



**Australian Government**

**AusAID**

# **FRAMEWORK FOR FINANCIAL SYSTEMS ASSESSMENT**

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Australian Agency for International Development

## **FRAMEWORK FOR FINANCIAL SYSTEMS ASSESSMENT**

### **Overview**

Australian NGOs, together with their Delivery Organisations, are jointly required to have effective project management, administration, internal control and financial systems to account for AusAID funding under the provisions of the AusAID Umbrella Contract and accreditation criteria.

To be accredited, NGOs must undergo an Organisational Review (OR) which includes a Financial Systems Assessment (FSA). The OR is intended to establish agency performance and capacity in terms of management, administration and financial and technical operations relevant to AusAID NGO schemes. From July 2002, Financial Systems Assessments are part of the ORA and are intended to establish that an NGO has 'necessary and sufficient' financial and management systems to be accountable for Commonwealth funds.

NGOs are required to be reaccredited every five years from the date of the Delegate's decision. The Financial Systems Assessment is a more complex assessment of NGO financial and management systems and is necessary to satisfy the accreditation requirements.

The purpose of this document is to assist the NGO and an external auditor to certify that the NGO has 'necessary and sufficient' financial systems to manage AusAID funds. This paper should be read in conjunction with the AusAID NGO Umbrella Contract, AusAID's new project proposal formats (including budget pro forma) and the ACFID Code of Conduct. A requirement for the ACFID Code of Conduct is that "an auditor must be appointed who is at least a member of the Australian Society of Certified Practising Accountants or the Institute of Chartered Accountants or a registered company auditor".

The following Framework should not be regarded as prescriptive. It is a guide to the types of issues auditors will need to address to complete a Financial Systems Assessment. The Financial Systems Assessment should check that the Australian NGO has financial and project administration systems in place and has documented arrangements with the Delivery Organisation for the management and accountability of funds.

### **Establishment of Budgets, their Basis and Authorisation**

#### Australian NGO and Delivery Organisation

- The basis and source of assumptions used in proposal budgets should be realistic (not inflated) for the proposed activities.
- The adequacy, description and number of line items in budgets should be sufficient to ensure proper disclosure of expenditure for activities undertaken and for monitoring purposes e.g. for identification of expenditure and trends, over-expenditure, and unauthorised activities.
- Line item descriptions for Project Activity Costs both in Australia and in country should be consistent so that the expenditure line items provide for transparency and audit trails when consolidated.

- For both line item descriptions and dollar amounts, budget line item changes for Project Activity Costs should be properly identified and approved.
- The Delivery Organisation budget proposals should have been scrutinised before consolidation into the overall project budget proposal.

If for some reason AusAID approves funding less than the NGO's proposal budget (the NGO bid for funds), the budget should be restructured to take account of the reduced AusAID funding. The new budget should be incorporated in the documented arrangement and endorsed by the Delivery Organisation to acknowledge that the revised budget is the "agreed budget" for the activity. Budget changes requested by the Delivery Organisation should be properly identified and approved by the authorised officer of the Australian NGO and by AusAID, where applicable. A suggested outline for budget change requests should consolidate information on the budget line item, the current amount, the proposed new amount in total for the line item, the amount of the difference, the justification for the change, and the approval.

#### Funds Contributed from Other Sources

- Funding contributions for the activity from other organisations/sources should be disclosed in budget proposals.

### **Australian NGO**

#### Receipt of Funds

For manual accounting systems:

- Mail opening and payment receipt procedures should follow good internal control practices.
- Payments received through the mail should be recorded in a remittance advice register.
- Commonwealth funds provided by AusAID should be properly receipted and banked promptly.
- Investment of surplus funds should be in cash or cash equivalent (prior to spending on AusAID authorised activities or sending tranches overseas) and should not be used for other purposes.

#### Ledger Accounts

- Each project should have a discrete ledger account through which all project expenditure should be recorded.
- The project accounts should generally be recorded as a liability within the general ledger.
- Adequate journal entry controls should exist, e.g. pro forma journal entry input sheets, sequential allotment of journal entry numbers, journal approvals, provision of adequate journal narrations and back up documentation.

## Payments:

### In Australia for Project Activity Costs

- Procurement , travel approval and expenditure systems should be in place.
- Goods and services received should be verified as to their good order, condition, and quality before payment is processed.
- Payments should be properly authorised.
- Where electronic means cannot identify invoices, these should be stamped “Paid” after payment to prevent their resubmission.
- Project expenditure transactions should be verified by supporting documentation and the acquittal statement when claimed against the contract.

### Funds Transfers to the Delivery Organisation

- Evidence should exist that overseas transfers to the Delivery Organisation have been properly authorized.
- Advice to the Delivery Organisation of payments (including source documentation) should exist.
- Evidence should exist of receipt of payment (back to the Australian NGO) by, for example, receipt or letter acknowledging funds received including the conversion exchange rate and local currency amount or hard currency (e.g. US\$ amount), if applicable.
- The transfer of funds to the overseas organisation does not constitute an acquittal by the Australian NGO for acquittal statement purposes until the funds have been actually expended by the Delivery Organisation on the agreed *activities*.

### Procurement of Project Goods and Services

- Quotations should be obtained and documented for significant purchases where possible and value for money principles followed.

### Cash Management

- Cash handling procedures:
  - should be adequate (these procedures should cover inter alias: individual personnel responsibilities for cash; division of duties principles where staffing resources permit; approval processes for the use of cash for authorized activity purposes);
  - petty cash advances should be properly controlled and held in a safe place;
  - petty cash advances should not be used for loan purposes;
  - petty cash expenditure should be supported by documentation when acquitted; and

- handover/take over procedures between Delivery Organisation personnel should be appropriate to deter fraud.
- Bank reconciliations should be:
  - undertaken on a monthly basis where possible;
  - reviewed by a responsible officer;
  - accurate and complete; and
  - large and unusual reconciling items should be resolved promptly.
- Delivery Organisation bank reconciliations/copies of bank statements should be requested from time to time to check unspent funds balances where monitoring visits are infrequent.

#### Interest Earned on AusAID Funds

- Where interest earned has to be estimated, the method of estimating interest should be stated.
- A transparent method should exist for the calculation of interest earned for funds provided by AusAID and its application to the approved project activities.

#### Progress Reporting by Australian NGO and Delivery Organisation

- The Australian NGO should have a procedure/system to:
  - monitor receipt of financial and physical reports;
  - follow-up overdue/outstanding reports; and
  - demonstrate that reports have been examined by the Australian NGO project officer and queries arising from the reports are followed up.

#### Acquittal Consolidation

Consolidation of the Delivery Organisation acquittal statement and the NGO Australia-based costs into the acquittal statement submitted to AusAID.

- The process of consolidating Project Activity Costs and acquittals incurred by the Australian NGO needs to be transparent. If the budget line items are complex, an intermediate spreadsheet showing the relevant expenditure by line item should provide consolidation and transparency as well as an audit trail.

Evidence should exist that the Australian NGO has verified that the budget used in the Delivery Organisation acquittal is the most current approved/agreed budget.

- Unusual expenditure variances from the agreed budget line item should be scrutinised and followed up with the Delivery Organisation for explanation before submitting the acquittal or the amalgamated acquittal (which includes the Australian NGO acquittal expenditure) to AusAID.

#### Acquittal Reporting

- The acquittal statement should disclose correctly:

- funds received from AusAID for the reporting period concerned;
  - interest earned on AusAID project funds under a revenue heading of “interest earned” in the acquittal statement and applied to the activity for approved purposes;
  - actual expenditure by line item against the agreed budget line items; and
  - provide explanations when line items exceed a 10% variation from the agreed budgets.
- All acquittals are to be based on an accrual reporting basis.
  - The wording of the acquittal certification to AusAID should be in accordance with the AusAID agreement and must be signed by a nominated NGO delegate.

#### Unspent Funds on Completion of Project

- Unspent funds, interest and exchange rate gains remaining after provision of the completion report should be refunded to AusAID.

#### Activity Management Documentation System

- An adequate filing system for project management should exist for:
  - correspondence between AusAID and the Australian NGO;
  - correspondence between the Australian NGO and the Delivery Organisation;
  - physical and financial progress reports and monitoring visit reports; and
  - contractual and other legal agreements.
- Systems to track provision of reports required under the contract should exist.

#### **Delivery Organisation Systems:**

##### Delivery Organisation acquittal reporting

- All budgets and acquittals should be based on an accrual reporting basis.
- The agreed/approved budgets should be re-incorporated in the acquittal statement as a separate column against which actual acquittal expenditure can be compared. Incorporation of the budget also confirms that the budget used by the Delivery Organisation is the agreed/approved budget.
- The acquittal statement should disclose:
  - funds received from the Australian NGO for the reporting period concerned;
  - interest earned;
  - funds remaining unacquitted below the line at the end of the reporting period. These unacquitted funds should be disclosed in the next acquittal as being carried forward to the new reporting period;
  - the acquittal expenditure by line item (columnar) against the budget line item column; and
  - the exchange rate used for the acquittal if the acquittal is in \$Australian.

- Acquittal statements should be properly certified by agreed officials of the Delivery Organisation (ie the expenditure disclosed in the acquittal statement should be correct and true and should have been extracted from the accounting records of the organisation and approved by an authorised official of the Delivery Organisation).
- Expenditure detailed in the acquittal statement should be extracted from the accounts and records of the organisation.

### **Verification of Delivery Organisation Internal Accounting Controls**

Where Delivery Organisations are not audited annually in-country by an in-country auditor, Australian NGO personnel should check that there are sufficient internal controls operating in Delivery Organisation accounting and activity management systems to provide assurances that Commonwealth funds are properly accounted for, controlled and spent for the agreed purposes. Verification of Delivery Organisation systems should occur from time to time, e.g. during or as part of project monitoring visits. The verification or assurances that adequate controls are operating could take the form of, but not necessarily be limited to, control checklists which are completed by Australian NGO personnel.

The Australian NGO external auditor would not normally be expected to visit the Delivery Organisation in order to certify that ‘necessary and sufficient’ financial systems and records exist. Given the audit costs involved, or the materiality of the Delivery Organisation’s activities, however, some assurance is required that the Australian NGO has verified and documented that adequate internal controls are operating in the Delivery Organisation to ensure accountability of AusAID funds. Such evidence could be given by monitoring visit reports, checklist results, and/or visit reports by the Australian NGO financial controller/accountant.

Internal control deficiencies resulting from spot checks/reviews by Australian NGO personnel should be reported to the chief accounting officer of the Australian NGO, and the NGO Executive/Board for follow up action.

### **Delivery Organisation Activity Management and Internal Control Systems**

- Where direct internal controls are absent, e.g. where separation of duties is not possible, adequate compensatory controls should exist wherever possible.
- Monitoring visits should include examination (using checklists) of Delivery Organisations’ internal accounting control systems to ensure continued effectiveness.
- Reporting requirements on activity implementation progress should have been complied with.
- The veracity of Delivery Organisations’ reports in terms of project implementation should be checked.
- Goods and services received should be verified before payments are processed.
- Where electronic means cannot identify invoices, these should be cancelled using a “Paid” stamp when payment has been made in order to prevent resubmission of invoices.

- Copies of acquittals should be retained when original acquittals are sent to the Australian based NGO.
- Acquittal of expenditure should be against the agreed budget line item descriptions.
- Verification of project expenditure transactions should be made in conjunction with supporting source documentation.
- Quotations should be obtained and documented for significant purchases where possible (other than sole supplier situations).
- Calculation of interest and its application to the project should occur where interest is earned.
- Cash handling procedures:
  - should be adequate (these procedures should cover inter alia: individual personnel who handle cash; the principle of division of responsibilities (where staffing resources permit); approval processes for the use of cash for authorised activity purposes);
  - petty cash advances should be properly controlled and kept in a safe place;
  - petty cash advances should not be used for loan purposes;
  - petty cash expenditure should be supported by documentation when acquitted;
  - handover/take over procedures between Delivery Organisation personnel should be appropriate to deter fraud.
- Bank reconciliations should be:
  - undertaken on a monthly basis where possible;
  - reviewed by a responsible officer;
  - accurate and complete;
  - large and unusual reconciling items should be resolved promptly; and
  - cash should be held in a secure environment to deter theft.
- Verification should occur of existence of project assets purchased and their entry into the assets register.
- The exchange rates used should be taken from a credible source, which should be named.
- Two signatories should be required to operate cheque accounts where Commonwealth funds are concerned.

#### Agreement with Delivery Organisation

- Documented arrangements between Delivery Organisations and the NGO should exist.

#### Asset Management of AusAID Funded Assets for Non-ANCP Activities

- Assets having a threshold value of \$1,000 or more and assets having a portable and attractive nature should be recorded in an assets register for each project in accordance with the requirements of the Umbrella Contract.
- Assets should be properly identified in the asset register providing an asset description, serial numbers, cost and date of purchase and location. Assets should be verified for their existence and checked against the asset register during an appropriate monitoring visit (check list item for verification of Delivery Organisation internal controls).
- Prior approval should be obtained from the relevant AusAID program officer for the disposal of assets purchased with Commonwealth funds. Statement of intended method of disposal in the original project proposal is sufficient to meet this requirement.
- The proceeds on sale of assets purchased with Commonwealth funds should be disclosed as a revenue item in acquittal statements and applied transparently to agreed project activities.
- Assets should not be used for private purposes.

#### Annual Independently Audited Financial Statements - Australian NGO

- The annual financial statements should be audited by either a member of the Australian Society of Certified Practising Accountants, or the Institute of Chartered Accountants, Australia.

Annual independently audited financial statements and NGO annual reports should be provided to AusAID within five months of the completion of the NGO financial year.

The annual audit should include a sample of AusAID funded projects in order to confirm that the NGO has effective project management, administrative and financial systems of accounting and internal controls, for both in-Australia and Delivery Organisations (for Delivery Organisations, see heading Verification of Delivery Organisation Internal Accounting Controls above). Provision of audited financial statements from Delivery Organisations is at the discretion of the Australian NGO.