

*BOND Guidance Notes Series 7*

## **Project Budgeting and Accounting**

- [Top Tips for Budgeting](#)
- [Top Tips for Analysing the Income and Expenditure Account](#)

### **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:

- help 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?**

Budgets are prepared by managers and other staff who are responsible for the activity concerned. Finance staff are 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 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 parameters of the organisation;
- **monitoring** - measuring how well the actual income and expenditure equates 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 new parameters for the following period. This takes place towards the end of the budget cycle. It is also an opportunity to see if the budget process itself could be improved.

## Stages in planning a 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 or the ability to implement a programme. Consider this throughout the planning stage.
- 3. Gather the data**  
Ensure all the information required is available. Likely sources include:
  - previous year's information (if available);
  - level of inflation;
  - amount of salary increases and increments;
  - estimates from suppliers - for example materials, training, rent;
  - level of income or grant support;
  - any external factors influencing income and expenditure (e.g. exchange rate).
- 4. Determine the amounts 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, e.g. unconfirmed funding from a donor.
- 5. Determine the amounts to be spent**  
Breakdown the items into types by following the budget headings, if they already exist. If the programme is to be funded by an external donor, it is essential to ensure that the financial system will allow information to be recorded and presented in the same format as the 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 also that the amounts reflect the current year's objectives. Inflationary increases and amounts for programme growth will also need to be added. Be as realistic as possible with the estimation.
- 6. Construct the budget**  
Write down the budget item by item, ensuring that the totals of income and expenditure are the same, and keep notes of all calculations. Inform everyone who needs to know the details of income and expenditure. It is also useful to produce a cash budget (or cash flow forecast) to indicate when money will come in to and go out of the organisation and to identify any months where there may be a shortfall.

When the budget has been prepared and the period has started, it is essential to monitor how close the actual income and expenditure is to that predicted. This allows those responsible for the budget to see the organisation's financial situation on a regular basis. Any differences or variances, need to be examined and are a basis for corrective action.

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## Stages in monitoring a budget

- 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 the example in Figure 1). The information is usually put together by finance staff and received by 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 the 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 focus on the higher differences in percentage variance. If the information is prepared or reviewed by different people, ask them 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 as happening in one month only, but where the budget shows, for example, the total amount divided over twelve months;
- a payment in advance could have been made and included, although the goods or service have not yet been received;
- the budget was incorrectly prepared.

3. **Take action**

Based on the information, action may need to be taken. There 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 donor or senior manager. Virement will usually happen no more than once or twice a year;
- inform people what is needed in order to keep within the budget;
- monitor the budget and ensure that any action has been effective.

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

<b>TRAINING FOR DEVELOPMENT BUDGET AND ACTUAL STATEMENT</b>					
	<b>Annual</b>	<b>Budget</b>	<b>Actual</b>		<b>%</b>
	<b>Budget</b>	<b>(Jan - Mar)</b>	<b>(Jan - Mar)</b>	<b>Variance</b>	<b>Variance</b>
	<b>12months</b>	<b>3months</b>	<b>3months</b>	<b>3 months</b>	<b>3 months</b>
<b>INCOME</b>					
Grants	300,000	150,000	150,000	-	-
Fees and charges	376,000	94,000	89,304	(4,696)	5%
Donations	50,000	12,836	5,289	(7,547)	(59%)
Interest	2,050	-	-	-	-
<b>Total income</b>	<b>728,050</b>	<b>256,836</b>	<b>244,593</b>	<b>(12,243)</b>	<b>(5%)</b>
<b>EXPENDITURE</b>					
<b>Training programme</b>					
Trainers' fees	224,000	85,600	47,251	38,349	45%
Materials/printing	55,690	15,350	20,387	(5,037)	(33%)
Hire of premises	107,860	42,750	41,299	1,451	3%
Travel/accommodation	116,510	31,120	35,109	(3,989)	(13%)
Other expenses	34,080	8,520	3,201	5,319	62%
<b>Overheads</b>					
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%
Hire of premises	107,860	42,750	41,299	1,451	3%
Office costs	34,390	8,598	9,109	(511)	(6%)
Audit fees	7,300	-	-	-	-
<b>Total expenditure</b>	<b>728,050</b>	<b>228,993</b>	<b>192,160</b>	<b>36,833</b>	<b>16%</b>

**Areas of concern from the example in Figure 1 include:**

- Grants have been received, as planned in the first three months. This is half the total for the year and therefore relates to six months' expenditure;
- Fees and charges are lower than the budget. Will this trend continue for the rest of the year?
- Donations are considerably lower than the budget. What is the reason for this? Will this be compensated for in the other quarters?

- Trainers' fees are well under budget. Most other costs of the training programme are fully spent so it is likely that part of the fees have simply not been paid. No adjustment is shown in the actual figure for this commitment. If this assumption is correct, will the total be over budget?
- Although materials/printing and travel/accommodation were expected to be a higher proportion of the annual budget in this quarter, the actual figure is still higher. Why is this? Will this overspending be reduced in the next quarter?
- What do other expenses cover and why have they not all been spent? Are there still some outstanding invoices to be paid?
- Overall actual expenditure is less than the actual income, however half of the grants have been received in this period and trainers' fees appear to be partially outstanding.

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### **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 (e.g. 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 are as follows:

#### **1. Receipts and payments account**

A straightforward statement that shows the opening cash and bank balance, the receipts or money coming in during the year, the payments or money going out during the year, and the closing cash and bank balance. Typically, no adjustments are made to the transactions to achieve a 'like with like' comparison with the budget. Therefore if, for example, only one month's rent had been paid during the year, the receipts and payments account would show just one month. **This would not allow a true comparison with the budget.** However, the receipts and payments account will show the amounts of money received and paid during the year and the cash and bank balance left at the year end.

#### **2. Income and expenditure account (equivalent of a profit and loss account in a profit-making organisation)**

This is an annual statement comparable with the budget. This statement will usually have been 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 will be placed in the year in which the transaction should have occurred, for the purposes of producing the income and expenditure account.

The income and expenditure account will also have been adjusted for depreciation (where applicable). This 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. If depreciation is shown in the income and expenditure account it would also have been shown in the budget.

**Figure 2: Example of an income and expenditure account**

<b>TRAINING FOR DEVELOPMENT INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDED 31 DECEMBER .....</b>		
		<b>BUDGET</b>
<b>INCOME</b>		
Grants	300,000	300,000
Fees and charges	323,192	376,000
Donations	70,298	50,000
Interest	1,409	2,050
<b>Total income</b>	<b>694,899</b>	<b>728,050</b>
<b>EXPENDITURE</b>		
<b>Training programme</b>		
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
<b>Overheads</b>		
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
<b>Total expenditure</b>	<b>705,312</b>	<b>728,050</b>
<b>Excess of expenditure over income/ deficit</b>	<b>(10,413)</b>	

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**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;
- 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?

### What does the jargon mean?

The following is a list of technical terms that are used in budgeting. Don't be put off by these.

	Meaning	Examples
<b>Accruals</b>	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 accruals adjustment is made to add the extra 2 months' expenditure (which has not yet been paid), to the actual figure for comparison purposes.
<b>Budget and actual statement (Other names are also used for this statement)</b>	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.
<b>Capital budget</b>	A forecast for long term items, such as buildings, vehicles, machinery and the organisation's income to fund it. Prepared separately from the revenue budget.	Three new vehicles are purchased next year and are included in a capital budget. Also included is a grant to fund them provided by a donor.
<b>Cash budget (Cash flow forecast)</b>	An addition 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 budget for March indicates that at the end of the month the bank account will be overdrawn.
<b>Limiting factor(s)</b>	The reason(s) why all objectives cannot be fulfilled.	Lack of skilled staff to implement a programme.
<b>Revenue budget</b>	Budget for ongoing income and expenditure, covering items such as fees and charges, grants, rent, salaries and travel.	The budget for an organisation's recurring income and expenditure.
<b>Seasonalising (or profiling)</b>	Placing the budgeted income or expenditure item in the	Rent paid twelve months in advance in January. The whole

	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.	amount is placed in January.
<b>Variance</b>	The difference between budgeted and actual income or expenditure.	If budgeted expenditure for travel is £1,000.00; actual £850.00 then the variance is £150.00.
<b>Virement</b>	Transferring (with permission) an amount from one budget item to another.	£5000.00 not needed for salaries in the current year's budget is transferred (or 'vired') to training.

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### Where can I find out more about budgeting and accounting?

- **Financial Management for Development: accounting and finance for the non-specialist in development organisations**, John Cammack. Oxford: Intrac, 1999, chapters 1, 2, 8 and 9.
- **Financial Accountability Guidelines**, Pascoal Denis and William Ogara. Nairobi: Corat, 1992, chapter 2.
- **The Oxfam Handbook of Development and Relief, Volume 1**, Deborah Eade and Suzanne Williams (eds.). Oxford: Oxfam GB, 1995, section 3, chapter 2.
- **Governance and Financial Management in Non-profit Organisations**, M. Kandasami. New Delhi: Caritas India, 1997, chapter 5.

### 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.
- 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.
- 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.

## TOP TIPS FOR ANALYSING THE INCOME AND EXPENDITURE ACCOUNT

- Compare each item in the income and expenditure account with: - the previous year's corresponding figure; - the budget amount for the same year; - 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 unresolved differences.
- Ask how appropriate each item of income and expenditure is.
- Obtain a breakdown for any figure containing several items grouped together, for example 'other'.
- 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

### **Acknowledgement**

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