Business Advocacy Network

Managing advocacy projects

Effective financial management

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This workbook has been written by David Irwin

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Public policy dialogue & advocacy

Managing advocacy projects

Effective financial management

1. Introduction

Business member organisations (BMOs) engage in private public dialogue and to advocate an improved business environment. If they are lucky and persuasive, they may secure grant aid to cover some or all of the cost but in most cases BMOs will have to find the resources from their own income. Either way, it is very important to budget carefully and to exert close financial control. Indeed, accurate accounting and financial management is a key component of good governance, which goes hand in hand with transparency and accountability. Stakeholders expect accountability for financial resources that have been entrusted to an organisation. This handbook introduces appropriate financial management processes and procedures and is thus intended to contribute to effective financial control and enhance good governance.

Financial management requires a systematic approach to the collection and reporting of financial data and then uses that information to make decisions about the operations of the organisation.

The aim of this handbook is to introduce a range of financial concepts and techniques which will help you to forecast accurately the cost of projects and then to exercise effective financial control. By the end of the book you will:

- Understand the need for effective financial management which can only be achieved through having in place good systems and processes;
- Understand the three core financial statements;
- Be able to record income and expenditure, receipts and payments in a simple accounting system;
- Understand the need to compare the actuals with the budget and the importance of corrective action.

2. Financial management

2.1 What is financial management?

Financial management describes the activities concerned with the planning, that is, budgeting, and controlling of an organisation’s financial resources. It encompasses a broad set of policies and procedures aimed at ensuring the effective control and efficient and effective utilisation of the scarce financial resources. The key requirements in financial management include:

- Understanding and implementing budget procedures and understanding the need to operate within the constraints imposed by the budget;
- Ensuring that all funds received are promptly and accurately recorded;
- Ensuring that all payments are promptly and accurately recorded;
- Implementing adequate financial control mechanisms;
- Preparing reports and submitting promptly to those who need them.
- Delivering value for money

A book-keeping and accounting system therefore has to meet two objectives: it has to record all transactions, as they occur, and it has to enable the easy preparation of management accounts.

2.2 Accounting

There are two generally accepted accounting systems: cash-accounting and accruals-accounting.

In cash-accounting, revenue is recorded as and when cash is received and payments are made regardless of when services were provided or when resources were used.

Advantages of the cash basis of accounting are:

- Simplicity
- Cash flow in and out of the organisation can be tracked
- Easy to understand
- Easy to control and audit

Disadvantages of cash-based accounting are:

- Financial statements are susceptible to manipulation
- There is no distinction between capital and operational expenses
- Assets and liabilities are not reflected
- It omits commitments and so fails to provide a comprehensive picture
- Cash statements do not provide a full picture of the financial position

In accruals-based accounting, records reflect when revenue is earned and expenses are committed, though the cash position may not immediately reflect that income or expenditure. In general, revenue is matched with the resources used to generate that revenues, regardless of the flow of cash in or out of the organisation.

Advantages of accruals-based accounting are:

- Presents accurate and complete recording of assets and reflects commitments more clearly
- Identifies sources and uses of cash
- Facilitates better financial control

- Provides a better assessment of financial health

Disadvantages of accruals-based accounting are:

- It is more complicated and requires more effort

Accruals accounting is the better option and we will return to this in the section on financial statements below.

2.3 The importance of control

Figure 1 illustrates the need for tight controls. The surplus, or profit, that your BMO makes is the comparatively small difference between two large numbers – revenue and costs. A relatively small change in either costs or sales can have a disproportionate effect on profit.

Figure 1: The Business Forum: target versus performance

	Budget (USD)	Change	Actual (USD)
Revenue	750,000	-10%	675,000
less: direct costs	375,000	+8%	364,500
Gross profit	375,000	-17%	310,500
Overheads	280,000	+10%	308,000
Net surplus	95,000	-97%	2,500

This association was budgeting for a high level of surplus – but a reduction in revenue, an unexpected increase in direct costs of 8 per cent and an increase in overheads of 10 per cent reduced the surplus to just $2,500, that is, a reduction of 97 per cent!

2.4 Keeping control

You need, therefore, to watch closely your costs and revenue since small changes can lead to substantial changes in your surplus. Control can then be exercised by comparing actual performance with budget. This requires:

- A financial plan – agreed as being achievable by all involved. Often the plan will be based on actual performance from the previous year though. It is usually better to start from scratch (known as zero based budgeting).
- Some means of monitoring performance against the plan. Monitoring will compare monthly accounting 'actuals' with projections. It is essential to have an accounting system capable of providing relevant, up-to-date information.

There are several other reasons why you should keep accurate records.

If you are a company there is a statutory obligation to keep financial records and to file annual accounts. In many countries, the accounts of limited companies are public documents. The tax authority will want to be assured about your record keeping to compute your tax liability and, if you employ people, to ensure that their personal tax is being correctly deducted.

In summary, record-keeping has to serve four purposes:

- To provide appropriate information for day to day management control of the business;
- To provide information which can be used to help in the preparation of next year's plan;
- To provide all the information for the preparation of annual accounts and statutory returns; and,
- To demonstrate creditworthiness, especially with potential sources of grant

The accounting records need to be detailed enough to enable you to be able to say at any time what the position of the business is: e.g. How much cash have you in the business? How much do you owe? How much are you owed? How big is your overdraft? How long could you keep on paying the bills if cash stopped flowing into the business? What is your profit margin?

3. Budgeting

3.1 Overview

Project budgeting is covered in the unit on planning your advocacy project. This section gives a brief reminder and expands the discussion to the whole organisation.

A budget consists of the estimated targets for revenues which are to be collected or received and the estimated expenditure for a project or organisation for a specified period. To be effective, a budget must be realistic. It must present a reasonable estimate of the revenue for the accounting period. Without a budget, you have nothing to measure your performance.

So, the purpose of a budget is to ensure that organisations:

- Are aware of how much revenue they will earn or generate and how much they will spend during a specified period;
- Limit their spending plans to the funds that they expect to receive;
- To monitor what they generate and spend; and
- Demonstrate how well (or poorly) they have performed.

3.2 Project costing and budgeting

Costing is the process of estimating all the financial resources required for a project. After all the costs have been estimated, they can be organised into a project budget. A budget outlines on what you will spend the money and how that spending will be financed. Budgets are a vital tool to:

- Control both project and organisation finances, that is, income and expenditure, receipts and payments;
- Organise project and organisation cash flow, both in and out, in good time;
- Enable you to make confident financial decisions and meet your objectives;
- Allocate appropriate resources to projects;
- Monitor project and organisation activities and financial performance;

- Plan for the future, including identifying problems before they occur – such as cash flow difficulties or the need to raise additional finance.

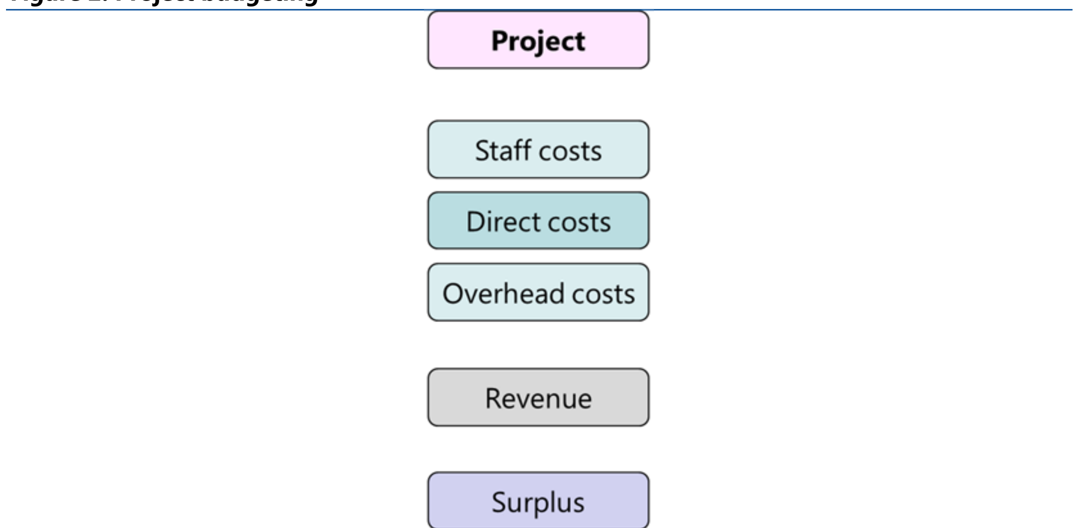
A budget should not be confused with a forecast. A forecast is a prediction – it defines what you anticipate will happen regarding your income and cost. A budget, however, is a planned outcome of the future – it defines what you plan to spend and from where you intend to get the money you will spend.

A detailed budget or financial plan needs to be developed for every project before you proceed – either to ensure that you have the resources required or to assist you to raise the finance. Some project budgets cover only part of the costs due to:

- A tendency to focus only on the initial purchase costs and ignore elements such as staff or capital equipment;
- Blind faith in 'optimistic' supplier estimates;
- Project designers' belief that the sponsors or others could not cope with knowing the true cost. This point should not be under-estimated. In some organisations, project managers find it easier to keep asking for small incremental sums than to give their sponsor or manager the shock of saying "this is what the whole project will actually cost". In fact, most project managers quickly lose faith in unreliable initial project estimates that lead later to frequent supplementary requests.

For an advocacy project, the costs will split into staff costs (the cost of employing staff for their time working on the project), direct costs (bought-in consultancy, but also events, travel, etc) and overhead costs (a fair share of the organisation overheads such as offices costs, accountancy, etc). Revenue, whether from a sponsor or from subscription income, will generally match the expenses, so there is unlikely to be a surplus. Whilst it is quite possible for a project to make a loss, the loss will have to be covered from somewhere.

Figure 2: Project budgeting



The budget will only be as good as the work you put into it, but it is there to help you manage and control the business. You must review it regularly. If the organisation is going off course, shown by variances from the budget, then you will need to take corrective action. All corrective action needs to be flexible, however. Major changes in one area may alter the performance in another.

It is important that management and staff all participate in the budget setting exercise; this will help in ensuring that everyone “owns” the targets and that everyone understands why expenses have to be controlled.

Whilst putting together a single budget is relatively straightforward, it becomes slightly more challenging when you combine project budgets to give an organisation budget. You may, for example, use surpluses in some projects to cover losses in other projects. To stay in control, however, you need to be clear about the whole budget as well as the individual budgets.

Figure 3: Organisation budgeting

Project 1	Project 2	Project 3	Organisation
Staff costs	Staff costs	Staff costs	Staff costs
Direct costs	Direct costs	Direct costs	
Overhead costs	Overhead costs	Overhead costs	Overhead costs
Revenue	Revenue	Revenue	Revenue
Surplus	Surplus	Surplus	Surplus

When preparing your budget, be clear about the assumptions, that is, figures and statements that you cannot easily prove but are reasonable to use.

With above items in mind, a project’s budget is therefore sometimes broken down into three components as follows:

- **Operating budget.** The expected revenues and expenses, and the operating expenses for the period, for example a year or a quarter;
- **Capital expenditure budget.** The organisation’s plan, or occasionally the project’s plan for the purchase of long term assets, remembering that not all funders will pay capital costs, in which case it is important to include depreciation in the operating budget, or else to lease equipment. If funders will cover capital costs, then it is important to be clear what will happen to the capital purchases at the end of the project. Some funders require them to be sold while others commit to donate them to the organisation.

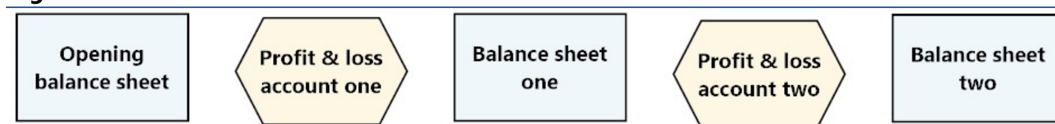
- **Financial budget (or cash flow statement).** This shows the cash inflows (for example, from project sales or project sponsors) and outflows for the period and shows when problems might occur – perhaps because salaries have to be paid before grants are received. Remember that cash flow does not indicate profitability – inflows exceeding outflows does not necessarily mean that the project is making a profit.

4. Financial statements

There are three basic financial statements which describe the activities and financial state of any business; being able to interpret these is key to understanding any business' financial position:

- The *profit and loss account (P&L)* shows how a business performed over a specific period and reveals the total revenue and total expenditure related to that period.
- The *balance sheet* summarises the state of a business at a specific date. Balance sheets are linked by a P&L which covers the period between the two dates.
- The *cash flow statement* summarises cash receipts to and cash payments from the business. A forecast of cash flow is one of the most important management accounting tools. It provides an estimate of the business's cash requirements for the next trading period.

Figure 4: Financial statements



It is often helpful to split up funds within a business to show sources and applications. Sources show from where the money has come; applications show to where the money has gone. Until a few years ago, British balance sheets showed *finance* or *liabilities*, that is, sources on the left and *assets*, that is applications on the right and many countries do still split in this way though some such as the US reverse the columns to show sources on the right and applications on the left. In the UK, balance sheets now tend to be set out in a single column which, as will be seen later, can be rather helpful. However, on occasion, there is merit in considering sources and applications separately.

Figure 5: Sources & applications

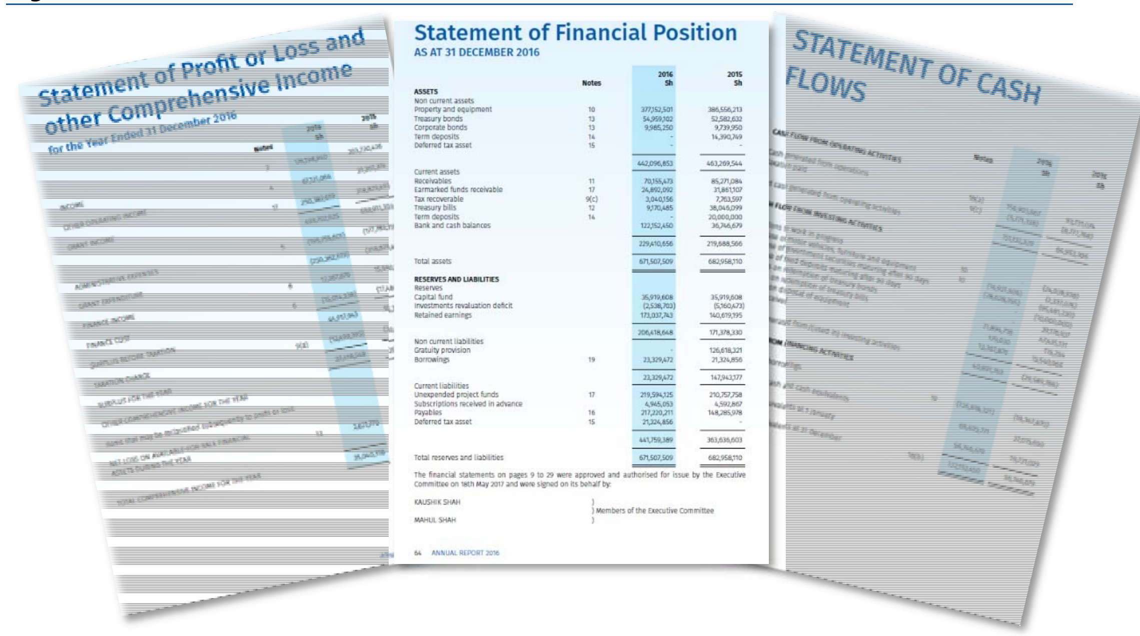
Source of funds	Application of funds

In double entry book-keeping every financial transaction requires two entries normally with each entry in a different ledger with the entries balancing one

another. In other words, as will be illustrated shortly, the sources and applications need to balance.

In the examples that follow, we will use figures from the actual accounts of a business membership organisation in Kenya.

Figure 6: Annual accounts



Statement of Profit or Loss and other Comprehensive Income

for the Year Ended 31 December 2016

Statement of Financial Position

AS AT 31 DECEMBER 2016

	Notes	2016 Sh	2015 Sh
ASSETS			
Non current assets			
Property and equipment	10	377,152,501	386,556,213
Treasury bonds	13	54,959,102	52,582,632
Corporate bonds	13	9,985,250	9,739,950
Term deposits	14	-	14,390,749
Deferred tax asset	15	-	-
		442,096,853	463,269,544
Current assets			
Receivables	11	70,155,473	85,271,084
Earmarked funds receivable	17	24,892,092	31,861,107
Tax recoverable	9(c)	3,040,156	7,763,597
Treasury bills	12	9,170,485	38,046,099
Term deposits	14	-	20,000,000
Bank and cash balances		122,152,450	36,746,679
		229,410,656	219,688,566
Total assets		671,507,509	682,958,110
RESERVES AND LIABILITIES			
Reserves			
Capital fund		35,919,608	35,919,608
Investments revaluation deficit		(2,538,703)	(5,160,473)
Retained earnings		173,037,743	140,619,195
		206,418,648	171,378,330
Non current liabilities			
Gratuity provision		-	126,618,321
Borrowings	19	23,329,472	21,324,856
		23,329,472	147,943,177
Current liabilities			
Unexpended project funds	17	219,594,125	210,757,758
Subscriptions received in advance		4,945,053	4,592,867
Payables	16	217,220,211	148,285,978
Deferred tax asset	15	21,324,856	-
		441,759,389	363,636,603
Total reserves and liabilities		671,507,509	682,958,110

The financial statements on pages 9 to 29 were approved and authorised for issue by the Executive Committee on 18th May 2017 and were signed on its behalf by:

KAUSHIK SHAH)
) Members of the Executive Committee
MAHUL SHAH)

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STATEMENT OF CASH FLOWS

4.1 Profit and loss account

A profit & loss account (P&L), sometimes known by not-for-profits as a statement of income and expenditure, shows what happened in terms of income and expenditure, during a specific period. All companies by law have to prepare a profit and loss account at least once each year, as part of their annual accounts. In that case the P&L covers a year's activities. However they can be prepared for any period of time.

Figure 7: sources & applications: income & expenditure

Source of funds	Application of funds
Revenues	Expenses

For example:

Figure 8: sources & applications: income & expenditure

Source of funds		Application of funds	
Revenues		**Expenses**	
Subscriptions	10,000	Materials & overheads	8,000
		Retained earnings	2,000
	10,000		10,000

Usually, of course, the P&L is set out in a single column though in formal accounts, figures for the previous year are usually shown as well. Figure 9 shows an example taken from published accounts. Negative figures are usually shown in brackets to make them more obvious. In the example, expenditure is shown as negative though often in published accounts it is simply assumed that the reader will know what is income and what is expenditure.

Figure 9: Statement of income & expenditure

for the year ended 31 December 2016

	2016	**2015**
	KES'm	KES'm
Subscriptions	90	84
Income from member activities	86	116
Sales revenue	0	3
Other operating income	67	31
Grant income	250	319
Total income	494	554
Staff costs	(80)	(68)
Administrative expenses	(116)	(110)
Grant expenditure	(250)	(319)
Total expenditure	(446)	(497)
Profit before interest & tax (PBIT)	48	57

Source: KAM annual accounts 2016 (used with permission)

The P&L shows:

- The revenue (that is, the income of the organisation) for the period (in this case, KES494m);
- The expenditure for the period (in this case KES446m); and,
- How much profit there was (that is, the surplus after deducting all the allowable expenses from the revenue – in this case KES48m).

Often there is also a 'distribution account' at the bottom of the profit & loss account which shows how the profit has been divided (to shareholders as dividends, to the government as tax or retained in the business).

4.2 Balance sheet

A balance sheet, sometimes called a statement of financial position, is a financial 'snapshot' which summarises the organisation's assets (what it owns) and liabilities (what it owes) at a specific point in time. Balance sheets are linked by P&L which covers the period between the two dates. All businesses have to prepare a balance sheet at least once each year as part of their annual accounts, but a balance sheet can be prepared at any time.

What a business owns (its assets) is always equal to what it owes (its liabilities). It is the liabilities that are used to finance the business. The starting point for every business is zero.

Figure 10: sources & applications: liabilities & assets

Source of funds	Application of funds
Liabilities	Assets

Imagine that you put £10,000 into a business. That £10,000 is effectively owed to you, but it is also used to finance the assets of the business. Initially it might be held as *cash in bank*. If the business then spends £7,000 on equipment, it has fixed assets of £7,000 and cash in bank of £3,000, still totalling £10,000.

Figure 11: sources & applications: liabilities & assets

Source of funds		Application of funds	
Liabilities		**Assets**	
Owners	10,000	Cash in bank	3,000
		Equipment	7,000
Total finance	10,000	Total assets	10,000

A balance sheet is a financial 'snapshot' which summarises the assets and liabilities of a business at a specific point in time.

The balance sheet shows:

- How much capital is employed in the organisation (that is, how much is the organisation worth and from where has the finance come – in the example below, KES206m)
- How quickly assets can be turned into cash (that is, how liquid is the organisation – though this requires comparing current assets and current liabilities)
- How solvent the organisation is (that is, the likelihood that the organisation might become insolvent – unable to meet its financial obligations – though this requires an assessment of the net finance and the liquidity of the business)

Figure 12: Statement of financial position

as at 31 December 2016	**2016**	**2015**
	KES'm	KES'm
FIXED ASSETS		
Property & equipment	377	387
Treasury bonds	55	53
Corporate bonds	10	10
Term deposits	0	14
	442	463
Current assets		
Receivables	70	85
Earmarked funds receivable	25	32
Tax recoverable	3	8
Treasury bills	9	38
Term deposits		20
Bank & cash	122	37
	229	220
Current liabilities		
Unexpended project funds	220	211
Subscriptions in advance	5	5
Payables	217	148
Deferred tax	23	21
	465	385
Assets less current liabilities	206	298
Liabilities falling due in more than one year		
Gratuity provision	0	127
	0	127
Net assets	206	171
RESERVES		
Capital fund	36	36
Investments revaluation deficit	(3)	(5)
Retained earnings	173	141
Net finance	206	171

Source: KAM annual accounts 2016 (used with permission) (reformatted and corrected)

4.3 Ratio analysis

Many people find it difficult to look at a profit and loss account or a balance sheet and derive a full picture. As a result, ratios – a ratio is the relationship between two numbers – are often used to interpret accounts. They indicate how a business is performing and suggest trends and patterns. They can be compared to the same ratios in previous years' accounts and the accounts of other businesses operating in a similar environment. Here are four suggestions for ratios that will help you to manage the organisation:

- Profitability - how good is the business as an investment.

- Solvency - how near is the business to bankruptcy.
- Liquidity - the amount of working capital available.
- Efficiency - how good is the management of the business.

Figure 13: Ratio analysis

	2016	2015
Current ratio	0.49	0.57
Net profit margin	10%	10%
Return on capital employed	23%	33%

The current ratio is the ratio of current assets to current liabilities. To be absolutely sure that you can pay your debts as they fall due, this needs to be more than one, that is, current assets need to exceed current liabilities. The net profit margin is the ratio of profit before interest and tax to income. The return on capital employed is the ratio of profit before interest and tax to equity plus long term debt (though for an organisation with a high level of short-term debt, I would include all debt). The target should be higher than the return generated from putting the money on deposit.

4.4 Cash flow statement

A cash flow statement simply shows all the receipts to and payments by the organisation. Cash flow statements for historical periods usually show what happened for a year though, as with other statements, they can be prepared for any period. The cash flow statement shows how money flowed into and out of the organisation during the period and relates the profit and loss statement to the balance sheet. In particular, it shows by how much the working capital (that is, the money tied up in activities) in the organisation increased or decreased and highlights the reasons for the changes. A cash flow statement only shows cash in and cash out, so non-cash items such as depreciation are ignored (though it may have to be added back if it is derived from the profit & loss account, as in the example).

Figure 14: sources & applications: receipts & payments

Source of funds	Application of funds
Receipts	Payments

It sometimes seems strange to people who are not accountants that a business can be profitable and yet be short of money or running an overdraft. It must be remembered that profit and cash are not the same.

The profit and loss account matches revenues and expenses for a specific period though the revenues accrued for that period may neither all have been received nor the expenses all paid. If, for example a business receives cash of £5,000 in respect of sales and has to pay out £6,000 in expenses, then it will have to borrow

£1,000 from the bank (or from the owners), even though the level of sales may, in reality, be far higher.

Figure 15: sources & applications: receipts & payments

Source of funds		Application of funds	
Receipts		**Payments**	
Debtors	5,000	Wages	3,000
Bank loan	1,000	Cash purchases	3,000
	6,000		6,000

A cash flow forecast, prepared on a monthly basis, will help to pinpoint occasions when you may have insufficient money available to pay the bills (or, too much money lying around unproductively) – so that you can take appropriate action.

Figure 16: Statement of cash flow

	2016 KES'm	**2015** KES'm
Cash flow from operating activities		
Cash generated from operations	157	94
Tax paid	(6)	(9)
Net cash generated from operating activities	151	85
Cash flow from investing activities		
Additions to work in progress		(24)
Purchase of motor vehciles, furniture & equipment	(15)	(2)
Purchase of government securities maturing > 90 days	(29)	(95)
Purchase of fixed deposits maturing > 90 days		(10)
Proceeds on redemption of treasury bonds		39
Proceeds on redemption of treasury bills	72	47
Proceeds on disposal of equipment	0	0
Interest received	12	16
Net cash generated from (used in) investing activities	41	(30)
Cash flow from financing activities		
Repayment of borrowings	(127)	(18)
Net increase in cash & cash equivalents	65	37
Cash & cash equivalents at 1 January	57	20
Cash & cash equivalents at 31 December	122	57

Source: KAM annual accounts 2016 (used with permission)

Look at the example in Figure 16. This summarises the receipts and payments. In particular, note the cash balance of KES122m. Compare this to the cash figure in the balance sheet.

4.5 Preparing a management account

Figure 17: Management account

Profit & loss account	
Income	
Subscriptions	90
Sales	86
Gramts	250
Other income	67
Total income	494
Expenditure	
Staff costs	(80)
Administrative costs	(116)
Project costs	(250)
Total expenses	(446)
Profit before interest and tax	48
Interest (net)	(3)
Taxation	(12)
Profit after tax	32
Balance sheet	
Fixed (and ling term) assets	442
Current assets	
Cash	122
Debtors (receivables)	107
Current liabilities	
Creditors (payables)	(217)
Other liabilities	(248)
Net assets	206
Reserves	
Capital fund	36
Investments revaluation deficit	(3)
Retained earnings	173
Net finance	206
Cash flow	
Opening balance	57
Receipts	192
Payments	(127)
Closing balance	122

Source: Prepared from KAM annual accounts 2016

If you are keeping your ledgers accurately, it then becomes very easy to prepare a management account for your project or your organisation. The most useful management account is one that combines the information from all three of the financial statements. You should expect to produce this at least monthly. Ideally you will want to show the figures for the month, the figures for the year to date and probably the figures for the forecast as well. This can tell you a great deal about the performance of the business. Figure 17 simply shows figures for the year.

5. Book-keeping

5.1 Keeping the books

The objective of bookkeeping is to ensure that all transactions are recorded in the books of account and that financial statements can be produced as required, usually monthly.

Keeping good financial records is very important – to exercise control, to demonstrate probity and to enable the preparation of end of year and end of project accounts. You may already have an accounting system established – and it may be computerised. It will be very easy then to integrate new projects into the system. If you don't, then you will need to ensure that you set up a system to record at least receipts and payments. For many organisations, there is a need to record income (money due to the organisation in a specified period) and expenditure (incurred by the organisation in a specified period) separately from receipts (money coming into the organisation) and payments (money leaving the organisation). This is because you may pay in advance, say for raw materials that have not been used, or you may sell a product but not receive the money for 30 days.

Other reasons why you will need to keep accurate records are:

- there is a legal obligation to do so;
- any donor who may be interested to fund your organisation may want accounts;
- the auditors will need them for audit purposes;
- the Revenue Authority might require them;
- you will need to identify areas of possible concern; and,
- you will need to investigate and explain variances (under or overspends against your budget).

For the purposes of advocacy projects, it may be simpler to work on a cash basis. If you are setting up a system specifically for the project, the easiest way to do it is with an accounting analysis book, or on a computer spreadsheet, usually called a ledger. Whatever the system, an essential mark of good financial management is a clear record of all receipts and payments each with an 'independently verifiable paper trail' of supporting documents. The number of ledgers required may depend on your activities: typical ledgers are described below.

Supporters of projects may require that you set up a separate bank account specifically for your advocacy project. Unless you have a sophisticated book-keeping system, this is sensible as it will help you to keep track of all of the money intended for the project and make reconciliation much easier. It is good practice to require two signatures on all cheques. If you need a simple book-keeping system, then the Business Advocacy Fund can provide one for you.

5.2 Sales ledger

The first ledger is usually called the sales ledger, though on the basis that you do not have much by way of sales, you may prefer to think of it as the revenue ledger or the income ledger. In here you record all income, irrespective of whether you have actually received the money. In some cases, you will only record it when you receive it, say with a grant; but in others, you should record it when you send out the invoice. Revenues for BMOs usually come from three sources: member subscriptions, fees for services and grants. All income, including that invoiced but not yet received, should be recorded straightaway. Setting out your ledger to provide an analysis will help you later. Here the analysis separates sales (or fees), grants and subscriptions. It is unlikely that a BMO will be registered for VAT, but if you are, you will collect VAT on your vatable outputs (the example shows VAT on fees for training only). It will be helpful to show VAT in the ledger separately from the fees since this element is later payable to the revenue authority.

Figure 18: Sales ledger

REVENUE							
Ref	**Date**	**Details**	**Amount**	**Sales**	**Grants**	**Subs**	**VAT**
S001	1 Sep	Subscription from Alex	1,000			1,000	
S002	5 Sep	Grant from Advocacy Fund	15,000		15,000		
S003	7 Sep	Fee for training course from Barbara	1,160	1,000			160
S004	9 Sep	Subscription from Charlotte	500			500	
TOTAL			17,660	1,000	15,000	1,500	160

5.3 Receipts

All monies actually received should be immediately recorded in the receipts ledger. There needs to be enough information to link each entry to the sales ledger – in this case through the use of reference numbers as well as the description. Note that it is good practice to pass all receipts through the bank, but occasionally there will be a need to hold monies as cash, so this allowed for in the analysis headings. Note in the example that it is the gross amounts that are recorded: there is no need to split amounts for example for VAT. Note also that in many cases, you will be completing the sales ledger and the receipts ledger at the same time.

Figure 19: Receipts ledger

RECEIPTS						
Ref	**Date**	**Details**	**Revenue ref**	**Amount**	**Bank**	**Cash**
R001	1 Sep	Subscription from Alex	S001	1,000	1,000	
R002	5 Sep	Grant from Advocacy Fund	S002	15,000	15,000	
R003						
R004						
TOTAL				16,000	16,000	0
Debtors (receivables)				1,660		

At the end of each month, you should compare the receipts and the sales ledgers. You may need to remind anyone who has not paid that they still owe you money. It will help you later if you calculate and record the total owed by debtors (known as receivables in the US).

5.4 Purchases

The purchases ledger matches the sales ledger. All purchases should be recorded, irrespective of whether you have paid for them. It makes sense once again to have some analysis and, if you are registered for VAT, to record the VAT separately on those inputs on which VAT is charged, as this can be offset against your output tax.

Best practice requires that you first receive a purchase invoice (sometimes known as a bill or receipt) stating the service or item you have purchased and how much you owe. Then you make payment on the basis of that purchase invoice, even if you make the payment straightaway.

Many people are carefree with bills, often tossing them in a desk drawer until the end of the month, or frequently never to be found when needed. Whilst this is simple, it is bad practice. Record the purchase invoice straightaway. Write the reference number on the purchase invoice. And file it carefully.

Figure 20: Purchases ledger

PURCHASES							
Ref	**Date**	**Details**	**Amount**	**Staff**	**Direct**	**Overheads**	**VAT**
P001	1 Sep	Printing	580			500	80
P002	2 Sep	Travel	100		100		
P003	5 Sep	Staff wages	2,000	2,000			
P004	9 Sep	Rent	1,000			1,000	
P005	30 Sep	Room hire	300		300		
TOTAL			3,980	2,000	400	1,500	80

5.5 Payments

The payments ledger matches the receipts ledger. All monies paid out should be immediately recorded in the payments ledger. There needs to be enough information to link each entry to the purchases ledger. It is good practice to make all payments by cheque so that they pass through the bank, but occasionally suppliers may require paying in cash, so this allowed for in the analysis headings.

Note in the example that it is the gross amounts that are recorded: there is no need to split amounts for example for VAT. Note also that in many cases, you will be completing the purchases ledger and the payments ledger at the same time.

Figure 21: Payments ledger

PAYMENTS						
			Purchases			
Ref	**Date**	**Details**	**ref**	**Amount**	**Bank**	**Cash**
R001	2 Sep	Travel	P002	100	100	
R002	5 Sep	Staff wages	P003	2,000	2,000	
R003	9 Sep	Rent	P004	1,000	1,000	
R004	30 Sep	Room hire	P005	300	300	
TOTAL				3,400	3,400	0
Creditors (payables)				580		

At the end of each month, you should compare the purchases and the payments ledgers. You may need to pay outstanding bills. It will help you later if you calculate and record the total owed to creditors (known as payables in the US).

5.6 Month end

At the end of every month all the columns for both the receipts and payments pages should be totalled. If you have transactions in cash as well as through the bank, then these need to be totalled separately and the two added together. As a check, ensure that the total column sum equals the sum of all the other totals. If it does not, you have a mistake somewhere. Deduct the payments from the receipts to give the net cash flow for the month. Then add the figure brought forward from the previous month to give the carry forward figure. As you would expect, this is also the balance that should be in the bank. If the figure is positive – ie you have money in the bank – it is carried forward to the next receipts page.

Total receipts	16,000
Total payments	3,400
Monthly balance	12,600
Brought down	0
Carried forward	12,600

5.7 Bank reconciliation

The cash book(s) shows the movement of money into and out of the project and should exactly represent every movement on the bank account. All money coming in, whether in cash or by cheque, should be banked, and all money being used for payments should be withdrawn from the bank for a specified purpose. Ideally, money should not come in and go out without passing through the bank because that is a crucial cash flow control. At the end of each month, you should reconcile the cash book with your bank statement. This is a means of ensuring that the cash book and statement agree.

Figure 22: Bank statement

STATEMENT				EAST AFRICA INTERNATIONAL BANK
Sheet 1	Account number 2345678			
		Debit	**Credit**	**Balance**
1 Sep	Balance brought down			0
1 Sep	200300		1,000	1,000
2 Sep	100525	100		900
5 Sep	200301		15,000	15,900
5 Sep	100526	2,000		13,900
9 Sep	100527	1,000		12,900

If there are items that have not been recorded, such as bank charges, interest, standing orders, etc, then these should be recorded on the appropriate page in the cash book(s). As you can see, all the transactions in the receipts and purchases ledger have been recorded except one that occurred too late in the month, the payment for room hire.

Book balance	12,600
less: uncleared receipts	0
plus: unpresented payments	300
Bank statement balance	12,900

You should reconcile the figures by taking the bank balance you have calculated from your records, deducting uncleared receipts (that is monies received and paid into the bank but not yet cleared into your account) and adding back uncleared payments (that is, monies paid out but not yet cleared from your account). This should give the statement balance. If it does not, then you have an error somewhere.

5.8 Year end

At the end of the financial year, you will need to ensure that the accounts for individual projects are all pulled together into a single statement of account for the association. If you have recorded and reconciled all the project figures monthly as recommended, then this will be very straightforward.

5.9 Project end

At the end of the project, you may be required to pull together a project financial statement summarising all the income and all the expenditure for the project. Again, provided that you have been rigorous with your monthly accounts, then this will be straightforward. All you need to do is sum the totals from each of the analysis columns. It is possible that the Fund may require an external audit. If all the paperwork is accurately recorded and filed this will not be onerous.

6. Variance analysis

Provided you are keeping your books accurately, it should be possible at any time, and at least monthly, to generate a comprehensive financial picture of the financial position of the project. You can then look at the *variances*.

A variance is simply the difference between the target and the actual performance. Variance analysis looks at the differences themselves, rather than comparing them with one another as in ratio analysis. Whether variances are positive or negative, they will have implications.

As explained earlier, budgeting is based on estimating future costs. It is essential, therefore, to monitor actual costs against budgeted costs to ensure that you are on track. Many businesses fail because action has not been taken to rectify problems that variance analysis would have highlighted.

Review the variances regularly, at least once per month, after you have balanced the books. For each difference, ask what caused it. Watch for variances simply caused by differences in timing. How accurate are your budgeted figures? If income is below budget, is there a problem? Are you spending too much? Can you find cheaper suppliers? Can you reduce overheads?

The table shows budget, actuals and variance for the direct costs of a project.

Figure 23: Analysing the variances

Variance analysis			Quarter ending 5 May
	Budget	Actual	Variance
Consultants	28,663	20,000	(8,663)
Travel	0	0	0
Accommodation	120,750	100,000	(20,750)
Workshops & room hire	252,000	275,000	23,000
Printing & publications	6,000	0	(6,000)
Publicity	0	0	0
Lunches & receptions	42,000	50,000	8,000
Other	10,500	0	(10,500)
Total direct costs	459,913	445,000	(14,913)

A negative figure (in brackets) shows where the actual is less than the budget; a positive figure shows where the actual has exceeded the budget. In this example, the total actual expenditure is less than the budget.

To show the complete picture, of course, you need to include the revenue as well as the staff costs and overhead costs. Each month, you should compare your actual performance with your forecast both for the month and, ideally, for the total period over which the project has been running.

7. Taking corrective action

If the actual expenditure closely reflects the budget, well done. If it does not, you may need to take action. As noted earlier, differences may be due to timing issues (such as project implementation delays) rather than decisions not to spend, or savings in forecast expenditure. It is sensible, therefore, to revise the cash flow forecast each month as well, so that you can ensure that you stay within the total budget. If expenditure really is higher than the budget, you will need to look at ways in which it can be reduced in the future to get back on track to the approved budget. Can you undertake activities in different ways in order to save money? Can you merge, or even cut, activities without detracting from the overall project?

If there is a staff team, as opposed to just you, encourage them to feel responsible for keeping costs under control, and involve them in discussions regarding corrective action.

It is equally important, if everything is on target, to praise staff for achieving the plan. It is a frequent complaint that managers are quick to criticise but never give praise, so seize the opportunities when they present themselves.

If possible, use a computerised accounting package and a spreadsheet package. Once properly set up, they will speed up considerably the process of extracting the appropriate and relevant information. Frequently review how the project activities and the finances are progressing against the plans. When you notice variances, act immediately. It is much easier than waiting until the problem has got worse.

Further reading and further information

- Irwin, D (1995) “Financial control for non-financial managers”, London: Pitman

This series of advocacy competence handbooks – divided into modules and units – is intended to support business member organisations (BMOs) to engage in public private dialogue and to advocate improvements to the business environment. You are free to use the units and other materials provided that the source is acknowledged.

Foundation Unit

0. Introduction to advocacy & dialogue

Module 1: The policy process

1.1 Understanding policy and regulation

1.2 Policy analysis

1.3 The process of formulating and reforming policy

Module 2: Policy positions

2.1 Identifying, understanding & framing issues

2.2 Preparing policy positions

2.3 Influence & argumentation

Module 3: Communications
3.1 Communications & public relations

3.2 Media relations & use of social media

3.3 Interview skills

Module 4: Written communications

4.1 Branding & house styles

4.2 Writing press releases

4.3 Preparing written documents

Module 5: Managing advocacy projects

5.1 Planning an advocacy project

5.2 Budgeting & financial management

5.3 Evaluation of advocacy

Module 6: Managing a BMO6.1 Leadership, strategy & business planning

6.2 Governance and ethics

6.3 Members and member services

Module 7: Research

7. Research methods

The Business Advocacy Network is an initiative of Irwin Grayson Associates and can be found at businessadvocacy.net. IGA can be found at irwingrayson.com and contacted at david@irwin.org. You can follow David Irwin on twitter at @drdavidirwin.