



FINANCIAL REPORTING AND CASH MANAGEMENT

Financial Management Training Module 1 of 4



MINISTRY OF LOCAL GOVERNMENT AND
PROVINCIAL COUNCILS



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AND PROVINCIAL COUNCILS**



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PREFACE

The Asia Foundation (TAF) implemented the Transparent Accountable Local Governance (TALG) Program with financial support from the United States Agency for International Development (USAID) from January 2005 - September 2007. The Foundation's main counterparts were the Ministry of Local Government and Provincial Councils and the Sri Lanka Institute of Local Governance. The International City/County Management Association (ICMA) and Environmental Management Lanka (EML) provided additional technical assistance and support.

The TALG Program developed a number of training modules and publications as part of its institutional strengthening programme for Local Authorities (LAs) in Sri Lanka. Each of the TALG training modules was used to train officials in thirty-five Local Authorities in Southern, Eastern, Central, North Western, North Central and Uva provinces. These were very successful in promoting effective, transparent and accountable local governance. Preparing the training modules was a painstaking process and support from the Australian Agency for International Development (AusAID) enabled The Asia Foundation to complete and publish this and the other publications in the series.

INTRODUCTION

Through the interventions made by the Foundation for the betterment of the Local Governance system in Sri Lanka, publications were developed in the following areas:

- Citizen Participation
- Local Planning
- Service Delivery
- Financial Management
- Policy and Regulations

These publications range from one-page documents of Leading Practices to Training Modules. Major categories of the publications are:

- Training Modules
- Guidebooks
- Reports and Documents
- Video Films
- Computer Applications

The Foundation developed many training modules mainly in the areas of Financial Management and Service Delivery. **Financial Reporting and Cash Management** is Module 1 under Financial Management Training. Other training modules in the series include:

Module 2: Revenue Enhancement

Module 3: Grant Management and Donor Relations

Module 4: Office Management

Users should note that there are a range of TALG publications including Technology of Participation and Resource Directory for Local Authorities that can be used by LAs to create an enabling environment for performing better financial management.

About this Training Module

Module 1: Financial Reporting and Cash Management

This module, Financial Reporting and Cash Management, is based on previous training sessions conducted under TALG, which mainly focused on budget forecasting and monthly reconciliation of LA finances. In addition, the training highlighted the necessity of understanding the LA budget process and budget information by its citizens. Officials were also trained in the proper techniques for handling and depositing cash, setting up the financial office space for maximum protection and how to monitor bank balances to ensure financial liquidity of the LA.

What is Inside this Module

These TALG training modules can be used by different users, ranging from beginners to practitioners, and from those working in LAs to those working as partners with LAs. This publication contains all of the resources required by trainers to deliver a two-day workshop in Financial Reporting and Cash Management.

Part 1: Learning Material about Financial Reporting – This gives an introduction to the purpose and theory of accounting and goes on to discuss in detail both the financial statements required by law and internal management reports that can be used for monitoring and decision-making.

Part 2: Tools for Financial Reporting and Cash Management – These are 'MS Excel' spreadsheets developed to help LAs measure and monitor their performance in Financial Reporting and Cash Management and can be found in the attached CD.

The Main Objectives of this Module

- To provide guidance to the officials who engage in financial management for LAs in Sri Lanka.
- To provide knowledge, skills and tools in financial management activities in a systematic manner.
- To assist LAs to deliver efficient and effective services, while ensuring better financial management.
- To assist LAs to adopt new methods and techniques in financial management.

How to Use this Module

The resources in this publication may be used:

- To enhance knowledge in this specific topic.
- To share the knowledge with others.
- To support a training programme and awareness campaigns.
- To improve the existing system and performance monitoring.

Learning materials will provide guidance to all decision-makers and staff who are involved in financial management activities.

PART 1: LEARNING MATERIAL ABOUT FINANCIAL REPORTING

SESSION 1: PURPOSE OF ACCOUNTING

Why LAs should keep accurate financial records.

1. It is required by Law.
2. To know the financial position of the LA and be accountable.
3. To understand which revenues are not being adequately collected.
4. To determine whether planned (budgeted) activities can be completed.
5. It will allow for proper management of the LA.

1. It is Required by Law

The Local Government Gazette from 1989 states that each PS must keep:

- (a) A monthly analysis of consolidated expenditure.
- (b) A monthly summary of consolidated expenditure.
- (c) A monthly analysis of consolidated receipts.
- (d) A monthly summary of consolidated receipts.
- (e) An annual Income and Expenditure account form.
- (f) An annual Balance Sheet.

Forms (a) - (d) are required to be completed monthly and kept at the PS office. They should be used at the end of the year to complete the final accounts (e) and (f).

2. To Know the Financial Position of the LA and be Accountable

Accounting and monthly reporting allows officials to know the financial position of the LA at all times. Additionally, keeping financial records allows LAs to be accountable to its' citizens for the rupees it is collecting. Whoever has a responsibility to others for his actions and their consequences, is accountable to them. That responsibility may derive from law, contract, LA policy or moral obligation. Accountability is a broad term that encompasses stewardship. Stewardship refers to the efficient and effective administration of resources, and the execution of plans for conserving and consuming them.

In order for LAs to be good stewards of the finances of citizens (ie those paying taxes, service fees etc), officials must know the current situation of the finances at all times. Without monthly reconciliation of the financial documents, officials cannot adequately know how much money they have to spend on service delivery. Additionally, having up-to-date and accurate financial information allows the LA to publish monthly revenue statements in order to show citizens how much money has been collected and the rate at which it is being received. This is one way to be accountable to citizens.

3. To Understand Which Revenues are not Being Adequately Collected

There are many revenue sources available to LAs. These include assessment taxes, rents, service charges, licenses,

warrants, fines etc. In order to complete a thorough budget for the LA, each of these revenue sources must be identified and budgeted for. This is why a budget is completed each year. It is important to understand which of these revenues are being collected, and which are behind schedule each month, according to the scheduled budget. LAs should then focus on collecting revenues that are behind schedule.

Discussion:

JCC Pradeshiya Sabha (PS) has budgeted for Rents for the current year to be Rs 1,200,000. Dividing that into monthly collections, the PS should collect Rs 100,000 each month. After 5 months, total collections for the year are Rs 386,432.18. Discuss the situation and determine if the amount collected is adequate or not and what should be done.

4. To Determine Whether Planned (Budgeted) Activities can be Completed

In order for a LA to complete all of the expenditure projects identified during the budgeting process, it must have the finances necessary to complete them. If expected revenues are not collected each month in any of the financing categories, then there will be a shortfall in expected revenues, resulting in projects being changed and/or reduced. If adjustments to spending need to be made because revenues are lower than anticipated, financial information will be readily available to make these decisions.

5. It will Allow for Proper Management of the LA

LA officials retain the ultimate authority and responsibility over the governance and management of their institution. They are stewards of the public trust. They are responsible for the prudent and effective use of resources. The Finance Committee of the LA headed by the Finance Officer is specifically charged with overseeing the financial management of the LA.

In order for LAs to meet their responsibilities, they must know their financial position. Each Council should require monthly financial reports in order to determine the proper manner for managing the projects undertaken by the LA. Once these monthly receipts and expenditure reports are reviewed, decisions can be taken concerning proper methods for proceeding with the work.

Notes: _____

SESSION 2: THE THEORY OF ACCOUNTING

Basic Formula

Assets = Liabilities + Fund Balance ($A = L + FB$)

Matching Principal

Revenue collected in a certain period should be shown for that period. If money is collected by a LA in one month, it must be shown as being received in that month.

Chart of Accounts

A Chart of Accounts rests at the heart of a financial accounting and reporting system. It provides the structure for the general ledger, from which the annual trial balance, balance sheet, and income and expenditure forms are prepared. The trial balance is the source of data for virtually all internal and external financial reporting.

A Chart of Accounts is a system for identifying and classifying accounts and transactions by the type of account or the nature of the transaction and by the activity or function involved. LAs in Sri Lanka use a standard coding system, which brings logic, order and structure to the Chart of Accounts.

Any LA's accounting system should enable it to record financial information systematically and consistently, with adequate supporting documents. It should include internal control to provide reasonable assurance that the organization's assets are properly safeguarded, that financial transactions are carefully recorded and that transactions are carried out as authorized. A LA's accounting system must be designed to enable it to develop internal budgets and periodic reports for its staff and Board of Directors. The accounting system must also be able to design budgets and reports for its stakeholders in accordance with reporting standards.

In sum, the basic purpose of a Chart of Accounts is to enable a LA to classify and record transactions once, with the detail necessary to produce all required reports. A LA's accounting system for internal management and reporting to stakeholders is usually more detailed than that required for external financial reporting.

Fund Accounting

LAs use the 'Fund Accounting' model for general purpose financial statements. Under this model, LAs sort their various funds into fund groups with similar characteristics. These are called 'Programmes', and in LAs in Sri Lanka there are seven 'Programmes', plus one 'Programme' for capital projects.

LAs should present the following set of Financial Statements:

1. Monthly Statements.
2. Annual Income and Expenditure.
3. Annual Balance Sheet.
4. Accompanying Notes to Financial Statements.

Monthly Statements, Income and Expenditure, and Balance Sheet

The primary purpose of a statement of financial position is to provide relevant information on a LA's assets and liabilities and their relationship to each other at a particular point in time. The statement of financial position must report and focus on the LA as a whole and must report on the LA's total assets and liabilities. The Statement should contain the following:

- Total Assets – Assets are cash and cash equivalents, receivables, short-term loans, inventories, deposits and prepaid expenses, long-term investments, land, buildings and equipment. Assets are shown according to their liquidity.
- Total Liabilities – Liabilities are accounts payable, accrued payroll, other accrued expenses, funds due to grantors, short-term loans and long-term liabilities. Liabilities are shown according to the nearness of their maturity and resulting use of cash.

Accompanying Notes to Financial Statements

Notes to financial statements are essential for the complete understanding of any financial report. Any information necessary for the full understanding of financial statements should be included in a note, if not, included on the face of the statements.

Accounts Coding System

The accounts coding has been determined by the Gazette, as follows:

Revenue

- 10 Rates and Taxes
- 20 Rents
- 30 License Fees
- 40 Charges for Service
- 50 Warrant Fees and Fines
- 60 Other Income
- 70 Revenue Grants
- 80 Capital Grants

Recurrent Expense

- 01 Salaries and Allowances
 - Cadre
 - Casual Labour
- 02 Travelling Expenses
- 03 Supplies and Equipment
- 04 Repair and Maintenance of Capital Assets
- 05 Transportation, Communication, Utility and Other Services
- 06 Interest Payments, Dividends and Bonuses
- 07 Grants, Contributions and Subsidies
- 08 Pensions, Pension benefits and gratuities

Capital Expenditure

- 09 Capital Items
- 10 Loan Repayment

Discussion:

Discuss with your group the following types of revenues and expenses and determine on which report each would be found. The four reports are:

- A. Monthly Revenue Report
- B. Monthly Expense Report
- C. Annual Income and Expenditure Sheet
- D. Annual Balance Sheet
- E. Annual Budget

Sample Financial Items:

Financial Item	Report
1. Telephone bill for month of June.	B
2. Value of all equipment owned by the LA.	D
3. Receipts received in advance of due date.	A
4. Fuel expenses for month of April.	B
5. Amount of total arrears for the year.	D
6. All rates and assessments collected in January.	A
7. Salary expenses for May.	B
8. Total salary expenses for the year at end of May.	B
9. Amount of receivables at the end of the year.	D
10. License fees collected for November.	A
11. Total equipment purchased for the year in 2005.	C
12. Fuel expenses for operating tractors for the year 2005.	C
13. Cost of tractor purchased in the month of July.	B
14. Total reimbursements from Provincial Council (PC) for salaries in the year.	C
15. Total population and land area for the LA (PS, Urban Council (UC), Municipal Council).	E
16. When looking at the amount of rental income for July, how do you know if you can expect to collect more or less than your budget for rental income for the entire year?	A&E
17. How much is planned to be spent on trash collection for the year.	E
18. Cost of casual labour for the first six months of the year.	B
19. The total amount of a loan received in April for the purchase of a new garbage cart.	A
20. Comparison of 2005 budget to 2006 budget, line by line.	E

SESSION 3: FINANCIAL STATEMENTS

The basic purpose of financial statements is to tell the ‘financial story’ of an organization: how the resources were acquired or where the resources came from; how and for what purposes the resources were spent; what efforts were exerted and what was accomplished with the resources. This is, of course, an oversimplification of the purposes of financial statements. Users of financial statements need to know and assess the financial health of the LA. How financially viable is the LA? What is the likelihood of its financial sustainability? Does it use the revenues it collects for the correct projects? In government, spending on solid waste collection or preschools should be assessed in terms of citizen satisfaction and improvement in students’ test scores, respectively. The context of the expenditure must be considered.

Financial statements are reports that show the financial matters of a LA. As discussed earlier, the law requires them to be completed each month and at the end of each year. The primary purpose of financial statements is to provide relevant information to meet the common interests of those people who have a stake in the work of the LA. These people can either be outside the LA – such as citizens, Commissioner of Local Government (CLG), Assistant Commissioner of Local Government (ACLG) and Ministry officials – or they might be internal people at the LA – Secretary, Chairman or others. Outside users of financial statements have common interests in assessing items such as the services provided by a LA, its ability to continue to provide these services, how government officials perform their stewardship responsibilities and also other aspects of their performance.

More specifically, the purpose of financial statements, including the accompanying notes at the end, provide information about:

- a) The amount and nature of a LA’s finances - assets, liabilities, etc.
- b) The effects of receipts and expenditure that change the operations of a LA.
- c) The amount and kinds of receipts and expenditure of a LA.
- d) How a LA obtains and spends cash, its borrowing and repayment of borrowing and other factors that may affect its ability to provide services to citizens.
- e) The efforts of a LA to provide services to the people.

Financial statements are one of the central features of financial reporting and are the principle means of communicating the services provided and the revenues collected in a LA. A financial statement is a formal tabulation of account names and rupee amounts derived from the accounting records maintained by a LA. Financial statements display either the financial position of the authority at a point in time (balance sheet) or various kinds of changes in financial position over a period of time (income and expenditure form). Individual financial statements come from the same receipts and expenditure information, and they report different aspects of the same financial transactions and explain their relationship to each other. Since each type of statement presents a different type of information, no individual statement provides all the necessary information for a particular decision. All statements must be completed.

LAs are required to complete a number of financial statements:

- A Monthly Analysis of Consolidated Expenditure.
- A Monthly Summary of Consolidated Expenditure.
- A Monthly Analysis of Consolidated Receipts.
- A Monthly Summary of Consolidated Receipts.
- An Annual Income and Expenditure Account Form.

- An annual Balance Sheet as at 31 December.
- An annual Summary of Revenue Expenditure.

Discussion:

Discussions will now take place about each of the above forms and the instructions for completing them.

SESSION 4: MANAGEMENT REPORTING

Purpose of Management Reporting

Management reporting is where the activities of the LA are recorded, measured and communicated to others. The purpose of management reporting is to provide information about the LA to the management and outside people, and includes the use of financial reports. Management reporting can be divided into broad categories according to the type of user. Management information is prepared primarily for officials inside the LA. Financial information is prepared primarily for those outside the LA, but will of course be useful to LA officials.

Financial Reporting for Internal Management Purposes

Although the financial information provided to those outside the LA is useful for internal management purposes, more detailed financial information is required for reporting internally to the elected officials and staff.

The audited annual Balance Sheet and Income and Expenditure financial reports are used by Provincial and Ministry officials, as well as other stakeholders. During the year, monthly financial reports (Balance Sheets, Statements of Activities, Functional Expense Statements, Cash Flow Reports and supporting notes) should be provided to the Finance Committee, other council members and staff. Each of these reports can be compared with reports for the previous month, previous year and corresponding periods in prior years in order to see the financial position of the LA.

There are several useful internal management reports that should be prepared monthly and at the end of the year. These are:

- Monthly Variance Reports
- Budget-to-Actual
- Trial Balance Sheet Report
- Annual Administration Report

Budget-to-Actual Reports (B-T-A)

B-T-A reports are among the most important and useful management reports. They are used for management purposes and are transparent, accurate and accountable. B-T-A reports require that an annual budget be prepared correctly and reviewed each month to see if (a) sufficient revenues have been received and (b) to see if expenses are in line with the budget. Developing and approving the budget, tracking actual revenues and expenses every month and comparing them to the budget are primary responsibilities of the financial staff and council, and of those staff members responsible for generating revenues or incurring expenses.

B-T-A reports include budgeted amounts, actual amounts, balances and variances (and if budget changes are approved by the Council during the year these are reflected also). They can present budgeted and actual amounts for both revenue and expenses for the current month and for the year to date. B-T-A reports do not deal with assets, liabilities or net assets. The current year's budget can also be compared with the previous year's budget or actual results to determine whether the LA finances are getting better or worse.

How B-T-A Reports Lead to Action

- 1) Are actual revenues, overall and by programme, behind projections in the budget? Is there a problem? What action is required? Should the budget be revised?
- 2) If actual revenues are in line with or ahead of projections, no action is required.

- 3) Are actual expenses, overall and by programme, ahead of budgeted expenses? Is there a problem? What action is required? Should the budget be revised?
- 4) If actual expenses are in line with or behind budgeted expenses, no action is required. However, there may be an opportunity to implement or enhance programmes that were originally limited because of budget constraints.

Conclusion

Management reports for financial reporting systems in LAs can achieve three important goals - improving the quality of the financial information they produce, strengthening their accountability and reducing the cost of producing and using the information. Achieving these goals require action, cooperation, collaboration and participation on the part of various workers, including council members, who manage and use the financial information of LAs.

Accountability protects and nurtures citizen trust. Rates and taxes and other fees that citizens pay are the fuel that keeps LAs' engines running and public trust is the lifeblood of these organizations.

Public scrutiny of government has increased significantly over the last few years. This is true not only of Ministry and Provincial Governments, but also of LAs. The law requires full public access and disclosure.

Finally, unlike businesses, LAs are driven by mission as opposed to profit. They exist to provide public services and to benefit citizens. They are expected to uphold the highest standards of ethics and accountability. They must report on their finances and operations honestly and accurately – not for fear of discovery or penalty, but because it is the right thing to do.

SESSION 5: PAPER SYSTEMS AND ACCOUNTING ON A COMPUTER

What is the Difference?

Discussion:

First step is to ensure your financial accounts are completed correctly on paper. Then this information can be transferred to the computer.

What is meant by 'Accounting on a Computer'?

What are the benefits of putting your accounts on the computer?

Is it possible to complete accounts on the computer?

SESSION 6: INTRODUCTION TO ELECTRONIC SPREADSHEETS

What is a Spreadsheet?

- A piece of paper with rows and columns.
- Headings and row names are added to the spreadsheet, in addition to numbers.
- Where do you use spreadsheets? Budget templates? LA financial forms? Other applications?
- An electronic spreadsheet is the same thing, but instead of paper, it is completed on the computer. It is usually completed on a computer using 'Microsoft Excel'.

Why Would You Want to do This on a Computer?

- If you use the same format of spreadsheet frequently, it is easier to complete on the computer.
- If your spreadsheet is long and complex, the computer simplifies the process.
- By inserting formulas, the computer will automatically sum the numbers for totals.
- Spreadsheets (other than simple one-time spreadsheets) would be easier to complete on the computer.

SESSION 7: HOW ELECTRONIC SPREADSHEETS WORK

Electronic Spreadsheets

- Electronic spreadsheets are similar to paper spreadsheets, with the exception of some minor features.
- Rows and columns.
- Rows are numbered (1 – ???).
- Columns lettered (A – IV) or 256 columns.
- Performs calculations on numbers that are entered into the spreadsheet.
- Uses formulas that refer to cells (intersection of a column and row) – example B14.
- If A1 was the number 5, and cell A2 was the number 6, the formula to find the sum of both numbers would be in cell A3 as '= A1+A2' – what would the answer be? If we changed the number in A1 to 6, what would A3 be?
- You can add columns of numbers easily using the 'sum' function.

Examples and Demonstrations:

- Pass out some blank spreadsheet forms.
- List 10 numbers and find the sum. In the next column, list a different set of 10 numbers and find the sum. In a 3rd column, list yet another list of 10 numbers and find the sum. Now find the average of the three sums.
- How would you do this in an electronic spreadsheet?
- With the projector on, ask for a volunteer to work on the computer. Have the volunteer enter the numbers in the three columns.
- Instructor will then enter the formula for the sum of the first column and then copy that formula to the other two columns.
- Then enter the formula for the average.
- Now demonstrate how changing one number automatically changes all the answers.

SESSION 8: INTRODUCTION TO FINANCIAL REPORTING SPREADSHEET

LAs need to adopt proper mechanisms to monitor their financial status. They need to share this information, not only within the LA, but also with stakeholders, particularly the public. Under the current local government financial management system, LAs have to prepare monthly financial reports. Most LAs carry out these legal requirements manually.

The Asia Foundation has developed a Computerized Spreadsheet tool using 'MS Excel' to prepare these monthly financial reports. This helps LAs to, not only prepare the financial forms in the required format to satisfy legal requirements, but also to analyze their financial performance on a monthly basis. The use of this reporting tool can bring many benefits, including:

- Using the computer, instead of manually preparing monthly accounts.
- LAs can prepare monthly financial management reports including variance analysis. This will support the decision-making process of the political leadership on financial matters e.g. what went wrong and the corrective measures that need to be put into place.
- The monthly income and expenditure reports and the management reports can be posted on a public notice board allowing citizens to view the financial position of the LA.

This tool is given in the CD attached to this manual.

SESSION 9: MANAGEMENT DECISIONS FROM REPORTS

LAs should, in addition to preparing normal reports, become accustomed to compiling financial and management reports. These management reports should include an administration report, which shows statistical data, graphs etc. These management reports with graphs will help to assess the financial performance of the LA. The management reports will explain the type of revenue and how much was collected monthly, the nature of expenditure and how much expense was incurred by category of expense. Additionally, the report can be organized to show how much of the revenue is in arrears so that the LA can focus on arrear payment efforts.

When the management reports are prepared with all the performance details, it empowers the LA to take the necessary management decision. When we say management decision, it's about taking the necessary action, working on action plans, improving revenue collection and cost control or rewarding employees for good work.

SESSION 10: MAKING REPORTS AVAILABLE TO THE PUBLIC

LAs are service-oriented organizations and they serve the citizens of that authority. Council members are elected by the citizens and, as such, they provide services and are accountable to citizens and the LA. The council members must ensure that the LA's financial position is transparent. Citizen involvement in understanding the financial position is essential in making them aware of what the LA is doing and how the citizens' money is being spent. In this way the citizens can be pleased with the work of, not only the LA staff, but also the council members.

The LA prepares various reports for their management and for internal purposes such as Revenue and Expenditure Account and/or Final Accounts. These reports are not required to be shared with citizens, although doing so is good practice for keeping citizens informed and involved.

The council members must ensure that staff members make all financial reports available to citizens, in multiple languages, to view and give their comments. Citizen participation is very important for the improvement of the LA's performance. Some ways of making these reports available to the public are to post them in the public library, LA offices or other public places.

PART 2: TOOLS FOR FINANCIAL REPORTING AND CASH MANAGEMENT

Financial Reporting and Financial Management

The budget plays a vital role in the management process of Local Government Authorities. It clearly shows the anticipated income and expenditure of the Council. Proper management of cash flow is crucial in the budgetary administration to ensure that flow of income and expenditure occurs correspondingly. If the cash income is faster than the expenditure, there is a possibility of investing excess funds.

The following reports are formulated through spreadsheets and can be found in a CD attached to this financial module:

1. Cash Flow Statement.
2. Progress Report of the Monthly Revenue Collection (monthly target and annual target).
3. Progress Report of the Outstanding Arrears of Revenue.
4. Graphical Charts (Revenue, Expenditure and Arrears).

Constant review of the above reports facilitates financial management of the Council. The Cash Flow Statement is identified as the most appropriate management tool, particularly to ascertain:

- How the necessary funds can be obtained.
- The period within which such funds have been obtained.
- How the funds have been utilized and how long it has taken.

It is the responsibility of the Chief Administration Officer of the Local Government Authority to present the Monthly Financial Management Report at the General Meeting to facilitate the successful operation of financial management of the Council.