asia catalyst

HOW TO MAINTAIN FINANCIAL RECORDS

Nonprofit Survival Guide

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WHAT ARE FINANCIAL RECORDS?

Financial records refer to any physical or electronic documents that provide evidence of expenditures or income. Your financial records obviously help to prove that your organization is using its funds in ways laid out in the global budget (see How To Create A Budget). This "evidence" can exist in many forms, such as: monthly bank and credit card statements, invoices and paid bills, payroll processing documents, receipts, bank deposit slips, deposit logs, purchase orders, cancelled checks, expense reports, reimbursement requests, and petty cash slips. They can also include evidence of funding relationships you have with others, such as grant letters and employee or consultant contracts.

Although many financial transactions now happen electronically (i.e. online), it is important that you maintain hard copies or printouts of these electronic transactions as well.

In addition to these hard copy pieces of "evidence," there should be a **centralized log** where your financial information is kept and regularly updated. This financial log (also known as your financial books) can be kept with accounting software or created manually in physical logs such as accounting ledgers, journals, and a checkbook. All these different types of records should be used to produce a periodic (often quarterly or even monthly) financial report, or a summary of your financial transactions in a given period of time. The categories listed on your global budget should be the basis of this periodic financial report.

The state of your financial records is often indicative of the way your organization works. If your receipts are a mess and your log is missing entries, how can you be sure that your organization is effectively carrying out its mission? Orderliness, completeness, and accuracy are crucial in recordkeeping because good records indicate that your organization is professional and reputable. Furthermore, incomplete or inaccurate financial records can get you into legal trouble when it is time to file with the government.

WHO NEEDS TO SEE OUR FINANCIAL RECORDS?

There are many people who may need access to your records, including:

- Current donors, who want to ensure that their funds are being used in ways that they authorized;
- Staff and volunteers involved in program management or financial management, who should be able to participate in monitoring your organization's financial health;
- Your board of directors, who (depending on the laws of your country) may be legally responsible for your financial management; and
- Local and federal governments, which require registered organizations to file annual returns and undergo regular audits.

CONTRACTS

In any relationship where you regularly pay money to an individual or are regularly receiving money from an organization, you should have a legal contract that clearly states the responsibilities of each side and the amount of money involved. This includes your donors, of course, but it also includes any paid staff or volunteers, and casual or part-time people who help with specific projects, such as translators or web designers.

Your organization should consult with a lawyer to draft a contract you can use with individuals who receive funds from your organization. No money should be paid until both your organization and that individual have signed the contract. You should keep a printed copy of the contract, with both sets of signatures.

SETTING UP A FILING SYSTEM

Given that there are so many different kinds of financial documents, it is imperative that you have an organized system for your records. Since the point of maintaining records is that you will need to retrieve them at some point, your system needs to allow you to find what you need easily.

Consider this scenario: you are in the third quarter of your one-year grant, and you receive a notice from your donor that your first quarter expenses are being audited. You are required to provide proof of every expense you listed in your financial report to this donor. If you cannot provide receipts, you will have to give the money back to the donor.

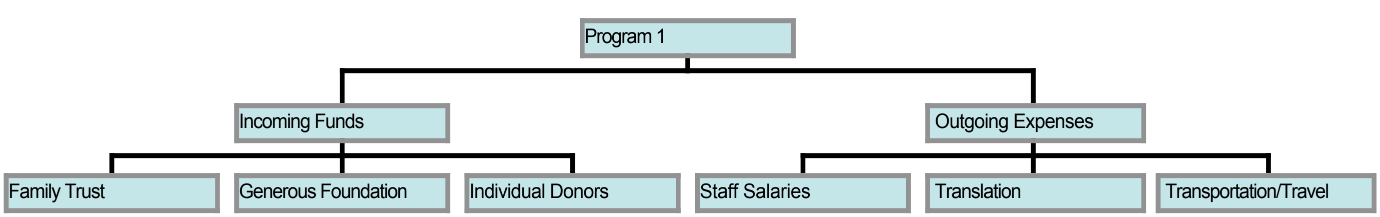
In order to be able to handle this kind of audit, you should establish a system that is intuitive and logical. This means that it should follow some sort of rule: it can be categorized chronologically, by program, by donor, or some combination of the above. You can even use different color folders to code the different reporting periods, programs, or donors. If you find it easier to look things up on your computer, you may want to maintain an online filing system in addition to a physical filing system. If you do this, you should make sure that updates are made to both systems simultaneously.

Regardless of which main categories you use to file your records, you should divide the documents up into further categories. For example, you must keep track of incoming funds as well as outgoing expenses. These two categories can then be broken down into several smaller categories. Incoming funds, for example, can be divided into files for each grant with a separate file for individual donations. To keep up with different grants, expenses have separate files for each program and then sub-files for each type of expense. If a project consists of multiple donors, you can organize the files first by grant, and then again into categories of expenditures.

Some people prefer to have their sub-files organized by names of vendors. At Asia Catalyst, we only do this if we have a lot of vendors of the same category (for example, we have several freelance translators and each gets her own file containing invoices and records of payment).

Sometimes you will need to go through the extra trouble of dividing up a single expenditure by grant; for example, if a staff person's salary is paid by two separate grants. To keep track, you should note on the respective invoice or receipt how much of the total amount is attributed to each grant. Then it is easy to make a copy for each donor and file each away in the appropriate donor file. In each of our donor files, there are records of how much was paid by the respective donor and how much by others.

SAMPLE SUB-CATEGORIES FOR FINANCIAL RECORDS



Each organization develops its own approach. Some organizations organize their financial records by date. They record all outgoing amounts in a journal where they note the date of the transaction, to whom it was paid, for which purpose, and the amount, all in one row in the journal. They also organize their receipts according to date. Because they report on a quarterly basis, they keep one folder for each quarter in which they keep all the receipts and documentation for that period. This works well for organizations that don't have many transactions or sources of funding.

Whatever system you choose, make sure it is consistent. Explain it to at least one other person in your office in case the bookkeeper or person in charge is not around. Ideally, your system should be so logical that it is self-explanatory when someone looks at your files.

TRACKING RECEIPTS

Tracking receipts is always challenging. Everyone in the organization can accumulate receipts, and they have no uniformity: they come in all different shapes and sizes, in various languages depending on where you are traveling, and with varying levels of detail.

Your organization should have a clear, written policy governing how funds are spent. In no case should only one person be in charge of handling funds or approving expenditures. Each expenditure should be approved by at least one other person who is senior to the person who spends the funds. If the person in charge of expenditures is the executive director, either the board of directors or a more senior group of advisors should be reviewing the executive director's expenditures and approving them on a regular basis (for instance, once a month or once each quarter).

A possible scenario: If you've seen a Chinese *fapiao* (official printed receipt) before, you'll know that they rarely indicate the exact purpose or amount of the expense! To illustrate: An Asia Catalyst staffer once bought office supplies at a Chinese bookstore and the goods were discounted. Rather than listing the discount price, her receipt listed the non-discounted price, which was MORE than she actually paid. In a case like this, you should ask for a handwritten *shouju* along with a *fapiao* because they tend to be more accurate.

In order to keep track of these approvals, you should have the following simple forms:

- A purchase order | This is a form used by a staff person to request funds to pay for a purchase of goods or services. It should include, at a minimum, the name of the staff person, name of the company providing the goods or services, the purpose for the expenditure, cost, and the signature of the person who approved this expense. It should be attached to the receipt.
- A reimbursement request form | This is a form that a staff person uses to request reimbursement for something she or he purchased, such as a hotel room while traveling, or postage from the post office. Receipts should also be attached.
- A deposit log | This is a list of funds to be deposited, such as donations or grant funds. One person creates the deposit, and at least one other person should review that the amount listed in the form is attached. After the deposit is made with the bank, the bank receipt should be attached to the form.

In any case where money changes hands, you must have evidence—a receipt, a statement, or even a handwritten invoice. In situations where you cannot get official receipts, such as for per diem payments to workshop participants or traveling staff, you should have a standard form with the organizational letterhead. This form should include a place for the recipient's name, signature, amount paid, date and purpose. It should be attached to a purchase order or reimbursement request and approved by someone more senior.

HOW LONG DO YOU KEEP THE EVIDENCE?

Physical documents can take up a lot of space. Once each year, you should review your documents to determine which, if any, should be destroyed.

It is a good idea to consult government guidelines on what records you are expected to keep and for how long, as well as donor requirements, in order to come up with an organizational policy about document retention. The policy should spell out clearly how long you and your colleagues will keep bank statements, receipts, correspondence, contracts, and other important documents. In the United States, for example, the

Internal Revenue Service (IRS) has set national guidelines published on their website. The IRS mandates that organizations must keep records for a minimum of seven years—unless you don't file a tax or information return; then you must keep them indefinitely.

Donors may also ask you to keep records for a certain number of years. Like nonprofits, they also have to file annual financial returns and undergo regular audits. If your donor is audited, the donor may require you to produce expense documentation on a grant you received several years ago. In addition, you should not keep email records longer than necessary, because they can be used as evidence in any future lawsuits against your organization.

Consult your accountant and your country's requirements in order to draft your own document retention policy. Once a year, use the policy to go through your documents and see if there is anything you need to delete or destroy.

KEEPING IT UP

Effective and continuous recordkeeping requires a certain amount of dedication: you not only need to create a system, but you also need to update it regularly. It is definitely worth the trouble, though, as you'll learn when (not if) you need to account for your finances to the government or to a donor.

For more of the Nonprofit Survival Guide, visit:
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