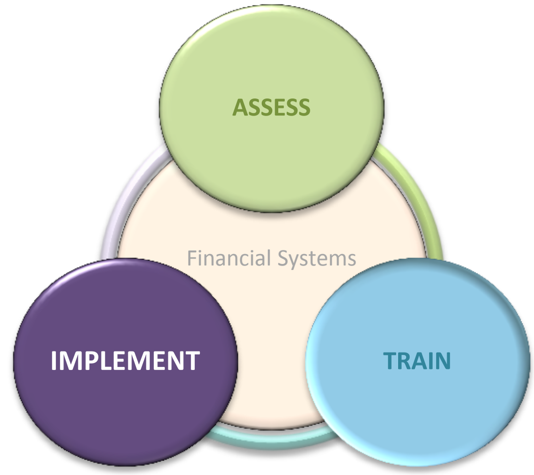
Financial Systems

Objectives



- Partner and field staff are better informed of minimum grantee financial system requirements
- Partner and field staff are better able to diagnose financial system weaknesses
- Partners are better able to assist grantees with improving their financial systems
- Partner and field staff can identify core financial documents and the support required for typical financial transactions

Course Content

1. What is a Good Financial System?

A good financial system is the aggregate of tools, documents, directives, practices, and policies and procedures which an institution uses to manage its financial resources in a transparent, sound and effective manner.

Financial systems differ depending on:

(i) Nature of Activities (e.g. manufacturing entity, trading entity, non-profit organization, service organization)

(ii) Size of Business Operations

A good financial system will provide for reliable and transparent use of grantee dollars and help prevent the misuse of funds.

2. Components of a Good Financial System

A. Budget

- **Annual Operating Budget** – a budget is a financial management and monitoring tool which guides management to: focus on planned income generating activities, planned expenditure areas, and monitoring financial performance.
  (1) A budget is nothing but an activity plan translated in monetary terms.
  (2) A well prepared budget provides projections of income, expenditure and indicates to management and owners whether the business is worth undertaking or not.
  (3) A budget is developed by Management in conjunction with Board of Directors, and it is approved by General Assembly for adoption as operational document.

B. Accounting System

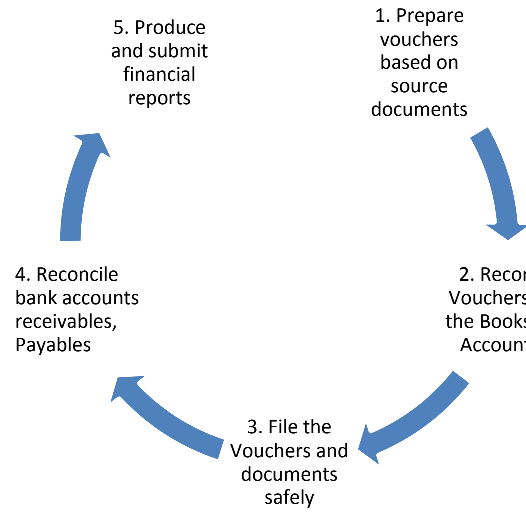
- An accounting system records all financial transactions of Income, Expenditure, Investments, Financing, Borrowing, Commitments, Assets and Liabilities etc.
- It summarizes financial information into meaningful and reliable reports which can be interpreted by users
- It keeps financial records for reference
- In order for accounting system to be reliable, it has to be correct and up to date
- An accounting system may be manual or computer software based
  Note: An excel worksheet is not accounting software.
- An accounting system consists of:
  (1) **Chart of Accounts-** which enables accountants to record and group

financial transactions of similar nature into classes. This facilitates easy production of meaningful financial reports

(2) **Books of Accounts**- to record the financial transactions including:
   (a) **General Ledger** is the main book in which all accounts are maintained.
   (b) **Receipts and Expenditures Journal** (or Project Cash Book) – This can be ONE journal to record cash receipts, including the USADF investment, and expenditures made using the USADF investment or TWO journals, one for receipts and one for disbursements. The information in the journal(s) should agree with bank statements and should include the following:
      - Date of payment (or receipt)
      - Explanation
      - Reference to the budget line item and the voucher number
      - Amount
      - Balance after receipt/payment
   (c) **Line Item Ledger**
      - Date (same as Expenditures Journal
      - Explanation/description
      - Reference (same as EJ)
      - Amount
      - Cumulative expenditure
      - Cumulative balance
   (d) **Petty Cash Ledger** to record petty cash transactions
   (e) **Subsidiary Ledgers** to record receivables and payables

(3) **Source Documents** include:
   (a) ***Cash Receipt Voucher-*** provides proof of payment
   (b) ***Bank Deposit Slip-*** provides proof of deposit
   (c) ***Sales voucher***- provides record of items sold
   (d) ***Invoices-*** show that the payment requests came from the vendor
   (e) ***Payment Voucher-*** provides documentation on the payment details
   (f) ***Check-*** method of payment
   (g) ***Petty Cash Voucher***- provides documentation on the payment details

(4) **Accounting Functions** involve:



C. Financial and Accounting Policies and Procedures
   - This is a set of written institutional statements of directives, rules, steps and approaches which guide staff and members in the daily management of financial resources.
   - Financial Policies and Procedures define the Why? When? Where? How? And by whom? in the whole process of financial management.

- Financial Policies and Procedures are designed to provide guidance and clarity of what financial transactions are allowed at what levels, and how they should be processed.
- Written procedures should be read and understood by management and staff to be sure that one is doing the right thing the right way.
- Management is responsible for ensuring that employees understand and follow the policies and procedures.
- Examples of financial policies
  (1) Any expenditure over 20m RWF will be sanctioned by the Board at an adhoc meeting.
  (2) The Board of Directors sets expenditure authorization brackets from time to time and appoints signatories to the bank accounts.

D. Financial Staff

Depending on the size of the entity and the complexity of its business, financial functions may be manned by one or more people. Small organizations would have fewer people than larger and complex organizations.

- Examples: An established manufacturing company would probably sell to clients on credit and would therefore need a Sales /Marketing/Credit Control Officer.

E. Internal Controls

- **Audit Trail** – a good system makes it easy to trace a transaction from beginning to end so that a manager can detect errors and irregularities. For example, the flow of a cash receipt from the time it is collected by an employee, deposited into the bank and recorded in the entity's books should be supported by documents, journal entries, ledger entries and bank reconciliations.
- **Separation of Duties** – A key cash control is having proper separation of duties so that no one person has control over a process from beginning to end. There are three functions that should be performed by different people:
  (1) ***Authorizing transactions –*** this person has the ability to approve transactions. For example, a person who approves payment to a vendor has this function.
  (2) ***Recording transactions -*** this person documents a transaction in the books and records. For example, the person who records the payment to a vendor authorized by someone else has this function.
  (3) ***Maintaining custody -*** this person has physical control over cash. For example, the person who prepares the payment to the vendor (cash or check) has this function
- **Physical protection of assets** – This control is extremely important with cash-based systems. Company assets should be protected against misuse, theft, and damage.
  (1) All cash should be locked away with a limited number of people having access to it. The same is true for checks. Checks must be secured and accounted for. Checks must be pre-numbered. Cancelled and voided checks should be maintained and reconciled to the check stub and the check register.
  (2) An asset register must be kept where all company assets are recorded with addition and deletions; regular servicing of

vehicles and equipment should be made to keep the assets in good running condition; clear policies regarding use of assets should be included in the procedure manual.

- **Use of checks –** While this may not be practical, using checks for cash disbursements is much safer than using cash. It provides a written record that funds were provided to a specific entity. It is more difficult to "lose" part of the payment or have the payment go to the wrong person. When not possible, use of cash must be accounted for using cash disbursement vouchers. The purpose of using vouchers is to be able to reconcile cash actually disbursed to requests for disbursements. The person receiving the cash must sign the voucher as evidence that the cash was given to the appropriate party.
- **Separation of cash receipts and disbursements** – It is, unfortunately, fairly common practice for small entities to mix up cash receipts and cash disbursements. That is, when cash is received, it is held and used for cash disbursements, not deposited intact in the bank. This can make it extremely difficult to account for cash, which makes it extremely easy for cash to become "lost." Instead, cash receipts should be deposited regularly and intact. Cash disbursements should be made using checks or checks written to cash.
- **Regular management review –** Managers must be prepared to review books and records regularly. They know best what transactions should have taken place. For example, if a manager thinks that receipts are too low compared to the sales that have taken place, she/he can investigate to find out why. Management reviews help discourage employees from taking advantage of loopholes in financial systems.
- **Reconciliation**
  Bank accounts, receivables accounts, and payables accounts must be reconciled and confirmed to establish accuracy of the balances.

2. Financial Transaction Types

A. Cash/Check Receipts
B. Cash/Check Expenditures
C. Petty Cash
D. Payroll

3. Roles, Process, and Risks

A. Cash/check Receipts

- General Process
  (1) Cashier receives cash and provides a receipt
  (2) Bookkeeper deposits the cash in the bank
  (3) Accountant compares the transaction against sales records and records the transaction
- Documents
  (1) Cash Receipt Voucher
  (2) Bank Deposit Slip
  (3) Sales Voucher
  (4) *Cash Receipts Journal*- lists cash transactions to reconcile with the bank statement
  (5) *Bank Statement*- provides record of funds to reconcile with the general ledger
- Risk Reduction Advice
  (1) All cash received is deposited into the bank.
  (2) All cash received is recorded in the Cash Receipts Journal.
  (3) No one person handles cash receipt transactions from

collection of cash to deposit of cash.

B. Cash/Check Expenditures

- General Process
  - (1) Cashier collects invoices
  - (2) Bookkeeper payment vouchers and prepares checks
  - (3) Accountant approves payments and reconciles the bank statement against the cash journal
- Documents
  - (1) *Invoices*
  - (2) *Payment Voucher*
  - (3) *Check*
  - (4) *Bank Statement*
  - (5) *Cash Disbursement Journal*- lists cash transactions to reconcile with the bank statement
- Risk Reduction Advice
  - (1) Cash Disbursements
    - (a) Keep to a minimum.
    - (b) Use petty cash for small payments.
    - (c) Batch cash payments rather than pay individually.
    - (d) Write a check to "cash" for amount of voucher.
    - (e) Make sure all appropriate approvals take place.
    - (f) Make sure cash is protected.
    - (g) Have recipients sign for cash received.
    - (h) Reconcile receipts to batch listing.
  - (2) All payments are supported by an invoice or request for payment
  - (3) All cash disbursement are recorded in the Cash Disbursements Journal
  - (4) No one person handles cash disbursement transaction from beginning to end

C. Petty Cash

- General Rules
  - (1) Establish a maximum for a petty cash request
  - (2) Protect cash in a safe
  - (3) Sum of cash in box and receipts for cash taken must equal maximum
  - (4) Establish a minimum cash balance for when to replenish the fund
- General Process
  - (1) Requestor presents a voucher for payment
  - (2) Cashier makes and records the payment
  - (3) Bookkeeper reviews and records the transaction
  - (4) Accountant spot checks cash in the box and signs the check to replenish the cash
- Documents
  - (1) *Petty Cash Voucher*
  - (2) *Petty Cash Ledger*- lists cash transactions to reconcile with the bank statement
  - (3) *Checks*- provides proof of funds added to the cash box
  - (4) *Record of Cash Count* – provides proof that the cash balance has been checked
- Risk Reduction Advice
  - (1) Petty cash is reconciled to approved vouchers signed by recipient and cash in box
  - (2) Only payments supported by approved vouchers are paid
  - (3) Recipient signs for cash received
  - (4) Amount disbursed is written in numbers and letters

D. Payroll

- General Rules
  - (1) Ensures all employees are paid on time, with the correct amount of money, for the hours worked
  - (2) Assign roles for managers and accounting personnel to handle all tasks such as hiring, checking references, firing, promoting, and payroll
  - (3) Establish policy on issues such as length of work day and work week, time off for breaks and lunch, overtime policy, sick and vacation policies, etc.
- General Process
  - (1) Timekeeper maintains time and attendance records for all employees
  - (2) Supervisor reviews and approves the time and attendance records and provides them to the bookkeeper at the end of the period
  - (3) Bookkeeper prepares the payments for employees and maintains the master payroll record
  - (4) Supervisor distributes the pay to the employees having the employee sign for receipt
  - (5) Accountant records and reconciles the payroll into the general ledger.
- Documents
  - (1) *Time and Attendance Sign-in Sheet*- provides a record of the time each employee worked
  - (2) *Master Payroll Record*- Contains an up-to-date listing of all employees with important information about their pay, such as gross salary, deductions made, net salary, etc.
  - (3) *Employee Pay Slips*- provides proof of the payment amount each employee received
- Risk Reduction Advice
  - (1) Only employees who worked (or were on approved leave) are paid
  - (2) Wage employees are paid for the hours they actually worked
  - (3) The amount paid is correct
  - (4) Payroll is correctly recorded
  - (5) Withholding is correct and sent to the appropriate tax entities
  - (6) Pay is distributed to the appropriate employee
  - (7) Pay not distributed is safeguarded until it can be distributed or re-deposited into the bank account

4. Advice from the Experts

- <u>EVERY GRANTEE IS DIFFERENT and will have unique financial system needs and processes</u>. The samples above provide one option for each transaction type, but will usually need to be modified to fit a particular situation. The key is to maintain strong internal controls and records regardless of the scale or capacity of the grantee.

Handouts

Sample Accounts Ledgers
Sample Source Documents
Sample Cash Receipts Process
Sample Cash Expenditures Process
Sample Petty Cash Process
Sample Payroll Process
Sample Two Person Cash Expenditure Process
Financial Systems Course Notes