Charity finances:

Common questions and problems

Know your charity's financial position

Your charity should have a budget. Check that it is being used. It helps to make sure you have realistic plans based on how much money your charity:

- currently has,
- plans to raise,
- plans to spend each year.

By checking how much your charity receives and spends against the budget, you can identify problems in good time and agree what to do about them. It's particularly important to do this where you see big differences between the budget plans and what is being spent.

The National Council for Voluntary Organisation's budgeting guide explains charity budgeting and planning in more detail. There is a useful funding and income planning tool – it's a pre-built spreadsheet that calculates your income percentages when you input your current funding and future targets.

Keep accurate financial records

Make sure that your charity keeps records to show all the money coming into your charity and the money it spends to help it meet its aims. You should check whether your charity's governing document has any specific rules on record keeping and follow them if it does.

Check that your charity has adequate records to show:

- details of money received and spent by the charity – for example bank statements and minutes of any meetings where significant decisions were taken,
- the charity's assets and liabilities.

These records are used to prepare the accounts which you should approve.

You must ensure that your charity keeps accounting records for:

- 6 years for a charity that is not a company.
- 3 years for a company charity.

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Management accounts

The key to management accounts is not what they look like but what they are for – they are financial information that helps managers and trustees:

- Monitor progress and performance
- Make effective decisions
- Plan for the future

Good management accounts should:

- be accurate and up to date
- be presented clearly – less is more, put the detail in the appendices
- tell a story – this is at least as important as numbers

You can experiment with graphics - but think about the trade-off between the quality and time you take to produce the report.

You should know what you want from your reader: decisions, advice, approval – it's much easier as a reader to know why you are reading something.

Focus on relevant information

As a starting point, management accounts should cover:

- summary/highlights
- comparison of actual income and expenditure to date against budget
- forecast income and expenditure to year end compared with budget
- updated cashflow forecast
- details of movements on restricted funds

Think about management accounts as the translation of the organisation's activity into money – they should reflect what the operational staff are telling you about how your organisation is doing. If staff say things are going well, the finances should be looking strong - probably on budget or better. If they say things are poor, the finances should look off.

Points to check on the management accounts:

- Are income and expenditure to date broadly in line with budget to date?
- Are there any significant differences?
- If so, what is the reason for them and what action needs to be taken on them?

- Is there a surplus or deficit? How does this compare with the budgeted surplus or deficit?
- Are there any restricted funds? If so, are the balances on restricted funds and the unrestricted funds shown separately?
- Is there a big funds balance? If so, is it being invested wisely?
- Is the unrestricted funds balance in line with the organisation's reserves policy?
- Are there any large amounts owing to the organisation? If so, who is chasing them up?
- Does the organisation owe any large amounts? If so, when will they be paid?
- Are the grants due during the remainder of the year guaranteed?
- What will be the likely financial outcome at the end of the year?
- Do you want the financial outcome to be different? If so, what do you need to do to achieve this?
- Is the organisation on target for its outputs?

How can particular funds be used?

When it comes to the type of funds a charity can receive, you need to pay special attention to two in particular.

First, there are unrestricted funds, which can be spent however the charity sees fit, and then restricted funds, which can only be spent on the purpose the money was given.

Being able to spot the types of funds your charity receives and whether they are being used correctly is essential for compliance purposes but will also ensure you can avoid a funding crisis because the money in the bank is restricted in some way.

Be wary when you're reading the accounts of a charity shop because if it receives over £50,000 worth of donated goods, it will appear alongside the 'cost' of running the shop.

So, if you see a huge amount of money going towards the running of the charity, stop and look at the value of donated goods, first.

Financial Ratios

Financial Ratios are a quick measurement tool which you can use to identify upward and downward trends in your numbers.

Do you know which financial ratios to use for your charity?

Measurement for fundraising efficiency:

Fundraising revenue

Fundraising expenditure

Also known as the "fundraising multiplier", this is a measure of the effectiveness of fundraising and can be calculated overall or by event / activity. It calculates the "return on investment" or "ROI" of the various fundraising activities carried out, and the higher the number above 1, the more successful the fundraising activity.

For example, if you raise funds of £33,000 with fundraising expenditure of £12,000 your "fundraising multiplier" is 2.75.

The aim is to increase that number so that the funds raised cover the cost of raising funds many times over. This helps to provide evidence of your impact.

Charities will not always make their decisions based on the ROI alone as some activities generate non-monetary value in areas such as profile raising in the community, recruitment of volunteers and outreach to the beneficiaries the charity aims to support in its mission.

Measurement for earned income:

Earned income

Unearned income

Another useful ratio for donors and funders is the ratio of earned to unearned income. For example, a charity may have £150,000 of earned income and £200,000 of unearned income and a target ratio of 1:1 i.e., equal parts earned and unearned income.

A charity that has a healthy proportion of well-diversified earned income (via trading, running events, investment income, performance-related grants and contracting for services) compared to unearned (non-performance-related grants from funders and donations from individuals) is likely to be more sustainable and more able to weather income downturns.

Review your charity's internal financial controls

You should review your charity's internal financial controls at least once a year.

Use a checklist to check your charity's internal finance controls against the legal requirements and good practice recommendations such as this Charity Commission one:

Internal financial controls for charities (CC8).

Make sure on funding bids you explain how your finances are managed and the balances and checks that are in place. For example, payments always require two signatories or authorisations.

Reserves

A reserves policy will be very specific to your charity. All charities have different funding streams and activities so the amount of money you need to hold in reserves will probably be different to other charities. It is important that you carefully consider the level of reserves your charity needs.

Why might you need reserves?

To understand why you might need reserves you first need to understand your charity's financial position and how this links with your charity's activities. Budgets and future plans need to be considered, in particular any uncertainty over future income or the risk of unexpected expenditure.

Particular areas to consider are:

- Funds to allow for unforeseen emergencies or other unexpected needs, for example an unexpected repair bill or requiring funding for an urgent project.
- Unforeseen day to day operational costs, such as cover for long-term sick absence.
- Grant income not being renewed, and how much notice you would get if this were the case.
- Planned commitments which may need higher levels of reserves.
- Funds to allow for increased beneficiary need - external changes may mean your charity receives additional beneficiaries.
- The need to fund short-term deficits in a cash budget, for example money may need to be spent before funding is received.

How much do you need in reserve?

You need to think about the reasons you might need reserves and the amount you would need for each reason.

The following are some other considerations to keep in mind:

Does my organisation name on the bank account need to be the same as the organisation name I've given on the application form?

Yes, it must be the same. The organisation name on the account must also be the same as what is registered on any registration websites such as Charity Commission or Companies House. This is one of the main reasons for rejection of a funding application.

What does your risk register look like? Do you have a risk register?

If not, then the trustees may not have a clear sight of any issues that may be bubbling under the surface that could cause problems later on.

If you do have a risk register, then assess which things are the most likely to occur and which are going to have a big impact if they do turn up.

Bank signatories

You should have at least two unrelated signatories to your bank account and require both signatures (or two out of three) to release any expenditure.

Financial investment

The purpose of financial investment is to yield the best financial return within the level of risk considered to be acceptable - this return can then be spent on the charity's aims. The Charity Commission provide guidance on this.

In order to act within the law, trustees must:

- know, and act within, their charity's powers to invest (legal requirement)
- exercise care and skill when making investment decisions (legal requirement)
- select investments that are right for their charity; this means taking account of:
- how suitable any investment is for the charity
- the need to diversify investments (legal requirement)

- take advice from someone experienced in investment matters unless they have good reason for not doing so (legal requirement)
- follow certain legal requirements if they are going to use someone to manage investments on their behalf (legal requirement)
- review investments from time to time (legal requirement)
- explain their investment policy (if they have one) in the trustees' annual report (legal requirement)

What are the options when a charitable company is facing insolvency?

When the trustees/ directors of a charitable company know, or ought to know, that there is no reasonable prospect of avoiding insolvent liquidation they must from that time take every step necessary to minimise the potential loss to the company's creditors. Paying professional fees for advice obtained is justifiable if incurred with a view to ensuring the best outcome for the charity's creditors.

Early identification of potential insolvency will mean more options and more time to explore and implement those options. Some of the things that can be considered:

- Obtaining new funding
- Amendments to existing financial commitments and facilities
- Engagement with stakeholders for assistance
- Reduction in expenditure/reviewing service provision
- Realisation of surplus assets
- Mergers with other charities or organisations
- It may be possible to enter an arrangement with creditors.