Financial management E2

MPAs receive income from various funding sources. The efficient management of this is vitally important both for effective management of the MPA and to demonstrate to donors that funds are being well spent. This sheet introduces the main components of financial management.

Financial management involves forecasting, monitoring and reporting on income and expenditure, preparing and overseeing budgets and expenditures, cash flow management and projection, auditing, and stock-taking and inventory control. Demonstrating good financial management can help to win confidence: users are more willing to pay entrance and other fees, and donors to continue their funding if they are sure that their contributions are being used efficiently and for the right purposes.

BUDGETS

These are detailed plans that specify anticipated income and expenditure for the activities involved in running the MPA over a certain period and usually complement annual work plans. A budget helps to clarify the relationships between programme and administrative costs, identify where financial resources are needed, and control expenses. An MPA generally has two types of budget:

- The annual operating budget, which should not exceed the expected total income for the year. This may have to be adjusted if there is an unexpected shortfall, or if extra funds become available;
- Budgets for activities of a specific duration, such as workshops or projects, for which funding may come from external sources.

Both the income and expenses sections are divided into budget lines (also called line items or accounts), reflecting the various types of expenditure. Examples include:

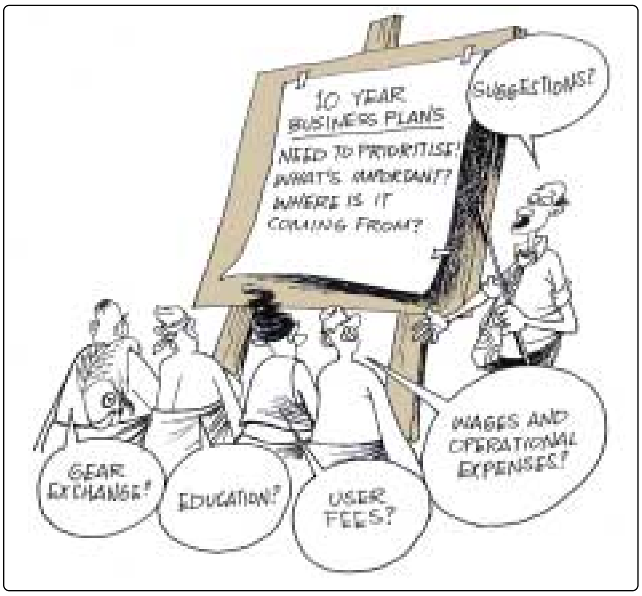
- **Recurrent costs -** Staff salaries (plus benefits and insurance), maintenance of infrastructure, and consumables (e.g. stationery, fuel, water, electricity).
- **Capital expenditures -** Infrastructure and equipment are common examples.
- **Occasional operational expenditures -** Covering, for example meetings or field trips.
- **Contingency -** Typically 10% of the total budget to cover unforeseen price rises or additional costs.

Funds should not usually be reallocated between different budget lines without justification and approval of the relevant authority(ies). Donors may allow funds to be moved between budget lines relating to one particular component of a project without consultation, and between different components within a certain percentage (e.g. 5-10%), but generally approval needs to be sought first. The terms and conditions of the funding should be checked carefully. A sudden need for a large re-allocation would indicate that the budget was inadequately prepared.

FINANCIAL REPORTING

This involves the preparation of a statement of income and expenditure. If the MPA is part of a national system, or is managed by an NGO or other organisation, there will be standard procedures. Accurate and timely financial reporting is essential to help with decision-making (e.g. if new equipment is needed), ensure useful information is available for donors, and to give reassurance that funds are well administered. Standard financial reporting systems are often also required to meet legal and contractual requirements.

As with budgets, two types of financial reports may be needed: an annual report for the MPA, and reports for short-term projects or separately funded activities (see also sheet C5). A basic financial report shows the income and expenditure in two columns according to the different budget lines. However, it may be more meaningful to report expenditures against objectives, and so consultation with those preparing the activity report that generally accompanies a financial statement is advisable. If there is a delay in producing the financial report, this should be explained in advance with the reasons, since payment of further instalments, whether from a donor or from the government, is generally linked to approval of the financial report from the previous work period.



MAINTENANCE OF ACCOUNTS

Accounting is the term used for financial record-keeping including book-keeping and the maintenance of ledgers.

This is a specialist task, best carried out by a trained accountant who can also help with other financial activities such as paying salaries and suppliers. Various accounting methods are used but all require that at the end of the fiscal year, a financial statement is prepared, that covers not only expenditures but also factors in all that is owed. Note the 'fiscal' year (i.e. the one-year long financial accounting period) is not always the same as the calendar year; for the MPA it may be useful to choose a fiscal year that matches that of a major donor or the government agency to which it reports; fiscal years may run July-June, or April-March. Separate accounts may be needed for different sources of funding if they are bound by different conditions, and it is vital that these are kept separate.

The balance sheet is a snapshot of the organisation's financial condition on a particular date, often the end of the fiscal year. Discrepancies between the expected balance and the actual funds held in a bank account should be investigated and corrected immediately. Two MPAs could have identical balance sheets but for one the financial situation might be improving, and for the other it could be declining. An income statement, showing 'financial activity' over a period of time is thus also needed. This shows the status of revenue and expenditures, determines surpluses or deficits, and shows any unusually large expenditures.

Invoices and receipts must always be kept and filed, and all financial records must be available for audits, with supporting evidence. Standard, approved accounting procedures should always be used, regardless of the size of the MPA and its staff, with appropriate internal controls so that the audits are clean each year. 'Controls' are the policies brought in to make sure that funds are correctly handled and to minimise the risk of mistakes and theft. For example, each financial transaction, such as receipt of cash, signing of a cheque, preparation of a financial statement, must require the involvement of at least two people. Major expenditures not in line with the budget should always be subject to approval by the oversight agency or Board. Where an MPA is very small, the manager may be directly responsible for much of the financial management and is therefore likely to benefit from some financial management training.

CASH FLOW

Good cash flow management is required to ensure that funds are available when needed. Temporary disruptions are sometimes inevitable but should be minimised as suppliers may not be helpful if payments are not made on time and operational activities can be disrupted if cash is suddenly unavailable (e.g. for patrol boat or vehicle fuel). The best way to prevent such problems is to do cash flow projections on an annual (using the budget) and quarterly or monthly basis. If a shortfall is predicted, fundraising can be started earlier, payments spread out in instalments and warnings given about potential deficits. Recurrent operational expenditures tend to be fairly stable and so are easy to predict, but there should be a contingency for unexpected price rises or equipment repairs. If an MPA is short of cash, the reserve or contingency funds could be used, or funds borrowed from other accounts, or from the bank (although this will incur interest payments), but all these options should be avoided.

COST SAVINGS

Keeping costs low is an important component of a sustainable financing strategy. Cost saving schemes might include using volunteers (and thus saving on salaries), in-kind support from the tourism industry, sharing resources (e.g. technical expertise) among MPAs, and organising for local communities to help with enforcement.

INTERNAL AND EXTERNAL AUDITS

An audit is an examination of the accounts, fixed assets and accounting procedures to verify them, and is often undertaken when the annual financial report is prepared. Audit requirements vary from country to country, and often differ for government agencies, NGOs and commercial companies. Requirements and procedures for an MPA will also depend on how it is being managed, and it might have its own internal audit or alternatively be part of a larger audit. For large grants over extended periods of time, donors may require an external audit at the end of the project and possibly mid-term as well. Such audits focus on how the donor funds have been spent and not on the MPA finances as a whole, emphasising the need for separate accounts for project funds.

KEY POINTS FOR THE MPA

- ❑ **Ensure that staff understand that good financial management is a pre-requisite for effective overall management of an MPA.**
- ❑ **Set up the standard accounting practices of the MPAs parent Ministry/organisation, bringing in advice and expertise as needed, and ensure that administrative and accounting personnel under-stand and are fully trained in implementing these.**
- ❑ **Make sure that audits take place as required and implement any resulting recommendations.**
- ❑ **Look out for special reporting requirements of external donors and apply these rigorously.**

Sources of further information

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