

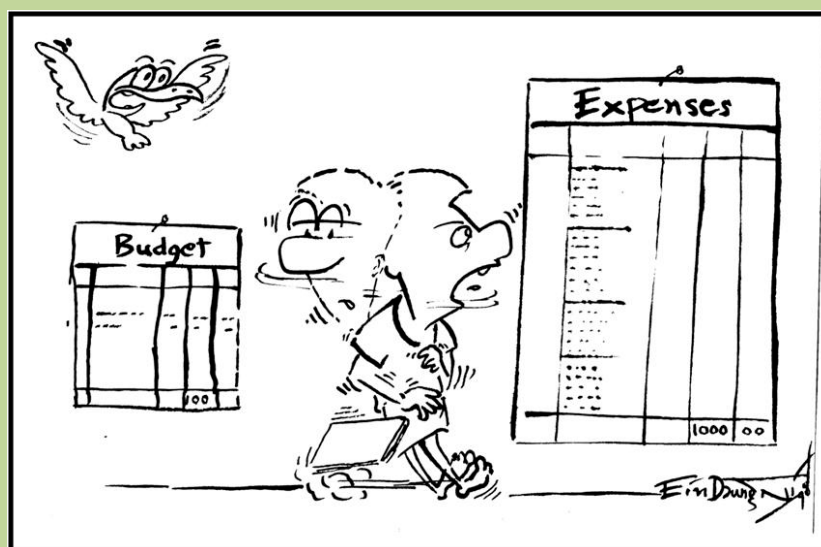
Financial Management

Module



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Overview

Financial Management will help you to acquire the knowledge and skills you need to work responsibly with regard to finance while working in a community organisation or project. It will focus specifically on helping you to understand the need for financial management and the how of day to day management. After studying this module, you may consider to study its companion module, "Financial Planning" which teaches the skills of financial forward planning.

It was very big news a few years ago that in a number of Southeast Asian countries, including Thailand, Indonesia etc, financial institutions such as banks and finance companies had made great losses and created huge economic problems for governments and the people. In 2009, the same problems rocked many western countries causing world-wide financial melt-down. In many cases people with responsibility have taken huge financial risks with other people's money and lost, or have used other people's money in a fraudulent (illegal) way. These financial problems could have been avoided if proper financial controls had been in place at the time.

Most financial problems occur in community organizations when people take risks with money and things don't go as planned. Sometimes people do foolish things with money, such as the business man who thinks that because he is the boss he should have an expensive car like a Mercedes Benz or BMW, when a Mazda pick-up would do just as well (and would be a lot cheaper).

In this topic we are going to look at the importance of financial management, control and accountability.

How to Use the Module?

This module is arranged as a series of "**topics**", i.e. like chapters of a book. In each topic, you will find:

- Learning content for you to study
- Self testing activities with answers provided for self-checking

Topic 1 - Financial Management

Accountability

Money is easily spent. Unfortunately, it is not always spent on the right things. The funds in a program or business should be spent on activities and resources that work towards achieving the **aims** of the program or business.

E.g.: You may be involved in a program which is helping orphans improve their situations. The money for the program could be spent on employing a teacher, setting up activities for the children or providing temporary accommodation. The money should not be used in ways which are not helping the orphans or on taking a trip to town which has nothing to do with the orphan program, or on buying office equipment and furniture that is not going to be used for the program or on helping out your own friends and relations.

To ensure that the money is spent correctly, businesses make people **accountable** for what they do. Being accountable, means being responsible for the money in the program and being required to explain how much money has been spent and on what.

In a company, the people who work in the business are accountable to the Board of Directors, (which is like a management committee). They must report to the board regularly, usually once a month. The board is made up of people who work in the business on a day to day basis and people who do not work in the business. It is the Board of Directors' job to make sure that the employees are working towards the aims of the program. If the board does not think an employee is doing a good job they must replace that person with someone who they believe will be more effective.

For community programs, the people who work in the program on a day to day basis are accountable to a committee or council, set up by the community to look after the financial management of the program and to

ensure that the program is working to plan. The committee is responsible for ensuring that the program is meeting the aims and goals, which are usually written down in a business, community or program plan.

The committee and the people working in the program are also accountable to the funding agency, which has provided the funds for the program. The committee and the people working in the program must make sure that they abide by the terms and conditions outlined in the funding arrangement.

For instance, NGOs providing funding usually provide funds of three different types:

- capital grants - the funds which must be spent on buying assets for a program;
- recurrent salaries grants - these funds must be spent on salaries for people working in a program;
- other recurrent grants - these funds must be spent on the day to day operating costs of a program, such as electricity, subscriptions, insurance and travel costs.

Money provided for buying assets cannot be spent on salaries or other recurrent costs. Money provided for recurrent salaries cannot be used to buy assets or be spent on other recurrent costs. Money that has been provided for other recurrent costs cannot be used for salaries or buying assets.

If you have spent too much on assets but you have some money left over from the salaries money, you might think that you can spend some of the salaries money on assets. In some cases you can, in some cases you cannot. Program managers and committee members must know exactly what the rules are in the funding agreement and be very careful that they do not break the rules.

If committee members have questions about a program they should talk to the people who work in the program. The people in the program have a duty to answer any questions honestly.



Self testing activity 1.1

In your own words, explain why it is necessary for people working in a program to be accountable to the funding agency for the financial management of the program.

Internal and external reporting

When the managers of a business or program report to people or organisations outside of the business or program this is called **external reporting**.

E.g: If a business reports to a bank, funding agency or an NGO, they are involved in **external reporting**.

When the managers of a business report to the owners, shareholders, or Board of Directors they are involved in **internal reporting**, because they are reporting to people directly involved with the business.

When the people working in a program report to a committee they are also involved in **internal reporting**, because the program is operating as part of the community.

Reporting to the funding agency

When the managers of a program report to the funding agency they are involved in **external reporting**. This reporting is external because the funding agency is not part of the community. The funding agency simply provides the funds to the community so that

they can operate the program.

This does not mean that the funding agency doesn't care if the money is used properly or not. Funding agencies are also accountable for the way they use money. Therefore, funding agencies are likely to ask detailed questions regarding the operation of the program, the resources involved, the role of staff members, the aims and goals, and so on.

Funding agencies usually require program managers to report monthly or quarterly. Reporting procedures (when reporting will take place and what it will involve) are usually established by agreement between the program managers and the funding agency at the start of the program.



Funding agencies usually require program managers to provide a Project Report annually (once a year), or possibly more often.

The report must outline:

- the purpose of the grant;
- the time period being covered;
- the outcomes that have occurred as a result of the program - the aims of the program are listed and the report outlines whether or not the aims have been achieved and why;
- the signature of the responsible person.

If the funding body doesn't approve of the way a program is being managed, it can stop making payments or order that the funds be repaid.

Such extreme measures would only be taken:

- if the program could not achieve its aims;

- in a situation where a program could not be managed effectively;
- where the terms of the agreement between the funding agency and the programme managers have been broken.

You can see that funding agencies have a lot of power regarding program operation and management.



Self testing activity 1.2

In your own words, explain why money granted for salaries must not be used for other recurrent costs.

Financial management and control

Control is an essential part of financial management. Control allows us to ensure that program funds are not used incorrectly or illegally. In other words, financial controls are established to ensure that the funds are used to achieve the program's aims and goals.

Program employees (staffs) and managers are in positions of responsibility and they must ensure that mistakes do not occur and that funds are not used in a fraudulent (illegal) way.

Avoiding mistakes

Mistakes usually occur when program employees and managers think they are doing the right thing, when in fact they are doing the wrong thing. Mistakes also occur when employees and managers are disorganised and forgetful.

E.g.: Forgetting to turn off the air conditioner at night, which results in a higher than expected electricity bill. Or talking on the telephone to a friend for half an hour when the call is a timed long distance call, resulting in a large telephone bill for the month.

Mistakes like these are easily made. However, program employees, and, in particular, program managers are responsible for ensuring that once a mistake has been made, it is identified and controls put in place to ensure that the mistake does not happen again. A program manager may even develop a set of office guidelines outlining what is and is not acceptable behaviour. These guidelines work towards ensuring that everyone involved in the program knows what they can and cannot do, which in turn reduces the likelihood of mistakes being made.

Fraud

Fraud occurs when people deliberately use other people's money or resources for their own purposes when they know they are not allowed to. Examples of fraud include:

- using the company or project vehicle for your own purposes;
- buying things for yourself using the program's money;
- taking money from the business for your own pocket.

Although fraud does occur in many businesses, it is the responsibility of managers, committees and funding agencies to ensure it does not happen. Most businesses and programs try to ensure that fraud does not occur:

- by involving more than one person when making the financial decisions, or
- by having more than one person involved in the handling and recording of the money, where possible.

Let's look at an example:

Imagine that you work for a program that needs a computer. In the application for funding, \$ 650 was budgeted for a computer and this money has been received. The coordinator of the program, who will use the computer, has been told to purchase it. He knows that he has \$ 650 to spend. When he gets to the computer shop, however, the salesman talks him into a few extras on the computer and the price finishes up as \$ 750. The coordinator thinks that by spending fewer funds on some of the day to day running costs of the program he will soon make up the \$ 100 he has over-spent on the computer.

The problem here is that there is a lack of financial control. It is always dangerous to allow employees, volunteers, managers or coordinators to buy things by themselves. If they are given the responsibility of purchasing resources or assets, they must be clear on how much they can spend and the consequences of overspending. They must understand the funding guidelines, which outline how money is to be spent and on what items. They must understand that they cannot spend more than the agreed amount of funds, without the approval of the funding agency. This approval must be obtained before the money is spent.

To avoid this type of situation, the program committee and the funding agency should insist that the purchase of major assets involve more than one person. The involvement of several people is more likely to ensure that the money is spent on items identified in the budget and that over-spending does not occur.



Self testing activity 1.3

Why is dangerous to allow employees etc to buy equipment for an organisation or project by themselves?



Self testing activity 1.4

In the example above, the manager wants to over-spend on an asset (the computer) and take the extra money out of recurrent expenses (running costs). Is this acceptable or not? Please comment why / why not?

The stages of financial management

The financial management of a program has three parts or stages, which are:

1. Planning
2. Implementation
3. Review

We will look at each of these stages separately.

Planning

The financial planning stage is probably the most important stage of the program.

There is a saying: *People, who fail to plan, plan to fail.*

In other words, if a program is not planned correctly it is highly likely something will go wrong. This often means that at some stage, the program will run into financial trouble.

E.g.: Equipment needed for the program cannot be bought because there is no money in the budget for it.

This could mean that some of the aims of the program cannot be achieved. Therefore, the program is not as effective as hoped. In the worst case, financial trouble could result in the collapse of the program.

The financial planning stage involves a number of steps:

- a) deciding what the program is trying to achieve – **aims**;
- b) deciding how the program will achieve the aims - **goals and strategies**;
- c) deciding what will be needed to achieve the aims - **resources**;
- d) deciding how many people will be employed to work in the program – **staffing**.

Once a detailed plan has been developed for the program, the budget can be developed, identifying the costs of the program. During this process, likely price increases and changes in the foreign exchange rate (if the program is funded by a foreign funding agency) should be considered and built into the costing.

The budget must include:

- all sources of income (money coming in);
- all expenditure items (money going out).

The budget for the program must be as detailed as possible.

Once the budget has been developed, it must be double checked to

ensure that the program has enough funds for operation, resources and salaries etc. The program management team must also ensure that the funds will be available when required.

E.g. If the program relies on the use of a computer from the very start of the program, the money for the computer must be available at the start of the program, not half way through or at the end.



Self testing activity 1.5

Explain why the planning stage is the most important stage in the financial management of a program.

Implementation

The implementation stage occurs when all of the plans are put in place and things start happening. From a financial point of view, the program managers start spending money on the items identified in the budget and start collecting any income.

It is very important that detailed financial records of all financial transactions (i.e. every time money is involved) are maintained. Most funding agencies will not supply funds unless the program management team agrees to, and is able to, produce

financial reports. These records provide a detailed account of how much money has been spent and on what. The record also shows how much



money has been earned or collected.

The program bookkeeper or accountant keeps these financial records and is responsible for ensuring that the records are filed, so that they can be found easily if someone wants to see them.

During this stage, it is the responsibility of the bookkeeper to prepare reports outlining the income and expenditure of the program. These reports show how the program is progressing, compared to budget. These reports also highlight any financial problems.

E.g.: If the program is using more money than stated in the budget.

These days computers can be programmed to produce financial reports. Using accounting programmes or software, the financial data is simply entered into the computer, which then produces the reports. The bookkeeper must ensure that the financial records are up to date and produced on time.

Review

The review stage occurs when people look at whether the program has gone to plan or not. This review involves comparing the budget with what has actually been spent. The statement below shows the budget figures (in US Dollars), amount spent in the quarter, and the amount spent so far for the year.

ABC Community Handicraft Training
Income and Expenditure Statement
for the period ended 31st December 201X

	Approved	This	Year to
Income	Budget	Qtr	Date
Funds from funding agency	50 000	5 000	40 000
Sales of handicrafts	10 000	3 000	4 700
Interest	300	175	291
Total Income	60 300	8 175	44 991
Expenditure			
Less* Expenses			
Wages for instructors	17 200	4 301	8 653
Office running costs	1 100	0	1 100
Travel allowances	5 600	1 005	2 205
Motor vehicle Expenses	6 400	1 658	2 956
Total Expenses	30 300	6 964	14 914
Less* Assets Purchased	30 000	0	30 000
Total Expenditure	60 300	6 964	44 914
Surplus/(Deficit)	0	1 211	77

* We say less because it is money going out, so even though we add expenditures and expenses together, because they are both 'minuses' we say expenditures 'less' expenses.

The review stage is very important. Using a statement like the one above you could review the actual spending for each item against the budget

which will help you to ensure that the programs (and future programs) do not run into financial trouble.

There are usually 2 reasons why the actual figures may be different from the budget. Either:

- the budget is wrong - the amount included in the budget was too low and costs cannot be kept to budget levels; or
- the budget is correct and the program is spending too much on some items.

Where the amount allowed for an item in the budget is wrong, the budget figure may have to be adjusted.

Where too much money is being spent, measures have to be taken to reduce spending. For example, telephone charges may be too high because people are making telephone calls for work purposes and then talking too long afterwards. In this case, the program manager may have to issue a memo stating that telephone calls must relate to work issues only.

A review should identify any financial problem and from there a solution can be developed. A review will:

- check that program is achieving its stated aims;
- show where the program is heading;
- identify potential problem areas so that they can be fixed quickly;
- highlight mistakes so that they can be avoided in the future;
- identify successful activities that will help program employees to perform better in the future;
- ensure that employees know what they are supposed to do to help the program achieve its aims; and
- provide the financial accountability required by the funding bodies.

Budgets are often difficult to develop and even harder to get right. However, if they are developed properly, they force people to think very carefully about programs and help communities to predict whether or not a good idea will work in practice.



Self testing activity 1.6

Describe in your own words the three stages of financial management.



Self testing activity 1.7

In your own words, explain why the review stage is so important in the program management process.

The review stage is important for program management, because it is essential that people look closely at how the program is progressing while it is operating, to ensure that the program, in the end, achieves its aims.

It is very easy for any project to lose its direction if the people involved do not take the time to review the figures against what was planned. Review reveals whether the actual costs and income are in line with the budget.

Topic 2 - Accounting and Bookkeeping

Introduction

This topic looks at the elements or parts of an accounting or bookkeeping system. An accounting system records a business' or programs financial transactions. In other words, each time a business or program does anything involving money; it is recorded in the accounting system.

First, the topic looks at the various parts of a business and the elements of an accounting system.

Next, the topic looks at the financial reports produced by the accounting system, for the financial management of the business.

Finally, the topic takes a closer look at what happens in the payroll, purchasing and accounts payable elements of a business and how an accounting system records the information.

The elements (parts) of a business

An accounting system records the financial life of an organisation. It provides a picture, in words and numbers, of how the organisation has performed over a period of time. If the system is to give an accurate picture, it must take into account all the different elements which together decide how the business or program operates.

Different businesses and programs have different elements.

Retail

If we look at a retail business (one that sells goods to the public, such as a store) we would be able to identify the following elements:

a) Sales

A retail business sells items to the public, such as cars, food, and clothes etc. The accounting system records the amount of money that the business makes from these sales.

b) Purchases

The retail business also buys things or pays for services to use in the business, such as raw materials to make the product, and office equipment.

These items can be divided up into goods and services. Goods include things such as paper for the photocopier and the printers, computer disks and petrol for the vehicle. Services include things such as insurance for the vehicle and the buildings, electricity, and legal advice etc.

The accounting system must record all of the purchases that the business makes.

c) Payroll

People working for a business or program must get paid and the payroll function of a business is very important.

The personal information regarding people's pay or salary or income is usually regarded as confidential. Therefore, the people responsible for calculating the pays must protect the information they have access to.

We will look more closely at the payroll function later in this topic.



d) **Stock**

Stock (i.e. all the things which are stored for sale) is a very important element in a retail business because the value of the stock (what it is worth) is usually very high. The stock kept for a retail business must be insured and kept in a safe place, because it is a target for thieves.

The accounting system shows how much stock has been purchased and, if stock records are kept, individual stock items and how many of each item there is.

e) **Accounts payable or creditors**

When a retail business manager buys something on credit (i.e. without immediate payment) he/she must know when to pay the bill. The accounts payable function of an accounting system records the details of all the bills that have not been paid and groups the bills together, according to the supplier. This ensures that the manager knows how much he/she has to pay, who the money is owing to, and when it has to be paid by.

Note: accounts payable and creditors mean the same thing.

f) **Accounts receivable or debtors**

The accounts receivable function of an accounting system does the same job as the accounts payable function except that it records the people or organisations who owe money to the business. Accounts receivable relate to customers who have purchased products or items from the retail business on credit (i.e. without immediate payment).

Note: accounts receivable and debtors mean the same thing.

g) Fixed assets

These are assets owned by the business that should last for a long time, such as cars, computer equipment, furniture, and filing cabinets, etc. A fixed asset is one that the business expects to last for more than 12 months.

The accounting system records these assets, when they were purchased, how much they cost, and how long they should last.

h) Cash

Cash is important to every business. The accounting system must provide information on the cash that has been received by the business (income) and the cash that has been paid out (expenditure).

Maintaining control over the cash of any business is very important. This includes physical control (actual handling of the money) and accounting control. Accounting control is the result of:

- careful paperwork that records receipts and payments of cash; and
- ensuring that the account records match the amount of money held in bank accounts.



Self testing activity 2.1

In your own words, explain what we must know about a business or program, before we can produce an efficient accounting system for it.

A service business

A service business or program is very much like a retail business except that it does not sell things, it sells services. Therefore, it does not sell stock.

E.g: Tuition classes where the students pay fees for tuition. Or, a community health program where the patients pay fees for the service.

Of course, the service provided by a program might be free, for example, a free hospital service, in which case there would be no income for the program.

A service program does not have to look after stock because stock because it does not sell stock.

The parts of a service business or program include:

- income
- purchases
- payroll
- creditors
- debtors
- cash
- fixed assets

So, it is easier to maintain an accounting system for a service business than it is for a retail business because a service business does not have stock.

The rest of this topic will concentrate on service programs.



Self testing activity 2.2

Outline the major accounting difference between a retail business and a service program.

Accounting systems

Accountants deal with the different parts of a business by placing things together in groups.

There are five major groups in an accounting system, which are:

- assets
- liabilities
- proprietorship or owner's equity
- income or revenue
- expenses

Assets

Assets are items that the business owns and uses in its operations.

Assets include things such as vehicles, buildings, furniture and cash. Debtors (people who owe money) are also regarded as an asset because they owe the business money - because the business has a right to the money, it is counted as an asset.

E.g. If you owe me a debt of \$5, then you are my debtor, because you are my debtor (i.e. owe me money) then you are an asset worth \$5 to me!

In a dollar accounting statement, a list of assets might look like this:

	(Dollar)
Cash on Hand	750
Debtors	1,250
Land and Buildings	68,750
Computers and office equipment	10,726
Vehicles	4,065,300
	<hr/>
	85,542
	<hr/>

Assets are usually divided into 2 groups:

- current assets
- non current assets (i.e. fixed assets)

Current assets include cash or items that will be turned into cash within 12 months. From the list above, the Cash on Hand and Debtors are current assets.

Non current assets, also known as fixed assets, are assets that will not be turned into cash within 12 months. In the example above, Land and Buildings, Computers and office equipment, and Vehicles are non-current assets.



Self testing activity 2.3

Outline the accounting difference between current and non-current (fixed) assets.

Liabilities

Liabilities are the amounts that a business owes to other businesses or people.

In another dollar accounting statement a list of liabilities might look like this:

Creditors	2,127
Bank Overdraft	6,029
Bank Loan	1,286
	<hr/>
	9,443
	<hr/>

As with assets, liabilities are divided into 2 groups:

- current liabilities
- non-current liabilities

Current liabilities are those that the business must pay for within 12 months, such as payments to creditors and a bank overdraft.

Non-current liabilities are those that the business does not have to pay off within 12 months, such as a bank loan.

Owners' Equity

Technically, owner's equity, or proprietorship is the interest or investment that the owners or proprietors have in a business. However, for the purpose of this module we will use the following definition:

Owners' equity is the difference between the assets and the liabilities.

Capital

Capital is the amount of money owned by a business, program or person. Capital often includes such things as land, buildings, share holdings and so on. These capital items are used by a business to create more wealth.

Income/revenue

Income/revenue is the money that comes into the program from sources, such as grants, sales, fees, charges for services and interest.

The main source of income for a community program is usually grants i.e. money given by some funding agency.

Expenses

Expenses are the bills that the business must pay to keep the business running.

Expenses will include such things as wages, travelling costs, insurance and electricity, etc.



Self testing activity 2.4

List three possible sources of income for a community service program.

Financial statements

This module has already looked at one very important financial statement - the budget. There are 2 other statements that are also very important. The first is traditional accounting report, which includes a profit and loss statement and a balance sheet. The second is the income and expenses statement,

Traditional accounting reports

In businesses that are run for profit, financial reports usually include the profit and loss statement and the balance sheet.

a) Profit and loss statement

This financial report shows the revenue and expenses related to the business, for a specific period of time. For most businesses these reports are prepared on a monthly basis.

b) Balance sheet

This financial report is produced at the same time as the profit and loss statement. It shows the assets, liabilities and the owners' equity related to the business, at a particular point in time.

Here is a Profit and Loss Statement and a Balance Sheet for a retail business for the month of October. The currency is dollar.

Space-age Computers

Profit and Loss Statement for the month of October, 201X

		(dollar)
Sales		9,558
Less Cost of Sales		4,223
Gross Profit		5,335
Less Expenses		
Electricity	198	
Rent	600	
Telephone	106	
Office Expenses	139	
Salaries	<u>3,254</u>	
		<u>4,299</u>
Net Profit		<u>1,036</u>

Space-age Computers

Balance Sheet as at 31st October, 200X

Assets	(dollar)
Cash at Bank	156
Debtors	1,256
Stock	4,159
Office Equipment	1,568
Vehicle	<u>1,523</u>
Total Assets	<u>8,664</u>
Liabilities	
Creditors	2,128
Bank Loan	<u>3,500</u>
	5,628
Owners' Equity	
Capital	2,000
Profit	<u>1,036</u>
	<u>3,036</u>
	8,664



Self testing activity 2.5

What are the two traditional accounting reports produced by businesses and, in your own words, explain the purpose of each of these reports.

The Accounting Equation

Note from the balance sheet that:

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$$

This is often written as:

$$A = L + OE$$

Note that for the previous example:

$$\text{Assets} = 8,664$$

$$\text{Liabilities} = 5,628$$

$$\text{Owners' Equity} = 3,036$$

So

$$\text{Liabilities} + \text{Owners' Equity} = 5,628 + 3,036 = 8,664$$

So $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$

This is known as the Accounting Equation and if the figures don't add up there is something wrong with the financial reports. Luckily these days with accounting software (programmes) on computers, the computer won't let you do anything wrong.

Therefore, you should always end up with:

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}.$$



Self testing activity 2.6

Use the following information to prepare a balance sheet.

Yadana Nyunt Store	
Item	Value (dollar)
Assets:	
Cash at bank	17 165

Debtors	4 356
Stock	19 050
Office equipment	28 555
Liabilities:	
Creditors	13 101
Personal loan	20 000
Owners Equity:	
Capital	20 000
Profit	16 116

The Income and expense Statement, the Profit and Loss Statement, the Statement of Revenue and Expenses.....

This statement has many names. It also comes in many forms, depending on what information the users require.

The statement for a retail business, such as a food shop, will look different to the statement for a service business, such as a tuition centre. Both of these statements will look different to the statement for a health program. However, they will all contain the same sort of information, so things are not as hard as they seem.

In all cases, this statement:

- lists the income that the program received for a period;
- lists the expenses for the period; and
- calculates whether the program has made a surplus (more income than expenses) or a deficit (more expenses than income).

There is no exact format for an income and expenses statement. In fact, different programs will have different information to report so their statements will look different. For example, a food shop will have stock and will make sales, but a tuition centre will not have stock and might not have any other source of income, other than the fees it receives.

The example below shows an income and expense statement for the month of October.

Community Health Program
Income and Expenses Statement
For the month of October

Revenue	(dollar)
Fees	265
Grant 1	6,000
Grant 2	2,000
Total Revenue	8,265
Less Expenses	
Wages	4,535
Insurance	89
Telephone	92
Stationery	38
Office Expenses	52
Total Expenses	4, 807
	3,457
Less Asset Purchases	(1,238)
Surplus/(Deficit)	2,218

This is a simple example, but it shows the basic structure of the statement.

When grant money is approved for a program, the main concern of the funding body is that the funds are used for approved purposes and that the program be well managed. Good program and financial management will greatly increase the chances that the program will run at a surplus and not at a deficit.

Often, grant monies are supplied for 3 types of spending, which are:

- asset expenditure, such as buildings, office equipment, vehicles and so on;
- salaries and wages; and
- other recurrent costs, such as telephone, electricity, stationery, postage, travelling costs etc.

a) Asset expenditure

When dealing with asset expenditure, a standard procedure which program managers are often required to observe, is to secure at least three quotes for the purchase of any item over a certain maximum amount. If the lowest quote is not accepted, the program manager must justify paying a higher price. Sometimes, for very expensive purchases, the manager must invite tenders, (i. e. publicly invite suppliers to send in quotations and specifications).



Self testing activity 2.7

There are many reasons why a program might accept a higher quote, i.e. buy something which costs more than the lowest price quoted. Outline two possible reasons.

b) Salaries, wages and other recurrent costs

When dealing with these costs it is important to remember that money provided for salaries cannot be used for other recurrent costs, and the money provided for other recurrent costs cannot be used for salaries.

E.g.: Let's say a program has saved some money on salaries because an employee resigned and was not replaced. On the other hand, the program has overspent on telephone charges. The program manager cannot simply adjust the budget to take money out of salaries and use that money to increase the amount for telephone charges.

The importance of paperwork

In order for information to be recorded in the accounting records of a business or program, the details must be recorded on paper. This paper could be:

- an invoice from a supplier;
- a statement from the phone company;
- a delivery document from a courier;
- a cash register tape from the store; and
- a payroll summary.

This piece of paper is **very important**. This piece of paper is called the **source document** and provides proof of the transaction. It provides a trail for the people who want to look at where the information provided in the financial statements has come from. This paper also provides information for the people who work in the program.

E.g: Employees (staffs) working in a program may sometimes, need to know when a piece of equipment was purchased. Or, employees may want to check how many items they purchased last time, as a guide to how many items they should purchase this time. Or,

employees may need to know who the supplier was and what his/her telephone number is, so that the supplier can be contacted again.

Because the paperwork is so important, it should be filed in an orderly and logical way that allows employees and people from the funding agency to access it quickly and easily.

There are a number of source documents for different financial transactions. They include invoices, cheque butts, receipts, credit notes, and purchase orders. These documents are covered in more detail in another module.



Self testing activity 2.8

In your own words, explain why paperwork is so important in regards to financial management.

Purchases

*In a traditional accounting system the word **purchases** refers to the items bought by a business and then sold by that business to its customers.*

E.g.: A computer business will buy computers, printers and modems etc, to sell to customers.

The computers, printers, modems and other items that it sells to customers are called purchases.

*In traditional accounting practice, purchases include goods that you purchase to sell, services that you sell and the assets that you purchase. This package will not be referring to purchases in the traditional sense. Instead we will rely on the following definition: **Purchases are goods or services that the business or program buys and uses in the day to day running of the business.***

E.g.: A program employee might purchase stationery items, such as pens, paper clips and paper, for the people working in the program. Coffee, tea, milk, sugar and drinking water might also be purchased, along with petrol for the program's vehicle, and insurance for the vehicle and the buildings and contents. The employee may also purchase travel tickets for the program administrator to travel to Yangon or Mandalay to talk to NGO representatives about the program's financial statements. All of these are purchases.

Purchase procedures

It is also important to examine what actually happens when a business purchases something. Let's look at a case study involving a community school.

The school needs paper for the photocopier. Teachers use a lot of paper, so, the school generally does not want just one or two packets of paper - it wants boxes, lots of boxes of paper. This means that the school will buy the paper from a supplier, not from the local shop. The following things take place:

The store person at the school or the responsible person e.g. the principal orders 20 boxes of paper from the supplier, a stationery shop.

The stationery shop delivers the paper, or if the school is a long way from the supplier, the boxes may be delivered by courier or by train or bus or perhaps somebody may be asked to collect the paper from the stationery shop.

The paperwork is usually attached to one of the boxes. This paperwork is an invoice (although in real life it could also be a delivery document). The invoice contains a lot of information.

The store person (or principal) who receives the paper, or the

person who collects the paper, should count the number of boxes and make sure that this number agrees with the number of boxes written on the invoice. Then he/she should sign the invoice to show that the goods have been received as ordered and that they are in good condition. He/she then sends the piece of paper to the people who do the accounts (finance department, program accountant or bookkeeper).

In general, the goods that are delivered to a business will not be paid for when they are received. They will be paid for later, usually at the end of the month. In such cases they have been purchased on credit.



Self testing activity 2.9

Outline two advantages and two disadvantages of purchasing items on credit.

What the accounting people do

Looking back at the case study, the fact that the school has purchased some paper and promised to pay the supplier must be recorded.

In this module we will use a paper-based, rather than a computer-based, accounting system. Paper based systems are basically the same as computer-based accounting systems except that in the computer based system the computer does the math for you.

The next thing to do is record the transaction.

Looking at the invoice, the accountant will find several pieces of important information, including:

- the delivery date for the paper – 2nd January 2010 - this information is recorded in the journal (see below);

- the name of the supplier of the paper – Clips Stationery - this information is recorded in the journal (see below); and
- the cost of the paper – 72\$ - the accountant would record the fact that the school spent 72\$ on stationery and that the school owes Clips Stationery 72\$.



Self testing activity 2.10

You have made a purchase and received an invoice. What information do you expect to see in the invoice?

Because the school owes Clips money, Clips is a creditor of the school. All of this information is recorded.

Date	Supplier	Petrol	Stationery	Electricity	Creditors
2.1.10	Clips Stationery		72		72

This information is then recorded in the stationery account and in creditors.

The next thing to do is look at the amount in the stationery account.

Let's say that the amount in the stationery account, before we record the purchase of the photocopier paper, is \$204. This means that the school has spent \$204 on stationery to date.

When the \$72 for the 20 boxes of paper is added, the amount in the stationery account will be:

$$\$204 + \$72 = \$276$$

Now let's continue with the case study, looking at electricity as a purchase.

In this case, the school does not get a delivery of electricity like it got a delivery of paper. The school uses electricity and gets billed on a regular basis. When the bill arrives, the details are recorded in the purchases journal in the same way that the information about the paper was recorded.

The bill was printed by ESB on 3rd January 2010 and the cost of the electricity was \$9. The entry in the purchases journal is below:

Date	Supplier	Petrol	Stationery	Electricity	Creditors
2.1.10	Clips Stationery		72		72
3.1.10	ESB			9	9

This information is then recorded in the electricity account and the creditors' account. If the amount in the electricity account, before the bill is recorded, is \$32 , then the amount after the bill has been recorded will be \$42. This means that the school has used \$42 worth of electricity.



Self testing activity 2.11

If the amount in the stationery account was \$970 before a bill of \$173 was paid, what will it be after the amount of the bill is entered into the account?

Accounts payable or creditors

The accounts payable function of an accounting system records:

- the amount of money that the business owes to other businesses or people;
- who the other businesses or people are; and
- when the amount needs to be paid.

The people or businesses that our business owes money to are usually called creditors.

The creditors ledger

The amounts owed to creditors are recorded in a book called the **creditors ledger**. Because the accounting system is paper-based, the records are kept in books, not in computer files.

The person who looks after the creditor's ledger in a large organisation is called an **Accounts Payable clerk**. These clerks are responsible for making sure that all the information regarding creditors is entered into the creditor's ledger. This information should come from the purchases journal that was mentioned earlier. (In a small organisation, this has to be done by the responsible person.)

Let's have a look at the Clips Stationery account in the creditor's ledger. They supplied the school with photocopier paper. They also supply the school with many other stationery items.

In January 2010 they supplied the school with:

- 20 boxes of paper on the 2nd January;
- pens, paper clips and staples worth \$25 on the 5th January;
- envelopes and exercise books worth \$5 on the 17th January; and
- coloured chinks worth \$8 on the 27th January.

So, there were four deliveries in the month of January and the school owes clips a total of: $72 + 26 + 50 + 8 = 156$ \$

An invoice stating the goods ordered and the amount owing would have

accompanied each of these orders. Here is an example of a Clips invoice.

Clips Stationery Supplies 62(C)Nawaday Street Dagon Township, Yangon		INVOICE		
SOLD TO		SHIP TO		
On the Ball Community Academy PO Box 229 NO.48. Strand Road, Lanmadaw Township, Yangon		Saw Richard Principal		
Qty Ordered	Qty Shipped	Description	Price	Total
20	20	Boxes of paper	3.60	72
2 / 1 / 10 Date		Subtotal		72
		Freight/cost of delivery		0.00
		Total		72
<p>Payment is required within 30 days.</p> <p>All freight costs to be paid by the purchaser.</p> <p>All cheques and money orders made payable to:</p> <p>Clips Stationery Shop</p>				

At the end of the month the school should get another piece of paper from Clips. This piece of paper is called a **statement**.

The statement lists the invoices that the school has been sent during the month and gives the total amount owing at the bottom of the statement. It will also list any amounts from previous months that have not been paid yet.

Here is an example of a statement sent out by Clips to the school, for the month of January 2010.

Account On the Ball Community Academy			
Account No. 1202			
Period January 2010			
Clips Stationery Supplies			
62(C), Nawaday Street, Dagon Township, Yangon			
Date	Number	Details	Amount
2.1.05	20	Boxes of paper	72
5.1.05	-	Pens, paper clips and staples	25
17.1.05	-	Envelopes and exercise books	50
27.1.05	24	Boxes of chalk	8
Statement for the period : 1/1/10 to 31/1/10			156
Total			
<i>Payments made after this date will show on your next statement.</i>			

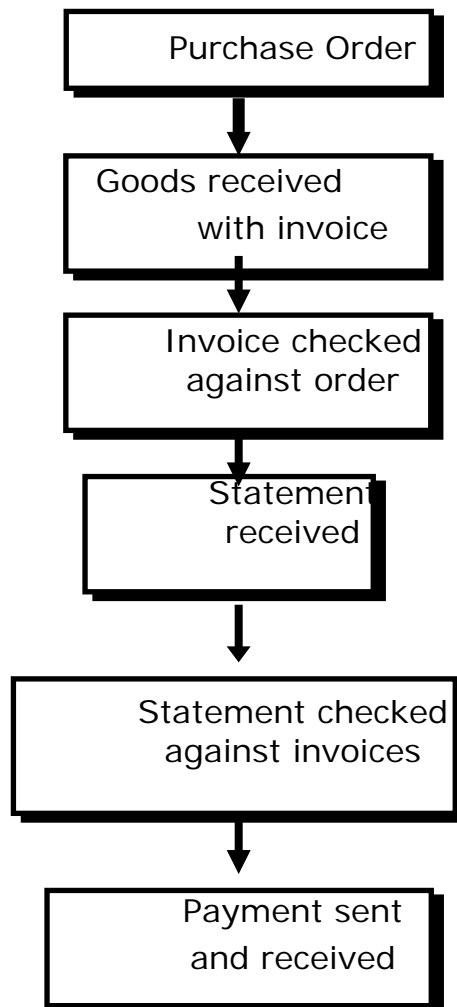


Self testing activity 2.12

Explain why a business owner/manager should always check a statement he/she receives from a supplier.

Here is an outline of the purchasing procedure.

Purchasing Procedure



The job of the accounts payable clerk or responsible person is to verify that the amount for January shown on the Clips Stationery statement is correct. To do this, the accounts payable clerk gets out all the invoices for Clips for the month of January and checks them off against the statement. These invoices should be stored in a safe place in the accounting area or office, for example in a filing cabinet.

If you refer back to the section on purchases, you will remember that the person who receives the goods must sign the invoice and pass it on to the accounting people or responsible person. That signature on the invoice now becomes very important. The accounts payable clerk or responsible person may not have checked the goods when they were delivered and may not know if they were in a reasonable condition on arrival. Because school or business should not pay anything unless the details are correct, the responsible person needs to check the signature.

Once all the items on the Clips statement have been checked to be correct, the responsible person can arrange for payment to be made to Clips. This may be done straight away or may be left until the end of the month.

If the responsible person does not agree with the details on the Clips statement, he/she must investigate and hopefully fix the problem. This might be a simple matter of checking to find a missing invoice which was not included with the accounts. It may, however, be the start of a dispute. If Clips say they supplied 30 boxes, but the school only received 20 boxes there is a real problem. Usually any disputes are cleared up quickly and in a friendly way, but sometimes they can be difficult! This process of checking the statements received from the suppliers against the financial records is called **reconciling the accounts**.

You may also access the Schedule of Accounts Payable when reconciling your accounts. This schedule is a list of accounts which are due to be paid. By looking at this list you can identify which accounts have been

paid and which are still outstanding (i.e. not yet paid). You would read this Schedule in conjunction with the statement you have received from the suppliers to ensure that all the amounts are correct. Here is an example of an Accounts Payable form.

PERIOD ENDING:

SCHEDULE OF ACCOUNTS PAYABLE

Invoice date	Invoice #	Acct #	Account Name	30 days	60 days	90+ days	Total
			TOTALS				
				GRAND TOTAL DUE			



Self testing activity 2.13

Explain the purpose of a Schedule of Accounts Payable.



Self testing activity 2.14

Sopheap, the treasurer of the local football club, has just received the statement for the month from the local sporting goods store. The statement shows that the club owes the store \$23 for the month. Sopheap has gone through all the paperwork. He believes the bill should be \$22. Explain whether or not Sopheap should pay the bill of \$23. Give reasons for your answer.

Payroll

The payroll function of an accounting system records the information regarding the employees' (staffs') pay rates, salaries, and wages etc..

When a person is employed he/she must fill out a form called an **Employment Declaration**. This form provides the following information:

- name
- date of birth
- address
- the type of employment (i.e. full time, part time or casual)

(Usually there are also special requirements regarding taxation, which vary from country to country.)

Once the employee has completed the form, he/she is required to sign

and date the declaration stating that the information provided is true and correct.

Note: In some countries there must be two copies of this form. The first copy goes to the Tax Office; the second copy is kept by the employer.

Records kept by the employer

There are two parts to the records kept by the employer.

The **first part** relates to the personal details about the employees. These details don't change very often and include:

- the employer's copy of the declaration form;
- the date the employee commenced work;
- pay rate; and
- number of dependents and so on.

The **second part** is made up of the information regarding the pay that the employee receives on a weekly or fortnightly basis (or whatever the pay period happens to be). This information includes:

- the number of hours worked;
- the amount of tax that has been deducted;
- the net pay;
- allowances (added on to basic pay); and
- deductions (taken from pay for special purposes).

The payroll records contain a lot of personal and private information and should be locked up when not in use by the accountant or accounting staff.

None of the information regarding the pays is entered into the ledger until the money is taken out of the bank account. So, the payroll records are quite separate from the ledger.

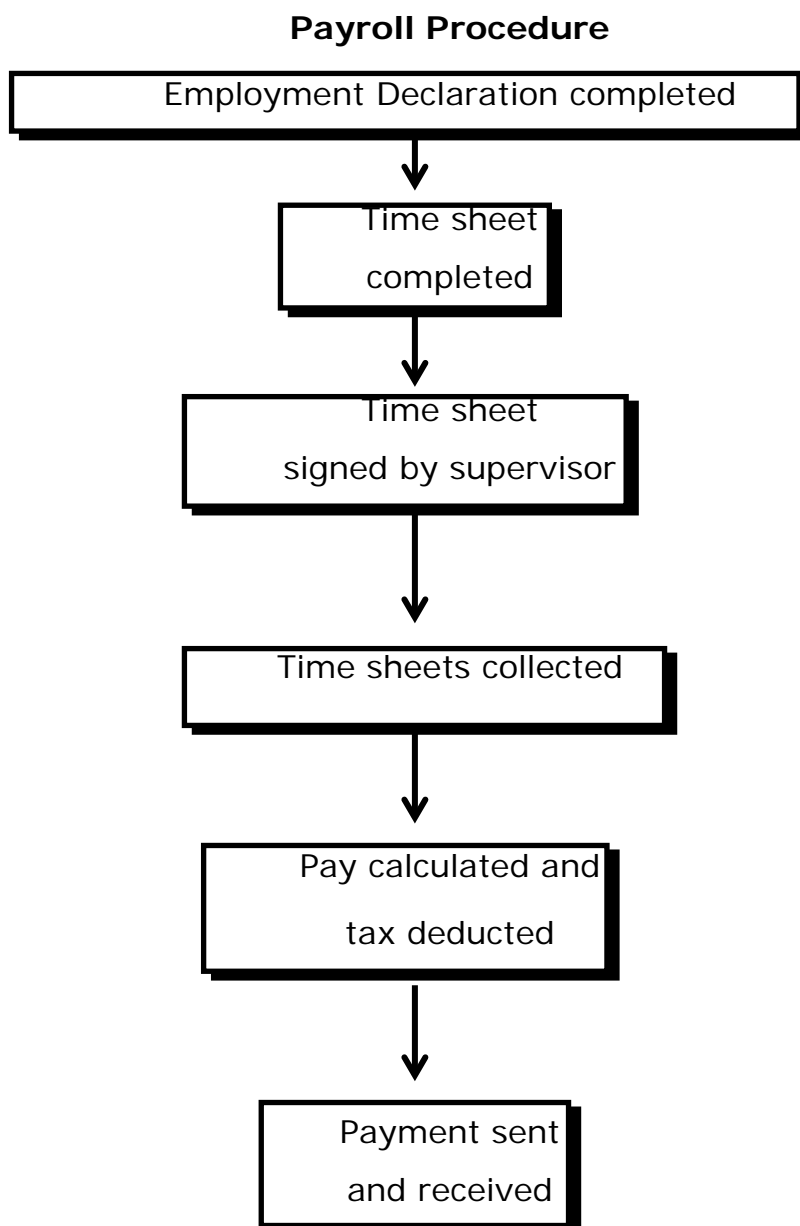


Self testing activity 2.15

In your own words, explain why payroll records are confidential.

Payroll procedures

The diagram on the following page outlines the payroll procedures.



Employers usually have rules about the number of hours worked by employees. If the organisation is small the employer and employee may have a trust

Financial Management Module

system, so that the employer trusts the employees to actually work the required number of hours and daily, weekly or monthly pay is fixed. If the organisation is large, with many employees, there is usually a system that requires employees to fill out time sheets that show the number of hours they have worked each day, what time they started and what time they finished, because they will only be paid for the actual hours worked. Here is an example of a time sheet.

DATE:	TIME SHEET
EMPLOYEE _____	
COST CENTER _____	
PAY PERIOD BEGINNING _____	
PAY PERIOD ENDING _____	

DATE	SUN	MON	TUE	WED	THUR	FRI	SAT	SUN	TOTAL
IN									
OUT									
IN									
OUT									
OVERTIME									
TOTAL HOURS									

DATE	SUN	MON	TUE	WED	THUR	FRI	SAT	SUN	TOTAL
IN									
OUT									
IN									
OUT									
OVERTIME									
TOTAL HOURS									

DATE	SUN	MON	TUE	WED	THUR	FRI	SAT	SUN	TOTAL
IN									
OUT									
IN									
OUT									
OVERTIME									
TOTAL HOURS									

CODES V=Vacation H=Holiday S=Sick	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th>REGULAR</th> <th>HOLIDAY</th> <th>OTHER</th> </tr> </thead> <tbody> <tr> <td style="width: 33%;"></td> <td style="width: 33%;"></td> <td style="width: 33%;"></td> </tr> <tr> <td>OVERTIME HOURS</td> <td>SICK</td> <td>VACATION</td> </tr> <tr> <td></td> <td></td> <td></td> </tr> </tbody> </table>	REGULAR	HOLIDAY	OTHER				OVERTIME HOURS	SICK	VACATION			
REGULAR	HOLIDAY	OTHER											
OVERTIME HOURS	SICK	VACATION											

These time sheets are often signed by a supervisor to verify that the employees have correctly recorded the time worked. These sheets should always be signed by the employee.

The person who makes out the pays collects the timesheets for the pay period and calculates how much each employee will be paid. Pays consist of:

- pay for the normal hours worked;
- pay for authorised overtime;
- allowances to be added, such as meal allowance, travelling allowance, etc;
- deductions, such as membership fees, health care, retirement fund etc.

It is important to note that overtime payments made to employees can cost programs a lot of money. If these payments have not been budgeted for, the program could run into serious financial trouble very quickly. For this reason, any paid overtime should be authorised by the program manager before it is worked.

In some countries the pay person must deduct (take out) the correct amount of income tax from each employee's pay and this must be paid to the tax office once a month. The amount each employee is paid will depend on a number of things including:

- their hourly pay rate;
- the amount of time they work during normal working hours;
- the amount of overtime they have worked (if they are paid for it);
- whether or not they have any deductions; and
- whether or not they have any allowances paid to them.

On the next page is an example of a company-style payroll. Yours may be simpler.

Payroll																
Employee	Rate \$	Normal			O/T 1.5			O/T 2			Gross Pay \$	Tax	Union dues	Supp. rannuation	Other	Net Pay
		Normal	O/T 1.5	O/T 2	Normal	O/T 1.5	O/T 2	Sick Leave	Annual Leave	Other						
Total																

Gross pay and net pay

Gross pay is the amount of money an employee earns each pay period - before the tax has been deducted.

Net pay is the amount of money each employee is paid or has paid into their bank account (or if paid in cash) – after all deductions (including tax, on fees etc--.)

Here is a simple example.

Let's say a worker's hourly rate is \$0.5 and she works 37.5 hours for the week. (No overtime, deductions or allowances)

$$\begin{aligned}\text{Gross pay} &= \text{hours worked} \times \text{number of hours worked} \\ &= 37.5 \times 0.500 = \$ 18.75\end{aligned}$$

Income tax is then deducted from the gross pay.

Let's say the tax on \$18.75 is \$ 0.850

$$\begin{aligned}\text{Net pay} &= \text{gross pay} - \text{tax} \\ &= 18.75 - 0.85 = 17.9\end{aligned}$$

The net pay is then paid to the employee while the tax is paid to the Tax Department. The gross pay is recorded in the financial accounts.

Let's say the amount in Salaries and Wages before the pay is \$57.82

\$11.25 must be added to Salaries and Wages

So, after the pay, the amount in Salaries and Wages is \$69.07

The summary of the payroll records is then posted to the journal and then the ledger.



Self testing activity 2.16

- a) Explain the difference between net pay and gross pay, and the purpose of an installment schedule.
- b) If an employee is paid \$14 an hour and works 20 hours in a week, what is this employee's gross pay?
- c) If this person then worked an additional two hours in overtime, which is double time, what is the employee's gross pay now?
- d) If the tax has been calculated as \$53, calculate the employee's net pay.

Summary

This topic has looked at the parts of a business and the accounting system that describe a business, from a financial point of view. To develop a good accounting system for a program, the manager must carefully consider what the program does.

The topic also looked at how accountants group together the different items of a business into assets, liabilities, owner's equity, income and revenue.

Financial statements use these groupings to provide information to management and the funding body.

Finally, the topic took a closer look at three parts of a business - purchases, accounts payable and payroll.