

How to Maintain Financial Records

What are Financial Records?

Financial records refer to the collection of individual physical or electronic documents that provide evidence of your organization's income and expenses, and the system you use to track your individual transactions.

Your financial records are made up of two key components:

1. Evidence of your Income and Expenses
2. Your Accounting System or Ledger system

These components together, should be designed and organized in a manner that helps to ensure and prove that your organization is using its funds in the way they were laid out in your global budget.

Evidence of Income & Expenses

This evidence can exist in many forms, but in a general rule of thumb, the more precise and thorough the documentation you have, the better. Some examples of financial documentation include: monthly bank and credit card statements, invoices and bills that the organization has paid, payroll processing documents, receipts for your expenses or bank transactions, bank deposit slips, deposit logs, purchase approval forms (such as purchase orders), cancelled checks, expense reports, reimbursement requests, and petty cash slips. Other items might be evidence of funding relationships you have with others, such as grant letters and employee or consultant contracts.

Although many financial transactions can now happen online, or by other electronic means, it is important that you maintain hard copies or printouts of these electronic transactions as well.

Ledgers & Accounting Systems

In addition to maintaining evidence of your income and expenses, there should also be a centralized system or log where your financial information is kept and regularly updated.

This financial log can be kept with accounting software or created manually in physical logbooks such as accounting ledgers, journals and a checkbook. Asia Catalyst uses a computer based accounting program, which is based on traditional ledger books, but provides more functionality and easier access to information than traditional paper ledgers. The underlying principles of accounting underly both systems, and the system you choose should be based on Generally Accepted Accounting Principles, or GAAP in the country in which you are based.

Your accounting system should allow you the ability to produce periodic financial reports, which can show a summary of your financial transactions in a given period of time. Often these reports are prepared monthly or quarterly, and it is helpful to include cumulative data for the current year. We'll talk more about preparing these reports in the next section.

The state of your financial records is often indicative of the way your organization works. If your receipts are a mess and your accounting logs are missing entries, how can you be sure that your organization is effectively carrying out its mission and acting as a good steward of the funds you take in? Orderliness, completeness and accuracy are crucial in recordkeeping because good records help to prevent corruption, track your progress, and course correct in the current year, and plan for the future. Having sound finances shows that your organization is professional and reputable, and allows you space and resources to carry out your mission. Furthermore, incomplete or inaccurate financial records have legal consequences, and in many jurisdictions you will be required to make regular government filings or undergo an audit from an outside firm.

Who Needs to See Our Financial Records?

When planning out the organization of your financial records, it is important to think of the ways in which you will use them, and who will need access to what information.

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

Current donors: they want to ensure that their funds are being used in ways that they authorized;

Staff and volunteers: they are involved in program management or financial management, who should be able to participate in monitoring your organization's financial health;

Your board of directors: they (depending on the laws of your country) may be legally responsible for your financial management;

Local and federal governments: they 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 template that 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.

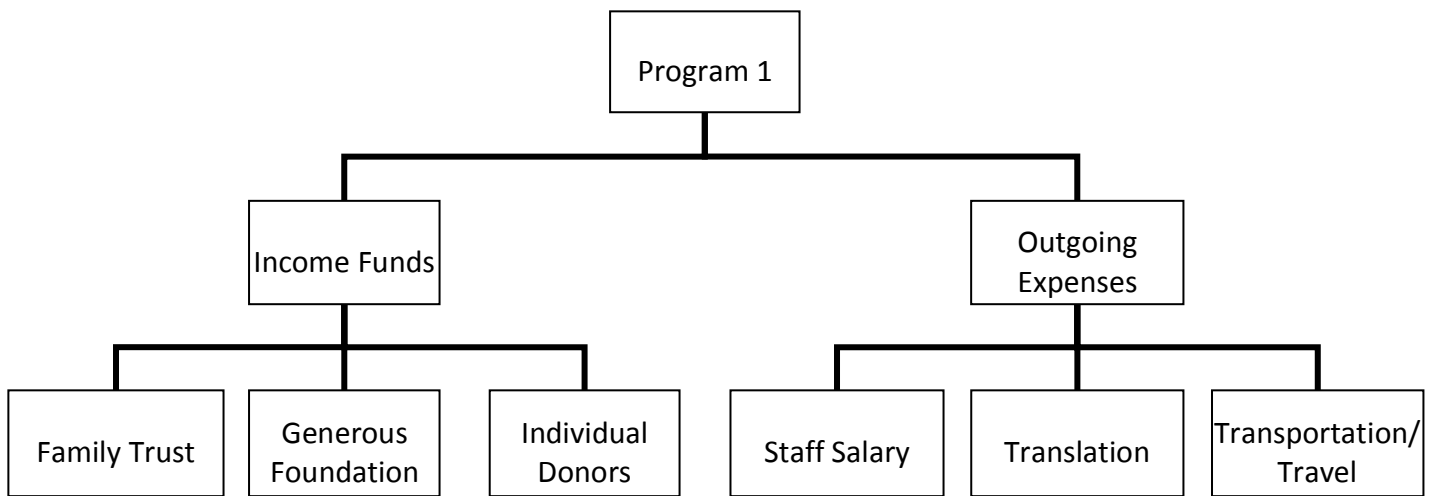
Setting Up a Filing System

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 member'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.

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 an organization that does not 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.

If you've seen a Chinese fapiao (official printed receipt) before, you'll know that they do not indicate the exact purpose and sometimes not even the amount of the expense!

To illustrate: An Asia Catalyst staffer once bought office supplies at a Chinese bookstore her receipt was MORE than she actually paid. In a case like this, you should ask for a handwritten receipt along with a fapiao because they tend to be more accurate.

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).

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 will learn when (not if) you need to account for your finances to the government or to a donor.