2011

Professional Accountants

Strengthening the Capacity of Professional Accountants and their organizations in financial management.

[NGO FINANCIAL MANAGEMENT]

Understanding the NGO financial management….

Darith Khun, ACCA
Founder and Chairman

Mobile: +855 99 554 455
Email: director@professionalaccountants.org
www.professionalaccountants.org

UNDERSTANDING NGO FINANCIAL MANAGEMENT

There are two important components in financial management for NGOs by which the CFO and all seniors managers shall understand for sound financial management in their NGOs:
They are: Principles and Responsibilities in financial management. Each one of them are explain below:

Principles

There are seven principles of financial management for NGOs. They provide a high-level guide for trustees and senior managers, to help them make sure that their organisation is using funds effectively and that staff are working appropriately. They also provide a useful checklist when deciding whether to fund other NGOs.

1. Stewardship

The organisation must take good care of the resources it is entrusted with and make sure that they are used for the purpose intended. The board of trustees has overall responsibility for this. In practice, managers achieve it through careful strategic planning, setting up appropriate controls, considering risks, and by setting up systems that work in tune with the two golden rules of NGO field work.

2. Accountability

The organisation must explain how it has used its resources and what it has achieved as a result to all stakeholders, including beneficiaries. All stakeholders have the right to know how their funds and authority have been used. NGOs have an operational, moral and legal duty to explain their decisions and actions, and submit their financial reports to scrutiny.

3. Transparency

The organisation must be open about its work, making information about its activities and plans available to relevant stakeholders. This includes preparing accurate, complete and timely financial reports and making them accessible to stakeholders, including beneficiaries. If an organisation is not transparent, then it may give the impression of having something to hide.

4. Integrity

On a personal level, individuals in the organisation must operate with honesty and propriety. For example, managers and trustees should lead by example in following procedures and by declaring any personal interests that might conflict with their official duties. The integrity of financial reports depends on the accuracy and completeness of financial records.

5. Viability

Expenditure must be kept in balance with incoming funds, both at the operational and the strategic levels. Viability is a measure of the NGO's financial continuity and security. The trustees and managers should prepare a financing strategy to show how the NGO will meet all of its financial obligations and deliver its strategic plan.

6. Accounting Standards

The system for keeping financial records and documentation must observe internationally accepted accounting standards and principles. Any accountant from anywhere around the world should be able to understand the organisation's system for keeping financial records.

7. Consistency

The organisation's financial policies and systems must be consistent over time. This promotes efficient operations and transparency, especially in financial reporting. While systems may need to be adapted to changing needs, unnecessary changes should be avoided. Inconsistent approaches to financial management can be a sign that the financial situation is being manipulated.

Responsibilities

Everyone involved in working with NGOs shares the responsibility of making sure that funds are used to help people effectively. This section describes specific responsibilities for NGOs' trustees, managers and staff - and has notes for donors too.

There are three key messages:

(a) **Good financial management is critically important for NGOs**. You cannot achieve your goals without it.

(b) **Financial management is everyone's responsibility** - trustees' and program managers' as well as finance staff's. Good financial management starts with the board and the Chief Executive.

(c) Good financial management depends on **program staff and finance staff working together**.

Trustees

The word **'trustees'** to refer to the most senior decision-makers in an organisation, who have overall responsibility for what the organisation does. They may be called by different names, such as Councillors, Board of Directors or Governors.

Trustees have overall responsibility for **using an NGO's resources to achieve its objectives**. They have to pay careful attention to financial affairs. They also have to make sure that senior managers take financial management seriously. Good financial management starts with the board.

Professional Accountants | All right reserves

This section provides a checklist of trustees' main financial management responsibilities. They focus on **overseeing** the organisation, rather than hands-on management, and include:

1. Making sure that funds are used to help beneficiaries effectively;
2. Making sure that the organisation has enough funding;
3. Making sure that the organisation has effective senior management;
4. Making sure that the organisation operates within the law;
5. Making sure that the board can handle its responsibilities effectively.

1. Making sure that funds are used to help beneficiaries effectively

- Ensuring the organisation has practical strategies for analysing and responding to social problems.
- Making sure that the organisation has appropriate internal controls (including keeping accounts) that encourage high quality and de-centralised decision-making.
- Regularly checking that internal controls are followed in practice.
- Monitoring if the organisation is actually doing a good job, putting its strategy into practice and achieving value-for-money.
- Monitoring whether the organisation is being accountable to its beneficiaries (e.g. presenting financial reports to them).
- Approving a realistic annual budget.
- Regularly monitoring financial reports, including the income and expenditure statement and the balance sheet.
- Taking an active role in internal controls as necessary (e.g. authorising large payments).

2. Making sure that the organisation has enough funding

- Approving a realistic annual budget and fundraising plans.
- Monitoring fundraising activities and the amount of income received.
- Actively working out how to ensure the organisation will be sustainable, including approving a financing strategy.
- Monitoring relationships with donors (e.g. if reports are submitted on time).
- Monitoring the amount of money held in reserves.

3. Making sure that the organisation has effective senior management

- Recruiting a Chief Executive with financial management skills (or supporting the Chief Executive to develop these skills).
- Supporting the Chief Executive to develop a culture of good financial management (e.g. leading by example and encouraging finance and programme staff to work together).
- Making sure that the most senior finance manager is a member of the most senior management team.
- Encouraging an open culture that recognises problems and aims to learn from them.
- Holding senior managers to account for the results of the decisions that they take and the initiatives they launch.

4. Making sure that the organisation operates within the law

- Understanding the NGO's legal requirements.
- Making sure that the management team meets legal requirements (e.g. paying taxes, filing annual reports).
- Appointing auditors and overseeing the audit.
- Approving the audited accounts and annual reports.
- Filing reports with government departments.

5. Making sure that the board can handle its responsibilities effectively

- Appointing a Treasurer - that is, a member of the board who has specific responsibilities for financial management and the skills to carry them out.
- Making sure that all board members understand their financial management responsibilities and supporting them to develop appropriate skills.
- Making time at board meetings to discuss the financial management aspect of all major decisions.

Senior managers

All senior managers have important financial management responsibilities - because they are employed to use an NGO's resources to achieve its goals. This includes programme managers and fundraisers as well as finance managers.

This section provides a checklist of senior managers' main financial management responsibilities. They focus on **actively running the organisation**:

1. Making sure that resources are used effectively;
2. Matching resources and activities;
3. Supporting field staff / managers;
4. Ensuring that finance staff and programme staff work together;
5. Supporting other stakeholders.

1. Making sure that resources are used effectively

- Creating an organisational culture that takes financial management seriously (e.g. by inspiring staff to stay committed to an NGO's values and leading by example).
- Developing practical approaches that staff can use to analyse and respond to social problems.
- Setting up internal controls that encourage staff to make good judgements and decentralise decision-making as much as possible.
- Checking that internal controls are followed in practice.
- Taking an active role in internal controls (e.g. signing off salary payments and authorising major payments).
- Setting up structured approaches for ensuring dialogue with beneficiaries (e.g. regular financial reporting to beneficiaries) - and checking to see that they are followed in practice
- Monitoring the quality of the organisation's work.

- Approving realistic budgets for the organisation's operational activities.
- Monitoring financial reports, including income and expenditure accounts and the balance sheet.

2. Matching resources and activities

- Leading the process of developing a realistic annual budget and making sure that it includes enough income to cover all planned expenditure.
- Regularly reviewing financial reports, including budget monitoring reports and the balance sheet (e.g. most NGOs review these every month).
- Regularly forecasting cash flow, making sure that all parts of the organisation have enough cash to pay for their activities and investing any cash reserves.
- Implementing the financing strategy approved by the board.

3. Supporting field staff / managers

- Recruiting staff with the right skills, experience and commitment for key field roles.
- Making sure the right number of staff are employed to carry out all of the organisation's activities.
- Ensuring that all staff understand their financial management responsibilities.
- Communicating strategies, policies and procedures effectively to staff (in simple ways that make it easier for them to do their jobs).
- Ensuring that staff have the right incentives, time, skills and support to carry out their financial management responsibilities.
- Providing training and learning opportunities - and making sure that staff have the time to make use of them.
- Holding staff to account for the decisions they take and the results of their actions.

4. Ensuring that finance staff and programme staff work together

- Employing finance managers and staff who have strong interpersonal skills and a commitment to your organisation's values, as well as technical skills.
- Making sure that finance staff / managers are always involved in decision making and budgeting, from the earliest stages of any new project.
- Actively considering the financial management implications of all major decisions.
- Encouraging finance staff to develop a greater understanding of programme work (e.g. by regular visits to field activities).

5. Supporting other stakeholders

- Supporting the trustees, e.g. providing them with financial information and helping them understand financial management issues.
- Monitoring relationships with donors and partner organisations and ensuring that the financial aspects of these relationships are in line with broader approaches.
- Presenting donors with realistic and honest strategies, plans and reports about your organisation's work.

Professional Accountants | All right reserves

- Meeting your legal obligations (e.g. supporting the annual audit and preparing returns for government departments).

Finance staff

Finance staff play a crucial role in **helping managers and trustees meet their financial management responsibilities**.

This section provides a checklist of finance staff's main responsibilities:

1. Actively supporting the organisation's values and culture;
2. Setting up and running financial systems;
3. Helping beneficiaries, managers and trustees understand financial management issues;
4. Supporting relationships with partner organisations;
5. Supporting audits and meeting legal requirements.

1. Actively supporting the organisation's values and culture

- Understanding how the NGO works in practice.
- Taking practical steps to maintain their commitment to the NGO's values (e.g. through field visits).
- Encouraging senior managers and trustees to recognise and consider their financial management responsibilities.
- Helping create a culture that balances centralised control with decentralised decision-making.

NGOs exist to work with people rather than money. Finance managers and systems can play an important role in helping NGOs do this effectively. But inappropriate systems can make life difficult for everyone.

2. Setting up and running finance systems

- Keeping accounts, including supporting documents and book-keeping records. (Tracking restricted funds received from each donor separately.)
- Supporting managers to prepare budgets, in discussion with beneficiaries.
- Preparing appropriate financial reports for all stakeholders, including beneficiaries, managers, trustees and donors.
- Setting up and implementing a system of controls that empower staff to make good judgements (within policies approved by the trustees).
- Implementing all other specific financial procedures, such as monitoring cash flow, paying salaries and tax, and making payments to suppliers.

3. Helping beneficiaries, managers and trustees understand financial management issues

- Ensuring that finance staff understand programme issues (e.g. through visits), so that they can support beneficiaries and programme staff effectively.
- Working closely with programme staff to explain and explore financial management issues.

- Making sure that beneficiaries are involved in financial decision-making (including budgeting and monitoring) - to make sure that funds are spent on their real needs.
- Presenting financial reports in different ways to different stakeholders, so that they are relevant and easy to understand.
- Discussing financial reports with all stakeholders, to help them understand what the figures mean.

Finance staff have to work closely with programme staff: they cannot deliver good financial management on their own. So NGO finance staff need strong interpersonal and team-working skills.

4. Supporting relationships with partner organisations

- Assessing partners' financial management capacity.
- Monitoring how partners use funds.
- Supporting partner organisations to develop their capacity.
- Handling formal agreements with partner organisations.
- Making payments to partner organisations.

5. Supporting audits and meeting legal requirements

- Planning and supporting internal and external audits.
- Presenting auditors' reports and management letters to senior managers and trustees.
- Understanding the NGO's legal requirements and helping senior managers and trustees understand them.
- Meeting legal requirements, including submitting reports to government agencies as required.

Donors

Donors often play a crucial role in helping NGOs strengthen their financial management and use funds effectively, due to five factors:

1. **Power.** Holding the money puts donors in a powerful position. They influence how NGOs work and this brings important responsibilities.
2. **Good practice.** Donors can encourage NGOs to adopt good practice.
3. **Bureaucracy.** Donors need bureaucratic systems to handle their funds. But too much bureaucracy can get in the way of good practice.
4. **Organisations.** NGOs thrive when donors help them develop as organisations, rather than focusing on individual projects.
5. **Accountability.** NGOs need systems that help them account to all their different stakeholders, including donors and beneficiaries. So do donors.

1. Power

NGOs have a strong financial incentive to tell donors what they think they want to hear - including adapting their work to donors' priorities and inflating claims about what they achieve. **This puts**

donors in a powerful position.

Donors can respond to this by basing their work on a realistic understanding of how NGOs work. In particular:

- NGOs often receive funds from several different donors, which may each impose different conditions and make different demands.
- Social change does not fit into neat projects with specific outcomes. It takes time to work with local communities; NGO work is normally affected by unpredictable local circumstances, which have a bigger influence than NGOs .
- NGOs need to invest in their own development, so that they can develop their staff and services, handle increased amounts of funds and cover their core costs.

Donors can harm NGOs if they abuse their power, for instance by delaying funding decisions or cash payments, or by imposing inappropriate conditions.

2. Good practice

Evidence shows that NGOs help people effectively when they follow the two golden rules of NGO field work :

- NGOs have to maintain a respectful dialogue with the people they aim to help,
- NGOs depend on their field staff and have to empower them to make good judgements.

These golden rules help NGO staff to work with the complicated realities of different people's lives. NGO staff need the flexibility to respond to changes in local circumstances - which always happen. So, to achieve good practice, NGOs have to design internal systems that work in tune with the golden rules. This can be tough: NGOs need donors' help.

3. Bureaucracy

Donors and NGOs need bureaucratic systems to organise their work. All NGOs struggle to balance the need for centralised control with the need for decentralised decision-making. Good systems form the backbone of an organisation, encouraging good practice. But bad systems soak up a lot of time and energy and can stop NGO staff from working effectively.

Many donors and NGOs rely on 'project-based' systems for oversight, which are based on the assumption that activities and results can be predicted with certainty. Unfortunately, evidence shows that these systems can push against the two golden rules of NGO field work.

Too much of the wrong sort of bureaucracy encourages field staff to focus on the needs of senior managers and donors - instead of the real needs of beneficiaries. This can be disastrous.

4. Organisations

NGO managers have the responsibility of developing their staff and organisations, over at least a three to five year period. They need the freedom to develop systems and approaches that work for them.

Donors generally have most impact when they help managers consider the needs of their entire organisation, not just one project. It is very difficult for managers to work with only project-based funding. It may not be helpful for donors to impose standard approaches (e.g. standard financial systems).

For example, even if donors cannot provide unrestricted funding, they can help by relying on an organisation-wide audit, rather than requiring additional project-specific audits.

5. Accountability

Donors have a crucial role to play in holding NGOs to account - recognising and encouraging good practice. Unaccountable organisations cannot be relied on to deliver high quality work. Donors also have the responsibility of being accountable to their stakeholders.

However, the mechanisms used for accountability have to reinforce good practice. There is a strong debate in the NGO sector about whether current mechanisms do this. For example, project-based systems may prevent flexibility and divert NGOs' attention away from their beneficiaries - which makes it harder to help them effectively. Some exciting new models for accountability are emerging.

The **Accountability** section of this Guide analyses the issues, discusses alternative approaches and highlights current initiatives

Professional Accountants team hope that by understanding the important principles and responsibilities, the CFO and senior managers will have better control for their NGOs.

.