

Preparing for a Successful Financial Due Diligence by Donors with Practical Tips

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https://www.youtube.com/embed/ID7IDCstkr4?si=blk_uVeov7Ubu0It

Risk-control tangle

- Risk: The **probability** and **potential impact** on achievement of objectives while encountering a threat.
- Risk management fundamentals-**Risk Appetite** is risk profile at org level (willingness to take risk to achieve objectives) and **Risk Tolerance** (ability or boundary to take risk/acceptable deviation from risk appetite) for activity/task. Risk appetite is about “taking risk” and risk tolerance is about “controlling risk”
- Risk management approach is how to bridge the gap between risk appetite and tolerance while making informed decisions (risk capacity)
- Unacceptable Risk: actions beyond the risk tolerance
- Residual risk: The risk which inevitably remains after all reasonable mitigation measures have been taken

What are internal controls

Internal controls are rules, procedures and mechanisms that help mitigate risks (risk management) to an acceptable level. Internal Controls are an integral part of an NGO's planning, implementation,

monitoring and achieving desired results

Internal controls help with:

- **Compliance:** Ensuring compliance with laws
- **Accountability:** Responsibility for outcomes/performance of organization
- **Fraud prevention:** Preventing loss of assets
- **Improved Operational efficiency:** streamline business processes, reduce redundancies, and optimize resource allocation
- **Attract capital and funds:** Internal controls assures donors that their funds will be effectively utilized for the intended purpose

Examples of Internal Controls

- **Preventive Controls:** Policies and procedures that include approvals, authorizations, verifications, reconciliations, reviews
- **Detective controls:** Designed to identify errors after event have occurred. These include audits and reviews, account reconciliations, and physical inventorying
- **Corrective controls:** Implemented to remedy problems that detective controls have identified
- **Physical controls:** Involve security measures like locks and alarm systems

What donors focus while reviewing Internal controls during due diligence

- Governance and delegation
- Accounts and Finance
- Costs, Budgets and Budgetary control
- Human Resources
- Procurement
- Inventory and fixed asset management
- Grant and Donor management
- Cash and Bank

- Statutory proceedings and penalties
- Program and finance MIS
- Record keeping and retention etc.

Governance & Delegation

- Current general and governing body members-due process of appointment, change or rotation as per rules with proper documentation. Too long holding of positions is a negative
- Founder as Chief functionary for long duration is evaluated against strategic contribution during such periods
- Key office bearers-Chairman, Secretary and Treasurer-their association,past track record in discharging of roles and responsibilities
- Direct blood relative/relative is a negative-independence of Board is questionable
- Specified person as per section 13 of IT Act-transactions and benefits thereof
- Any beneficial relations with other organisations
- The governing body members list is duly updated with registering authority, Darpan and FCRA
- Number and periodicity of Meetings of general body and governing body as per constitution documents or as per law
- Attendance and Minutes of meetings maintained in minutes register and should be with CEO
- Member Register
- Meetings take up items of business as per roles and duties/responsibilities of the respective body laid down in constitution document

Governance & Delegation

- Sub committees delegated Board responsibility should be as per constitution documents and recommendations through such delegation are duly approved by the governing body. Sub committees could be FAC, HR, Grantee selection etc
- Demonstration of strategic guidance, compliance and internal controls through policies in place
- Public servants on governing board/ executive committee

- Political affiliations of organisation or any of its directors/ trustees
- Affiliations with religious/faith based bodies/organisations
- Does the organisation work attract the definition of political nature/party politics?
- Does the organisation understand the boundaries if its work relates to Advocacy, Rights C Entitlements, Activism etc

Accounts and Finance

- Fund based accounting
- Finance policy and systems in accounts and finance function and implementation in letter and spirit
- Accounting software
- Basis of accounting
- Accounting records-vouchers, supporting bills/invoices for exp, PO/contract, approvals, printouts, filing
- Monthly and Annual Closing of books
- Delegation matrix for approvals
- Maintenance of books of accounts and other records as per Rule 17AA of Income Tax Act
- Qualification and vintage of accounts/finance staff
- Segregation of duties/checks and balances
- Separate accounting for local, FC and business incidental operations
- Data security, Backup and audit trail, Rectification entries in succeeding period
- Concurrent and internal audit
- HO-branch accounting and reconciliation

Costs, Budgets and Budgetary Control

- Understanding the concept of costs-functional and natural heads
- Policy framework for budgeting costs-HR, travel, utilities mainly
- Common cost apportionment as per common cost policy
- Budget formulation and approval process-annual master budget including all projects

- Templates may vary for donors but the basic principles of formulation are same-LOE, unit of measurement and unit cost for an activity, budget by activity and budget line
- Budget monitoring process-budget vs actual derived from software
- Expenditure reporting vis-à-vis budget estimates to donor-rolled up or detailed
- Budgetary control process-propose action based on tolerance/variance permitted which may vary by donors

Human Resources

HR policy is a key policy that donors look for which details

- Mission, Vision C Values
- Org structure-updated
- Processes for Recruitment, selection, engagement contract
- Employee vs consultant vs contractual dilemma
- Compensation and breakup-compliance with social security laws
- Employee benefits-leave, insurance, gratuity
- Payroll and allocation of employee costs for shared HR
- Attendance records (timesheet for foreign donors) by donor projects
- Performance appraisal
- Disciplinary action
- Employee strength currently including in finance function vs org structure

Understanding of various social security laws-central and state is essential so that policy and procedures are as per law

Team due diligence: leadership, experience, alignment with mission, vision and culture values, transparency etc

Procurement

Procurement Policy

- Donors fund assets and inventory also in grant budgets
- Sample procurement transactions insisted by donors to validate policy implementation
- Team's understanding and compliance of Procurement Policy for goods, services and works
- Does donor insist on following its own procurement policy/Guidelines
- Dedicated admin staff to handle procurement in organisation
- Conflict of interest, ethics and transparency issues

Fixed asset and inventory management

- Distinction between asset and inventory understood by staff
- Acquiring asset and inventory following procurement process laid down in policy
- Recoding, marking, issue and return, upkeep, depreciation, verification, loss, sale due to obsolescence of FA
- Recording, issue and return, verification, disposal of inventory not needed/useful
- Insurance of assets to cover loss
- Recording of land and building in books
- FA presented separately in FC audited financials and annual reporting for FC assets in FC-4

Cash and Bank

- Petty cash-custody, administration and replenishment. Restrict petty cash to meet small payments not feasible using banking channels.
- Reduce cash handling and transactions to bare minimum necessary as good practice
- Bank:
 - Provisions on banking in constitution document-at times it is only nationalised bank, SB account be insisted with Banks
 - Local, FCRA accounts-do's and don'ts
 - See your member list is updated on NGO Darpan
 - Dedicated bank account for grants
 - Recording and treatment of interest in pool account

- Signatory to bank accounts- see constitution documents-dual signatories, signatories non-related, prefer net banking.
- Bearer payments-40A(3) provisions
- Bank reconciliation and follow-up
- Minimise visit to branch-sometime one person is engaged for banks only
- Bank statements copy for past 2 years insisted by donors to ascertain operations are using banking channels.

Grant and donor management

- Current status of grant funding. Donor funding is a factor of annual budgets and spends for past few years
- Besides historical audited data, donors obtain projections of grants and income in future 3 years also
- Understanding the donor is essential for positioning your organisation
- Understanding and internal dissemination of grant contract
- Grant compliance checklist since accounting, utilisation and reporting will be different for donors-FC, CSR, others
- Accounting for grant-cost centre basis with dedicated accounting staff for big ticket grants
- Program C financial Reporting very crucial-template, periodicity etc for each grant contract
- Timely request for course correction and revision
- Community contribution, leveraging, cost matching help build your case
- Communication is key

Statutory proceedings and penalties

- Income Tax-assessments, proceedings
- TDS deposit and return filing related
- FCRA related
- Social security laws-PF, ESI, PT, Gratuity
- GST related

- Proceedings against chief functionaries and Board members

MIS and software related

- Accounting, TDS, Assets
- HR-Payroll, timesheet, leave, travel etc
- Audit
- Program MIS
- Grant Management for donor entities

Integrated MIS where all parts are on the same app.

Mandatory accounting Record and Retention

- For books of accounts and other documents, there is specific law now regarding what records to maintain, in what form, where and for the period to be maintained and consequences for non compliance since August 2022 vide Rule 17AA by Income Tax Department

The specified books of accounts shall include:

- cash book
- ledger
- journal
- copies of serially numbered receipts, original copy of invoices, etc

Other documents

- Record of all the projects and institutions run by the organisation
- Record of income of the organization during the previous year
- Record of application out of the income during the year
- Record of specified application out of the income of preceding years
- Record of voluntary contribution with a specific direction to form Corpus
- Record of contribution received under 80G(2)(b) being treated as corpus
- Record of Loans and Borrowings
- Record of properties held by the assessee

- Record of specified persons, as per section 13 (3) of the Act
 - Any other document
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- Form-written form or electronic form or digital form or print-outs or any other form of electromagnetic data storage device.
 - Place-shall be kept and maintained at its "registered office". If not at regd office or at various project locations, intimate Assessing Officer in writing, giving full address of the other places supported by resolution of the board
 - Period-Kept and maintained for a period of ten years from the end of the relevant assessment year

Donors may stipulate record retention clauses in their respective grant contracts. For other records, specific provision maybe made in policy

Tips for making your organisation due diligence ready

- Understand the background, focus areas and causes funded by potential/prospective donor
- Donor credentials is important-PRC, sin goods etc
- Develop understanding of regulatory framework applicable to donor category
- Ensure all kinds of compliance we have learnt in previous sessions to maximum extent possible. This maybe done in phased manner but dedicatedly and per a plan
- Continuous education of organisation key members on statutory and regulatory changes and action required
- Risk management framework in place
- Be proactive and manage adverse proceedings regarding organisation, staff office bearers and have latest update ready
- Use technology and tools-lot of them are freely available
- Spread your work through social media-low cost and high impact and reach. Show your competitive edge.

- Be progressive, innovative and forward looking (latch on to new ideas and new ways) as environment is evolving)
- Ensure internal controls specially key policies are actually followed and demonstrated in action and on record
- Chief functionary and key staff should have clarity on vision, mission and values of the organisation and its demonstration
- Be prepared upfront-Have a folder of all documents and details that are likely to be asked during org due diligence and also updating them. The folder should have different sections covering the areas that we have studied in past sessions
- Use a generic checklist for org due diligence and make your folder containing sections using the generic checklist. This can be prepared basis past checklist you have received from donors.
- Avoid scrambling for information during donor due diligence exercise
- Reduce undue reliance on auditor or reference to auditor by donor, it adversely affects your chance to qualify.
- Auditors role in due diligence in conveying a message is very crucial. Sit down and have a dialogue with your auditor-it can make or break.
- Be careful in terms of your working style-while donors need you, you need to handle them and their staff with care and that understanding and skill needs to be inculcated among key staff who facilitate due diligence.
- Try to build a new business development team in a gradual manner as your organisation grows. Till a team is setup, have a dedicated staff to facilitate donor due diligence. This brings focus on new business and sharpens your chance of success in fund mobilisation going forward
- If you are too small and cannot pilot/handle fund mobilisation, take help of professionals

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