HUMANITARIAN ACADEMY · HUMANITAIRES JOBS

Mini MBA Finance and Grants: managing donor money and financial health

Course handout · Week 1 : NGO accounting: principles, restricted funds and financial statements

A programme of exactly 3 months (12 weeks, 144 hours) to manage the finances of a humanitarian organisation and donor funds: NGO accounting and restricted funds, budgets and shared costs, cash and foreign exchange, budget monitoring and forecasts, eligibility rules, the grant cycle, partner funding, audits and fraud, financial health, full cost, reserves and diversification, governance and turnaround. Corrected numerical exercises, three monthly exams with case studies, and a verifiable diploma from the Humanitarian Academy.

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Week 1 : NGO accounting: principles, restricted funds and financial statements

Objectives

- Understand the accounting principles that apply to an NGO: accruals, matching, prudence, and the distinction between restricted and unrestricted funds.
- Read and interpret the balance sheet, the income statement and the cash flow statement of a humanitarian organisation.
- Spot warning signs in financial statements: an unrestricted funds deficit, tight cash, restricted funds used for other purposes.

Why accounting matters for a manager

A country director or programme coordinator does not need to be an accountant, but they must be able to read the accounts: they are the ones who commit expenditure, sign reports to donors and answer auditors. Most NGO financial crises do not come from spectacular fraud, but from an accumulation of uncovered costs, unreimbursed pre-financing and ineligible expenditure that nobody saw in time.

Accounting has three purposes: **accountability** (to donors, the board, the authorities, the public), **management** (knowing where you stand and deciding) and **protection** (preventing errors and misappropriation through an audit trail). NGOs follow the accounting framework of their country of registration (for example the ANC regulation in France, the SORP in the United Kingdom, US standards for not-for-profit organisations, or the revised SYSCOHADA and its system for non-profit entities in the OHADA area).

> Basic rule: an undocumented expense is an expense you may have to pay back. An invoice, proof of payment, proof of receipt and authorisation are the minimum for any supporting document.

Accruals, cash and matching

In **cash accounting**, a transaction is recorded when money comes in or goes out. In **accrual accounting**, it is recorded when the right or obligation arises: an invoice received in December and paid in January is a December expense. Official financial statements are kept on an accruals basis; many field offices work on a cash basis day to day and post adjusting entries at year-end.

The **matching principle** requires expenses to be linked to the period they relate to. An annual rent of 24,000 USD paid in advance on 1 October for a financial year ending 31 December: 6,000 USD is an expense of the year, 18,000 USD is a **prepaid expense** (an asset) on the balance sheet.

For grants, the usual rule is to recognise income as eligible expenditure is incurred. If a donor pays 500,000 USD in November for a project that has spent 120,000 USD by 31 December, the income for the year is 120,000 USD and 380,000 USD appears as **deferred income** or deferred funds, that is, a liability towards the project. This money is in the bank, but it does not freely belong to the organisation.

Prudence. Probable losses are recognised as soon as they are known (for example an expense the donor will very probably disallow), but uncertain gains are not. A provision for ineligible costs protects the organisation from a nasty surprise at the final audit.

Restricted and unrestricted funds

The most important distinction in an NGO's accounts is between **restricted funds** and **unrestricted funds** (free funds).

- **Restricted funds**: given for a specific purpose (a project, an area, an activity). They can only be used for that purpose; using them elsewhere, even temporarily without agreement, is a breach that can lead to repayment and loss of the donor's trust.
- **Unrestricted funds**: free donations, membership fees, recovered indirect costs, miscellaneous income. They fund what donors do not pay for (part of headquarters, business development, ineligible costs, pre-financing) and make up the **reserves**.
- **Designated funds**: unrestricted funds that the board has decided to set aside for a purpose (for example an emergency response fund). The board can reverse this decision; they remain legally unrestricted.

A common trap: an organisation can show comfortable cash while its unrestricted funds are negative. If it has 900,000 USD in the bank, including 1,100,000 USD of restricted funds received in advance, its free resources are in fact −200,000 USD: it has already used donors' money to cover other expenses.

> Key indicator for a board: the unrestricted funds balance and how it changes. A negative or steadily falling balance is a warning, whatever the cash position shown.

Reading the balance sheet

The **balance sheet** is a snapshot at a given date: what the organisation owns (assets) and what it owes, plus its funds (liabilities and funds). Typical items for an NGO:

Assets	Liabilities and funds
Fixed assets (vehicles, buildings, equipment)	Funds: unrestricted funds (reserves) and restricted funds
Receivables from donors (expenditure incurred but not yet reimbursed)	Deferred funds or deferred income (grants received but not spent)
Advances to partners and staff	Trade payables, payroll and tax liabilities
Inventory (goods to be distributed)	Provisions (disputes, end-of-contract indemnities, probable ineligible costs)
Cash (banks, petty cash)	Any loans

Three quick readings:

- **High receivables from donors**: the organisation is pre-financing its projects; you need to check that reports are sent on time and that the amounts will be accepted.
- **Old advances to partners**: advances unjustified for more than six months are a risk of loss or fraud.
- **Provisions for end of contract**: in many countries, labour law provides for indemnities; if they are not provided for, the end of a large project can create an unexpected liability.

Income statement and cash flow statement

The **income statement** (or statement of financial activities) presents the income and expenditure of the year, often by nature (salaries, purchases, transport) and, in NGOs, also by **function**: charitable activities, fundraising, administration. The **programme expense ratio** (share of expenditure devoted to programmes) is closely watched by the public, but it must be read with caution: an organisation that underinvests in its support functions shows a fine ratio and takes great risks.

The result is read by fund. An overall surplus can hide an unrestricted funds deficit offset by restricted funds received but not yet spent. The accounts therefore normally present a **statement of movements in funds** by category.

The **cash flow statement** explains how cash has changed: flows from operating activities, investing activities (vehicle purchases) and financing activities (loans). An organisation can be in surplus and short of cash, if its donors pay late; or in deficit and have plenty of cash, if it has received large advances.

Reading example. Income 8.2 million USD, expenditure 8.4 million: a deficit of 200,000 USD. Unrestricted funds: opening 650,000, closing 410,000. Cash, however, rose by 300,000 USD thanks to an advance of 1.5 million received in December. Conclusion: the underlying situation is deteriorating (free reserves fell by 37%), even though the bank balance is healthier.

Closing and dialogue with the finance team

The **monthly close** is the basis of reliable information. At a minimum it includes: entry of all the month's documents; bank reconciliation of each account (statement balance = book balance, differences explained); a cash count signed by two people; follow-up of advances to staff and partners; checking of coding (right project, right budget line); and sending the accounts to headquarters within a set deadline (often 10 to 15 days).

The **bank reconciliation** is the simplest and most powerful control. A difference unexplained for several months, cheques issued but not cashed for a long time, or unknown transfers are signals to deal with immediately.

For a non-finance manager, three habits are enough to change the quality of management: read the budget monitoring of your projects with the accountant every month; check that coding matches the reality of the activity; and ask the question "what might the donor disallow?" before signing off an unusual expense.

> Coding "to balance" (charging an expense to the project that still has budget rather than to the one that actually consumed it) is falsification, even if the intention is good. Auditors detect it through timesheets and evidence of activity.

Exercise: reading an NGO's financial position

Situation. At 31 December, an NGO shows: cash 1,300,000 USD; receivables from donors 700,000 USD; advances to partners 260,000 USD, of which 140,000 are more than 9 months old; fixed assets 400,000 USD; trade and payroll payables 350,000 USD; deferred funds (grants received but not spent) 1,650,000 USD; provisions 0. Its annual expenditure is 6,000,000 USD. It employs 140 people in a country where the law provides for an end-of-contract indemnity estimated at 180,000 USD in total.

Tasks. 1) Calculate the funds (total assets minus payables, deferred funds and provisions). 2) Recalculate them with a provision for indemnities and a provision of 50% of the old advances. 3) Assuming fixed assets are entirely financed by the funds, how many months of expenditure do the free resources represent?

Answer. Assets: 1,300,000 + 700,000 + 260,000 + 400,000 = 2,660,000. Funds: 2,660,000 − 350,000 − 1,650,000 = 660,000 USD. With provisions: 660,000 − 180,000 − 70,000 = 410,000 USD. Free resources excluding fixed assets: 410,000 − 400,000 = 10,000 USD, i.e. 10,000 / 500,000 = 0.02 months of expenditure. The organisation has practically no available reserves: its apparent cash rests on donors' money. It must make provisions, recover or obtain justification for the old advances, and build a plan to rebuild its reserves.

Key takeaways

- Accrual accounting: you record when the obligation arises, not when the money moves.
- A grant received but not spent is a liability towards the project (deferred funds), not free wealth.
- The key indicator is the unrestricted funds balance, not cash.
- Provide for what is probable: end-of-contract indemnities, ineligible costs, irrecoverable advances.
- Monthly bank reconciliation and coding that reflects reality: two non-negotiable controls.

Quiz

1. An annual rent of 36,000 USD is paid in advance on 1 July; the financial year ends on 31 December. The expense for the year is:
   A. 36,000 USD
   B. 18,000 USD
   C. 0 USD
   D. 12,000 USD

2. An NGO has 1,000,000 USD in the bank, including 1,200,000 USD of grants received but not spent. Its free resources are:
   A. Negative: −200,000 USD
   B. 1,000,000 USD
   C. 2,200,000 USD
   D. 200,000 USD

3. Funds "designated" by the board are:
   A. Funds restricted by a donor
   B. Public funds
   C. Liabilities
   D. Unrestricted funds set aside by a board decision, which the board can reverse

4. Charging an expense to the project that still has budget rather than to the one that actually consumed it is:
   A. Good management practice
   B. Mandatory at year-end
   C. Falsification, even with good intentions
   D. Acceptable if the amount is small

5. An organisation in surplus can be short of cash because:
   A. That is impossible
   B. Its donors reimburse late and it pre-finances its projects
   C. It has too many reserves
   D. It has no bank account

Quiz answers : 1. B · 2. A · 3. D · 4. C · 5. B