Exercising financial control

Introduction

Exercising effective financial control is important not only to ensure that you do not run out of money part way through a project but also to demonstrate that you are a responsible and professional organisation. There are three requirements in exercising control: you need to prepare a budget which is as accurate as you can make it; you need to record carefully all your income and expenditure; and you need to compare the actual against the budget and take corrective action as and when necessary. This factsheet introduces book-keeping and variance analysis.

Book-keeping

Keeping good financial records is very important – to exercise control, to demonstrate probity and to enable the preparation of end of project and end of year accounts. 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.

For short projects, it is 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. 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.

Supporters of projects may require that you set up a separate bank account for your 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. Good practice requires two signatures on cheques.

Receipts

This is likely to be very simple with only occasional entries. For each record:

- Reference number (can be helpful if you need to link other paperwork)
- Date of receipt
- Details of the source of the money
- Amount and currency, if you work with different currencies.

Use a new page for each month.

RECEIPTS

Ref	**Date**	**Details**	**Amount**
001	1/5/07	Contribution from trade association	250,000
002	10/5/07	Advocacy fund	750,000
003	28/5/07	XYZ Foundation	100,000
TOTAL			1,100,000

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Payments

Best practice requires that you first receive a purchase invoice (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.

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. Many honest people have been accused of mis-using funds because they could not produce believable evidence of how they spent the money entrusted them.

Whenever you make a payment, obtain a purchase invoice and, if necessary, further evidence that you have paid, perhaps through the invoice being signed (receipted) by the person receiving the money. Record the information as follows:

- Reference: whilst it is not essential to use reference numbers, it makes sense. Number the purchase invoices sequentially as received and record in the ledger so that you can easily retrieve the bill if a query arises later;
- Date: date the purchase invoice was received;
- Details: name of the supplier;
- Amount;
- The extra columns are used for analysing the expenditure – not essential, but it speeds up preparing accounts – in practice you would have more analysis columns than shown here: use them to reflect the major areas of expenditure set out in your budget.

Use a new page for each month. File purchase invoices in reference number order.

PAYMENTS

Ref	Date	Details	Total	Staff	Direct	O/heads
001	10/5/07	Printing	100,000		100,000	
002	20/5/07	Travel	10,000		10,000	
003	25/5/07	Staff	100,000	100,000		
004	30/5/07	Overheads	20,000			20,000
TOTAL			230,000	100,000	110,000	20,000

Month end

At the end of every month all the columns for both the receipts and payments pages should be totalled. 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 – that is, you have money in the bank – it is carried forward to the next receipts page.

Total receipts	1,100,000
Total payments	230,000
Monthly balance	870,000
Brought forward	0
Carried forward	870,000

Bank reconciliation

The cash book 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.

					East Africa International Bank
Statement					
			DEBIT	CREDIT	BALANCE
	Sheet 1	Account number 2345678			
1 May	Balance brought forward				0
1 May	Transfer	200300		250,000	250,000
10 May	Transfer	200301		750,000	1,000,000
10 May		100525	100,000		900,000
20 May		100526	10,000		890,000
25 May		100527	100,000		790,000

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.

As you can see, all the transactions in the cash book have been recorded except two that occurred too late in the month. These are the payment for overheads and the receipt from XYZ Foundation.

Book balance	870,000
Less: uncleared receipts	(100,000)
Plus: unpresented payments	20,000
Bank statement balance	790,000

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.

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.

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.

Variance analysis

Provided you are keeping the 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.

Quarter ending 5 May 07

	Budget	**Actual**	**Variance**
Direct Costs			
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 greater than the budget; a positive figure shows where the actual is less than 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.

Taking corrective action

If the actual expenditure closely reflects the budget, well done. If it doesn't, you may need to take action. 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? When you notice variances, act immediately. Do not wait until the problem has got worse.

If there is a staff team, and not just one person, 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 the team 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.

Further resources

For a very simple, project based book-keeping system, use our 'Accounts in an Envelope' package.

Understanding how the figures are summarised in the three basic financial statements, which describe the activities and financial state of any business, will undoubtedly be helpful. See the factsheet on Understanding Financial Statements