report is a management tool to assist in the above process.

f) Investment Status Report: An organisation may be making different types of investments. Funds must be invested in a creative manner and then be measured in terms of capital appreciation; safety, liquidity, and rate of return thereby the resources of the organisation effectively and efficiently.

g) Funding Partners Status Report: Funding Partners have their own obligations to ensure that the funds provided by them are properly utilized for the right purpose. For this purpose they do require reports in their own prescribed formats. It is for the Board to ensure that the reports prescribed by the funding partners are compiled with time and properly.

6.8. REPORTING TO THE EXECUTIVE DIRECTOR\COMMIITTEE

While it is the Board which frames policies, it is the executive director\Committee which implements such policies and takes care of the day to day affairs of the organisation. Therefore following reports will be required for the executive director more frequently than they are require by the Board.

i) Monthly Financial Reports–

a. Receipts and Payments Accounts
b. Income and Expenditure Accounts
c. Balance Sheet

ii)Annual Budget Comparison Report

iii) Investment Status Report

iv) Donor agency Status report

v) Bank reconciliation statement

vi) Legal Compliance Status Report

Summary Of The Activities

The reports needs to provide a summary of the major activities carried out during the period in focus. This should be structured according to the approved budget line items. It needs to also include the relevant statistical data along with meaningful photographs of the progress made.

Assess The Activities Carried Out:

The report needs to assess the achievement in comparison to the planned objectives along with the indicators identified for assessing achievements.

Analyze Deviations

It is very crucial that the report not only shares the success stories but also speaks about deviations and failures including the indicators identified for overcoming the same. It will be more meaningful if the report also speaks about the steps/ strategies worked out by the organization to overcome the same.

Another important element is that these narrative reports needs to draw link to the corresponding expenditure incurred for the particular activity which will enable not only the reader but will also enable the organization to review periodically its progress and the strategies adopted.

6.9. PROGRAMME BASED FINANCIAL REPORTING

Program based financial reporting is essential to understand the expenses of each program and the unutilized balance and how it is kept.

Further, budget comparison report of each program facilitates analyzing the reason for variance. Program based financial reporting can be consolidated into overall financial report of the organization.

Frequency Of Reporting

The frequency of reporting is crucial for online monitoring. The reports to the various Governing structures depend on the site and complexities involved in the organization. For example, reporting to the Governing Body could be once in a quarter or six months. Reporting to the Director could be monthly. Reporting to the General Body could be once in a year. Timely submission of reports is a very factor for a healthy financial management.

CHAPTER-7

INTERNAL CONTROLS

7.1. INTRODUCTION

For an organization to function effectively, certain goals and objectives must be set clearly. Control in a way, helps to measure the progress towards the accomplishment of such goals. It should be noted that plans are realized only through effective managerial control. Internal control system of an organization consists of all actions that are taken to ensure that the objective of the organization is achieved. It ensures that programmes and its activities are conducted effectively with maximum efficiency and reliable reporting is done. It also ensures that all the applicable laws of land are properly followed. Control will be enhanced if the duties of the members of the organization are divided so that one person does not handle all aspects of day to day operation from beginning to end. Although a complete separation of functions may not be feasible for small organization, some measures of effective control may be obtained by planning the assignment of duties carefully

7.2. IMPORTANCE OF INTERNAL CONTROLS

The effective implementation and monitoring of a sound internal control system helps ensure that the organization meet their objectives. Good internal controls will:\

- Help to align the performance of the organization with the overall objectives through continuous monitoring of the performance and activities carried out by the organisation.
- Encourage good management and allow the management to receive timely and relevant information on performance against targets, as well as key figures that can indicate variances from targets.

- Ensure proper financial reporting by maintaining accurate and complete reports required by legislation and management, and minimizing the time lost in correcting errors and ensuring that the resources are correctly and efficiently allocated
- Safeguard assets ensuring the organization's physical, intellectual property and monetary assets are protected from fraud, theft and errors.
- Deter and detect frauds and errors ensuring that the systems quickly identify errors and fraud when they occur.
- Reduce exposure to risks and minimize the chance of unexpected events.

7.3. CHARACTERISTICS OF INTERNAL CONTROL

Internal Control has some basic characteristics. These are:

7.3.1. End Function: Control, being an end function of the management process is not the beginning, but a follow up to the other functions of Management. Control is said to be the end function, since, it judges the performance of different factors engaged in the attainment of the objective of the enterprise.

7.3.2. Continuous Process: Just like planning, control process is also continuous. Control should also be prompt in dealing with deviations. A Manager should monitor the performance of his staff continuously and assure himself that they are on the right track.

7.3.3. Flexible Activity: Controlling process cannot be rigid. It has to be flexible and is required to be adjusted according to the needs and situations arising from time to time. As plans and objectives may change according to the needs of the situation, control must also adjust itself to them.

7.3.4. Forward Looking: Control is related to the future though it lives in the present. It is the present over which control is exercised with a view to guard against future loss and wastage which may arise due to deviations from plans, policies, programs and schedules, etc.

7.3.5. All Level Exercise: Control, like all other managerial functions, is exercised at all levels of Management. Its nature and degree may change according to the level but it is to be performed throughout the organisation. It is a non-interfering process. It does not curtail the right of an individual or of a group.

7.3.6. Employee Behavior: Control guides and integrates the employee's behaviour towards attaining organisational goals. It guides the employees to work according to the predetermined standards, motivating and instructing them in achieving the organisational goals. Supervising will help in integrating their behaviour towards attaining the goals of the enterprise.

7.3.7. Anticipating Probable Changes: Changes can be anticipated via information collected. Reports and information from people working on different jobs will enable the management to anticipate that :

It is economically realistic.

It is accurate - timely - objective and comprehensive.

It focuses on strategic control points.

7.4. BENEFIT OF CONTROL SYSTEM

At this specific point, it should be agreed that control is vital to an organization. But in what ways? The following points will make this clearer:

7.4.1 Proper Implementation of Plans:

Control through the feedback information will enable the Management for the proper implementation of plans.

7.4.2 Detection of Weaknesses: Control highlights omissions (if any) and makes it possible to take corrective measures. Control keeps a check on other functions for ensuring successful management. It is the control function of Management that reveals and brings necessary feedback for indicating managerial weaknesses and determination of remedial actions. It helps the Management in knowing which department needs more attention.

7.4.3. Proper Action: Control gives the correct picture of the nature of corrective action to be taken. Taking corrective action may lead to modification of planning, organizing and directing. If anything is wrong with planning, organizing and directing, it is brought to light through the process of control.

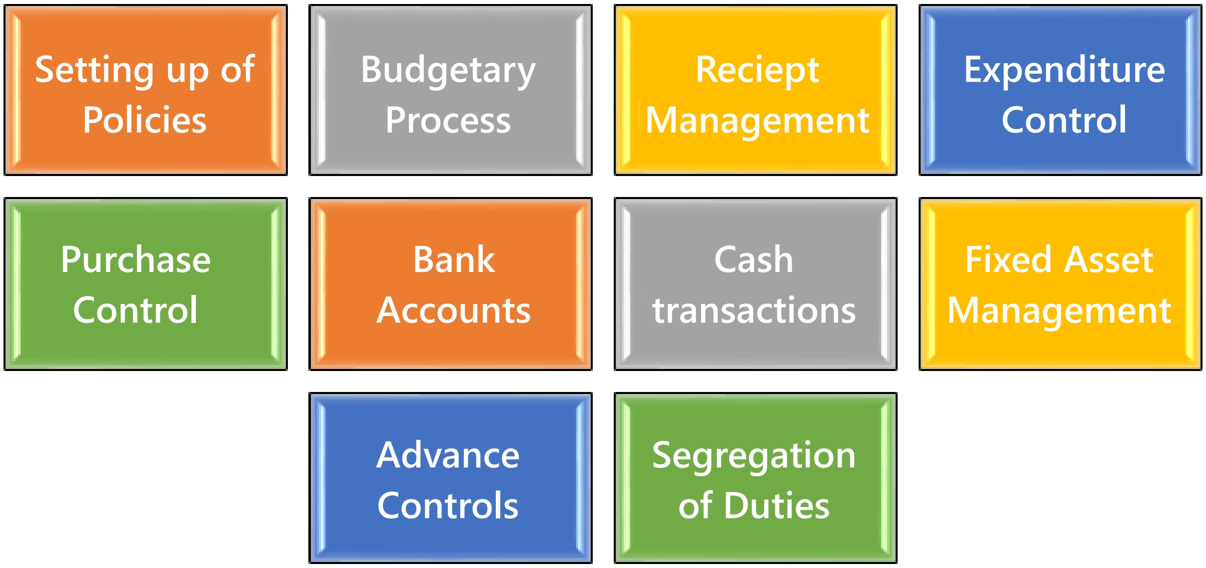
7.4.4. Decision Making: Control is basic to decision making. According to W.T. Lerome, "Control is needed both to simplify the making of subsequent decisions and to ensure the realization of the objectives implicit in the original long range policy decisions". The process of control is complete only when corrective action is taken.

7.4.5. Consistency: Control enables top Management to get the feedback information which helps them to ensure that the decision taken at the lower levels are consistent with the policies and the interest of the enterprise. The modern trend towards decentralization, calls for a systematic attempt for controlling.

7.4.6. Co-ordination: Control facilitates co-ordination by keeping the routine activities and efforts within the fixed boundaries established by the pre-determined goals and objectives. It also provides guidance to each member of the organisation to move towards common goals through coordinated directions.

7.5. TYPES OF INTERNAL CONTROLS

We can subdivide the internal control system into ten categories, the details of which is provided



7.5.1. SETTING UP OF POLICIES

Policy is an implicit framework that guides the day to day actions on a job. Policy includes a range of elements which are:

- Policy creates a framework for action within the organization so that there is a clear picture in the minds of all the employees as in how a work is to be carried out.
- Policy should be grasped and known to all the employees so that they can act on it accordingly.
- Policy creation is an ongoing process, as mentioned earlier the good practices can be recognized and formally documented as a policy.
- Policy is a wider framework within which the organization works.

7.5.1.1. Need of policy

It is needed so that people working in an organization can have a framework for action that helps them get on with the job they do. So that people don't have to discuss and re-discuss again and again the same issues. One thought out decision can be applied to many similar cases. This helps in increasing the efficiency of the organization. Further, policy documents help to ensure that statutory requirements are met and it also ensure that quality of work is improved. The following are the key requirement of having the policy documents in the organization:-

✓ To ensure consistency
✓ To promote transparency
✓ To promote accountability
✓ To guide how decisions are made

7.5.1.2. What does policy look like?

Policy has many forms. What is included in a particular organization's policy is often related to the size of the organization. In a small organization of let's say Board of Management and 10 staff, an Organizational policy of less than 100 pages could include most of the significant policies the organization may need. However, in a large organization there may be a series of organizational manuals such as:

- Human Resource Policies and Procedures
- Administration Policies and Procedures
- Finance Policy and Procedures etc.

Some of these could run to hundreds or even thousands of pages each. So, the bottom line is that the look of a policy will always depend on the size of the organization. Moreover, as stated earlier, Policy making is an ongoing process. So, just as the size of organization will keep on changing, the policy will also keep changing accordingly.

7.5.1.3. Criteria to develop a good policy

- A good policy must have clarity
- A good policy must be user-friendly
- A good policy must be robust
- A good policy must be implementable

7.5.1.4. Results of a good policy

- A good policy recognizes the issues and addresses them.
- A good policy brings uniformity in the organization.
- It eliminates discretion of personnel.
- Reduces risk by bridging gaps.

7.5.2 BUDGETARY CONTROL

- An organization makes budget on the basis of plan to achieve the objective. Budget gives the quantitative picture of the plan of action. Along with the document for plan of action, budget provides a tool to control the implementation of the project. The actual work is compared to the planned work along with the comparison of actual expenditure with that of planned expenditure. The deviation between the actual and plan/budget is analysed to take corrective action.

- Budget is also a tool for the cost control. The budget gives a standard for the expenditure for activities and prevents unnecessary extravagance in the work. This is very important control since excess expense in one activity has negative effect on the implementation of rest of the activities as fewer amounts would be left to carry out some of the other activities.

- Budget as a document prepared at the planning stage helps in monitoring as well as review of activities in line with the expenditure.

The essentials of budgetary controls are:

- Establishment of budgets
- Executing responsibilities in order to perform the specific tasks to attain the desired objectives
- Continuous comparison of actual performance with standard performance
- Taking corrective actions, if there are deviations
- Revision of Budgets

7.5.2.1 Why Budgetary Control is important?

➤ **Restricted & Specific Purpose**:- In general, project funds received by NGO's are restricted. The restriction is imposed on its usage and can only be utilize for the specific purpose as agreed upon between the donor and NGO.

➤ **Time Bound:-** As we know that 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. Therefore, it is very important that the planned activities are completed in the time set in accordance with the budget.

➤ **Programme. Vs. Administrative Expenditure:-** It very important to have control over the administrative expenditure, as it is always a better practice to have minimum administrative expenditure in the overall project cost. All organizations should assess and book the administrative expenditures separately, as there can be a matter of compliances like FCRA. Sometimes, donors also give instructions to the organizations in matters related to administrative expenditure and program expenditure.

➤ **Cost Plan:-** Since, budget is made to track the expenditures, therefore, before any expenditure it is suggested to refer to the cost plan.

➤ **Coordination between various costs:-** Budgetary control helps to verify various individual program costs and keeps a check on overspending.

➤ **Clarity on the progress of the project:-** As discussed earlier, budgets provide a clear estimation of the various programme costs. This in return acts as a reference point as organizations can refer back to the budget and find out the achievements and progress of the project.

➤ **Deviation from the Budget:-** The event of deviating from the budget would be considered as deviation from the financial track set. Since the deviation which may be positive or negative i.e. over expenditure or under expenditure may change the overall scenario of the project, it is vital to monitor it in line with the planned activity. For example, in the project of building houses for poor where the construction is done step by step and which ends basically with the roof and finishing's, the over expenditure in case of initial construction steps may leave the house without roof and doors. This will lead to total failure of the project.

➤ **Actual Implementation:-** For any type of control mechanism we need to have a reference point. Budget acts as reference for control over actual implementation of the project. Thus, we have to compare the actual happening with that of the plan/budget.

➤ **Comparison statement:-** Comparison statement as mentioned above in itself does not serve the purpose of control process. It merely gives an idea of deviation that may require our attention. Control process means taking action against something which is not favorable.

➤ **Timely Corrective Decisions can be made:-** Since budgets act as a reference point for projects, any variance in the actual and estimated budget can be detected and rectified in due time.

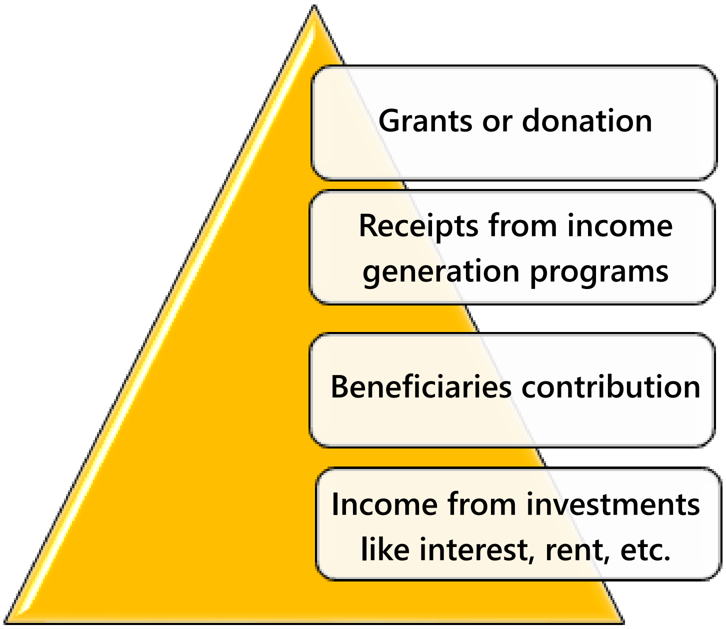
7.5.3 RECEIPT MANAGEMENT

Organizations should have systems to secure their incomes. There are some basic checks and control to ensure that money received by the organization is not leaked and properly accounted for. Some of such checks and controls are:

- Opening official mails at secured place and in the presence of more than one person as the mails may contain cheques.
- Receipt should be issued immediately for all cash receipts. If this system is not in place then, the cash received may go unaccounted and would result in loss of revenue of the organization.
- Any receipt should immediately be recorded in the books of account.
- All the receipts should be deposited in bank account to have a proper trail.
- There should be system of regular check to ensure that all the incomes are being recorded properly on time.

Types of Receipts

Normally, the nature of receipts includes the following:



7.5.4 EXPENDITURE CONTROLS

Expenditure Control is an approach to ensure that the funds are utilized for the intended purpose and objective of the organisation and is within the scope and framework as defined under the policies of the organization or any other contractual agreement/laws of the land. There should be proper control over expenditure to ensure that all the expenditures are reasonable and as agreed with the donor, which finally leads to achieve the project objective.

To strengthen the internal control over the expenses, the organisation should ensure the following –

- Ensure that all the expenditures should be recorded with appropriate voucher with adequate supporting document.
- Ensure that authorization is in place.
- A senior staff should authorize the expenditure before it is paid.
- The person authorizing expenditure should be different from the one who prepares and signs cheques.
- All payments to suppliers be made against original invoice. In case the payment is made on the basis of scan/ photocopy of the invoice, there should be necessary controls to ensure the receipt of original invoice to avoid the duplicate payment.
- It is required to use the requisition form for the withdrawal of funds and project advances.
- Monitoring of the existing balance in the fund/project.

All the activities of an organization involve expenditure. All the expense should be done on proper authorization by the person conversant with the overall programme for which the expenses are done. For e.g. Programme Coordinator of a particular project should always be part of authorization/ approval system, so that the viability and validity of expense is properly referred and linked to respective budget head. As far as possible, the payments should be made only on receipt of proper and original documents supporting the expenditure.

Payment to vendors should always be done on receipt of original invoice.

It is very important that the expenditure incurred against one budget should not be booked under another budget. Further, expenditure which does not pertain to the project should not be charged to the project.

Key Elements of the Expenditure Control –

• **Activity Plan** –Every organisation should develop clear plans as it is very essential to carry out the activity in a systematic/timely manner. It should be in line with the vision and mission of the organisation. Activity plan and finance plan needs to be clearly linked so that the resources can be utilized in an effective and efficient manner.

• **Project Budget** – Project budget should be made to ensure time plan, remittance and usage of funds for the programmes and it should be strictly adhered to. The same should be reviewed on regular basis.

• **Accounting Structure** – the accounting head should be structured in sync with the budget head. This will help in correct booking of expenditure as well as monitoring on regular basis.

• **Program and Natural Heads** – The accounting structure should enable to track natural head expenses under the respective program heads. This will help in ensuring better control over the project/program expenses.

• **Approval and Authorization** - Expenditure should be approved & authorized by the authorized signatory (senior staff).

- **Booking of Expenditure** – It should be ensured that the expenditure has been booked to the project to which it belongs and as per the approved budget. Further, it should be checked twice whether the expenditure has been booked under the correct head on quarterly basis (time period depends upon the size of the organizations).

- **Regular Updation of the Books of Account** – Proper books of account should be maintained and it should be regularly updated.

- **Role of Audit** – Auditor should report that the expenditure are in conformity with the project objective, donors compliances etc.. Project has been implemented according to the approved budgets. Adequate notes/disclosures should be made by the auditor for transparency.

7.5.5 PURCHASE CONTROLS

Another aspect of control system is the purchase process. Purchases involving considerable amount should properly be processed to avoid any possibility of excess payment as well as inferior products being received. There should be proper purchase policy in the organization that ensures that correct decisions are taken regarding the purchase to be made as well as the vendor from whom it is purchased.

Following simple steps should be followed while ensuring control over purchases:

- Check the Approved Budget
- Requisition / Demand letter
- Approval from the Senior Management or Purchase committee
- Collect at least three quotation
- Ensure the comparative analysis
- Take the approval from the committee or appropriate authority
- Prepare a contract

- Issue purchase order
- Deliveries reported to the management.

Purchase Committee is responsible for all matters pertaining to purchases (as per guidelines of the finance manual) of the organisation. The Purchase Committee should consist of a group of members from various departments of the organisation such as Finance, Admin, Programme and the target community.

7.5.6 BANK TRANSACTIONS

In India it is mandatory to have a separate bank account for foreign contributions notified by the Ministry of Home Affairs. It should be ensured that only foreign contributions are received in this account and no domestic receipts of any nature should be deposited in this account. For local funds, separate account has to be made and such funds should not be mingled with foreign contribution account. Every month the organization must prepare a bank reconciliation statement. It should be verified by the internal and the statutory auditor. The bank account should be operated on joint signatory basis. Postdated cheques should not be issued. The authorized signatories should never sign blank cheques. It is advisable to have two or three authorized signatories for the operation of the bank account. NPO's should maintain cheque issue register and "Account Payee Cheque" should only be issued unless it is office cash withdrawal. Cheque books should be kept under lock and key with some responsible and accountable person. Cheques received should be deposited on the same day or the next day. Any delay should be reported with reasons. The organization should issue cheques only if they have sufficient balance in their accounts as bouncing of the cheques is a serious crime as per Indian law. A bank balance confirmation certificate should be obtained from each of the banks for the purpose of audit.

7.5.7 CASH TRANSACTIONS

Control over cash, both transaction and the physical cash is very important since it involves high risk. Cash remaining unaccounted is cash lost. Hard cash is also more prone to theft. Cash if not properly handled and monitored may pose problem at the time of cash reconciliation and the accountant may get into trouble. Likewise, cash payment should also be properly handled as cash payment done without accounting for the same may cause the actual cash and the balance as per book to mismatch. Cash advance, like advance to staffs also should be properly recorded and tracked.

Some of the ways for Cash control are following;

- Cash should always be kept at a secured place within lock and key. A person should be designated as cash custodian who should be responsible for cash transactions and keeping track of the same
- Where there is high cash transaction done and balance kept in the office premise is large, appropriate cash insurance should be taken. This is true in case of high and frequent cash in transits.
- Cashier/cash custodian and the person recording the transactions should be different.
- There should be system of immediate recording of cash transactions in the cash book as transaction not entered may remain unaccounted for.
- Receipt should be issued immediately for all the cash received. There should be system of triplicate cash receipt. The original receipt should be given to the payee, one carbon copy should be attached with the receipt voucher and another carbon copy should be left in the receipt book. The receipt issued should be pre-numbered. Full receipt book should be used before taking out another receipt book which should also be numbered chronologically. Receipt books should be kept in the custody of higher authority and issued only after ensuring that the last one is used. The authority issuing the receipt books should verify the last used receipt book before issuing the next.

- There should be policy for cash payment where maximum possible cash payment should be specified. Cash payment over and above the limit should always be specifically approved by higher authority.
- There should be a system of regular cash count and surprise cash count by the senior authority

7.5.8 FIXED ASSET MANAGEMENT

Organisation's resources include assets that are used for carrying out the activities for achieving the objective. Safeguarding assets of the organization is an important area of internal control mechanism. Therefore, the access and use of the assets should be properly monitored. In doing so, following options may be used;

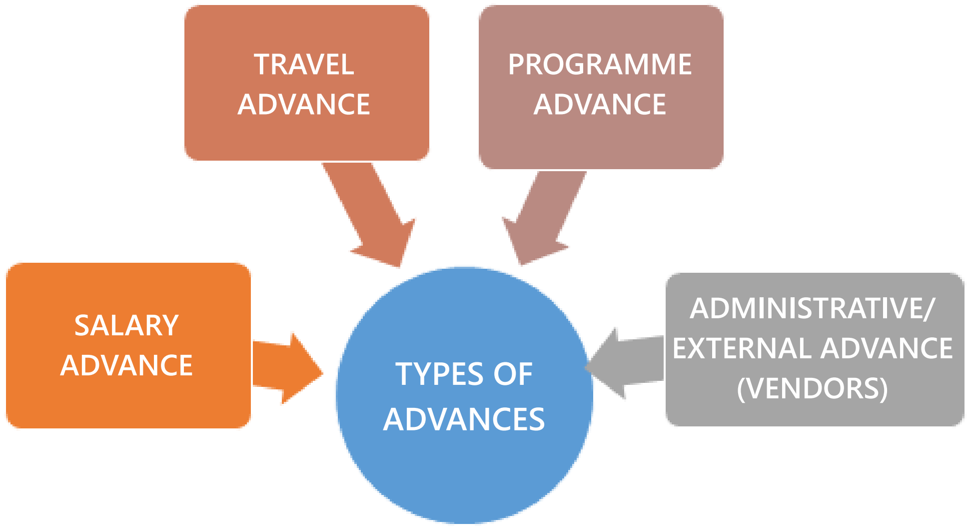
- There should be proper authorization for using valuable assets like vehicle, Computers etc.
- All the assets should be in the name of the organisation and not personal name
- The office premise should be properly secured
- Proper insurance should be taken for all the assets of the organization as well as the office premise.
- There should a policy for use of assets by staff
- Above all, there should be detailed and proper record for all the assets and period physical verification should be done. Condition of all the assets should be noted and assets that are no longer usable should be disposed of after proper authorization.

7.5.9 ADVANCE CONTROL

Advances in an organization can be given both internally and externally. Internally the advances can be given in the form of salary advances for personal use, travel advances for official purpose and programme advances for implementation of programmes. Similarly, advances can also be given externally to vendors. Advance given to the staff as well as vendors should be settled within the specified period of time. Advance if left unsettled for long and not tracked may remain unsettled forever. This is because, the staffs who have taken advance may leave the organization, the vendor may close down etc. In these cases, the advance given and not settled would become loss to the organization.

Following would help to avoid the above situations;

- A clear policy should be made for the advance provision as well settlement.
- Advance should be given only on proper authorization. There should be policy of mandatory settlement of advance within a specified time limit, say 7 days of completion of travel in case of travel advance etc.
- Status of all the advance should be review at the end of specified period, say a month
- No second advance should be provided to the same person without the first being settled
- All the balances including the advances should be properly checked at the time a staff leaves the organization.
- There should be a recourse for recovery of long due advances and action should be taken on time in all such cases.



7.5.10 SEGREGATION OF DUTIES

- The principle of internal check where one person's work is automatically checked by other due to the process followed is applicable at each level and for all the work whether it is cash management, asset management, bank transactions, accounting or other. Proper segregation of duty in itself is a control mechanism which along with operational control keeps moral check too.
- Segregation of duties also helps in detection of errors caused by omission or otherwise as well as frauds and intentional errors.
- Internal control is must in all organization irrespective of the size and nature of the organization. However, the extent and vastness of the system would depend on the size and nature of the organisation.