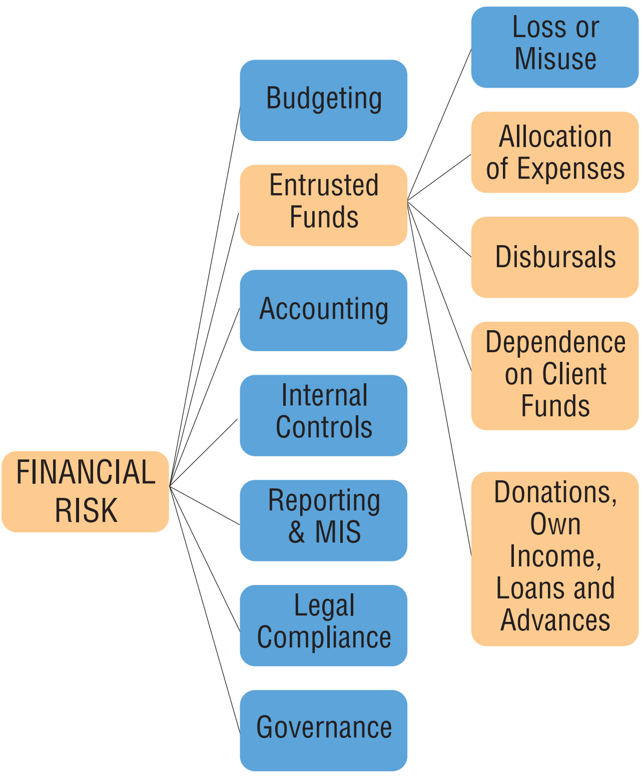
auditAble

15. Illustrative Financial Risks – Entrusted Funds (Part 2) - March '13

In this Issue

Continuing our discussion on entrusted funds,[1] let us now look at other risks associated with these.



Allocation of Expenses

Most accountants are good with using traditional accounting heads (salaries, purchases, traveling, etc.). However, project-based donor accounting calls for charging such expenses to budget-line items under particular projects. The accountant must first set up account heads which are aligned with budget line items. Then he/she must identify the right project or activity to which the expense will be allocated. This becomes complicated when an NGO is running several projects from the same location or in the same area.

Risk Statement

Payments made for other projects may be charged incorrectly to Client project.

Issue

Project-based accounting requires that expenses are charged to the correct project. However, this can be a problem – often it is difficult to identify the project to which an expense should be charged. Sometimes, an accountant may run out of budget in one project, and may book these, wrongly, in the project you are reviewing.

Questions to ask

Who guides the accountants regarding the project to be charged for an expense? Are any expenses for other projects being charged to Client[2] funds? Is this happening due to lack of understanding or deliberately?

Risk Statement

Allocation of shared expenses to Client may not be valid or in proportion of agreed budget.

Issue

There are some expenses which are incurred for multiple projects. One example is rent for a field office, where two-three donors are supporting different projects.

Sometimes a common or shared expense is wrongly allocated to a project, even when the expense is not related to the project at all. If done as a percentage, the loading on Client funds may be unreasonably high.

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[1] See AuditAble 14: Illustrative Financial Risks – Entrusted Funds (Part 1), www.AccountAid.net

[2] The donor agency who has commissioned the FRAMS+ audit

Questions to ask
How are common expenses allocated to various projects? Do the allocated expenses indirectly contribute to Client-supported project? Is Client bearing more than its fair share of common expenses? Is Client paying too little for common expenses?

Risk Statement
Shared expenses allocated to Client or other donors may not be permanently recorded in account books.

Issue
In some cases, shared expenses are pooled in general accounts in the NGO’s books. Later, when reporting to the donors, these are allocated using a spreadsheet. The allocations are added to the donor reports. However, no transfer entry is passed in the books. This can lead to double allocation of same set of shared expenses.

Questions to ask
Can the amounts for shared expenses be ticked with account books? Is the allocation booked using a journal entry? If not, how is the allocation recorded or managed? How does the NGO ensure that total of expenses reported to various donors does not exceed the actual total expenses?

Risk Statement
Basis of allocation of common expenses may not be available or appropriate.

Issue
Allocation of common expenses is a confusing matter for most NGOs. This problem is compounded because the basis is not defined clearly. In some cases, the basis may not be reasonable or applied consistently.

Questions to ask
What is the basis for allocating common expenses? Is it available in writing? Is the basis sound in theory? Is it being applied as written down? Does it result in a fair allocation of common expenses to different projects?

Risk Statement
Co-funder shares may not be raised as per agreed budget.

Issue
A large project may be supported by a number of donors, where each contributes a part of the funds. This may be done as a consortium, where each donor is named and the shares defined. However, more commonly, this is done as loosely defined co-funding. This creates a number of accounting, reporting and auditing problems. For example, how do you verify that a particular contribution is related to the project under review? Then again, if the money is not routed through the NGO, how do you validate the amount of contribution?

Questions to ask
Is the Client-supported project part of joint-funding? Are other donors or community contributing a part of the funds? If so, then are these shares being raised in agreed proportions of the total budget?

Are the co-funder shares defined at line item level also? Are these being raised in the agreed proportions at line-item level?

Are the co-funders identified by name in the approved proposal or agreement? Are co-funder shares being raised from these donors only? If co-funders are not identified by name, can these be linked with the client’s project in some other way?

How is community contribution valued and recorded? What about funds disbursed directly to the community? Do these form part of joint funding shares? How are these disbursements tracked?

Disbursals

Most donor agencies provide project funds in advance.[3] The

[3] In contrast, government funds often reach the NGO after the project is over.

funds are generally disbursed in a number of instalments. This reduces the risk of unused funds building up at the NGO level. It also helps the donor agency support a larger number of projects each year. However, each instalment should be planned carefully. The NGO should neither run short of funds nor should it carry excess unspent funds. Excess build-up of funds could lead to Client funds being 'borrowed' for other projects (or even non-supported construction activities).

Risk Statement

Client funds may be drawn in excess of reasonable requirements or may be insufficient for planned activities.

Issue

There may be excessive build-up of unspent donor funds at NGO level. Or project implementation may be suffering from funds drying up.

Questions to ask

Who prepares the fund-request for the next disbursement? Who reviews this? If Client officers make any changes in this, are these communicated clearly to the NGO?

Are fund-requests based on agreed activity plans? Are these adjusted based on changes in activity plans? Are activities spaced out evenly through the year (or the timing is based on program needs)? Are activities likely to cluster around end of grant-year?

Has unspent balance from the previous disbursal been considered? What about the balance brought over from previous year?

What is the maximum level of unspent Client funds with the NGO? Minimum level? Are these acceptable?

Risk Statement

Client disbursals may not be received in time.

Issue

If the NGO runs out of funds due to delayed disbursals, it may have to stop a number of project activities. This affects project performance. It also leads to less efficient utilization of infrastructure and human resources.

Questions to ask

How do we ensure that NGO has adequate fund balance to run planned activities? What is the time-cycle of a typical disbursal, from the end of the quarter to the actual credit of funds in NGO's bank? Are there avoidable delays at Client's end or at NGO's end? Are these delays recurring?

Dependence on Client funds

Most implementing NGOs are dependent on donor agency funds. However, donor agency program priorities change over the years. If an NGO has not developed a sustainability plan, then it can be severely affected by such changes.

Risk Statement

Withdrawal of Client's financial support may lead to significant organisational or programmatic disruption.

Issue

If the NGO is overly dependent on Client funds, it can become a problem for both. Over time, the NGO may become reluctant to take on new challenges. The Client may also start feeling morally responsible for the NGOs, and thus unable to discontinue support, even if necessary.

Questions to ask

What portion of the total annual funding of the NGO comes from the Client? Is the Client-supported program significantly dependent on Client funds alone? What would happen if Client's support comes to an end? Are there alternate donors who could take up the NGO's program if Client ends support? Do they have a present relationship with the NGO? What is the Client doing to wean the NGO from being totally dependent on it for financial support?

Donations, Own Income, Loans and Advances

Lack of discretionary income creates a number of prob-

lems. Sometimes an NGO tries to solve these by creating fictitious sources of income. This is a form of money-laundering, where donor funds are taken out and then brought back through an alternative fictitious channel. These funds are often used to finance construction.

Risk Statement
Donations from individuals are significant and may not reflect genuine transactions.

Issue
NGO may be recording fictitious donations from individuals to boost its discretionary funds.

Questions to ask
What is the annual inflow from donations by individuals?[4] Who gives these donations? Are these in cash or by cheque? Are receipts issued for these? Do these receipts show donor's name, address, may be phone number?

Risk Statement
Own income from other sources is significant and may not reflect genuine transactions.

Issue
NGO may be recording inflated income from other sources to increase general funds.

Questions to ask
What is the amount of discretionary income from other sources, such as beneficiary contributions, project recoveries, IGP income, etc.? How is this recorded in books? What is the documentation to support this income?

Risk Statement
Funds reported from staff or others may not reflect genuine transactions.

Issue
An NGO may have asked its staff to give back part of the project salary as a donation towards general funds. Sometimes, vendors may be asked to donate back part of their income (from transactions with the NGO).

Questions to ask
Does the organisation get any donations / contribution from staff or vendors? Are these voluntary, or some compulsion is used? Are these reasonable, considering the individual's income?

Risk Statement
Loans and advances from individuals are significant and may not reflect genuine transactions.

Issue
Sometimes fictitious loans are recorded in books. These are used to provide book funds for recording inflated expenses. In some cases, this may be done to cover up payments recorded in advance.[5]

Questions to ask
What is the size of loans and advances from individuals? Have these been received in cash or by cheque? How long have these remained outstanding? What was the reason for borrowing this money? How are these repaid?

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[4] Excluding donations / grants from organizations

[5] Many NGOs record payment of salary on 31st March, even though it is actually paid 5-6 days later in April. This creates a theoretical shortage of cash, which is covered up by recording book loan or 'hand-loans'. This problem can be easily resolved by passing a journal entry for salary payable.

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