# Chapter 6:

# Finance

GUIDE

CRS
CATHOLIC RELIEF SERVICES

Cover photo: A vendor at a market near the town of Benguela, Angola. Photo by Melita Sawyer/CRS.



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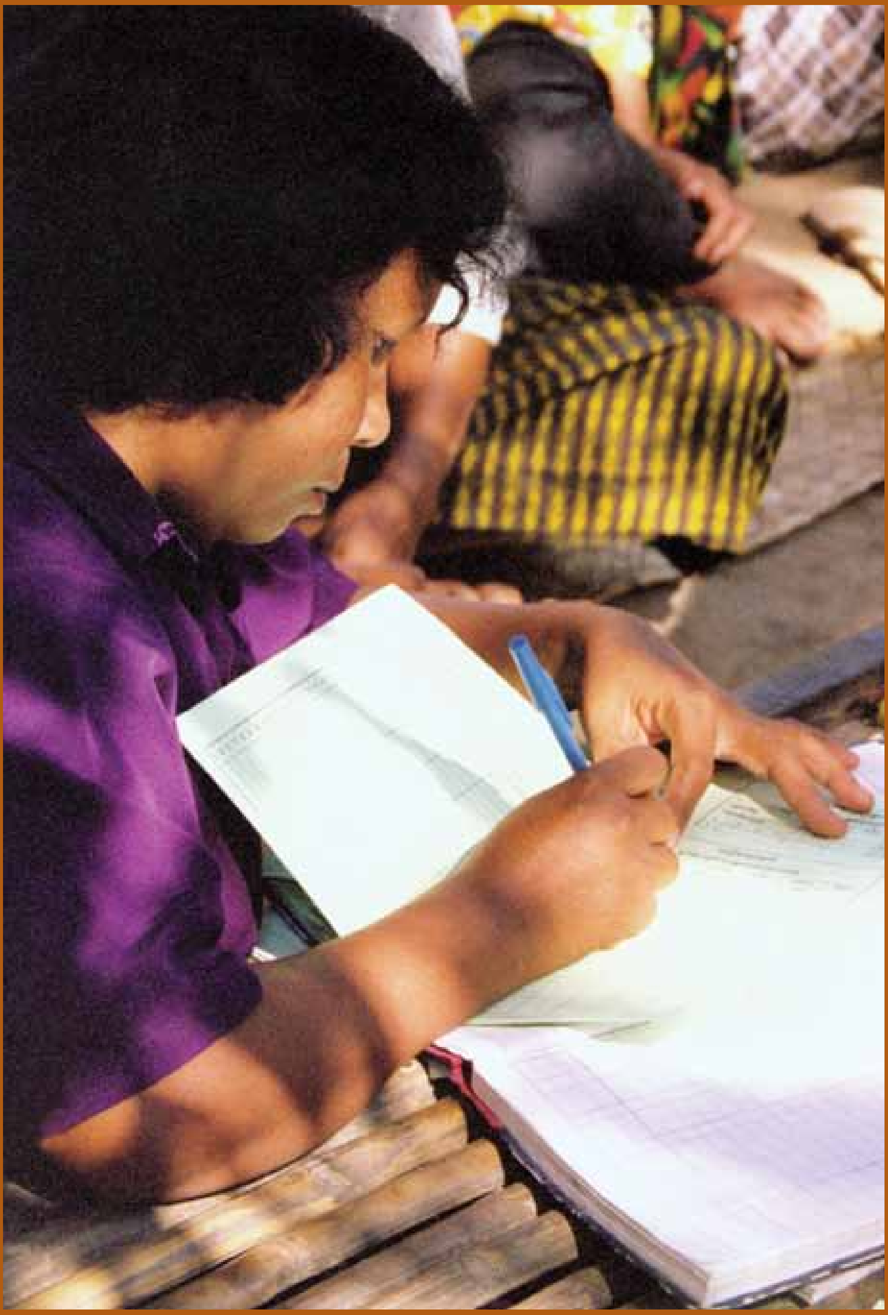

MIKE SPINGLER/CRS

A microcredit group meets in Cambodia.

# FINANCE PROCESS MAP

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# PURPOSE OF THIS GUIDE

Adoption of these policies and procedures will lay the foundation for a controlled and formalized environment for the accurate recording and timely reporting of financial transactions. It will also help to establish effective management of and accountability for funding received and expenditures made against that funding. This section is designed to aid in enhancing an organization's financial management systems and also provides guidelines for development of financial policies and procedures.

# WHAT FUNCTION DOES FINANCE SERVE?

Finance performs the following functions for an organization:

- Processes the organization's financial transactions and keeps the books of account in which those transactions are recorded
- Provides financial information needed by management to plan and control the organization's activities
- Develops and enforces financial policies, procedures, and systems designed to establish and maintain effective and efficient controls over the organization's resources

A well-run Finance department produces reliable and timely financial reporting that enables management to quickly assess whether the organization's objectives are being achieved. Financial systems that are properly maintained aid in improving controls to safeguard assets with the reduced likelihood of errors, loss, misuse, and fraud.

# SUMMARY

This chapter is intended to provide a summation of most key accounting processes and concepts that apply to not-for-profit organizations. It is not intended to serve as a detailed treatise of accounting theory on the subjects covered, nor is it intended to cover all accounting concepts.

The chapter has been prepared on the assumption that the readers of this guide will use the accrual basis of accounting for recording their financial transactions. The chapter's authors recognize that many not-for-profit organizations continue to use a "strict cash basis" or a "modified cash basis" of accounting. From institutional-strengthening and capacity-building perspectives, Catholic Relief Services strongly recommends adoption of accrual basis accounting concepts for organizations presently on the cash basis. Doing so will help such organizations to successfully compete with others for donor funding and increase their chances of long-term sustainability.

An organization that keeps its books on a cash basis records revenues when cash is received and expenses when cash is disbursed. Under accrual basis accounting, revenues are recorded in the periods they are earned and expenses are booked in the periods they are incurred. Accrual basis accounting is a more accurate method since it follows the matching concept. Under accrual basis accounting, revenues are booked in the same accounting period in which the expenses that generate the revenues are incurred.

Under strict cash basis accounting, assets, such as receivables and prepayments, and liabilities are not recognized. For example, an organization using this method would not record severance expense until it was paid, possibly resulting in a significant understatement of the expenses attributable to a grant or project at a given point in time.

Organizations that maintain their accounting on a cash basis should ensure that their donor agreements address how prepayments and expenses incurred but not paid as of the award expiration dates should be treated. Normally, grant donors will not allow recipients to charge their awards for the portions of prepayments that pertain to post-award periods. Cash basis organizations should seek to negotiate terms with donors that will allow them to be reimbursed for expenses incurred but not paid as of the award expiration dates.

Thirteen topics are covered in this chapter as follows:

1. **Basic Accounting Requirements** – Addresses setting up the chart of accounts and the general ledger and documenting financial transactions.
2. **Budgeting –** Contains information on budgeting principles such as approvals, clarity, structuring the budget, estimating costs, and amending the budget. Also deals with grant budgeting and the concept of line item flexibility.
3. **Cash Management** – Focuses on receipts, disbursements, forecasting, bank reconciliations, and maintaining petty cash funds.
4. **Receivables Management** – Describes the various types of receivables and reviews standard pertinent disciplines, including the need for Finance to provide receivables “aging” reports to management monthly.
5. **Fixed Assets Accounting** – Stresses the need to set up and maintain a fixed assets register. Explains the concept of depreciation expense. Goes over the accounting entries needed to record fixed assets

disposals. Underscores the requirement to conduct fixed asset counts and to reconcile them to the general ledger balances.

6. **Accounting for Prepaid Expenses and Security Deposits** – Differentiates between prepayments and security deposits and the accounting treatments to be used for each.

7. **Accounts Payable Processing** – Gives the various steps for handling accounts payable transactions. (Accounts Payable processing is used by those organizations that set up their pending payments as liabilities before paying them. This process does not apply to those organizations that use a single-step approach, whereby expenses are recorded when paid.)

8. **Accounting for Accrued Liabilities** – Provides guidance on setting up and adjusting accruals for liabilities, including those that involve estimates or those that are not expected to be settled in the short-term.

9. **Revenue** – Distinguishes among cash contributions, grants, and in-kind contributions. Depicts the special accounting treatment needed for grants, for which revenue is recorded when earned, not when received.

10. **Payroll Processing** – Emphasizes the need to segregate the Human Resources department's responsibilities for overseeing staffing changes from timekeeping and payroll functions, which should be performed by the Finance department. Cites key relevant responsibilities, such as maintaining a payroll master file, updating payroll deductions, processing time and attendance data, preparing and recording the payroll, and disbursing the payroll.

11. **Cost Allocation** – Explains the process whereby shared expenses can be distributed to benefiting cost centers. Introduces the concept of capturing shared expenses in various pools and allocating expenses from those pools based on various cost "drivers." Offers examples of pool types and allocation methods.

12. **Grant Accounting** – Furnishes an overview of the grant cycle. Concentrates on the financial responsibilities associated with grant administration, most importantly those relating to grant implementation, reporting, and closure.

13. **Financial Reporting** – Lists the various types of financial reports that should be provided to internal and external audiences and the frequency at which those reports should be made available.

# KEY PRINCIPLES

The following are ten key financial principles:

1. Record all acquisitions of goods and services at their historical costs (original purchase prices or, for in-kind donations, fair market values on the dates received).

2. Financial reporting must be reasonably accurate, supported by the appropriate evidentiary matter, and pertinent.

3. Revenue is recorded in the fiscal month in which the organization distributes goods or performs a service.

4. Expenses incurred to generate revenues must be recorded in the same fiscal month in which the revenues are recorded. Expense is recorded in the fiscal month in which the organization has received (taken title) to goods or received a service.

5. All significant items should be disclosed in financial statements if they are likely to influence the decisions of users of the financial statements. Financial statements and the accompanying notes must include all significant, relevant accounting information to enable users of the financial statements to make informed decisions.

6. The organization must follow the same accounting policies and practices in the comparative periods reported in its financial statements. If an accounting change has taken place that significantly impacts the activities or financial condition of the organization, that change must be disclosed in the notes that accompany the financial statements.

7. When faced with uncertainties, accountants must make accounting decisions that neither materially overstate nor understate the financial results or balances reported. If there is uncertainty, the bias should be to accelerate recording a loss or expense and to postpone recording an income or revenue. The organization should exercise similar caution in reporting its assets and liabilities.

8. The organization should have in place a system of authorizations, approvals, and verifications. Authorization is the principal means of ensuring that only valid transactions and events are initiated as intended by management. Authorization and approval procedures should be documented and clearly communicated to all staff. Transactions should be verified before and after processing. Access to resources and records should be restricted to authorized individuals who are accountable for their custody and/or use.

9. Reconciliations should be performed on a monthly basis. General ledger balance sheet account balances should be reconciled to the appropriate supporting internal documents or external information (such as bank statements) to allow for prompt corrective action if warranted.
10. Management should compare information about current financial performance to budgets, forecasts, prior period reported results, or other benchmarks to measure the extent to which goals and objectives are being achieved and to address unexpected results or unusual conditions that require follow-up.

DAVID SNYDER/CRS

Steven Chege, a community nurse with Kenya's Kijabe Hospital, consults with a fellow care provider during a home visit in the nearby community. Steven monitors 60 home care patients, an invaluable function in this rural area.

# FINANCE BUSINESS PROCESS 6.1 – BASIC ACCOUNTING REQUIREMENTS

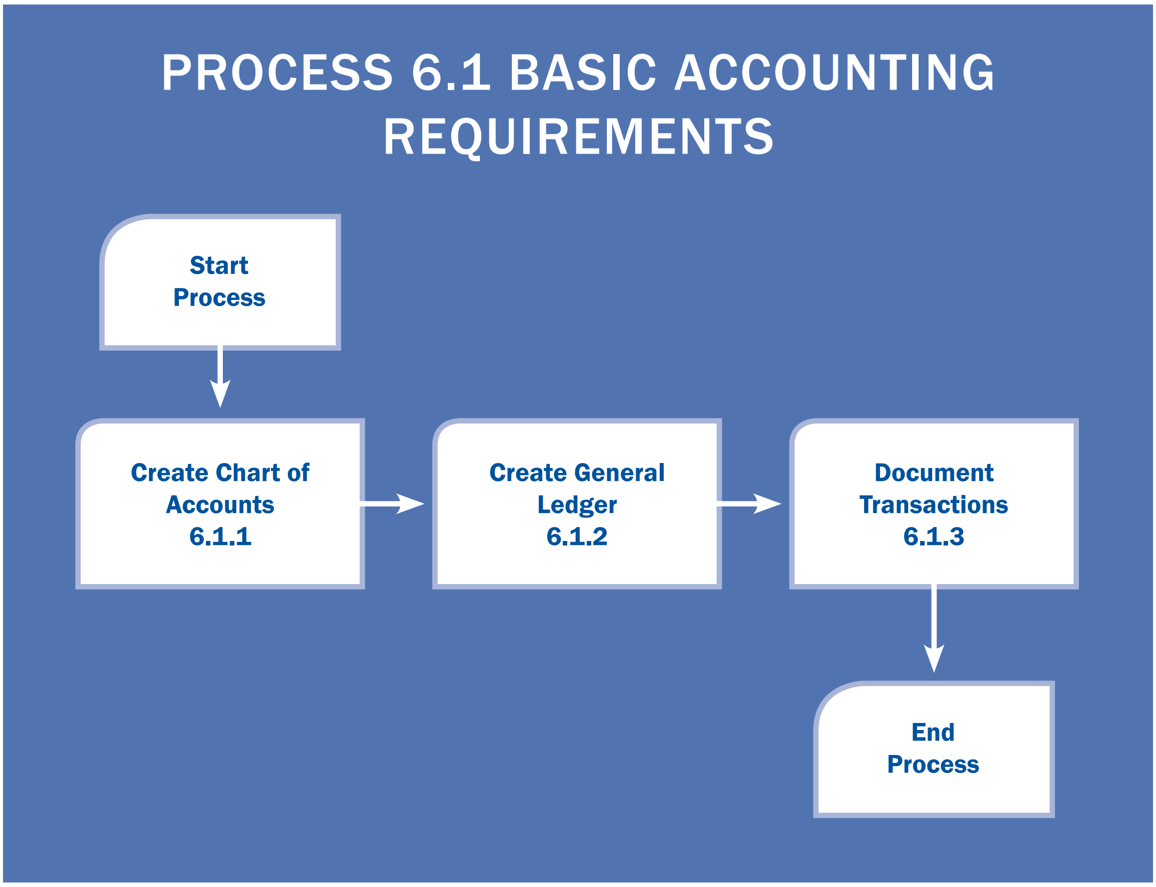
## PROCESS DESCRIPTION

To properly fulfill its recordkeeping and reporting responsibilities, it is important that the organization's Finance staff maintain an accounting record, known as a general ledger, for capturing all financial transactions. Financial transactions are recorded using general ledger accounts that indicate the nature of the expense incurred, good or service received, or revenue generated.

Before setting up a general ledger, management must decide how it wants its accounting transactions to be structured. It is critical that the organization set up its accounting structure to provide for reporting that meets all concerned parties' needs and that is in compliance with the professional accounting standards that prevail in the organization's home country. Cost centers typically used by nonprofit organizations are those that group financial activities by project, office, operating department, geographic region, and/or donor funding source.

It is of equal importance that all transactions be supported with the proper documentation. The organization's Head of Finance should establish standards that indicate which types of documentary internal and external evidence are needed to support each type of financial transaction. The Head of Finance should also indicate the length of time that the organization's various financial documents should be retained on file.

## PROCESS FLOW



## STEP 6.1.1 – CREATE CHART OF ACCOUNTS

| STEP NAME | CREATE CHART OF ACCOUNTS |
|---|---|
| **Step Number** | 6.1.1 |
| **Organizational Role** | Management team |
| **Inputs** | Organization's accounting needs<br>Organization's reporting needs |
| **Outputs** | Chart of accounts |
| **Integration Points** | N/A |
| **Summary** | Most nonprofit organizations satisfy their reporting needs through the use of cost centers and general ledger account codes. Cost centers should be aligned with management objectives and responsibilities. |

Account codes identify the nature of the items affected by accounting transactions. General ledger accounts are usually grouped into the following major categories:

- Assets
- Liabilities
- Net Assets (formerly known as Fund Balances)
- Revenues
- Expenses

Assets may be subdivided into two main groups depending on their degrees of liquidity and their expected asset lives. The most liquid assets are generally expected to be used up in the normal course of business in the short term and are normally grouped into one range, often called "Current Assets." Those assets with less liquidity, longer anticipated useful lives, and long-term benefit are placed into a range usually called "Fixed Assets" or "Property, Plant, and Equipment."

Each of the major account groups should appear in a specially designated range. The following are a possible set of ranges:

- (Current or Short-Term) Assets – Account ranges from 1000 to 1999
- Fixed Assets – Account ranges from 2001 to 2999
- Liabilities – 3000 to 3999
- Net Assets (Fund Balances) – 4000 to 4999
- Revenues – 5000 to 5999
- Expenses – 6000 to 6999

Organizations should tailor the ranges to meet their specific needs. The accounts should be set up in a logical sequence. The accounts should be assigned in a way that will allow the organization to add accounts or account ranges in the event of future growth or increased reporting needs.

The organization may wish to add minor account codes to provide more detailed information to financial report users. Minor account codes usually follow the major account codes and typically are three to four characters in length. They can be longer if deemed necessary by the organization, subject to accounting software limitations. Minor account codes can be used for various reasons, such as to denote bank accounts, project materials, or salary categories.

The following are some examples of minor account codes:

1. Bank accounts – assuming that General Ledger (G/L) Account (A/C) 1010 is used to denote checking accounts.
   a. A/C 1010.101 – Main Office General Purpose Checking Account
   b. A/C 1010.102 – Main Office Grant Checking Account – Donor A
   c. A/C 1010.103 – Suboffice General Purpose Checking Account
   d. A/C 1010.104 – Suboffice Grant Checking Account – Donor A
2. Salaries and Wages – assuming that G/L A/C 6010 is used for salaries.
   a. A/C 6010.101 – Base Salaries
   b. A/C 6010.102 – Overtime Salaries
   c. A/C 6010.103 – Sick Time
   d. A/C 6010.104 – Vacation Salaries
   e. A/C 6010.105 – Holiday Salaries
3. Project Materials – assuming that G/L A/C 6100 is used for project materials
   a. A/C 6100.101 – Construction Materials
   b. A/C 6100.102 – Seeds
   c. A/C 6100.103 – Agricultural Tools
   d. A/C 6100.104 – Medicine

It is recommended that another field or code be used to identify vendors, employees, donors, and subrecipient partners. Minor account codes are not recommended for identifying those parties.

An authorized finance officer should control the issuance of account numbers, and additions should be kept to the minimum number needed. All active account numbers should be made available to all employees in a listing known as the chart of accounts. The chart of accounts should be updated and reissued for each change. Accounts that are no longer to be used should be deactivated and the organization’s employees should be notified accordingly.

To minimize misunderstanding as to the use of each account, organizations should consider adding full explanations for each account to the chart. This type of chart is known as an annotated chart of accounts.

## STEP 6.1.2 – SET UP GENERAL LEDGER

| STEP NAME | SET UP GENERAL LEDGER |
|---|---|
| **Step Number** | 6.1.2 |
| **Organizational Role** | Head of Finance |
| **Inputs** | Chart of accounts<br>Accounting structure based upon the organization's accounting and reporting needs |
| **Outputs** | Financial reports |
| **Integration Points** | Management |
| **Summary** | All financial transactions of an organization must be recorded in an accounting record known as the general ledger. |

Access to the general ledger should be firmly controlled and the general ledger should be in balance at all times. Transactions are recorded in the general ledger on a daily basis and should be summarized, at a minimum, monthly. The summarized totals are called "general ledger balances." These are used as the bases for financial reporting to management, donors, the board of directors, prime recipients, government regulatory agencies, and other interested parties. At the end of the organization's business year (known as a fiscal year), the general ledger is closed and the final reporting to management for the year is prepared.

The general ledger may be a manual (hand-prepared) ledger or a computerized version that uses software specifically designed for that purpose. The computerized general ledger has proven to be the better choice for most organizations for the following reasons:

- Access to the computerized general ledger can be restricted to authorized individuals.
- General ledger software provides a complete audit trail. It can indicate who entered and/or posted each transaction.
- Computerized general ledger systems can be backed up to minimize the loss of data in the event of a theft or a catastrophic event.
- Computerized general ledger systems require all transactions to balance, eliminating the out-of-balance conditions that frequently result when manual ledgers are used.
- Computerized general ledger databases store a large amount of data for

extended periods of time, enabling the organization's Finance department to provide a wide variety of reports that can include historical data.

- Computerized general ledgers generate financial reports more quickly and accurately than manual ledgers.
- Computerized general ledgers can collect and process data from multiple input sources. Only one employee can post to a manual ledger at a given time.

A computerized spreadsheet application such as Excel does not have the necessary built-in controls to prevent unauthorized changes or to provide a complete audit trail and is therefore not recommended as a substitute for a computerized general ledger system. If Excel is used, on each posting day the spreadsheet containing that day's transactions should be printed, signed by the designated approver, and retained on file.

If an organization uses a manual ledger and has a high volume of activity for certain types of transactions, those transactions may be recorded in a subsidiary ledger and then summarized for posting into the general ledger. If subsidiary ledgers are used as books of original entry, care must be exercised to ensure that all balances from the subsidiary ledgers are properly carried forward into the general ledger. Some examples of subsidiary ledgers are cash receipts journals, cash disbursement journals, accounts receivable ledgers, voucher registers (accounts payable), and fixed assets ledgers.

General ledger transactions can be grouped into three basic types, namely the following:

- Cash receipts, which are recorded on cash receipts vouchers
- Cash disbursements, which are recorded on cash disbursement vouchers
- All other transactions, which are recorded on general journal vouchers or variations thereof, such as an accounts payable voucher
- "Other" transactions, which typically include those types of activities that do not involve the receipt or outlay of cash. Accruals, write-offs or write-downs, depreciation, amortization, adjustments, and reclassifications are among the more common types of general journal entries. These terms are explained in the glossary section of this chapter.

## STEP 6.1.3 – DOCUMENT FINANCIAL TRANSACTIONS

| STEP NAME | DOCUMENT FINANCIAL TRANSACTIONS |
|---|---|
| **Step Number** | 6.1.3 |
| **Organizational Role** | Finance staff |
| **Inputs** | Source documentation |
| **Outputs** | Completed vouchers |
| **Integration Points** | Procurement<br>Administration/Human Resources<br>Vendors<br>Partners<br>Management |
| **Summary** | All financial transactions must be fully documented to the extent that is appropriate for the type of transaction. |

Every accounting transaction should be recorded on a separate accounting voucher, also known as an entry. A fundamental accounting rule is that each voucher must balance, that is, its debits must equal its credits so that the general ledger remains in balance at all times. Debits increase assets and expenses and reduce liabilities and revenue. Credits increase liabilities and revenue and reduce assets and expenses.

Each accounting voucher must meet the following requirements:

- Sequentially numbered
- Appropriately documented
- Properly approved
- Carefully filed to allow for easy retrieval

All vouchers should be signed by the employees who prepared, entered, approved, and posted them. If the organization assigns the responsibility of data entry verification to an additional employee, that employee should also sign the voucher. Immediately after approval and before filing, each voucher and its supporting documents must be canceled to prevent their reuse. Cancellation usually entails marking, stamping, or perforating each document as “paid” or “processed,” as applicable.

The appropriate supporting documentation for a cash receipts voucher includes the following:

- Bank deposit slip or cash receipt form, as applicable
- Cash receipt form
- Photocopy of each check deposited (the payer's check number should also be shown in the description field for that line item on the cash receipts voucher.)
- Any other material, such as a remittance advice, submitted by the paying party with its payment

The appropriate supporting documents for a cash disbursement voucher normally include the following:

- Approved purchase requisition form
- Price quotations or pro-forma invoices
- Bid comparison reports with explanation for vendor selection or why a sole source vendor was chosen
- Purchase order and/or vendor contract (for consultants, landlords, etc.)
- Goods received note (receiving report)
- When warranted, a memo justifying variance between quantities or descriptions of items ordered versus those received
- Vendor's original invoice
- Approved Payment/Advance Request form

The appropriate supporting documents for a general journal voucher vary depending on the nature of the transaction. These can include the following:

- For accruals – Internal analyses and external documents such as correspondence, legal notices, or copies of disputed billings
- For write-offs – Management authorization memoranda and copies of all correspondence with the debtor documenting collection efforts
- For liquidations of amounts advanced by the organization – Travel expense reports (from employees), financial liquidation reports (from subrecipients), invoices, plus purchasing and receiving documentation (from vendors)
- For correcting entries or reclassifications – The original accounting entry and the correcting or reclassification entry should be cross-referenced. If the amounts corrected or reclassified are the sum of multiple transactions, a complete list of the transactions or balances impacted by the change should be attached to the correcting or reclassification entry as support. A full explanation should be attached to the entry explaining the reason why the correction or reclassification was necessary.

If the source documents are confidential in nature, such as those for a payroll entry or a legal accrual, a reference should be made on the entry as to where the supporting documents are located. A complete description of the transaction should be attached to each general journal entry.

The organization should establish and enforce firm record retention policies. All documents should be protected while in storage both onsite and (if applicable) offsite. Donor requirements and local statutes should be taken into consideration when determining the length of the record retention period needed. (For project activities funded by U.S. government awards, it is recommended that all financial supporting documentation be retained for a minimum of 10 years.)

# FINANCE BUSINESS PROCESS 6.2 – BUDGETING

## PROCESS DESCRIPTION

A budget is a detailed financial estimate of anticipated activities for a specified period of time. The following are several types of budgets:

- Annual Operating budget – an estimate of an organization's total revenues and expenses for a fiscal year
- Cash budget – the cash an organization expects to receive and disburse
- Capital budget – the total costs to acquire fixed assets (capital additions)
- Project Budget – the estimated cost of a specific project
- Grant Budget – the estimated cost to conduct project activities funded by a grant

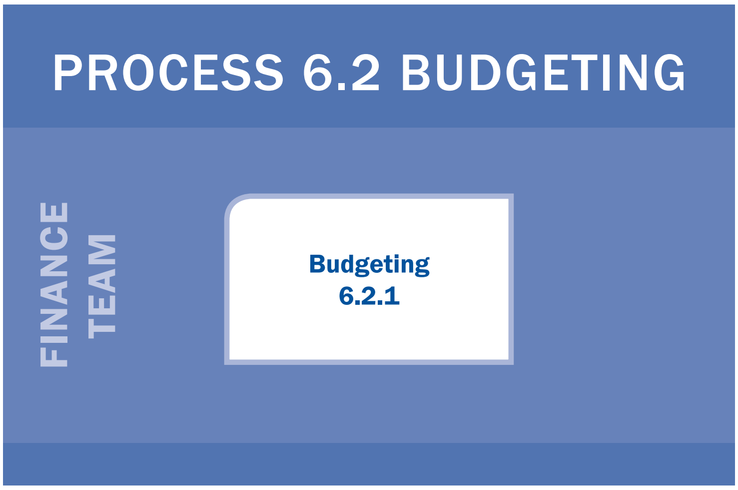
Planning – A budget is necessary for planning upcoming activities so that an organization can reasonably estimate the cost of those activities. This allows the organization to determine if it has the resources needed to perform activities and if it is making the best use of the resources.

Fundraising – The budget can be used as a major tool for fundraising. The budget sets out in detail what the organization plans to do with the funds raised, including on what the funds will be spent and what results will be achieved.

Project Implementation – A realistic budget is needed to control an activity once it has started. The most important tool for ongoing monitoring is comparing the actual costs against the budgeted costs. Without a realistic budget, this is impossible. Given that plans may change, it is necessary for department heads to review the budget after an activity has started and to amend the budget, if warranted. Approval may be needed from designated officials if changes to the budget require additional funding.

Monitoring and Evaluation – The budget is used as a tool for evaluating the success of the activity during its project life and when it is completed. It helps to determine whether the planned objectives were met and within the cost parameters.

## PROCESS FLOW



### STEP 6.2.1 – BUDGETING

| STEP NAME | BUDGETING |
|---|---|
| **Step Number** | 10.2.1 |
| **Organizational Role** | Head of Finance<br>Project officer/project director – For each individual project<br>Board of directors – For the organization's total annual budget |
| **Inputs** | Organization's annual funding needs<br>Organization's available resources |
| **Outputs** | Approved budget<br>Budget comparison reports |
| **Integration Points** | Collaboration with donors, project officers |
| **Summary** | Effective budgets can only be produced as a result of good underlying plans. Financial planning lies at the heart of effective financial management. The organization must have a clear idea about what it intends to do and how it intends to do it. |

**The Budgeting Process**

The process of preparing a meaningful and useful budget is best undertaken as an organized and structured group exercise. The budget process involves asking a number of questions including the following:

- What activities will be involved in achieving the planned objectives?
- What resources will be needed to perform these activities?
- What will these resources cost?
- What will be the sources of the funds?
- Are the anticipated results realistic?
- What approvals are required to accept budget variances?
- Do the various departments within the organization have budgets?

Once the budget has been agreed upon and the activity implemented, the process is completed by comparing the plan (budget) with the eventual outcome (actual).

**Budgeting Principles**

*Approval* – The board of directors will need to approve the organization's budget at the start of the fiscal year. Anticipated unfavorable budgetary variances over the stipulated threshold require written prior approval from a designated official (often the Head of Finance) and, when applicable, from grant donors.

*Budget Accountability* - A budget manager should be designated for each of the organization's cost centers or projects. The budget manager has the following responsibilities for the assigned cost center or project:

- Developing the budget
- Effective and timely programmatic and financial monitoring
- Managing and anticipating the needs of the cost center or project
- Preparing and justifying requests for amendments when necessary
- Ensuring that the actual costs are in line with the budgeted costs
- Taking the necessary steps to prevent material cost overruns
- Achieving the stated objectives
- Providing regular programmatic reporting
- Complying with donor requirements where applicable
- Closing projects/grants timely, effectively, and completely

*Clarity* – Since many different people will need to use the budget for different purposes, the budget should be sufficiently clear and detailed to allow all potential users to understand it. Clarity and accuracy are critical, so it is important to keep notes on budgeting assumptions and how estimates have been determined.

*Budget Structure* – When setting a budget for the first time or when reviewing a budget, it is important to refer to the organization's chart of accounts to determine whether it feeds into the reporting requirements from a donor. This is because the budget line items also appear in the accounting records and on management reports. If the budget items and accounting records are not consistent, then it will be very difficult to produce monitoring reports once the project implementation stage is reached.

*Estimating Costs* – It is important to be able to justify calculations when estimating costs. The Finance department should work closely with other department heads to identify types of activities and related costs. Do not be tempted to simply take the previous year's budget and add a percentage amount for inflation. While the previous year's budget could be very helpful as a starting point, it could also be very misleading and contain historical inaccuracies. Expenses to be distributed to various cost centers and projects via a cost allocation process should be considered during the budgeting phase and included in the total estimated cost for each cost center and project. (See the cost allocation section of this chapter for guidance.)

*Budget Amendments* – If during the course of the year, a department head determines that a change is needed due to an anticipated additional need for resources from the organization's unrestricted funds, the approval of the organization's Executive Director may be required. If additional funding is needed for a grant-funded project, the organization will need to seek approval from the donor for a modification of the grant agreement. If the grant donor agrees to the change, a revised budget should be prepared and submitted to the grant donor.

Once approved, the amended budget becomes the new operating budget for that agreement. If internal approval is given, the department head will be required to prepare a budget amendment form, obtain the necessary approval(s), and forward the approved form to the Finance department. The Finance department should use the new approved budget for budget comparison reporting purposes.

The best approach is to make a list of all the inputs required and specify the quantity and estimated unit cost of each item. From this detailed working sheet it is a simple matter to produce a summarized budget for each line item and is very easy to update if units or costs change.

## SAMPLE BUDGET WORKSHEET

| LINE ITEM DESCRIPTION | UNIT COST | UNIT OF MEASURE | QUANTITY | TOTAL ANNUAL BUDGET REQUESTED | NOTES |
|---|---|---|---|---|---|
| **Salary** | 10,000 | Month | 2 | 240,000 | Salaries for project accountants |
| **Rent** | 500 | Month | 1 | 6,000 | Rent for leasing office building |

*Overlooked Costs* – Many failed projects are based on an underestimated budget. The most common of the overlooked costs are the indirect or support costs. The following are some of the most often overlooked costs:

- Staff-related costs (e.g., recruitment costs, training, benefits, and statutory payments)
- Project start-up costs (e.g., publicity)

- Allocated costs (e.g., rent, insurance, and utilities)
- Vehicle operating costs
- Equipment maintenance (e.g., for photocopiers and computers)

**Budget Categories for Project Management**

Budget line items are specific budget headings or account classifications that match project proposal budgets. Each line item should be identified by a specific account code. Some grant donors will ask their grantees to use specific budget templates with standard cost categories and line items when requesting and reporting on the use of funds.

When a donor requires reporting by cost categories, which is a grouping of several account line items, the organization must start the budget process by each individual line item and roll up to a cost category.

**Line Item Flexibility for Project Management**

Within a grant agreement, the donor will specify the line item flexibility that is applicable to the award. If donor approval is needed prior to incurring certain types of expenses, follow donor regulations for seeking approval. For example, a donor can grant line item flexibility of up to 10 percent of the amount budgeted per line item.

The following is an example of **acceptable** flexibility that does not need prior approval from donor:

| DESCRIPTION | BUDGET | ACTUAL SPENT | DIFFERENCE – ACTUAL OVER/(UNDER) BUDGET |
|---|---|---|---|
| **Salaries** | 300 | 330 | 10% |
| **Domestic travel** | 100 | 90 | (10%) |
| **Office expenses** | 200 | 180 | (10%) |
| **Total** | 600 | 600 | 0% |

**Actual spending did not exceed the budget**

**Difference must not be more than 10 percent of the budgeted line item**

The following is an example of **unacceptable** flexibility:

| DESCRIPTION | BUDGET | ACTUAL SPENT | DIFFERENCE – ACTUAL OVER/(UNDER) BUDGET |
|---|---|---|---|
| **Salaries** | 300 | 450 | **50%** |
| **Domestic travel** | 100 | 90 | (10%) |
| **Office expenses** | 200 | 180 | (10%) |
| **Total** | **600** | **720** | **20%** |

**Difference is more than 10 percent of the budgeted line item**

**Actual spending exceeded the budget**

The following is an **additional** example of **unacceptable** flexibility**:**

| DESCRIPTION | BUDGET | ACTUAL SPENT | DIFFERENCE-ACTUAL OVER/(UNDER) BUDGET |
|---|---|---|---|
| **Salaries** | 300 | 360 | **20%** |
| **Project materials** | 600 | 580 | (3%) |
| **Domestic travel** | 100 | 80 | (20%) |
| **Office expenses** | 200 | 180 | (10%) |
| **Total** | **1,200** | **1,200** | **0%** |

**Difference is more than 10 percent of the budgeted line item**

**Actual spending exceeded the budget**

**Even though the total budget was not exceeded, the Salaries expense was exceeded by more than 10 percent**

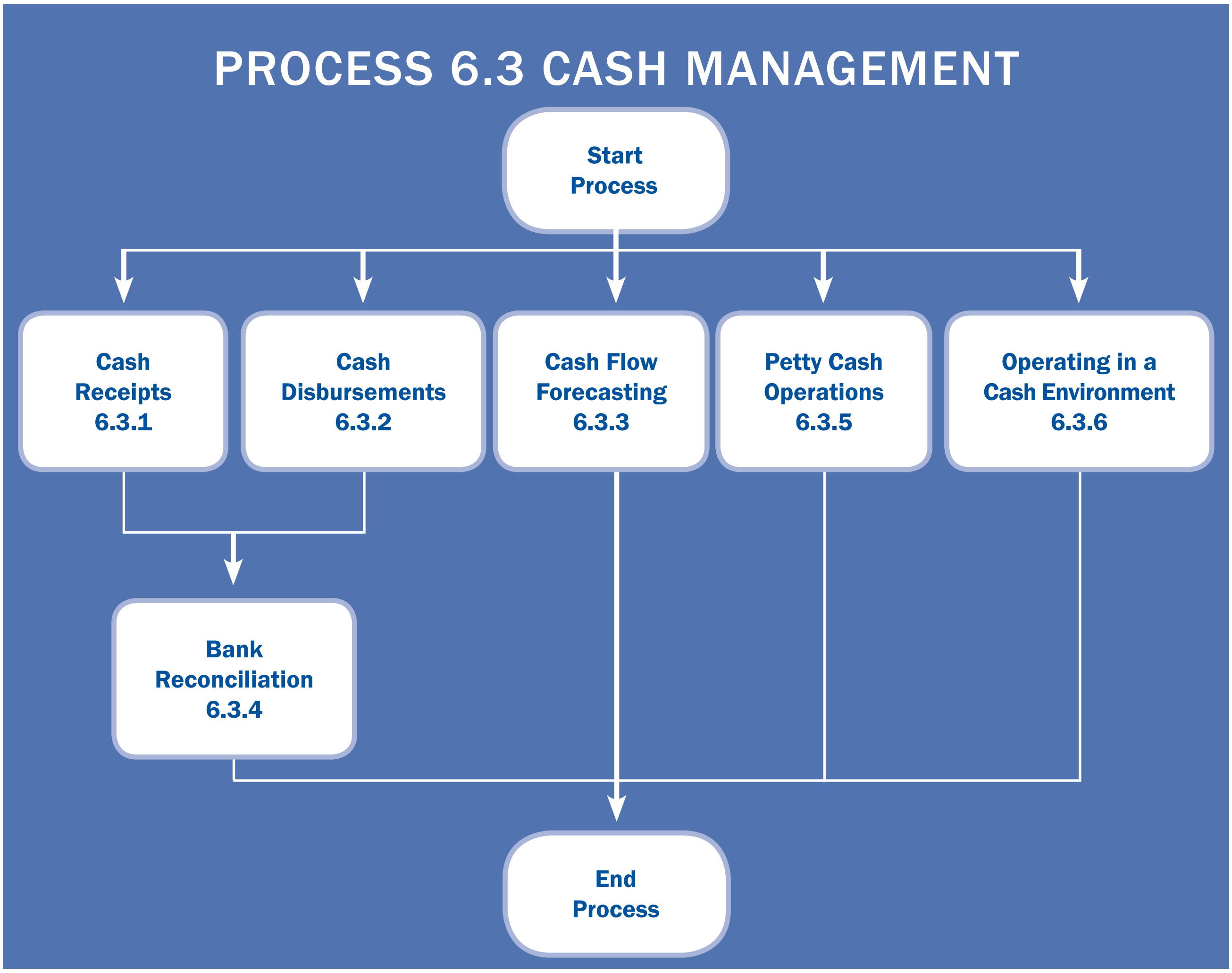
With regard to line item flexibility, the organization should always refer to the terms of the specific agreement with each grant donor since line item flexibility can change from donor to donor and for various agreements with a given donor. In the examples shown above, the restriction was on a line item basis. For certain U.S. government donors, there is a cumulative limitation of 10 percent of the total budget. For other donor awards the flexibility restrictions are on a program category or component basis, not by line item.

# FINANCE BUSINESS PROCESS 6.3 – CASH MANAGEMENT

## PROCESS DESCRIPTION

Cash management is an important function in any organization. In order to maximize its cash position, an organization should implement cash procedures for effective management of cash receipts and disbursements. Forecasting and budgeting are important aspects of cash management. The organization should try to plan in as much detail and as far ahead as possible what receipts can be expected and what disbursements will be required. Cash management functions revolve around receipts, disbursements, forecasting, and reconciliation.

## PROCESS FLOW



## STEP 6.3.1 – CASH RECEIPTS

| STEP NAME | CASH RECEIPTS |
|---|---|
| **Step Number** | 6.3.1 |
| **Organizational Role** | Head of Finance<br>Cashier<br>Management |
| **Inputs** | Grant agreements<br>Contributions<br>Remittance advices |
| **Outputs** | Cash receipt slips<br>Cash receipts voucher<br>Bank deposit slips |
| **Integration Points** | Collaboration with donors<br>Collaboration with project officers and department heads |
| **Summary** | The organization's cash receipts are from various sources such as donations, grants, sales, fees for services rendered, and collection of accounts receivable. All cash receipts must be accounted for in a timely manner. |

All cash receipts should be dated upon receipt and pre-numbered to facilitate checking of the numerical sequence for missing documents. The following procedures should be followed:

- Cash should be banked upon receipt.
- Cash receipts should be properly classified as donations, grant funding, cash from sales, accounts receivable collections, service delivery, disposal of assets, or borrowing. Reconciliation must be done in the respective accounts to determine whether all entries were made to show all cash received by the organization.
- Bank reconciliations should be done monthly by someone independent of cash custody or record keeping responsibility. Cash receipts journal entries should be regularly compared to the remittance lists and deposits.

## STEP 6.3.2 – CASH DISBURSEMENTS

| STEP NAME | CASH DISBURSEMENTS |
|---|---|
| **Step Number** | 6.3.2 |
| **Organizational Role** | Head of Finance<br>Accounts payable officer |
| **Inputs** | Required cash disbursement documentation |
| **Outputs** | Approved cash disbursement voucher<br>Vendor receipts issued |
| **Integration Points** | Collaboration with project officers<br>Collaboration with suppliers |
| **Summary** | Cash disbursements should be authorized and supported with proper documentation. |

1. Designated officials should authorize cash disbursement. Proper documentation for cash disbursements includes, but is not limited to, the following:
    - Approved purchase requisition form
    - Price quotations or pro-forma invoices
    - Bid comparison reports with explanation for vendor selection or why a sole source vendor was chosen
    - Purchase order and/or vendor contract
    - Goods-received note (receiving report)
    - When warranted, a memo justifying variance between quantities or descriptions of items ordered versus those received
    - Vendor's original invoice
    - Approved Payment/Advance Request form

2. Cash disbursements information should be summarized on a cash disbursement (CD) voucher. The voucher should contain the date of transaction, account code, and reason for payment. The voucher should balance, i.e., the debits should equal the credits. Segregation of duties dictates that the cash disbursement voucher must be verified by a person other than the one who prepared it and must be approved by a senior official. This approval is sufficient to make payment and post the transaction to the general ledger.

3. The organization should ensure that all payments, with the exception of petty cash disbursements, are made using pre-numbered checks to provide independent identification by the bank. It is more difficult to manipulate check payments because of the increased audit trail, whereas cash cannot be traced. All check disbursements have to be approved by authorized signatories.
4. Check signatories/wire approvers should be clearly designated. These should be as few as possible to narrow down the responsibility. Checks should require at least two signatures.
5. A copy of the signed check should be attached to the cash disbursement voucher. The organization should always obtain acknowledgment of receipt from the supplier in the form of a supplier-issued receipt form. If the supplier cannot furnish such a form, the supplier should sign a copy of the check. An organization employee who is independent of the cash and procurement functions should prepare a goods-received note (receiving report).
6. Ensure that individuals who prepare checks have no access to cash receipts. (If the organization cannot segregate these duties because of a limited staff, that control weakness should be documented along with the compensating controls put into place to offset it.) Access to blank checks should be restricted to authorized persons. The numerical sequence should be verified when new checks are received, and missing checks should be listed.
7. Checks should be dated when issued. Pre-dating or post-dating checks should be strictly prohibited. The date of the check should be shown on the cash disbursement voucher and recorded in the cash disbursement journal/general ledger.
8. Signing of blank checks should be prohibited. Checks should not be written until a payment request voucher has been prepared and approved.
9. Before a check is signed, all relevant documents supporting the payment should be attached to a cash disbursement voucher to show that the expenditure is genuine. All supporting documents must be canceled with a “PAID” stamp immediately after approval to prevent the documents from being presented again for payments.
10. To avoid alteration, signed checks should be dispatched directly to the designated payees without having to go back to the check preparer. If staffing limitations dictate that checks need to be routed back to the check preparer, compensating controls must be put into place. Such controls include having an employee other than the check preparer/distributor perform the bank reconciliation and the voucher postings.

DAVID SNYDER/CRS

Two young boys in Laguna Patzijon, Guatemala. There are few opportunities for young men in rural areas, with low literacy rates and few jobs outside of farming.

11. To prevent duplicate payments or recordings, check numbers should be used as transaction references when posting to the cash disbursement journal or general ledger. Original copies of voided cash disbursements and voided checks must be kept on file.
12. Checks should be made to order. Checks should be crossed with "Account Payee Only" and "Not negotiable," if that is the standard practice in the country.
13. It is recommended that a check dispatch (disbursement) register, which accounts for the sequence of checks issued, be maintained.
14. Voided checks will be marked prominently with the stamp "Canceled" and kept securely for reference. It is recommended that each voided check be attached to a blank cash disbursement voucher and entered into the cash ledger system as "voided" for tracking purposes.
15. Bank transfers from other accounts should be posted in the cash disbursements journal when the transfer has been initiated and to the cash receipts journal when the transfer has been completed. It is recommended that a cash-in-transit account be used to track and monitor the transfer of cash between bank accounts.
    a. When funds are transferred from account A to account B
        i. Debit Cash in transit account
        ii. Credit Bank A account
    b. When funds are reflected as received in account B
        i. Debit Bank B account
        ii. Credit Cash in transit

**Note:** **Cash-in-transit** is the general ledger account used to track cash that is being transferred from one bank account to another. Since the cash disbursement is recorded on a separate accounting voucher than the cash receipt, the cash-in-transit account is needed to balance each of the two entries. When the cash receipt is recorded, the balance in the cash-in-transit account should zero out.

## STEP 6.3.3 – CASH FLOW FORECASTING

| STEP NAME | CASH FLOW FORECASTING |
|---|---|
| **Step Number** | 6.3.3 |
| **Organizational Role** | Head of Finance |
| **Inputs** | Approved budget<br>Activity plans |
| **Outputs** | Approved cash flow forecast |
| **Integration Points** | Collaboration with donors<br>Collaboration with project officers |
| **Summary** | The cash flow forecast allows the organization's managers to predict periods when cash balances are likely to be insufficient to meet spending needs and periods when there are surplus funds. |

Effective cash flow management is vital to organizations. It is a key element in planning and in efficient operational management. If cash inflows and outflows are not successfully planned and monitored, organizations may encounter cash shortfalls and may not be able to serve beneficiaries or pay employees and vendors in a timely manner. A cash flow forecast is often required by external parties to enable them to plan the timing of issuance of funding to the organization.

The cash flow forecast is linked with budget planning and involves, at a minimum, the following steps:

1. Determine the cash position at the beginning of a given period from the organization's accounting records.
2. Plan the timing of anticipated future cash receipts, approved sources of grant funding, and other projected sources of income. The main sources of cash inflows for an organization include contributions, donors' advances or reimbursements, collection of accounts receivable balances, and cash receipts from income-generating activities.
3. Estimate the timing of cash disbursements, taking into consideration the organization's planned activities. Organizations that maintain their accounting on an accrual basis should keep in mind that payments to vendors may be needed to decrease previously recorded liabilities.
4. Summarize the information above in a spreadsheet showing forecasted cash balances by period.
5. Provide the forecast to the executive director or other applicable official for use in projecting cash surpluses or needs.

### STEP 6.3.4 – BANK RECONCILIATION

| STEP NAME | BANK RECONCILIATION |
|---|---|
| **Step Number** | 6.3.4 |
| **Organizational Role** | Head of Finance<br>Authorizing official |
| **Inputs** | Official bank statement<br>Ledger transactions |
| **Outputs** | Bank reconciliation statement |
| **Integration Points** | Collaboration with bank |
| **Summary** | Bank reconciliations are performed at least monthly to reconcile differences between bank records and the organization's records. |

The following are items that may cause differences between an organization's accounting ledger and a bank statement from the bank:

- Incoming transfers
- Bank charges and interest booked by the bank but not by the organization
- Checks issued by the organization but not presented to the bank
- Deposits in transit, defined as deposits made and recorded by the organization toward the end of the month but not booked by the bank as of the ending bank statement date. This difference may be due to processing delays or to posting errors.

Bank reconciliation best practices include the following:

1. Bank reconciliations should be prepared monthly to verify that the accounting records are correct. The bank account mirrors cash book activity. Therefore, the preparer should look for possible discrepancies that could be caused by either error or misuse. Bank account reconciliation responsibility should be vested in persons not involved in handling receipts or disbursements. Otherwise, possible discrepancies can be covered up. A designated responsible official should review reconciliations. Bank reconciliations should be retained on file in the event of audit or other internal reviews.
2. Documents that support the reconciling items need to be attached to the related bank reconciliation. Such documents might include a list of outstanding checks, deposits in transit, and other relevant documents.

3. When appropriate, a general journal entry should be made to record the reconciling of items that appear on the bank statement but are not recorded in the organization’s general ledger.
4. Bank reconciliation preparation should always start with the opening balance brought forward from the previous reconciliation and end at an adjusted balance that reconciles with the ending balance per the bank’s statement.
5. Reconciling items identified during the bank reconciliation process should be cleared by the subsequent month. The Head of Finance should follow up if a reconciling item appears two months in a row.
6. Management action is required for irreconcilable or unidentified variances identified during the bank reconciliation process.
7. All disbursement checks that have been outstanding for more than a stated period of time (such as three or six months) should be voided and replaced.

### STEP 6.3.5 – PETTY CASH

| STEP NAME | PETTY CASH |
|---|---|
| **Step Number** | 6.3.5 |
| **Organizational Role** | Petty cash officer/custodian<br>Head of Finance |
| **Inputs** | Petty cash vouchers |
| **Outputs** | Petty cash ledger |
| **Integration Points** | Requisitioners and approvers |
| **Summary** | The purpose of setting up a petty cash fund is to allow access to cash on demand for small payments. It is the responsibility of the organization's management to set the maximum petty cash balance, establish a limit of individual disbursement from the petty cash, and designate a petty cash custodian. Petty cash should be maintained on an imprest basis. The recommended level of the petty cash fund should range from two weeks' to one month's cash needs. |

1. Organizations should establish a petty cash policy and procedures. The procedures should describe the petty cash location, maximum petty cash fund balance, roles and responsibilities of staff involved in the custodianship, petty cash voucher preparation, approval levels, maximum disbursement amount, and the petty cash replenishment process.
2. A custodian should be designated and trained to handle the petty cash.
3. The petty cash custodian should not perform any other cash function.
4. The petty cash fund must be kept in a locked safe and access to the safe must be limited to the custodian.
5. All petty cash payments must be made only for authorized payments using a petty cash request form and pre-numbered petty cash slip, and must be supported by evidence for payment such as customer invoices and payee signatures. The petty cash custodian should never authorize payment.
6. The petty cash custodian must record all payments in a petty cash ledger, which may be a formal register (preferred) or worksheet. The petty cash ledger captures information on the date and purpose of the payment, the payee, the amount paid, and the running balance of the petty cash fund.

7. The custodian must reconcile the petty cash fund on a daily basis. The cash remaining in the petty cash box plus the sum of payments made from the date of the fund's last replenishment must agree to the petty cash fund imprest balance. Any difference should be brought to the attention of the Head of Finance for action.
8. Whenever there is a change of custodial responsibility, a cash count must be performed and an official handover of cash and documents must be made. A third person must witness and sign the handover process.
9. There should be an unannounced cash count conducted by a person other than the petty cash custodian at least once a month. It is recommended that additional independent counts be performed at regular intervals during the month.

**Petty Cash Reimbursement/Replenishment**

1. When the petty cash fund balance reaches a pre-defined minimum balance, the custodian prepares a replenishment statement. The replenishment statement is a list of payments categorized by general ledger account.
2. A designated Finance officer should review the replenishment statement for accuracy and validity of the supporting documentation.
3. When confirmed by Finance and approved by the organization's designated official, a check should be issued for the amount of the replenishment submitted. It is recommended to issue the replenishment check in the name of the custodian.
4. At this point, the petty cash custodian receives reimbursement for the replenishment submitted, which brings the cash in the fund back to the imprest balance.

**Recording Petty Cash**

1. When the initial petty cash fund is set up, a cash disbursement journal voucher will be prepared to debit the imprest account and credit the bank account.
2. Whenever there is need to replenish the petty cash account, a cash disbursement journal voucher will be prepared with the amount needed to adjust the petty cash to the float amount. The accountant will record a debit to the expense account and a credit to the bank account.

## STEP 6.3.6 – OPERATING IN A CASH ENVIRONMENT

| STEP NAME | OPERATING IN A CASH ENVIRONMENT |
|---|---|
| **Step Number** | 6.3.6 |
| **Organizational Role** | Cash custodian<br>Head of Finance |
| **Inputs** | Cash transfers and related documents<br>Remittance advices<br>Grant agreements<br>Purchasing documentation<br>Receiving documentation<br>Vendor invoices |
| **Outputs** | Cash receipt slips<br>Cash disbursement slips<br>Cash receipt vouchers<br>Cash disbursement vouchers<br>Cash ledger<br>General ledger |
| **Integration Points** | Requisitioners and approvers<br>Suppliers<br>Project officers |
| **Summary** | Organizations may operate in a location or operating environment in which no formal banking options are available. In those situations, all transactions may be conducted in cash (currency), with an increased need for effective internal control throughout the cash cycle. |

When an organization is operating in a cash environment, the following measures are recommended to ensure that cash is properly safeguarded:

1. The organization should establish firm policies and procedures that clearly indicate the roles and responsibilities of staff members involved in cash custodianship, the documentation required for each step of the cash cycle, and the approvals needed to disburse funds.
2. A custodian should be designated and trained to handle the cash.
3. To the extent possible, all cash-related functions should be clearly segregated. There should established checks and balances for each cash process. If staffing limitations prevent a full segregation of duties, those weaknesses must be documented and compensating controls must be put into place in order to minimize the organization’s exposure.
4. When not in use, the cash must be kept in a locked safe; access to the safe must be limited to the custodian.

5. If possible, the organization's executive director and the Head of Finance should establish a maximum level for cash-on-hand. Any cash in excess of the prescribed on-hand level should be kept at a secure banking location elsewhere; funds should be drawn from that bank when needed.
6. Each cash receipt should be documented by the following:
    a. Cash remittance advice or cash transfer advice (when applicable)
    b. Pre-numbered, multi-part cash receipt slip, signed and dated by the custodian and by the payer or cash courier. The original slip should be returned to the payer or courier and a copy should be attached to the cash receipts voucher. The custodian should retain another copy in a separate file for sequential control purposes.
    c. Cash receipts voucher signed by the voucher's preparer and approver, with copies of the cash receipt slip and remittance or transfer advice (when applicable) also attached. (Note multiple cash receipts can be included on a single cash receipts voucher as long as they are shown separately on the voucher.)

7. Each cash payment must be made only for an authorized purpose and should be supported by a combination of the following documents, as applicable:
    a. Approved purchase requisition
    b. Price quotations or pro-forma invoices
    c. Bid comparison reports with explanation for basis of vendor selection
    d. Approved purchase order and/or contract
    e. Goods-received note
    f. When warranted, explanatory memo justifying any significant variance between items and quantities ordered versus those received
    g. Vendor's original invoice or employee's travel expense report
    h. Approved payment/advance request
    i. Pre-numbered, multi-part cash disbursement slip (required for all cash disbursements). The cash disbursement slip should be signed and dated by the custodian disbursing the cash and the payee. The original cash disbursement slip should be attached to the cash disbursement voucher and a copy should be given to the payee. The custodian should retain another copy for sequential control purposes.
    j. Cash disbursement voucher that includes all of the supporting documentation cited above, signed by the voucher's preparer and approver. A separate voucher should be prepared for each

cash disbursement. No two disbursements should be combined on a single voucher.

8. The custodian should be prohibited from authorizing payments.
9. The custodian must record all payments in a formal cash ledger. The ledger should show the date of and brief explanation for the purpose of the payment, the payee, amount paid, account(s) charged, and the running balance of the fund.
10. All cash transactions should be posted immediately to the cash ledger.
11. In addition to the cash ledger, the organization must maintain a general ledger that includes all of the cash transactions plus all journal entries such as those to record liquidation of receivables balances, depreciation, reclassification, or correcting entries. Someone other than the cash custodian should maintain the general ledger. The journal entries should be recorded on standard documents known as General Journal Vouchers. The voucher's preparer and approver and the person who entered the transaction in the general ledger should sign the vouchers.
12. The custodian should count the cash-on-hand daily. The cash remaining in the petty cash box plus the sum of payments made from the date of the fund's last replenishment, less any cash received during the period, must agree to the total authorized cash level. Any difference should be brought to the attention of the Head of Finance or site manager for action.
13. Whenever there is a change of custodial responsibility, the cash count must be performed and an official handover of cash and documents must be made. A third person must witness and sign the handover process.
14. A designated employee should conduct an independent cash count at least once a week. The results of that count should be documented and reported to the Head of Finance or site manager.
15. At least once a month, a designated employee who is independent of the other cash functions should conduct an unannounced cash count. That cash count should be documented and reported to the Head of Finance or site manager.
16. All cash disbursement vouchers should be canceled to prevent their reuse.
17. All vouchers should be systematically filed in a lockable cabinet or locked room; access to those files should be restricted to designated employees.
18. Similarly, access to the cashbook and the general ledger should be restricted. If the cashbook and/or general ledger are/is prepared

manually, it should be stored in a locked safe during non-working hours. If the cashbook and/or general ledger are/is kept on a computer, the files or computer should be password protected and backed up, at a minimum, weekly. Daily back-ups are recommended, if possible.

# FINANCE BUSINESS PROCESS 6.4 – RECEIVABLES MANAGEMENT

## PROCESS DESCRIPTION

Amounts owed to the organization are assets and should be classified in the asset category “receivables.” The liquidation of trade receivables generally results in future cash inflows. However, other types of receivables, such as amounts advanced to employees for business-related travel or to subrecipient organizations to perform project-related tasks, when liquidated, will usually result in expense charges.

The organization needs to establish firm deadlines for receivables collection. For receivables that arise from transactions with external parties, the deadlines for cash remittances and/or liquidation reporting should be clearly spelled out in the contracts or agreements between the parties. For receivables due from the organization’s employees, the cash remittance and/or liquidation report submission deadlines should be made clear in the organization’s policies and procedures and consistently enforced.

Effective management of receivables requires that all accounts receivable balances be analyzed at least on a monthly basis. The most common and effective receivables analysis is the aging report, in which the various individual open balances are listed along with the dates of the financial transactions that gave rise to those balances and the accounting voucher references. The reports should be distributed monthly to the respective organization officials responsible for collection and/or liquidation of the balances.

## PROCESS FLOW

### STEP 6.4.1 – RECEIVABLES MANAGEMENT

| STEP NAME | RECEIVABLES MANAGEMENT |
|---|---|
| **Step Number** | 6.4.1 |
| **Organizational Role** | Head of Finance<br>Accountant |
| **Inputs** | Approved advance requests |
| **Outputs** | Aging reports |
| **Integration Points** | Collaboration with management as well as Purchasing and Programming departments |
| **Summary** | Amounts owed to the organization should be recorded as receivables, which are assets of the organization. They should be closely monitored to ensure timely collection or liquidation and should be accurately stated and appropriately classified. |

**Types of Receivables**

A separate general ledger account should be set up for each type of receivable that the organization expects to administer. Types of receivables that are common to many organizations include the following:

1. Trade Receivables – Balances arising from trade sales, where applicable. Balances in this account are cleared through cash/check/wire remittances.
2. Travel Advances – Amounts advanced to employees for business travel purposes. Balances in this account are normally cleared by the submission of approved travel expense reports and or cash receipts, supported by the appropriate documentation. Such advances are to be fully liquidated at the end of each trip. New advances should not be issued before an old advance is fully liquidated.
3. Employee Receivables – Amounts owed by employees for payments made on their behalf. These balances are cleared by collection of cash/checks or by payroll deductions where allowed by law.
4. Project Advances – Advances to subrecipient organizations to conduct approved project activities. Balances in this account are normally cleared through the submission of liquidation reports. The amounts reported should be verified by the organization through the inspection of the subrecipient's supporting documentation.
5. Salary Advances – Amounts advanced to employees with the understanding that the amounts advanced will be repaid by the

CARL D. WALSH FOR CRS

A village leader in the Democratic Republic of the Congo keeps order while beneficiaries wait to receive their cassava seed in the North Kivu province.

employee within the period dictated by local labor law as deductions against wages to be paid. The organization should have a policy that will be applicable with local laws regarding the repayment of salary advances.

6. Advances to Suppliers – Amounts paid to suppliers prior to the receipt of goods or services. This account is cleared when the goods purchased are delivered or the service is rendered by netting the advance against the amount due.

**Standard Receivables Management Disciplines**

The following are standard disciplines that aid in managing receivable balances:

1. The organization's policies should clearly indicate when each type of receivable is due. The collection or liquidation deadlines should be communicated in writing to the other parties. When appropriate, a deadline should be incorporated into the terms of an agreement with the party to whom funds will be advanced.
1. One or more organization officials should be assigned the responsibility of monitoring open balances and for following up on delinquencies.
2. Advances should not be issued to parties that have delinquent balances.
3. Each balance should clearly indicate the party that owes the funds.
   a. If the organization uses a computerized general ledger system, each owing party should be assigned an identifying number (vendor code) that is entered into the general ledger or a subledger every time a receivable transaction with the owing party takes place.
   b. If the organization uses a manual general ledger, it is recommended that the receivable transactions with the various debtors be also recorded in a separate subsidiary ledger or other record that is summarized and reconciled to the general ledger monthly. A separate subsidiary ledger or other record should be maintained for each receivable general ledger account.
5. Shortly after the books are closed each month, the organization's Finance department should provide management and the employee(s) assigned the responsibility for receivables collection and follow-up reports for the open receivable balances. The reports should be "aged" to show when each open balance arose to facilitate the monitoring and collection efforts.
6. The general ledger system or the subsidiary ledger should provide a complete audit trail to support each open balance.
7. Reserves should be set up for those account balances that appear to be uncollectible. A reserve is set up by recording a debit to a bad debts expense and a credit to a receivables reserve account.

It is recommended that approval from a senior official such as the executive director be required to set up reserves.

8. Account balances that are uncollectible should be written off. In a policy, the organization should describe the process to be followed for write-offs and the approval(s) needed. Receivable balances are written off by recording a debit to a reserve account and a credit to the applicable receivable account. It is recommended that approval from a senior official such as the executive director be required to write off receivable balances.

# FINANCE BUSINESS PROCESS 6.5 – FIXED ASSET ACCOUNTING

## PROCESS DESCRIPTION

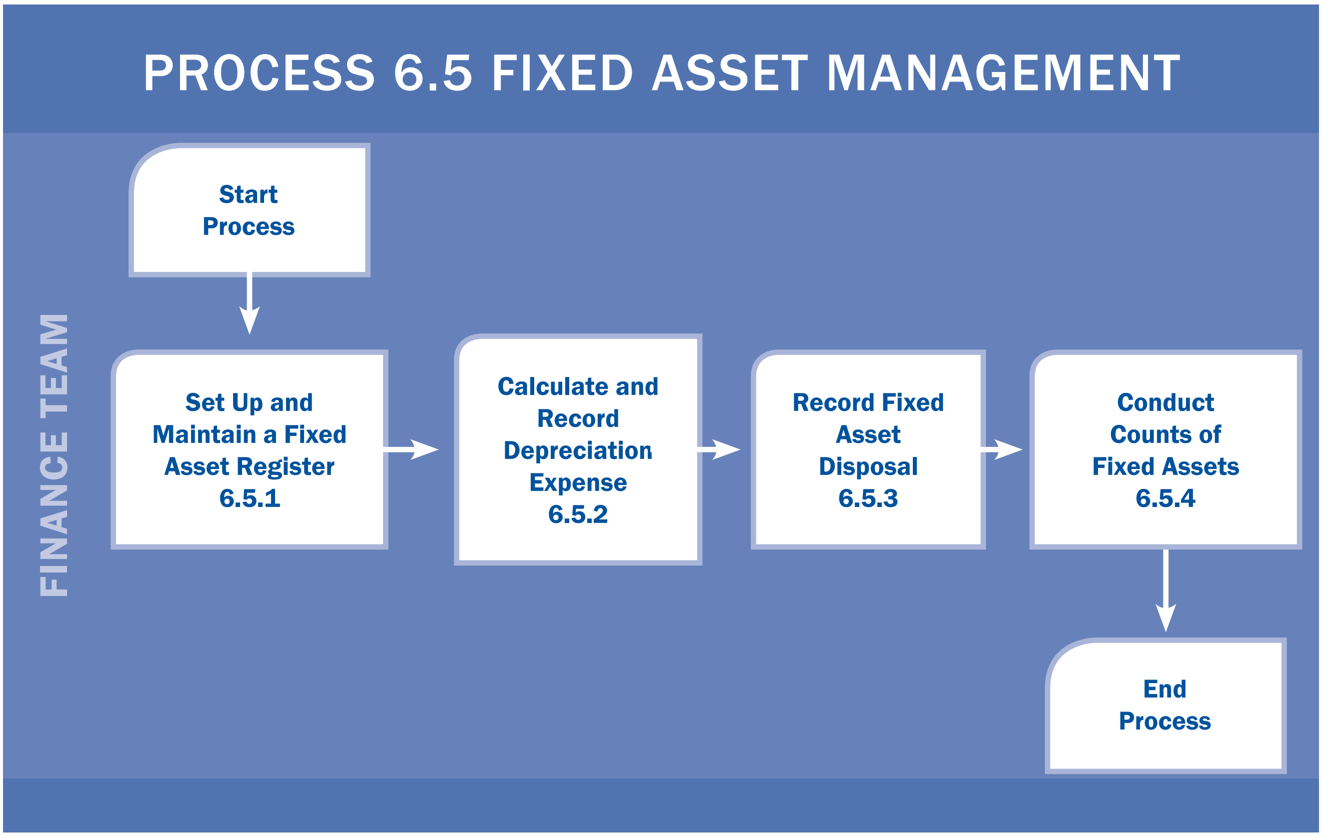
Fixed assets are the organization's tangible long-term property, plant, and equipment that have estimated useful lives of more than one year.

The Finance department should record each fixed asset addition in the general ledger and in the Fixed Assets register (ledger) as per the following guidelines:

- If the asset was purchased from the organization's unrestricted private funds, the accounting entry would be made on a cash disbursement voucher as a debit to the fixed asset account and a credit to cash.
- If the asset was received as an-kind contribution from a private donor or as an unencumbered in-kind award from a grant donor, the accounting entry would be made on a general journal voucher as a debit to the fixed asset account and a credit to in-kind contributions revenue.
- If the asset was received from a grant donor that retains ownership of the asset and requires its approval for disposition of the asset at the conclusion of the grant award, the accounting entry would be made on a general journal voucher as a debit to the appropriate grant line item expense account and a credit to the grant liability account. (The liability account will be reduced when the organization recognizes grant revenue for the expense recorded against the grant.) *

* **Note –** *Generally accepted accounting principles (GAAP) require that long-term assets be recorded as fixed assets and depreciated over their estimated useful lives. For fixed assets purchased with grant funds or received from a grant donor that retains ownership of the asset, additional accounting entries will be needed to comply with GAAP while accommodating the grant donor's reporting requirements. Organizations should seek guidance from their external auditors on any additional accounting entries needed.*

## PROCESS FLOW



## STEP 6.5.1 – SET UP AND MAINTAIN A FIXED ASSET REGISTER

| STEP NAME | SET UP AND MAINTAIN A FIXED ASSETS REGISTER |
|---|---|
| **Step Number** | 6.5.1 |
| **Organizational Role** | Accountant |
| **Inputs** | Fixed asset additions<br>Fixed asset disposals |
| **Outputs** | Depreciation expense<br>Fixed assets reporting |
| **Integration Points** | General ledger transaction processing |
| **Summary** | The register is used to capture detailed information about the organization's fixed assets. |

The fixed asset register should contain the following information:

- Name and description of the asset
- Cost, including purchase price, unreimbursed taxes, duties, delivery costs, and installation fee
- Accounting transaction reference number
- Cash disbursement voucher or check number (for purchased assets)
- General journal voucher number (for donated assets)
- Acquisition date (month and year)
- Location
- Employee to whom the asset has been assigned or who has custodial responsibility for the asset
- Condition
- Asset number (Should be assigned by the Administration department)
- Manufacturer's serial or model number
- Owner (Indicate who has title to the equipment)
- Estimated useful life
- Monthly depreciation expense
- Funding source, if asset acquisitions have been funded by multiple donors

## STEP 6.5.2 – CALCULATE AND RECORD DEPRECIATION EXPENSE

| STEP NAME | CALCULATE AND RECORD DEPRECIATION EXPENSE |
|---|---|
| **Step Number** | 6.5.2 |
| **Organizational Role** | Accountant |
| **Inputs** | Fixed asset additions<br>Fixed asset disposals |
| **Outputs** | Depreciation expense general journal entries |
| **Integration Points** | General ledger transaction processing |
| **Summary** | Since fixed assets benefit the organization over a number of years, their cost should be expensed over the periods that benefit from use of the asset. Depreciation expense is the distribution of the cost of a fixed asset over its estimated useful life. |

The organization needs to designate an estimated useful life for each type of fixed asset it acquires and should use that estimated life to depreciate all assets in that category. The organization should refer to local professional accounting standards or practices to make the determination of useful life. Suggested asset lives are the following:

- Computer equipment – three to five years
- Furniture and equipment other than computers – 10 years
- Vehicles – three to five years
- Buildings – 40 years
- Leasehold improvements – If the related facility lease has an automatic renewal option, then the recommended asset life is 40 years. Otherwise, the improvements should be depreciated over the remainder of the lease term.
- No asset life should be assigned to land, nor should land ever be depreciated.

Depreciation expense should be recorded monthly on a general journal voucher as a debit to depreciation expense and a credit to accumulated depreciation. Accumulated depreciation is the sum of the depreciation expense recorded since an asset's acquisition date. Depreciation entries should cease for a given asset once it has reached the end of its estimated useful life. The accumulated depreciation for a given asset should never exceed its cost. The asset cost and the accumulated depreciation should remain on the books until the disposal of the asset takes place.

There are various methods of recording depreciation expense. It is recommended that the organization use the straight-line method of recording depreciation expense unless local standards or local practice dictate otherwise. The straight-line depreciation method spreads the asset's cost evenly over its estimated useful life, beginning with the month it was first placed into service. The organization may elect to use one or more expense accounts to record depreciation expense in the general ledger, depending on donor requirements.

The information contained in the fixed assets register should be used to develop the standard monthly depreciation expense entry. The following should be noted:

- If the fixed assets register is maintained using fixed assets computer software, the software will calculate the amount of depreciation expense each month.
- If a manual ledger is used, the monthly depreciation expense over the estimated life of each asset should be shown in the ledger. A spreadsheet should be prepared to summarize the depreciation expense for all assets by each asset type and funding source. The totals per the spreadsheet should be used as the basis for the depreciation entry.

## STEP 6.5.3 – RECORD FIXED ASSET DISPOSALS

| STEP NAME | RECORD FIXED ASSETS DISPOSALS |
|---|---|
| **Step Number** | 6.5.3 |
| **Organizational Role** | Accountant<br>Administration department |
| **Inputs** | Fixed asset disposal forms |
| **Outputs** | General journal entries (for disposals) |
| **Integration Points** | Custodial department (administration)<br>Cashier |
| **Summary** | A key responsibility of any organization is to safeguard its assets. Fixed assets are the most visible and often the most significant assets owned by an organization. Documentation and reporting are necessary to ensure that the physical controls are effective. |

The organization should use a standard form to document its fixed asset disposals. A pre-numbered two-part form is recommended. The form should contain two sections: a request section and a disposal section.

**Request**

The department responsible for the custody of the organization's assets (normally the Administration Department) should submit a form for each requested disposal and route it to the appropriate official for approval. The following information should be contained in the Request section of the Fixed Assets Disposal form:

- Description of the asset
- Current condition of the asset
- Asset cost
- Current net book value of the asset (cost less accumulated depreciation)
- Asset location
- Fixed Asset number (as assigned by the organization)
- Serial number (as affixed by the vendor, if applicable)
- Reason for the disposal
- Nature of the disposal (sale, transfer, discard, or abandonment)
- Date of the request

- Name and signature of the requester
- Name and signature of the designated approver
- Date approved
- Estimated amount of proceeds to be received, if to be sold
- An indication as to whether prior approval has been obtained from the donor, if required
- An indication as to whether clearance for a sale has been obtained from the local government if the organization is tax exempt and if such approval is so required by local regulations

If a disposal request has been approved for an asset sale, the organization should require the solicitation of sealed bids. Bids received should be opened in the presence of several specified organization officials. Once a winning bidder has been selected and notified, documentation to support the bidding process and buyer selection should be kept on file. If the asset was purchased via funding from a grant donor, the organization should seek donor approval, if required, prior to the sale.

**Disposal**

Once disposal has taken place, the custodial department should complete the second half of the disposal form, which should contain the following **additional** information:

- Date disposal took place
- Amount of proceeds received (if sale)
- Amount of cost incurred to dispose of the asset (if any)
- Name and signature of the designated employee attesting to the disposal

The original disposal form should be sent to the organization's Finance department for support of the accounting entry/entries needed to record the disposal. The custodial department should retain a copy of the completed form.

At the time of the disposal, the Finance department should do the following:

- If a sale took place, the cashier should receive the cash directly from the purchaser and record the receipt of the proceeds on a cash receipts journal voucher by debiting the cash account and crediting a gain/loss on the sale of fixed assets account, which is an "other income" account. The cashier should issue a Cash Receipt form to the purchaser (original), retain a copy of the form on file, and attach a copy of the form to the cash receipts journal voucher. If the purchaser paid by check, a copy of the purchaser's check should also be attached to that voucher.

- In the same fiscal month, the Finance department should record the disposal of the asset on a general journal voucher. The original fixed asset disposal form should be attached to the general journal voucher, which should be cross-referenced to the cash receipts journal entry if a sale took place. The disposal entry will vary depending upon whether or not the asset is fully depreciated.
- If the asset is fully depreciated, the entry will be to debit the accumulated depreciation account and to credit the fixed asset account.
- If the asset is not fully depreciated, the entry would be to debit the accumulated depreciation account for the amount of its balance, to debit the net book value of assets disposed of or sold account for the asset's net book value, and to credit the fixed asset account for the asset's cost. (Net book value is the difference between the asset's cost and the accumulated depreciation balance as of the date of the sale or other disposal.)
- The general journal voucher should be routed to the appropriate employee per the organization's authorization matrix for approval.
- After approval, the general journal voucher should be entered into the general ledger.
- The fixed assets register should be updated for the disposal using the information contained on the general journal voucher and the attached fixed asset disposal form.

## STEP 6.5.4 – CONDUCT COUNTS OF FIXED ASSETS

| STEP NAME | CONDUCT COUNTS OF FIXED ASSETS |
|---|---|
| **Step Number** | 6.5.4 |
| **Organizational Role** | Accountant<br>Head of Administration |
| **Inputs** | Fixed asset count forms |
| **Outputs** | Count reconciliations<br>General journal entries (for missing fixed assets) |
| **Integration Points** | Custodial department (administration) |
| **Summary** | Finance must reconcile fixed asset counts with the general ledger balances and prepare general journal vouchers for unreconciled differences. The organization should conduct physical counts of its fixed assets on a predefined frequency during the course of the year. It is highly recommended that the counts occur at least quarterly. In no case should the counts be made less frequently than yearly. |

Employees who are independent of the fixed asset custodial and record keeping functions should supervise and conduct fixed asset counts. The head of administration should direct the counts. A standard preprinted form should be used to record the counts. The count sheets should be signed by the person(s) who performed the count(s) and approved by the head of administration. The original count sheets should be sent to the Finance department for reconciliation with the fixed assets register and the general ledger balances for the respective types of fixed assets. The Administration department should retain copies of the count sheets.

Count differences should be investigated and any asset shortages should be explained. In the event that a count is proven to be in error, an adjustment should be made to the pertinent count sheet after proper approval to make the adjustment has been obtained. For any missing asset, the head of administration should prepare and approve a fixed asset disposal form. That form should be attached to the general journal voucher used to record the reduction in the applicable fixed asset balance. The general journal voucher should be routed to the appropriate employee per the organization's authorization matrix for approval. After approval, the general journal voucher should be entered into the general ledger.

The fixed assets register should be updated for the disposal, using the information contained on the general journal voucher and the attached fixed asset disposal form.

Physical controls should be such that instances of missing fixed assets should be rare. The heads of administration and Finance should jointly address repeated occurrences or significant instances of missing assets with the Executive Director.

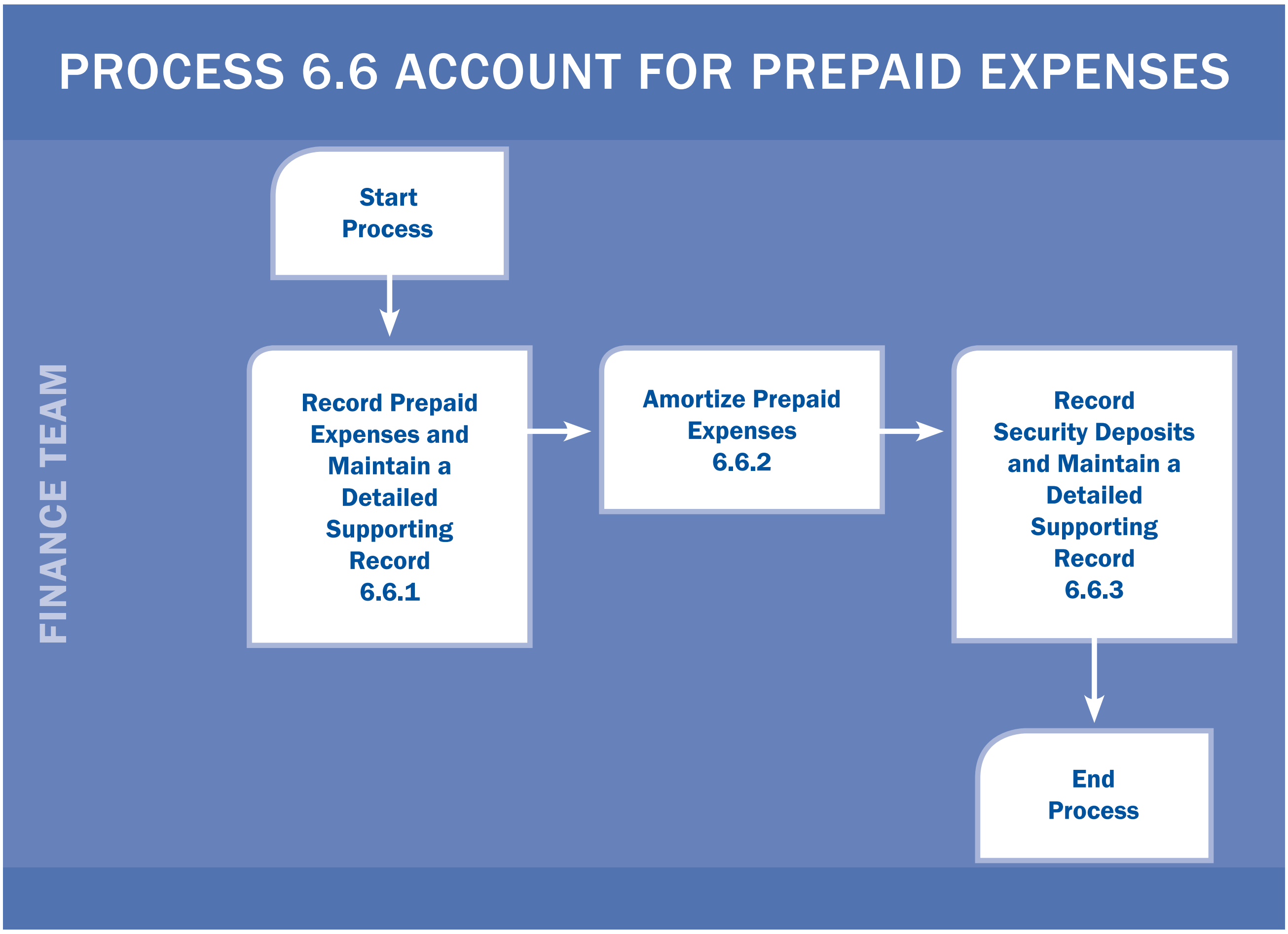
# FINANCE BUSINESS PROCESS 6.6 – ACCOUNTING FOR PREPAID EXPENSES AND SECURITY DEPOSITS

## PROCESS DESCRIPTION

Expenses paid in advance of the accounting periods that will benefit from those expenditures need to be accounted for as prepaid expenses. The cost of these assets is charged to expense (amortized) over the benefiting months. The organization's Finance department should maintain a detailed analysis of open prepaid items to facilitate their review and to help ensure that the balances are properly amortized.

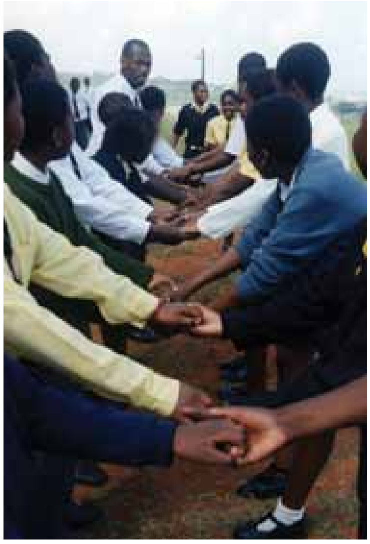
Security deposits, if material to the organization, should be recorded as assets. Unlike prepaid expenses, security deposits that are set up as assets should not be amortized since they are not consumed in the business and their value does not diminish over time.

## PROCESS FLOW



## STEP 6.6.1 – RECORD PREPAID EXPENSES AND MAINTAIN A DETAILED SUPPORTING RECORD

| STEP NAME | RECORD PREPAID EXPENSES AND MAINTAIN A DETAILED SUPPORTING RECORD |
|---|---|
| **Step Number** | 6.6.1 |
| **Organizational Role** | Accounts payable clerk<br>Accountant |
| **Inputs** | Documented standard practices established by the Head of Finance |
| **Outputs** | Cash disbursement entries<br>Detailed analysis (register or worksheet) |
| **Integration Points** | Head of Finance |
| **Summary** | In the normal course of business, most organizations make payments that benefit future periods. Common examples of prepayments are those made in advance for office leases, insurance premiums, and computer maintenance contracts. The portion of the payment that benefits future periods should be recorded as a prepaid expense. To aid in tracking prepaid expense balances, the Finance department should maintain a detailed analysis of the open prepaid items. |


DAVID SNYDER/CRS

In South Africa, a local non-governmental organization called SINOSIZO provides home based care and orphan support in HIV-affected communities around Durban.

### Record Prepaid Expenses

The organization's Head of Finance should make the determination based on materiality and types of expenditures as to which disbursements should be set up as prepayments. Prepayments below the minimum threshold established by the Head of Finance should be expensed when paid. The decisions should be documented by the Head of Finance and copies of the documented decisions should be retained on file by the accountant.

The organization may set up a separate general ledger prepaid expense account for each type of prepayment or it may decide to keep all prepayments in a single account. If multiple types of prepayments are kept in a single general ledger prepaid expense account, care should be exercised to ensure that each prepayment is properly amortized.

### Maintain a Detailed Supporting Record

The detailed record may be a formal ledger (register) or a worksheet. If an organization has more than one type of prepaid expense or has multiple general ledger accounts, a separate ledger or worksheet should be maintained for each.

The types of information that should appear in each detailed record include the following:

- Description of the prepayment
- Vendor
- Transaction reference number
- Transaction date
- Periods that will benefit from the prepayment (the term over which the prepayment is to be expensed, usually expressed as the number of months)
- Total amount of the prepayment
- Amount that will be expensed (amortized) each month
- Monthly beginning balance
- Additions (cash disbursements)
- Reductions (e.g., general journal entries for monthly amortizations, insurance premium refunds)
- Monthly ending balance

The monthly ending balance in each detailed record (if multiple prepaid expense accounts are used) should agree with the corresponding general ledger balance for each account. If only one prepaid expense account is used, the total of the ending balances for all of the detailed records should agree with the general ledger balance.

The detailed records should be reviewed monthly by the Head of Finance to ensure that they are sufficiently detailed and agree with the general ledger balance.

### STEP 6.6.2 – AMORTIZE PREPAID EXPENSES

| STEP NAME | AMORTIZE PREPAID EXPENSES |
|---|---|
| **Step Number** | 6.6.2 |
| **Organizational Role** | Accountant |
| **Inputs** | Data from detailed prepaid expense records |
| **Outputs** | General journal entries |
| **Integration Points** | Head of Finance |
| **Summary** | Prepaid assets should be charged to expense in the period(s) in which the organization derives benefit from the original expenditures. The process by which the prepaid expense balances are charged off to expense is known as amortization. |

A designated employee in the Finance department should be responsible for preparing the monthly amortization entry. The designated employee should refer to the detailed accounting record(s) for the amount to be amortized for each account and/or type of prepayment every month. If a spreadsheet is used for prepaid expense tracking, a copy of the spreadsheet should be attached to each month's amortization entry.

Generally, prepaid expenses are amortized evenly over the benefiting periods. For example, if an organization is required by contract to pay the next year's rent in advance, payment should be recorded on a cash disbursement voucher as a debit to prepaid expenses and a credit to the cash-in-bank account. Each month during the lease term, the Finance department should record a debit to expense and a credit to the prepaid expense account on a general journal voucher for one-twelfth of the prepaid rent. By the end of the lease term, the rent prepayment should be fully amortized.

If several types of prepayments are maintained in a single general ledger account, care should be exercised to ensure that the cumulative amortization for each type of prepayment does not exceed the amount of the original asset.

If the benefit derived from the prepayment does not extend beyond the life of a specific associated project, the prepaid expense should be amortized within that project's term.

## STEP 6.6.3 – RECORD SECURITY DEPOSITS AND MAINTAIN A DETAILED SUPPORTING RECORD

| STEP NAME | RECORD SECURITY DEPOSITS AND MAINTAIN A DETAILED SUPPORTING RECORD |
|---|---|
| **Step Number** | 6.6.3 |
| **Organizational Role** | Accounts payable clerk<br>Accountant |
| **Inputs** | Documented standard practices established by the Head of Finance |
| **Outputs** | Cash disbursement entries<br>Detailed listing of all open security deposit balances |
| **Integration Points** | Head of Finance |
| **Summary** | Security deposits such as those required by utility and phone companies are not prepaid expenses and should be recorded in a separate asset account if these expenses are significant to the organization. If security deposits are minor in amount, consideration may be given to expensing them when paid. |

Security deposits that are set up as assets should not be amortized. The Finance department should maintain a listing of all amounts charged to the security deposit account. The listing should contain the voucher reference, vendor name, date paid, amount paid, and a brief description of each payment. It is recommended that the Finance department also keep copies of related supporting documentation for each charge to the security deposit account until the deposit is recovered. Monthly, the Head of Finance should review the detailed records to ensure that they are sufficiently detailed and agree with the general ledger balance.

If the Head of Finance decides that payments for small security deposits should be expensed when paid, the criteria and threshold for making that determination should be documented in writing.

If the benefit derived from the security deposit does not extend beyond the life of a specific associated project, the security deposit should be liquidated before that project is closed.

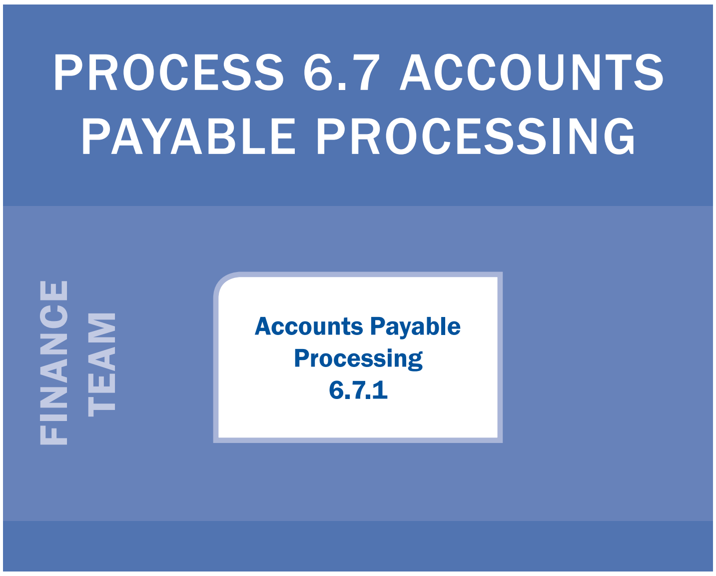
# FINANCE BUSINESS PROCESS 6.7 – ACCOUNTS PAYABLE PROCESSING

## PROCESS DESCRIPTION

Organizations that operate on an accrual basis for accounting purposes normally set up their impending payments as liabilities before they pay them. This process is known as *accounts payable*. Use of an accounts payable system, whether manual or automated, helps to ensure that expenses and asset acquisitions are recorded in the proper accounting periods, and that the corresponding liabilities are correctly stated at month's end. Accounts payable systems also aid in tracking open vendor invoices until they are paid.

Accounts payable transactions are recorded on a standard accounting entry document known as an accounts payable voucher.

## PROCESS FLOW



## STEP 6.7.1 – ACCOUNTS PAYABLE PROCESSING

| STEP NAME | ACCOUNTS PAYABLE PROCESSING |
|---|---|
| **Step Number** | 6.7.1 |
| **Organizational Role** | Accounts Payable clerk<br>Head of Finance |
| **Inputs** | Approved purchase order<br>Supplier's delivery note<br>Supplier's invoice<br>Goods-received note<br>Payment request |
| **Outputs** | Accounts payable voucher<br>Check disbursement |
| **Integration Points** | Collaboration with procurement officer, Head of Finance and other unit heads |
| **Summary** | The Finance department is responsible for making payments after ensuring that all payment requests are duly approved, with adequate supporting documentation attached. |

This process does not apply to those organizations that pay their vendors on a cash basis. For those organizations, all payments (other than payroll) are recorded on cash disbursement vouchers and vendors are paid immediately upon receipt of the goods or services.

### Accounts Payable Process

Many organizations use an alternative process by which all types of impending payments (other than payroll) are recorded on a standard accounting entry document known as an accounts payable voucher and then paid at a later date. For those organizations that follow an accounts payable cycle, the process flow is as follows:

1. To begin the accounts payable process, the Accounts Payable clerk receives the following documents, when applicable:
    - From the procurement officer – purchase order, purchase requisition, competitive bid documentation, basis for vendor selection
    - From the supplier – invoice and delivery note
    - From the receiving clerk – goods-received note
    - From administration or Procurement – signed contract
    - From the requesting department – payment request (for services or for payments other the purchase of goods, such as for travel advances)

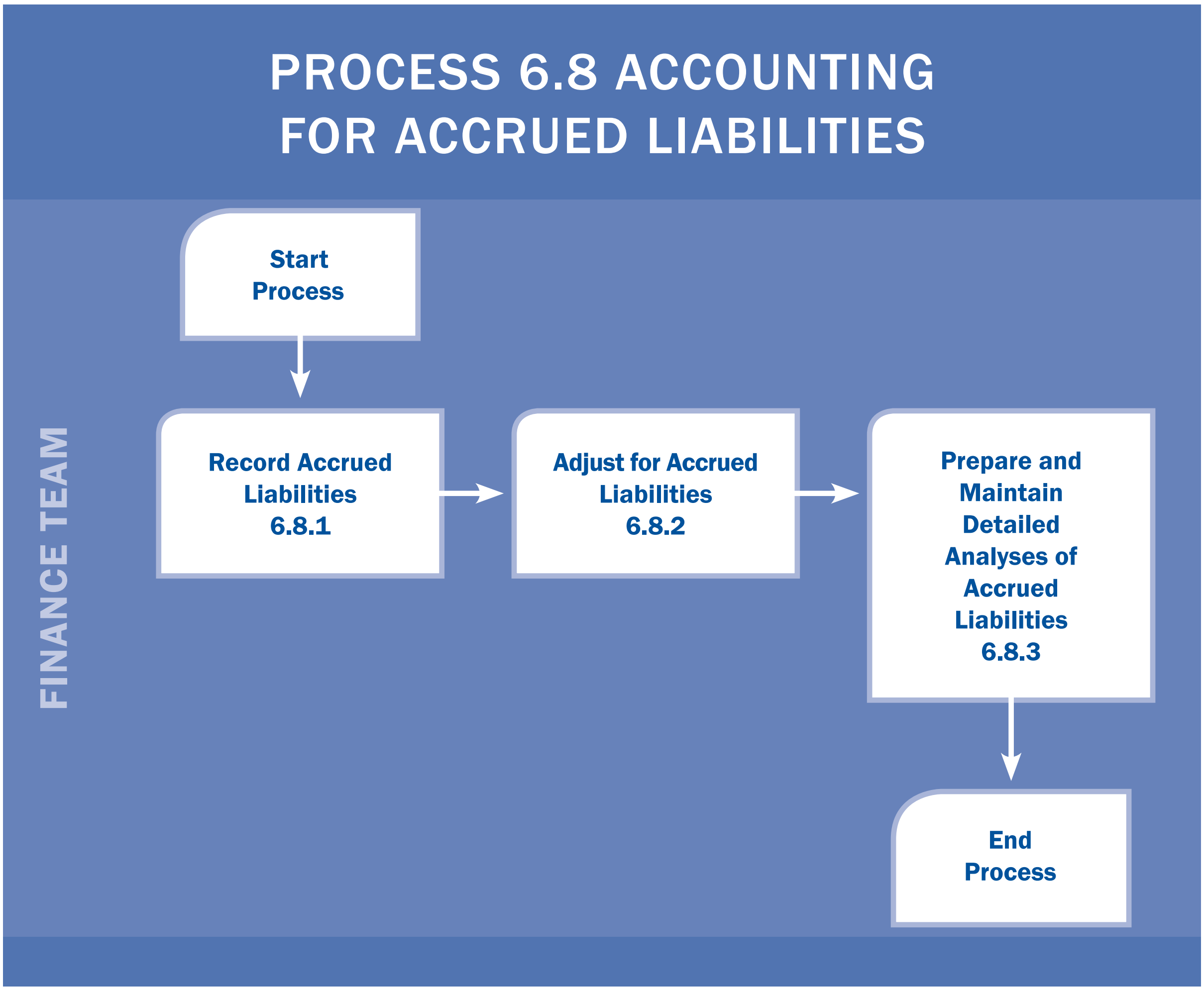
2. The Accounts Payable clerk then compares and verifies the documents received as described below:
   - If the transaction is for a goods purchase, the Accounts Payable clerk matches the descriptions, quantities, and unit prices per the supplier's invoice and delivery note to those indicated in the purchase order and the goods-received note.
   - If the transaction is for a contracted service, the Accounts Payable clerk matches the vendor's invoice against the terms of the contract and against the payment request.
   - If the transaction is for another type of payment, such as a travel advance, the clerk checks the request form received for proper approvals and account coding information and also checks open balances to see if the requested payment is compliant with the organization's policies.
3. Upon satisfactory completion of the verification process, the Accounts Payable clerk prepares an accounts payable voucher and attaches the supporting documents. On the accounts payable voucher, the appropriate account(s) is/are debited and Accounts Payable is credited. The clerk also prepares a payment request form if one was not received previously and submits the voucher and the request to the designated organization official for approval. The Accounts Payable clerk then attaches the approved payment request form to the voucher and posts the voucher to the general ledger or accounts payable (voucher) register, as applicable.
4. When it is time to make the payment, the Accounts Payable clerk prepares a disbursement check and routes the check and the voucher to the designated official for signature and approval. The disbursement is recorded in the cash disbursements journal as a debit to Accounts Payable and a credit to cash. The check, check copy, or check stub (if applicable) should contain a cross-reference to the related accounts payable voucher transaction reference number(s).
5. Once the check is signed, the check is distributed to the supplier/payee. If the payee or the payee's authorized representative picks up the check, that individual should be required to sign to acknowledge receipt of the payment. The payee's acknowledgment and a copy of the signed check should be attached to the voucher. The voucher package is then canceled and filed.

# FINANCE BUSINESS PROCESS 6.8 – ACCOUNTING FOR ACCRUED LIABILITIES

## PROCESS DESCRIPTION

A liability is an amount owed by an organization. For an accrual basis organization, the Finance department should record a liability for any debt incurred but not settled (paid) during a given month. It is often necessary to record an accrual if a liability has not been set up in the normal course of business. An accrual aids in ensuring that the organization's expenses, assets, and liabilities are properly stated at month's end.

## PROCESS FLOW



### STEP 6.8.1 – RECORD ACCRUED LIABILITIES

| STEP NAME | RECORD ACCRUED LIABILITIES |
|---|---|
| **Step Number** | 6.8.1 |
| **Organizational Role** | Accountant<br>Head of Finance |
| **Inputs** | Management estimates<br>Organizational policy criteria<br>Local government regulatory requirements<br>Professional advisory services (attorneys, accounting firms, actuaries) |
| **Outputs** | General journal entries |
| **Integration Points** | Head of Finance<br>Executive office<br>Outside professionals |
| **Summary** | Organizations regularly incur expenses that will be paid in the future. To ensure that these expenses are booked in the proper period, organizations that maintain their records on an accrual basis should set up accrued liabilities in the months in which the expenses are incurred. |

It is recommended that the organization set up a separate accrued liabilities general ledger account for each type of significant, recurring accrual. Accrued liabilities are recorded on general journal vouchers as debits to the appropriate expense accounts and credits to one or more accrued expense (liability) accounts.

The following are types of expenses for which accruals are usually needed:

- Pension
- Employee severance
- Employee salaries and wages (including vacations) earned but not yet paid
- Normal operating expenses that were incurred but for which the suppliers have not submitted invoices as of the end of a given month*
- Risk related to fraud or legal cases**

The Head of Finance should make the determination as to when an accrued liability should be set up or liquidated. Documentation supporting the reason for the accrual should be attached to the general journal voucher. If the reason for the accrual is confidential in nature, the documentation should be retained on file by the Head of Finance and a notation to that effect should be attached to the general journal voucher.

* *If the organization has received goods and the supplier's invoice, but has not paid the supplier before the end of a given month, the liability should be recorded as an account payable and not as an accrued expense.*

** *Expenses arising from fraud or legal issues should not be charged to donor awards.*

### STEP 6.8.2 – ADJUST ACCRUED LIABILITIES

| STEP NAME | ADJUST ACCRUED LIABILITIES |
|---|---|
| **Step Number** | 6.8.2 |
| **Organizational Role** | Accountant |
| **Inputs** | Instructions from the Head of Finance<br>Notices from external parties |
| **Outputs** | General journal entries |
| **Integration Points** | Head of Finance |
| **Summary** | Accrued liabilities should be reviewed monthly and adjusted as necessary. |

When a liability has been paid in full or in part, the portion of the liability that has been settled (paid) should be reversed on a general journal voucher as a debit to the accrued liability account and a credit to the account that was charged on the accrual entry. The reversing entry and the payment voucher should be cross-referenced and an explanation for the reversal should be included on the reversal voucher.

If management decides that all or a portion of an accrual relating to a non-grant activity is no longer needed, the portion of the accrual that is no longer needed should be reversed and an explanation of the reason that portion of the accrual is no longer deemed necessary should be attached to the general journal voucher.

If the organization has accrued an allowable expense against a grant award, but has determined that all or a portion of the accrual is no longer needed, the portion of the accrual that is no longer needed should be reversed. If the award is still active, the expense credit should reduce the next cash drawdown or reimbursement from the grant donor for that award. If the award has been closed, a payment should be made to the grant donor for the amount of the expense reversal. An explanation of the reason for the reduction in the liability should be included on the general journal voucher. All accrued liabilities booked for a grant or project must be settled before closing the grant or project.

If an accrued liability was based on an estimate that needs to be adjusted, the explanation and the basis for the adjustment should be provided on the general journal voucher.

The appropriate approver should sign all accounting entries for adjustments to or reversals of existing accruals.

## STEP 6.8.3 – PREPARE AND MAINTAIN DETAILED ANALYSES OF ACCRUED LIABILITIES

| STEP NAME | PREPARE AND MAINTAIN DETAILED ANALYSES OF ACCRUED LIABILITIES |
|---|---|
| **Step Number** | 6.8.3 |
| **Organizational Role** | Accountant |
| **Inputs** | Previous month's account analysis<br>Review of current month's general ledger activity |
| **Outputs** | Account analysis for current month |
| **Integration Points** | Head of Finance |
| **Summary** | To aid in tracking accrued expense balances, the Finance department should prepare updated account analyses of the accrued expense balances at the end of every month. |

A detailed account analysis should be prepared for each type of accrual. It is recommended that the account analysis be updated monthly and cover the entire fiscal year.

The types of information that should appear in the account analysis for each type of accrual are the following:

- Description of the accrual
- Party to whom the liability is owed
- Basis for the accrual (how it is calculated)
- Accrual balance at the beginning of the month
- Addition(s) to each accrual (indicate amount, transaction number, and transaction date) during the month
- Reductions in each accrual (indicate amount, transaction number, and transaction date) during the month
- Accrual balance at the end of the month

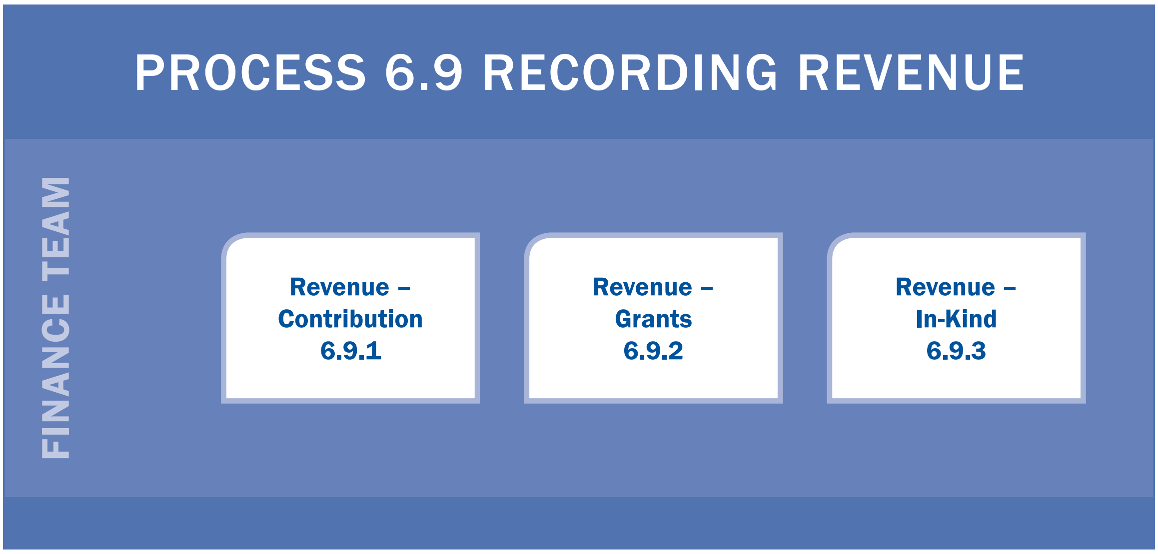
The ending monthly balance reported on each account analysis should agree with the ending balance in the corresponding general ledger account. The Head of Finance should review the account analyses monthly to ensure that they have been properly prepared and agree to the general ledger balance(s).

# FINANCE BUSINESS PROCESS 6.9 – RECORDING REVENUES

## PROCESS DESCRIPTION

This section will focus on revenue generated from cash contributions, cash grants, and in-kind donations. The accounting treatment for the funding received will vary depending upon whether the donor has placed any special conditions on the funding it has provided to the organization. There may be restrictions or requirements regarding the use of the funds, the time in which the funds are to be expended, reporting, or other areas. It is recommended that an organization maintain separate accounts for the different types of funding it expects to receive or for any revenue it expects to generate. This will make the process of analysis and reporting easier to manage.

## PROCESS FLOW



### STEP 6.9.1 – RECORD CASH CONTRIBUTIONS

| STEP NAME | RECORD CASH CONTRIBUTIONS |
| --- | --- |
| **Step Number** | 6.9.1 |
| **Organizational Role** | Head of Finance |
| **Inputs** | Donor gift |
| **Outputs** | Cash receipt slip or contribution acknowledgment (form or letter)<br>Bank deposit slip<br>Cash receipt journal voucher |
| **Integration Points** | Fundraising staff<br>Executive director |
| **Summary** | Contributions are defined as unconditional transfers of assets from a donor. *Unconditional* means the assets immediately belong to the recipient, even if there may be a restriction on the purpose for which they may be used or the time when they become available for use in the future. |

The following are among the typical characteristics of cash contributions:

- No agreement is involved, other than fulfilling the donor's restricted intent (if any)
- No contractual liability exists to return any of the funds
- No formal financial reporting is required
- Funding is usually received from private parties, generally not from public entities

A cash contribution is recorded on a cash receipt voucher. The accounting entry that the Finance department should make to record a cash contribution is as follows:

- Debit bank account
- Credit contributions revenue account

### STEP 6.9.2 – RECORD GRANT REVENUE

| STEP NAME | RECORD GRANT REVENUE |
|---|---|
| **Step Number** | 6.9.2 |
| **Organizational Role** | Head of Finance<br>Project officers |
| **Inputs** | Grant agreement |
| **Outputs** | Bank deposit slip<br>Incoming wire confirmation |
| **Integration Points** | Collaboration with donors, project officers, subgrantees |
| **Summary** | Grants, also referred to as awards (including subawards) or cooperative agreements, are arrangements whereby the organization has a contractual funding relationship in which a donor provides financial support in return for the delivery of specified program services by the organization or its subawardee. |

Organizations typically are required to perform the following actions to apply for and receive grants:

- Sign an agreement with the donor and agree to its specified terms
- Submit an itemized budget for approval by the donor
- Return unspent funds to the donor
- Submit formal financial reporting to the donor
- Comply with applicable donor regulations or requirements in administering the award

Grant revenue should be recorded in each month during which the organization incurs reasonable, allowable, and allocable expenses against the award. The steps that are typically followed are:

1. Grant funding received in advance should be recorded as a liability to the donor when received.
    a. Debit cash
    b. Credit grants payable

2. When reasonable, allowable expense is incurred.
    a. Debit expense
    b. Credit cash

CRS STAFF

In Laos, disability is still misunderstood and discrimination is common. CRS works with villagers to promote the acceptance and ensure that all children have an opportunity for education.

3. At least monthly, when expenses are incurred against the award, grant revenue should be recognized and the liability should be reduced.
    a. Debit grants payable
    b. Credit grant revenue

Each month, the Head of Finance should reconcile the total cash received from the donor with the revenue recorded against the grant and the outstanding liability to the grant's donor.

### STEP 6.9.3 – RECORD IN-KIND CONTRIBUTIONS

| STEP NAME | RECORD IN-KIND CONTRIBUTIONS |
|---|---|
| **Step Number** | 6.9.3 |
| **Organizational Role** | Head of Finance |
| **Inputs** | Donations<br>Documents to support the value assigned to the donation |
| **Outputs** | General journal voucher |
| **Integration Points** | Collaboration with donors, project officers, fundraisers, executive director |
| **Summary** | In-kind revenue is defined as the donation of goods or services by an organization that does not require any form of payment in return. |

Accounting for in-kind donations can be complex. The organization needs to fully understand the complexity and the appropriate accounting entries for recording in-kind donations in its general ledger. There is also a need to understand local laws, the donor's regulations, if applicable, and accepted accounting practices for undistributed commodities when revenue was already recorded by the donating agency.

1. In-kind donations received by an organization are typically valued and recorded in the general ledger as revenue. The valuation of the goods and services may be derived from the donor or the organization can conduct a market analysis to place a value on the item or services received.

2. When the valuation is complete for an unrestricted in-kind gift, the Finance department should record the following entry for the donation in the general ledger:
   a. Debit appropriate inventory/fixed asset/expense account
   b. Credit in-kind revenue

3. If an inventory account is debited when the goods are received, there must be a documented system for relief of inventory when the goods are removed from inventory for use by the organization or for distribution to beneficiaries. The accounting entry for relief of inventory items acquired via a non-grant source is as follows:
   a. Debit expense
   b. Credit inventory

4. For grant-funded projects, when goods are received the following entry should be recorded:
    a. Debit appropriate inventory/fixed asset/expense account
    b. Credit grant payable
5. For grant-funded projects, when inventoried goods are used or distributed, the entries needed are as follows:
    a. Debit expense
    b. Credit inventory
    c. Debit grant payable
    d. Credit grant revenue

# FINANCE BUSINESS PROCESS 6.10 – PAYROLL PROCESSING

## PROCESS DESCRIPTION

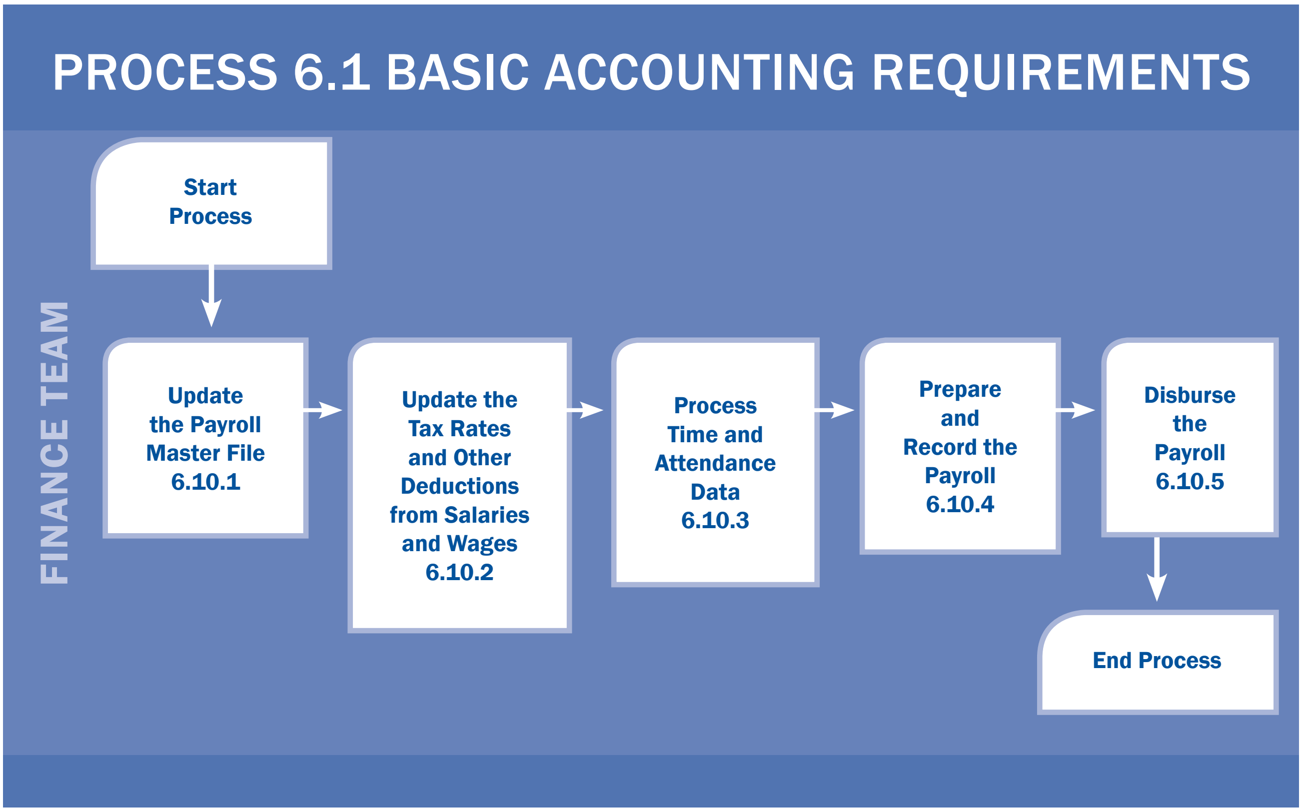
Payroll consists of all employee salaries, wages, bonuses, cash benefits, and deductions. The payroll function also includes the processing of all timesheets/effort-reporting documents. An employer must retain all records pertaining to payroll. Such records include salary and wage histories and all salary and wage deductions for the periods of time stipulated by statute and standard business practices.

The following are the main features of a payroll system:

- Master salary records are maintained for all employees showing the current rates of pay, allowances, and statutory and voluntary deductions.
- The Finance department prepares both the payroll and payslips or pay notices, using information received from the Human Resources department.
- Regular full-time employees should be paid by check or wire transfer.
- Temporary employees may be paid in cash upon approval by management.

The payroll function must be independent of the Human Resources function. Due to the sensitive and confidential nature of payroll, it must be administered with due care and diligence.

## PROCESS FLOW



### STEP 6.10.1 – UPDATE THE PAYROLL MASTER FILE

| STEP NAME | UPDATE THE PAYROLL MASTER FILE |
|---|---|
| **Step Number** | 6.10.1 |
| **Organizational Role** | Payroll accountant/clerk |
| **Inputs** | Personnel action form |
| **Outputs** | Updated payroll master file |
| **Integration Points** | Human Resources |
| **Summary** | The first activity in the payroll cycle involves updating the payroll master file in liaison with the Human Resources department to reflect various types of payroll changes. These include new hires, terminations, changes in employment status or pay rates, changes in discretionary or voluntary deductions, and changes in bank account numbers. |

The Finance department should note the following when updating payroll files:

- For each employee, a master salary record is maintained. This serves as a permanent record of the data to be included in the monthly payroll and is in addition to the personnel files maintained for all employees by the Human Resources department.
- Finance receives changes to permanent employee records from the Human Resources department using an approved master salary record amendment form, often called a personnel action form. Personnel action forms are issued for each change in employment status or in the employee's deductions.
- It is important that all payroll changes are entered in a timely manner and are reflected in the proper pay period.
- Every pay period, the payroll master file should be reconciled with the Human Resources department's personnel files for each employee.
- Finance should provide Human Resources a cut-off date for submission of salary adjustment notices to allow sufficient time for processing in the current payroll.

### STEP 6.10.2 – UPDATE THE TAX RATES AND OTHER DEDUCTIONS FROM SALARIES AND WAGES

| STEP NAME | UPDATE THE TAX RATES AND OTHER DEDUCTIONS FROM SALARIES AND WAGES |
|---|---|
| **Step Number** | 6.10.2 |
| **Organizational Role** | Payroll Accountant/clerk |
| **Inputs** | Tax notices<br>Personnel action forms<br>Human Resources (administration) memoranda |
| **Outputs** | Payroll register<br>Updated payroll master file |
| **Integration Points** | External – local revenue authority<br>Internal – Human Resources/administration department |
| **Summary** | The second activity in the payroll cycle is updating information about tax rates and other deductions. The Finance department makes these changes when it receives notification of changes in tax rates and other payroll deductions. |

Notices pertaining to salary and wage deductions come from external and internal sources. External notices pertaining to changes in tax rates usually come from local regulatory authorities. It is recommended that the organization seek a professional opinion on the application of payroll taxes. Notices pertaining to other deductions are generally received from the organization's Human Resources/administration department in the form of either personnel action forms (if directed to one or more specific employees) or official memoranda (if applicable to all employees or certain classes of employees). These inputs are used to update the payroll master file.

## STEP 6.10.3 – PROCESS TIME AND ATTENDANCE DATA

| STEP NAME | PROCESS TIME AND ATTENDANCE DATA |
|---|---|
| **Step Number** | 6.10.3 |
| **Organizational Role** | Payroll accountant/clerk |
| **Inputs** | Employee timesheets |
| **Outputs** | Labor distribution<br>Payroll register |
| **Integration Points** | Department or unit heads |
| **Summary** | The third step in the payroll cycle is to process each employee's time and attendance data. |

It is recommended that timesheet processing be conducted by the organization's Finance department. If the function is carried out by the organization's Human Resources department per local practice or regulatory requirements, the employee who performs the role should not engage in other payroll related tasks.

The organization should have a timekeeping system for tracking employees' salaries and wages charged to projects. Many grant donors require the use of individual timesheets to document employee time charged to their awards. This section has been developed under the premise that individual timesheets are required by the organization.

The following information, at a minimum, should be reported on the timesheet:

- Employee name (first and last names)
- Employee's identification number
- Assigned activities during the pay period (numerical codes may be used for this purpose)
- Hours worked each day
- Paid time off (for example, vacation or holidays)
- Signature of the employee
- Signature of the employee's supervisor
- Dates during which the reported activity was performed

Each employee should submit a timesheet for each pay period, using the organization's standard form. The timesheet should be submitted to the employee's immediate supervisor for approval and then routed by the supervisor to the employee who processes the timesheets. Timesheet preparation and submission process may either be manual or automated.

The timesheet should meet the following standards:

1. It must show an after-the-fact determination of the actual activity of the reporting employee.
2. All hours worked by the employee and all work-related activities in which the employee was engaged must be reported on the timesheet.
3. If the organization's practice is to submit timesheets manually, the timesheet must be prepared in ink and signed and dated by the reporting employee.
4. It must be prepared on a basis consistent with the employee's pay period, but not less than on a monthly basis. (See the example below.)

To allow time for timesheet and payroll processing, the timesheet reporting period for salaried employees should be cut off before the payroll period ends, since salaried employees are usually paid currently. Because the pay for hourly employees depends upon the hours they work, hourly employees are generally paid in arrears. Consequently, the timesheet cutoff dates for salaried and hourly employees may differ.

### EXAMPLE OF TIMESHEET CUT-OFF FOR SALARIED EMPLOYEES

In this example, the following is assumed:

- The salaried employees are paid monthly on the thirtieth day of the calendar month.
- The pay period is through the end of the calendar month.
- It takes five working days to process the timesheets and to prepare the payroll.
- Employees are regularly instructed to cut off their timesheets as of the twenty-third day of the calendar month.

In this case, the labor distribution (gross salary expenses charged to each cost center) for the timesheet period from October 24 to November 23 will be the basis for the monthly payroll for salaried employees for the month ending November 30. The gross salaries per the labor distribution for the reporting month ending November 23 must agree with the gross monthly payroll for the month ending November 30.

### STEP 6.10.4 – PREPARE AND RECORD THE PAYROLL

| STEP NAME | PREPARE AND RECORD THE PAYROLL |
|---|---|
| **Step Number** | 6.10.4 |
| **Organizational Role** | Payroll accountant/clerk |
| **Inputs** | Employee timesheets |
| **Outputs** | Payroll register<br>General journal entry |
| **Integration Points** | N/A |
| **Summary** | The fourth step in the payroll cycle is preparing payroll. Each payroll must be documented in a report known as the payroll register, which contains the names of the employees paid during the period and their pay rates, gross pay, payroll deductions, and net pay. |

Payroll is summarized for all employees as follows:

1. Salaries and wages expenses, the employer's portion of payroll taxes, and other benefits and allowances are totaled by cost center or other charge code.
2. The employee's net pay is summed by payment type (e.g., bank payments, cash, or checks).
3. Payroll deductions are calculated for subsequent remittance to the appropriate parties.

An accounting entry is then prepared for recording the salaries and wages. The distribution of salaries and wages expense to the organization's various departments and projects as shown on the accounting entry must agree with the distribution of time charges on the employees' timesheets.

To ensure accuracy, the gross pay for the current pay period should be reconciled with that for the previous period using a standard reconciliation form.

Upon completion, the payroll register, payroll summaries, payroll reconciliation form, and the accounting entry for the salaries and wages are then submitted to the appropriate level of management for approval.

The Finance department should record liabilities for amounts withheld and pay the amounts due per statutory deadlines.

### STEP 6.10.5 – DISBURSE THE PAYROLL

| STEP NAME | DISBURSE THE PAYROLL |
|---|---|
| **Step Number** | 6.10.5 |
| **Organizational Role** | Payroll accountant/clerk |
| **Inputs** | Approved documents |
| **Outputs** | Cash disbursement entries, paychecks/payments to employees and pertinent payees |
| **Integration Points** | Approval authorities, Accounts Payable clerk/accountant, cashier, employees |
| **Summary** | The final step in the payroll cycle is the disbursement of the net pay to the employees and payment of the amounts withheld to the appropriate parties. |

The payroll disbursement process entails the performance of the following tasks:

1. Once the payroll register, payroll summary, payroll reconciliation form, and the general journal entry for salaries and wages have been approved, those documents are then passed along to the designated employees for preparing payment to employees and the pertinent payees for salary deductions where applicable.
2. Cash disbursement vouchers are prepared to support the payment of salaries and the pay deductions.
    a. For those employees who are to be paid in cash, a check is issued to the cashier for encashment and payment.
    b. For those employees who are to be paid by check, individual checks are prepared in the names of the respective employees.
    c. If the organization does not have a commingled bank account, then it may be necessary to issue multiple checks to those employees whose salaries have been charged to more than one donor award.
    d. For those employers who are to be paid by bank transfer, a wire transfer request is prepared, approved, and submitted to the pertinent bank.
    e. An individual payment request is made for each type of payroll deduction that will require payment to an outside party.

- The checks and wire transfer requests, along with the respective cash disbursement vouchers, are then forwarded to the designated check signatory/voucher approver for signature.
- After the cash disbursement vouchers, checks, and the wire transfer

request (if applicable), have been signed, they are routed to the designated employee(s) and the payroll is disbursed as follows:

a. For employees paid in cash, the designated Finance employee, who receives a signed payslip form from each employee to acknowledge receipt of the pay, distributes the net payments.
b. For employees paid by check, for control purposes it is recommended that designated personnel other than the payroll preparer and the employees' immediate supervisors distribute payroll checks. The employees should sign to acknowledge receipt of their net pay.
c. For employees paid through bank transfers, an order is issued to the bank with pay summaries and the employees' personal bank account numbers.
d. In the event of absence of any employees who are paid in cash or by check, the undistributed amounts should be returned to the Finance department for retention in a safe until distribution takes place. For control purposes, the cash or checks should be returned to a designated employee other than the payroll clerk. Release of the cash or checks should be made directly to the employees upon presentation of the prescribed identification documents, not to the employees' supervisors.
e. For payments made in settlement of salary deductions (PAYE), checks are mailed/distributed or wire transfers are performed by the designated employee(s).
f. All employees should receive pay stubs with each pay. The pay stub should show the employee's gross pay, itemized payroll deductions, and net pay.
g. Given the confidential nature of payroll information, after the salaries and wages have been paid, the payroll register and all other supporting payroll documentation should be stored in a secured file, not with the related payroll voucher.

RICK D'ELIA FOR CRS

In Brazil, a woman prepares an order of shredded cassava for a hungry customer in the shop run by a local women's group.

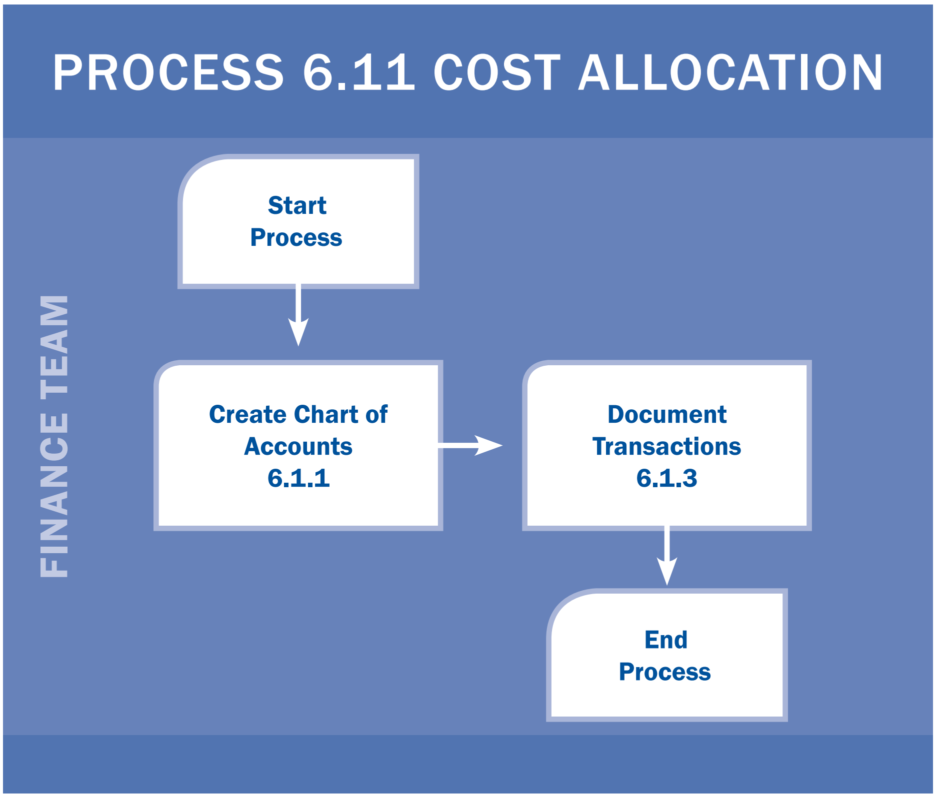
# FINANCE BUSINESS PROCESS 6.11 – COST ALLOCATION

## PROCESS DESCRIPTION

Shared costs are those expenses that are incurred for a common purpose but cannot be assigned directly to any particular project, donor, department, product, or segment of the business. Cost allocation is the process of distributing shared costs to the appropriate projects. Assigning expenses to projects in a consistent fashion provides management with the total cost of each project being implemented. For this information to be useful, management needs to have costs charged to projects using a methodology that is consistent and rational. The cost allocation methodology covered in this section will focus on allocating cost in the context of project management.

The objective of cost allocation is to charge expenses to projects based on the benefit that each project receives from the expense incurred. Using a documented systematic method to allocate shared costs ensures that each donor covers its “fair share” of allocable expenses. Allocating shared costs also helps to improve project management and resource stewardship through a fair and reasonable distribution of allocable operational costs across all funding sources.

## PROCESS FLOW



### STEP 6.11.1 – DEFINE AND DEVELOP COST ALLOCATION METHODOLOGY

| STEP NAME | DEFINE AND DEVELOP COST ALLOCATION METHODOLOGY |
|---|---|
| **Step Number** | 6.11.1 |
| **Organizational Role** | Finance<br>Management<br>Programming |
| **Inputs** | Define cost drivers |
| **Outputs** | Documented cost allocation methodology |
| **Integration Points** | Administration<br>Grant management |
| **Summary** | An effective cost allocation system will enable the organization to more accurately budget program needs. It will aid in compliance with donors' policies, procedures, and regulations and assist in maintaining a consistent, reasonable, and reliable accounting system. |

There is no hard and fast rule for allocating shared costs to projects. Logic should be applied and the criteria chosen should be justifiable. The best cost drivers are those that can closely link the cost incurred to the benefit a project receives. For example, in allocating support staff salaries to projects, the number of employees working in each project might be used. For apportioning the cost of office rent, the office space occupied by the project staff assigned to each project is a reasonable allocation factor. Whatever method is chosen, it must be fair and justified, and once established it should be applied consistently.

The following steps are essential in implementing a cost allocation methodology:

1. Define Cost Drivers: The "fair share" is normally calculated by defining the cost driver.  A cost driver is any activity that causes a cost to be incurred. This will vary based on the types of costs being incurred. Cost drivers have a direct cause and effect impact upon a cost. The following are examples of cost drivers:
    - Direct labor and/or machine hours
    - Beds occupied
    - Number of organization employees working on a project
    - Number of cost centers

- Amount of spending on a project
- Project staff costs
- Amount of space used by a department
- Number of beneficiaries in each project
- Actual consumption, e.g., kilometers traveled or photocopies made

2. Determine which costs the organization considers to be common costs that should be allocated using a cost allocation methodology. Some examples of common costs that normally benefit multiple projects are utility bills, office supplies, office rent, and administrative staff salaries.
3. Set up an auditable system to determine shared costs and how to account for them.
4. Develop a written policy that incorporates the allocation concepts.
5. Use the cost allocation methods described in the policy consistently throughout the year.
6. Base the cost allocation formulas on current actual data. Cost allocation formulas should be updated monthly to ensure that charges allocated to each project accurately reflect what happened for the month.

### STEP 6.11.2 –PROCESSING OF COST ALLOCATION FOR POOLED COSTS

| STEP NAME | PROCESSING COST ALLOCATION FOR POOLED COSTS |
|---|---|
| **Step Number** | 6.11.2 |
| **Organizational Role** | Finance<br>Management<br>Programming |
| **Inputs** | Create pools<br>Collect cost driver information<br>Allocate costs |
| **Outputs** | Projects receive fair portion of shared costs |
| **Integration Points** | Administration<br>Fleet management |
| **Summary** | While allocation ratios can be applied at the transaction level, it is highly recommended the organization use the pooling method and allocate the shared cost at the end of an accounting period. Under the pooling method, all applicable expenses are charged to one or more cost centers at the time they are initially processed. |

1. Finance sets up predetermined allocation pools in financial system.
2. Costs that benefit all projects are consistently charged to the appropriate pool throughout the month.
3. Finance collects cost driver information from the responsible staff/ departments at month's end.
4. At the end of the month, the pooled cost is allocated to different projects/departments using predetermined criteria.
5. The Head of Finance should ensure that all pooled expenses are allocated, leaving each pool's balance at zero at the end of each month.

**Allocation of vehicle expenses**

The most logical cost driver for vehicle expenses is the distance driven to administer each project or non-support department in a given period. Using this methodology, vehicle logs must be maintained to capture distances driven for each project/non-support department. The distance driven should be summarized at the end of a reporting period by project/non-support department. The ratio of each project/non-support department's distance driven to the total distance driven will be the basis for allocating vehicle expenses.

Distances driven for general support purposes and those that are not associated with one or more specific projects should be excluded from the total kilometers driven. If the organization allows employees to use its vehicles for personal purposes, those kilometers should also be excluded from the total kilometers driven and the employees should be billed for the use of the vehicles at the prescribed rate. Billings for personal use of vehicles should be recorded before the monthly vehicle expense allocation takes place.

Example: Organization X records all of its petrol, insurance, and vehicle maintenance costs in a given month to its vehicle pool, which totals $4,203. The following consolidated kilometer totals are pulled from the vehicle logs:

| PROJECT | KILOMETERS DRIVEN |
|---|---|
| **Project 1** | 1,856 |
| **Project 2** | 678 |
| **Project 3** | 2,789 |
| **Project 4** | 953 |
| **Total** | 6,276 |

This means the cost per kilometer is $0.67 ($4,203 ÷ 6,276 kilometers). Based on this calculation, each project would be charged the following fair share and the pool would zero balance after the allocation was processed:

| PROJECT | ALLOCATION | CALCULATION |
|---|---|---|
| **Project 1** | $1,243 | 1,856 x $.67 |
| **Project 2** | 454 | 678 x $.67 |
| **Project 3** | 1,868 | 2,789 x $.67 |
| **Project 4** | 638 | 953 x $.67 |
| **Total** | $4,203 | |

**Allocation of Support Costs**

Several cost drivers could be used; this section provides examples of two methods. It is the responsibility of the organization to choose the most appropriate driver for its programming portfolio so that the allocation is a fair and reasonable calculation and aligns with the support received.

**Scenario 1: Using Beneficiary Counts**

Organization Y provides medical services; each project serves a targeted group of beneficiaries. Using beneficiary numbers as the cost driver, the organization calculates total number of beneficiaries for each project during the month and its percentage of the total beneficiaries served by all projects. The month's total support cost (for Finance staff, information technology costs, etc.) of $14,789 is multiplied by the beneficiary calculation.

| PROJECT | NO. OF BENEFICIARIES | % OF TOTAL BENEFICIARIES |
|---|---|---|
| **Project 1** | 478 | 11% |
| **Project 2** | 1,267 | 28% |
| **Project 3** | 2,567 | 56% |
| **Project 4** | 234 | 5% |
| **Total** | 4,546 | 100% |

Based on this calculation, each project is charged its fair share and the pool zero balances after the allocation is processed, as follows:

| PROJECT | ALLOCATION | CALCULATION |
|---|---|---|
| **Project 1** | $1,627 | $14,789 x 11% |
| **Project 2** | 4,141 | $14,789 x 28% |
| **Project 3** | 8,282 | $14,789 x 56% |
| **Project 4** | 739 | $14,789 x 5% |
| **Total** | $14,789 | |

**Scenario 2: Using Direct Expenses**

Organization Z implements justice and peace programming and has decided that each project's monthly direct expenses are what drive its support costs. Using direct expenses as the cost driver, the organization calculates the total direct expenses, net of exclusions,[1] for each project at month's end. The direct expenses at month's end for each project are divided by the total expenses for all projects to calculate the fair portion of support costs to be applied to the project.

1 If this method is chosen, the organization should determine what types of expenses, if any, should regularly be excluded from direct expenses when allocating support costs. The types of expenses that the organization decides to exclude should be listed in the organization's cost allocation policy.

Organization Z records all of the support costs that benefit all projects in the support cost pool during and at the end of the month for a total of $11,231. The following direct costs were charged to each project during the month:

| PROJECT | DIRECT COSTS FOR THE MONTH | % OF TOTAL DIRECT COST |
|---|---|---|
| **Project 1** | $22,789 | 46% |
| **Project 2** | 18,750 | 38% |
| **Project 3** | 7,678 | 16% |
| **Total** | $49,217 | 100% |

Each project takes its fair share of that month's support costs by multiplying the total support costs by the project's percentage of total direct costs. Based on this calculation, each project is charged its fair share and the pool zero balances after the allocation is processed, as follows:

| PROJECT | ALLOCATION | CALCULATION |
|---|---|---|
| **Project 1** | $5,166 | $11,231 x 46% |
| **Project 2** | 4,268 | $11,231 x 38% |
| **Project 3** | 1,797 | $11,231 x 16% |
| **Total** | $11,231 | |

**Allocating Occupancy Expenses**

The most logical cost driver for allocating occupancy expenses (e.g., office rent, electricity, water, etc.) is the office space occupied by the staff assigned to each project. Using this methodology, the organization must measure the total office space and calculate the square meters of common areas,[2] office space occupied by support staff, and office space assigned to projects. Common area space and that used by support staff should be deducted from the total office space measurement (referred to a revised base).

Each project's benefit is calculated by dividing the space used by the project by the revised base. The resulting percentage should then be applied to the total monthly occupancy expenses, including rent, electricity, water, maintenance, and security.

2 Unassigned space such as walkways, bathrooms, reception area, and general storage space

One benefit derived from using the floor space method is that it enables the organization to calculate the cost per square meter of the organization, which will help in the budgeting process. One drawback of using the floor space method is that some space may be used for more than just one project, which complicates the calculations. Depending on the method chosen, allocation of shared costs will require frequent updating as new project funds are initiated, projects are closed, and new employees are hired. The updates to the allocation computations should be carried out, at a minimum, quarterly.

Example: Organization X records all of its facilities expenses (rent, utilities, office security, etc.) in a given month to its facilities pool, which totals $14,603. The office measurements are:

| OFFICE MEASUREMENTS | |
|---|---|
| **AREA DESCRIPTION** | **OFFICE SPACE SIZE – SQUARE METERS** |
| **Common Space** | 18 |
| **Support Staff Space** | 9 |
| **Project 1** | 6 |
| **Project 2** | 12 |
| **Project 3** | 22 |
| **Total** | 67 |

The organization then calculates the revised base by excluding the common space and that used by support staff (those staff not charged directly to a project):

| AREA DESCRIPTION | OFFICE SPACE SIZE – SQUARE METERS | % OF TOTAL REVISED BASE |
|---|---|---|
| **Project 1** | 6 | 15% |
| **Project 2** | 12 | 30% |
| **Project 3** | 22 | 55% |
| **Total** | 40 | 100% |

Each project is assigned its fair share of that month's facilities costs by multiplying the total support costs by the percentage facilities revised base allocation. Based on this calculation, each project is charged the following fair share, with the pool zero balanced after the allocation is processed:

| AREA DESCRIPTION | ALLOCATION | CALCULATION |
|---|---|---|
| **Project 1** | $2,190 | $14,603 x 15% |
| **Project 2** | $4,381 | $14,603 x 30% |
| **Project 3** | $8,032 | $14,603 x 55% |
| **Total** | $14,603 | |

**Budgeting for Cost Allocation**

Allocated costs should be included in the organization's annual budgets. Estimates of the total annual costs should be developed for each of the pools for the upcoming year. The actual pooled costs for the preceding 12-month period may be used as the starting point for the estimate, adjusted for projected inflationary increases. Other factors that could affect the cost pools or the allocation of the pooled costs should also be taken into consideration. These factors may include changes in the organization's size, structure, project mix, or funding. Estimates for allocated costs should also be included in all grant budgets when proposals are submitted to donors.

# FINANCE BUSINESS PROCESS 6.12 – GRANT ACCOUNTING

## PROCESS DESCRIPTION

Grant accounting entails reviewing and complying with the terms and conditions stipulated in a grant agreement and recording of the revenue and expenses in an organization's general ledger. Grants, also referred to as awards (including subawards) or cooperative agreements, are arrangements whereby the organization has a contractual funding relationship in which a donor provides financial support in return for the delivery of specified program service by the organization or its subawardee. This section covers major finance-related functions for grants; it does not cover the broader spectrum of grants management that includes programmatic oversight.

## PROCESS FLOW

### STEP 6.12.1 – GRANT ACCOUNTING

| STEP NAME | GRANT ACCOUNTING |
|---|---|
| **Step Number** | 6.12.1 |
| **Organizational Role** | Project officer<br>Head of Finance |
| **Inputs** | Grant proposal<br>Grant agreement<br>Itemized budget and budget narrative |
| **Outputs** | Financial reporting |
| **Integration Points** | Collaboration with project officer and Head of Finance |
| **Summary** | Grant accounting is defined as a system of financial recording, monitoring, and reporting on the use of resources awarded to an organization from a donor agency. |

**1. The Proposal**

An organization will be required to submit an itemized budget and a budget narrative/justification to support the activities described in the grant application.

**2. Approval/Agreement**

A donor will issue a notification letter to its awardee if it approves the funding application. The notification letter serves as approval to withdraw/request funding from the donor. In some cases, the donor will issue an agreement, requiring the grantee to sign it as evidence of acceptance of the terms and conditions of the award.

An organization's Finance department must familiarize itself with the financial terms and conditions of the agreement, including the treatment of interest, program income, reporting requirements, report formats, and the expected frequency for submitting financial reports.

Copies of the initial agreement and all subsequent modifications to the agreement should be kept in the Finance department.

Where donor funds are subgranted, the terms and conditions listed in the agreement, including reporting requirements, must be cascaded to the lowest level recipient.

### 3. Implementation

Grant funds drawn down in advance by the donor must be recorded as a liability in the general ledger.

Grant revenue should be recorded in each month in which the organization incurs reasonable, allowable, and allocable expenses against the award. The revenue recorded will reduce the grant liability created during the cash drawdown process.

Grant funded expenses should be recorded to the organization's general ledger. Each transaction must be reviewed to ensure that it meets the criteria set forth in the donor's regulations. All expenses must be reasonable, and allowable, and adequately documented.

If the organization subgrants to other partners, subrecipient awards will be issued to partners. Once executed, copies of the subrecipient award documents, including any modifications, must be filed in the organization's Finance department. The organization should make the appropriate entry in the general ledger to track and monitor advances issued and expenses liquidated as follows:

- When an advance is issued to a subrecipient the following entry will be recorded on a cash disbursement voucher:
  - Debit subrecipient advance account (receivable)
  - Credit cash account
- When a subrecipient submits a liquidation report for the expenses it has charged against the project and the documentation has been reviewed and verified by the Finance department, the Finance department will record the following entry on a general journal voucher:
  - Debit expense account
  - Credit subrecipient advance account

### 4. Reporting

According to the terms of the agreement with the donor, reporting requirements will be specified in the grant agreement. The organization may be required to report monthly, quarterly, semi-annually or annually and must ensure that it captures its spending and that of its subawardees.

### 5. Grant Financial Closure

The grant agreement and regulations governing the donor award will stipulate the closure requirements. At a minimum an organization will be required to perform the following tasks during a grant financial closeout process:

DAVID SNYDER/CRS

The CRS peace building team conducts a training on conflict resolution for traditional leaders in the war torn community of Tumbulo, near Cubal, Angola.

a. Review and ensure that all expenses charged to the award are allowable expenses incurred within the grant-funding period. Any costs determined to be unallowable should be reclassified before closing a grant.
b. The Head of Finance should determine if there are valid expenses incurred but not yet paid as of the grant's expiration date. If so, an expense accrual should be recorded in the general ledger on a general journal voucher with appropriate supporting documentation. The accountant will record a debit to the appropriate expense account and a credit to the accrued liability account. When the payment is made, a reversal to the accrued liability account will be recorded as a debit to accrued liability and a credit to the cash account.
c. Reconcile the general ledger with the fixed assets register and request for disposition of any fixed assets procured using grant funds.
d. Ensure that total spending charged to the grant funds in the general ledger does not exceed the total donor-obligated amount.
e. Clear all outstanding balance sheet items from the grant's cost center in the general ledger.
f. Return any unused funds to the donor.
g. Submit a final financial report to the donor.

**6. Grant Specific Audits**

Certain grant donors may require external audits of all activities and asset balances associated with their awards. This requirement is intended to provide assurance that their funds were properly safeguarded and all charges against their awards were in accordance with the terms and conditions of their grant agreements and in compliance with the applicable regulations.

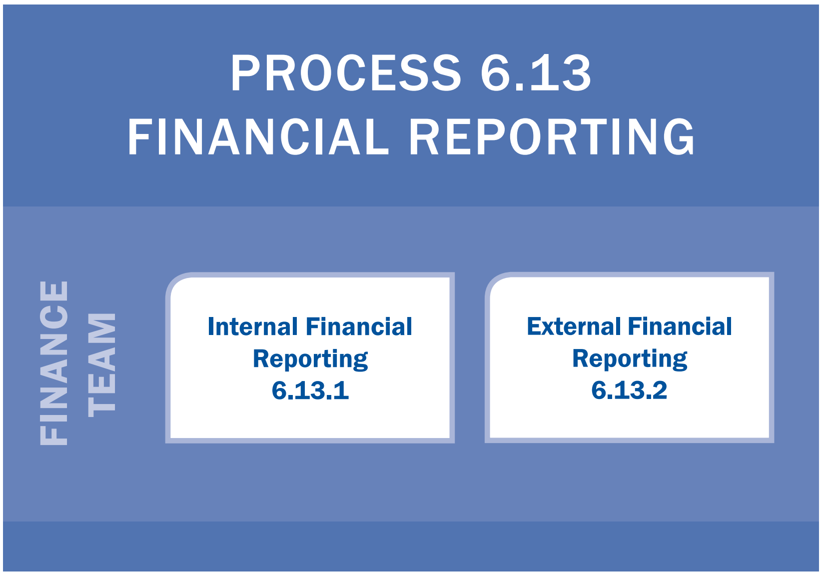
As a result of a grant-specific audit some expenses charged to the grant might be questioned or disallowed. Disallowed costs should be reclassified from grant expenses and the amount disallowed should be refunded to the grant donor. Questioned costs should be resolved to the satisfaction of the auditor. Any questioned costs that cannot be resolved to the auditor's satisfaction should be reclassified from the grant and returned to the donor.

# FINANCE BUSINESS PROCESS 6.13 – FINANCIAL REPORTING

## PROCESS DESCRIPTION

The purpose of a management reporting system is to consolidate financial information so that the organization's financial condition and activities can be monitored on a regular basis by management and other interested parties. This is achieved by the preparation of work plans and budgets that specify desired targets, results, and costs prior to the start of each fiscal year. During the year, financial reports enable management to assess the organization's progress against its planned objectives.

## PROCESS FLOW



### STEP 6.13.1 – INTERNAL FINANCIAL REPORTING

| STEP NAME | INTERNAL FINANCIAL REPORTING |
|---|---|
| **Step Number** | 6.13.1 |
| **Organizational Role** | Finance department<br>Management |
| **Inputs** | Financial results |
| **Outputs** | Financial statements<br>Trial balances<br>Budget comparison reports<br>Cash flow statements |
| **Integration Points** | Board of directors<br>Management<br>Programming staff |
| **Summary** | The Finance department must provide management with consolidated financial information so that the organization's financial condition and activities can be monitored on a regular basis. |

Financial reports should be prepared under the direction of the organization's chief financial officer. Prior to their distribution, all reports should be reviewed by the chief financial officer or equivalent. It is strongly recommended that the organization create a finance committee to review financial reports and to incorporate the reported results into the organization's decision-making processes. Descriptions of the trial balance, statement of activities, statement of position, and the cash flow statement appear in the glossary in this chapter's Appendix.

The following reports should be prepared monthly or quarterly as indicated and distributed to all members of the organization's executive management team and to the appropriate managers:

1. Trial Balance (monthly)
2. Statement of Activities – Income statement (monthly)
    a. Format 1 – Compares actual revenues and expenses for the month and year-to-date against the budgeted revenues and expenses for the comparable periods. This is essential.
    b. Format 2 – Compares actual revenues and expenses for the month and year-to-date against the prior year's actual expenses for the comparable periods. This is optional but recommended.

3. Budget Comparison Reports (monthly)
   a. Compares the actual expenses for each cost center (department and project) for the month and year-to-date by expense line item against the budgeted amounts for the same periods.
   b. A separate report should be prepared for each cost center.
4. Statement of Position – Balance sheet (monthly)
5. Memorandum explaining major variances between actual results and budgeted performance for the month and year-to-date (monthly)
6. Cash Flow Statement (at least quarterly and reviewed by executive management team members only)
7. Inception-to-date budget comparison reports for all grant-funded projects (at least quarterly)
   a. Provided to all related project managers, their immediate supervisors, and the head of programming operations.
   b. These reports should compare the cumulative actual expenses for each grant funded project against the comparable totals per the organization's amended internal budgets and the life-of-project totals approved by the donor in the related grant budget.
8. Any customized reports deemed relevant by the organization's chief financial officer, or equivalent, and the executive director.
9. Balance sheet accounts should be reconciled monthly. The analyses should be reviewed by the Head of Finance and retained on file. Each analysis should show the specific components of the account and the total for each analysis should agree with the ending general ledger balance for that account. Misclassifications and other posting errors that surface during the reconciliation process should be corrected immediately.

### STEP 6.13.2 – EXTERNAL FINANCIAL REPORTING

| STEP NAME | EXTERNAL FINANCIAL REPORTING |
|---|---|
| **Step Number** | 6.13.2 |
| **Organizational Role** | Finance department<br>Management |
| **Inputs** | Financial results |
| **Outputs** | Financial statements<br>Trial balance<br>Budget comparison reports<br>Cash flow statement |
| **Integration Points** | Banks, donors, government, prime recipients, and vendors |
| **Summary** | The organization's Finance department must provide external parties with consolidated financial information so that activities can be monitored on a regular basis. |

External Reporting includes financial reports required by donors, the local government, banks, vendors, and prime recipients of grants. Reports required by external parties frequently include the organization's most recent audited financial statements, consisting of the following reports and the accompanying notes:

- Statement of activities (income statement)
- Statement of position (balance sheet)
- Cash flow statement

Standard practice for year-end reporting is to include the audited financial statements for the previous fiscal year. Any significant changes in accounting methods between the two years should be included in the footnotes to the financial statements.

Other reports required by donors are usually grant- or project-specific. Reports to grant donors should be submitted in accordance with the reporting deadlines and formats specified in the grant agreements and/or the donors' regulations. Grant reporting requirements may also include the following:

- Statement of cash receipts and payments reflecting all receipts, payments, and cash balances pertaining to the donor's award
- A copy of the organization's accounting policies
- Management's assertion that the funds provided by the grant donor have

been expended in accordance with the intended purposes as specified in the relevant agreement

All financial reports submitted to external parties must be prepared by the Finance department and must agree with the financial results recorded in the general ledger for the reported period. Reports to the local government should be prepared and submitted in accordance with local statutory requirements.

# COMPLIANCE CHECKLIST FOR FINANCE

Finance is a discipline charged with responsibilities to determine value and aid decision-making about allocation and use of resources. In the commercial world the finance function has the responsibilities of acquiring, allocating, investing, and managing financial resources. The Finance function goes beyond recordkeeping; it brings together other functions, as the activities carried in the other functions have financial implications. The emphasis in the nongovernmental sector, beyond accurate recording, is on stewardship. The notion of stewardship manifests itself in concepts such as corporate governance and accountability.

Financial and physical resources are the tangible assets of the organization. Partners have a responsibility to exercise good stewardship of the resources—accomplishing programmatic objectives in a cost efficient manner, ensuring that there are effective internal control systems, and maximizing the benefits derived from use of those assets.

Financial management entails planning, organizing, controlling, and monitoring the financial resources of an organization to achieve its objectives. It should not be left to Finance staff alone.

**Accounting and Auditing**

*Accountancy* involves the writing-up of books of accounts and preparation of financial statements based on principles laid down by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). Bookkeeping and accounting creates accounting records. *Auditing* refers to the independent checking of accounts and statements. It verifies records created by others. Audits are required to provide evidence that financial reports do not contain errors, do not hide frauds, are not misleading, do not fail to disclose relevant information, and do not fail to conform to regulations. The auditors will express an opinion on the financial statements, and they also produce detailed management reports on internal controls.

The principal characteristics of financial reports are the following:

- Understandability
- Reliability
- Relevancy
- Comparability

### Users of Financial Reports

For each organization, there are various stakeholders who rely upon the organization's financial statements and other financial reports. Such stakeholders include the following parties:

- Employees
- Customers
- Suppliers/vendors
- Local and international governmental agencies
- Donors, whether providers of unrestricted or restricted funds or grants

Financial accounting in the not-for-profit sector differs somewhat from accounting in the for-profit sector, but there are fundamental accounting concepts that remain the same.

### Accounting Concepts

Financial records should be maintained in accordance with the following fundamental accounting concepts:

- Going Concern – Management expects the organization to continue to run in the same way and to remain in operation for the foreseeable future.
- Consistency – Accounting policies, once adopted, should be applied consistently from one accounting period to the next.
- Prudence – Revenues should not be booked until they have been realized, but expenses should be recorded and liabilities recognized as soon as possible.
- Accrual Basis – Under this accounting method, revenue is recognized when earned and expenses are recorded when incurred. All income and expenses relating to the accounting period are taken into account, irrespective of the actual date of receipt or payment. (Those small not-for-profit organizations that operate on a cash basis should refer to ***Step 6.3.6 – Operating in a Cash Environment*** for detailed guidance.)

### Objectives of Financial Reviews

Financial reviews are carried out to ensure that resources are used for authorized purposes in compliance with the laws, regulations, and provisions of the contracts or grant agreements and those performance goals are achieved. Compliance reviewers should obtain an understanding of the organization's policies and procedures and consider whether or not they are appropriate for the project activities as well as assess consistency with generally accepted accounting practices.

In most organizations, the Finance department is the custodian of internal control assessment and risk assessment. Such responsibilities go beyond the mandate of finance. In the absence of an internal audit department or a compliance unit, Finance is tasked with review of other function's manuals.

The organization manuals including finance and accounting manuals will vary, ranging from summaries to detailed and extensive manuals. The organization should have a comprehensive operations manual or separate manuals for each functional area.

Compliance reviews should be mandated by senior management. Approval of terms of reference and the review program should be received ahead of review.

**Finance Compliance Review Steps**

To have a better understanding of the organization's setup the following preliminary actions are essential:

- Review partner registration documents
- Review award agreements and amendments
- Inquiries of management and others within the organization
- Review external audit reports
- Review internal audit reports
- Review special project audits
- Review the Finance/Accounting manual
- Review contracts
- Review the general correspondence file
- Review project files
- Obtain the organizational chart. If one does not exist, document description of organizational set-up
- Obtain a copy of the organization's authorization chart
- Obtain chart of accounts
- Determine whether or not accounts are computerized
- Determine who prepares the accounts. Are there sub offices and decentralization? Are there project accountants?
- Receive sample copies of reporting formats, both financial and narrative
- Review income and expenditure reports, comparing levels of income and expenditure with prior period reports
- Verify reporting formats are in compliance with approved formats

- Obtain explanations for significant expenditure variances from budget line by line and by cost category

**Compliance Checklists**

Under this section the audit approach includes stating the control objectives where applicable and asking relevant questions to test risk assessment and compliance with policies and procedures. The checklists will ensure that there is an effective internal control system over the financial system to enable the organization to manage significant risks and monitor the reliability and integrity of financial and operating information. The checklists help identify gaps in the internal controls.

There should be a Finance manual that covers the following:

- Purpose and scope of manual
- Intended audience – who should use and how
- Procedures and authority for updates
- Financial calendar and internal reporting
- Fiscal year for the organization
- Fiscal periods
- Reporting periods and deadlines
- Reporting periods to headquarters – monthly, quarterly, and annual financial reports
- Cash and banking
- Budgeting
- Cash flow management
- Asset management
- Payroll
- Reporting

**Control Objectives**

- To ensure that the Finance department is managed in an orderly and efficient manner and supports partner operations
- To ensure adherence to management policies
- To safeguard assets
- To secure the accuracy and reliability of records

### Segregation of Duties

Segregation of duties is a key component of an effective internal control system. ***No one person should be responsible for recording and processing a complete transaction.*** Every financial transaction involves the following five steps:

- Request – request to purchase/spend
- Approval – authorized personnel approve request
- Authorization – approval to purchase, issuance of purchase order
- Execution – purchasing, receiving, and payment
- Recording – accounting

### Questions for Segregation of Duties

- Is the there an organigram for the department?
- Are the senior members of the team qualified accountants?
- Do Finance staff members have job descriptions?
- Are job descriptions updated?
- Are staff roles clear?
- Are staff roles meaningful?
- Are the job descriptions current and relevant?
- Do Finance staff members have copies of the authorization matrix?
- Do different employees prepare, approve, and post the accounting journal entries?

### Basic Accounting Requirements

The organization should keep a complete set of accounting records. At a minimum, the accounting records should include the following:

- A general ledger that is all-inclusive. There should not be separate ledgers for separate donors. All activity for the organization should be included in one general ledger, unless the partner has multiple legal entities, in which case a separate general ledger should be used for each legal entity.
- A cash receipts journal
- A cash disbursements journal
- If cash (currency) is received, a cashbook for recording cash received and expended (the cashbook should show a balance at the end of each business day that agrees to the actual cash-on-hand.)
- Detailed account analyses of the organization’s assets and liabilities that agree to the respective general ledger balances at the end of each accounting period.

Account codes identify the nature of the items affected by transactions. General ledger accounts are usually grouped into the following major categories:

- Assets
- Liabilities
- Net Assets (formerly known as Fund Balances)
- Revenues
- Expenses

**Questions for Basic Accounting**

- Is there a chart of accounts/ledger listing?
- How are the different ledger accounts identified?
- Are the ledger accounts fully described?
- Does the chart of accounts match the accounting package accounting structure?
- Is the chart of accounts capable of tracking income and expenses by source of funding/donor?
- Who has the authority to update the chart of accounts (to add and delete leader accounts)?
- If there is an accounting package, is there a manual?
- Is there a cashbook?
- Who writes the cashbook?
- Are cashbook entries reviewed before posting to the accounting system?
- Is there a monthly review of the trial balanced and balance sheet?
- Is there a review of the statement of activities (Income Statement)?
- Is there a review of the budget comparison reports for all cost centers (department and project)?
- How are the expenditure vouchers filed?
- Is there a filing system for the vouchers?
- Can all vouchers be accounted for?
- Is there adequate security over vouches and other accounting records?
- Is there a security items register for checkbooks, purchase orders, invoices?
- Is there a system to ensure that payment vouchers are completed properly (requested, approved, authorized, and checked) before payment?
- Are receipts completed in full (dated, signed by payee and recipient, with amount shown in words and figures, and a reason for payment given)?

SR. ANN DUGGAN/CRS

Healthcare workers at Kenya's Kendu Adventist Hospital, in the city of Morcau.

- Are the receipts recorded properly with necessary information from the receipt voucher matching that in the entry in the ledger?
- Does the organization maintain a general ledger?
- Does the organization use a numbering system to account for all of its cash receipts, cash disbursements, general journal entries, purchase orders, goods receiving notes, waybills, etc.?

**Bank Accounts and Disbursements**

Wherever possible, organizations should establish and use bank accounts for the receipt and disbursement of funds. Bank accounts provide far more control over the flow of cash than the use of cash-on-hand funds. Nevertheless, it is important that the organization establish and enforce firm controls over setting up bank accounts, access to cash-in-bank funds, and disbursements.

**Control Objectives**

- To prevent unauthorized payments being made from the bank accounts
- To ensure all checks and cash received are banked intact
- To ensure that checks and cash received are banked without delay at prescribed intervals
- To ensure that all checks and cash received are accounted for

**Questions Regarding Bank Accounts and Disbursements**

- Is there a policy on opening bank accounts?
- Who approves opening and closing of bank accounts?
- Does the check register/cashbook/ledger show any unusual items (for example, unusually large payments, transfers between bank accounts, or payments to unusual suppliers)?
- Is there an approved list of bank signatories on file?
- Is there a policy on the number of signatures for each check, such as one signature for payments below $5,000 and two or more signatures for amounts above $5,000?
- Are there clearly outlined procedures on supporting documentation for payments?
- Are major payments, especially procurement, supported by the following?
    - Payment voucher (fully completed)
    - Supplier invoice (original)
    - Copy of contracts
    - Bid summary/bidding sheet

    - Local purchase order, duly authorized and approved
    - Pro-forma invoices or quotations
    - Goods-received note
    - Supplier advice note
    - Purchase requisitions
    - Other attachments
- Are all checks pre-printed as crossed payee only?
- If not, is the explanation for this reasonable?
- Are the blank spaces on checks crossed out to prevent alteration?
- Is the payee always written in full?
- Are blank checks ever signed by either of the signatories?
- Are checkbooks held in a secure location, e.g., in a safe?
- Are they recorded in a security items register and signed when issued?
- Are all canceled checks retained and filed/kept?
- Are check numbers verified to ensure that all checks have been registered in the check register and that canceled checks have been appropriately marked and held for verification?
- Are all expenditures documented on a sequentially numbered check voucher?
- Are they pre-printed?
- Are paid vouchers and the related supporting documents such as supplier invoice, purchase order, goods-received note, and all attachments stamped as "RECEIVED" and/or "PAID"?
- Does the check voucher contain the following standard information?
    - Check/voucher number
    - Nature/date/amount of the expense
    - Payee's name
    - Bank transfer details
    - Approving and authorizing signatures
    - Check number
    - Accounting codes
    - Name and signature of the authorized representative who received the payment

- Do all checks and check vouchers presented to the authorizing signatory have the required supporting documentation?
- Are check vouchers approved for payment by the Finance officer/ manager prior to preparation of the checks for payment?
- Is there adequate segregation of duties between the person who prepared the check payment and the person who authorized/signed the check?
- Is a check performed of the vouchers to ensure that all have been registered in the cashbook?

**Questions for Payments/Transfers to Partners**

- Who is authorized to request transfers to projects?
- Who approves the transfers?
- How are the transfers sent? Are checks or cash hand carried by staff or are they sent by bank transfer?
- If hand carried, what checks are in place to ensure that the funds arrive safely?
- Do transfers comply with insurance conditions?

**Petty Cash**

The purpose of setting up a petty cash fund is to allow access to cash on demand for small payments. It is the responsibility of the organization's management to set the maximum petty cash balance, establish a limit of individual disbursement from the petty cash, and designate a petty cash custodian. Petty cash should be maintained on an imprest basis. The recommended level of the petty cash fund should range from two weeks' to one month's cash needs.

**Questions for Petty Cash**

- Is there a petty cash policy? Does the policies and procedures manual outline the imprest amount?
- Is there a designated custodian? Is the custodian trained to handle the petty cash?
- Is the petty cash fund kept in a locked safe with access limited to the custodian?
- Are petty cash records written up daily?
- Does a supervisor regularly review the records?
- Do the policies and procedures specify a maximum payment amount from petty cash?

- Are amounts above the limit paid by check?
- Are all payments accounted for? Are payments entered in the petty cash record in numerical sequence of petty cash vouchers?
- Does each voucher have following included?
  - Nature, date, amount of the expense
  - Claimant's name
  - Authorized signature
  - Claimant's signature on receipt of cash
  - Sequential number, if applicable
  - Approval of voucher additions
- Is each voucher supported by receipt, invoice, or other documentation?
- Are there IOUs held in petty cash? All such transactions should go through the proper channels.
- Are there procedures for petty cash handovers (e.g., when the keys are passed from the accountant to the cashier)?
- Is a petty cash count carried out during handovers?
- Do both officers sign and date the cash count sheet to confirm the count?
- Are receipts issued for cash received?
- Is the receipt/cash receipt voucher signed by the cashier as "RECEIVED"?
- Is the payee/staff signing on the receipt/cash receipt voucher?
- Is the receipt/cash receipt voucher approved?
- Is proper coding for cost center, account, activity, etc., entered on the voucher?
- Is there insurance coverage for cash held in office and cash in transit?
- Does the amount held in the safe conform to the cash limits in the cash insurance policy?
- Does the method of cash storage conform to insurance requirements?
- Does the policies and procedures manual outline security procedures for petty cash?
- Are these being followed? For example, is cash stored in a locked box, safe or steel drawers?
- What is the location of the safe or steel drawers?

- Are there restrictions on access to keys and areas where cash is held?
- Is there evidence of regular cash counts by a supervisor?
- Does the cashier count the cash daily and document such checks?
- Are all the receipts in the official receipts book recorded in the cashbook/ledger?
- Are all receipts banked promptly?
- Are all cash collections banked intact?
- Are there unusual items in the cashbook, such as unusually large receipts, transfers between bank accounts, or receipts from unusual sources?
- Is there a pre-defined minimum balance on hand for replenishing petty cash?
- Does the custodian prepare a replenishment statement? (The replenishment statement is a list of payments categorized by general ledger account.)
- Is there a designated Finance officer who reviews the replenishment statement for accuracy and validity of the supporting documentation?
- Is a check issued for the amount of the replenishment submitted? (It is recommended to issue the replenishment check in the name of the custodian.)
- Are the accounting entries to establish petty cash, replenish petty cash, or to close the petty cash account understood and followed?

**Bank Reconciliations**

Bank reconciliations should be prepared monthly for each bank account by a qualified employee who is independent of the cash processing functions. The reconciliations should be in a standard format and should be reviewed by an appropriate official. The reconciliation should be signed and dated by the preparer and the reviewer, who should ensure that:

- The bank and book balances agree to the bank statement and general ledger, respectively, as of the given ending date
- The book balance is fully reconciled to that per the bank
- All reconciling items are well-documented and promptly cleared

**Control Objectives**

- To ensure that bank reconciliations are performed at least monthly to reconcile bank records and the organization’s records

- To ensure that differences (reconciling items) between the organization's bank ledger account and the bank statement are identified and reconciled

**Questions for Bank Reconciliations**

- How many bank accounts does the organization hold?
- Are all bank accounts active?
- Is there a separate bank account for each project if required by the donor?
- Are bank reconciliations prepared monthly to verify that accounting records are correct?
- Are bank account reconciliation responsibilities vested in persons not involved in handling receipts or disbursements?
- Does a designated responsible official review reconciliations?
- Are bank reconciliations retained on file for review in the event of audit or other review?
- Are documents that support the reconciling items attached to the related bank reconciliation? Such documents include a list of outstanding checks, deposits in transit, and other relevant documents.
- Are proper reconciliation steps followed? (Bank reconciliation preparation should always start with the opening balance brought forward from the previous reconciliation and end at an adjusted balance that reconciles with the ending balance per the bank's statement.)
- Are reconciling items identified during the bank reconciliation process cleared by the subsequent month?
- Are outstanding checks written off after a set period, e.g., six months? (This period should not exceed the time after which local statute makes such checks invalid.)
- Does the Head of Finance investigate any reconciling items appearing two months in a row?

**Budgeting**

A budget is a detailed financial estimate of anticipated activities for a specified period of time. The following are several types of budgets:

- Annual operating budget – an estimate of an organization's total revenues and expenses for a fiscal year
- Cash budget – the cash an organization expects to receive and disburse
- Capital budget – the total costs to acquire fixed assets (capital additions)
- Project budget – the estimated cost of a specific project

- Grant budget – the estimated cost to conduct project activities funded by a grant

The process of preparing a meaningful and useful budget is best undertaken as an organized and structured group exercise. The budget process involves asking a number of questions including the following:

- What activities will be involved in achieving the planned objectives?
- What resources will be needed to perform these activities?
- What will these resources cost?
- What will be the sources of the funds?
- Are the anticipated results realistic?
- What approvals are required to accept budget variances?
- Do the various departments within the organization have budgets?

Once the budget has been agreed upon and the activity implemented, the process is completed by comparing the plan (budget) with the eventual outcome (actual). Types of budgets in use include the following:

- Operating
- Capital
- Grant budgets
- Budgeting cycle
- Budgeting instructions and management
- Budget formats

The organization should run budget comparison reports monthly to determine whether expenses are in line with the respective budgets. The organization should maintain amended budgets for its reviews. Since the original approved budget is often soon outdated, it is advisable to keep an amended budget during the year for more meaningful comparisons.

**Cash Management**

Control Objectives:

- To ensure that there is effective cash management
- To ensure that the organization has cash to meet its financial obligations

Cash management is an important function in any organization. In order to maximize its cash position, the organization should implement cash procedures for effective management of cash receipts and disbursements. Forecasting and budgeting are important aspects of cash management. The organization should try to plan, in as much detail and as far ahead as possible, what receipts can be expected and what disbursements will be required. Cash management functions revolve around receipts, disbursements, forecasting, and reconciliation.

Effective cash flow management is vital to organizations. It is a key element in planning and in efficient operational management. If cash inflows and outflows are not successfully planned and monitored, organizations may encounter cash shortfalls and may not be able to serve beneficiaries or pay employees and vendors in a timely manner. A cash flow forecast is often required by external parties to enable them to plan the timing of issuance of funding to the organization.

### Questions for Cash Management

- Does the organization determine the cash position at the beginning of a given period from the organization's accounting records?
- Does the organization plan the timing of anticipated future cash receipts, approved sources of grant funding, and other projected sources of income?
- What are the main sources of cash inflows for the organization? (These may include contributions, donors' advances or reimbursements, collection of accounts receivable balances, and cash receipts from income-generating activities.)
- Are estimates of cash disbursements carried out, taking into consideration the organization's planned activities? Organizations that maintain their accounting on an accrual basis should keep in mind that payments to vendors may be needed to decrease previously recorded liabilities.
- Is the cash flow plan summarized in a spreadsheet showing forecasted cash balances by period?
- Are the forecasts provided to the executive director or other applicable official for use in projecting cash surpluses or needs?

### Receivables Management

Amounts owed to the organization should be recorded as receivables. These are assets of the organization. They should be closely monitored to ensure timely collection or liquidation and should be accurately stated and appropriately classified.

### Control Objectives

- To ensure that all receivable invoices are entered in the books
- To ensure that all efforts are made to claim outstanding receivables

- To ensure that no unauthorized write offs or credits are made
- To ensure that travel advances, short term advances, staff loans, and services such as use of telephone are invoiced

**Questions for Receivables Management**

- Are receivable ledgers accounts scrutinized for the following?
    - Balances in the organization's employee receivable account that are due from individuals who are not in the current employ of the organization
    - Non-moving balances
    - Unusual items or balances
- Are all significant debit balances on the trial balance reviewed for validity and value?
- Are invoices sent to debtors for each transaction?
- Are monthly statements sent to debtors?
- Are aging reports prepared every month?
- Are the aging reports reviewed by an appropriate officer?
- Are there efforts to investigate the recoverability of significant balances over three months old?
- Are any write-offs properly authorized?
- Are the write-offs or provisions correctly recorded and the journals properly supported and authorized?

**Staff Debtors and Loans**

The types of staff debtors are as follows:

- Staff advances
- Staff travel advances
- Other staff loans

**Questions for Staff Debtors and Loans**

- Are the staff debtors in line with organizational policies?
- Does the accounting system record receivables by each member separately or in subsidiary ledgers?
- Are policies and procedures, such as not exceeding ceiling limits or staff not approving their own advances, properly followed?
- Is information passed on to the payroll department to ensure that recovery of the outstanding debts is made as proposed and agreed?

- Are repayments made within the allotted time period?
- Is a statement of account detailing the outstanding balances prepared and circulated to each staff debtor?
- Are there procedures to handle any disputed balances and/or entries?

**Questions for Staff Advances (Work Advances)**

- Does each staff member have a separate ledger account in the accounting system for his/her work advance?
- Are policies and procedures, such as denying new advances until an old advance is settled, properly followed?
- Are the advances settled/liquidated according to the organization's policy on retirement of advances?
- Are advances settled/liquidated before new advances are issued? Are any deviations from this authorized, with a reason given in writing?
- Are reserves set up for those account balances that appear to be uncollectible? (A reserve is set up by recording a debit to a bad debts expense account and a credit to a receivables reserve account.)
- Is a senior official such as the executive director responsible for approving the establishment of the reserves?
- Are account balances that are uncollectible written off in accordance with the policy?

**Fixed Asset Accounting**

Fixed assets are the most visible and often the most significant assets owned by an organization. Documentation and reporting are necessary to ensure that the physical controls are effective.

The organization should use a standard form to document its fixed asset acquisitions and disposals. A pre-numbered two-part form is recommended. The form should contain two sections, a request section and a disposal section.

The fixed asset register/record should contain the following information:

- Name and description of the asset
- Cost including purchase price, taxes, duties, delivery costs and installation costs
- Accounting transaction reference number
- A cash disbursement voucher or check number (for purchased assets)
- A general journal voucher number (for donated assets)
- Acquisition date (month and year)

- Location
- Condition
- Asset number (should be assigned by the administration department)
- Manufacturer's serial or model number
- Owner (indicate who has title to the equipment)
- Estimated useful life
- Monthly depreciation expense
- Funding source, if asset acquisitions have been funded by multiple donors

**Control Objectives**

- To ensure that all tangible fixed assets exist, are owned by the organization, and are in use
- To ensure that fixed assets are correctly recorded in the books, adequately secured, and properly maintained
- To ensure that acquisitions and disposals are properly authorized
- To ensure where applicable that the assets are properly depreciated and depreciation is properly accounted for

**Questions for Fixed Asset Accounting**

- When assets are purchased, are proper accounting entries made? (The accounting entry should include a debit to the fixed asset account and a credit to cash/bank.)
- If the asset was received as an in-kind contribution from a private donor or as an unencumbered in-kind award from a grant donor, was the accounting entry properly recorded as a debit to the fixed asset account and a credit to contributions revenue?
- If the asset was received from a grant donor that requires its approval for disposition of the asset at the conclusion of the grant award, was the accounting entry properly recorded as a debit to the fixed asset account and a credit to the grant liability account? (The liability account will be reduced as the organization recognizes revenue for the depreciation expense recorded against the grant.)
- Does the organization conduct physical counts of its fixed assets on a predefined frequency during the course of the year? (It is highly recommended that the counts occur at least quarterly.)
- Are fixed asset counts supervised and conducted by employees who are independent of the fixed assets custodial and record keeping functions?

- Does Finance reconcile the fixed asset counts to the general ledger balances and prepare general journal vouchers for unreconciled differences?

**Depreciation**

Since Fixed Assets benefit the organization over a number of years, their cost should be expensed over the periods that benefit from use of the asset. Depreciation expense is the distribution of the cost of a fixed asset over its estimated useful life.

Generally accepted accounting principles (GAAP) require that long-term assets be recorded as fixed assets and depreciated over their estimated useful lives. For fixed assets purchased with grant funds or received from a grant donor that retains ownership of the asset, additional accounting entries will be needed to comply with GAAP while accommodating the grant donor's reporting requirements. Organizations should seek guidance from their external auditors for the additional accounting entries needed.

The organization should designate an estimated useful life for each type of fixed asset it acquires and should use that estimated life to depreciate all assets in that category. The organization should refer to the local professional accounting standards or practices to make the determination. Suggested asset lives are the following:

- Computer equipment – three to five years
- Furniture and  equipment other than computers – 10 years
- Vehicles – three to five years
- Buildings – 40 years
- Leasehold improvements – If the related facility lease has an automatic renewal option, then the recommended asset life is 40 years. Otherwise, the improvements should be depreciated over the remainder of the lease term.

**Questions for Depreciation**

- Does the organization have a depreciation policy?
- Are assets properly classified and deprecation rates determined?
- Are depreciation rates changed from time to time?
- Are the depreciation rates followed from one accounting period to another?
- Are depreciable assets depreciated consistently every month?

**Accounting for Prepaid Expenses and Security Deposits**

In the normal course of business, most organizations make payments that benefit future periods. Common examples of prepayments are those made in advance for office leases, insurance premiums, and computer maintenance contracts. The portion of the payment that benefits future periods should be recorded as a prepaid expense. To aid in tracking prepaid expense balances, the Finance department should maintain a detailed analysis of the open prepaid items.

The organization's Head of Finance should make the determination based on materiality and types of expenditures as to which disbursements should be set up as prepayments. Prepayments below the minimum threshold established by the Head of Finance should be expensed when paid. The Head of Finance should document the decisions and the accountant should retain copies of the documented decisions on file.

The organization may set up a separate general ledger prepaid expense account for each type of prepayment or it may decide to keep all prepayments in a single account. If multiple types of prepayments are kept in a single general ledger prepaid expense account, care should be exercised to ensure that each prepayment is properly amortized.

Security deposits such as those required by utilities and phone companies are not prepaid expenses and should be recorded in a separate asset account, if significant to the organization. If security deposits are minor in amount, consideration may be given to expensing them when paid.

**Questions for Accounting for Prepaid Expenses and Security Deposits**

- Does the organization keep details of the prepayments including the following information?
    - Description of the prepayment
    - Vendor
    - Transaction reference number
    - Transaction date
    - Periods that will benefit from the prepayment (the term over which the prepayment is to be expensed, usually expressed in months)
    - Total amount of the prepayment
    - Amount that will be expensed (amortized) each month
    - Monthly beginning balance
    - Additions (cash disbursements)
    - Reductions (general journal entries for monthly amortizations, insurance premium refunds)
    - Monthly ending balance

- Are the detailed records reviewed monthly by the Head of Finance to ensure that they are sufficiently detailed and agree with the general ledger balance?
- Are prepaid assets charged to expense in the period(s) in which the organization derives benefit from the original expenditures? (The process by which the prepaid expense balances are charged off to expense is known as amortization.)
- Is there a designated employee in the Finance department responsible for preparing the monthly amortization entry?
- Does the designated employee refer to the detailed accounting record(s) for the amount to be amortized for each account and/or type of prepayment every month?
- Is a copy of the detailed spreadsheet/record attached to each month's amortization entry?
- Are the prepaid expenses amortized evenly over the benefiting periods? (For example, if an organization is required by contract to pay the next year's rent in advance, payment should be recorded on a cash disbursement voucher as a debit to prepaid expenses and a credit to the cash-in-bank account. Each month during the lease term, the Finance department should record a debit to expense and a credit to the prepaid expense account on a general journal voucher for one-twelfth of the prepaid rent. By the end of the lease term, the rent prepayment should be fully amortized.)
- Are the detailed records of security deposits reviewed monthly by the Head of Finance to ensure that they are sufficiently detailed and agree to the general ledger balance?

**Accounts Payable**

Accounts Payable is the process, performed by the organization's Finance Department, by which amounts owed by the organization are set up as liabilities for subsequent payment. Documentation standards and approval disciplines must be in place and firmly enforced to ensure that all necessary approvals are obtained before commitments are incurred and payments are made.

**Control Objectives**

- To ensure that goods/services are only ordered in the quantities or quality needed and at the best terms available. There should be appropriate requisition, approvals and authorizations
- To ensure that goods and services received are inspected and only acceptable items are accepted

- To ensure that invoices are checked against authorized orders and goods received notes
- To ensure that all goods and services are properly recorded in the books

**Questions for Accounts Payable**

- Are all creditors reviewed every month?
- Is an invoice register maintained to log and track invoices?
- Are invoices approved before they are entered in the ledger?
- Are supplier statements reconciled to the supplier ledger balance regularly?
- Is the subsidiary ledger for the creditors control account, if applicable, reconciled every month with the suppliers?
- How is it ensured that credit terms are used in full?
- How is the creditors list reviewed to ensure payments are not overdue?

**Accounting for Accrued Liabilities**

The types of information that should appear in the account analysis for each type of accrual are the following:

- Description of the accrual
- Party to whom the liability is owed
- Basis for the accrual (how it is calculated)
- Accrual balance at the beginning of the month
- Addition(s) to each accrual (indicate amount, transaction number, and transaction date) during the month
- Reductions in each accrual (indicate amount, transaction number, and transaction date) during the month
- Accrual balance at the end of the month

**Control Objectives**

- To ensure that the policy on accrued liabilities is adhered to
- To ensure that all accruals are recorded correctly

**Questions for Accounting for Accrued Liabilities**

- Are all accruals reviewed every month?
- Are accruals supported by individual account analyses?
- Are accrual entries approved before they are entered into the ledger?
- Is each accrual balance supported by the appropriate documentation?
- Is each accrual reviewed monthly to determine if the accrual is needed

and the amount accrued represents the most recent assessment of the amount due?

- Is there an effective system to ensure that liabilities are cleared in a timely fashion?

**Revenue/Funding**

The accounting treatment for the funding received will vary depending upon whether or not the donor has placed any special conditions on the funding it has provided to the organization. There may be a restriction on the use of the funds or the time in which the funds are to be expended, or the donor may impose reporting or other requirements. It is recommended that an organization maintain separate accounts for the different types of funding it expects to receive or for any revenue it expects to generate. This will make the process of analysis and reporting easier to manage.

Organizations typically are required to perform the following actions to apply for and receive grants:

- Sign an agreement and agree to its specified terms
- Submit an itemized budget for approval by the donor
- Return unspent funds to the donor
- Submit formal financial reporting to the donor
- Comply with applicable donor regulations or requirements in administering the award

Grant revenue should be recorded in each month in which the organization incurs reasonable, allowable, and allocable expenses against the award. The steps that are typically followed are as follows:

- Grant funding received in advance should be recorded as a liability to the donor when received
    - Debit cash
    - Credit grants payable
- When reasonable, allowable expense is incurred
    - Debit expense
    - Credit cash
- At least monthly, when expenses are incurred against the award, grant revenue should be recognized and the liability should be reduced
    - Debit grants payable
    - Credit grant revenue

### Control Objectives

- To ensure that revenue is properly stated and recorded in the proper accounting period
- To ensure that revenue is correctly classified (Unrestricted, Restricted, Grant, Contract)

### Questions for Revenue/Funding

- Are grant revenues and any corresponding grant receivables (if the organization operates on a reimbursement basis) or grant liabilities (if the organization receives its grant funding in advance) reviewed each month to ensure that they are correctly stated?
- Is a review performed each month to determine whether or not revenue booked during the month has been correctly classified?

### Payroll Processing (Wages and Salaries)

Payroll consists of all processing of employee salaries, wages, bonuses, cash benefits, and deductions. The payroll function also includes the processing of all timesheets/effort reporting documents. An employer must retain all records pertaining to payroll. Such records include salary and wage histories and all salary and wage deductions for the periods of time stipulated by statute and standard business practices.

The payroll function must be independent of the human resources function. Due to the sensitive and confidential nature of payroll, it must be administered with due care and diligence.

### Control Objectives

- To ensure that wages and salaries are paid only to actual employees at authorized rates of pay
- To ensure payrolls are calculated correctly
- To ensure that payroll deductions are correctly accounted for and paid over to the appropriate third parties
- To ensure that the payrolls are charged to correct donor project numbers and budget lines in a timely manner (before expiry of projects)

### Questions for Payroll Processing (Wages and Salaries)

- Are there procedures to ensure new and terminated staff are respectively included and removed from the payroll in a timely fashion?
- Are there procedures to ensure that changes to the employee payroll details are properly recorded?
- It there payroll software?

- Do employees keep timesheets?
- Are there procedures for timesheet approvals?
- Are timesheets used for payroll preparation?
- Are there written policies and procedures for overtime?
- Does a responsible officer approve the payroll before the wages/salaries are paid?
- Are wages/salaries paid by check or bank transfer?
- Are the people involved in making the payments different from those who prepare payroll?
- Is a payroll journal prepared to enter wages/salary charges to the projects?
- Is the payroll journal approved by the Head of Finance?
- Are salary deductions remitted to third parties on time?
- Are there ledger accounts for the payroll deductions, and are they cleared every month?
- Are outstanding balances on payroll deductions accounts, such as National Social Security Fund (NSSF) and Pay As You Earn (PAYE), and health insurance investigated?

**Cost Allocation**

Shared costs are expenses incurred for a common purpose but which cannot be assigned directly to any particular project, donor, department, product, or segment of the business. Cost allocation is the process of distributing shared costs to the appropriate projects. Assigning expenses to projects in a consistent fashion provides management with the total cost of each project being implemented. For this information to be useful, management needs to have costs charged to projects using a methodology that is consistent and rational.

The objective of cost allocation is to charge expenses to projects based on the benefit that each project receives from the expense incurred. Using a documented systematic method to allocate shared costs ensures that each donor covers its "fair share" of allocable expenses.

The following steps are essential in implementing a cost allocation methodology:

1. Define cost drivers.
2. Determine which costs the organization considers to be common costs that should be allocated using a cost allocation methodology.
3. Set up an auditable system to determine shared costs and how to account for them.

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Wooden bicycles can frequently be seen around the Democratic Republic of the Congo and other East and central African countries. Most have no brakes and riding them can be exhilarating.

4. Develop a written policy that incorporates the allocation concepts.
5. Use the allocation methods described in the policy consistently throughout the year.
6. Base the cost allocation formulas on current actual data.

**Allocation of Vehicle Expenses**

The most logical cost driver for vehicle expenses is the distance driven to administer each project or non-support department in a given period. Using this methodology, vehicle logs must be maintained to capture distances driven for each project/non-support department.

**Allocation of Support Costs**

Several cost drivers could be used such as direct expenses. It is the responsibility of the organization to choose the most appropriate driver for its programming portfolio and to use it consistently. The allocation method should demonstrate a fair and reasonable calculation.

**Allocating Occupancy Expenses**

The most logical cost driver for allocating occupancy expenses (e.g., office rent, electricity, water, etc.) is the office space occupied by the staff assigned to each project. Using this methodology, the organization must measure the total office space and calculate the square meters of common costs.

**Questions for Cost Allocation**

- Are the costs that the organization considers to be common costs defined? Some examples of common costs that often benefit multiple projects are utility bills, office supplies, office rent, and administrative staff salaries.
- Has the organization set up an auditable system to determine shared costs and how to account for them?
- Is there a written policy that incorporates the allocation concepts?
- Is the adopted cost allocation method applied consistently throughout the year?
- Are cost allocation formulas based on current actual data rather than budgets?
- Are cost allocation formulas updated monthly to ensure that charges allocated to each project accurately reflect what happened during the month?
- Is a cost pooling method used to allocate the shared cost at the end of an accounting period? Under the pooling method, all applicable expenses are charged to one or more cost centers at the time they are

initially processed. (Some partners may be so small that their preference is not to pool costs but to direct charge them when each transaction is recorded.)

- What other method is in use?
- If the organization uses cost pools to capture its allocable expenses, are those pools allocated out in full at the end of each month so that each pool's expense total nets to zero?

**Grant Accounting**

Grant accounting entails reviewing and complying with the terms and conditions stipulated in a grant agreement and recording the revenue and expenses in an organization's general ledger. Grants, also referred to as awards (including subawards) or cooperative agreements are arrangements whereby the organization has a contractual funding relationship in which a donor provides financial support in return for the delivery of specified program service by the organization or its subgrantees.

Many grant-funded projects include the following phases:

- Pre-award requirements
- Post-award requirements
- Financial and program requirements
- Property standards
- Procurement standards
- Reports and records
- Termination and enforcements

**Questions for Grant Accounting**

- Is the there a grant tracking system?
- Are there project files with information on the project, including the following?
    - Donor agreement
    - Communication with the donor
    - Points of focus in the donor agreement
    - Budget management
- Is there a system of tracking expenses and income by project?
- Are there controls to ensure that funds are used for their intended purposes?
- Does the organization have and regularly use a grant closure checklist?

### Financial Reports

Organizations have internal and external reporting requirements. The Head of Finance should ensure that the organization's management team is provided with financial reports regularly during the course of the year. Internal financial reports should contain sufficient relevant information that is presented in formats that will enable the management team to make informed business decisions. External reporting may be required by donor agreements, donor regulation, professional accounting standards or government statute. All financial reports should be accurate, timely and verifiable.

### Control Objectives

- To determine whether the types of internal financial reports provided to management are appropriate, comprehensive and value-added
- To ascertain whether all external reporting requirements are met per donor agreements and government regulations
- To verify that the internal and external financial reports prepared by the organization are accurate, verifiable, timely, and submitted within the established deadlines

### Questions for Financial Reports

- What management reports are required to be produced every month, quarter, and semiannually?
- Are the reports meeting the following requirements?
    - Reporting formats
    - Distributed as required
    - Reporting deadlines
    - All donor requirements
- Are the month-end financial closing and reporting deadlines being consistently met? If not, obtain explanations.
- Are reports distributed and received as expected?
- Does the Head of Finance meet with the CEO each month to discuss the financial reports?
- Does the Head of Finance present the monthly finance reports to senior management each month? What action is taken when budget lines have been overspent?
- Is the reporting cycle defined?
- Are budgets appropriately detailed by line item and are all reporting currencies for grant funded projects clearly indicated?

- Who reviews and responds to donor feedback on liquidation reports submitted to the donor?
- Who reviews and provides feedback on liquidation reports received from subrecipients?

**Financial Transaction Documentation**

All financial transactions should be recorded on standard accounting forms known as journal entries or vouchers and should be supported by the appropriate documentation. The vouchers should be sequentially numbered, properly approved, and systematically filed to allow for easy retrieval.

**Control Objectives**

- To ensure that all financial transactions are properly documented, approved, and supported
- To verify that all journal entries and their supporting documents, once filed, are stored securely and can be retrieved quickly

**Questions for Financial Transaction Documentation**

- Are all journal entries signed by the respective employees who prepared, verified, entered, approved and posted them?
- Are the journal narratives adequate?
- Are the back-up documents adequate and appropriate?
- Are journal vouchers numbered, with the same number maintained in the accounting system?
- Are all cash disbursement journal entries and general journal entries and their supporting documents canceled to prevent their reuse?
- Have all entries selected for testing and their supporting documents been easily located?
- Are entries and their supporting documents safely secured at all times?
- Are entries and their supporting documents retained on file for the appropriate amount of time?
- When it is not practicable to attach the supporting documents to entries for confidentiality reasons or due to their size, are the storage locations for the supporting documents indicated on the journal entries?
- Are cross-references made on correcting entries, adjustments, or reclassifications to the original entries and vice versa?
- Are individuals required to sign documents attesting to their receipt and issuance of cash?

### Expenditure Review

The general criteria affecting allowability of costs under awards are the following:

- Costs must be reasonable and necessary for the performance and administration of awards.
- Costs charged to U.S. government grants must be allocable to the awards under the provisions of the White House Office of Management and Budget (OMB) cost principle circulars. A cost is allocable to a particular cost objective if the goods or services involved are charged or assigned to such cost objective in accordance with relative benefits received.
- Costs must be given consistent treatment through application of those generally accepted accounting principles appropriate to the circumstances. A cost may not be assigned to an award as a direct cost if any other cost incurred for the same purpose in like circumstances was allocated to the award as an indirect cost.
- Costs must conform to any limitations or exclusions set forth in the circulars; national, state, or local laws; sponsored agreements; or other governing regulations as to types or amounts of cost items.
- Costs must be net of all applicable credits that result from transactions that reduce or offset direct or indirect costs. Examples of such transactions include purchase discounts, rebates or allowances, recoveries, indemnities on losses, insurance refunds or rebates, and adjustments for overpayments or erroneous charges.

### Questions for Expenditure Review

- Are donor rules for the applicable awards on file?
- Have all pertinent staff been adequately trained on understanding and complying with those rules?
- Are costs allowable as per donor requirements?
- Have all projected expenditures been considered in the organization’s approved budget or approved amendments thereto?
- Do costs conform to the organizational policies and procedures?
- Are the dates of expenditure within the grant period?
- Is there full documentation of such expenditures?

# GLOSSARY

**Account Balance**

The cumulative amount in a general ledger account, equal to the net of its cumulative debits and credits. Account balances for revenues and expenses are closed out at year-end and are not carried over to the next fiscal year. Account balances for assets, liabilities, and net assets (fund balances) are cumulative from their inception.

**Account Code or Number**

Account codes identify the nature of the items affected by financial transactions. General ledger accounts are usually grouped into the following major categories: assets, liabilities, net assets (formerly known as fund balances), revenues, and expenses.

**Accounting Entry**

A double-sided entry in which the debits must equal the credits. See also *Voucher*.

**Accounting Policies**

The principles, bases, conventions, rules, and practices applied by an entity in recording financial transactions and in preparing and presenting financial statements.

**Accrual Basis**

The accounting discipline whereby revenues are recorded in the accounting periods in which they are earned and liabilities or expenses are recorded in the periods in which they are incurred (or in which they provide benefit).

**Accrued Liability**

A liability recorded for expenses incurred, but not paid as of the end of a given period. Frequently involves an estimate of the liability owed.

**Accumulated Depreciation**

The cumulative amount of depreciation recorded by an organization against a given asset. This account is netted against the corresponding asset account for financial statement presentation purposes. Accumulated depreciation should remain on the organization's books until the corresponding asset's disposal or write-off takes place.

**Advance**

Funds issued to another party with a requirement that the party that received the funds must account for them in the future. An advance is cleared by providing a good, rendering a service, submitting an approved report, and/or returning cash, depending on the nature of the transaction.

### Amortization

The gradual reduction of a prepaid expense by apportioning its cost over the accounting periods (months) that benefit from the original expenditure.

### Annotated Chart of Accounts

A list of general ledger accounts showing the account numbers, names, and descriptions (intended purpose) of each account.

### Authorization

The process of approval over financial transactions, normally the decision to commit or expend the organization's resources.

### Authorization Matrix

An organization's list of approval authorities. Usually shown in the form of a grid that lists the various positions in the organization and the levels of their respective authority. Can also indicate the types of commitments, expenditures, or documents that the designated employees are authorized to approve. Also known as the *Authorization Chart*.

### Balance Sheet

See *Statement of Financial Position.*

### Bank Reconciliation

The process through which the organization's cash balance per its general ledger is reconciled to the ending balance per the bank statement as of the same date and all differences between the two are accounted for. An employee who is independent of the cash custodial and recordkeeping functions should perform this task. It serves as a check on the completeness and accuracy of the organization's recorded cash balance and cash transactions.

### Bank Statement

A report issued by a bank that shows the beginning and ending balances and all activity in an account holder's bank account for the statement period. Bank statements are sent to account holders on a regular basis, usually monthly.

### Capital Addition

Acquisition of a fixed asset.

### Cash

Within the context of this guide, this refers to cash currency, cash-in-bank, or a combination of the two.

### Cash Flow

The difference between cash received and cash spent in a given period.

### Cash Flow Statement

This report shows the cumulative totals for the sources and uses of funds for the period reported. Also known as the *Statement of Cash Flows*.

### Cash Flow Forecast

An estimate of anticipated cash receipts and payments in future periods, which may be months, fiscal quarters, or fiscal years, depending on the nature of the forecast undertaken. This task requires that the organization assess how much will be received and disbursed in each of the designated periods. Input should be solicited from all key members of the management team during this effort to ensure that all funding sources and organizational expenditures are factored into the projections.

### Chart of Accounts

The list of general ledger accounts used for recording financial transactions. The list is shown in account number sequence and shows account numbers and account names.

### Check (or Bank) Signatories

Those employees who are authorized to sign checks on behalf of the organization.

### Cost

The purchase price of a good or service. It includes all expenditures made to place an acquired good into service. Also used to mean the value of donated goods.

### Cost Center

A structural element of an organization used to capture costs for monitoring and reporting purposes. Also known as a business unit, it may be used to designate a specific project, grant, location, or department.

### Cost Allocation

The process of distributing shared expenses to the applicable benefiting cost centers.

### Credit

The right side of an accounting entry. Credits increase revenues and liabilities and reduce expenses and assets.

### Creditor

Any party to whom the organization owes money.

### Debit

The left side of an accounting entry. Debits increase assets and expenses and reduce revenues and liabilities.

### Debtor

Any party who owes money to the organization.

### Depreciation

The distribution of the cost of a tangible long-term asset over its estimated useful life. Long-term assets are those that are expected to provide benefit to the organization for more than one year. Depreciation is recorded monthly.

### Double-Entry Bookkeeping Method (or Double-Sided Entry)

The fundamental accounting discipline that requires each accounting entry to balance, i.e., the debits must equal the credits.

### Expenditure

Broadly means a disbursement of cash. It should not be confused with the term *Expense*.

### Expenses

Expenses are an organization's operating costs. These are recorded in the periods (accounting months) in which they are incurred. An expense is considered to be incurred in the month during which the services rendered or goods purchased were received, not when the purchase order was placed or other commitment was made. An accrual should be made for each expense that has been incurred, but not paid as of the end of the reporting period. Preferably this should be done monthly. At the very least it should be done at the end of the organization's fiscal year. Expenses are considered to be period costs because they have no future value to the organization.

### Fair Share

The concept of charging expenses to projects based on the benefit that each project receives or derives from the activity for which the expense is incurred.

### Financial Statements

Financial reports prepared by an organization for reporting to management, the board of directors, and outside parties. On an interim basis, such as monthly or quarterly, these reports may be audited internally. The organization's year-end financial reports should be subjected to external audit, however. Common types of financial statements are the statement of financial position, the statement of activities, and the statement of cash flows.

### Fiscal Year

The twelve-month period used by the organization to conduct its activities and report its financial results. The fiscal year does not necessarily correspond to a calendar year.

### Fixed Assets

The organization's tangible, long-term property, plant, and equipment that have estimated useful lives of more than one year.

### Fund Balance

See *Net Assets*.

### Imprest Basis

An accounting concept used to describe a cash fund that is replenished for exactly the amount expended. Once established, the general ledger balance for an imprest fund does not change except by management decision.

### Income Statement

See *Statement of Activities*.

### Journal

A chronological or sequential record of a certain type of financial transaction. Some commonly used journals are the cash receipts journal, the cash disbursements journal, the general journal, and the sales journal.

### Journal Entry

See *Voucher*.

### Ledger

Normally means an accounting "book" in which financial transactions are recorded and cumulative balances are computed. A ledger may be a general ledger in which all financial transactions of the organization are recorded (if computerized) or summarized (if manual) or a subsidiary ledger. Entries into the general ledger must always balance, i.e., the debits must equal the credits. A subsidiary ledger is usually limited to a specific type of transaction or one or more specific types of general ledger accounts. It is not used for double-sided (balancing) entries. Some common types of subsidiary ledgers are petty cash ledgers, cashbooks, accounts receivable ledgers, accounts payable ledgers, and fixed assets registers. A warehouse ledger is normally used to record the balances and movement of inventoried assets. It may be used as a quantitative record to compute the number of units of inventoried goods on hand and also as a record of their values.

### Liability

An amount owed by the organization to other parties. Types of liabilities include, but are not limited to, those to grant donors (for funds received in excess of grant expenses), employees, suppliers, government entities, and lenders.

### Net Assets

The general ledger accounts that represent the difference between an organization’s assets and its liabilities. Also the cumulative difference between an organization’s revenues and its expenses since its inception. (Formerly known as *Fund Balance*.)

### Petty Cash

A small supply of cash used to meet daily operating needs for which disbursement checks are not appropriate or their use is not efficient or cost-effective. Usually maintained on an imprest basis.

### Post

To record a financial transaction in a ledger.

### Prepaid Expenses

The asset account charged for those payments of operating expenses that will benefit future periods. See also *Amortization*.

### Procurement

The process through which goods or services are purchased.

### Projection

Quantitative estimate of future financial or operating performance or results.

### Recordkeeping (Bookkeeping)

The act of recording various financial transactions in a ledger.

### Revenues

The sum of the amounts received by an organization from outside sources. The term includes sales, contributions, grants from various donors, subscriptions, membership dues, fees for services rendered, rentals, and interest received from bank deposits and investments. Contributions are recorded in the periods they are received. All other types of income are recognized as income in the periods in which they are earned.

### Statement of Activities (Income Statement)

This financial report shows the cumulative revenues and expenses for the organization for a given period. The revenues and expenses are itemized by major categories. Expenses are typically broken down into program and support costs. Cumulative totals for a comparable period in the previous fiscal year are usually included in this statement for comparative purposes.

**Statement of Financial Position (Balance Sheet)**
Shows the financial position of the organization at a given point in time. Ending balances for the major groupings of the organization's assets, liabilities, and net assets (fund balances) are displayed in this report. Ending balances for a comparable period in the previous fiscal year are often included in this statement for comparative purposes.

**Support Costs**
Costs that support all of the organization's programs and projects and that are not specifically identifiable with one or more programs or projects.

**Supporting Documentation**
Documents that support a financial transaction. The types of documents needed vary depending upon the nature of the transaction. The organization's policies and procedures should spell out the documents that are required as support for each type of transaction.

**Travel Expense Report (Travel Expense Voucher)**
The organization's standard form used by its employees to report the expenses incurred during authorized business trips or activities. The form is used to account for either amounts previously advanced to the employee or the amount to be reimbursed to the employee.

**Unrestricted Funds**
Funds received from donors who have imposed no time or use constraints.

**Verification**
Within the context of this guide, an independent check of the completeness and accuracy of one or more documents, records, reports, balances, physical counts, or other actions by a designated employee.

**Voucher**
Within the context of this guide, an accounting entry made to record a financial transaction. The term has also been used to mean the prescribed accounting form used to record a transaction and all of the supporting documents attached thereto. The term is used interchangeably with *Accounting Entry* or *Journal Entry*.

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