



A quick Guide to the FMD Pro

Financial Management for Development,
Humanitarian and Conservation Professionals

fmdpro.org
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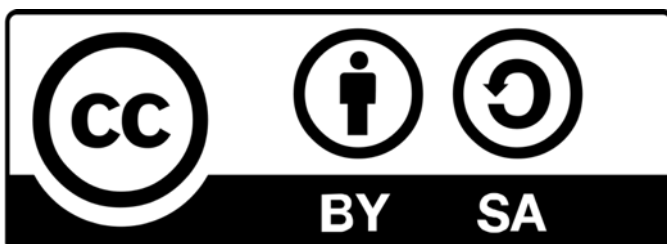
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Preface

The demand for financial accountability in the NGO sector is greater than ever before but there remains a widespread deficit in expertise and agreed standards of competency at the project level. FMD Pro - Financial Management for Development Professionals - has been designed to meet this challenge and build the skills of managers who are not finance experts, thereby raising standards across the development, humanitarian and conservation sectors. This *quick* guide is a **brief overview** of the Guide to FMD Pro. The full guide, downloadable for free at <https://fmdpro.org>, contains many useful examples and case studies to illustrate good financial management practise. You will need to study the full guide if you are planning to take the certification exam. Also, take a look at FMD Pro Starter at <https://fmdprostarter.org> which provides a useful financial toolbox for use in projects and is downloadable for free.



1. INTRODUCTION

Financial management: a key contributor to project success

FMD Pro focuses on one of the most critical disciplines needed to ensure project success—financial management. It concentrates on the fundamentals of financial management in the context of projects in the development, humanitarian, and conservation sectors. FMD Pro provides a contextualized, comprehensive, and adaptable resource for anyone managing project finances in these sectors.

Establishing high standards in financial management benefits organizations and projects on many levels. Here are some of the most persuasive reasons for getting it right:

- Enables effective and efficient use of resources to achieve goals and fulfil obligations.
- Promotes accountability to funders and other stakeholders.
- Encourages the respect and confidence of funding agencies, partners, and beneficiaries.
- Provides an advantage in the competition for increasingly scarce resources.
- Prepares the ground for longer-term financial sustainability.

Yet, while there are many reasons why financial management is critical to project success, ultimately one could roll up these benefits into two overarching categories: accountability and ‘response-ability’.

Accountability: organizations serving the world’s vulnerable communities can “account” for the use of their resources. Good financial management in projects helps ensure organizations improve accountability in three directions: upward, horizontal and downward

Response-ability: when project teams better understand and manage their financial resources, they make better decisions, respond more effectively to stakeholder needs, and are more agile in adapting to ever-changing environments, risks, and issues.

FMD Pro target audience

This Guide to the FMD Pro is written for project team members who work in the development, humanitarian, and conservation sectors. It aims to give them a fundamental understanding of financial processes based on best accounting practises, and to help them collaborate with their finance department in the planning, implementation, monitoring, reporting, and control of financial resources. This collaboration is critical to project success. Good financial management is the responsibility of *everyone* in an organization.

Audiences other than project team members will also find the FMD Pro Guide helpful. For example, managers and mentors can use its tools, techniques, and guidance to enhance the existing skills of their teams. Also, trainers and training organizations can use the FMD Pro Guide to inform and structure their curricula, and as a supporting resource for their training activities.

FMD Pro is not designed for any specific organization or financial system but instead is intended to provide the fundamental skills that project team members need regardless of the organization or system they use.

FMD Pro is not envisaged as a guide for non-finance staff who lead organizations or country and regional programs. People in those roles have financial responsibilities that extend beyond those of project team members. While they may benefit from the contents of the Guide, they will need to develop additional higher-level skills to deliver more strategic responsibilities.



How the FMD Pro Guide is organized

An Introduction, is followed by two sections, a glossary and a table of FMD Pro Learning Outcomes.

Section 1: An overview of key concepts and tools in financial management (Chapter 2) introduces the key concepts. It includes models for assessing good practice in financial management and explores the different roles and responsibilities required at a project level.

Financial management is an essential leadership skill for a competent project manager and an approach that should be embedded within the processes and understanding of all project teams. Some staff will have more responsibility than others for managing resources but at a minimum everyone should understand the basics.

Section 2: The four building blocks of financial management (Chapters 3-6) are the essential skills and tools of project financial management. These chapters contain examples and case studies to demonstrate key financial management tools and concepts. These are:

- ⇒ Accounting Records
- ⇒ Financial Planning
- ⇒ Financial Monitoring
- ⇒ Internal Control

Application

FMD Pro has drawn from best practice in both the public and private sectors, making use of tried and tested approaches and adding new tools to enhance ways of working. Most importantly, it offers a model that, once learned and embedded, can be replicated across projects and programs and from organization to organization to raise standards across our sector. But it's NOT intended as a template to be replicated blindly across all organizations and projects. FMD Pro concepts, practices, and tools should be adapted to an organization's unique needs and contexts:

- **Development and humanitarian emergency responses:** FMD Pro is as adaptable for use in emergencies as it is for long-term development. The timeline for delivering different elements of the model can be reduced and extended depending on the context within which it's applied.
- **Restricted and unrestricted funding:** Grant funding can be restricted to deliverables and project goals set by a funder. Funding may also come from the organization's own sources, received without restrictions. The tools and approaches in FMD Pro can provide reporting about both.
- **Small and large:** Organizations of any size can make use of FMD Pro. Some of the tools and techniques will be recognizable and already used, others will provide a breakthrough for financial management. The standards set by the overall FMD Pro approach allow organizations to assess and monitor whether their financial management processes are as transparent and accountable as they should be.

2. KEY CONCEPTS AND TOOLS

This chapter introduces you to key financial management terminology and principles and some tools that are used throughout FMD Pro. By the end of this chapter, you will be able to:

- ✓ describe what financial management means in practice
- ✓ identify financial management roles and responsibilities at different levels in the organization, including for project staff
- ✓ understand the Plan–Do–Review and the financial planning process
- ✓ outline the four building blocks of good financial management systems
- ✓ describe the purpose and contents of a finance manual
- ✓ understand the seven principals of financial management.



What is financial management?

Financial management involves four types of activity: planning, organizing, monitoring, and controlling the financial resources of an organization to achieve its objectives.

- **Planning.** To look ahead and build a comprehensive overview of the resources needed to implement activities and produce a Project Financial Plan.
- **Organizing.** To organize project implementation efficiently, such as people, buildings, vehicles, money, and financial paperwork. Roles and responsibilities assigned to project team members.
- **Monitoring.** To track progress so as to identify risks or issues early on and taking corrective action if required. It's essential to have up-to-date financial information which compares actual performance with the plan.
- **Controlling.** To ensure efficient and effective use of resources and to protect people from false accusation, being manipulated, or the temptation to misuse organizational resources.

The role of project teams in financial management

Employees at all levels of an organization are responsible for contributing to strong financial management. Organizations use a model of delegated authority, a formal process by which decision-making is delegated from one party to another. This allows an employee or trustee to represent and act on behalf of an organization within specified instructions and limits (tolerances).

Project Managers and their teams are responsible for the day-to-day financial management of their projects in line with their delegated authority. This typically includes four areas of operations:

- *Resource Management:* Ensuring funds are used properly to best effect.
- *Risk Management:* Risks must be actively managed to limit their impact.
- *Strategic Management:* Keeping in mind the “bigger picture”.
- *Project Management:* Progressing and monitoring the project objectives.

The finance team provides support to project teams and other non-financial staff as they engage in the financial management process. Their support includes:

- Handling an organization's cash, including issuing receipts and banking money
- Administering payment processes to ensure that accounts are paid on time
- Ensuring that financial data from projects is entered into the books of account and reconciled every month
- Ensuring that all financial documents are filed and available for auditors to view

Plan–Do–Review and the financial planning process

To **Plan** a project, you establish clear objectives and prepare budgets so you can get funding. Having got funding, you **Do** the project and start spending money, accounting for the financial transactions. Throughout the project you **Review** progress against the plan and the budget. Learning from this you move forward to the next planning phase and repeat the process.

Foundations for strong financial management

Financial control is a strong foundation for financial management. Financial control happens when the financial resources of an organization are used correctly and effectively. Strong and relevant financial policies and procedures must be in place to ensure financial control, otherwise money and equipment are put at risk of theft, fraud, or abuse. Funds that are not spent according to the project's objectives or the funder's contract calls into question the competence of project staff.



The foundation of effective financial management is therefore a strong financial system essential to planning, organizing, monitoring, and controlling of financial resources. While there is no universal standard for a financial management system, FMD Pro uses the four building-block model as a framework for good practice.

- **Accounting records:** Every organization must keep an accurate and complete record of all financial transactions that take place during the financial year so they can show how funds have been used. Accounting records include both the physical paperwork (such as receipts and invoices) and the books of account where the transactions are recorded and summarized.
- **Financial planning:** Linked to an organization's strategic and operational plans, budgets are the cornerstone of any financial management system and play an important role in monitoring the use of funds. The financial planning process includes building longer-term plans, such as a financing strategy, shorter-term budgets, and cash flow forecasts for projects and programs.
- **Financial monitoring:** Providing an organization has kept accurate and timely accounting records and has set its budgets, it is possible to produce financial reports for use by different stakeholders. For example, budget monitoring reports help managers to monitor the progress of their projects, and annual financial statements provide accountability to external stakeholders.
- **Internal control** is a system of common-sense controls, checks, and balances designed to manage internal risk and safeguard an organization's money, equipment, staff, and other financial resources.

These building blocks are interconnected. For example, accounting records should be subject to internal control checks to identify errors and omissions, and to detect any fraudulent invoices.

The finance manual

Your organization should have a **finance manual** containing financial policies and procedures that guide operations and determine how it uses and manages its money. It serves as reference to avoid any misunderstandings and encourage consistency. There's no standard template for a finance manual but content headings would include accounting rules and routines, bank and cash handling procedures, a code of conduct and financial coding structures.

Seven principles of financial management

These seven high-level principles (or guiding rules) to set a standard of good practice and provide a benchmark for assessing your current financial practices for strengths and weaknesses. A useful mnemonic, CAT VISA, is formed using the first letter of each principle to help you to remember:

- ✓ **Consistency** in the use of financial policies and procedures enable staff to follow clear processes, use consistent accounting codes. This can help to ensure compliance and promotes transparency.
- ✓ **Accountability** is the moral or legal duty, placed on an individual, group, or organization to explain how funds, equipment or authority given by a third party have been used.
- ✓ **Transparency:** Organizations must be open about their work, providing information about activities and plans to all stakeholders. This includes preparing accurate, complete, and timely financial reports.
- ✓ **Viability:** To be financially viable, spending must be kept in balance with money coming in, both at the operational and strategic levels.
- ✓ **Integrity:** On a personal level, individuals must operate with honesty and propriety, declaring any conflicts of interest. The integrity of financial reports is dependent on accuracy and completeness of financial records.



- ✓ **Stewardship** involves taking good care of the financial resources entrusted to us, to make sure they are used for the purpose intended through strategic planning, assessing financial risks, and setting up appropriate systems and controls.
- ✓ **Accounting standards:** The system for keeping accurate financial records and documentation must observe internationally accepted accounting standards and principles.

3. ACCOUNTING RECORDS

This chapter explores the first of the four building blocks of financial management: accounting records. It will introduce you to the process of accounting for projects and enable you to interpret and use financial reports. By the end of this chapter, you will be able to:

- ✓ explain why we need to keep accounts and which records to keep.
- ✓ describe the difference between financial accounting and management accounting.
- ✓ describe how to sort financial transactions using accounting codes.
- ✓ outline two different methods used to record financial transactions.
- ✓ describe the process used to account for cash advances.
- ✓ describe the '3 Ps of procurement': process, people, and paperwork.

Why do we need to keep accounts?

All organizations, whatever their size, need to keep accurate and complete accounting records for their operations to ensure accountability and transparency, and to provide data for future decisions.

Financial accounting and management accounting

Financial accounting is the everyday important work of recording, classifying, and summarizing financial transactions for an organization. The main outputs of financial accounting are the mandatory annual financial statements: a retrospective view (showing historical data) that is used for external accountability.

Management accounting uses the data gathered by the financial accounting process and analyzes this information (e.g. by comparing it to the budget) for decision-making and control purposes. Management accounting is therefore primarily for internal use and is forward-looking.

Accounting codes

Every organization needs a list of appropriate codes to classify and sort financial transactions, to summarize internal budgets and create financial reports. The two key coding tools are:

The chart of accounts. To record different kinds of financial transaction we need to sort them into predetermined descriptive categories or *account codes*. The list of income and expenditure codes is the *chart of accounts* to be applied consistently across the organization.

Project or activity cost centers are used to separate the same account codes for different activities within financial accounts and budgets.

Which accounting records to keep

Keeping accounts is about finding a way to store financial information so that the organization can show how it has spent its money and where the funds came from. Accounting records fall into two main categories: books of account and supporting documents.



Books of account are used to keep track of all financial transactions. The main ones are:

- ⇒ Cashbook (or bank book or cash analysis book), one for each cash holding or bank account
- ⇒ Accounts payable and receivable ledgers
- ⇒ General or nominal ledger (the principle book for recording & totalling transactions)
- ⇒ Journal register or day book
- ⇒ Salaries or wage records
- ⇒ Assets register
- ⇒ Stock register.

While cashbooks are regularly used, not all of the other books of account are required. This will depend on the size of the organization, the number of transactions, reporting requirements and the method of accounting used. Accounting data is now usually kept on a computer as a spreadsheet or in an accounting package.

Supporting documents are the original paper or electronic records of financial transactions such as invoices and receipts which show when, how much, what, who and why. Information is transferred from these to the relevant books of account. Remember every financial transaction **MUST** be supported by at least one valid supporting document as it provides evidence that the transaction took place for audit purposes. It also protects staff against any suspicion of mishandling funds. It's important that organizations should have a self-receipt process, approved by its funders, for small purchases where receipts are not issued (e.g. market stalls).

All supporting documents must be filed and kept in a safe place so that they are available for cross-reference and audit. It is important to mark invoices as paid to prevent fraudulent reuse. Each country will have regulations about how long organizations must keep original supporting documents. Typically, it is for the current year plus the previous five years. Funders also include rules about retaining receipts in their grant contracts, which may be different from the local regulations.

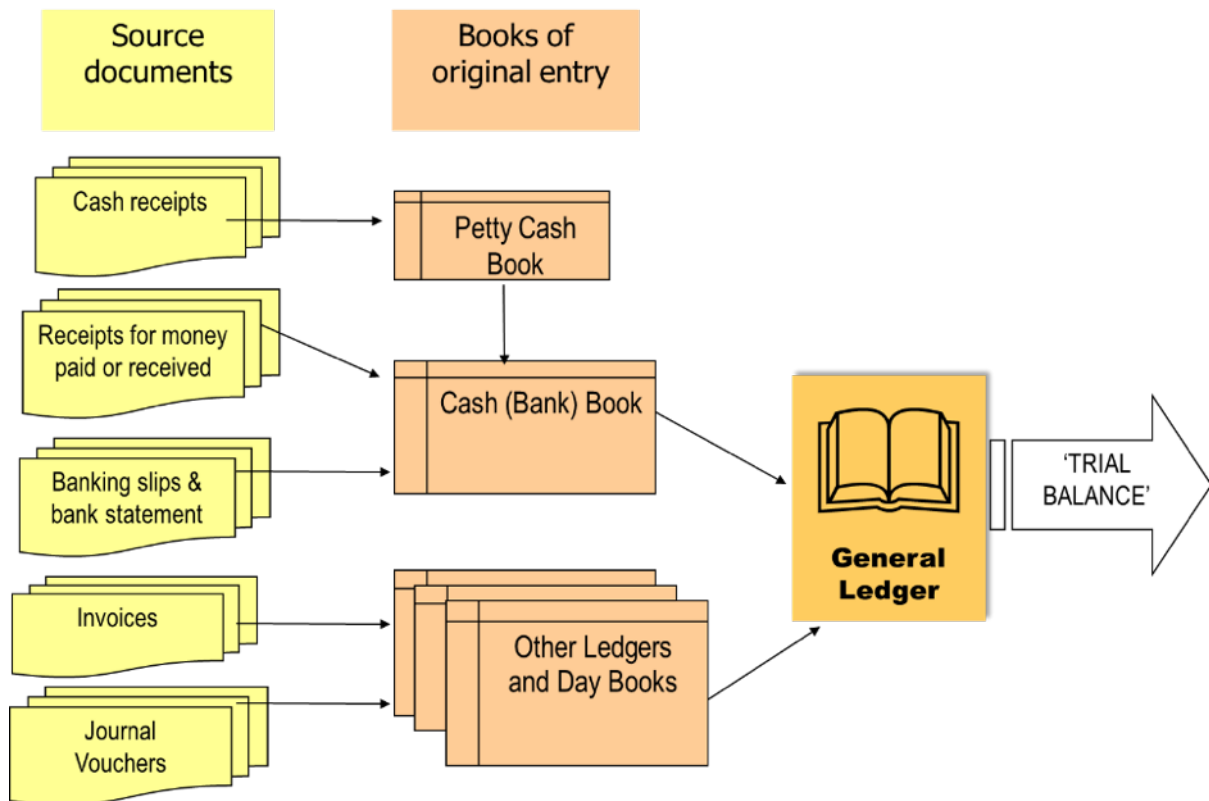
The financial accounting processes

As we have seen, financial accounting is about recording all the financial transactions that occur on a day-to-day basis. There are many different types of transactions that will need to be tracked and recorded, such as project materials, staff salaries, money received from funders, and many more. These transactions are documented in source documents and entered into the books of original entry (books of account), which are, in turn, rolled up into the general ledger as shown in the diagram on the next page – how the accounting records fit together. The term **trial balance** means a list of (debit and credit) balances for each nominal account that is used to prepare financial statements.

There are two different approaches to account for financial transactions, **cash** and **accruals** accounting. The key difference is in how they deal with the timing of cash and credit transactions.

The difference between cash and credit transactions is the timing of the payment. With **cash** there is no time delay because the receipt of goods and payment occur at the same time. With **credit** there is a time delay – the goods are delivered and the invoice is paid after an agreed period (e.g. the end the month).

Some financial transactions involve no physical exchange of cash but will have an impact on the organization's overall financial position, for example in-kind donations such as a vehicle, and depreciation costs reflecting the loss of value of fixed assets over their useful life.



Cash-based accounting system

This is the simplest way to keep accounting records and does not require advanced bookkeeping skills. It's often known as the *Receipts & Payments* system. The main features are:

- ⇒ The main book of account is called the **cashbook** (which incorporates the petty cash book).
- ⇒ Incoming cash is called a **receipt** and cash going out is a **payment**.
- ⇒ Transactions are recorded in the cashbook on the date they happen.
- ⇒ There is no record yet of outstanding credit transactions; these only get accounted for when the payment is made.
- ⇒ This system cannot record non-cash transactions because there is no physical cash transaction.
- ⇒ When summarized, these records produce a receipts and payments report for a given period. It simply shows the movement of cash in and out of an organization under different categories (accounts) and the cash available at the start and end of the reporting period. It does not show the value of the resources owned by the organization (assets) and the amounts owed to other parties (liabilities).

Accruals-based accounting system

This is a more sophisticated and comprehensive approach to accounting that requires a higher level of bookkeeping skills. The main features are:

- ⇒ It uses double-entry bookkeeping, which recognizes that there are always two sides to every transaction: the giver and the receiver. The dual aspects of each transaction are referred to as debits and credits.
- ⇒ The main book of account is the general ledger (backed up by other ledgers, such as accounts payable and accounts receivable, as well as cashbook data).



- ⇒ The terminology used for incoming and outgoing transactions is **income** and **expenditure**.
- ⇒ Income is recorded when it is earned or due, rather than when the cash is received. Expenditures are recorded as they are incurred, rather than when the invoice is paid. This overcomes the problem of time delays with credit transactions.
- ⇒ The system can deal with all types of transactions, including non-cash transactions.
- ⇒ Adjustments are included in the accounts, which compensate for the timing delays caused by credit transactions. These adjustments are called accruals (which is how this accounting method gets its name).
- ⇒ By recognizing financial commitments when they occur, not when they are paid or received, the system automatically builds in up-to-date info on the organization's assets and liabilities.

This process produces a more comprehensive picture of an organization's financial position. The reports produced from a general ledger are described as the **financial statements**. Financial statements usually include information on the previous year and are required in all countries applying *International Financial Reporting Standards* (almost all the countries where development practitioners and humanitarians work). Financial statements include a **balance sheet report** and a **statement of income and expenditure**. See the full Guide for examples.

A footnote on accounting methods

Many smaller organizations cannot afford to employ qualified accountants and therefore adopt a "half-way house" approach to accounting. They use the simpler cash accounting basis during the year (which requires basic bookkeeping skills) and then, with the help of an external accounting firm, convert the cash-based figures to an accruals basis at the year-end for the annual accounts & audit.

Cash advances

It is common practice to give project staff a cash advance (or cash float) to make cash purchases when implementing projects, especially for trips to the field to cover expenses such as fuel, per diem, accommodation, and meeting expenses. If you are given a cash advance, you must be ready to account for every cent of it, keeping an itemized record and providing supporting documentation.

The 3 Ps of procurement

We need to be organized about the procurement process to ensure efficient, effective, and economic use of resources. There are three key aspects of procurement, the 3 Ps: **Process** describes the rules we follow to make different kinds of purchases. The higher the value and the risk more **People** are involved in the process to protect it from fraud. Each part of the process generates **Paperwork** which should be filed for audit purposes.

4. FINANCIAL PLANNING

The second of the four building blocks, financial planning, lies at the heart of effective financial management as it helps organizations to achieve both their longer-term strategic goals and shorter-term project objectives. By the end of this chapter, you will be able to:

- ✓ describe how the financial planning process works in programs.
- ✓ describe different budget formats.
- ✓ describe the three main types of budgets.
- ✓ explain how to create an activity-based budget using a budget worksheet.
- ✓ explain why it is important to budget for central support costs.



Financial planning in programs

Financial planning is essential for achieving successful program outcomes. A long-term view is gained by **Strategic Planning** and a much more detailed short-term view through **Operational Planning**, which includes preparing program budgets and forecasts.

A **budget** describes an amount of money that an organization plans to raise and spend for a set purpose over a given period of time. The budgeting process involves people at all levels of the organization providing information, writing and approving. External stakeholders such as funders and community partners rely on these budgets. There are two approaches to preparing budgets:

- ⇒ **Incremental** budgeting for projects where activity and resource levels change little from year to year and is therefore based on the previous year's actual or budgeted figures.
- ⇒ **Zero-based** (including activity-based) budgeting for new and one-off projects, or those that experience a lot of change year on year. Starts with a clean sheet (a 'zero base') and builds the budget according to planned activities and targets. Resources are individually costed.

Whatever approach you use it is important to work out the true costs of running a project (i.e. what the project demands) before you look at possible funding options and to not be influenced by the supply of funds or a specific pot of money.

Different forms and types of budgets

Budgets have a wide range of uses and users with different content and layouts:

- ⇒ **Activity level.** Budgets can be prepared for one activity area, a project (several activity areas), a program (several projects), or the whole organization.
- ⇒ **Budget detail.** Some users require very detailed budgets (to show how each line is calculated) accompany a funding proposal. Other users prefer to see a summarized version of the budget.
- ⇒ **Layout.** Most organizations and funders use a standard format to present internal budgets, which will be consistent with the codes and budget descriptions in their chart of accounts.
- ⇒ **Time frame.** A budget always covers a specific time period related to each activity e.g. monthly.
- ⇒ **Currency.** Budgets can be prepared in any currency or more than one depending on the need.

Budgets have a hierarchy, with lower level project budgets summarized (consolidated) into the program budget, and program budgets consolidated into a master, organization-wide budget. There are three main types of budget:

- ⇒ **Income and Expenditure budget** shows the estimated costs of running an activity, project, or entire organization, and identifies the funds to cover the costs for a specified period of time. It's created using either incremental or zero-based budgeting. It's important for fundraising. The budget will have a "bottom line" status as balanced, deficit or surplus. Note that some organizations such as international NGOs with country programs manage their projects using what called an **expenses-only budget** format based on the amount authorized by Head Office. There's no income section.
- ⇒ **Capital budget** lists one-off expenditures for expensive items, such as equipment and construction works, which will be used over several years and form part of the organization's fixed assets. It separately lists, and is able to monitor, the major investment and one-off costs involved in capital projects. It is only possible to create it with a zero-based budgeting approach. It should include a contingency line for unpredictable variations, such as exchange rate fluctuations, and also a line for running costs. For small capital expenditure a capital budget section can be included in a separate section of an Income and Expenditure budget.



⇒ **Cash flow forecast** is a financial planning tool based on existing budgets and plans that shows the predicted flow of cash in and out of a project or organization each month. It shows periods of cash shortages or surplus and will highlight any requirement for corrective action.

Activity-based budgeting

Activity-based budgeting is a form of zero-based budgeting which is widely used in the development and humanitarian sector. It is ideal for creating accurate and complete project budgets. The technique systematically lists, quantifies, and costs all the resources (i.e. people, materials, and equipment) that are needed to run the activities described in a project plan.

The resources, quantities, and calculations are captured in a detailed table called a budget worksheet, usually stored as a computer spreadsheet. The budget worksheet is then used to summarize the project budget for use in whatever format is needed, i.e. for internal use or for budgets required by funders. Before you start you should ensure you have:

- Clear and measurable project plans: key documents include the project proposal, log-frame, and timed activity plan (such as a Gantt chart)
- Budgeting policies and guidance, such as for staff salaries and benefits, indirect costs contribution, and inflation rates
- Price list for commonly used resources
- Budget worksheets and templates
- Latest chart of accounts
- Timetable for submitting budgets for approval.

There are eight steps involved in creating an activity-based budget:

1. **Identify the project objective(s)** as set out in the project design documents. Create one activity-based budget for each objective; sometimes a budget has to cover more than one.
2. **List the project activities** (for each separate objective) which will be found in the project design documents and should have clear and quantifiable indicators.
3. **Identify and quantify resources** is probably the most important step in creating your activity-based budget. Each project activity will need to be unpacked, with all the tasks and deliverables listed so that you can identify the resources needed to run it. The project design documents will help with this, but it is a good idea to imagine yourself running each of the various activities to understand what resources will be needed. Be aware of any hidden project resources such as shared vehicles or project staff. It is helpful to list all the resources and quantities needed for each activity in a separate document or page of the spreadsheet. We call this the activity or **Project Breakdown Sheet**. Note the date or month when the resources will be used as this information is needed to create phased budgets and forecasts.
4. **Research the cost of resources.** Using your project breakdown sheet, find out how much each resource will cost at the time when the project will be implemented. Wherever possible, get a unit price or base cost for one item. Your finance team may provide a price list for items that are regularly purchased or where there are set amounts for budgets, such as staff allowances or consultancy fees. Don't be tempted to guess the price! Although budgets are a best estimate of costs, they must be based on reliable evidence, not on invented amounts. If you get your unit prices wrong, you will over- or underestimate the costs, jeopardizing the integrity of your budget.
5. **Identify known income** sources that will be used to support the project and make a list. For example, anticipated contributions to costs from services users and communities. Do not include income that is yet to be negotiated.



6. You are now ready to **compile the budget worksheet**. Each activity will be described in a separate section including its required resources, quantities, and unit costs. Each budget line item is assigned a budget code from the chart of accounts and, where relevant, a funder budget code.
7. **Review the results** and check that the final draft budget is realistic and complete. If possible, get someone else (a budget buddy) to check it.
8. **Summarize the budget** in whatever data format you need for internal or external use, or used by the funder for fundraising.

The Project Breakdown Sheet contains all the information needed to begin building out the activity-based budget, using a **budget worksheet** as described in the next section.

Using a budget worksheet in activity-based budgeting

A budget worksheet is a table with pre-set headings and rows or lines for each item in the budget. It is usually set up in a computer spreadsheet (such as Excel). Each project activity area has its own section in the worksheet, with a list of all the resources needed and in what quantities, to calculate the cost of each item needed. This makes it possible to see how much each activity area would cost to deliver. The full Guide shows a worked example of this in section 4.4.

Typical budget worksheet column headings are: Line reference; Description; Unit Type; Number of Units; Number of Times (frequency); Unit Cost; Total; Notes; and Account Code. The Unit Cost should include an allowance for price inflation. Getting the Unit Type right is critical to the understanding and successful completion of the budget worksheet. There are two special unit types:

- *Lump sum* is a special unit type used to include a one-off amount or general estimate, often for multiple items or services, that are detailed in a supplier quotation or a separate schedule. It is important to be able to justify lump sum amounts. Some funders ask that this unit type not be used.
- *Compound unit type* combines two different units and is used when writing a budget for a large project with multiple activities.

In-kind donations (or gifts in-kind) are resources donated to a project as materials and equipment rather than funds. You should include the value of the item as 'known income' if it is essential to the success of the project and you would have had to purchase it.

Sometimes we need to include an extra amount in a budget for unforeseen expenses, called a **contingency**. It's **good practice** to include a specific and explained contingency line for the specific budget lines that need a just-in-case cushion. For example, a contingency against fluctuating exchange rates. It's **bad practice** to add an overall percentage to the budget on the bottom line as it's difficult to justify and to monitor.

The **currency** that you choose to use for budgeting depends on several factors, in particular where your main sources of income come from and the stability of your home economy. As there can be a significant time lag between the initial submission of a proposal to a funder and a project starting, before you sign a grant contract, review the exchange rate assumptions in the budget and renegotiate the rate with the funder if it is significantly different.

Finally, it's important to keep a separate note of any key **budget assumptions**, such as the inflation rate and salaries, as well as the line-by-line notes on your budget worksheet.



Budgeting for indirect project costs

When budgeting for projects, we need to consider both direct and indirect project costs. Direct costs are incurred directly delivering the project, such as the salary of a project officer or equipment. **Indirect costs** are the general, shared costs that support and administer an organization's projects, for instance: the chief executive, office rent, and accountancy costs. These are known variously as overheads, central support costs or core costs.

When setting your budgets, your finance team will provide guidance as to what to include in your budget for indirect costs, usually a bottom-line percentage. It is usual to create a table to show the apportionment of indirect costs between different project cost centers. This data is then incorporated into the organization's consolidated budget, which we look at next.

Budgeting for income: restricted and unrestricted funding

Income that organizations use to cover the costs of their planned projects and activities may come from various sources. These will either be designated as **Restricted Funds**, which will have conditions on what the funds may or may not be used for, or **Unrestricted Funds**. When planning for the income that will be incorporated into your budget you need to know the designation.

Summarizing and consolidating project budgets

When the project budget worksheet is completed, the final stage is to summarize the data into different formats with appropriate levels of detail for different users.

The accounts code column in the budget worksheet makes it easy to summarize budget data. Each line in the worksheet is allocated a code from the Chart of Accounts. It's possible to add higher level codes to a worksheet and map lower level codes to them.

When an organization runs multiple projects and departments, managers can combine, or consolidate, multiple budgets into one table in order to give a useful overview at the program or organization levels. This will include Central Support cost budgets and any indirect costs.

Creating budgets for funding agencies

To create a budget for a funder, you will follow the same process described above for internal budgets. First find out what format the funder requires, then use your activity-based worksheet to map their accounts codes to yours. Check what can and can't be included as project expenses and indirect costs. Funders may also ask you to share any known income or to state match funding. Finally, be sure to include important budget notes and assumptions, such as inflation rates and exchange rates used.

When you apply for a grant, a funder will often require that you include a **budget narrative** to support the budget in the funding proposal. The budget narrative, also known as a budget justification, has two purposes: to explain to the reviewer of the funding proposal how the costs were estimated, and to justify the reason for costs. Budget narratives are especially useful to explain hidden or confusing costs listed in a proposal budget. The full Guide contains a table with suggested content for the budget narrative. Finally, get a colleague to check your budget proposal and narrative to make sure that it is clearly explained and justified.

The phased budget

A phased budget breaks down the project budget into time periods (or phases), usually monthly or quarterly, to show when the budget will be used up during project implementation, according to the



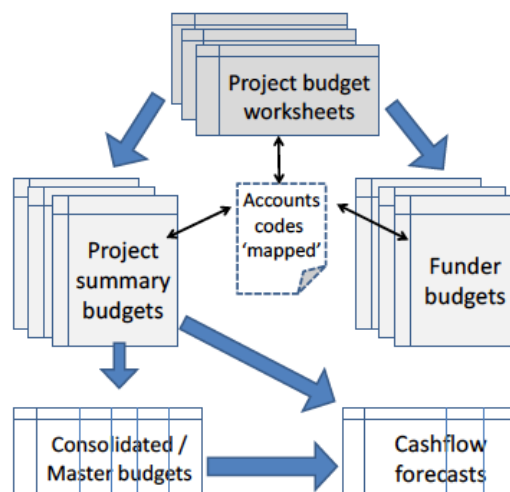
activity plan. This to compare the plan with the actual performance of a project during implementation and to check progress (and take action if it is not on target). Also, to advise a funder about how you expect to utilize their grant during project implementation. It's a similar process to that of creating a cash flow forecast but this time we are looking at when the budget is needed, not when the cash transactions will take place. Note that a phased budget is NOT the total budget divided by 12 months or 4 quarters. It must mirror the activity plan!

Using a funding grid

When there are multiple sources of income an internal planning tool called a **funding grid** is used to provide an overview of **who** is funding **what** at project, program, or organization levels. It is presented in table format and matches each anticipated source of income with budgeted expenditure. This reveals where there are gaps in funding, and also any double funding, by budget line. The funding grid has columns showing each source of income, restricted and unrestricted, mapped to the internal chart of accounts codes.

Summary

The diagram below summarizes the budgeting process and illustrates the relationship between the different budgets, as covered in this chapter. Notice that accounts codes are placed prominently in the center of all the budgets, underscoring their importance in mapping the different budgets to each other.



5. FINANCIAL MONITORING

In this chapter we look at the third building block of financial management, financial monitoring, which builds directly on the previous two areas: accounting records and financial planning. Financial monitoring in projects is all about having regular and up-to-date financial reports to review project progress and make resourcing decisions. By the end of this chapter, you will be able to:

- ✓ identify who needs financial reports and why
- ✓ describe the different types of financial reports for program management and stakeholder accountability
- ✓ explain how to use the information in budget monitoring and other management reports
- ✓ outline the main features and purpose of reports to funding agencies
- ✓ explain the benefits of being accountable to project beneficiary communities.



Overview of financial reports

Financial reports must be **TIMELY**, **ACCURATE**, and **RELEVANT**. To achieve this, we must have robust accounting records and good financial planning systems to enable the budget monitoring process. Below is a list of the key finance reports, outlining who they are aimed at and how they are used for project monitoring and accountability.

- ⇒ **Budget monitoring report** is used by project staff and board members to track project funds and identify any problems so that corrective action can be taken, usually monthly.
- ⇒ **Cash flow report** is used by finance staff, managers, and project staff to ensure that there is enough money in the bank to run programs and solve any cash flow problems, usually monthly.
- ⇒ **Funder progress report** to explain how project funds are being used, compared to the original plan and targets, and to be able to request changes to the budget or terms of the agreement.
- ⇒ **Partner progress report** shows how the funds raised for the community projects is being used.
- ⇒ **Financial statements (audited)** are an annual public record showing the income, expenditure, assets and liabilities.

Finance teams usually compile financial reports. However, in some field operations or smaller organizations with no dedicated finance support, project staff may need to compile reports themselves. The **financial statements** are the main output of the financial accounting process.

The financial statements

The annual financial statements tell us where an organization's funds came from (income), how the funds were used (expenditure), outcome for the year (surplus or deficit), and the net worth of the organization (assets less liabilities). They commonly include the previous year's figures for comparison. They are the basis for the annual external audit and comprise:

- The **balance sheet**, or statement of financial position, and
- The **income and expenditure statement**, also known as the statement of financial activities, statement of activities, statement of financial performance, statement of comprehensive income or Income statement.

Budget monitoring report: how it works

Regular and timely budget monitoring reports are an essential resource for project staff to review progress against the original plan and identify any problem areas. They are known by many names and the format of your budget monitoring reports will vary depending on the audience.

Budget monitoring reports take the budget for the reporting period, preferably the phased budget, and compare it with the actual income and expenditure for the same period for each accounts code. These *variance* figures, often expressed as a percentage, will be positive, negative or zero. Negative numbers are shown surrounded by brackets.

Another useful measure is the *utilization ratio* or burn rate. It's the difference between the actual spend to date expressed as a percentage of annual budget. This shows how much of the total project budget has been used up for each accounts code so far. A figure over 100% means that more than the total budget for the year has been spent at this point in the year.

Commitments (or committed expenditure) refer to significant expenses that have been incurred for a project in a particular period, but haven't yet been accounted for, or which belong to a future reporting period. Commitments are more relevant in a cash accounting system or where there are time delays in reporting some expenditure, e.g. from remotely based field offices. In this situation you may add an extra column or notes to your report.



Analyzing budget monitoring reports

The key to making best use of budget monitoring reports for project management purposes is to analyze *variances*. This involves looking at budget monitoring reports to identify significant or unusual issues, and to understand what has caused them to happen. This helps us plan the next phase and to take any corrective action. Things to check are:

- ✓ Check the accounting basis of the report, cash or accruals.
- ✓ Look at the bottom line. Is the overall result (surplus or deficit) within budget? If not an outcome of plus or minus 10% is considered reasonable.
- ✓ Look at sub totals for “family groups”. Is spending overall on target across the group?
- ✓ Check overall expenditure as being broadly in line with the budget within +/- 10%.
- ✓ Check overall income. Is this what we expected? Are there any large sums outstanding?
- ✓ Look for unusual or unexpected results. This could show any miscoding or misuse of funds.
- ✓ Look for significant variances in line items. Underspending suggests there are delays.
- ✓ Check for consistent results across linked line items.
- ✓ Refer to any supporting narrative reports.

Sometimes figures just do not look right. Trust your instincts and follow your concerns.

In all cases, a variance represents a change from the original plan. Variances will be the result of one or more of the following three change factors (or possibly caused by an accounting error):

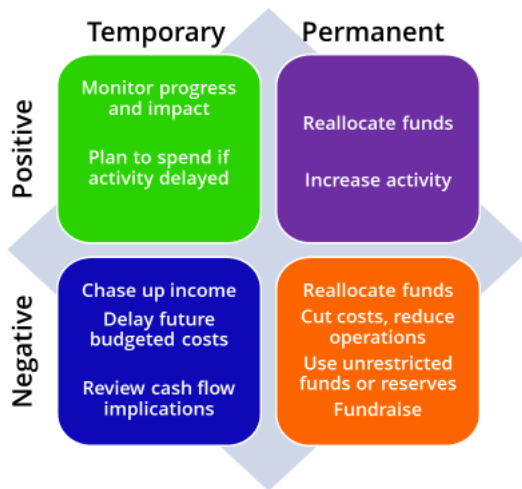
- Change in the actual timing of the activity
- Change in the actual price paid or
- Change in the actual quantity of goods or services used.

Variances should not come as a surprise because the budget is only your best estimate. They can be temporary, caused by a change in the planned timing of an activity, or permanent, caused by changes in pricing. In the latter case corrective action is needed via an action plan. By highlighting significant variances, the budget monitoring process will focus on activities that require attention and ignore those that appear to be running smoothly. It is the cause and significance of a variance that matters, not simply whether it is positive or negative.

Taking action on variances

Having analyzed the figures in the budget monitoring report, the budget holder must next create an action plan to get the budget, or more importantly, the project, back on track. They must discuss recommended actions with their manager and the project funder where relevant. Deciding on which actions to take will depend on many factors, such as:

- Awareness of external factors: What are the inflationary trends? What dependencies exist with other programs that influence our ability to meet project targets?
- Internal policies: e.g. rules on budgetary control and flexibilities (or tolerances).
- Funder rules: e.g. for budget variances and flexibility on over- or under-spending budget lines.
- Significance: How serious is the variance and how urgently does it need to be resolved?
- How controllable: Is it possible to control future spending on the budget items under pressure?
- Impact: What would the impact be if we take no action?
- Availability of unrestricted funds: e.g. to finance over-spends.



The diagram left summarizes possible actions to take for different categories of variance, according to whether they are positive or negative, temporary, or permanent.

Permanent negative variances are the hardest to resolve. Check if it is possible to reallocate funds from elsewhere in the budget. Formal approval is only needed if the transfer exceeds 10% of the budget line. It may be possible to cut costs or find other (unrestricted) sources of income.

It is good practice to hold monthly budget review meetings, with both program and finance staff, to discuss

results and make action plans to resolve any 'red flag' issues. Recommended actions should then be discussed with managers and project funders, where relevant. To help you monitor your budget the full Guide includes a budget monitoring action planner.

Sometimes changes to activity plans or project operating context affect multiple lines in a project budget making a project budget substantially out of date and therefore more difficult to manage. In this situation, it may be better to rework the whole budget (re-budget) with the approval of your management team and project funder(s). This is often called a budget revision.

Budget forecast reports

Some budget monitoring reports also include a budget forecast column that predicts income and/or expenditure for a future period, such as the next quarter, six months, or to the end of the planning year. This can help project staff identify trouble spots and take necessary action, re-budget, or undertake fundraising in good time. It's important to be aware of the likely outcome for your project as a small deficit or surplus will suggest to stakeholders there's good overall budget management.

A forecast is based on current knowledge and past trends, not simply the project budget for the forecast period. Knowledge of the project is essential. Useful information for your forecast:

- ✓ Income and expenditure for the year so far.
- ✓ Commitments, i.e. outstanding bills or payments for goods and services that have been purchased or received but not yet paid for.
- ✓ Historical data and trends for previous periods.
- ✓ Activity plans, including any changes or additions for the forecast period.
- ✓ Current pricing information - have any budget items been hit by unexpected price increases?

You need to estimate how much is needed for each budget line. When your forecast figures are complete, identify any areas of concern and create an action plan to mitigate the risks presented.

The cash flow report

The cash flow report is used to predict any periods when cash balances are likely to be critical. Cash shortages may potentially hamper the project implementation plans. It looks exactly like the *cash flow forecast* we discussed in chapter 4, with the difference that it contains the actual receipts and



payments plus any new information on future spending or income plans. So, it is partly a report on what has actually happened, and partly a forecast for the future, including the most up-to-date data.

Cash flow reports are especially important where operations are highly dependent on cash, such as humanitarian responses or projects operating in remote areas. In these cases, a cash flow report is needed on a weekly basis rather than the more typical monthly report.

Project staff and finance teams should work together to discuss options for overcoming predicted cash flow problems.

Reporting to funding partners

Funding agencies require evidence of how their funds are being used before approving the release of funds. Periodic and annual financial reports fulfil that role. It is important to comply with the funder's reporting conditions to establish credibility and to make sure your grant arrives on time!

Where multiple funders are supporting a project or program, it is important to set up appropriate project accounting systems and coding structures so that the information required by each funder can be easily retrieved. Setting up separate cost centers for each funding source is particularly useful here. It is also important to map the funder's accounting codes referenced in the budget to your internal chart of accounts codes, adding new codes where needed.

Check the funding agreement to be aware of reporting requirements and any budget restrictions. The frequency of reports can vary from monthly to quarterly or even just once a year. Reports are typically required to coincide with release of grant instalments, so it is important to meet the reporting deadlines. Most funders require some form of a budget compared to actual report and/or a grant utilization (burn rate) report, based on the project budget that accompanied the original funding application.

In most cases, a report to a funder will include financial data accompanied by a short, written progress report. The narrative report will include comments on the following:

- ✓ Activities and targets achieved during the reporting period, compared to the plan
- ✓ Any challenges experienced and lessons learned
- ✓ Plans for the next period
- ✓ Requests for budget realignment and transfers.

Funders often disburse funds in their home currency, not the project's local currency, and require budgets and reports to be prepared in this currency. However, the organization may have converted these funds into other currencies to pay for goods and services and must have a system to re-convert for reporting purposes. Exchange gains and losses are a natural product of operating in different currencies. These gains and losses need to be tracked for the purpose of reporting to funding agencies.

The top tips for reporting to funders:

- ✓ DO meet reporting deadlines (or request an extension).
- ✓ DO produce accurate and verifiable figures.
- ✓ DO NOT conceal underspends or overspends.
- ✓ DO explain any significant variations.
- ✓ DO keep the funder informed of any potential problems.
- ✓ DO remember that staff from funding agencies will have a lot of experience of working with groups such as yours. They will almost always respond positively to requests for advice.



Reporting to partner communities

Most organizations recognize the need for *downward accountability*, which means reporting back to communities about what has been achieved with funds that were raised on their behalf. To participate fully in an organization's work, partner communities need access to information about an organization's plans, programmatic as well as financial; resources; and activities. This has many benefits:

- Strengthening trust and respect between staff and partner communities
- Improving the quality of program decisions, as beneficiaries provide feedback on how funds are being spent
- Empowering people to make their own decisions on their own behalf
- Reducing the risks of inefficiencies and fraud
- Encouraging finance staff to get more involved with field work.

Financial reports to the communities that an organization serves should have content which is brief, easy to understand and relevant to the local community. Publish reports in local languages and media, and hold face-to-face sessions. Include pictures and/or non-complex graphs

6. INTERNAL CONTROL

The final block in the model of financial management is internal control. Simply stated, internal control systems help deter opportunistic theft or fraud, and detect errors and omissions in the accounting records. By the end of this chapter, you will be able to:

- ✓ explain how the four-actions model of internal control protects projects against the risk of losses due to errors, theft or fraud,
- ✓ use procedures and practices from each of the categories of the four-actions internal control model,
- ✓ define corruption and list illicit actions that contribute to corrupt practice,
- ✓ identify warning signs of potential fraud in your projects,
- ✓ employ strategies to counter bribery in project implementation.

Why internal control matters

Internal control systems are designed to protect an organization's financial resources from everyday internal risks. Internal controls use practical and common-sense checks and balances to ensure an organization's resources are used for the purposes intended, and to the best effect. A strong system of internal control benefits all stakeholders who are involved in a project and its operations:

- **Project level:** Actively manage the risk to project resources with appropriate policies, procedures and checks, to minimize losses and detect errors in accounting records.
- **Organization level:** Improve the reliability of financial information and reports with timely feedback, and compliance with rules and regulations.
- **Funder/contributor level:** Increase accountability and transparency for donated funds, and ensure sure funds entrusted to a project or organization are used effectively.
- **Community level:** Help to ensure that scarce project resources go where they are most needed, where they can be most effective, and to those who need them most.
- **Individual level:** Finally, and arguably most important of all, internal control systems protect staff involved in the financial affairs of a project or organization. They can prevent the temptation or opportunity to misuse resources, and protect staff from mis-placed suspicion of abuse of funds.

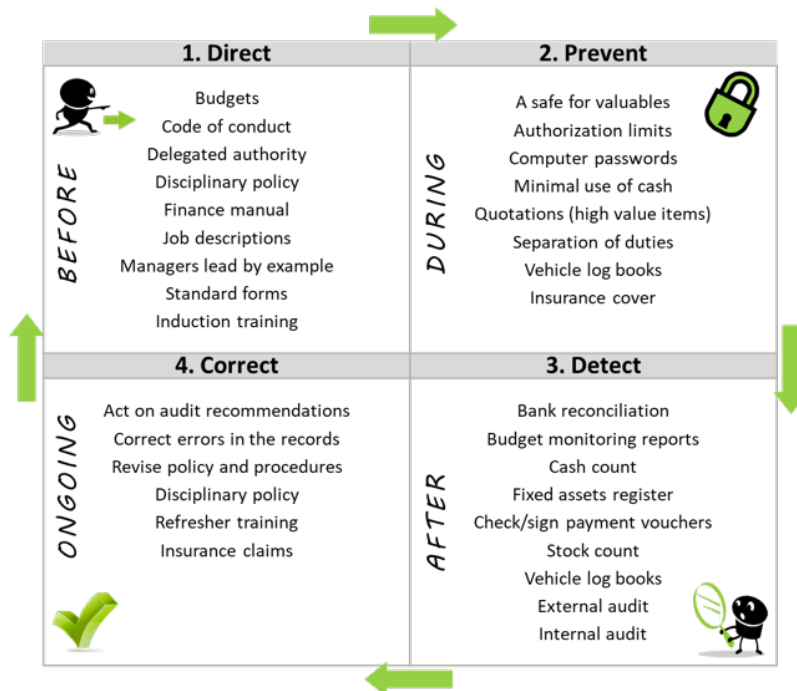


The four-actions model for internal control

A strong system of internal control is intended to minimize the everyday risks to financial resources, such as errors and omissions in accounting records, or theft and fraud. To manage these risks in your projects, you need to set up systems to support day-to-day operations, such as the Four Action model:

- ⇒ **DIRECT:** Set clear guidance, policies, and expectations for good financial practice. These actions generally take place before project activity begins.
- ⇒ **PREVENT:** Establish systems that remove the opportunity for theft and minimize the risk of losses due to errors and incompetence. These actions happen during project implementation.
- ⇒ **DETECT:** Implement processes and procedures that identify if and where activities have gone wrong. These actions identify problems after the improper activity has taken place.
- ⇒ **CORRECT:** Update and improve internal control systems as the project team learns from experience. These actions are ongoing and aim to provide continuous improvement to the system.

We'll now look more closely at each of the four-action categories and explore some of the key tools, procedures, and practices a project team can use to minimize losses due to errors, theft and fraud.



Direct actions

Direct actions include setting clear guidance, policies and expectations usually before an action occurs. Many actions fit into this category including:

- The **finance manual** sets out principles, policies, and practices on matters that affect the operations of an organization. It includes guidance on 'HOW to do it', as well as 'WHY we do it'. *Policies* outline the reasons why things are done the way they are, and the *procedures* explain how things are done on a day-to-day basis.
- A **delegated authority document** clarifies who has the authority to make decisions, commit expenditure within specified limits, and sign legal undertakings on behalf of the organization so that there is no confusion about responsibility or conflict of interest. It will also cover deputizing arrangements due to the absence of key staff. It may be necessary to make



temporary changes to the document for an emergency response project or to meet funders' conditions.

- Other direct actions include having a code of conduct and a disciplinary policy, having formal job descriptions, induction training, standard forms, and budgets.

Prevent actions

While the direct actions are intended to encourage people to do the right thing, prevent actions are intended to remove or limit opportunities to misuse resources or commit theft. Prevent actions, like direct actions, are proactive and address risks before they become an issue that needs to be corrected. These include:

- The concept of **separation of duties** (or segregation) is to share around, to as many people as possible, the responsibilities for: authorizing transactions, receiving goods, custody of assets, entering transactions into the accounting records, reconciling, and verifying transactions. By sharing the various duties in a finance procedure around a team, it protects those involved and removes the temptation and opportunity to misuse funds.
- Organizations working in the development and humanitarian sector often work in environments where cash is used extensively or is the preferred, or the only, way to pay for goods and services. **Cash control** is all about preventing loss and misuse of cash. The *seven golden rules* for handling cash are:
 1. Keep money coming in separate from money going out
 2. Always give receipts for money received
 3. Always obtain receipts for money paid out
 4. Pay surplus cash into the bank
 5. Have properly laid down procedures for receiving cash
 6. Restrict access to petty cash and the safe
 7. Keep cash transactions to an absolute minimum.
- **Physical controls** include many common-sense prevent actions intended to safeguard project assets. Physical controls apply to all of the valuable assets used by your project: from cash to building supplies, from valuable documents to vehicles, and everything in between. Use a safe to keep cash and safeguard fixed assets by:
 - Maintain an asset register
 - Document a building and equipment maintenance policy
 - Obtain insurance cover
 - Establish a vehicle policy
 - Maintain vehicle logs

Detect actions

Direct and prevent actions cannot stop all problems before they occur. Detect actions implement procedures and practices designed to identify if and where things have gone wrong after the activity has taken place. They are intended to identify irregularities, errors, fraud, and theft, and include:

- **Reviewing records** checks procedures are being followed correctly and transactions are valid
- **Audits** are an independent examination of records, procedures, and activities of an organization, resulting in a report on the findings. There are three main types of audit: internal, external, and funder (or donor). Audits are important for organizations as they demonstrate a commitment to transparency and accountability and bring credibility.
- Other detect actions include doing fixed asset register checks, stock counts, budget monitoring, payment vouchers, checking vehicle log books, cash counts, and bank reconciliation.



Correct actions

Correct actions update and improve internal control systems as the team *learns from experience*, to reduce the chance of the loss happening again. Illustrative actions in the correct category include: acting on audit recommendations, correcting errors in the records, revising policies and procedures, taking disciplinary actions, conducting refresher training, and processing insurance claims.

Deterring and detecting corrupt activities

One of the areas where internal controls are especially helpful is in deterring and detecting corrupt activities. Corruption takes place all over the world and affects all levels of society, particularly in the developing world, and poses a significant project risk. Forms of corrupt practice are:

- *Bribery*: Offering or accepting an inducement for an action which is illegal or unethical.
- *Collusion*: A secretive agreement to limit open competition, such as price fixing.
- *Cronyism*: The appointment of (unqualified) friends and associates to positions of authority.
- *Embezzlement*: Fraudulently acquiring funds entrusted to your care owned by someone else.
- *Extortion*: Obtaining something, especially money or property, through force or threats.
- *Facilitation payments*: A form of bribery by government officials to facilitate services.
- *Fraud*: Wrongful or criminal deception intended to result to financial or personal gain.
- *Nepotism*: Favouring (unqualified) friends or relatives in giving them jobs.
- *Sexual exploitation*: Where someone uses their position to gain sexual favours.

Addressing fraud

Fraud is defined as *intentionally lying or cheating to gain an advantage or to cause someone else to make a loss*. These are serious and illegal offences, and include the theft of goods or property, falsifying expenses claims, or the falsification (or destruction) of records to conceal an improper action. Fraud has a damaging effect on an organization with wide-ranging consequences if it's not properly managed. Some ways to take action to prevent fraud before it happens include:

- ✓ ensure that robust internal control systems are in place
- ✓ establish schedules for regular project visits, so that the project team can monitor project expenditures and check they are in line with implemented activities
- ✓ share financial reports with beneficiaries, and ask if they think the project is achieving value for money
- ✓ hold regular meetings with staff at all levels and with partners, to discuss financial reports and make budgets and reports openly available to ensure transparency
- ✓ take time to help non-finance staff and managers to improve their financial skills.

Warning signs of fraud in accounting records:

- Lots of corrections to accounting records e.g. with white-out or blocked-out figures
- Pristine documents could indicate rewritten or duplicate books
- Delayed banking of received cash could be unauthorized 'borrowing' of cash
- Records not kept up to date, or are deliberately delayed, could be false accounting
- Supporting documents are missing, e.g. bank statements or lost receipts
- Payments have been made but are not accounted for on a budget line
- Handwritten supporting documents that include errors and corrections could indicate changes made after goods or services were purchased.
- There is a cash shortfall in a safe or cash box, but next time you count it, the amount is OK.

Warning signs of fraud in reports:

- Budget monitoring reports reveal inconsistent behaviour between line items
- Vehicle logbooks are not maintained in an appropriate level of detail



- Delayed budget monitoring reports could be covering up unauthorized activities.

Warning signs of fraud in non-financial areas:

- Look out for irregular work patterns, e.g. if someone is first in, last out of the office
- A staff member who never takes holidays could be needing to cover up irregular activities
- A significant change in lifestyle or spending patterns that doesn't match a person's income
- Creating a smoke screen by making a false accusation about another team member.

If you suspect that fraud or other irregularities are taking place, think before you act so that you can deal with the situation appropriately and confidentially. Your organization may have a fraud policy or whistle-blowing (speaking up) procedures that you need to follow. *If unsure, it's important to involve your line manager.*

When an incident is reported, it must be dealt with quickly and sensitively. Look for corroborative evidence before starting a formal investigation. If all the evidence points to an irregularity, the individual(s) involved should be formally interviewed with a third person present to take notes. Depending on the nature of the irregularity, an investigation could be conducted by a senior manager or board member, the internal auditor, the external auditor or, in more serious cases, the Police. Finally, don't underestimate the long-term and less tangible impacts of fraud. It will involve a lot of management time during the investigation and afterwards. In particular:

- ⇒ People will be distressed by the experience and need to be supported.
- ⇒ New staff may need to be recruited and trained.
- ⇒ The media may get hold of the story and ask for information.
- ⇒ Funders will need reassuring that their resources are safe and the project will not suffer.

Managing the risk of bribery

Bribery is the offering, promising, giving, accepting, or soliciting of an advantage as an inducement for an action which is illegal, unethical, or a breach of trust. Like fraud, it is a form of corruption. It is often endemic in the countries where we operate. It is commonly in the form of *facilitation payments* to corrupt officials in exchange for providing services for which there are no fees payable, such as speeding up a customs clearance.

In many countries is illegal to *receive* and *pay* a bribe with severe penalties. Project teams therefore need to aware of the bribery risks and have a strategy the minimizing it. Bribery is a two-way transaction: there has to be a payer and a receiver. Therefore, if we cut off the flow of bribes, bribery cannot happen. This is the basis for the argument for a **zero-tolerance** approach to bribes, for which there are *seven* principles:

1. *High-level commitment* by the board and senior management to a policy of zero-tolerance.
2. *Risk assessment* for bribery should form part of each organization's risk management process.
3. *Devise and implement robust anti-bribery procedures* proportionate to the risks faced.
4. *Due-diligence assessment of partners, agents, and contractors.*
5. *Dissemination and communication* of policy and procedures to staff and partners.
6. *Monitoring and evaluation* reporting should include a review of anti-bribery procedures.
7. *Collective action* to prevent bribery and sharing information.

To put these principles into practice there are *five* key tactics you can follow to minimize the risk:

1. *Assess the risk* of encountering bribes in your projects and programs.
2. *Resist paying bribes* by training staff to give them confidence to resist bribes safely.
3. *Avoid paying bribes*, for example by removing urgency by building in longer timescales.
4. *Report*: Share information about corrupt practices and officials with other organizations.
5. *Collaborate*: with other organizations to publicize and fight against well-known corrupt practices.