

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Religion is part of society. Human beings belong to one religious society or the other. A person could be a Christian, Muslim, Traditionalist, a Buddhist, etc.

Christians and for that matter, churches constitute about 69% of the religious denominations in Ghana. According to the census figures, out of Ghana's 18.8 million people, Muslims constitute 2.9 million, representing a mere 15.6 per cent, while Christians make up 69 percent of the population.

Source:(http://www.newsfromafrica.org/newsfromafrica/articles/art_7902.html). Some churches have schools, universities, hospitals, insurance companies, etc and also embark on other socio-economic activities.

Financial management of churches is similar to financial management in commercial sector in many respects; however, certain key differences shift the focus of church financial manager. Church's primary goal is not to increase member's value, rather it is to provide social desirable need on an ongoing basis. The resources provided are directed towards providing services to the society than the actual members. Thus the churches must demonstrate it stewardship of donated resources- money donated for a specific purpose must be used for that purpose. That purpose is either specified by the members or implied in the churches' stated mission.

Capital budgeting plays a vital role in investment decision making. As church ministers/administrators are expected to undertake projects, it is important to make use of capital budgeting practices in their investments decision to avoid waste of funds. These decisions are crucial to the long term financial health of the church. It involves huge amount of money committed for long periods of time and once the funds have been committed and the project has begun, it is difficult or impossible to reverse. Therefore churches with good capital budgeting decisions may benefit but those with poor capital budgeting decisions may suffer for many years.

The ultimate success of a firm's operations depends upon sound capital budgeting decision. Not-for-profit organizations, Churches, invest money in their operations for a reason. The reason, generally, is to receive a return on their precious resources. To test the link between earnings performance and capital budgeting practices, Christy (1967) used growth of earnings per share as an indicator of performance, but could not establish a consistent relationship between earnings performance and capital budgeting practices.

Furthermore, although research has been conducted on the capital budgeting techniques used by large, medium, and small sized companies as cited by Sangster (1993), Louma (1967), Grablowsky and Burns (1980), and Peel and Wilson (1986), no previous research has focused on this aspect of Capital Budgeting in respect of Not- for-profit organization in Kumasi.

However, many not-for-profit organizations in Ghana especially the churches make little or no use of capital budgeting practices in their investment decisions.

1.2 PROBLEM STATEMENT

There are many projects and capital investments all over the country which have been started by many churches and are either abandoned or never being completed as a result of poor capital budgeting or no investment appraisal decision making. This has led to;

- Inability to complete church projects on time
- Lack of proper investment decisions
- waste of funds and resources as a result of projects been abandon

1.3 OBJECTIVES OF THE STUDY

The following are the objects of the study;

1. To determine whether or not, not-for-profit organizations (Churches) use capital budgeting in their investment decisions.
2. To suggest the use of capital budgeting practices for investment decisions to churches
3. To bring to the awareness of church leaders or administrators the benefits and importance of capital budgeting

1.4 RESEARCH QUESTION/HYPOTHESES

The study is to enquire whether or not, Not-for-profit organization especially churches in Kumasi practice capital budgeting in their investment projects.

1.5 SIGNIFICANCE OF THE RESEARCH

The study will highlight the importance and benefits of capital budgets and budgeting planning and control, cash flow planning for not-for –profit organizations especially the churches.

1.6 ORGANIZATION OF CHAPTERS

This was how the chapters of the research work on capital budgeting practices in not-for-profit organizations (An empirical study of churches in Ghana) were organized.

Chapter one covers introduction, background of the study, problem statement, objectives of the study and research question and significance of the research respectively.

Chapter two consist of the literature review of the study. What writers and authorities say about account in relation to the study?

Chapter three comprises the methodology; that is the methods by which data was collected, through primary data such as questionnaire, interview based on sample size. Also was the use of secondary data such as church budget statements, accounts books, internet and magazines.

Results from data collected from various sources and discussions constitutes chapter four.

The final and concluding part which is chapter five and the summary and conclusion or recommendation of the research.

Attached is the bibliography and appendix.

CHAPTER TWO

LITERATURE REVIEW

2.1 BUDGET

Budgets are the organization's operating plan for a fiscal period. They express, in monetary terms, the board's and staff's decisions regarding how the organizations will fulfill its stated purpose. The board and staff decide what programs will be undertaken for the upcoming fiscal year. The staff then allocates resources to ensure that those programs are delivered. The budget charts a direction for allocating and maximizing the use of resources. Ideally it also identifies any financial problems that could arise in the coming year. In addition, the budget should provide indicators for guarding staff performance and give staff goals to reach and steps to achieve them. Methodical tracking and classification of program expenditures enhance management's ability to report on service efforts and accomplishments.

2.2 THE PURPOSE OF BUDGETING

- It forces managers to plan
- It provides resource information that can be used to improve decision making
- It aids in the use of resources and employees by setting a bench march that can be used for the subsequent evaluation of performance.
- It provides communication and coordination

Hansen & Mowen (1999), pg 267

2.3 BUDGET PLANNING ISSUES

The scope and size of a not-for-profit's programs and asset base dictate the complexity of its budgets. In its most complete form, a budget is a compilation of the plans and objectives of management that covers all phases of operations for a specific period of time. If a goal of an organization is to build working capital, it might want to project a budget imbalance of revenues over expenses. However, building too much of a surplus too aggressively might indicate to users of financial statements that the organization is not effectively carrying out its stated purpose.

Program priorities should be balanced in an effective budget. The not-for-profit's management must allocate its capabilities and resources to impact the maximum number of the intended audience or beneficiaries. Not-for-profit organizations that charge for their services might not be able to easily increase their prices for their programs.

Lead-time for grant requests and multiyear programs must be factored into the budgetary planning process. The financial manager of a not-for-profit must prepare the budget to ensure adequate funds for programs slated to be run over a period of time longer than the average budget cycle. The budget, once adopted, should be used by the staff as a management tool to guarding operational performance.

An effective budget should establish criteria that would signal management if a change is needed or if a course of action should be refined or altered. A budget that is updated for new situations enhances its value as a monitoring system. As unforeseen conditions arise, the budget should be tailored to respond to those conditions. Staff and management accountability is an aspect of budgeting; responsibility should be associated with those that

are actually capable of realizing the goals. Without active awareness and participation of those carrying out the organizational mission, a budget's usefulness is diminished.

2.4 ZERO-BASED VERSUS INCREMENTAL BUDGETING

Zero-based budgeting incorporates the planning process for setting organizational objectives as part of the budgeting process. An organization starts from zero by assuming that no program is necessary and that no money need be spent. Programs that will be continued have to be proven worthy as well as fiscally sound every fiscal year. Zero-based budgeting involves an orderly evaluation of all elements of revenue and expense. Each program must be examined to justify its existence as well as its effectiveness as compared to alternative programs. Programmatic priorities should be established. Each cost center should be challenged to prove its necessity. Each cost center's contribution to the overall organizational objective should be measured. Goals and objectives should be clear as well as quantitatively measurable.

Incremental budgeting treats existing programs and departments as pre-approved, subject only to increases or decreases in financial resources allocated. A not-for-profit's historical costs are the usual base from which budget planning starts. The focus is on the changes anticipated over or under last year's numbers. The planning process is considered complete and program priorities as established. The organization must decide whether its budget is to be based on measurable and predictable statistics or only on good guesses.

2.5 BENEFITS OF BUDGET PREPARATION

- A thoroughly planned and implemented budget enhances the likelihood that a not-for-profit will be financially successful.
- A comprehensive budget is a tool that translates abstract goals into controllable parts.
- It stipulates performance goals for the upcoming year.
- The planning and preparation process leading to a budget forces the organization to set priorities and to narrow its choices.
- A budget can facilitate coordination and cooperation between the various programs and financial departments.
- Periodic budget comparison to actual financial performance can reveal problems and should allow the board and staff to respond quickly to changing financial conditions.
- The budget provides a measurement of financial performance in relation to the not-for-profit's expectations; it guides financial decision-making over the course of a fiscal year.

There is a natural tendency to emphasize cost control because of uncertainty, and the presence of such controls can stifle creative responses to a change in demand for an organization's services. The board and senior staff should provide leadership as to the usefulness and flexibility of the budget. The budgeting process and the subsequent use of the budget as a touch point for financial performance should not overshadow the ability of an organization to respond to the pace of rapid societal change.

The master budget coordinates all of the financial projections in the organization's individual budgets in a single organization-wide set of budgets for a set time period. It encompasses both operating decisions and financing decisions.

Operating decisions focus on the acquisition and use of scarce resources.

Financing decisions focus on how to get the funds to acquire resources.

The use of rolling budgets ensures that a plan is always available for a specified future time period by adding a month, quarter or a year in the future as the month, quarter or year just ended is dropped. A rolling budget continually forces management to think concretely about the coming 12 months regardless of the month at hand.

2.6 STEPS IN PREPARING A BUDGET

The revenue budget is generally the starting point in a budget planning process because program delivery will depend on the forecasted level of revenue. The second step is program or project budget — how much should be offered to support the estimated level of service revenue. Fundraising goals will also determine programmatic service levels because service revenues alone will not necessarily finance all program offerings. How much money the development office plans to raise over the fiscal year will determine the extent of current and future program offerings.

2.7 CAPITAL BUDGETS

Capital budgeting is the process of making long-term planning decisions for investments. It means a financial manager must be able to decide whether an investment is worth undertaking and be able to choose intelligently between two or more alternative projects. Capital budgeting practices start with the recognition that a good investment opportunity exists. Example, schools, hospitals, insurance companies, church buildings for the communities and the society at large. All these situations involve capital expenditure and investment decision. Poor long-term decisions can affect the future stability of an organization because it is often difficult to recover money tied up in bad investments. Good

long-term decisions help an organization to extend its reach into the community and to expand the services it provides.

2.8 NATURE OF INVESTMENT DECISIONS

Capital investments have the following characteristics:

- They have long-term consequences
- They often involves substantial outlays
- They may be difficult or expensive to reverse

2.9 TYPICAL CAPITAL BUDGETING DECISIONS

Virtually any decision that involves an outlay now in order to obtain some returns (increase in revenue or reduction in cost) in the future. Typical capital budgeting decisions includes:

Cost reduction decisions

Should new equipment be purchased to reduce cost?

Expansion decisions

Should a new plant, “Church building”, or other facility be acquired to increase capacity and sales?

Equipment selection decisions

Which of several available machines will be the most cost effective to be purchased?

Lease or Buy decisions

Should new equipment be leased or purchased?

Equipment replacement decisions

Should old equipment be replaced now or later?

(Garrison Noreen (2000), pp. 668)

2.10 TYPES OF CAPITAL EXPENDITURE THAT WILL BE EVALUATED USING CAPITAL BUDGETING TECHNIQUES:

Replacement Projects

Not-for-profit organizations routinely invest in equipments meant to replace absolute and inefficient equipments, even though they may be in serviceable condition. An example is investment in a new generator plant. The objective of such investments is to reduce costs, increases yield, and improve quality.

Expansion projects

These investments are meant to increase or widen capacity. Such investments call for an explicitly forecast of growth. Since this can be risky and complex, expansion projects normally warrant more careful analysis than replacement projects

Diversification Projects

These investments are aimed at producing new products and services or entering into entirely new geographical areas. Often, these projects entail substantial risks, large outlays, and require considerable managerial efforts and attention.

Research and development projects

Traditionally, research and development projects absorbed a very small proportion of capital budget in most Ghanaian companies. Companies are now however allocating some funds to research and development projects, more so in knowledge intensive industries. Research and Development projects are characterized by numerous uncertain and typically involve sequential decision-making. Hence the standard discounted cash flows analysis is not applicable to them. Such projects are decided on the basis of managerial judgment. Firms,

which rely more on quantitative methods, use decision tree analysis and option analysis to evaluate research and projects.

Mandatory investments

These are expenditure required to comply with statutory requirements. For example pollution controls equipment, medical dispensary, fire fitting equipment. These are often non-revenue producing investments. In analyzing such investments the focus is mainly on finding the most cost-effective way of fulfilling a given statutory need.

2.11 IMPORTANCE OF CAPITAL BUDGET

Capital budgeting is an extremely important aspect of a firm's financial management. How a firm finances its investments and how it manages its short-term operations are definitely issues of concerns but how it allocates its capital (the capital budgeting decision) really affects the strategic asset allocation. This is why the process of capital budgeting is also referred to as strategic asset allocation. Some of the special reasons of its importance are stated below:

The influence the firm's growth in the long run

A firm's decision to invest in long-term assets has a decisive influence on the rate and direction of its growth. A wrong decision can prove disastrous for the continued survival of the firm. Unwanted or unprofitable expansion of assets will result in heavy operating costs to the firm. On the other hand, inadequate investment in assets would make it difficult for the firm to compete successfully and maintains its market share.

The affect the risk of the firm

A long term commitment of funds may also change the risk complexity of the firm. If the adoption of a capital expenditure increases a firm's average gain but causes frequent fluctuations in its earnings, the firm may become more risky.

They involve commitment of large amount of funds

Capital budgeting expenditure decisions generally involve large amount of funds, which make it important for the firm to plan its investment programme very carefully and make an advance arrangement for procuring finances internally or externally.

They are irreversible, and if reversible it is at substantial loss

Most investment decisions are irreversible. It is difficult to find a market for such capital items once they have been acquired. The firm may incur heavy losses if such assets are scrapped.

They are among the most difficult decisions to make

Capital investments decisions are the most complex ones. They are an assessment of future events, which are difficult to predict. It is really a complex problem to correctly estimate the future cash flow of an investment. Economic, social and technological forces may cause uncertainty in cash flows.

2.12 CAPITAL BUDGETING PROCESS OR STAGES

Capital budgeting is a complex process as it involves decisions to the investment of current funds for the benefit to be achieved in future and the future is always uncertain. A capital budgeting process may involve a number of steps depending upon the size of the firm, nature

of projects, number of projects, complexities and diversities etc. Let us analyze the procedure and the various stages involved in the capital budgeting process.

Step 1

Identification of investment proposals or forecasting investment needs

Investment opportunities have to be identified or searched for since they do not occur automatically. The capital budgeting process begins with the identification of investment proposals. The first step in capital budgeting process is the conception of a profit making idea. Investment proposals of various types may originate at different levels within a firm, depending on their nature. They may originate from the level of workers to top management level. For example, most of the proposals, for cost reduction, replacement or process for product improvement take place at plant level. The proposal for adding new product may come from the marketing department or from plant manager who thinks of a better way of using idle techniques arise at the factory level. The departmental head analyses the various proposals in light of the corporate strategies and submits suitable proposals to the capital expenditure planning committee in case of large organization or to the officers concerned with the process of long term investment decisions. A continues flow of profitable capital expenditure proposals is itself an indication of a healthy and vital business concern. Although business may pursue many goals, survivals and profitability are the two most important objectives.

Step 2

Screening the proposals or identifying project (s) to meet needs

Screening and selection procedures may differ from firm to firm. Each proposal is then subjected to a preliminary screening process in order to assess whether it is technically

feasible; resources required are available and the expected returns are adequate to compensate for the risk involved. In a large organization, a capital expenditure planning committee is established for screening of various proposals received from different departments. The committee views these proposals from various ways to ensure that these are in accordance with the corporate strategies. Care is also taken in selecting a criterion to judge the desirability of the projects. The criterion selected should be a true measure of the investment projects profitability, and as far as possible, it must be consistent with the firm's objective of maximizing its shareholders value. This stage involves the comparison of the proposals with other projects in line with criteria of the firm. This is done either by the financial manager or by a capital expenditure planning committee. Such criteria should cover the supply and cost of the expected returns from alternative investment opportunities.

Step 3

Evaluation of various proposals or appraising the alternatives

The next step in the capital budgeting process is to evaluate the profitability of various proposals. If a proposal satisfies the screening process, it is then analyzed in more detail by gathering technical, economic and other data. Projects are also classified, for example, products or expansion or improvements are ranked within each classification with respect to profitability, risk and degree of urgency. There are many methods which may be used for this purpose such as payback period method, rate of return method, net present value method etc.

Step 4

Establishing priorities or selecting the best alternatives

After evaluation of various proposals, the unprofitable or uneconomic proposals are rejected. The accepted proposals or profitable proposals are put in priority. It may not be possible for

the firm to invest immediately in all the acceptable proposals. Thus, it is essential to rank the various proposals and to establish priorities after considering the urgency and profitability.

Step 5

Final approval or making the expenditure

Proposals finally recommended by the committee are sent to top management along with a detailed report, both of capital expenditures and or sources of capital. Financial manager will present several alternative capital expenditure budgets. When capital expenditure proposals are finally selected, funds are allocated for them. Projects are then sent to the committee for incorporating them in the capital budgets.

Step 6

Implementing Proposals

Preparation of a capital expenditure budget and incorporation of a particular proposal in the budget does not itself authorize the department to go ahead with the implementation of the project. A request for the authority to spend the amount should further be made to the capital expenditure committee, which may like to review the profitability of the project in the changed circumstances. Further, while implementing the project, it is better to assign responsibilities for completing the project within the given times frame and cost limit so as to avoid unnecessary delays and cost over runs. Net work techniques used in project management such as PERT and CPM can also be applied to monitor the implementation to the projects.

Step 7

Performance review or monitoring project(s)

Last but not the least important step in the capital budgeting process is an evaluation of performance of the project, after it has been fully implemented. It is the duty of the top management or executive committee to ensure that funds are spent in accordance with the allocation made in the capital budget. A control over such capital expenditure is very much essential and for that purpose a monthly report showing the amount allocated, amount spent, approved but not spent should be prepared and submitted to management. The evaluation is made through post completion audit by way of comparison of actual expenditure on project with the budgeted one, and also by comparing the actual return from the investment with the anticipated return. The unfavorable variances, if any, should be looked into and the causes of the variances identified so that corrective action may be taken in future.

Settor Amediku (2010), page 124-127

2.13 CAPITAL BUDGETING TECHNIQUES

Once the relevant cash flows necessary to make capital budgeting decisions have been determined, firms need to evaluate the attractiveness of the various investment proposals. Investment decision will either accept or reject each proposal. Investment analysis is arguably, the most important part of corporate financial analysis. Allocating scarce resources among competing uses requires a decision rule that separates those investments that are worth making from those that are not.

2.13.1 Features of capital budgeting evaluation techniques

1. The criterion must be able to incorporate all the cash flows associated with the proposal.

2. It should also incorporate the time value of money. It means the cash flows arising at different points in time of the project must be differentiated in respect of their worth to the firm.
3. It should be capable of ranking different proposals in order of their worth to the firm.
4. It should be objective and unambiguous in its approach.

The technique must be in line with the objective of maximization of shareholders wealth.

Settor Amediku (2010), pp. 143)

12.13.2 Payback period

The payback period is the number of years required for the proposal's cumulative cash inflows to be equal to its cash outflows. In other words, the payback period is the length of time required to recover the initial cost of the project.

The payback period calculated for a proposal is compared with some predetermined target period. If the payback period is more than the target period, then the proposal should be rejected, otherwise it may be accepted if the payback period is less than the target period. Further, if the different proposals are to be ranked in order of priority, the proposal with the shortest payback period will be the first in the priority list.

12.13.3 Accounting Rate of Return (ARR)

The ARR is based on the accounting concept of return on investment or rate of return. The ARR may be defined as the annualized net income earned on the average funds invested in a project. In other words, the annual returns of a project are expressed as a percentage of the net investment in the project

The ARR calculated is compared with the pre-specified rate of return, then the project is likely to be accepted, otherwise it would be rejected. ARR can also be used to rank various mutually exclusive proposals. The project with the highest ARR will have the top priority while the project with the lowest ARR will be assigned lowest priority.

12.13.4 Net Present Value (NPV)

The NPV is the first and foremost of the discounted cash flow techniques. NPV is used simply to assess the elements of trade-off between investment outlays and the future benefits in equivalent terms and to determine whether the net present value is favourable or not.

The decision rule is 'Accept the proposal if NPV is positive and reject the proposal if the NPV is negative'.

12.13.5 Profitability Index (PI)

This technique which is a variant of the NPV technique is also known as Benefit-cost ratio, or Present Value index. The PI is also based on the basic concept of discounting the future cash flows and is ascertained by comparing the present value of the future cash inflows with the present value of the future cash outflows.

Decision rule of profitability index is 'Accept the project if its PI is more than 1 and reject the proposal if the PI is less than 1'

12.13.6 Discounted Payback Period

This method is a combination of the original payback method and the discounted cash flow technique. The cash flows of the project are discounted to find their present values. The present value of the cash inflows is then compared with present value of the outflow so as to

identify the period taken to recover initial cost or the present value of outflow. Since it is a variant of the original payback period method, the discounted payback period is also calculated in the same way as the payback period, except that the future cash inflows are first discounted and then the payback is calculated.

12.13.7 Internal Rate Of Return (IRR)

The other important discounted cash flow technique of evaluation of capital budgeting proposals is known IRR technique. The IRR of a proposal is defined as the discount rate , which produces a zero NPV that is, the IRR is the discount rate which will equate the present value of cash inflows with the present value of cash outflows. The IRR is also known as Marginal Rate of Return or Time Adjusted Rate of Return. Like NPV, the IRR is also based on discounting technique. Future cash inflows are discounted in such a way that their total present value is just equal to the present value of total cash outflows. The schedule of occurrence of the future cash flows is known but the rate of discount is not. Rather this discount rate is ascertained, by the trial and error procedure. The rate of discount which equates the present value of future cash inflows with the present value of outflows is known as the IRR.

2.14 CASH FLOW PLANNING

Cash is a vital resource for a not-for-profit organization. To maintain financial viability, the organization must have enough cash to pay its bills. Accrual basis financial statements can report an excess of revenues over expenses but this does not necessarily mean that there is cash in the bank. Cyclical and seasonal fluctuations also have an impact on an organization's cash.

Cash inflows and outflows for most not-for-profits typically fluctuate throughout the year. This increases the importance of the budgeting process because obligations must be met on a timely and consistent basis. The organization must plan ahead for those periods when cash inflow tends to be less than cash outflows. Postponing expenditures or accelerating constituent billings are two options for solving the problem.

Once the annual operating and capital budgets are authorized, they can be converted into cash flow budgets to verify the availability of resources and to highlight times of lower than expected cash flow. The process includes estimating when collections on year-end receivables will occur; calculating the normal time lag between invoicing or billing for services or pledges and the actual receipt of cash; and charting the expected expenditure of cash according to the month payment is due.

Then factor in the expected capital expenditures, sales of assets, borrowing, debt repayment and other financing transactions. A model cash flow budget reflects a policy decision to maintain a minimum cash level. Organizations need to plan from day one to build working capital reserves equivalent to at least several months of operating expense. When excess cash reserves have accumulated, the organization must plan for temporary cash investments to maximize the return on those resources. As much money as possible should be kept in federally insured, interest bearing accounts to maximize an organization's yield on its cash. Short term investments of excess cash should be chosen to balance maximization of interest earned with emergency access to the invested cash. Some options are certificates of deposit, treasury bills, and money market accounts.

Once cash reserves exceed the amount needed for one operating cycle, longer-term investments need to be evaluated. Investment policies must weigh the permissible level of risk to the organization's resources in relation to expected returns. Any equity or debt investments chosen will depend on the board's written investment policy. If the not-for-profit is a trustee on a charitable remainder trust, then it is under a duty to the ultimate beneficiary to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements and any other circumstances of the trust.

Under common law, the not-for-profit owes a fiduciary duty to its contributors and grantors to use gifts for the purposes for which the funds are given. A mechanism for tracking donated money and its use must be in place. Many organizations achieve this by isolating restricted gifts. There can be additional accounting expense associated with a restricted gift. Grant expenditures often require very specialized reporting to granting agencies.

2.15 INFLATION

An inflationary environment affects both the expected cash flows and the cost of capital. Cash flows increase due to the increase in the general price level and the cost of capital rises since investors and debt holders require compensation for the decline in purchasing power (Levy & Sarnat, 1982). Several researchers have described how inflation affects investment decisions (Nelson, 1976; Van Horne, 1971).

It is hence vital to consider inflation. According to Van Horne (1986) and Bierman & Smidt (1993), inflation can be considered in investment analysis by using either nominal (money units) or real (purchasing power units) terms. They assert that the key aspect is that the analysis is done in a consistent manner. Nominal cash flows are to be discounted by a

nominal discount rate and real cash flows are to be discounted by a real discount rate. If consistency is not accounted for the analysis will be biased, resulting in an under or overestimation of the profitability of the investment.

2.16 TAXES

Corporate taxes are actual cash outflows and must be accounted for when evaluating a project's desirability. Taxes reduce the expected cash flows and a failure to consider them results in an overestimation of the present value. When calculating the after-tax cash flows it is crucial to consider the tax shield created by depreciation (Pike & Neale, 1996). Tax regulations do, in this case, influence expected cash flows through the depreciation tax shield (Levy & Sarnat, 1982).

The cost of capital should also be estimated after-tax. For levered firms the tax shield from interest rates has to be taken into account since it lowers the cost of debt. The higher the tax rate, the lower will be the effective cost of using debt (Levy & Sarnat, 1982). Dividends are, in contrast, not tax deductible (Honko, 1977).

2.17 CAPITAL RATIONING

The availability of funds for capital expenditures affects the firm's decisions. If a firm has unlimited funds for investment, making capital budgeting decisions will be quite simple. All independent projects that will provide returns greater than some predetermined level can be accepted. However, firms are not in such a situation. Firms operate under capital rationing. This means that they have only fixed funds available for capital expenditure hence numerous projects will compete for these funds. The firm must therefore ration its funds by allocating

them to projects that will maximize shareholders value. Capital rationing is a situation where a constraint (or budget ceiling) is placed on the total size of capital expenditure during a particular period.

2.18 ACCEPT OR REJECT APPROACH TO CAPITAL BUDGETING

The accept-reject approach to capital expenditure budgeting involves evaluating capital expenditure proposals to determine whether they meet the firm's minimum acceptance criterion. This approach can be used when the firm has unlimited funds, as a preliminary step and when evaluating mutually exclusive projects, or in a situation in which capital must be rationed. In these cases only the acceptable projects should be considered.

The second method, the ranking approach, involves ranking projects on the basis of some predetermined measure, such as the rate of return. The project with the highest return is ranked first, and the project with the lowest return is ranked last. Only acceptable projects should be ranked. Ranking is useful in selecting the best of a group of mutually exclusive projects and in evaluating projects in an environment of limited capital.

Independent projects

Independent projects are those where cash flows are unrelated or independent on one another. The acceptance of one project does not necessarily eliminate the other projects.

Mutually exclusive projects

Mutually exclusive projects are projects that are competing with one another. The acceptance of mutually exclusive projects automatically eliminates other mutually exclusive projects that are competing with one another.

Research and development projects

Traditionally, research and development projects absorbed a very small proportion of capital budget in most Ghanaian companies. Companies are now however allocating some funds to research and development projects, more so in knowledge intensive industries. Research and Development projects are characterized by numerous uncertain and typically involve sequential decision-making. Hence the standard discounted cash flows analysis is not applicable to them. Such projects are decided on the basis of managerial judgment. Firms, which rely more on quantitative methods, use decision tree analysis and option analysis to evaluate research and projects.

Mandatory investments

These are expenditure required to comply with statutory requirements. For example pollution controls equipment, medical dispensary, fire fitting equipment. These are often non-revenue producing investments. In analyzing such investments the focus is mainly on finding the most cost-effective way of fulfilling a given statutory need.

CHAPTER THREE

METHODOLOGY

3.1 POPULATION AND SAMPLING PROCEDURE

The population of this study included carefully selected church leaders in the Kumasi Metropolis. These people include, Bishops, Pastors, Stewards, Retired Pastors, members and theological students of Christian Service University College.

The mixed-method strategy was adopted for this study to reduce the possibility of personal bias by not depending on only one method of approach or response coming from one or two churches. A mixed-method strategy is one in which more than one method of approach is used in data collection and analysis while conducting research. This approach is similar to what Denzin, (1978) described as triangulation.

The sample techniques provided information from Orthodox, Pentecostal and Charismatic Churches in Ghana.

3.2 DATA COLLECTION METHOD

The main data used to gather information for this study are Primary and Secondary data.

3.2.1 Primary Data

The main methods used to collect the data elaborated below.

3.2.2 Interviews

Both structured and unstructured interviews were employed in this study. The structured was done face to face with some church leaders, administrators, members, and some retired pastors. This is aimed at getting the right answers to augment the research.

3.2.3 Questionnaire

Questionnaires used here were open-ended and close-ended. The open-ended questionnaires were used to allow the respondents answer in their own words without limiting them. The close-ended questionnaires were used to facilitate quick responses for the researcher. Both were prepared and distributed to some, church members, pastors, bishops and student pastors.

3.3 SECONDARY DATA

Library materials such as textbooks, financial reports of some churches and the internet were used to enhance the information to make it more vital.

3.4 SAMPLE SIZE

The questionnaires were distributed to 5 churches, ten (10) head of churches and twenty (20) church members.

3.4 DATA ANALYSIS

For the study to be comprehensive, the data was analyzed with tables, percentages, pie charts and bar charts to give it a pictorial meaning.

3.5 LIMITATION TO THE STUDY

Among some of the modest limitation or challenges encountered in conducting these studies are;

- Time frame for conducting this study was limited this makes it impossible to contact some of personalities as planned.
- Unwillingness on the part of the respondents to disclose certain vital information with all persuasion was another limited factor.

- Financial constraint in terms of transportation to meet some of the dignitaries or Men of God was a problem as some of them stay far off. The cost of printing, typing and internet charges also posed a challenge in this research.
- Finally, combining this with other academic work and studies also makes it difficult.

CHAPTER FOUR

RESULTS AND DISCUSSIONS

4.1 RESULTS

4.2 THE USE OF CAPITAL BUDGETS

It was revealed from the 29 questionnaires received representing 100% (hundred) do not make use of capital budgeting practice.

This is illustrated in the diagram below.

OPINION	FREQUENCY	PERCENTAGE (%)
YES	0	0
NO	29	100
Total	29	100

4.3 PROJECTS

From the questionnaires distributed, 18 respondents representing 39% had mission houses and buildings. Twelve (12) respondents representing 26% have schools. Eleven (11) respondents representing 24% have lands. Two churches (2) representing 4% have hospitals and those who had nothing are three (3) representing 7%. The information is summarized in the table below.

Table 2: The project used by the various church.

Project	Frequency	Percentage (%)
Mission houses/Buildings	18	39
Schools	12	26
Lands	11	24
Hospitals	2	4
Nothing	3	7
Total	29	100

This is illustrated in the bar chart below.

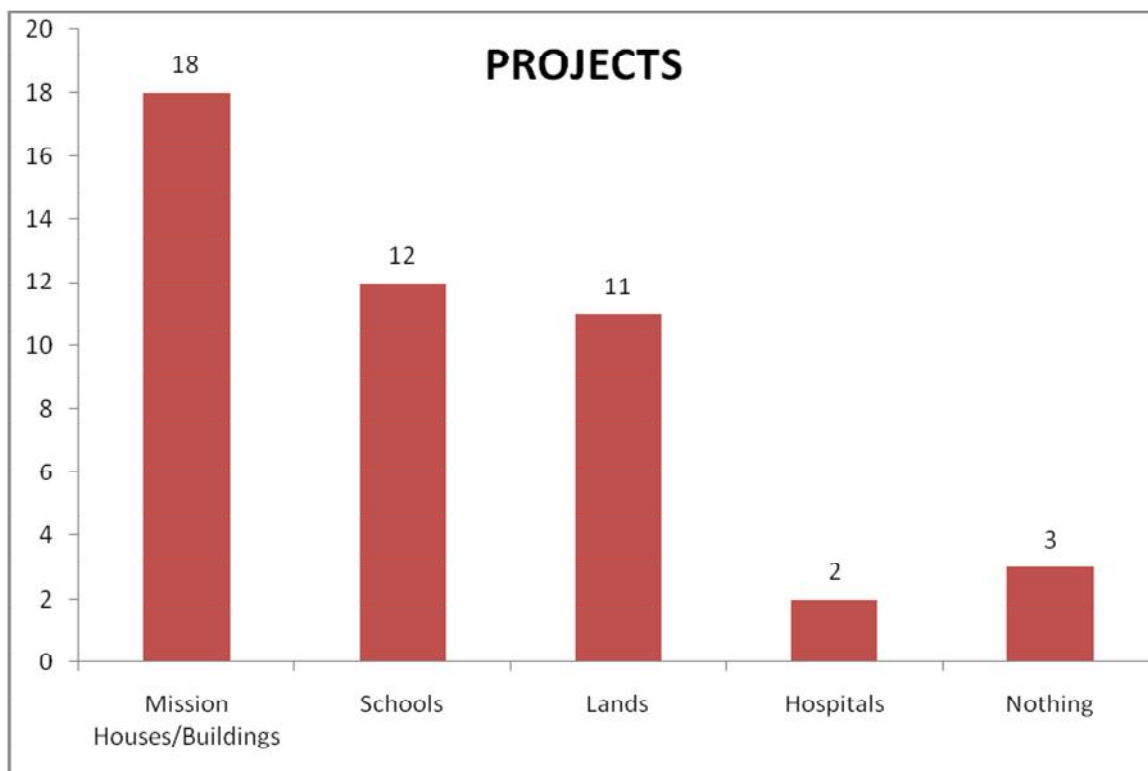


Figure 1: A bar chart showing the various types of projects being operated by selected churches in Kumasi.

4.4 SOURCES OF FUNDS FOR PROJECTS

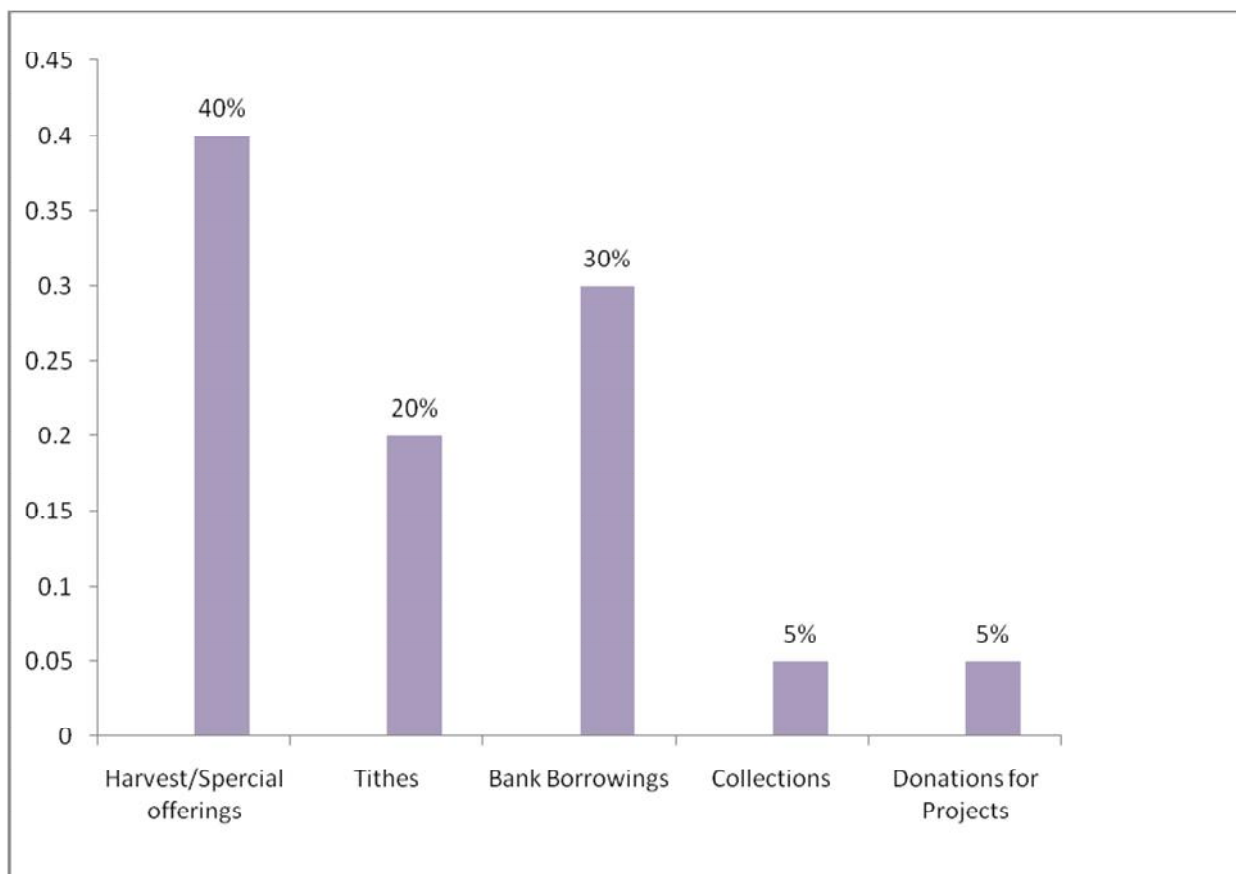
The sources of funds available for the church's activities or projects comprises the following, tithes, harvest and special offerings, collection and donations/appreciations. This applies to almost all churches except for some few differences. From the analysis, 40% of funds for projects are from harvest and special offerings, 20% constitute tithes, bank borrowing constitute 30% while 5% constitute collections and donations respectively. This is summarized in the table below.

Table 3: Sources of Funds

Sources of funds	Response	Percentage (%)
Harvest/Special offerings	12	40%
Tithes	6	20%
Bank Borrowings	8	30%
Collections	1.5	5%
Donations for Projects	1.5	5%
Total	29	100

The above information is used to illustrate in the Bar chart below.

Figure 2: A Bar chart showing the response on the sources of funds available to churches in our research findings.



4.5 PREPARATION OF BUDGETS

When a question was asked on their opinion with regards to the church's preparation of budget, 27 respondents representing 93% said that they do prepare budgets while two (2) respondents representing 7% do not prepare any budget. This table illustrates their opinion on the preparation of budget.

Table 4: Preparation of budgets

RESPONSE	FREQUENCY	PERCENTAGE (%)
YES	27	93%
NO	2	7%
TOTAL	29	100

The above table is illustrated below by a pie chart.

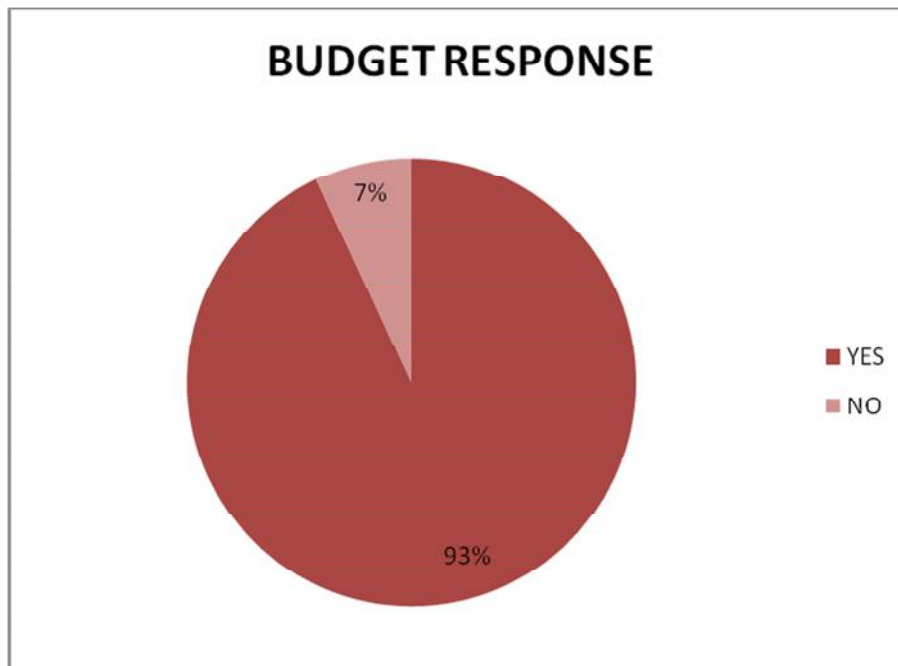


Figure 3: A pie chart showing the opinions on the preparation of budgets at some selected churches in Kumasi.

4.6 CAPITAL BUDGETING TECHNIQUES

Investigations reveal that none the churches use these techniques of capital budgeting in their capital investment appraisal representing (hundred) 100%. This is summarized in the table below:

Table 5: Capital Budgeting Techniques

METHOD USED	RESPONSE
NPV	NO
PAYBACK	NO
IRR	NO
ARR	NO

DISCOUNTED PAYBACK	NO
PROFITABILITY INDEX	NO

4.7 TYPES OF BUDGETING SYSTEM USED BY THE CHURCHES

According to the study, twenty (20) churches representing 69% use incremental budgeting system for their investment projects. Three (3) churches representing 10% used the rollover budgeting system in their investment projects. Only one church representing 3% made use of zero based budgeting system. The rest five (5) churches representing 18% do not make use of any budgeting system for their investment decisions.

This information is summarized in the table below:

Table 6: Types of budgeting system used by the churches

TYPES	NUMBER OF RESPONDEDNCE	PERCENTAGE
INCREAMENTAL	20	69%
ROLLOVER	3	10%
ZERO BASED	1	3%
NON	5	18%
TOTAL	29	100

The above information is illustrated in the pie chart below;

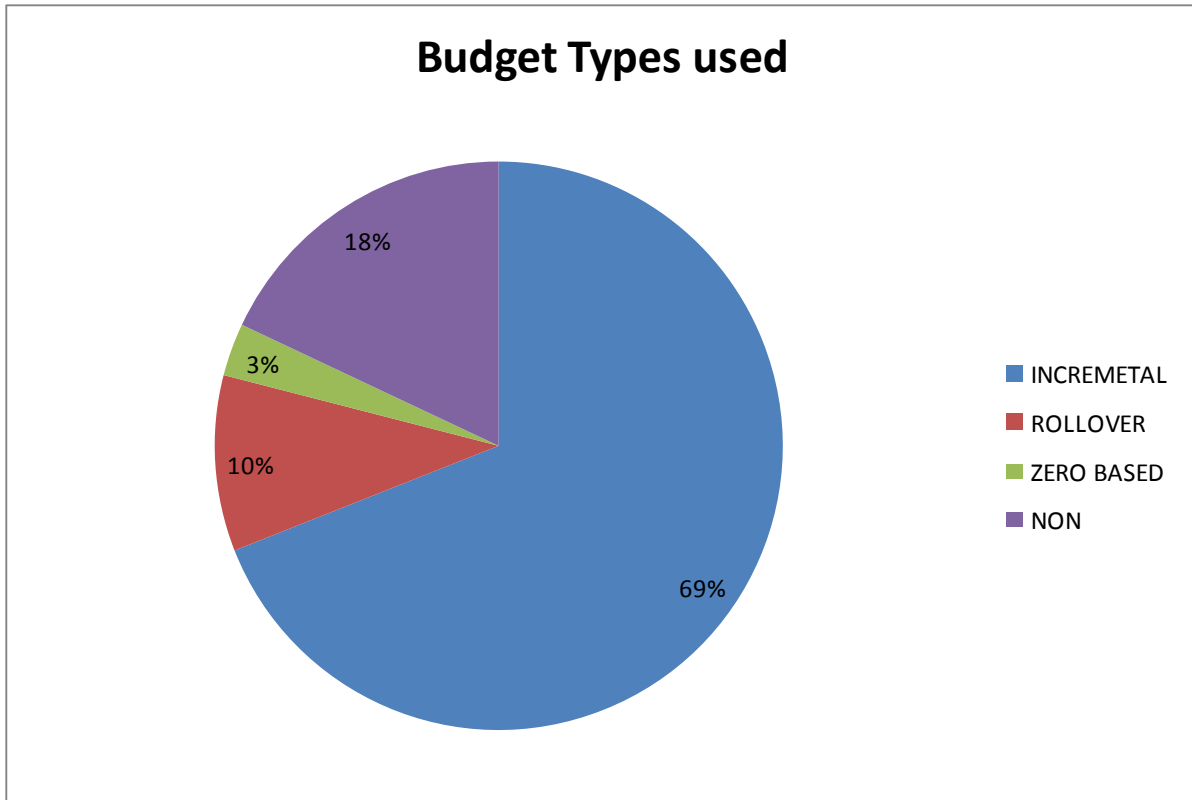


Figure 4: showing the types of budgeting systems used by churches

4.7 PROJECT IN PROGRESS

From the study, it is revealed that, eight (8) churches representing 28% has some of their projects in progress.

4.8 PERIOD OF COMPLETION

It was revealed that of the eight (8) churches whose projects are in progress, six (6) of them representing 75% should have been completed between 3 and 7 years ago but are still battling to complete them while some have even been abandoned and the resources wasted.

4.9 REASONS FOR THE DELAY OF PROJECTS

From the questionnaires and interviews, the following are some of the reasons for the delay of church projects;

- Lack of proper planning
- Lack of funds
- High cost of projects due to inflation.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 SUMMARY OF FINDINGS

5.1.2 Capital Budgeting Techniques.

Firms, Banks and other financial institutions normally will finance their projects with following characteristics:

- I. Shorter pay back periods,
- II. Higher returns on capital employed
- III. A positive net present value (NPV), implying that future cash flows from the project under review, expressed in their present value terms using an appropriate interest rate was positive, implying profitability of the project under review.
- IV. A positive internal rate of return (IRR) of the project, implying that the rate at which the project generates funds, relative to the cost of capital is positive.

From the study, the capital budgeting techniques used by the firms in the study, capital budgeting techniques; Payback Period, Accounting rate of return (ARR), Discounted cash flow including Net present value(NPV), and Internal rate of return (IRR)], none of the respondents have ever used them and seems not to have knowledge on what they mean or used for.

The other capital budgeting techniques like Payback Period, Accounting rate of return, Discounting cash flow and internal rate of return have never been used by the Churches studied.

Thus, the findings of the study run contrary to earlier studies done in US by Luoma (1967) and Grablowsky and Burns (1980). In Luoma's study 63% used the pay back method, 30% used the accounting rate of return and 22.2% used the discounted cash flow method.

It was revealed from the study that churches do not make use of capital budgeting practices because they believe they are not into profit making. Once the project will benefit the community(s) they don't regard its returns to the church.

Most of the churches studied do not have access to qualified finance personnel as they cannot afford to pay them well.

From the findings of the study enumerated above the following conclusions can be made.

5.2 CONCLUSIONS

On reflecting on the research work it can be said the aim and objectives have been achieved. Thus the study has tried to investigate into the Capital Budgeting Practices of some selected churches Kumasi and came out with some convincing findings to identify some factors which could be contributed to the inefficient usage of capital budgeting. Though the results of the findings may not be perfect but with the responses received from respondents, it may be assumed to have served the purpose of the study. As stated in earlier part of the study, this is an exploratory study, the prime objective of which is to encourage future research using large sample.

It is important that all the churches adopt and implement a sound capital budgeting system to ensure that projects are properly managed. Again, proper capital budgeting system should be in place to safeguard the church's assets or funds invested. Arranging the capital budgeting

system for the churches will serve as a source of employment to church members. It will also give the best financial position for the churches.

5.3 RECOMMENDATIONS

Professional accountants engaged in providing services to small firms should charge reasonable fees to enable these companies use their services. The inability of these small firms to pay the high fees charged by qualified accountants is often cited as the main reason why these companies avoid using their services. The qualified accountants should not also use the small fees being recommended to cut corners in the services provided to the small firms.

Church leaders or men of God should avail themselves with the various capital budgeting practices programmes organised by government and other bodies like; government-sponsored business support services such as the National Board for Small Scale Industries (NBSSI), Ghana Regional Appropriate Technology and Industrial Service (GRATIS), Empretec Foundation, and Ghana Chamber of Commerce and Industries, to polish their knowledge in Capital budgeting practices. This will help improve their investment activities as poor capital skills have commonly been identified with the churches studied.

The business of the church is not profit oriented but to win souls for Christ and to help society in general. It is not enough for the church to concentrate on soul winning but to also consider investment decision that will bring some kind of benefit and income to the people. Administrators of church funds should ensure that church projects are properly managed.

5.4 RECOMMEDATION FOR FURTHER STUDIES

For the purpose of further research, below are some suggestions;

- Administrators of church funds should ensure that church projects are properly managed.
- Future studies should investigate into financial management for Churches.
- Investigation should be conducted into working capital management for the churches.
- The sample size should be broad enough to cover other religious organizations

BIBLIOGRAPHY

1. Anthony, Robert N. and David W. Young (1994), *Management Control in Not-for-profit Organizations 5th Edition*, Richard D. Irwin, Inc., Boston, MA,
2. Ben Agyei-Mensah/SSRN
3. Bierman, Harold & Seymour Smidt (1993) *The Capital Budgeting Decision*:
4. Blazek, Jody, Financial (1996) *Planning for Not-for-profit Organizations*, John Wiley & Sons, Inc., New York, NY 1996.
5. Christy, G. A., (1967). *Capital budgeting: Current Practices and their efficiency*, Bureau of Economic Research, University of Oregon.
6. *Cost Management, Accounting and Control*, Hansen and Mowen, 3rd Edition. Decisions". New Jersey: Prentice Hall Inc. Third Edition. *Economic Analysis of Investment Projects*, New York: MacMillan.
7. Garrison Noreen (2000), *Managerial Accounting*, 9th Edition, McGraw-Hill.
8. Grablowsky, B. J., and W. L. Burns (1980), *The Application of Capital Allocation Techniques by Small Business*, *Journal of Small Business Management* 18 (3), 50-58.
9. Honko, Jaakko (1977) *Planering och kontroll av investeringar*, Stockholm:
10. Horngren, Charles T., George Foster, and Srikant M. Datar (1997), *Cost Accounting: A Managerial Emphasis* 9th edition, Prentice Hall, Upper Saddle River, NJ.
11. http://www.newsfromafrica.org/newsfromafrica/articles/art_7902.html, the population census report. Accessed on the 5th of December, 2010.

Introduced by Inflation (in Communications)", *The Journal of Financial and*
12. Levy, Haim & Marshall Sarnat (1986) "Capital Investment and Financial
13. Luoma, G. A. (1967), *Accounting Information in Managerial Decision-Making for Small and Medium Manufacturers*. Research Monograph No. 2, New York: National Association of Accountants.

14. Pike, Richard & Bill Neale (1999) *Corporate Finance and Investment*.
Prisma. *Quantitative Analysis*, Vol. 6, No. 1, January, pp. 653-658.
15. Sangster, A. (1993), 'Capital Investment Appraisal Techniques: A Survey of Current Usage', *Journal of Business Finance and Accounting*, 20(3), pp307-331.
16. Van Horne, James C. (1971) "A Note on Biases in Capital Budgeting

APPENDIX
QUESTIONNAIRES
CHRISTIAN SERVICE UNIVERSITY COLLEGE

This questionnaire is designed solely for academic purpose, your confidentiality is assured.

Please tick the option that is applicable to you and provide in writing where necessary.

1. What is the name of your Church?
2. Where can the Church be located?
3. Does the Church have any capital investments such as those listed below?
 - a. Schools []
 - b. Hospitals []
 - c. Lands []
Buildings (e.g. mission house, office) for the use of your pastors/church leaders []
 - d. Any other
.....
4. What are some of the ways in which funds are raised for the church projects? Tick where applicable.
 - a. collections []
 - b. Special offerings for projects/ Harvests []
 - c. Tithes []
 - d. Donations and appreciations []
 - e. Any other

5. Does the Church prepare Capital budget?
 Yes [] No []
6. What are some of the Capital Budgeting techniques used?
 - a. Net Present Value (NPV) []
 - b. Payback []
 - c. Internal Rate Of Return (IRR) []
 - d. Accounting Rate Of Return (ARR) []
 - e. Discounted cash flows []
 - f. Discounted Payback []
 - g. Profitability index []
7. Do your church employ expert in preparing capital budget?
 YES [] NO []
8. Does the church have any project in progress or yet to be completed?
 YES [] NO []
9. What is the expectancy period of the project be in place
 - 1-5 years []
 - 6-10 years []
 - 11-15 years []
10. What has caused the delay?
11. What type of Budgeting System do you use for your projects?
 - a. Incremental []
 - b. Rollover []
 - c. Zero Based []
 - d. Non []

12. What is your opinion about capital budgeting? Please specify in the space provided below.

.....

13. Do you personally support the use of capital budgeting as a performance tool in your church? Yes [☐] No [☐]

Your consent to participate in this survey is indicated by returning the questionnaire.

CAPITAL BUDGETING PRACTICES FOR CHURCHES IN KUMASI, GHANA.

**BY
MARFO JOSEPH NKRUMAH**

DENYIGBA ALBERT

MAHAMA ROBERT RUFAL

ALIMAM HAWA

AGYAPONG JOYCE

DISSERTATION SUBMITTED TO THE DEPARTMENT OF BUSINESS
ADMINISTRATION, CHRISTIAN SERVICE UNIVERSITY COLLEGE IN PARTIAL
FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A BACHELOR OF
BUSINESS ADMINISTRATION.

JULY, 2011

STATEMENT OF AUTHENTICITY

We have read the university regulations relating to plagiarism and certify that this report is all our own work and do not contain any unacknowledged work from any other source. We also declare that we have been under supervision for this report herein submitted.

NAME	SIGNATURE	DATE
Marfo Joseph Nkrumah
Denyigba Albert
Mahama Robert Rufai
Alimam Hawa
Agyapong Joyce

SUPERVISOR'S DECLARATION

I hereby declare that the preparation and presentation of the dissertation were supervised in accordance with the guidelines on supervision laid down by Christian Service University College

Supervisor's Name

Mr. Ben Agyei-Mensah
-----------------------------	-------	-------

Head of Department's Name

Mr. Stephen Banahene
-----------------------------	-------	-------

ABSTRACT

Capital budgeting plays a vital role in investment decision making. These decisions are crucial to the long term financial investment for not-for-profit organization. It involves huge amount of money committed for long periods of time and once the funds have been committed and the project has begun, it is difficult or impossible to reverse. Therefore churches with good capital budgeting decisions may benefit but those with poor capital budgeting decisions may suffer for many years.

The study is to enquire whether or not, Not-for-profit organization especially churches in Ghana practice capital budgeting in their investment decisions.

From the study, none of the respondents, representing 100%, have never used the capital budgeting techniques such as Payback Period, Accounting rate of return (ARR), Discounted cash flow including Net present value(NPV), and Internal rate of return (IRR)], and seems not to have any knowledge on what they mean or used for.

The nature of this study calls for both primary and secondary data collection. The main instruments used to collect the data were based on sampling questionnaires and interview of which the analysis being presented with percentages, bar and pier charts.

The outcome of the study conducted revealed that it is a welcoming idea for churches in their investment decisions but it was unfortunate that it did not received enough recognition by many churches from our sample size chosen.

Nevertheless, we hereby recommend that all the churches should be actively involved in the use of capital budgeting in their investment decisions.

ACKNOWLEDGEMENTS

The completion of this Research work has been possible thanks to the Almighty God for the strength, health and wisdom and to a number of people.

First of all, we would like to acknowledge our gratitude to Mr Ben Agyei-Mensah, who has invested a lot of time and effort in supervising us throughout the research work. His brilliant suggestions, essential comments and ideas have been of the greatest importance to this work. Without his efforts, the accomplishment of the work would not have been possible. Finally, we would like to express our thanks to all those, who answered the questionnaires and interview questions and thereby helped us with the completion of this work.

Thanks to all of you for your help!

DEDICATION

We dedicate this research work to the Almighty God for his protection and wisdom granted to us, Our Supervisor Mr. Ben Agyei-Mensah of Christian Service University College, Our parents and guardians and all the churches studied whose contributions made this work possible.

TABLE OF CONTENT

	Page
CHAPTER	
ONE	INTRODUCTION OF THE STUDY
	Background of the Study 1
	Problem Statement 3
	Objectives of the study 3
	Research Question/Hypotheses 3
	Significance of the research 3
	Organization of chapters 4
TWO	LITERATURE REVIEW
	Budget 5
	The Purpose of Budgeting 5
	Budget Planning Issues 6
	Zero-Based Versus Incremental Budgeting 7
	Benefits of Budget Preparation 8
	Steps in Preparing A Budget 9
	Capital Budgets 9
	Nature of Investment Decisions 10
	Typical Capital Budgeting Decisions 10
	Types of Capital Expenditure That Will Be Evaluated Using 11

Capital Budgeting Techniques	11
Importance of capital budget	12
Capital Budgeting Process or Stages	13
Capital Budgeting Techniques	17
Features of Capital Budgeting Evaluation Techniques	17
Payback Period	18
Accounting Rate of Return (ARR)	18
Net Present Value (NPV)	19
Profitability Index (PI)	19
Discounted Payback Period	19
Internal Rate of Return (IRR)	20
Cash flow Planning	20
Inflation	22
Taxes	23
Capital Rationing	23
Accept or reject approach to capital budgeting	24

THREE METHODOLOGIES

Population and sampling procedure	26
Data collection method	26
Primary data	26
Interviews	26
Questionnaire	27

	Secondary data	27
	Sample size	27
	Data analysis	27
	Limitation to the study	27
FOUR	RESULTS AND DISCUSSIONS	
	RESULTS	29
	The use of Capital Budgets	29
	Projects	29
	Sources of funds for Projects	31
	Preparation of Budgets	32
	Capital budgeting techniques	33
	Types of budgeting system used by the churches	34
	Project in progress	35
	Period of completion	35
	Reasons for the delay of projects	36
FIVE	SUMMARY, CONCLUSION AND RECOMMENDATION	
	Summary of Findings	37
	Capital Budgeting Techniques	37
	Conclusion	38
	Recommendations	39
	Suggestions for Further Research	40

BIBLIOGRAPHY	41
APPENDIX A questionnaire of passengers	43

LIST OF FIGURES

	Page
Figure 1: Projects	30
Figure2: Sources of funds for Projects	32
Figure 3: Preparation of Budgets	33
Figure 4: Types of Budgeting system used by Churches	35

LIST OF TABLES

Table 1: The Use of Capital Budgets	29
Table 2: Projects	30
Table 3: Sources of Funds for Projects	31
Table 4: Preparation of Budgets	32
Table 5: Capital Budgeting Techniques	33
Table 6: Types of budgeting system used by the churches	34