# Annex 1 Guide to financial management capacity assessment

The following is a tool to guide a financial management capacity assessment of a potential partner during the appraisal phase and at any other time the MFA deems it relevant to carry out a capacity assessment.

The assessment is developed to assess all types of partners with different levels of administrative and financial capacity, but is especially relevant to help assess the capacity of new, small to medium size partners and is primarily focused on operational issues.

The assessment covers six areas: budgeting, accounting, internal controls, governance and staff, financial reporting and auditing.

For each area a number of minimum requirements and best practice statements are presented. The statements that are underlined are considered to be minimum requirements and must be included in the assessment.

The scope and depth of the assessment beyond the minimum requirements will depend on the size of the engagement, the complexity of the activities, and prior history of, and knowledge about, the administrative and financial management capacity of the partner by the MFA or other donors.

The decision on the scope of the financial capacity assessment can be guided by risk and materiality considerations. The higher the risk and the higher the materiality, the more extensive the financial management capacity assessment carried out should be (see annex 1.A. for guidance). Other considerations that should go into determining the scope of the financial capacity assessment is the extent of other quality assurance and appraisal activities carried out or planned.

The conclusions of the assessment are to be used for implementing mitigating measures where the financial capacity is assessed to be weak.

A capacity assessment should be in place before the first disbursement is made.

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| **#** | **Financial management capacity assessmentMinimum requirements of the assessment are underlined**  | **Y/N** | **Comments** |
| **Budgeting**Budgeting is a planning and decision-making tool that allows the management and the organisation to estimate the cost of planned activities, control cost, measure performance through the comparison of actual cost against budget, and enforce financial accountability. |
| 1.
 | Budgets are prepared for all the costs running the organisation/engagement. |  |  |
|  | Project budgets are based on the cost of planned activities. |  |  |
|  | Budgets are accrued into quarters across all project/programme activities. |  |  |
|  | Project budgets are prepared in accordance with the structure of the results framework/log frame. |  |  |
|  | Both finance and programme/technical staff are involved in setting budgets to ensure that budgets are based on both financial and technical skill and knowledge. |  |  |
|  | Budget reallocations are aligned with results framework/log frame revisions and created in collaboration between the staff responsible for activities and finance staff. |  |  |
|  | Budget reallocations are approved by officers responsible for project activities. |  |  |
|  | Budget sheets include explanatory notes and clear calculations which ensure transparency in the basis for the budget. |  |  |
|  | A separate budget is prepared for core costs (overhead). |  |  |
|  | Budget codes/lines match or correspond to accounting codes to allow for tracking actual against expected spending. |  |  |
|  | The type and number of budget lines used reflect the organisation and complexity of the organisation. |  |  |
|  | A cash flow forecast is prepared every month to allow for monitoring of cash flow for operational costs. |  |  |
|  | Budgeting has been reliable and accurate in the past (few or no material budget overruns, reputation for having robust budgeting procedures or the like. |  |  |
| **Accounting** The purpose of accounting is to provide reliable information about cost and expenditure. This is done through application of a relevant accounting system, accounting policies and standards. Accounting supports both controlling, reporting and auditing of the financial performance of the organisation. |
| *Basic accounting system* |
|  | A standardized electronic/computerized accounting system is in place and used |  |  |
|  | The accounting system can deliver relevant data for reporting purposes, for instance through extracts of raw data to Excel for analysis and reporting. |  |  |
|  | The accounting system only allows access for authorized users. |  |  |
|  | The accounting system logs all entries. |  |  |
|  | The accounting system has a reliable and regular back-up system |  |  |
| *Accounting practices* |
|  | Every payment made has supporting documentation providing evidence. |  |  |
|  | Original vouchers, original invoices and original signed receipts document all expenditures. |  |  |
|  | All accounting and supporting documents are retained and kept safe for up to ten years  |  |  |
|  | All cash received is recorded (preferably in electronic accounting system or alternatively on pre numbered carbon copy receipts) and deposited in Bank OTHERWISE cash or cheques cannot be used. |  |  |
|  | All payments and receipts are recorded (in the electronic accounting system or alternatively in cashbooks). |  |  |
|  | A standard chart of accounts is used to classify each transaction. |  |  |
|  | Transactions are also classified by project or donor using a standard list of cost centers or other accounting system dimensions. |  |  |
|  | The funds received from MFA are to be kept in a designated bank account or alternatively the designated ledger account must be established. |  |  |
|  | A bank reconciliation is prepared each month for every bank account. |  |  |
|  | A cash reconciliation is witnessed by senior staff and recorded each month  |  |  |
|  | Petty cash records are checked every month, must be checked by a different person than the one who keeps them. |  |  |
|  | The organisation keeps track of amount owed to others and owed by others. |  |  |
|  | An accounting manual/policy is used and maintained specifying accounting procedures, roles and segregation of duties. |  |  |
|  | Accounting practices follow local legislation or international standards. |  |  |
| **Internal Controls** The purpose of internal controls is to safeguard assets, make sure that accounting records are accurate and prevent and detect fraud and errors. Essential internal controls include separation of duties, authorization and reconciliation. It can be relevant to include an audit of the internal controls in the audit of the financial statements (this will often be part of the auditor’s work to produce an opinion in a financial audit).  |
|  | Segregation of duties is implemented and adhered to (segregation of duties means that e.g. money handling duties are separated from the record keeping duties, purchasing duties are separated from payment etc.). |  |  |
|  | All fixed assets owned by the organisation are controlled using a fixed assets register stating at least asset tagging code, purchase price, location and book value. |  |  |
|  | Periodic physical inventories of assets or stocks are carried out against fixed asset list or inventories. |  |  |
|  | There is a written policy detailing who can authorise expenditure of different types or value. |  |  |
|  | All transactions are properly authorised by signatures. |  |  |
|  | All expenses are properly signed and documented with the application of purpose and participants. |  |  |
|  | Assets are sufficiently insured given a cost/benefit evaluation (only applicable for non-governmental partners) |  |  |
|  | *Cash management* |  |  |
|  | Cash is kept safely, e.g. in a locked cashbox or a safe, and is in the custody of authorized individuals. |  |  |
|  | All cheques are signed by at least two signatories and no blank cheques are ever signed. |  |  |
|  | Proper controls are built into banking arrangements, e.g. authorization of disbursements and payments, double signatures on checks and transfers, conduct of regular bank reconciliations etc. |  |  |
|  | Appropriate controls over management of cash is in place, including limits to the amount of cash held OR no cash is held. |  |  |
| *Staff expenses* |
|  | Staff and payroll records such as contracts, salary statements, etc. are in place. |  |  |
|  | Staff salaries are checked each month by a senior manager. |  |  |
|  | Statutory deductions (e.g. payroll taxes) are properly made and paid on time. |  |  |
|  | Expenses claims for staff advances are checked by the same person who authorized the advance. |  |  |
|  | Time sheets are used to document hours. |  |  |
| *Procurement*  |
|  | A procurement manual covering request, authorization, selection of suppliers, order, receipt and payment when purchasing goods and services is used and maintained. |  |  |
|  | Different steps of the procurement process (e.g. order, receipt and payment) are shared among different staff members.  |  |  |
|  | A description/manual on different methods of procurement and tendering and when these are to be used is in place. |  |  |
|  | A code of conduct exists to avoid occurrence or perceptions of conflicts of interest in relation to procurement and tendering. |  |  |
| **Governance and staff**The financial management of an organisation is supported by governance structures and competent staff. All business and financial processes need to be supported by governance, organisation and skills. |
|  | A written procedure manual covering finance, procurement and HR is in place, used and regularly updated. |  |  |
|  | The organisation is financially viable and sustainable. |  |  |
|  | Staff roles are clearly defined, and the staff members are aware of their roles and responsibilities and of the organisation’s policies and procedures. |  |  |
|  | Management is involved in the financial management of the organisation/projects or programmes. |  |  |
|  | The partner has adequate policies and procedures in place to guide personnel activities and assure staff accountability. |  |  |
|  | All planned operational costs are adequately funded. |  |  |
|  | Different roles in the finance function are clearly defined, known and followed. |  |  |
|  | The organisation has the necessary registration, authorization and mandate to undertake planned activities. |  |  |
|  | An anti-corruption policy including a section on handling and protection of whistleblowers is in place, used, and regularly updated and shared with staff. |  |  |
| *Staff Skills* |
|  | Key financial positions are held by qualified and competent personnel. Qualifications and competences are documented and match the size and complexity of the organisation. |  |  |
|  | The finance staff have the specific skills and qualifications needed to carry out all financial activities. Skills and qualifications are documented and match the size and complexity of the organisation. |  |  |
|  | A person with ultimate responsibility for the financial management, including for the MFA grant, is clearly identified and this person has the appropriate skills, experience and qualifications. |  |  |
|  | Managers and technical/programme staff have the relevant skills to manage budgets and budget monitoring. This includes training in budgeting and experience with budgeting and monitoring. |  |  |
| *Sub partners* |
|  | The organisation has procedures in place to assure transparency and accountability where funds are transferred to sub-partners. |  |  |
|  | The organisation has mechanisms for assessing the financial capacity of sub-partners.  |  |  |
|  | The organisation has previous experience with grants/disbursements to sub-partners.  |  |  |
| **Financial reporting**Management needs continuous financial reporting to oversee the finances of the organisation to monitor and make decisions regarding the activities of the organisation and projects. Proper financial reporting is essential in being able to communicate financial and technical results to management and donors.  |
|  | Senior management discuss financial reports at least once every three months. |  |  |
|  | Donors and/or management receive financial reports in the right format and on time. |  |  |
|  | The organisation meets statutory reporting requirements. |  |  |
|  | Financial reports include details on income and expenditure, actuals and budget and deviations between actuals and budget. |  |  |
|  | Financial reports are accrued into quarters or less. |  |  |
|  | Financial reports include details on cash and bank balances, amounts due and owed. |  |  |
|  | Project management discuss financial reports monthly. |  |  |
|  | Financial reports show the relevant level of detail according to their use/the need of their intended audience. |  |  |
|  | Financial reports include explanations and comments about deviations made by project responsible staff. |  |  |
| **Auditing** Auditing verifies the accuracy of financial statements and the accounting practices and internal controls of the organisation. Auditing builds trust and transparency.  |
|  | The organisation is subject to regular audits. |  |  |
|  | A properly registered and independent external auditor/audit firm is selected and used. |  |  |
|  | Annual accounts are audited according to appropriate international auditing standards, i.e. IASs and ISSAIs. |  |  |
|  | Annual audited accounts are without material misstatements. |  |  |
|  | The organisation is deemed a going concern by the auditor. |  |  |
|  | Annual audits are up-to-date (signed within six months of the financial year-end). |  |  |
|  | The organisation reacts on auditor’s reports, comments and recommendations and implements relevant changes. |  |  |
|  | Major issues in management letters from the auditor are subsequently followed up and addressed by management. |  |  |

If the assessment is to be carried out by external consultants, a ToR for the work should be elaborated based on the above.