

AuditAble

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In AuditAble 5 and 6 (May-09), we discussed how risk-based internal auditing can be applied to NGOs¹. This approach helps the NGO managers and donor agencies focus on risks that affect systems, safety and effective utilisation of funds. This approach has been consolidated as FRAMS – Financial Risk Assessment & Mitigation System. It codifies the various types of risks that should be covered during a review (for example, budgeting, management of funds, accounting & internal controls, reporting & MIS, legal compliance, governance).

A FRAMS+ review usually takes 3-6 days, and follows a clear process. The output is a number of practical suggestions on bringing down control and regulation risks. Most NGOs find such a review more useful than a simple expense audit.

This issue of AuditAble discusses illustrative risks in project budgeting. In subsequent issues, we will take up other areas as well. Discussion on each risk includes a formal statement of the risk, followed by a brief explanation of the issue.

FRAMS+

This is followed by a number of suggested discussion points, which could help you assess the actual risk in a particular case.

¹ This is an adaptation of the risk-based internal auditing approaching described in *Guide on Risk-based Internal Audit* (ICAI 2007).



Figure 1: What happens during a FRAMS+ Visit

Accounting System

Before looking at specific areas, we should look at the accounting environment itself. This includes the staff as well as the books and records. This understanding is important in assessing risks and proposing mitigation measures.

Accounts Department

Risk Statement

Accounts Department may not be able to function effectively.

Issue

Getting and retaining good accountants is a problem for many NGOs. Due to this, sometimes the Accounts Department is not staffed suitably. At other times, their roles or responsibilities may not be clear. All these can hinder efficiency as well as effectiveness.

Questions to ask

How many persons are there in Accounts? What is their education and experience? How long have they been with the organisation? What are their roles? Is their advice sought in key financial matters? Or are they mainly doing book-keeping? Do they help in budgeting and reporting also? Do they help with commercial and administrative matters (purchases etc.)? Is each one of them actually performing their duties? Or is someone functioning as a shadow accountant / proxy for another?

Risk Statement

Organisation may not be able to get reliable advice on accounting and legal matters.

Issue

In most cases, an NGO's auditors are the best point of reference for crucial advice on accounting and legal compliance. However, often the relationship between the two is limited to an annual audit of financial statements only.

Questions to ask

How does the annual audit take place? Do the auditors come to location or do the books go to the auditor's office? How much fees is charged? Is it paid in cash or by cheque? Who handles income tax and FCRA returns? Does the organisation consult the auditors on various financial matters? Are the auditors experienced in NGO matters?

Accounts and Records

Risk Statement

Book-keeping structure may lead to inefficiency, opacity or

mis-accounting of donor funds.

Issue

The structure of the book-keeping system determines the kind of book-keeping and control issues that will arise. Many NGOs keep separate cash books for each project or agencies. This is often encouraged or mandated by the donor agencies. This results in compartmentalization and opacity. It also increases risk of mis-accounting, double-booking of expenses and diversion.

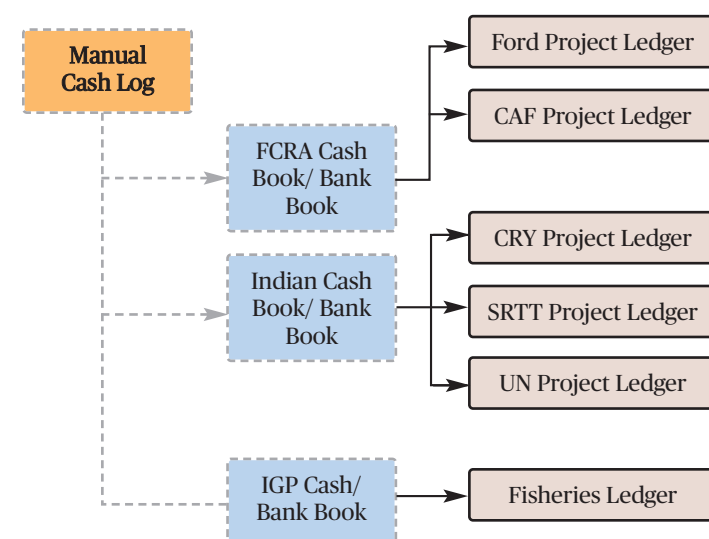


Figure 2: Suggested book-keeping structure (Manual Accounts)

Questions to ask

How are accounts kept? Do they use a maximum of three integrated cashbooks (FCRA, Indian, IGP)²? Or do they keep project-wise cashbooks instead? Do they keep separate ledgers for each project? Is the NGO reluctant to give access to accounts of other donors or general fund?

If accounts are computerised, which software (name, version) is used? Is the software licensed? Have they opened separate company for each project? Are Donor Agency's accounts kept in a separate company?

Are vouchers kept in separate files? How are the vouchers numbered (annual serials or monthly)?

² Compulsory under rule 11 of FCR Rules 2011 and sec. 11(4A) of Income Tax Act, 1961. See Accountable Handbook on FCRA 2010 (p.122-123) for more on this.

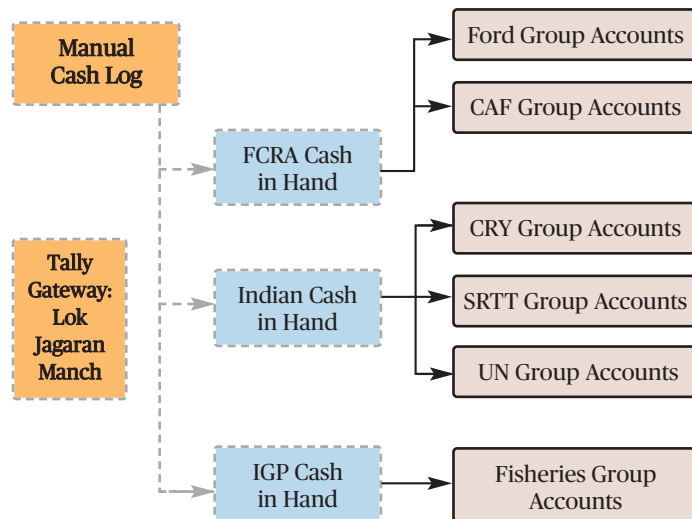


Figure 3: Suggested book-keeping structure (Computerised Accounts)

Risk Statement

Financial transactions may not be verifiable with program or administrative records.

Issue

Most NGOs keep a number of program and administrative records. These should be located and studied before taking up the review. This will help you understand their utility during verification of transactions.

Questions to ask

Do they keep a salary register?³ What other financial, administrative and program records are kept? Such records might include attendance register, stock register, meeting register, distribution register, *dak* register, bills register, donation register, fixed assets register, field movement register, leave register, daily diary, phone calls register, log books for vehicles, etc.

Project Budgeting

Most grants are based on an agreed budget for the project activities. This defines a framework for allocating funds, spending money and then reporting its use.⁴ There can be a number of issues with project budgets. These could result in weakening control over expenditure or reporting for the donor funds. Some of the more common risks are discussed below:

Risk Statement

Project budget may not be sufficiently detailed or clear to allow effective accounting and monitoring.

Issue

Some agencies are comfortable with specifying a few broad objectives of expenditure – others require detailed calculations for each line item in the budget. There is no standard on how much detail is sufficient for monitoring. However, if the budget is being used as a tool for monitoring program and finances, then it should come as close to how the money would be spent. On the other hand, a very specific budget can sometimes restrict the NGO’s freedom of action, and retard project implementation.

Risk Statement

Project budget may contain calculation errors.

Issue

If the calculation error is material, it could result in excess funds being released or funds falling short of requirement. Use of spreadsheet programs such as Excel can actually increase the chances of errors, as budgeting becomes mechanised. One good way to mitigate this risk is to scan the final spreadsheet once and see that it makes sense.

Questions to ask

Who prepares and finalises the project budget? Are there any calculation errors in the project budget? Is the stated breakup the same as the actual Excel formula? Have any rows been left out while calculating totals? Were the calculations eye-balled and also test-checked manually, using a calculator?

Risk Statement

Changes in project budget may not be formally approved by the concerned Donor.

Issue

Sometimes a budget revision or recasting may be agreed verbally with the grant-maker, but not recorded in writing.

³ Separate registers are now needed for FCRA and Indian funds.. See Accountable Handbook on FCRA 2010 (p.124-128) for more on this.

⁴ See AccountAble 37: Grant Budgets at www.AccountAid.net for more on this.

This can result in disputes over what was actually agreed. All changes in project budget should therefore be recorded through an email or formally approved by the agency.

Questions to ask

What are the limits beyond which the NGO is expected to get donor's permission for expenditure variations? Are the project staff aware of these? Does the NGO get prior consent from the donor for any reallocation / recasting of budget? For exceeding the budget for a line item? Is this taken in writing / email or just verbally?

Risk Statement

Project budget variances may not be analysed and monitored regularly or effectively.

Issue

Actual expenditure should be compared with the budgets regularly. This ensures that any under-spending or overspending can be tackled in time.

Questions to ask

Does the NGO calculate Agency budget variances periodically? How often does this happen? Does the NGO analyse the reasons for this? Is any remedial action taken? Is this documented / recorded?

Risk Statement

Growth in overall funds or in the donor's support is substantial and may be unsustainable.

Issue

Sometimes quick growth is followed by a sharp decline, just like the notorious boom and bust business cycles. This can be painful for the staff and confusing for the communities. Excessive focus on growth can also distract management from program goals.

Questions to ask

What is the compound rate of growth in Agency funds? In overall funding for the NGO? Is the NGO growing too fast? Too slowly? Is the growth sustainable? Are donors visiting the office very frequently? Does it distract the Management from program activities or governance?

What is AuditAble:

Each issue of 'AuditAble' covers a different topic related to NGO auditing and is mailed to about 800 NGO auditors and grant-makers in India. AccountAid encourages reproduction or re-distribution of 'AuditAble' in professional circles for non-commercial use, provided the source is acknowledged.

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Questions and doubts? AccountAid provides complimentary advice to implementing NGOs and NGO auditors on matters related to accounting or financial regulation. You can send your questions by e-mail (query@accountaid.net) or letter. You can also discuss these over the phone.

Comments: Your comments and suggestions can be sent to AccountAid India, 55-B, Pocket C, Siddharth Extension, New Delhi-110 014; Phone: 011-2634 3128; Phone/Fax: 011-2634 3852; e-mail: query@accountaid.net

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Content: Shri Sanjay Agarwal

Editing: Ms. Soumyasree Mullick

Design: Ms. Moushumi De

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