

Diploma in Financial Management & Accountability

- a joint initiative of TISS & FMSF

Course Material



Control Systems
Paper - VI

Module - III
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UNIT- 5

MEASUREMENT, COMPARISON & CORRECTIVE ACTIONS

5.1. Measurement of Actual Performance

5.1.1. Introduction

This is a process through which the actual performance is measured and documented. The process of measuring and documenting the financial transaction is known as financial accounting whereas programs are also being documented to evidence the conduct of the program like maintenance of training register.

5.1.2. Accounting of Financial Transactions

Introduction

Accounting can be defined as a process largely for regular and systematic recording and assessment (evaluation) of the organisation's quantifiable financial transactions, procedures, amounts and valuables, in order to plan, manage and monitor the mission developments. For instance, when a nonprofit receives a donation it is essential to quickly record the amount and wish of the donor (for instance, the money can only be spent for a given cause) and report how it was spent. The aim of accounting is to obtain an instrument that is for internal (e.g., executive directors, supervisory directors) and external stakeholders (e.g., creditors, donors, the Treasury, members) and can be used to manage or contribute to the organization or any other institution connected to the organization in a goal-oriented and responsible manner. Ideally, accounting and financial reporting systems lead to better decision-making on the part of internal managers and external donors.

The purpose of accounting is mainly two fold :

1. one is mainly directed to the past (historical) and oriented towards accountability over income, spending, liabilities due and valued assets whereas the second type focuses on the future with the purpose of good decision making, planning and governing.
2. A second main purpose of accounting is to support goal-oriented decision-making and future-oriented governing (steering toward the goal or mission and regulation of goal oriented behavior) in the organization. For this purpose, the organization collects, saves, handles, processes and interprets data (sales, for example) and converts it into information (annual surplus or deficit) and further into knowledge (how to avoid losses or deficits) as well as into illustrations of target-figures (budget salaries), sub-ordinate targets (salaries of administrators versus counselors) and target variances (such as actual administrative expenses may have been higher than budgeted)
3. Accounting has to provide various information for management control as well as it has to satisfy the information need of the various stakeholders. Hence the organisation should frame its accounting in such a way that these multi objectives from the accounts can be achieved. In order to achieve better control the following accounting issues should be kept in mind :

3.1. Accounting Period:

- The accounts should be maintained on the basis of accounting year of the organisation which is from 1st April to 31st March.
- The reporting period of the project as agreed with the donors may be different from the accounting year of the organisation. However it does not mean that the accounts should be maintained on the basis of reporting period. The reports can be generated for the donor

agencies on the basis of books of accounts maintained on the basis of accounting year of the organisation.

- For control purposes it is recommended that the report for each funding arrangement should be made in accordance with the accounting year of the organisation so as to facilitate easy comparison of donor wise report with the statutory returns and the consolidated financial statements.

3.2. Location of Maintenance of Accounts:

- In the case of multi location organisation, it has to be decided whether the accounts needs to be maintained centrally at one place or books of accounts should be maintained at different locations where the expenses are being incurred and controlled.
- The centralized accounting facilitates easy monitoring and reporting but may result in loose financial control at project level.
- Whereas decentralized accounting though provides a scope for more control over the project level expenses but at the same time it requires higher qualified or educated financial staff at project level.
- The organisation should choose between the centralized accounting or decentralized accounting depending upon its size, qualification of staff, available infrastructure and other related contextual issues.

3.3. Fund/Project Accounting:

The Books of account shall be maintained on the principle of fund accounting and more specifically the organization should maintain the separate books of account:

- For recording the transactions out of the foreign contribution with complete identification for each funding arrangement so that income, expenses, corresponding assets & liabilities, opening & closing balance of each funding arrangement is easily identifiable.
- For recording the transactions out of the other grant including Government & private, with complete identification for each funding arrangement so that income, expenses, corresponding assets & liabilities, opening & closing balance of each funding arrangements are easily identifiable.
- For recording the transactions in relation to Income Generation Programs.
- For unrestricted income and fund.

3.4. Classification of Expenses :

- In the case of NGOs it is important to know the expenditure incurred for a particular activity so that the reader can understand from the reports as to how the expenditure fulfills the objectives of the NGO. At the same time it is also necessary to classify the expenditure as per budget head as approved by the funding agencies and as required by the statutory bodies.
- It is therefore recommended that the expenditure should be linked to the activity as approved by the funding agencies and it needs to be sub-grouped on the basis of nature of expenses.

3.5. Joint cost/Common Cost :

- The costs, which cannot be directly allocated to the individual projects / program, should be classified as joint cost.

- The joint cost should be determined and shall be allocated to the funded programs and also to the other programs as per the policy of allocation as approved by the board.
- The basis of allocation of joint costs may include :

Expenditure Method : Joint cost can be allocated on the basis of direct costs incurred for various programs and projects.

Income Method: Joint cost may also be allocated on the basis of income out of grant or service charges under various programs/projects.

The organisation may choose any other basis for allocating joint cost on prudent consideration (accepted Accounting Principles)

3.6. Foreign Exchange Difference/Foreign Exchange Fluctuation :

Normally the agreements from the foreign donors are executed in foreign currency, which are subject to fluctuation. As a result an organisation may receive more or less amount of money than the budgeted amount depending upon the fluctuation of currency. Hence it is very much important to have a control over this figure of fluctuation so that appropriate decisions can be taken.

It is therefore, recommended that :

- The entries for receipt of foreign grant shall be made based on the Exchange rate as actually realized. However the difference of the remittance actually realized and the amount of remittance that would have been received based upon the Exchange rate considered

at the time of finalisation of budget should be determined and transferred to the foreign exchange difference a/c.

- The balance of this account, if there is a gain, shall be utilized only on proper authorization by the concerned authorities.

3.7. Expenditures incurred by Head Office on behalf of Project/Centre :

- In certain cases head office has to make specific purchases on behalf of projects and has to send the materials to the projects.
- These expenses need to be duly accounted for in the project's books of account in order to have the control over expenses and also for ensuring proper budgetary control system.
- It is, therefore, necessary that for expenditures incurred by head office on behalf of projects, necessary advice along with all the supporting documents should be sent to the project and the same should be duly accounted for, by the projects.

3.8. Contribution in kind :

- An NGO, apart from receiving contribution in cash, also receives contribution in kind. The contribution in kind may be in the form of goods, use of facilities, labour charges or service.
- Normally the accounting entries are made when the transaction is effected in cash. Hence contributions in kind are normally not accounted for in the books of account.
- However there is a need for accounting of contribution in kind in order to reflect the total receipts by an

organization and the actual cost of implementing the program.

5.1.3. Documentation of the conduct of the programs:

For recording of financial transactions, the accounts are kept in order to ascertain how much expenses are being incurred under each approved heads and for satisfying the need of the various stakeholders as regards financial reporting.

In a similar way, it is equally important to keep records of all the programs so that programme implemented by the organisation can be measured, recorded and reported. This aspect of record keeping of program is known as 'Social Book Keeping'.

Social book keeping is defined as a process by which information is routinely collected about performance in relation to the social objective. As the definition suggests, social book keeping is a process of collecting information. This information forms the basis for preparation of social accounts. Therefore, the organization has to be very clear right from the beginning of the implementation of the program as to the social books to be maintained.

The social books have to be maintained at the following two levels:

- Field Level
- Organisational Level

Field Level:

In the field level, the books have to be maintained which relate to the type of programs that are being implemented. For example, if non-formal education program is being implemented, then some basic records need to be maintained. These records would include;

- Enrollment or Admission Register;
- Daily Attendance Register;
- Monthly Performance Register;
- Test Records;
- Vocational Training Records etc.

Now at the end of the month, the responsible teacher/trainer of such centers should compile such information into one sheet, which is generally termed as Monthly Information System or in a broader sense Management Information System (MIS). This sheet would provide all the information, like the total number of enrolled children, male female classification, attendance rate, drop-out rate, number of vocational training classes conducted etc. These sheets then need to be verified by the concerned person responsible co-ordination of the program (Field Coordinator/Cluster Coordinator). The Coordinator would then compile records of all the centers that falls into his area of work and send a final complied MIS sheet of the whole area to the head office. Similarly, for awareness programs, the record of the meetings, minutes, resolution passed in the meeting, and other related records may be kept.

Organizational Level:

At the organizational level, macro social records need to be maintained. These are the basic records of programs. Unlike financial aspects, information on programmatic aspects are sometimes not available in clear and concise form. In case of financial information required, there are number of records available, like Cash Book, Fund Flow Statement, Budget Variance Report etc., which provides all the relevant information at any given point of time. Similarly, necessary records should provide information on programmatic aspects on any given point of time in clear and systematic manner.

Program Ledger could perhaps provide the desired solution. Program Ledger is a record book which provides all the relevant information of the program. Details like the activities that were planned (at any given point of time), undertaken, and what could not be carried out. Additionally, it also provides financial information relating to the project in terms of amount of fund that has been planned for particular activity, actual expenditure and deviations if any. This Program Ledger can capture the information of the activities undertaken during a given period of time. As explained above, it provides all the relevant information relating to a particular program. The organization may follow some other form of social accounting. However, what remains non-negotiable is that any record maintained by the organization should provide relevant information in clear and concise manner and such information should be available at any point of time. Additionally, it is also important to note that the organization has to decide ahead of the implementation of the program as to which records they would be maintaining to substantiate the qualitative as well as quantitative impact of the programs. Accordingly, necessary formats and other procedures need to be developed which would provide the above information.

5.2. Comparing the Actual Performance with the Pre-Determined Standards/ Budget

5.2.1. Introduction

Once the standards are set and the performance is accurately measured, the next step is to compare them to see any variation between the two. In case of the difference between the actual performance and the desired performance, the management should also find out the reasons and the significance of such differences.

This is an important aspect of control and for comparing the actual performance with the budgeted performance certain specific control tools are being used by an organization. These tools include :

5.2.2. Budgetary Control

1. As regards Monitoring & Variances

The monthly variance statement, i.e. the statement comparing the actual expenses with the planned expenses for that month as per the operational plan, both in term of quantity and finance should be prepared, analysed and corrective actions needs to be taken. It is also suggested that the monthly variance statement should be discussed involving both the program staff and the finance staff.

2. As regards Linkages

It is recommended that the following linkages should be made in order to monitor the expenses and to assess the cost effectiveness of the expenses :

2.1. A report should also be prepared linking the financial expenditure with the quantity of activity undertaken and its comparison with the budget.

2.2. The expenses incurred should also be linked with the control register like Log Book and the operational register like Training Register and also with the utilization records like Muster Rolls.

5.2.3. Policy Compliance Report

It is the responsibility of the Chief Functionary to adhere to the policy framework and prepare a report on the policy compliance. The policy compliance report should be submitted to the Board along with the supporting evidence. This would ensure that all the policies set by the Board are being complied with. If not, the reasons for doing so have to be explicitly stated in the report. Apart from the Chief Functionary, the Policy

Compliance Report should be signed by two other employees of the leadership level.

Sometimes the internal Auditors are also requested to verify the policy compliance and to prepare a report for the Board.

5.2.4. Audit : Internal & Statutory :

1. Statutory Audit :

1.1. Statutory audit is mainly a process of certification of the financial results but it also act as a control process when the statutory auditor submits the management letter.

1.2. Management Letter :

Management letter is a letter issued by a statutory auditor to the management pointing out :

- significant internal control deficiencies;
- constructive recommendations;
- other matters that the external auditor wants to bring to the attention of the Management and audit committee.

The auditor should solicit and consider management comments on a draft of the management letter before preparing the letter in final form for presentation to the Board/audit committee.

Hence, management letter is a process by which issues are brought to the knowledge of Management for taking corrective and remedial actions.

2. Internal Audit :

Internal audit is not merely an examination of financial records but is a tool of management control which measures and evaluates the effectiveness of all other controls. The internal audit keeps a check on the systems of the organisation. The internal audit report should be presented to the Board of the Organization. This would provide a clear view of the internal state of affairs. It would be advisable if the internal audit is conducted by the person other than the external Auditors.

5.2.5. Evaluation and Assessment

Evaluation in the context of development work refers to a systematic and objective assessment of an on-going or completed operation, program or policy, its design, implementation and results. Any evaluations should aim to assess or measure the **relevance, effectiveness, impact, efficiency, sustainability & replicability** of the concerned development program.

The effectiveness of evaluation as a tool lies in its vast scope, Evaluations can cover financial, programmatic, governance as well as administrative aspects of an organisation's operation. An evaluation that covers all these aspects would provide a wholistic view of the organisation's work and operation. In other words, evaluations of development programs and projects is basically about describing, judging and explaining what has been done, how activities have been performed, what has been achieved and what should be the future course of action. It is the primary responsibility of the Board to have evaluation at regular intervals. This would act as a reality check and provide a clear picture of the organisation's standing vis-à-vis its vision & mission.

5.3. Corrective Actions

Control process would be incomplete if corrective action is not taken. Corrective action calls for the necessary action with a view to put in the performance on a proper track. Also, corrections should be undertaken promptly as soon as deviations are detected to avoid accumulated loss. It should also be noted that not all deviations need correction. Such action may be either remedial (which is taken after the wrong has been done) or preventive (which is taken before). It is obvious that the latter is preferred to the former. Those having the authority over the actual performance put the corrective action into effect. As such, the control process ends with such proper corrective action.

The examples of actions taken by an NGO as a measure of corrective action includes the following :

1. The budgetary Control System points out variances together with the reasons and based on which the following actions are taken :
 - 1.1. Certain variances indicate the need for taking measures to control cost and based on which appropriate actions are taken.
 - 1.2. In certain cases because of increased cost, budgetary allocation needs to be modified after taking necessary consent of the concerned authorities.
 - 1.3. The results of the variance are also taken into consideration while formulating the new budget proposal.
2. The review of internal control system by the auditor and the evaluator suggests the necessary modification in the present system and based on which corrective actions are taken and if required policies are also being amended.
3. Some times the corrective measures include the necessary capacity building program for the staff members of the organization.

4. In certain cases the corrective actions may result in re-defining the role of an auditor or even replacing an auditor.

SELF ASSESSMENT QUESTIONS:

1. Why Accounting is necessary?
2. What is Social Book Keeping?
3. What is Budgetary Control?
4. What is Management Letter?
5. Why Internal Audit is considered as important control technique in the hands of management?
6. What are the normal corrective steps being taken by an organisation as regards budget?