HB Publications

Finance for Non Financial Public Sector Managers

Jennifer Bean & Lascelles Hussey

Second Edition

essential skills for the public sector

Finance
for
Non Financial Public Sector **Managers**

Second Edition

Essential Skills for the Public Sector

HB PUBLICATIONS

Jennifer Bean
Lascelles Hussey

HB PUBLICATIONS
(Incorporated as Givegood Limited)

Published by:

HB Publications
London, England

First Published 1997 © HB Publications
Second Edition 2011 © HB Publications

British Library Cataloguing in Publication Data

ISBN 978 1 899448 67 8

For further information see www.hbpublications.com
and www.fci-system.com

Contents

Chapter 1

Introduction

Finance is a vital resource for every organisation and it is important that all staff, particularly managers, have an understanding of finance. Often this area remains the domain of a few, and non-financial managers may be excluded from detailed financial issues. This book is therefore written to help managers gain a basic understanding of key financial concepts that affect an organisation's day to day operations.

The public sector has undergone many changes in recent years with respect to commercialisation and accountability. These changes have included outsourcing, competitive tendering, Public Private Partnerships, and a general increase in public services being delivered by the private sector, to name a few. It is becoming increasingly important for all public sector organisations to demonstrate that they are financially viable entities in their own right. This means that income, regardless of its source, can fully support all expenditure, and that value for money services can be provided to meet the requirements of end users.

Ideally, managers should have some knowledge of finance such that the financial implications of service decisions are correctly taken into account. This book covers the most important aspects of financial accounting, enabling managers to have a greater understanding of the financial information presented to them and to assist communications with colleagues and finance professionals.

The text covers key concepts such as keeping the accounts, understanding financial statements such as income and expenditure, and the balance sheet. It also explains how cash flows are calculated and examines key financial performance indicators.

In addition to providing a practical text with illustrations, the book also incorporates exercises at the end of each chapter to enable readers to practice the techniques covered, and apply the concepts to their work situation. Suggested solutions are provided at the end of the book and the final chapter contains a glossary of key financial terms.

This book is one of a series of "Essential Skills for the Public Sector" titles. The series aims to assist public sector managers become more efficient and effective in carrying out their important management responsibilities. We consider this book to be an important part of the tool kit for public sector management development.

Chapter 2

Keeping the Accounts

Keeping Financial Records

Organisations maintain financial records to keep account of all transactions, and it is these records which are used to develop the key financial statements. The two main statements produced by all public sector organisations are the “income and expenditure account” (similar to a profit and loss account for a private sector organisation), and the “balance sheet”.

The income and expenditure account is a statement showing the surplus or deficit arising as a result of the organisation’s activities over a period of time, for example a year. The balance sheet, on the other hand, provides a statement of assets and liabilities at a particular point in time, for example, the last day of the financial year. By deducting the liabilities from the assets, the balance sheet is able to establish the “net worth” of an organisation. Both these statements are discussed in more detail in chapters 3 and 4 respectively.

Maintaining proper financial records is essential for the following reasons:

- *They provide the basis for the management accounts which are produced on a regular basis, monthly, quarterly, etc.*
- *They form the basis for the financial statements that have to be produced at least once per year*
- *They provide a record of what has actually occurred within the organisation in financial terms*
- *They are essential to ensuring accountability and protection against fraud*
- *They provide the information required for financial monitoring and control*
- *They provide an audit trail for each financial transaction that takes place*

Financial Transactions

Most organisations now operate some form of computerised financial recording system. Depending upon the organisation's size, this may vary from a large and powerful integrated real time system which handles far more than just financial data, for example, personnel information, to a system which is used solely for the accounting functions. A very small non-profit organisation, however, may be able to maintain their accounts on a computer spreadsheet. All financial recording systems, regardless of their complexity, are based on basic "double entry" book-keeping principles.

Double entry refers to the fact that each transaction requires two entries in the accounting system.

Book-keeping refers to the maintenance of accounting records which historically were kept in books or ledgers.

This book will not attempt to cover the theory of double entry book-keeping, however, it will illustrate the process for recording transactions using double entry principles with the following example.

A school has set up a charity account to supplement its income for which separate records are being kept. Each transaction that has taken place is recorded in a red book, such that a set of charity accounts can be produced at the end of the year. The first month's transactions and the accounting entries that were made are given as follows:

Month 1	Transactions	Accounting Implications	
4th	Donations were received of £500	Income increases by £500	Cash increases by £500
9th	Models and toys were sold for £250	Income increases by £250	Cash increases by £250
10th	Prize for raffle was purchased for £100	Expenditure on prizes £100	Cash decreases by £100
14th	Raffle tickets were sold raising £500	Income increases by £500	Cash increases by £500
20th	An invoice of £50 was paid for the hire of stalls	Expenditure on hire charges £50	Cash decreases by £50
27th	A new globe was purchased for the geography classroom for £100	Expenditure on equipment £100	Cash decreases by £100
28th	New equipment was purchased for the media classroom for £300	Expenditure on equipment £300	Cash decreases by £300

At the end of the month, it is possible to calculate the following:

- Total income for the month is £1,250 (£500 + £250 + £500)

- There has been expenditure on a range of items. Depending on the organisation, some of the expenditure would be regarded as capital expenditure whilst others would be classified as revenue expenditure (these terms are explained in Chapter 3)

- In this example, total expenditure is £550 (£100 + £50 + £100 + £300)

The Financial Statements

As previously mentioned, the two key financial statements are the income and expenditure account and the balance sheet. These statements have to be produced at least once a year, and most organisations are required to have the statements audited by an independent auditor who provides an opinion as to whether or not the financial statements "present fairly", the financial position of the organisation for the period concerned.

The format of the financial statements will vary from organisation to organisation. However, there are standard terms and layouts, and the content of the statements should comply with accounting standards. An example format for the two statements is shown as follows:

Income and Expenditure Account

	£'000	£'000	
INCOME			
Sales		1,000	
Less: Cost of Sales		400	
Gross Profit		600	
Grants		8,000	
Fees and Charges		4,000	
Interest		400	
Rent		-	
Total Income		13,000	**A**
EXPENDITURE			
Employee Costs	5,500		
Transport Costs	500		
Accommodation Costs	2,000		
Goods and Services	3,000		
Central & Support Service Costs	400		
Sundry Expenses	800		
Finance Charges	200		
Depreciation	300		
Bad Debts	100		
Total Expenditure		12,800	**B**
Surplus for the Year		200	**A-B**

Balance Sheet Format

	£'000	£'000	£'000	
Fixed Assets *				
Land and Buildings			4,250	
Plant and Machinery			400	
Motor Vehicles			1,300	
Equipment, Fixtures and Fittings			800	
Total Fixed Assets			6,750	
Current Assets				
Stock	0			
Debtors	3,000			
Cash	50			
		3,050		
Current Liabilities				
Creditors	2,000			
Overdraft	800			
		2,800		
Net Current Assets			250	
Less: Long Term Loans			(4,000)	
Total Net Assets			3,000	**A**
Represented by:				
Reserves b/f		2,800		
Surplus for the year		200		
Accumulated reserves c/f			3,000	**B**
(Net Worth)				

A always equals B

*** Fixed Assets are stated after depreciation has been deducted from the cost**

The above statements may sometimes be referred to by different names. For example, some public sector organisations call the "income and expenditure account" a "revenue account". Regardless of the name given to the statement, it will always show key features such as the surplus or deficit arising from the year's activities.

Summary

- The two main financial statements produced by all public sector organisations, are the income and expenditure account and the balance sheet

- The income and expenditure account is a statement showing the surplus or deficit arising as a result of the organisation's activities over a period of time

- The balance sheet provides a statement of assets and liabilities at a particular point in time and establishes the net worth of the organisation

- All financial recording systems whether computerised or manual, are based on basic double entry book-keeping principles

Exercise 1

Accounting Entries

For the following scenarios identify the accounting entries, i.e. show which accounts will be affected.

For example, if a housing manager pays a builder £1,000 to undertake repairs, the accounting entries will be

Increase in repairs expenditure account	*£1,000*
Decrease in asset of cash	*£1,000*

a) A fire officer purchases new uniforms for £10,000 but has yet to pay the supplier.

b) A doctor charges £50 for writing a letter on behalf of a client for which the client had to pay in advance.

c) A school contracts out its cleaning services to a private contractor and has to pay £24,000 a year in monthly instalments. Show the entries for this month.

d) The planning department advised three clients during the week, all of whom were charged £200 each. Two paid immediately, however, the third has yet to pay.

e) Three managers of a day care centre service, decide to set up their own company in order to bid independently for contracts. To make the initial start, they all invest £10,000 each in the new company.