FINANCIAL MANUAL

making sense of money

STREETNET INTERNATIONAL

- a handbook for -

ORGANISATIONAL SUSTAINABILITY

STREETNET INTERNATIONAL

StreetNet International, an alliance spanning five continents, was launched in November 2002, Durban, South Africa, to unite organisations whose membership comprises street vendors, market vendors and/or hawkers. StreetNet promotes the exchange of information and ideas on critical issues that affect street vendors, market vendors and hawkers (mobile vendors), as well as practical organisation and advocacy strategy.

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FINANCIAL MANUAL

INTRODUCTION

This manual offers guidance to those wishing to establish a non-profit organisation. The manual provides insight into the advantages, disadvantages and legal requirements governing the various types of non-profit organisational structures. It also includes sections on budgeting, basic bookkeeping and various other financial procedures in order to provide support for financial staff and ensure sustainability, consistency and accountability within an organisation.

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PART A: UNDERSTANDING FINANCIAL MANAGEMENT

1 WHAT IS FINANCIAL MANAGEMENT?

Financial management is more than keeping financial records. It involves planning, controlling and monitoring the financial resources of an organization in order to achieve its goals.

ELEMENTS OF AN EFFECTIVE FINANCIAL SYSTEM

FINANCIAL RECORD KEEPING

Basic accounting records must be kept. These include:-

- *Records of all money received*
- *Records of all money spent*
- *Files for all supporting documents*

FINANCIAL PLANNING

- It is crucial to plan where money will come from and what an organization will spend it on.
- Budgets are key elements of any financial system.

INTERNAL CONTROL

- Organisations need to control how they use their resources and their assets.
- This reduces risks like errors and fraud and helps all to know what the organization expects from them.

FINANCIAL MONITORING

- By monitoring how funds are used, an organization can tell if work is on track and whether it is spending within budget.
- This is based on preparing financial reports and comparing them against organizational plans and objectives.

THE IMPORTANCE OF FINANCIAL MANAGEMENT AND CONTROLS

Organisations should ensure that:

- *There is effective and efficient use of resources to meet objectives and fulfill stakeholders' commitments;*
- *They are fully accountable to donors and other stakeholders;*
- *The organisation's assets are protected;*
- *They gain the respect and confidence of funders and other stakeholders by handling money wisely and keeping accurate and complete financial records;*
- *They plan for the future and prepare for long-term sustainability;*
- *They comply with legal and financial reporting requirements.*

2 WHO IS RESPONSIBLE FOR FINANCIAL MANAGEMENT?

It is important to understand the Non-Profit Organisation (NPO) structure and its legal status to appreciate who is responsible for various financial management duties.

Financial staff are not responsible for financial management on their own. They need the assistance of the following people:

- *Programme managers*
- *Project managers*
- *Organisers*
- *Coordinators*

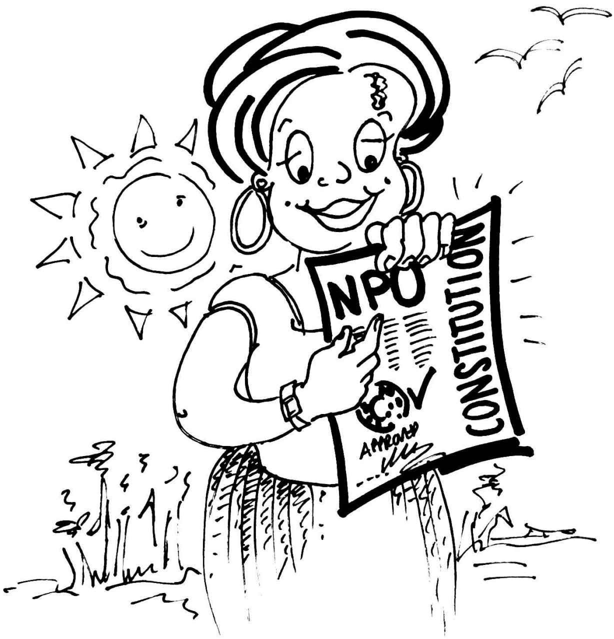
WHO CONSTITUTES FINANCIAL STAFF?

Financial staff are responsible for accounting for an organisation's various forms of revenue and expenditure in a transparent, consistent and easily accessible form. Accounting functions include check processing, management of income and expenditure accounts, bank confirmations and the payroll. These functions are essential for the effective management of an organisation's day-to-day operations and play a key role in meeting financial goals, maintaining good governance and sustainable future planning.

3. WHAT IS A NON-PROFIT ORGANISATION (NPO)?

Non Profit simply means that the financial profits of the organization cannot be distributed or shared among its members, but must be used in pursuit of the organisation's goals and objectives.

Organisations are established for many different reasons and each organisation's goal and objectives differ from each other. These objectives need to be clearly stated in the organisation's governing documents (ie its Constitution).



NPOs are often dependent on donor funding. Funding can come from a range of sources, including: the general public, grants from donor agencies, or private foundations. Donors need to have confidence that their funds will be used to pursue the objectives of the organisation.

LEGAL STRUCTURE OF AN NPO

The most common legal structures are:

- **Voluntary Associations (VAs)**
- **Trusts**
- **Section 21 Companies**
- **Public Benefit Organisations**

Each is governed by certain laws, eg if an organisation chooses to register as an NPO, then it will be governed by the NPO Act (No 71 of 1997).

(*The NPO Act No 71 of 1997 applies only to South African organisations. Please refer to your own country's relevant legislation.)

BENEFITS OF REGISTRATION AS AN NPO*

Registration as an NPO has different implications for different legal structures. All non-profit organisations, regardless of their structure, are encouraged to register under the Non-Profit Organisation (NPO) Act No 71 of 1997. Registration under this Act means that the organisation is a separate legal person from its members and can enter into contracts and sue in its own name. It also affords assurance that certain basic, minimum provisions have been included in the constitution or governing documents.

(*The NPO Act No 71 of 1997 applies only to South African organisations. Please refer to your own country's relevant legislation.)

VOLUNTARY ASSOCIATIONS (VAs)

WHAT IS A VOLUNTARY ASSOCIATION?

A VA is an agreement by a group of people to form an organisation to achieve a common non-profit objective. The agreements can be verbal. Although an agreement does not need to be is writing, a written agreement can help avoid disputes.

Examples: *Voluntary associations are suitable for small community-based organisations that do not need to own or manage substantial amounts of money or valuable property and equipment in order to carry out their activities.*

GOVERNANCE STRUCTURE

Usually the constitution provides for the appointment of a group of people with executive powers (such as an executive committee) to manage the affairs of the VA subject to the terms of the constitution.

WHAT LAWS GOVERN VAS?

VAs are governed by the common law which requires the VA's objectives must be lawful and not primarily for gain or profit of its members.

INDEPENDENT LEGAL PERSONALITY

If you want to create a VA that is an incorporated association with an independent legal personality, the common law requires that you have provisions in your constitution that specify that:

- *The organisation will continue to exist despite changes in its membership (perpetual succession)*
- *The assets and liabilities of the organisation will be held separately from those of its members.*

ADVANTAGES OF HAVING AN INDEPENDENT LEGAL PERSONALITY

- *Clarity and formality*
- *Public accountability*

HOW TO FORM A VA

An agreement (written or verbal) is all that the law requires to recognize your organisation. There is no government registry with which you must register. If you choose to register a VA in terms of the NPO Act (No 71 of 1997)*, it must comply with the Act's registration requirements. These are similar to the common law requirements for establishing a VA.

(*The NPO Act No 71 of 1997 applies only to South African organisations. Please refer to your own country's relevant legislation.)

THE FOUNDING DOCUMENT OF A VA

The written agreement of founding document is called the constitution. The constitution sets out the agreed rules which govern the VA such as its main purpose and objectives, its membership, governance structures and procedures, and the rights and duties of the organisation, its members and office bearers. A constitution provides clarity about these issues for everyone, both inside and outside the organisation.

BASIC CLAUSES FOR INCLUSION IN YOUR CONSTITUTION

Constitutions of VAs vary enormously depending on the organisation, but there are basic clauses that must be included for your constitution to comply with the legal requirements of both common law and the NPO Act, as well as clauses that will enable your organisation to function properly.

- ***Background:*** *Background clauses describe the context, circumstances and motivations that gave rise to the creation of the VA.*

- ***Name:*** *Your constitution must state the full name and any abbreviations of the name of your VA. Usually the name tells people what kind of VA it is.*

- ***Objectives:*** *The objectives describe the purpose of the VA and what it intends to do. These clauses should show that the VA exists to promote a public interest objective and not primarily for the self-interest, gain or profit of its members and office-bearers. You must list your main objectives in general terms.*

- ***Legal status:*** *Your constitution must define your VA as an incorporated association with its own legal identity.*

- ***Non-profit status:*** *Your constitution must state that the income and property of the VA will be used to promote its objectives and will not be distributed to its members or office-bearers, except as reasonable payment for their work. You must make it clear that your organisation's members and office-bearers have no personal right to the property of the VA. This principle applies not only during the lifetime of the organisation, but also when it closes down ('dissolution' in legal language). Your constitution must state that on dissolution, your VA's property will be given to an organisation with similar objectives.*

- ***Powers:*** *A VA may, for example, need powers to purchase, mortage and sell movable or immovable property, or invest the VA's funds in a way to* *employ and pay employees. Your constitution must set out your VA's powers and they must be consistent with its non-profit objectives.*

- ***Members:*** *Membership clauses define who may become a member of the VA, the procedures for admitting and removing members, and members' duties and privileges. You may include a list of your initial members in your constitution.*

- ***Structure:*** *This is an important part of the constitution because structures and procedures build in the VA's office-bearers and members' accountability. There should be a clause that identifies the highest governing body of the VA, usually a general meeting of members or managing body. There is usually a clause that entrusts all the powers of the VA to a managing body to enable it to manage and control the VA's affairs. But if the managing body is not the highest governing authority, then such powers should be subject to the instructions of the highest governing authority, such as members in a general meeting.*

  Your constitution must specify the structure of your VA and its mechanisms and procedures for governing and management. You must include clauses that specify how your VA will conduct meetings and make and record decisions. There may also be clauses on the appointment of office-bearers.

- ***Financial matters:*** *This section of the constitution states how the VA's money will be managed and accounted for. There should be clauses that describe how the organisation will prepare its annual financial statements. You must also have clauses that set a date for the end of the VA's financial year and state that it will use a banking account.*

- ***Amendments to the constitution and dissolution:*** *You must have clauses that explain how the constitution can be changed and how the VA can be closed down by its members.*

- ***Indemnity:*** *The constitution should provide that the VA's members and office-bearers are not liable for any of its financial obligations and debts. These clauses reinforce the principle of limited liability captured in the legal status clauses.*

- ***Disputes:*** *The constitution may set out a procedure for resolving serious disputes between members about how to interpret the constitution.*

ONGOING REGULATORY REQUIREMENTS

Because a VA does not have to register with a government registry, there may be no public authority that regulates its conduct or affairs. If a VA chooses to register an NPO, it will have to comply with the ongoing regulatory requirements of the NPO Act No 71 of 1997*.

ADVANTAGES AND DISADVANTAGES OF VAS

Being easy to register can be both an advantage and a disadvantage to a VA.

<u>ADVANTAGES</u>

- Not having to register with a government registry means a VA can be established quickly, easily and cheaply.

<u>DISADVANTAGES</u>

- VAs may not be particularly attractive to funders because of the lack of government regulation and statutory control. Even the general public who interact with the VA generally prefer greater formal accountability and transparency.
- A VA's constitution may not protect members if key clauses are missing or not properly drafted (eg if clauses relating to a VA's legal status are not clear)

IMPLICATIONS OF THE NPO ACT

In the past, VAs could not register with a government registry. This caused problems because donors and others often require organisations to have the degree of legal formality and public accountability that registration provides. The NPO Act No 71 of 1997 now provides a regulation and regulatory authority for VAs that has proved helpful to the non-profit sector. We have seen registration as an NPO can remedy the disadvantages of the VA structure by providing compliance with the government's ongoing regulatory requirements.

TRUSTS

WHAT IS A TRUST?

*A trust is an arrangement, set out in a written document (called the '**trust deed**) in which an owner or founder hands over property and / or funds to a group of people (called **trustees**) who administer the assets for the benefit of other people (called **beneficiaries**) for a stated objective. Trustees do not hold trust assets in their personal capacity.*

Example: *The Legal Resources Trust (LRT), which was set up to establish and support the Legal Resources Centre to give free legal advice to the vulnerable and marginalized, is an example of a civil society trust.*

GOVERNANCE STRUCTURE

A board of trustees governs a trust. Trustees' powers are normally as wide as possible to enable them to achieve the objectives of the trust and are similar to the powers of a company. Trustees are expected to exercise their duties with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another. Trustees should not make self-serving decisions and should avoid taking decisions in situations where there is a conflict between what is best for the trust and what is best for the trustees personally (**conflict of interest**). They may receive reasonable payment for their work for the trust if this is provided for in the trust deed.

WHICH LAWS GOVERN TRUSTS?

Trusts are regulated by the common law and the Trust Property Control Act 57 of 1988*.

(*Similar trust legislation is common to all countries. Please refer to your own country's specific legislation requirements.)

INDEPENDENT LEGAL PERSONALITY

Except in certain circumstances, such as for tax and insolvency purposes, trusts do not have an independent legal personality. If there is a legal dispute (**litigation**), the trustees acting in that capacity, can sue or be sued, but not the trust. However, trust property is protected as the Trust Property Control Act requires trust property to be kept separate from trustees' personal property. Trusts are also required to have their own bank accounts.

HOW TO FORM A TRUST

You need a **notary public** (this is an attorney with an additional qualification that authorises him or her to certify that documents to be filed in a government registry are authentic) to write and attest your trust deed. Then you must register the trust deed with the Master of the High Court. While the trust deed names your intended trustees, the Master of the High Court formally appoints them.

SECURITY

The Master of the High Court may ask trustees to provide security for the proper performance of their duties. This is usually arranged through an insurance company. If you want to do away with the need for security, the Master usually requires that you appoint auditors and give a full set of reasons why the trustees should be exempted.

THE FOUNDING DOCUMENT OF A TRUST

The trust deed is the trust's founding document. Trusts vary enormously, but all trust deeds should contain certain common clauses. Tax laws also require specific clauses if you want tax exemption, while the NPO Act will require other clauses if you want to register as an NPO. A trust deed usually contains the following:

- ***Preamble***
- ***Record of why the trust came into being***
- ***Name***
- ***Purpose***
- ***Donations***
- ***Founding and future donations***
- ***Trustees powers***
- ***Use of trust funds:*** *Clauses regulate and control how trustees use the trust's funds and partial indemnity for losses sustained through reasonable error.*
- ***Appointment of trustees and alternatives***
- ***Trustees exemption from paying security***
- ***Procedures***
- ***Meetings and notices***
- ***Financial control and annual filing of accounts***
- ***Amendments to the trust deed and dissolution of the trust***
- ***Clauses recording the non-profit purpose and character of the trust which must state:*** *All income and property must be applied solely towards the promotion of the trust's main objectives and no amount or asset may be given or distributed to the trustees, except as reasonable payment for their services;*
  On dissolution of the trust, all surplus assets must be transferred to another organisation with similar purposes.

ONGOING REGULATORY REQUIREMENTS

The Master of the High Court registers the trust and oversees and controls the appointment of trustees. You must notify the Master if you change any of your trustees. The Master exercises a high degree of supervision over the appointment of trustees, but not over their activities. Although the Master may call trustees to account for the administration of trust property, in practice this supervision is limited. If a trust registers as an NPO it must also comply with the ongoing regulatory requirements of the NPO Act.

ADVANTAGES AND DISADVANTAGES OF FORMING A TRUST

ADVANTAGES

- A trust is very flexible and can suit many NPOs, the objectives and situations.

DISADVANTAGES

- You will need professional legal assistance to establish a trust. This can be expensive and take a long time.
- The requirements for public disclosure for trusts are very limited. For example, there need be no auditor or audited financial statements unless these are required by the trust deed.
- Except in certain circumstances, a trust does not have a legal personality. However, trust property is protected and a trustee acting in that capacity is not personally liable for trust debts (except if he or she has been grossly negligent or committed fraud.)

IMPLICATIONS OF THE NPO ACT

Before the NPO Act was passed, trusts could not have an independent legal personality other than for certain specific purposes such as tax and insolvency. Now, a trust that also registers as an NPO, (in addition to registering with the Master of the High Court), is recognised by the law as a body corporate ith an independent legal personality. Trusts acquire independent legal personality through such registration.

DIFFERENT TYPES OF TRUSTS

In South Africa, trusts are classified according to the following types:

- OWNERSHIP TRUST under which the founder transfers ownership of assets or property to a trustee(s) to be held for the benefit of defined or determinable beneficiaries of the trust.
- CURATORSHIP TRUST under which the trustee(s) administers the trust assets for the benefit of a beneficiary that doesn't have the capacity to do so, for example, a curator placed in charge of a person with a disability.

SECTION 21 COMPANIES

WHAT IS A SECTION 21 COMPANY?

Section 21 of the Companies Act 61 of 1973 allows for a **not-for-profit company** *or* **association incorporated not for gain**. *Section 21 companies resemble business orientated (for profit) companies in their legal structure, but do not have a share capital and cannot distribute shares or pay dividends to their members. Instead, they are* **limited by guarantee** *meaning that if the company fails, its members undertake to pay a stated amount to its creditors. Section 21 companies are usually intended to provide services to various* **communities**, *for example, women's empowerment groups, feeding schemes for the poor, charitable organisations, etc.*

Examples: *You may choose to be a Section 21 company if you are a large organisation like a development foundation, because a company has a well-developed legal structure, that is familiar to the business world, and which provides transparency and accountability.*

GOVERNANCE STRUCTURE

A company has a two-tiered governance structure consisting of members and directors. The members exercise their powers in general meetings. For example, they have the power to appoint and remove directors, amend the company's founding documents and dispose of the NPO's assets. The directors have broad executive responsibility but must appoint independent auditors and convene an annual general meeting at which various matters, including the presentation of the audited financial statements, are attended to.

WHAT LAWS GOVERN SECTION 21 COMPANIES?

Section 21 companies (like for-profit companies) are governed by Section 21 of the Companies Act and have independent legal personality.

HOW TO FORM A SECTION 21 COMPANY

All companies, including Section 21 companies, are registered with the Registrar of Companies in terms of the Companies Act. Before you are registered, the Registrar must approve the name you have chosen. A company may not begin its work until it is registered, which takes about 2 - 4 months.

To register as a Section 21 company:

- *Your organisation must be established for a lawful objective.*
- *Your main objective must be the promotion of religion, the arts, science, education, charity, social activity or have a communal or group interest.*
- *All income and property must only be used for the promotion of the main objective and no amount or asset may be given or distributed to the organisation's members of office-bearers, except as reasonable compensation for their work for the organisation.*
- *On dissolution of the company, all surplus assets must be transferred to another organisation with similar purposes.*
- *Along with other public companies, your organisation must have at least 7 founding members and 2 directors.*

THE FOUNDING DOCUMENTS OF A SECTION 21 COMPANY

The founding documents for a Section 21 are the memorandum and articles of association. The memorandum sets out the purpose of the NPO; the articles of association regulate how it operates. A typical memorandum and articles of association will contain clauses dealing with the following:

- ***Name:*** *the phrase 'association incorporated not for gain' must follow the name*
- ***Statement of purpose:*** describing the main objective and business of the company
- ***Powers of the company***
- ***Governance structure***
- ***Procedural clauses***
- ***Meetings, quorums, notice periods***
- ***Financial control and reporting***
- ***Standard of conduct required of office-bearers***
- ***Indemnity for officers acting in good faith***

ONGOING REGULATORY REQUIREMENTS

In order to be registered and then remain registered, a company is obliged to comply with the extensive formalities and ongoing reporting requirements of the Companies Act. The company must also:

- *Appoint auditors and inform the Registrar of Companies of any change of auditors.*
- *Appoint a registered address and inform the Registrar of any change of address.*
- *Keep up-to-date registers of members and directors in the prescribed form.*
- *Publish the directors' names on all letters, catalogues and circulars it distributes.*
- *Ensure that directors keep proper minutes and attendance registers of all meetings.*
- *Hold an annual general meeting in accordance with the prescribed procedures.*
- *Keep financial and accounting records in the prescribed form, present these to members at the AGM and file them with the Registrar.*
- *Ensure the directors' report is presented to the AGM.*

ADVANTAGES AND DISADVANTAGES OF A SECTION 21 COMPANY

ADVANTAGES

- Section 21 companies allow for substantial public disclosure and internal independence.
- Because the provisions of the Companies Act are complex and detailed, companies have freedom in their internal management and the day to day running of their affairs.

- The independent legal personality of a company is a clear and well-understood concept.
- Registration and compliance in terms of the NPO Act may be needed in future to become eligible for government benefits such as tax benefits.

DISADVANTAGES

- You will need professional assistance to set up a company
- The annual reporting requirements for companies are complex, extensive and can be costly and therefore not always suitable for small community-based organisations.

IMPLICATIONS OF THE NPO ACT

The requirements of the Companies Act make Section 21 companies accountable to the public. So unlike VAs, which need the Act to register, and trusts, which need the Act to acquire independent legal personality, there is no particular reason for Section 21 companies to register in terms of the NPO Act. However, in future, if they wish to be eligible for government benefits (such as tax benefits), they may need to register.

PUBLIC BENEFIT ORGANISATIONS

WHAT IS A PUBLIC BENEFIT ORGANISATION (PBO)?

A public benfit organisation is a company that does not work for profit and does not pay tax in or out of South Africa. The organisation is most likely involved with charitable work. An NGO or NPO may apply to SARS for tax exemption as a Public Benefit Organisation (PBO), if it meets the requirements of the Income Tax Act of 1962. As is the case with NPO registration, PBO registration is also voluntary (an organisation does not need to be an NPO in order to be approved as a PBO).

GOVERNANCE STRUCTURE

A PBO is governed according to its constitution in the same manner as all other non progit organisations.

WHAT LAWS GOVERN PBOS?

To qualify for registration as a PBO, organisations must have as their primary objective, one or more of the following Public Benefit Activities listed in Part 1 of the Ninth Schedule to the Income Tax Act:

- *welfare and humanitarian*
- *health care*
- *land and housing*

- *education and development*
- *religion, belief or philosophy*
- *cultural*
- *conservation, environment and animal welfare*
- *research and consumer rights*
- *sport*
- *provision of funds, assets or other resources*

For more on legislation, regulatory requirements and tax implications regarding PBOs please refer to **Part D: Tax Benefits and Implications.**

HOW TO FORM AND REGISTER A PBO

To register as a PBO, organisations need to submit the following documents to the Tax Exemption Unit of SARS:

- *A certified copy of the organisation's founding document*
- *A completed application form to register a PBO (Form EI 1)*
- *A written undertaking to be signed by three trustees confirming that they take fiduciary responsibility for the PBO (Form EI 2)*
- *A written undertaking to be signed by three trustees if the organisation provides bursaries or award for study.*

ADVANTAGES AND DISADVANTAGES OF A PBO

The main reason why organisations might want to consider registering as a PBO, is that PBOs are entitled to the following further tax benefits:

ADVANTAGES:

- Certain receipts (mainly derived from Donors) are exempt from income tax.
- In specific instances certain PBO trading activities will be tax exempt (for more information please refer to **Part D: Tax Benefits and Implications, Allowable Trade.**)
- Donations made to PBOs are tax deductible which sometimes encourages donors to be more generous.

DISADVANTAGES:

- Under certain circumstances PBOs that engage in trading may now be liable for Capital Gains Tax

IMPLICATIONS OF THE NPO ACT

The NPO Act provides for a PBO to register as an NPO although it is not mandatory. The same legislation therefore applies.

4. COMPONENTS OF A FINANCIAL SYSTEM

THE BUDGET

The budget is an estimate of organizational costs, revenues and resources over a specified period, a projection of future financial conditions and goals. One of the most important administrative tools, a budget serves also as a:

- ***Plan of action for achieving quantified objectives;***
- ***Standard for measuring performance;***
- ***Device for coping with foreseeable adverse situations.***

It is important for organisations to create accurate and up-to-date annual budgets in order to maintain control over their finances and to show funders exactly how their money is being used. How specific and complex the actual budget document needs to be depends on how large the budget is, how many funders there are and what their requirements are, and the number of different programmes or activities for which the money will be used. At some level, however, budgets will need to include the following:

Projected expenses: The amount of money you expect to spend in the coming 'fiscal year'* broken down into the categories you expect to spend it on, for example salaries, office expenses, etc.
('Fiscal year' simply means 'financial year' and is the calendar you use to figure your yearly budget. It determines when you file tax forms, get audited and close your books. There are many different fiscal years you can use. Businesses often use the calendar year - 1 January to 31 December.)*

Projected income: Your organisation's expected income for the coming fiscal year from your various funding sources including grants, contracts, your own fundraising efforts, membership fees and sale of goods or services.

The interaction of expenses and income: This relates to what is funded by which particular source. In many cases, this is a condition of funding received: a funder may agree to provide money for a specific purpose, activity or item. If funding comes with restrictions, it is important to build these restrictions into your budget so that you can make sure you spend the money as agreed with the funders.

Adjustments to reflect reality as the year progresses: Your budget will likely begin with estimates, and as the year progresses, will need to be adjusted to accurately reflect all financial transactions and the impact they have on your organisation's financial situation.

WHY PREPARE AN ANNUAL BUDGET?

- *It sharpens your understanding of your goals*
- *It gives you an accurate picture of what you can afford and where the funding gaps are. Your budget allows you to plan ahead to meet needs and decide what you are really able to do in a given financial year.*
- *It encourages effective money management by showing you what you cannot afford with known income. A budget can therefore motivate you to be creative - and successful - in seeking other funding sources.*
- *It fills the need for required information for funding proposals and reports to funders and the community.*
- *It facilitates discussion about the financial realities of the organisation.*
- *It helps you avoid surprises and to maintain fiscal control.*

PLANNING AND GATHERING INORMATION TO CREATE A BUDGET

THE PRELIMINARIES

What will you need to spend money on in the next fiscal year?
It is important to know what the priorities are and what makes the most sense for the organisation at its particular stage of development. Actually figuring out on what you should be spending your money, involves planning processes that include the organisation in its entirety.

What one should consider:

- *What are the activities or programmes that will do the most to advance your cause and mission? Which do you think can be carried out with the income and resources you already have or are guaranteed in the future?*
- *How many staff will it take to run these activities or programmes effectively?*
- *How much (in terms of hourly wages, salary, consultant fees, benefits, etc) and from which sources will staff be compensated?*
- *What else will be needed to to run the organisation and its activities, eg office space and supplies, equipment, phone and utilities, insurance, transportation, etc?*
- *Consultants' services which may include an annual audit, accounting or bookkeeping services, payments to other organisations for specific services etc.*

NB: Most organisations are required, either by funders or by the state tax authority, to undergo an annual audit. *This means that a Certified Public Accountant (CPA) must check the organisation's financial records to make sure they are accurate, and work with the organisation to correct any errors or solve problems. If there is nothing illegal or seriously wrong, the CPA then prepares financial statements using the organisation's books and certifies that acceptable accounting practices have been followed and that its financial records are in order. The larger an organisation's budget, the more complicated, lengthy and costly the audit process is likely to be.*

ESTIMATING EXPENSES: WHAT WILL IT ALL COST?

STEP 1: OPERATING COSTS
Develop ways of estimating your expenses. Estimate your expenses for the coming fiscal year. In some cases (eg annual rent, salaries etc) you may know what thesecosts will be in advance. In other cases (eg telephone and utilities) you will have to estimate an average monthly cost.

STEP 2: BASIC NECESSITIES
List the estimated annual expense totals for the organisation's most basic necessities (eg rent, levies, electricity and water, telephone, stationery and printing).

STEP 3: ACTIVITIES
List the estimated expenses for what will be needed to conduct your organisation's activities (eg workshops, field or exchange visits, leadership training).

ESTIMATING INCOME: WHERE WILL WE GET ALL THE MONEY?

STEP 1: FUNDING
List all actual figures and estimates of what you expect to receive from your known

funding sources. This includes sources that have already promised you money for the coming year, or that have regularly funded you previously. These may include state or local government agencies, private and community foundations, religious organisations, corporations or other private entities.

STEP 2: FUNDRAISING
Estimate the amount your organisation expects to raise from fundraising during the next fiscal year. Fundraising efforts may include community events (eg raffles, a sports day), more ambitious events (eg a benefit concert by a world-class performer), media advertising, or phone or mail solicitation.

STEP 3: SERVICES / FEES
If you charge fees or sell services, also estimate and include this income. Your organisation may, for example, offer consulting or training services.

STEP 4: MEMBERSHIP FEES / DUES
Include any annual membership fees or dues.

STEP 5: SALES
If you sell items such as T-shirts, pins, books, blood pressure cuffs, or create training materials that can be purchased by others working in the same field, estimate and include this income for the year.

STEP 6: RENTAL
Estimate any income from rental or if your organisation sublets space to others.

STEP 7: RETURN ON INVESTMENTS
This could include investments, endowment income, annuities, or interest earned (eg from a certificate of deposit, money market or cheque account).

STEP 8: OTHER
List and estimate any other income that might be obtained from other sources during the year ahead.

STEP 9: ADD UP ALL THE INCOME YOU HAVE LISTED
This total is the money you have to work with - your projected income - for the next fiscal year.

CREATING AN ACTUAL BUDGET DOCUMENT

While a spreadsheet is probably what you will use to keep track of your finances, you might also want to put the budget in a form everyone in the organisation can understand.

Probably the simplest way of doing this is to create a document that lists projected expenses by category, and projected income by source, with totals for each. Anyone can then see clearly how much you intend to spend, how much income you expect, and what is the difference, if any.

WORKING WITH YOUR BUDGET

For accuracy, most organisations ensure they review and revise their budgets regularly, usually once a month. If you get a grant you did not anticipate, or have unexpected expenses, these must be factored into the budget.

The budget therefore becomes the basis for financial documents that you may need to prepare during the year (eg balance sheets) that give an up-to-the-minute overview of the financial status of your organisation.

Your budget should:

- ***Tell you if there are still any funding gaps and exactly where they are;***
- ***Show you exactly what you need to do to close those gaps;***
- ***Make it possible to keep careful track of your money, to adjust to changes and not to overspend.***

SUMMARY

Devising a budget process that examines the organisation's priorities and then using it to produce an accurate, balanced budget for the coming fiscal year will help you keep control of the organisation's finances, and will help guide the work of the organisation. A rational and accurate budget will allow you to give accurate reports to funders and to spend their money as has been mutually agreed. It will also give you clear guidelines regarding what you can spend and when.

EXAMPLES OF BUDGETS

TO BE PRESENTED TO ALL SOULS COMMUNITY CHURCH CONGREGATION AT SEMI-ANNUAL MEETING 12/11/05 * APPROVED BY BOARD OF TRUSTEES	2006 Annual Budget
REVENUES	
PLEDGES - GENERAL FUND	$93,396
ESTIMATED CARRYOVER FROM 2005	$11,714
PLATE - GENERAL FUND	$10,000
FUND RAISERS NET	$7,000
GROSS REVENUES	$122,110
EXPENSES	
ADVERTISING EXPENSE	$3,500
UUA FAIR SHARE	$6,477
DISTRICT UUA DUES	$2,286
UNCOLLECTED PLEDGES	$7,376
ORDER OF SERVICE	$750
CHOIR DIRECTOR, ACCOMPANIST	$2,250
MUSIC PROGRAM	$2,456
BUILDING RENTAL EXPENSE	$19,000
MISCELLANEOUS	$100
COFFEE SERVICE	$100
MINISTER HOUSING ALLOWANCE	$37,000
MINISTER SALARY	$6,000
MINISTER PROFESSIONAL COSTS	$450
MINISTER'S RETIREMENT	$7,020
INSURANCE(OTHER THAN PASTOR)	$1,200
OFFICE SUPPLIES EXPENSE	$250
P. O. BOX	$60
POSTAGE EXPENSE	$200
WEB PAGE COSTS	$135
COMMUNITY LIFE	$700
COVENANT GROUPS	$400

Expenditures	Actual Budget	Love	Prayer	Developing Leaders	Harvest	Ministries Support	Pastoral Care	Running Total
		1	2	3	4	5	6	
COGOP (IO and NC):								
1 IO: 10% Tithes, HPL1/L2, HLD, TC, HC	$ 11,700	$ -	$ 2,340	$ 2,340	$ 2,340	$ 2,340	$ 2,340	$ 11,700
2 NC: 2% Tithes, HLD	$ 4,500	$ 750	$ 750	$ 750	$ 750	$ 750	$ 750	$ 4,500
Subtotal	$ 16,200	$ 750	$ 3,090	$ 3,090	$ 3,090	$ 3,090	$ 3,090	$ 16,200
People (Staff)		$ -	$ -	$ -	$ -	$ -	$ -	$ -
3 Pastor (see Compensation Designations)	$ 13,920	$ -	$ -	$ -	$ -	$ -	$ 13,920	$ 13,920
4 Other Salaries	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
5 Benefits (see Compensation Designations)	$ 39,432	$ -	$ -	$ -	$ -	$ -	$ 39,432	$ 39,432
Subtotal	$ 53,352	$ -	$ -	$ -	$ -	$ -	$ 53,352	$ 53,352
Property (Overhead)								
6 Utilities (Light, Heat, & Water)	$ 9,500	$ -	$ -	$ -	$ -	$ 9,500	$ -	$ 9,500
7 Telephone	$ 600	$ -	$ -	$ -	$ -	$ 600	$ -	$ 600
8 Insurance	$ 6,000	$ -	$ -	$ -	$ -	$ 6,000	$ -	$ 6,000
9 Maintenance & Supplies - recurring	$ 1,100	$ -	$ -	$ -	$ -	$ 1,100	$ -	$ 1,100
10 - capital	$ 600	$ -	$ -	$ -	$ -	$ 600	$ -	$ 600
11 Mortgage - Principal	$ 12,000	$ -	$ -	$ -	$ -	$ 12,000	$ -	$ 12,000
12 - Interest	$ 400	$ -	$ -	$ -	$ -	$ 400	$ -	$ 400
Subtotal	$ 30,200	$ -	$ -	$ -	$ -	$ 30,200	$ -	$ 30,200
Programs (Ministries)								
13 Church Life (Small Grps, Fellowship)	$ 4,000	$ 1,000	$ -	$ 500	$ 2,500	$ -	$ -	$ 4,000
14 Student (Children, Youth, Nursery)	$ 3,000	$ -	$ -	$ 500	$ 2,500	$ -	$ -	$ 3,000
15 Christian Ed (SS, CIMS,Wed pm)	$ 6,562	$ -	$ -	$ 5,062	$ 1,500	$ -	$ -	$ 6,562
16 Adults (Seniors, Men's, Women's)	$ 2,400	$ -	$ -	$ 900	$ 1,500	$ -	$ -	$ 2,400
17 Outreach, Evangelism, Revivals	$ 2,000	$ 1,000	$ -	$ -	$ 1,000	$ -	$ -	$ 2,000
18 Music (Choir, A/V, Praise Team)	$ 5,624	$ 2,000	$ -	$ 500	$ 3,124	$ -	$ -	$ 5,624
Subtotal	$ 23,586	$ 4,000	$ -	$ 7,462	$ 12,124	$ -	$ -	$ 23,586
Property (Operations)								
19 Postage	$ 150	$ -	$ -	$ -	$ -	$ 150	$ -	$ 150
20 Copier Costs	$ 1,100	$ -	$ -	$ -	$ -	$ 1,100	$ -	$ 1,100
21 Office Supplies - recurring	$ 200	$ -	$ -	$ -	$ -	$ 200	$ -	$ 200
22 Office Supplies - capital	$ 2,362	$ -	$ -	$ -	$ -	$ 2,362	$ -	$ 2,362
23 Hospitality Supplies	$ 2,160	$ 2,000	$ -	$ -	$ -	$ 160	$ -	$ 2,160
24 Miscellaneous	$ 4,132	$ 2,062	$ 2,000	$ -	$ -	$ 70	$ -	$ 4,132
25 Bank Service Charges	$ 60	$ -	$ -	$ -	$ -	$ 60	$ -	$ 60
26 Advertising	$ 60	$ -	$ -	$ -	$ -	$ 60	$ -	$ 60
Subtotal	$ 10,224	$ 4,062	$ 2,000	$ -	$ -	$ 4,162	$ -	$ 10,224

FINANCIAL POLICIES AND PROCEDURES

All financial management systems are upheld by sound financial policies and procedures that guide operations and determine how your organisation uses and manages its money. A financial procedures manual helps to establish financial controls that ensure financial data is accurate, up-to-date and complete for reference by financial staff, trustees, managers and other staff.

There is no one model for a financial procedures manual and yours will depend on the needs and structure of your organisation. The guidelines below can act as a starting point for your own manual and can be adapted to the specific needs and activities of your organisation.

TYPICAL CONTENT HEADINGS FOR A FINANCIAL PROCEDURES MANUAL

- **Trustees financial responsibilities**
- **Expenditure controls:** ie who can spend what and on whose authority
- **Financial asset controls:** ie for records, cheques received and who banks them
- **Budgetary control:** ie who can spend how much and on what, and what expenditure needs special permission
- **Human resources controls:** ie who can recruit and for what roles, and what permissions are needed
- **Physical assets controls:** ie who can authorize the sale and lease of buildings and equipment.
- Your manual may also need to include key elements of external financial regulations.

THE ACCOUNTING PROCESS

The accounting cycle, also commonly referred to as the **accounting process,** is a series of procedures in the collection, processing, and communication of financial information. Accounting involves recording, classifying, summarising and interpreting financial information.

Financial information is presented in reports called **financial statements.** Before they can be prepared, accountants need to gather information about business transactions, and record and collate them to determine the amounts to be presented in the reports.

The cycle does not end with the presentation of financial statements. Further steps need to be taken to prepare the accounting system for the next cycle.

ACCOUNTING CYCLE STEPS

STEP 1: IDENTIFYING AND ANALYSING BUSINESS TRANSACTIONS:

- The accounting process starts with identifying and analysing business transactions and events. Not all transactions and events are entered into the accounting system, only those that relate to the business entity or organisation(eg a personal loan made by the owner that does not have anything to do with the business entity is not accounted for).
- All relevant transactions are then analysed to determine the accounts affected, and the amounts recorded. This includes the preparation of business documents or **source documents.** A business document serves as a basis for recording a transaction.

STEP 2: RECORDING IN THE JOURNALS

- A journal can be in book, paper, or electronic format and is where transactions are recorded. Business transactions are recorded using the **double-entry** bookkeeping system, meaning they are recorded in journal entries containing at least two accounts (**one debited and one credited**). To simplify the recording process, special journals are often used for transactions that recur often such as sales, purchases, cash receipts and cash disbursements. A general journal is used to record any transactions that cannot be entered in the special books.
- Transactions are recorded in chronological order and as they occur.
- Journals are also known as **books of original entry**. (This means they are the books in which business transactions are first recorded.)

STEP 3: POSTING TO THE LEDGER

- Also known as **books of final entry,** the ledger is a collection of accounts that shows the changes made to each account as a result of past transactions and their current balances. After posting all transactions to the ledger, the balances of each account can be determined. (For example, all journal entry debits and credits made to CASH will be transferred into the CASH account in the ledger. You will then be able to calculate increases and decreases in cash to determine the final CASH balance.)

STEP 4: UNADJUSTED TRIAL BALANCE

- A trial balance is the listing of all closing balances of the general ledger accounts by a certain date, before any adjustments are made to balances, in preparation for financial statements produced at the end of an accounting period. This is the starting point for analysing account balances before making adjustment entries.
- All account balances are extracted from the ledger and arranged in one report. Then all debit and credit balances are added. Total debits should equal total credits.

- When errors are discovered, **correcting entries** are made to rectify them or reverse their effect. However, a trial balance is simply to test if the total debits equal the total credits, not to determine the accuracy of accounting records.
- Some errors could exist even if debits equal credits, such as double posting or failure to record a transaction.

STEP 5: ADJUSTING ENTRIES

- Adjusting entries are prepared as an application of the **accrual basis of accounting.**
- This means at the end of the accounting period, some expenses may have been incurred but not yet recorded in the journals. Some income may have been earned but also not entered in the books. Adjusting entries are therefore prepared to update accounts before they are summarised in the financial statements. Adjusting entries are made for accrual of income or expenses, deferrals (income method or liability method), prepayments (asset method or expense method), depreciation and allowances.

STEP 6: ADJUSTED TRIAL BALANCE

- An **adjusted trial balance** is prepared after adjusting entries are made, prior to the preparation of the financial statements. This is to test if all debits are equal to all credits after the adjusting entries have been made.

STEP 7: FINANCIAL STATEMENTS

- When the accounts are up-to-date and debits and credits balance, the financial statements can be prepared. This is the final accounting stage of the accounting system. A complete set of financial statements consist of:
  - ***Statement of Comprehensive Income or Income Statement and Other Comprehensive Income***
  - ***Statement of Changes in Equity***
  - ***Statement of Financial Position or Balance Sheet***
  - ***Statement of Cash Flows***
  - ***Notes to Financial Statements***

FINANCIAL PERIOD

An accounting (financial) period is a specific 12-month time frame during which business transactions are accumulated into financial statements. Management and donors require this information to compare results and performance over successive periods of time. Although they may differ, a typical example of a financial period would be from 1 March 2016 to 28 February 2017, the last date being the financial year end.

CHART OF ACCOUNTS

A chart of accounts is a listing of the names of the accounts that a company or organisation has identified and made available for recording transactions in its general ledger. An organisation has flexibility to tailor its chart of accounts to best suit its needs, including adding accounts as needed.

Within the categories of operating revenues and operating expenses, accounts might be further organised according to business function (such as producing, selling, administrative, financing, etc) and / or by the organisation's various departments or programmes.

The entity's organisation chart can serve as the outline for its accounting chart of accounts. For example, if a large organisation divides its operations into 10 departments (eg administration, marketing, human resources, etc) each department will likely be accountable for its own expenses (salaries, supplies, phone, etc). Each department will have its own phone expense account, its own salaries expense account, etc.

A chart of accounts will therefore likely reflect the size and complexity of the organisation itself. For example a large international foundation with several divisions may therefore need thousands of accounts, while a small, community-based, voluntary association may only need a few accounts.

Overleaf is an example of a non-profit Chart of Accounts guide and key below:

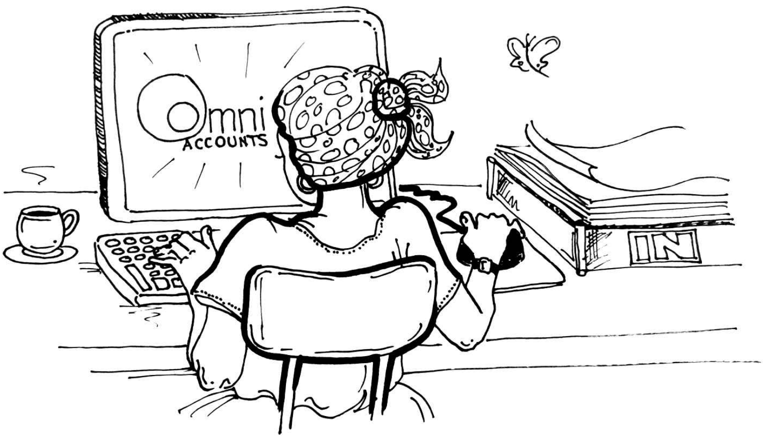
1. ACCOUNT NAME: *The name of the account in the general ledger*
2. FS: *The Financial Statement in which the account appears*
3. SFP: *Statement of Financial Position*
4. SA: *Statement of Activities*
5. GROUP: *The type of account*
6. CODE: *A suggested account code for the account*

NON-PROFIT CHART OF ACCOUNTS

Account Name	FS	Group	Code
Cash in bank	SFP	Cash	1010
Petty cash	SFP	Cash	1040
Savings & short-term investments	SFP	Cash	1070
Accounts receivable control	SFP	Accounts receivable	1110
Doubtful accounts allowance	SFP	Accounts receivable	1115
Prepaid expenses	SFP	Other assets	1450
Accrued revenue	SFP	Other assets	1460
Investments	SFP	Investments	1580
Leasehold improvements	SFP	Fixed operating assets	1630
Furniture, fixtures, and equipment	SFP	Fixed operating assets	1640
Accum amort – leasehold improv	SFP	Accum depreciation	1735
Accumulated deprec – ff & e	SFP	Accum depreciation	1745
Accounts payable	SFP	Payables	2010
Accrued expenses	SFP	Accrued liabilities	2150
Deferred revenue	SFP	Accrued liabilities	2310
Short-term liabilities – other	SFP	Short-term notes & loans	2570
Long-term liabilities – other	SFP	Long-term notes & loans	2770
Unrestricted net assets (funds)	SFP	Funds	3010
Temp. restricted net assets (funds)	SFP	Funds	3110
Perm. restricted net assets (funds)	SFP	Funds	3210
Contributions	SA	Direct contributions revenue	4010
Donations	SA	Donated goods & services revenue	4110
Non Government grants	SA	Non government grants revenue	4230
Fundraising	SA	Indirect contributions revenue	4430
Government grants	SA	Government grants revenue	4510
Program service fees	SA	Program-related sales & fees	5180
Membership dues	SA	Revenue from dues	5210
Interest-savings/short-term invest	SA	Revenue from investments	5310
Miscellaneous revenue	SA	Revenue from other sources	5490
Officers & directors salaries	SA	Salaries & related expenses	7210
Wages and salaries	SA	Salaries & related expenses	7220
Pension costs	SA	Salaries & related expenses	7230
Employee benefits – not pension	SA	Salaries & related expenses	7240
Payroll taxes, etc.	SA	Salaries & related expenses	7250
Accounting fees	SA	Contract service expenses	7520
Legal fees	SA	Contract service expenses	7530
Professional fees – other	SA	Contract service expenses	7540
Rent	SA	Facility & equipment expenses	8210
Occupancy costs	SA	Facility & equipment expenses	8215
Utilities	SA	Facility & equipment expenses	8220
Equipment rental & maintenance	SA	Facility & equipment expenses	8260
Depreciation	SA	Facility & equipment expenses	8270
Depreciation and amortization	SA	Facility & equipment expenses	8270
Travel	SA	Travel & meetings expenses	8310
Conferences, conventions, meetings	SA	Travel & meetings expenses	8320
Interest	SA	Other expenses	8510
Insurance	SA	Other expenses	8520
Membership dues	SA	Other expenses	8530
Staff development	SA	Other expenses	8540
Outside computer services	SA	Other expenses	8560
Advertising expenses	SA	Other expenses	8570
Contingency provisions	SA	Other expenses	8580
Other expenses	SA	Other expenses	8590
Bad debt expense	SA	Business expenses	8610
Sales taxes	SA	Business expenses	8620
Taxes – other	SA	Business expenses	

ACCOUNTING SOFTWARE

Accounting software describes the type of computer applications (software) used to record and process accounting transactions within functional modules such as accounts payable, accounts receivable, general ledger, payroll and trial balance. This functions as the accounting information system. Some examples of accounting software packages include: **Quickbooks, Sage Pastel and OMNI.**



FINANCIAL REPORTING

FINANCIAL STATEMENTS

Financial statements or a **financial report** is a formal record of the financial activities and position of an organisation where relevant financial information is presented in a structured and easily understood manner. Financial statements provide information about the results of an organisation's operations, financial position and cash flows. These may be used to make decisions about the allocation of resources, or to account to funders.

COMPARING ACTUAL EXPENDITURE TO BUDGET AND VARIANCES

Most organisations prepare a budget for every activity they engage in, as well as their normal, day-to-day operations. At the end of the given activity or project, or at certain intervals, the budget is compared to the actual costs and income and any differences are analysed. This practice, called **variance analysis**, is important in management accounting for it produces projected information needed for developing budgets, measuring performance, planning activities, strategic planning and the evaluation of business results.

MEASURING RESULTS

Measuring actual results against the budget is needed to monitor and record business activities, the results of which are used for further performance evaluation. The comparison between actual expenditure versus an estimated budget often shows a difference, or **variance**. This can either be favourable (eg if the actual costs of an activity were equal to, or less than, the amount budgeted) or unfavourable (if the actual expenditure exceeded the amount originally budgeted).

ANALYSING VARIANCE

Variances are analysed to establish what caused the difference between actual expenditure and budgeted spending. Planning budgets and measuring results are only the start of the process of comparing actual versus budgeted expenditure. Management uses the budget report to identify the reasons for any variation so that it can recommend appropriate corrective actions. Potential causes for unfavourable variances may include unrealistic budgeting, poor performance or unforeseen events over which the organisation may have had no control.

TAKING ACTIONS

Variance analysis better informs managers about the organisation's current operations. Identifying what has been successful and cost effective and what has not, allows managers to take corrective actions. The purpose of comparing actual versus budget adds value to the organisation through improved planning, monitoring, evaluation and controls. Management is therefore able to adjust a budget upward or downward to better reflect reality and implement new cost-cutting devices or seek additional sources of income.

PART B: CASH FLOW MANAGEMENT

WHAT IS CASH FLOW?

Cash flow is the money that is moving (**flowing**) in and out of your organisation each month. While it may sometimes seem that cash flows only in one direction - out of your organisation - it does flow both ways!

Cash flows in from funders, fundraising, sale of services, membership fees, rental etc. If this income is not received when anticipated or due, some of your cash flow will be coming from collections of accounts receivable.

Cash flows out in the form of payments for expenses such as rent, or monthly loan repayments, taxes or other accounts payable.

Think of cash flow as a picture of your organisation's checking account. If more money is coming in than is going out, you are in a **positive cash flow** situation and you have enough to cover your expenses. If more cash is going out than coming in, you are in danger of being overdrawn and you will need to find money to cover expenses. This is why new organisations often need **working capital** in the form of sufficient start up funding, a loan, or access to credit to cover shortages in cash flow.

WHY IS CASH FLOW SO IMPORTANT?

Lack of cash is one of the biggest reasons why organisations fail. **Inadequate cash reserves** or **running out of money** will shut down your organisation faster than anything else. A cash flow forecast is an estimate of the amount of money you expect to flow in and out of your organisation and includes all your projected income and expenses. A forecast usually covers the next 12 months, but can also cover short-term periods such as a month or week.

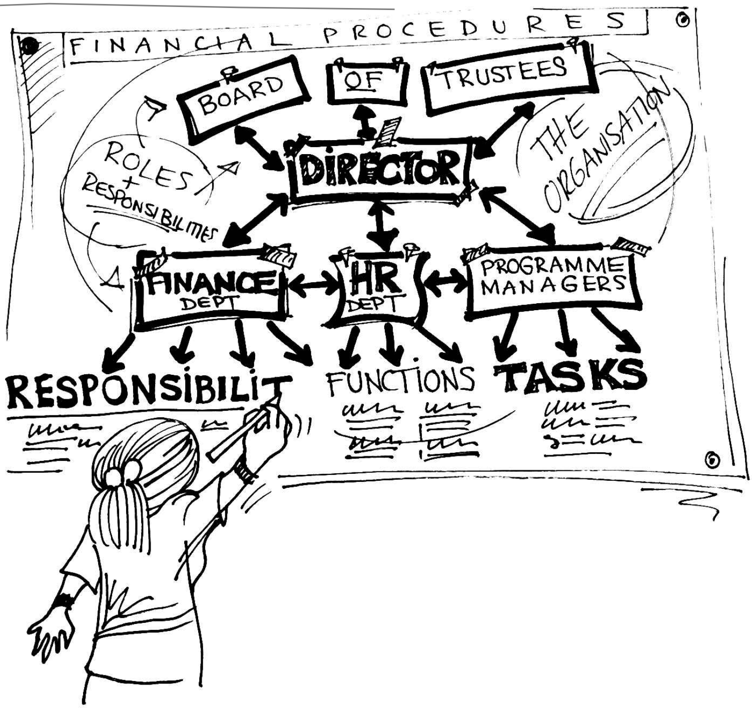
HOW TO MAXIMISE CASH FLOWS

Maximising an organisation's cash flow allows you to receive income faster, complete projects within a shorter period and at lower total operating costs. Each method used to maximize your cash flow, by trimming business costs and setting project priorities, can work in combination to provide streamlined benefits for your organisation.

EXAMPLE OF A CASH FLOW STATEMENT

	A	B	C	D	E
1			**[Company Name]**		
2			**Cash Flow Statement**		
3					
4			For the Year Ending	12/31/2008	
5			Cash at Beginning of Year	15,700	
6					
7		Operations			
8		Cash receipts from customers		693,200	
9		Cash paid for			
10			Inventory purchases	(264,000)	
11			General operating and administrative expenses	(112,000)	
12			Wage expenses	(123,000)	
13			Interest	(13,500)	
14			Income taxes	(32,800)	
15		Net Cash Flow from Operations		**147,900**	
16					
17		Investing Activities			
18		Cash receipts from			
19			Sale of property and equipment	33,600	
20			Collection of principal on loans		
21			Sale of investment securities		
22		Cash paid for			
23			Purchase of property and equipment	(75,000)	
24			Making loans to other entities		
25			Purchase of investment securities		
26		Net Cash Flow from Investing Activities		**(41,400)**	
27					
28		Financing Activities			
29		Cash receipts from			
30			Issuance of stock		
31			Borrowing		
32		Cash paid for			
33			Repurchase of stock (treasury stock)		
34			Repayment of loans	(34,000)	
35			Dividends	(53,000)	
36		Net Cash Flow from Financing Activities		**(87,000)**	
37					
38		Net Increase in Cash		**19,500**	
39					
40			Cash at End of Year	35,200	
41					

PART C: INTERNAL & FINANCIAL CONTROL SYSTEMS



Internal controls are policies and procedures put in place to ensure the continued reliability and accuracy of accounting systems that are critical for financial integrity and accountability. Without accurate accounting records, financial reports may contain errors, managers cannot make fully informed decisions, the organisation cannot account accurately to its funders and its integrity and efficiency will be negatively affected. Internal control procedures in accounting can be broken down into 7 categories, each designed to prevent fraud and identify errors before they become problems. These categories are:

1 APPROVAL AUTHORITY

Requiring specific managers to authorise certain types of transactions can add a layer of responsibility to accounting records by proving transactions have been seen, analysed and approved by the appropriate individuals. Requiring approval for large payments and expenses can prevent unscrupulous employees from making large fraudulent transactions with the organisation's funds.

2 SEPARATION OF DUTIES

Separation of duties involves splitting responsibilities for bookkeeping, deposits, reporting and auditing. The more duties are separated, the less chance any single employee has of committing fraud. For small organisations with only a few accounting employees, sharing responsibilities between two or more people (eg co-signing cheques or bank withdrawals) or requiring critical tasks to be reviewed by co-workers can be effective.

3 ACCESS CONTROLS

Refers to the control of access to different parts of an accounting system. By using passwords and electronic access log-ins, unauthorized users can be prevented access to the system. This also provides means of auditing usage of the system in order to identify the source of errors or discrepancies

4 DOCUMENTATION

Standardising documents used for financial transactions, such as invoices, internal materials requests, inventory receipts and travel claims, can help to maintain consistency in record keeping over time. Using standard document formats that are numbered can make it easier to review past records when searching for the source of a discrepancy in the system. A lack of standardisation can result in items being overlooked or misinterpreted in such a review.

5 TRIAL BALANCES

Use of a double-entry accounting system ensures that the books are always balanced. Calculating daily or weekly trial balances can provide regular insight into the state of the system and allow discrepancies to be identified and investigated at the earliest possible stage.

6 RECONCILIATIONS

Regular accounting reconciliations can ensure that balances in your accounting system match account balances held by other entities, eg banks, suppliers and credit customers. For example, a bank reconciliation involves comparing cash balances and records of deposits and receipts between your accounting system and the bank's statements. Any differences between these types of complementary accounts can immediately reveal errors or discrepancies in your own accounts, or the accounts held by other entities.

7 PHYSICAL AUDITS

Physical audits include hand-counting cash and tracking physical assets in the accounting system, such as inventory, materials and equipment. Physical counting can reveal well-hidden discrepancies in account balances by bypassing electronic records altogether. Counting cash in if your organisation regularly sells products or services can be done daily or even several times a day. Larger projects, such as hand-counting an inventory, should be performed less frequently, perhaps on an annual or quarterly basis.

PART D: FINANCIAL SUSTAINABILITY

WHAT IS FINANCIAL SUSTAINABILITY?

> ***"Sustainability is the ability of an organisation to secure and manage sufficient resources to enable it to fulfill its mission effectively and consistently over time without excessive dependence on any single funding source."*** Lisa Canon - *'Life Beyond Aid.'*

Sustainability in financial terms can also be described as follows:

> ***"Financial continuity and security"***
> ***"The organisation and its core work will not collapse if external funding is withdrawn."***
> ***"…when your work is recognized to the extent that you don't have to fundraise."***

In practice, non-profit organisations which have achieved financial sustainability, are characterised by:

- ***A diversified funding base***
- ***Availability of unrestricted funds***
- ***Availability of financial reserves***
- ***Strong stakeholder relationships***

Organisations that seek to attain financial sustainability must develop strategies that are relevant to their current financial and resource-raising context.

THE IMPORTANCE OF FINANCIAL SUSTAINABILITY

It is important to address the longer-term issue of how the organisation plans to continue financing and resourcing its overall operations to meet its objectives into the future. In order to do so, the organisation needs to have a long term financing strategy to:

- ***Survive*** *in an environment that is more 'competitive' in which funds are scarcer and restrictive.*
- ***Facilitate expansion*** *and programme development in a world that is complex, challenging and changing. Organisations must be able to research and respond to the changing needs of those who they work to benefit, sometimes taking innovative or experimental approaches that are not easy to fund from traditional sources.*
- ***Reduce dependency*** *and spread financial risk.*
- ***Develop a support base*** *local to the programme activities, which will increase the strength and credibility of the organisation.*
- *Explore avenues for making viable and* ***sustaining all the operations*** *of the organisation, not just short-term projects.*

STRATEGIES FOR FINANCIAL SUSTAINABILITY

A financing strategy and plan for sustainability could include the following:

- ***Diversification*** *of income sources*
- *Identifying new* ***potential resources***
- *Increasing* ***unrestricted income***
- ***Expanding*** *the funding mix through effective ongoing* ***fundraising strategies***
- *Maximizing potential* ***collaborations*** *and in-kind* ***donations***
- ***Income generation***
- ***Building reserves*** *and savings*
- ***Managing financial investments*** *for the future*
- *Increased* ***effectiveness and efficiency*** *in the management of resources*

In addition, the development of the financing strategy must also take into account:

- *Key points of* ***organizational and financial history***
- *Current* ***relevance*** *of programmes*
- ***Competitors***

DIVERSIFICATION OF INCOME SOURCES

Increasing the diversity of funding sources and funding types enhances sustainability. Consistent, regular and dependable income is required and it is generally true that ***"money attracts more money!"***

IDENTIFYING THE AVAILABLE RESOURCES

- *What resources are available to the organisation?*
- *Where do, or could, these resources come from?*

POTENTIAL RESOURCE SOURCES

GENERAL PUBLIC: · *Community fundraising events* · *Membership fees* · *Individual donations* · *Volunteering* · *Bequests*	**GOVERNMENT / QUASI-GOVERNMENT:** · *Contracts / tenders* · *Grants* · *Funding from: the National Development Agency, National Lottery** · *SETAs and the National Skills Fund**
INTERNATIONAL DONORS: · *Programme grants* · *Grants for core funding* · *Endowments*	**CORPORATE SECTOR:** · *Grants* · *Partnerships* · *Sponsorships* · *Provision of skills / volunteers* · *Product endorsements* · *Equipment donations*
CIVIL SOCIETY: · *Community Chest* · *Universities, colleges, schools* · *Religious organisations* · *Trade unions* · *Other NPOs*	**TRUSTS / FOUNDATIONS:** · *Endowments* · *Grants* · *Bequests*
Support can be provided in the form of: - *Grants* - *Space* - *Skills* - *Equipment* - *Volunteers* - *Being a market for goods or services* - *Sharing resources*	**Income may be generated by:** - *Fees for services* - *Contracting* - *Rental* - *Product sales* - *Endowments* - *Interest from investments / deposits*

*(*Available to South African organisations only. Consult your own government for similar state initiatives.)*

TYPES OF INCOME GENERATION

UNRESTRICTED INCOME

The financing strategy should include a plan to increase funding that can be utilised at the discretion of the organisation and that is **not restricted or earmarked for any specific purpose**. This unrestricted income gives the organisation **flexibility** in financing its operations, dealing with funding gaps, responding to immediate needs or building its reserves.

RESTRICTED INCOME

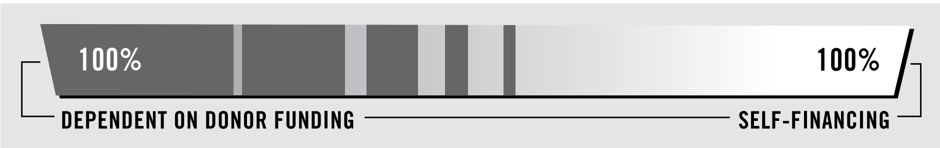
Increasingly, funding contracts provide grants that fall into the restricted income category where **specific conditions are set out regarding the use of the funds** given. The conditions may govern what the funds can be spent on, or what outcomes must be achieved with the use of the funds. In such cases, the contracts may require specific reporting on the use of the grant or may require unspent funds to be returned to the donor.

FUNDING MIX

Funders are more often enthusiastic about providing grants if they know of other funders who also fund the organisation. Many organisations are dependent on one or two major international / bilateral funders. This results in:

- *The funder potentially having too much control and reducing the autonomy of the organisation*
- *Greater levels of financial risk - if a key funder withdraws, it could result in the closure of the organisation*
- *Undue reliance on an increasingly scarce resource*

The degree of diversity of funding sources (both in terms of the types of different funders, and of the types of income) can be illustrated as a continuum (below) and organisations must, as part of their financial strategy, decide where they are currently placed and where they want, realistically, to move on this continuum.



The diversity of funding sources needs to be monitored and this can be done using the ratio of **donor dependency** - to what extent is the organisation dependent on donor funds?

TOTAL DONOR FUNDS X 100 ÷ TOTAL INCOME = PERCENTAGE DEPENDENCY

This ratio can be assessed by comparison to past years and to other similar organisations, but it should be noted that the outcome very much depends on the nature of the work.

The objective of the review of the funding mix is to increase resourcing flexibility (by **increasing unrestricted funding**) without unacceptable levels of risk. The exercise must be undertaken realistically:

- *Self-financing involves **time, effort and specialized skills***
- *Not all organisations are involved in activities that **lend themselves well to self-financing schemes***
- *The greatest risk is that the organisation **may lose sight of its objectives**.*

THE PATH TO A MORE DIVERSIFIED FUNDING BASE

Deciding your funding mix (adapted from Norton, 1996 [1].)

FUTURE FUNDING PLANS

The fundraising strategy of the organisation should take into account not only the ongoing funding needs of the organisation, but also the events for which a particular fundraising initiative is required, such as:

- *New objectives, programmes or activity plans*
- *The possibility of new funding sources*
- *The impending departure of previous funders*
- *The need to expand existing services*

The process of financial planning should **continually monitor the environment for fundraising** so that the need for additional fundraising resources can be planned for when appropriate.

Fundraising can be **expensive**, no matter how it is carried out. Specialist staff / consultants are highly sought after and costly. The results of fundraising efforts typically take **12 - 18 months to come through**. It is therefore important to:

- *Carry out a **cost benefit analysis** to ensure that the anticipated additional income outweighs the additional fundraising costs. These costs will not only be the remuneration but all the associated costs, such as premises, travel (possibly overseas), equipment, communications and mailing. There will also be time costs as the fundraiser obtains programme information from other staff members.*
- *Decide whether the fundraiser should be a consultant or employee. If an employee, a **fixed-term contract** should be seriously considered. In either case, there should be negotiation on the fundraising targets, [NB: The South African Institute of Fundraisers does not approve of **commission-based fundraising** and believe that fundraisers should be paid a market-related rate commensurate with the job requirements.]*
- *Ensure that a commitment to targets goes hand-in-hand with the need to **build long-term funding relationships** and to develop sustainable fundraising methods and schemes.*

INCOME GENERATION

In order to assess the organisation's potential for generating its own income, it is important to answer and address appropriate questions related to potential areas of income generation. Some of these are included below.

MAXIMISING RETURNS FROM EXISITING ASSETS

- *What assets or resources does your organisation own (eg land, a vehicle, computer)?*
- *Are these assets under utilised by the organisation?*

- *Are these assets under utilised by the organisation?*
- *Would others want to make use of these assets (growing vegetables, sharing transport costs, preparing documents) and be prepared to pay for the use?*
- *Can we lease out, share or sublet the asset and earn a regular rental income (eg leasing part of a plot to others for agricultural purposes and you transport and sell the produce)?*
- *Can we convert the asset for another purpose and generate income from it (eg renting out space on a plot, using your vehicle for a lift club)?*
- *Can we develop the land or sell or lease it out?*
- *Will it be necessary to employ additional staff to run or monitor the new activity (will a dedicated driver be needed for a lift club, or someone to monitor computer use)?*
- *Will the additional costs be fully covered by the expected income?*
- *Does your governing document / constitution allow such activities in terms of the objective of the organisation?*
- *Is there a need to consider forming a separate legal entity for this income generating activity?*
- *Have the costs of such a separation been considered (ie legal fees, audit fees, taxation)?*
- *What are the options if the asset is no longer needed at all?*
- *Can the asset be sold and the proceeds utilized for other purposes? Are there restrictions on either the sale or the use of the proceeds (eg could proceeds from the sale of the asset be used for the organisation's running costs or would it need to be used to replace the original asset or purchase something similar)?*

COMMUNITY FUNDRAISING EVENTS

- *Are there willing volunteers available who would be keen to organize the activity and work on it?*
- *What are the risks attached to the event (loss of money, bad publicity)?*
- *Have the control risks been considered as cash will be handled?*
- *Do your efforts consider the nature and interests of the potential participants?*
- *Is the fundraising effort focused on a particular purpose?*
- *Is the effort worth the potential distraction from the organisation's core activities?*

CHARGING FOR SERVICES

- *Do the organisation's services have value?*
- *Can existing clients afford to pay for services?*
- *Does it make developmental sense to charge a small or nominal fee to existing clients?*
- *Can any of the services be extended to others who may be able to afford to pay more?*
- *Will servicing new clients compromise or detract from the organisation's objectives and vision?*
- *Can specialist services be offered through other organisations to achieve common objectives?*
- *Do the services meet a government service objective (eg community health training)?*
- *Is there sufficient expertise to tender for the delivery of services?*
- *Is there a possible match between the organisation's services and the needs of business (eg literacy training, trauma counseling, HIV/AIDS education)?*
- *Can the full cost of delivering these services be determined?*
- *How much would business clients be prepared to pay? Is it worth the effort in terms of cost and impact?*
- *Are the systems in place to ensure that all amounts earned are charged to clients and collected by the organisation?*
- *Is there a clear policy regarding employees receiving payment or* ***honoraria*** *for work done for third parties, which ensures that there are no double or inappropriate payments (eg the organisation or the director get the income from a presentation of lecture presented by the director)?*

STARTING A BUSINESS

- *Will the business absorb too much of the organisation's resources (money, time, energy)?*
- *What business is suitable (skills training, providing services, facilities)*
- *Is there a market for the end product?*

- *Can the market pay an appropriate price?*
- *How will the market be reached - both in terms of delivery and marketing?*
- *Are there in-house skills to run the business; if not, where will they be obtained from?*
- *Are there realistic objectives and targets for the business?*
- *Is the necessary capital available?*
- *Who will own and manage the business (a separate structure may be needed)?*
- *Are all necessary structures and resources in place?*
- *Can the structure be set up to minimise tax on profits?*

PARTNERING WITH A BUSINESS CORPORATION

- *Has strategic thinking and research been done to identify possible areas where a corporate partnership could be beneficial?*
- *Have local businesses been considered as potential partners?*
- *Does the organisation have current information about business trends and interests in the area?*
- *Is there a **match** of interests with a company?*
- *What are the ways a company could support the organisation and its objectives?*
- *Is it possible to commit to communication, education and information for the company and its staff?*

MAXIMISING INVESTMENT INCOME AND GAINS

(Also refer to the section on the Investment of Reserves)

- *What is the investment policy of the organisation?*
- *Are there ethical or other reasons, linked to the objectives of the organisation that would rule out certain investments?*
- *What is the risk profile of the organisation and how does that affect the choice of the investment?*
- *Is good investment advice available on the governing body or through other advisors?*
- *What is the projection of funds available for investment and over what period?*
- *Are there properly controlled mechanisms in place to monitor cash flows and move money on a daily basis?*
- *Can the organisation operate with only one current (cheque) account?*
- *Can the organisation negotiate an automatic sweeping facility with the bank to move surplus money overnight into a call / deposit account?*

CHARGING FOR SERVICES

- *Do the organisation's services have value?*
- *Can existing clients afford to pay for services?*
- *Does it make developmental sense to charge a small or nominal fee to existing clients?*

BUILDING RESERVES

UNDERSTANDING FUNDS AND RESERVES

Funds and reserves can generally be defined as **the balance of unspent resources** which can be **used** to fund the future expenditure of the organisation or which are **invested in property or fixed assets** and therefore not available for other purposes. The **accumulated funds and reserves**, as reflected in the balance sheet at the end of the financial year, make up the pool of unused funds held by the organisation. The only way to increase the accumulated funds is to **generate a surplus in the current year**, which is added to the accumulated funds of previous years.

WHY ARE RESERVES NECESSARY?

While some argue that funds given to an organisation should be put to use immediately, organisations do need to have reserves to ensure, as far as is reasonably possible, that their **future objectives and expenditure related to them, can be met**, and that the organisation is **sustainable** into the future.

In the short-term, organisations may need **extra resources to fill the gap if there is an unexpected deterioration in their flow of income** (eg a delay in receiving grants, an unsuccessful fundraising initiative, the loss of a regular funder). There may also be a need to **complete an activity** that was not fully covered by funding received, or to have the **flexibility needed to meet unexpected / changing programme / beneficiary needs**. In the longer-term, many organisations now seek to **reduce or eliminate their dependence on donor funding** by building reserves. The objective is to ensure that an increasing amount of costs (particularly the core administrative basic operating costs that are difficult to raise funds for) **can be covered by the income generated** from the wise investment of reserves.

HOW CAN RESERVES BE BUILT UP?

It is important to remember that reserves are built up through accumulated surpluses. Surpluses can be created in two ways:

REDUCED EXPENDITURE

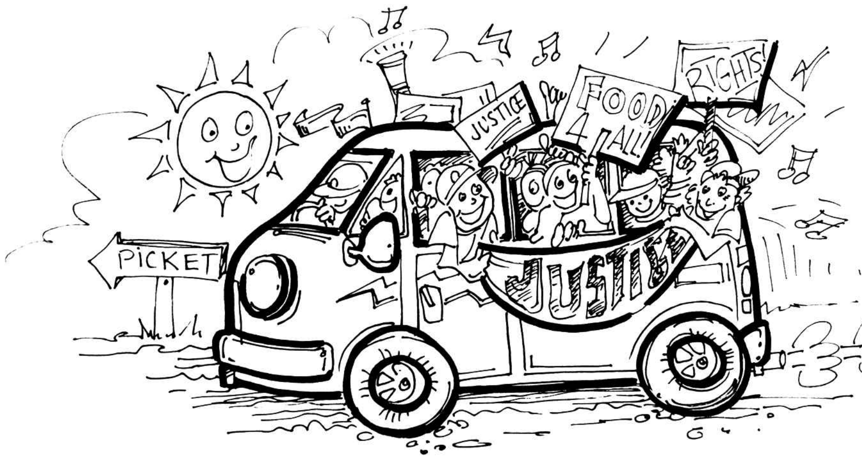
It may be possible to carry out all planned activities and achieve the expected results / outcomes at a **lower cost than was anticipated** (budgeted) by effectively managing expenditure. This will result in a surplus. However, it is important to note that expenditure may also be less than the matching income, if income has been received in advance and some of the activities will need to be carried out / completed in the next year. This is not a surplus and should be recorded as income received in advance.

INCREASED INCOME

Additional restricted income will generally require additional expenditure and therefore does not contribute to a surplus. **Maximising unrestricted income** is therefore key to building a surplus that can be added to reserves. Examples of ways to increase reserves through unrestricted funds are detailed below:

- ***Set aside any unspent unrestricted income***, *such as:*
    - *Income on **investments** (interest, dividends, etc);*
    - *The organisation's **self-generated income** (fees for services, sale of resources etc);*
    - *All **undesignated donations**;*
- ***Minimise the expenditure incurred to generate unrestricted income*** *by seeking*

***sponsorships or donations in kind**, that would meet at least part of the costs (eg by obtaining a donation to cover the production costs of a training manual which could then be sold by the organisation so that the net income generated from sales would be higher than the production costs).*



- ***Create charges for your programmes**. If a strategy of charging out costs to programmes is pursued, there must be transparency and communication with the funders who provide funding for these programmes.*
    - ***Make provision for future contingencies** by putting through **charges** for a retrenchment provision, for vehicle and equipment replacement costs etc. These **charges** will, of course, be included in the programme budgets that have been approved by programme funders. [NB: Generally Accepted Accounting Principles (GAAP) do not allow a retrenchment reserve to be included as a liability in the audited financial statements; however, it could be reflected as a designated reserve.]*
    - ***Charge an internal management or overhead fee to each of the programmes**. This fee could either be fixed or based on a reasonable percentage of programme costs. The fee will form part of unrestricted income of the organisation and, after being offset against the relevant management / overhead costs, any unspent balance would create a surplus that could be added to reserves.*
    - ***Charge programmes for the use of resources** such as premises, vehicles, a photocopier, or staff resources. Such resources should be*

charged out at a realistic rate that is applied consistently. The rate at which the resource is charged out could be:

- ***Cost recovery***
- ***An agreed rate***
- ***Market related***

(See Appendix B for examples of charges to programmes)

- *If programmes are to be charged the costs of the resources they use, a number of additional points must be noted:*
    - *The same* ***costs should never be covered twice*** *in order to create a reserve (eg if running costs for vehicles are being fully and specifically funded, these costs should not also be charged to the programme budgets).*
    - *The* ***accounting for the cost recoveries is quite complex****. It is best achieved by having control accounts for the actual costs and for the costs recovered. A periodic exercise can then be carried out to ensure that the costs and recoveries are properly matched before any surplus is taken to the relevant reserve account.*
    - *The* ***method of charging the programmes must be applied consistently*** *throughout, and should be the same method as utilized in the budgeting process. Charging the use of resources to the programmes should be disclosed and should be characterized by transparency in all interactions.*

A SPECIFIC SUSTAINABILITY RESERVE

Another option for building reserves is to specifically **enlist the support of funders** for the process of building a specific sustainability reserve by:

- ***Making specific contributions to the reserve*** *on a once-off or annual basis;*
- ***Providing funding for the organisation's own income generating capacity*** *and activities;*
- *Agreeing that any* ***cost saving or other under spending*** *that has not affected programme delivery* ***is transferred to the sustainability reserve****;*
- *Making a* ***specific appeal for funds*** *for a particular purpose (eg funds to purchase a property for the organisation's use). This would also provide some capital appreciation as the value of the property increases.*

In reality, the **building of reserves is likely to be a slow process**, unless the organisation is fortunate enough to have a **nest egg** or other windfall. It is also easy, without stringent financial planning, to **allow reserves to dwindle** (***"this is only a temporary decline in income," "God will provide," "we must allow a budget deficit this year as we cannot retrench staff,"*** etc). As a result, the financing strategy must clearly state the criteria for building reserves and weak / poor management must not be allowed to deflect the organisation from its path.

ACCUMULATED FUNDS

As explained above, reserves can only be built up through the accumulation of surpluses from prior years. The **accumulated surpluses are often called accumulated funds on the balance sheet but are not always broken down into their component parts** (eg specific grant funding that has not yet been spent and unrestricted income that has been generated by the organisation).

It is important to provide an explanation (breakdown) of what makes up the accumulated funds so as to be transparent and to provide valuable information to the users of the financial statements. The accumulated funds of the organisation may be made up of:

- RESTRICTED FUNDS: funds that are subject to specific conditions imposed by the donor or stated in the specific appeal that generated the funds.
- INVESTED FUNDS: funds that are already invested in property or other fixed assets and are therefore not available for other purposes.
- UNRESTRICTED FUNDS:

  Designated reserves - these are funds that the organisation itself has designated or allocated for a **specific purpose** and which therefore remain at the discretion of the governing body

  General funds - these **surplus resources** can be **freely deployed** at the discretion of the governing body but should not rise and fall without proper control and authorization. We would recommend that such a reserve should aim to be built up to **cover operating expenditure for 3 - 6 months** to cover eventualities such as a deterioration in funding. To monitor the level of the reserve, the **survival ratio** should be used:

TOTAL UNRESTRICTED FUNDS & RESERVES ÷ TOTAL ANNUAL EXPENDITURE X 52 = NUMBER OF WEEKS

This calculates how long the organisation could continue (in terms of weeks) if income dried up and the levels of activity and expenditure remained the same.

TYPES OF DESIGNATED RESERVES

ENDOWMENT FUND

An endowment fund is built up from setting aside unrestricted income over a long period of time and donor funds provided specifically for this purpose. This reserve would provide a primary (capital) amount from which the organisation could **cover a growing proportion of its costs from income generated** from its wise investment. This reserve is typically invested in unit trusts or equities so that there is capital growth as well as interest or dividend income. The income is reinvested (to grow the primary amount until such time as the income is required by the organisation to fund part of its costs. The intention would also be that **the primary amount is not converted into income**, but rather held permanently as part of the organisation's capital - reserves which would only be accessed in an emergency.

RETRENCHMENT RESERVE

This is not something that many organisations want to consider. However, prudent management ensures that should staff need to be retrenched, there are **sufficient funds available to pay retrenchment packages**. The reserve sets aside funds for this purpose. The amounts needed should be recalculated annually based on the entitlement of current staff members according to their salary and length of service.

ASSET REPLACEMENT FUND

Organisations need to consider the cost of replacing assets at the end of their useful lives (ie when they are no longer functional). The **funds needed to replace the assets** required for the effective functioning of the organisation will often not be provided by funders on a one-off basis - so sufficient funds should be set aside in a reserve for this purpose. This reserve can be built up through the charges to various programmes for the use of assets, less the actual running / operational costs of the assets.

> ***NB: Each reserve MUST be represented by available cash in the bank or in investments. It is advisable to physically transfer designated amounts into separate (interest bearing) bank accounts or investments.***

RESERVES POLICY

There is a risk that a prudent organisation that builds reserves loses the support / sympathy of donors because it **has not explained the reasons for having reserves**. It is therefore vitally important that, as an organisation plans to build reserves, it should also **prepare and approve a reserves policy**. Other reasons for the governing body to approve a reserves policy include:

- *It is **fundamental to planning**;*
- *It **supports the fundraising** effort;*
- *It **improves the effectiveness of decision-making**, by ensuring that reserves are not built up to the point where managers become complacent or lazy in running the organisation.*

The policy must clearly state:

- *The **nature** of the reserve*
- *The **purpose** for which it was formed*
- *The **target amount** that the reserve should be built up to (if relevant) and the **target date** by which the fundraising strategies should seek to have achieved the target amount*
- *The **level of authority and controls** needed to release the reserve for the purpose for which it was originally intended.*

To establish a reserves policy, an organisation must:

- ***Examine its balance sheet** and decide what must be covered in its reserve calculations*
- ***Establish its future expenditure plans** (distinguishing between capital and revenue commitments)*
- ***Establish the sources and reliability of future income flows** and identify any links between income and expenditure (such as income from the provision of a contracted service)*
- ***Assess the level of financial risk** that these reserves are required to cover. This could be achieved by analysing income and expenditure variables on a case-by-case basis and might include a review of past budget shortfalls as well as assessment regarding the degree of variability of future expenditure commitments. The assessment could, however, include an actuarial computation of the capital fund that would be required to finance future expenditure commitments (particularly useful for organisations with research commitments or to maintaining homes.)*
- *Decide whether to **state the policy** in terms of specific monetary amounts, or as a **coverage ratio** (eg the ratio of reserves to expenditure). Some organisations aim for a reserve to be equal to at least **3 months of permanent staff salaries** (to cover the costs of retrenchments, if necessary, as required by law). Other organisations aim to cover a certain number of months of total expenditure.*
- ***Review what is done by similar organisations.***

Once the policy has been established, it should be **kept under review** (perhaps on a three-year cycle) as the policy will ultimately be based on assessment according to what is most appropriate for prevailing circumstances. *(See Appendix C for an example of a Reserves Policy).*

INVESTMENT OF RESERVES

An organisation should conscientiously decide how best to invest its reserves to ensure the protection of its capital, the need for capital growth, and the requirement for longer-term financial sustainability. This should result in the approval by the governing body of a ***reserve investment strategy and policy*** *(see Appendix C for an example)*. The policy would, amongst other things, take account of:

- *The level of **risk** that the organisation is prepared to take in its investing*
- *The likely **timing and uses** of the reserves (each type of reserve may require a different investment approach because of differing liquidity needs)*
- *The availability of investment advice to the governing body (and the cost, if any)*
- *The degree of **diversity needed in the investment portfolio**.*

If organisations are not careful in setting aside the cash that represents the reserves and in managing that cash effectively, they can find themselves in a situation where the cash, or assets related to the reserves are **used up** or **borrowed** for other purposes.

It should also be noted that **funds should not be invested** if the:

- *Cash is required for operational expenditure (such funds should be held in an interest bearing call, or current account)*
- *Cash arises from the receipt of grants for specific purposes (such funds would be deposited according to the relevant funding contract's terms)*

EFFECTIVE MANAGEMENT OF RESOURCES

Financial sustainability is improved if the organisation is able to:

- ***Manage its current resources effectively***
- ***Utilise the income received as efficiently as possible***

It is possible to **analyse how fully the income is used** by looking at the percentage of the income spent on different costs, such as salaries, administration, fundraising and programme activities. This can be compared to the past and to the **performance** of other similar organisations.

EXPENDITURE PER ITEM/GROUP X 100 ÷ TOTAL INCOME = PERCENTAGE

It is also important to consider total expenditure utilisation - **less than 75% income utilisation** is not considered acceptable, unless there are special circumstances.

When carrying out financial planning, it is **important to set standards for the various indicators**, in the context of past performance, comparison with other organisations, perceptions of what is acceptable, and future organisational targets. Donors often ask just one question:

> ***"How much of my money goes towards the objective for which the organisation exists?"***

One key indicator, based on the efficiency ratio above, is **the level of fundraising and administrative expenditure**. It is generally felt that 20% is too high, but there is no single figure that can be applied to all organisations because:

- *Organisations are at **different stages of development** and will therefore have different needs regarding the development of administrative infrastructure, fundraising and income-generating initiatives*
- *Organisations **generate income in different ways** - some are almost guaranteed funding if they are linked, for example, to a church denomination or an endowment fund. Others will have to work for every cent they raise.*
- *Different organisations have **different accounting policies** and treat expenditure in different ways. For example, some will treat advertising, not as fundraising, but as public education or advocacy expenditure.*

- *Organisations give **different emphasis** to the importance of these tasks. Some will spend the bare minimum on administration in the hope of being seen as efficient, while others see good administration as the foundation on which the organisation must be built to ensure it is fully resourced. Some will only have to administer a small number of grants or programmes; others may deal with many of either, or both. Some organisations carry out their work through grant funding from other organisations, whereas others manage and implement a variety of programmes.*

The best approach is to **carry out whatever research is necessary** to establish a reasonable and justifiable level of administration and fundraising expenditure, compared to direct 'charitable' expenditure for the particular organisation. The appropriate method of measurement and the target levels must then be established and included in a policy adopted by the governing body which should then monitor how the proportion moves when budgeting from one year to the next or across a 3 - 5 years moving average.

TAX BENEFITS AND IMPLICATIONS

"But in this world nothing can be said to be certain, except death and taxes,"
- Benjamin Franklin, one of the founding fathers of the United States, 1789.

Although today's organisations can avoid **death** (at least in the immediate future) by having good plans for sustainability, they are **subject to laws of taxation**, although it is a commonly held myth that NPOs have a divine right that excludes them from any taxation!

It would therefore not be possible for sustainability planning to be finalised without **proper consideration of potential tax implications**. The sections below address some of the tax issues that organisations will need to consider as part of sustainability planning.

INCOME TAX

All persons who receive income are liable to pay income tax. The definition of **persons** includes organisations, companies, trusts, associations, foundations, etc. Therefore organisations such as schools, churches, trade unions, charities, cultural and sports development organisations and foundations are all **juristic persons** and could be taxed on their surplus of income minus expenditure.

However, the South African Revenue Service (SARS) recognises that non-profit organisations play a significant role in society and therefore make provision for **tax exemptions**. If an organisation has a non-profit motive, it does not mean that it will automatically be exempt from tax. An organisation must apply and receive approval for tax exemption status and also comply with relevant tax legislation.

The requirements and conditions for income tax exemption are set out in the Income Tax Act of 1962. Section 10(1)(cN) applies to organisations carrying out one or more public benefit activities; while Section 10(1)(d)(iii) together with Section 30 of the Act applies to trade unions and others. These sections cover the concept of **partial taxation on gross income from trading activities**. However, tax-exempt organisations will still be taxed on:

- ***Surplus income from non-allowable trading activities*** *above the prescribed limits, and*
- ***Capital gains on the disposal of assets (excluding investments) that are not substantially used for public benefit activities*** *or are* ***used in a business*** *(taxable trading activity).*

GENERAL REQUIRMENTS FOR INCOME TAX EXEMPTION

In order for the SARS Commissioner to grant tax exemption, an organisation must comply with a number of conditions relating to its legal structure, its objectives and intent. The organisation must submit a copy of its **written constitution or governing document** to the Commissioner. These documents must include certain important clauses and meet specific requirements:

- *The organisation must have at least 3 persons (who are **not related or connected to each other in any way**) to accept fiduciary responsibility for the organisation (ie its governing body, management committee, etc). No single person can directly or indirectly control the decision-making powers of the organisation.*
- *The organisation must be **prohibited from distributing funds to any person other than in the course of its normal activity**, and must use funds solely for the organisation's stated objectives.*
- *On **dissolution**, the organisation must transfer assets to a similar organisation.*
- *The organisation is prohibited from accepting **any donation that can be withdrawn** by the donor, except in the event that the organisation fails to conform to its designated purposes.*
- *Any **changes to the organisation's constitution or governing document must be submitted to the SARS**.*

Income tax exempt organisations are required to **submit the required income tax returns** and make their annual financial statements available as supporting documents. The SARS will **review exemption annually** based on these returns. An organisation may not knowingly be a party to a **tax avoidance scheme. Records** must be kept 4 years after the entry in the organisation's books or records.

The organisation must also not pay its employees, office-bearers or members **excessive remuneration** in relation to what is generally considered reasonable according to the sector and services rendered.

TRADING RULES

The **trading rules** governing income tax exempt organisations allow for a system of **partial taxation**.

WHAT IS TRADE?

Income from trade comprises of the organisation's earnings from work performed, services provided or goods delivered. The Income Tax Act defines trade as including any profession, business, employment, calling, occupation or venture, including

WHAT IS ALLOWABLE TRADE?

In the case of **public benefit organisations** the income from certain trading activities will not be taxed if such trading is:

- ***integral and directly related*** *to the organisation's sole objective;*
- *on an **occasional basis**, carried out predominantly by **volunteers**;*
- *performed mostly on a **cost recovery basis** only;*
- *will not cause **unfair competition** in relation to other taxable entities **approved by the SARS Commissioner** after having evaluated all of the above.*

Rental income derived from property letting would only be considered **allowable trade** if the income comprises 15% or less of the total use of the building. **Substantially the whole** (ie not less than 85%) of the property must be used by the PBO to conduct its public benefit activities in accordance with the organisation's objectives contained in its governing documents. Depending on the type of property, usage can be measured in terms of space or time.

WHAT IS TAXABLE TRADING INCOME?

Income from trade that **does not fall within the allowable trade category**, will be taxed if the revenue received or accrued **exceeds R200 000 per year, or 5% of the organisation's total annual revenue** - whichever is greater. On income that exceeds these amounts, the flat taxation rate that normally applies to commercial companies (**currently 28%**) will be charged, instead of differing rates according to whether the organisation was formed as a trust, association or company.

A COMMERCIAL COMPANY ***is a company that has to follow normal accepted business practices and operates in order to make a profit - a company that is not a financial institution.***
A PUBLIC BENFIT ORGANISATION ***is one that does not work for profit and does not pay tax in or out of South Africa. The organisation is most likely involved with charitable work.***

Income from interest earned on bank deposits is generally not taxed as the investment of surplus funds and other **passive investments** are not regarded as a trading activity.

OTHER TAX ISSUES

CAPITAL GAINS TAX (CGT)

CGT is payable on assets disposed of on or after 1 October 2001. Previously, any organisation that qualified for tax exemption status was exempt from CGT. However, since the introduction of partial taxation for PBOs that engage in trading, a tax-exempt organisation **will now be liable for CGT on the disposal of an asset that has not been substantially (more than 85%) used to further its public benefit activities**.

If CGT is payable, the taxable value of the capital gain will be included with taxable income. The **taxable value is determined by calculating the difference between the proceeds from the sale of the asset, and its base cost**.

The capital gain or loss, on the disposal of an asset to produce exempt income, must be disregarded; therefore a capital gain or loss on the disposal of a passive investment is not subject to CGT.

SECTION 18A

In terms of Section 18A of the Income Tax Act, donors (individuals and companies) to organisations that have obtained Section 18A status, benefit from tax deductions that **allow their donations to be off-set against their income tax to a limit of 10% of the donor's taxable income**. Section 18A provides for NPOs to obtain PBO status (if their work is of public benefit) so that donors can reflect these monies as tax deductible on their annual returns. This sometimes encourages donors to be more generous in their funding. However, a PBO does not necessarily have to register as an NPO to qualify for Section 18A benefits.

These deductions will only be permitted if:

- *It is supported by a proper receipt issued by a Section 18A compliant organisation, detailing the name and address of the donor; the name, address and registration number of the organisation; the amount / nature and date of receipt of the donation.*
- *The receipt includes certification that the receipt is issued for the purposes of Section 18A*
- *The receipt states that the donation will be used exclusively for the object of the organisation.*

The following do not qualify as donations in terms of Section 18A:

- *Services (in kind)*
- *Amounts paid for a fundraising event*
- *Amounts paid for goods purchased at a charity auction*
- *Non-listed financial instruments (such as shares in a private company)*
- *Payment of a debt due by a PBO.*

Recent amendments to tax legislation place the onus on the organisation to comply with the above regulations. If it fails to do so, the organisation may lose its Section 18A status and be liable for tax on the amounts received.

DONATIONS TAX

In terms of Section 54 of the Income Tax Act, donations tax, (currently at a rate of 20% of the value of the donation) is payable by the donor for all donations made by South African residents and companies. However, **all donations of up to R100 000 per year qualify for a *de minimus* exemption** (are deemed tax-free). If the donor fails to pay the tax within the prescribed period, both the donor and recipient will be held liable - jointly and separately - in terms of Section 59 of the Income Tax Act.

However, Section 56 of the Income Tax Act now enables a company or other for-profit organisation to donate any amount to organisations that qualify for tax exemption status (as defined in Section 30 of the Income Tax Act and approved by the Commissioner), without having to pay donations tax.

VALUE ADDED TAX (VAT)

VAT is a tax on the supply of goods or services for a **consideration** (ie for a fee). Supplies made in South Africa that are not exempt from VAT are known as **taxable supplies**. A person or organisation carrying out an **enterprise** where the consideration for the supply of goods or services (taxable supplies) during a 12-month period is, or is expected to be, over R1 million, must register as a tax vendor. However, there is provision for voluntary VAT registration by NPOs. It is important that an organisation compare the benefits and costs of voluntary registration before making the decision to register or not (ie does the potential net recovery of VAT exceed the additional costs of administration that registration as a VAT vendor would give rise to?)

> An enterprise is defined as:
> ***Any activity that is carried out continuously or regularly by any person…. in the course of which goods or services are supplied to any other person for a consideration, whether or not for profit.***

ASSOCIATIONS NOT FOR GAIN

- **Associations not for gain** enjoy some VAT benefits.
- Any payment made by any person as an **unconditional gift** to any association not for gain is not treated as a **consideration** for the supply of goods and services and therefore not subject to VAT.
- An organisation can **register voluntarily** to become a VAT vendor if it carries out an enterprise where the consideration for the supply of goods or services during a 12-month period is only R50 000.
- The R1 million threshold can be applied separately to branches (on application).
- The payment basis of accounting for VAT can be used.
- **Grants** from the government are **zero-rated**.

WELFARE ORGANISATIONS

- A **welfare organisation** is an association not for gain, registered under the NPO Act, exempt from income taxation, that carries out specified welfare activities (a specific list is provided by the SARS).
- The VAT benefits that accrue to welfare organisations are:
    - *Voluntary registration is allowed even if there is no consideration.*
    - *Organisations may claim VAT on goods or services purchased.*
    - *State subsidies are generally zero-rated for welfare organisations involved in the activities listed by the SARS*
    - *Funding from agencies that receive their funding from the European Union (EU) is generally zero-rated.*

VAT EXEMPT SUPPLIES

- A supply may be exempt from VAT if it falls within Section 12 of the VAT Act 89 of 1991. The input tax for exempt supplies may not be claimed. Examples of exempt supplies include:

- ***Transport*** *of passengers by road or rail.*
- ***Education services*** *provided by institutions exempt from income tax and which have been formed for specified educational purposes and registered under the relevant authority (such as the SA Schools Act, the Higher Education Act and the Adult Education and Training Act, etc). Registration with the regulatory body would have had to have been undertaken by 1 March 2002.*
- *The services of* ***crèches and after-school centres****.*
- ***Financial services*** *such as interest or dividends.*
- *A t****rade union's services*** *to its members.*

VAT EXEMPT SUPPLIES

- A supply of goods or services may be zero-rated if it falls under Section 11 of the VAT Act. The related input VAT can be claimed although there is no output VAT included in the amount. Zero-rated supplies can include:
    - *Most* ***goods and services*** *that are used or consumed* ***outside of South Africa.***
    - ***Funding from a public authority*** *for the provision of basic and specific services by welfare organisations whose activities are recognised by the SARS.*
    - ***Services supplied to a public or local authority*** *to the extent that the payment is made from donor funds granted under an international agreement with the South African government.*
    - ***International travel*** *and related insurance.*

(The tax examples provided in this section apply to South African organisations. Please refer to your own country's tax legislation for guidance regarding your organisation's tax requirements.)

DEVELOPING A SUSTAINABILITY PLAN

Having considered the importance of financial sustainability and all the variables involved, it is important to develop, with the assistance, and for the approval, of the governing body, a **sustainability plan**. This can be developed through the following process:

- ***Brainstorm and investigate all potential ways of raising resources***
- ***Gather ideas from stakeholders (staff, board, etc) on how to improve current operating efficiency and effectiveness.***
- ***Address all the factors impacting sustainability (see Appendix A) to introduce best practice.***
- ***Identify quantitative measures of sustainability, calculate the current status and set definite goals for the future.***
- ***Work through the tax implications and other key considerations fro trade or income generating activities.***
- ***Document goals and specific actions to be taken.***

This process may be internally or externally facilitated but should be **overseen** by a committee of key management and staff members. It could start with a workshop for staff, board members and community participants.

PART E: APPENDICES

APPENDIX A: FACTORS IMPACTING SUSTAINABILITY

SERVICE DELIVERY

Organisations need not only have an **impact**, but must be able to demonstrate that impact. This requires the development, implementation and enhancement of measurement tolls and a systematic prorgamme of monitoring and evaluation, based on predicted outcomes specified at the time of planning. In developing the necessary tools, organisations may be able to work together with universities and other research institutions or may, alternatively, be able to access toolkits from sister agencies or other sources.

STRATEGIC DIRECTION

To be effective, organisations must establish, as part of their planning process, **clear and achievable goals**. There is always a danger, when there is too much need, that organisations will try to do too many things, which can have considerable effects on staff's health and morale and on the ability to deliver in terms of impact. Funders appreciate a clear focus and the organisation will gain greatly in reputation if it is able to stay focused and carry out its work successfully.

IDENTITY

When preparing business plans, entrepreneurs are encouraged to articulate their **unique selling point** that will make consumers buy from them on an ongoing basis. This links impact and focus to **branding** - which is to create an image of the organisation that flows through its communications and will point to its strengths. Public and funder perceptions of organisations and loyalty to those organisations are affected by image and reputation. It may, therefore, be appropriate to engage an advertising agency or image consultant periodically to refresh the

organisation's image. Alternatively, help may be obtained from students in advertising or other suitably skilled volunteers.

EXTERNAL RELATIONS

It is important for sustainability that organisations are involved in **networks** with other national / international organisations and belong, where appropriate, to **umbrella bodies.** Less formal networking is also helpful, such as maintaining good relationships with funders, sister agencies, related government departments, etc.

GOVERNANCE

Good governance is now commonly accepted as a crucial element in ensuring that an organisation is effective, efficient and sustainable. It is therefore important to **obtain all necessary legal registrations and to ensure that structures and practice within the organisation supports effective governance** at board and senior management level.

MANAGEMENT PRACTICES

The need for accountability and transparency means that a sustainable organisation must have **adequate policies, systems and controls** in place that will lead to the production and utilisation of accurate, regular financial reports in decision-making.

HUMAN RESOURCES

Properly **skilled and experienced staff** members are another key component of sustainability. This not only affects recruitment, but also requires ongoing development, training, motivation and support. At a time of rapid staff turnover, succession planning also becomes an important factor.

FINANCIAL RESOURCES

Increasing the **diversity of funding sources and funding types** enhances sustainability. Consistent, regular and dependable income is required and it is generally true that ***"money attracts money."*** Funders are often more enthusiastic about providing grants if they know of other funders who also fund the organisation. Many organisations are dependent on only one or two major international / bi-lateral funders. This could result in:

- ***The funder potentially having too much control and reducing the autonomy of the organisation.***
- ***Greater levels of financial risk - if a key funder withdraws, it could result in the closure of the organisation.***
- ***Undue reliance on an increasingly scarce source.***

APPENDIX B: EXAMPLES OF MAKING CHARGES TO PROGRAMMES

VEHICLES

The organisation could charge out vehicle usage based on a rate per kilometre using one of the following methods:

- **Cost recovery** - this would mean adding up the costs of fuel, licences, insurance and servicing and dividing the total by the number of kilometres actually driven to determine a rate required to recover the actual costs.
- **Agreed rate** - this would require the organisation to set a standard rate per kilometre for all vehicles (usually the SARS rate).
- **Market-related rate** - this could be obtained by using the Automobile Association (AA) rate per kilometre according to the specific make and model of vehicle.

PHOTOCOPIER / STATIONERY CHARGES

The organisation could charge out photocopier usage based on a cost per sheet using one of the following rates:

- **Cost recovery** - this would be calculated as a proportion of the photocopier machine leasing costs, plus the costs of toner / cartridge and paper, divided by the number of pages.
- **Agreed rate** - the organisation would agree on a standard cost per page to cover the actual copying costs plus a percentage of the administrative costs for managing the photocopying.
- **Market-related rate** - this would be calculated in line with prices charged by local photocopying service providers.

PREMISES

- **Cost recovery** - would be calculated by dividing the overall rent by the rate per square metre occupied by the programme.
- **Market-related rate** - would be based on standard local rental costs charged per square metre.

TELEPHONE CALLS

- **Cost recovery** - a recording system (itemised billing) would show time spent per telephone extension which can be used to determine actual costs.
- **Agreed rate** - costs could be charged at an agreed rate per call.

STAFF TIME

- **Cost recovery** - an hourly cost per employee could be calculated based on the number of productive days.
- **Market-related rate** - costs for the relevant services (such as programme management) could be researched and used.

APPENDIX C: RESERVES POLICY EXAMPLE

Once adopted, a reserves policy will be confirmed in the governing body's meeting minutes, the organisation's policies and procedures manual, and the notes to the financial statements. It would also be helpful to include reference to it in the annual report. The following is an extract from a policy developed for an organisation:

> ***The funds and reserves of the organisation are made up of:***
>
> RESTRICTED FUNDS *(funds that are subject to specific conditions imposed by the funder or stated in the specific appeal that generated the funds):*
>
> - ***Restricted income funds*** *- unspent income that was given for a specific purpose or in response to a specific appeal and which will be used for that purpose.*
> - ***Permanent endowment funds*** *- funds given which must be held permanently as part of the capital of the organisation and cannot be converted into income. The donor may also specify in what way the income generated from the endowment must be used.*
> - ***Expendable endowment funds*** *- these funds must be held as part of the capital of the organisation unless or until the Trustees exercise their power to convert the endowment into expendable income. The Trustees, working with staff, may be seeking to build an endowment fund, through fundraising and other means, that will enable the organisation to generate a stated percentage of the annual financial resources it requires from income from the fund.*
>
> UNRESTRICTED FUNDS
>
> - ***General funds*** *- these 'surplus resources' are not immediately needed to finance operations and can be freely deployed at the discretion of the Trustees.*
> - ***Designated funds*** *- these unrestricted funds have been designated or allocated for a particular purpose by the organisation itself; they remain at the discretion of the Trustees (general funds set aside for a special purpose).*
>
> ***The organisation has designated four reserves:***
>
> - ***Base reserve*** *- an amount equivalent to three months' budgeted expenditure on recurring activities (including grants, capacity building, fieldwork and all other operational activities). This base reserve is designated to enable the organisation to absorb temporary downturns in fundraising, or in the value of the organisation's investments, without having to reduce programme expenditure.*
> - ***Property fund*** *- this designation represents the extent to which funds are invested in property and are therefore not available for any other purpose.*
> - ***Fixed asset reserve*** *- an amount equal to the net book value of the fixed assets owned by the organisation (excluding land / buildings) and is therefore unavailable for any other use.*
> - ***Sustainability reserve*** *- funds that are set aside to enhance the longer-term financial sustainability of the organisation. This reserve is not used to fund shortfalls in current expenditure as the capital is protected. The income arising from the reserve is reinvested unless the Trustees agree that, in specific circumstances, it can be used for operating costs.*

APPENDIX D: INVESTMENT POLICY EXAMPLE

INVESTMENT POLICY

The investment policy of an organisation provides the framework for the **prudent investment of funds and for maximising the efficiency of its cash management** system. Preference is given to restrictions / conditions placed on fund utilisation by the particular donor. Subject to this, the investment goal is to enhance the return on funds, while investing the funds prudently, in order to achieve the **maximum acceptable yield and the long-term financial sustainability** of the organisation.

Key considerations relating to investment include:

- **Accessibility** - *how easily can we access the funds when needed?*
- **Potential income** - *are we maximising income / returns available? How much income does the organisation need to generate for use in the short-term?*
- **Risk / reward** - *what risk is the organisation prepared to take weighed against the potential reward?*

Interest received and dividends accrued could be either capitalised and reinvested, or made available to fund expenditure or grants in terms of the investment policy.

The policy statement below is aligned with all relevant South African legislation such as the Financial Advisory and Intermediary Services Act No 37 of 2002 (FAIS), the Financial Intelligence Centre Act No 38 of 2001 (FICA), as well as the Income Tax Act of 1962. It also makes provision for internationally accepted practices and standards. Compliance with this policy statement should be reviewed periodically by the Trustees.

DEFINITIONS AND CRITERIA

Prudent investor / person standard means the judgement and care, under prevailing circumstances, which persons with prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

The investment criteria of the policy, in order of priority shall be as follows:

PRUDENCE

Funds will be invested with **prudence** - a standard of care that would be exercised by a person of intelligence and integrity when investing their own funds. The safeguarding of principal funds shall be the foremost objective of the investment policy, and other objectives shall be subordinate to the attainment of this objective.

LIQUIDITY

Liquidity refers to the **ability to convert an investment to cash promptly** with minimum risk of losing some portion of the principal or interest. The investment portfolio shall be managed at all times with sufficient liquidity to meet all daily and seasonal needs, as well as special projects and other operational requirements either known or which may be reasonably anticipated.

YIELD AND CAPITAL GROWTH

Yield (or return on investment) is the average annual return on an investment based on the interest rate, price and length of time to maturity. Assets purchased for income within the investment portfolio shall be managed with the objective of obtaining no worse than a market rate of return, taking into account the constraints contained herein, the guidelines for public benefit organisations as from time-to-time are legislated and the cash flow patterns of the organisation.

Capital growth is the increase in value of equity or bond-based investments, principally contained within unit trusts. Assets purchased for capital growth shall be managed with the objective of obtaining capital growth that at least matches the increase of the JSE all share index for the relevant time period (or the increase in another index that the Trustees may, at their discretion, decide upon).

The Trustees will, in addition to consideration of immediate yield and capital growth and taking into account of the primary criterion of prudence, also consider investing in transactions of broad-based black economic empowerment that:

- *Reflect the **vision** of the organisation;*
- *Provide the organisation with **representation** on the management board of the empowerment company; and*
- *Offer the prospect of a long-term financial return that will at least match **market movements** (as defined in the earlier part of this section - ie by making prudent investment choices to buffer the organisation against economic fluctuations, inflation etc).*
- *The consideration of such investments will include review of the **prospectus** for the transaction and, if considered necessary, the advice of an independent, authorised financial advisor.*

SUSTAINABILITY

The investment of funds and consequent yield and / or capital growth must further the objective of the organisation to be **financially sustainable in the long term.**

DIVERSITY

The investment portfolio shall be managed to **avoid undue concentration of ownership** in a single issue and / or financial institution or type of investment. It shall also be sensitive to opportunities to promote the objectives of the organisation through investment opportunities that meet the criteria set out in the previous paragraphs of this section. Funds that represent the sustainability reserve are available for longer-term investment but **no more than 20% of the total value** of such funds is to be invested with any one counterpart.

INVESTMENT PROCEDURES

GENERAL

The procedure for the investment of reserves differs according to the source of the funds and any restrictions placed on their use:

- RESTRICTED FUNDS will be placed in a call or other term deposit accounts. Cash required for operational purposes will be placed in a current account. Cash on hand will be determined from time to time by forecasting cash flow requirements. Cash required will be available in a **call account** and transferred to the current account by the day prior to its requirement. The call account will be held with the organisation's bankers to expedite release of funds when necessary and to maximise cash flow management.
- DESIGNATED AND UNRESTRICTED FUNDS will be **managed by reserve type**, as follows:
    - **Property fund** - *the investment committee may, from time to time, recommend to the Trustees that a certain proportion of the organisation's designated and unrestricted reserves is used to invest in commercial property in order to generate an income stream and / or the prospect of capital gain. It is intended that property will form a maximum of 10% - 15% of the overall investment portfolio.*
    - **Fixed asset reserve** - *the organisation requires fixed assets for operational purposes and the funds used for their purchase (net of accumulated depreciation) are ring-fenced in the fixed asset reserve to identify the funds utilized in this way).*
    - **Base reserve** - *as these funds need to be available to meet potential funding shortfalls, the money will be placed in call or other term deposit accounts.*
    - **Sustainability reserve** - *the criteria and procedures applicable to the investment of the sustainability reserve funds will be set according to the investment criteria approved by the Trustees.*

PART F: REFERENCES & RESOURCES

REFERENCES

- [1] ***“The Worldwide Fundraiser's Handbook:*** *A Guide to Fundraising for Southern NPOs and Voluntary Organisations”* - Michael Norton, 1996, published by Directory of Social Change, London, in association with the International Fund Raising Group (pg ??)

- **C Master Development Services Finance Workshop** course material

- **What are the Seven Internal Control Procedures in Accounting?**
  http://smallbusiness.chron.com/seven-internal-control-procedures-accounting-76070.html

- **The Southern Africa Institute of Fundraising**
  http://www.saifundraising.org.za/faq/#1498460370343-9dbebb71-f5a1

RESOURCES & FURTHER READING

- *“**Legal Structures commonly used by Non-Profit Organisations”*** - Education & Training Unit for Democracy and Development
  http://www.etu.org.za/toolbox/docs/building/lrc.html

- ***“Finanacial Management for Nonprofits”*** - Corporation for Supportive Housing
  http://www.in.gov/ihcda/files/Financial_Mgmt_for_Nonprofits_Guide(1).pdf

- ***“How to maximise cash flow”*** - Johnathan Lister, writer and content marketer
  http://smallbusiness.chron.com/maximize-cash-flow-32978.html

NOTES


ANNUAL BUDGET
SALARIES
OPERATIONAL COSTS
FUNDING
DONORS
BUDGET
OVERHEAD
COSTS

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