Guidance Notes No.4.1

Project Budgeting and Accounting

WHAT IS A BUDGET?

A budget can be defined as a financial plan of an entity relating to a period of time. It involves setting objectives to be achieved and the co-ordination of people and their organisational aspirations. The financial budget is a way of quantifying the resources needed to achieve these objectives.

WHAT ARE THE ADVANTAGES OF USING A BUDGET?

Budgets for an organisation or project are used to:

- Plan and implement objectives.
- Calculate the estimated income and expenditure.
- Co-ordinate activities.
- Communicate plans.
- Motivate staff by setting clear targets.
- Monitor and evaluate actual performance.

WHO IS RESPONSIBLE FOR A BUDGET?

Managers and any other staff who are responsible for the activity concerned prepare budgets. Finance staff is a technical resource and ensure that the budgeting process is completed professionally. Budgeting requires those responsible to have good interpersonal skills. It is important to be able to listen carefully and negotiate both when planning and monitoring a budget.

WHAT IS INVOLVED IN BUDGETING?

Budgets are usually managed in three stages:

• **PLANNING** - setting the objectives and deciding what this will mean in terms of income and expenditure, within the overall limitations of the project or organisation.

• **MONITORING** - measuring how well the actual income and expenditure compares to the planned amounts. Regular statements identify the differences between budgeted and 'actual' figures. Any corrective action is taken on the basis of these statements.

• **REVIEWING** - evaluating through a general review how closely objectives have been achieved and identifying a new framework, if necessary, for the forthcoming period. This takes place towards the end of the budget cycle and may be the start of the following year's planning. It is an opportunity to see if the process of planning and monitoring the budget could be improved.

WHAT DOES THE JARGON MEAN?

The following is a list of technical terms used in budgeting:

TERM	MEANING	EXAMPLE
Accruals	Adjustments made to the actual income and expenditure for items referring to the budget period but not yet received or paid. The adjustment helps to give a 'like with like' comparison with the budget.	Rent is in the budget for 6 months, but is compared with actual rent paid for 4 months only. An 'accrual' adjustment is made to add the extra 2 months expenditure (which has not yet been paid), to the actual figure for comparison purposes.
Budget and actual statement (or budget report, variance report,management accounts)	Produced regularly (usually monthly or quarterly) to compare the budget from the beginning of the year to date, with actual income and expenditure.	A statement is produced after 6 months to compare the budget with 6 months' actual income and expenditure.
Capital budget	A forecast for long term items, such as buildings, vehicles, machinery and the organisation's income to fund it. Sometimes prepared separately from the revenue or recurring budget.	Three new vehicles are to be purchased next year and are included in a capital budget. Also included is a grant to fund them provided by a donor.
Cash flow forecast (or cash budget)	An additional budget showing when the money will come in and go out and the anticipated bank/cash balance at the end of each month.	The cash flow forecast for March indicates that at the end of the month the bank account will be overdrawn.
Limiting factor(s)	The reason(s) why all the objectives cannot be fulfilled.	Lack of skilled staff to implement a programme.
Revenue budget (or recurring budget)	Budget for ongoing income and expenditure, covering items such as fees and charges, grants, rent, salaries and travel. Sometimes this will include longer-term (capital) items as well.	The budget for an organisation's ongoing income and expenditure items.
Seasonalising (or phasing, profiling, weighting.)	Placing the budgeted income or expenditure item in the month when it will be received or spent rather than dividing the total by, for example, 12 months and putting that amount in each month.	Rent paid twelve months in advance in January. The whole year's amount is placed in January in the budget.
Variance	The difference between budgeted and actual income and expenditure.	If budgeted expenditure for travel is £1,000.00 and actual £850.00, then the variance is £150.00.
Virement	Transferring (with permission) an amount from one budget item to another.	£5,000.00 not needed for salaries in the current year's budget is transferred (or 'vired') to training.

STAGES IN PLANNING A BUDGET

There are 6 simple stages to follow in order to construct an accurate budget:

1. IDENTIFY ORGANISATIONAL OR PROJECT OBJECTIVES

Involve a range of staff in this process.

2. DECIDE WHAT IS THE 'LIMITING FACTOR'

The 'limiting factor' is what restricts the budget. It could be a lack of money, human or other resources and time required to implement a programme. Remember this factor throughout the planning stage.

3. GATHER THE DATA

Ensure all the information is available including:

- The previous year's information (if a continuing programme).
- Level of inflation.
- Amount of salary increases and increments.
- Estimates from suppliers - for example for materials, training or rent.
- Level of income or grant support.
- External factors influencing income and expenditure (eg exchange rate).

4. DETERMINE THE AMOUNT TO BE RECEIVED

How much is confirmed and what is merely wishful thinking? Be as realistic as possible in the estimation and show the status of any possible amounts as a note to the budget, eg unconfirmed funding.

5. DETERMINE THE AMOUNTS TO BE SPENT

Breakdown the items into types by following any existing budget headings. If the programme is to be funded by an external donor, it is essential to ensure that the internal financial system will allow information to be recorded and presented in the same format as their budget headings. If a budget has been prepared in the previous year, this and the actual costs recorded against it, will be a guide to this year's required amount. However, check that the amounts also reflect the current year's objectives, inflationary increases and amounts for programme growth. Again, be as realistic as possible with the estimation.

6. CONSTRUCT THE BUDGET

List the budget item by item, ensuring that the totals of both income and expenditure are the same, and include notes of all calculations. As soon as the budget has been completed, inform everyone who needs to know the budgeted income and expenditure figures. It is also useful to produce a monthly cash flow forecast (or cash budget) for the next year or project period. This indicates when money will come in to and goes out of the project or organisation and identifies any months where there may be a shortfall of funds.

STAGES IN MONITORING A BUDGET

After the budget period has started, it is essential to monitor regularly how close the actual income and expenditure is to that predicted in the budget. This allows managers, members of governing bodies or others responsible to assess the organisation's up to date financial situation. Any differences, or 'variances', must be examined and are a basis for corrective action.

The stages are as follows:

1. PREPARE OR RECEIVE THE INFORMATION COMPARING THE BUDGET WITH 'ACTUAL'

A comparison of the budget to 'actual' income and expenditure is normally prepared monthly or quarterly. It is sometimes called a budget and actual statement (*see Figure 1*).

Other names include 'budget report', 'management accounts' or 'variance report'. The information is usually prepared by finance staff and passed on to those responsible for the budget, as soon as possible after the end of the period.

2. MONITOR THE INCOME AND EXPENDITURE REGULARLY

Those responsible should identify any difference between each budget and actual income and expenditure items - the variance - and be able to explain the reason(s) for this. It is helpful to add notes to the figures to explain the variances.

There could be many reasons for a difference between budget and actual, for example:

- An invoice has not been processed for an item already received.

• Timing differences where the actual shows an activity has happened in one month only, but where the budget shows the total amount divided over twelve months.

• A payment in advance has been included, although the goods or service have not yet been received.

• The budget was incorrectly prepared.

3. TAKE ACTION

Based on the monitored information, action may be needed. These are the following possibilities:

• Take no action if the actual income or expenditure is temporarily incorrect, but will right itself in the next period. Ensure that it does.

• Predict what will happen if the current trend continues for the rest of the budget period.

• Take action to ensure that an income or expenditure item reverts to what was expected in the original budget. It might be necessary, for example, to reduce costs, to cut back on a planned programme, to increase fees and charges or to follow-up on an expected grant that has not been received.

• Consider obtaining permission to 'vire' for under/over budget items. This means that an under spending on one budget item, for example travel, is transferred to an overspending on another budget item, for example salaries, at some point during the year. If virement occurs it will simply 'tidy up' the budget and actual statement. Permission to do this is usually needed from a senior manager and/or donor. Virement will usually happen no more than once or twice a year.

• Inform people what action is needed in order to keep within the budget.

• Continue to monitor the budget and ensure that any action has been effective.

TOP TIPS FOR BUDGETING

• Involve a range of staff in budget planning.

• Use objectives as the base for the budget - rather than just using 'last year plus a bit'.

• Use all available sources of information to compile the budget.

• Add notes to explain calculations.

• Ensure the information needed from the accounting system will be available in the same format as the budget - if not, can the accounting system produce it?

• Be as realistic as possible.

• Prepare the budget in plenty of time.

• Communicate the budget details to everyone who needs to know.

• Ensure budget and actual statements are produced quickly.

• Add notes to the budget and actual statement to explain variances.

• Monitor the budget compared with actual figures regularly.

• Take action when necessary and ensure it has the desired effect.

• Let people know what is needed to keep within the budget.

• Compare the annual budget with the income and expenditure account (or its equivalent) after the end of the year.

Figure 1: Example of a budget and actual statement with notes for the first three months of the year

Training for Development Budget and Actual Statement

	Annual Budget 12 months	Budget (Jan - Mar) 3 months	Actual (Jan - Mar) 3 months	Variance 3 months	% Variance 3 months	Notes
INCOME						
Grants	300,000	150,000	150,000	-	-	-
Fees and Charges	376,000	94,000	89,304	(4,696)	5%	1
Donations	50,000	12,836	5,289	(7,547)	(59%)	2
Interest	2,050	-	-	-	-	3
Total Income	**728,050**	**256,836**	**244,593**	**(12,243)**	**(5%)**	
EXPENDITURE						
Training programme						
Trainers' fees	224,000	85,600	47,251	38,349	45%	4
Materials/printing	55,690	15,350	20,387	(5,037)	(33%)	5
Hire of premises	107,860	42,750	41,299	1,451	3%	-
Travel/accommodation	116,510	31,120	35,109	(3,989)	(13%)	6
Other expenses	34,080	8,520	3,201	5,319	62%	7
Overheads						
Office salaries	11,230	2,807	2,833	(26)	(1%)	-
Rent	82,000	20,500	20,500	-	-	-
Electricity	38,970	9,743	9,265	478	5%	-
Travelling expenses	16,020	4,005	3,206	799	20%	8
Hire of premises	107,860	42,750	41,299	1,451	3%	-
Office costs	34,390	8,598	9,109	(511)	(6%)	9
Audit fees	7,300	-	-	-	-	-
Total expenditure	**728,050**	**228,993**	**192,160**	**36,833**	**16%**	

Notes to help explain the budget and actual statement:

1. Training activities have been 5 per cent less than the predicted level in the first 3 months.
2. A large proportion of the donations will be received in the May and November appeals.
3. Interest will be added in June and December.
4. 32,370.00 of trainers' fees for this period is due to are paid in April. With this included the actual expenses are 7.5 per cent under budget, largely caused by the reduced training activities in the period.
5. Materials and printing have been purchased for a significant part of the year. It is estimated that the actual expenditure will be slightly under budget at the year-end.
6. Due to the lack of training activities some of the staff and volunteers have been travelling to promote the project's activities. This has resulted in additional travel and accommodation costs.
7. The estimate for 'other expenses' was significantly over budgeted. It is now predicted that total expenditure for this item will be 20,000.00.
8. It is expected that there will be additional travel expenses in the next three-month period.
9. Stationery for the whole year has been bought in this three-month period.

ASKING QUESTIONS

The notes with the budget and actual statement (*Figure 1*) provide an explanation for some of the differences. The statement and notes can often be read in conjunction with a narrative report of the project or organisation's activities. The statement is useful information on which staff, governing bodies and donors can base their questions.

It is important for those reviewing this statement to raise queries and obtain clarification. The notes will already answer some of these questions.

In this example, however there are still some areas of concern and questions that could be raised.

- Why are the training activities 5 per cent lower than predicted? Will this be the same/better/worse during the rest of the year?

- What is the reason for the under spending on trainers' fees, apart from the reduction in activities?

- Which trainers have been travelling to promote the activities? What fees were they paid for this? Where were the volunteers recruited and how many were there? What training did they receive for their task?

- What do 'other expenses' cover?

- Why will there be additional travel expenses in the next three-month period?

- Have any adjustments been made in the actual figures for items still outstanding or those paid in advance?

WHAT HAPPENS AT THE END OF THE YEAR?

Comparing the budget and actual expenditure is an important way of measuring how an organisation or project is progressing throughout the year. It is also valuable to compare the annual budget figure with financial statements (eg the income and expenditure account) after the end of the year.

The advantage of the budget and actual comparison is that it can be examined quickly. The comparison of the budget and the financial statement is likely to take place some time after the year-end.

The financial statement's main advantage is that the figures will have been adjusted to show a complete 'like with like' comparison.

This then provides 12 months' budget and 12 months' income and expenditure. The figures can also be compared with the following year's budget and previous year's accounting statements. The statements produced by an organisation or a programme at the year-end is as follows:

1. RECEIPTS AND PAYMENTS ACCOUNT

A straightforward statement that shows the opening cash and bank balance, receipts or money coming in during the year, payments or money going out during the year, and the closing cash and bank balance.

No adjustments are made to the transactions to achieve a true comparison with the budget.

If, for example, only ten months' (rather than twelve months') rent had been paid during the year, the receipts and payments account would show just ten months. The comparison with the budget would be limited and would not then present a 'like with like' picture.

2. INCOME AND EXPENDITURE ACCOUNT (EQUIVALENT TO A 'PROFIT AND LOSS ACCOUNT' IN A PROFIT-MAKING ORGANISATION)

An annual statement that is comparable with the budget. It is rather like a version of the budget and actual statement, adjusted to show a full twelve months' income and expenditure. It is likely to have been adjusted for items paid in arrears or in advance.

These adjustments will be placed in the year, in which the transaction should have occurred, for the purposes of producing the account. Therefore a 'like with like' comparison can be made with the budget.

The income and expenditure account may also have been adjusted for depreciation. Depreciation is a 'bookkeeping' entry charged to expenditure that estimates the value lost during the year on a long term item, such as a vehicle or furniture.

Whenever depreciation is shown in the income and expenditure account, it will have also been shown in the budget.

FIGURE 2: Example of an income and expenditure account

Training for Development Income and Expenditure account for the year Ended 31 December ...

		Budget
Income		
Grants	300,000	300,000
Fees and charges	323,192	376,000
Donations	70,298	50,000
Interest	1,409	2,050
Total Income	**694,899**	**728,050**
Expenditure		
Training programme		
Trainers' fees	232,490	224,000
Materials/printing	53,246	55,690
Hire of premises	101,293	107,860
Travel/accommodation	99,579	116,510
Other expenses	33,487	34,080
Overheads		
Office salaries	11,198	11,230
Rent	82,000	82,000
Electricity	37,135	38,970
Travelling expenses	14,213	16,020
Office costs	33,371	34,390
Audit fees	7,300	7,300
Total expenditure	**705,312**	**728,050**
Excess of expenditure over income/deficit	**(10,413)**	

Areas of concern from the example in Figure 2 include:

- Training for Development is showing a deficit (excess of expenditure over income) for the year of 10,413.00. It is difficult to see why this is by looking at the income and expenditure account alone. It is therefore necessary to compare these figures with the annual budget. The budget amounts, in the right hand column, are the annual budget amounts from Figure 1. If last year's income and expenditure figures were available, this too would be a useful comparison.
- The income indicates that the shortfall is due to the failure of fees and charges and interest to meet the budgeted figure. An increase in donations was insufficient to offset this shortfall.
- Apart from trainers' fees the expenditure budget has been tightly controlled. Why are trainers' fees higher than expected? If more courses than planned were undertaken, why are the other costs not over budget?
- Why are hire of premises and travel/accommodation so much lower than anticipated in the budget?
- Will the deficit be continued next year? How might this be avoided? If the budget for the following year is available, how do the figures compare with this year's budget and income and expenditure account?

Note:
The budget figures are not usually included on the income and expenditure account. However, if the figures are available it is important to compare them.

WANT TO FIND OUT MORE?

• Cammack, John (2003), "Basic Accounting for Small Groups, second edition: with exercises for individuals and group learning", Oxford: Oxfam.

• Cammack, John (2000), "Financial Management for Development: accounting and finance for the non-specialist in development organizations", Oxford: Intrac.

• Kandasami, M. (1997), "Governance and Financial Management in Non-profit Organisations", New Delhi: Caritas India.

• Shapiro, Janet (1995), "Financial Management for Self-Reliance", Durban, South Africa: Olive.

• Denis, Pascoal and Ogara, William (1992), "Financial Accountability Guidelines", Nairobi: Corat (Africa).

Acknowledgement

These guidance notes are drawn from training on Project Budgeting and Accounting course conducted for BOND by John Cammack, Financial Management for Development (Training and Consultancy for NGOs).
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TOP TIPS FOR ANALYSING THE INCOME AND EXPENDITURE ACCOUNT

• Compare each item in the income and expenditure account with:

I. the previous year's corresponding figure
II. the budget amount for the same year
III. the budget amount for the following year

• Identify the reasons for any changes between the figures and identify how reasonable this is. Ask questions about unusual changes.

• Ask how appropriate is each item of income and expenditure.

• Obtain a breakdown for any figure containing several items grouped together, for example 'other' or 'miscellaneous'.

• Donors should check that their grants shown as income in the account agree with their own records.

• Check the maths.

• Ask what will be done to avoid a deficit (or continue a surplus) in future years.

• Compare the account with any narrative reports.

• Find out if the accounts have been audited and by whom.

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