Community &
Voluntary Services
cheshire east

Good Financial Management

Tuesday 17th November 2020

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Welcome

Outcomes for the Session

Understand the key financial controls you should consider
Understand what to consider in the development and monitoring of Budgets

Your Outcomes

What do you want to gain from the Session?

Financial Responsibilities

Trustees are responsible for directing the affairs of the charity and ensuring that that organisation is solvent, well-run and delivers public benefit.

You must manage your charity's resources responsibly

- **make sure the charity's assets are only used to support or carry out its purposes**
- **avoid exposing the charity's assets, beneficiaries or reputation to undue risk**
- **not over-commit the charity**
- **take special care when investing or borrowing**
- **comply with any restrictions on spending funds or selling land**

Key areas you need to consider that we will cover today

- **Monitoring Activities**
- **Financial Controls**
- **Internal Audit committee**

CC3 Charity Commission Guidance

Financial Controls

Charities must follow the legal requirements and good practice recommendations set out in the commission's guidance on internal financial controls for charities. The Charity should review their procedures at least once a year.

Key within Financial Controls

- **Develop Procedures for keeping cash safe, recording and reporting transactions**
- **Review these procedures regularly**
- **Internal audit committee – or a Finance Committee - this would monitor the budget and financial procedures.**
- **Prepare and File Accounts**
- **Identify and Monitor financial risks**

https://www.gov.uk/guidance/managing-charity-finances

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Financial Controls

Sections within the Financial Procedures document.

1. Overall Financial Controls - Covers;

- **Responsibilities of Board, Audit Committee, Staff**
- **Segregation of duties**
- **Internal Audit process**
- **Appointment of external auditor for accounts**

Budgets

2. Budget Setting and Approval

- Budget Setting - Who is responsible for creating
- Budget Content – what you may be considering including
- Budget Planning Cycle – dates, actions and responsibilities
- Budget Revisions – how are these approved
- Budget Holders – who they are and authorisation levels

Staff	Certify details on transaction as correct	Authorise payment	Authorisation level
Chief Executive	√	√	Up to £10,000
Finance Manager	√	√	Up to £500
Budget Holder	√		Up to £500
Finance & Compliance Sub Committee		√	Between £5,000 and £10,000
Board of Trustees		√	Over £10,000

Timescale	Action	Responsibility
Monthly reports, quarterly reviews	Meetings with budget holders to review year to date and implications for next year's budget	Chief Executive and Finance Manager
Monthly meetings and quarterly reviews	Gap analysis	Chief Executive and Management team
September - December	Budget preparation	Chief Executive
January / February meeting	Draft budget submitted to Audit Committee	Chief Executive
March board meeting	Budget revised according to Audit committee requests and submitted to Board for approval	Chief Executive
April	Approved budgets distributed to budget holders	Finance Manager

Planning a Budget

What is a Budget?

- It’s a financial Plan

Why have a Budget?

- Control our finances
- Monitor our income and expenditure
- Understand what it costs to run the service

Types of Budget

- Incremental Budgeting – Building on a previous budget
- Zero Budgeting – starting from scratch

How are your accounts/budget produced

Receipts and Payments – recorded at a cash basis

Accruals – accounting in the period but may not be paid then e.g. invoice driven

Setting and Approving of Budget

- Involvement of staff and volunteers
- Formal approval from Trustees and Committee

Planning a Budget

Discussion

- Do you have a budget?
- How do you prepare this?
- What do you need to do differently?
- Or any Questions

Management Reports

3. Management Reports – Monitoring your finances

Two types of Reports
- Financial Report
- Cash flow report

Financial Report – Management Accounts
- provide a regular check of the income and expenditure
- Enable monitoring of variances

Cash Flow- Show the predicted income and expenditure
- Are you able to meet your obligations

For both reports need to consider
- How and who they are prepared by
- Who they are distributed to
- Who reviews and analyses them

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Management Reports

Tools to monitor and report – Example Spreadsheet

Excel – This can be used to provide reports to the relevant stakeholders and can be a way to manage the financial data

Benefits – most people are familiar with and can set up budgets

Cons- this is not secure and can be easily changed – incorrect formuleas

Budgeting Software

e.g. Calaxa - links to your accounting software and can produce reports in a preformatted way.

Benefits – links to your accounting software so will contain all data

Cons – there is a cost and you need to learn how to use it.

Would recommend that if you are paying staff or have contracts that you consider using an accounting package e.g. Sage, Xero, Quickbooks

These secure your finances and mean they are auditable and you can identify funding between projects.

Financial Controls

4. Transactions

Income

How you processing Money Received/Income

- Via Post
- Cash
- Cheques
- BACS
- Fundraising platforms

Managing Invoices

- How they are produced – what triggers this?
- What information must be on an invoice

Essential Info

- Date of Transaction
- Amount
- Name of person involved
- Brief Description of transaction

4. Transactions

Expenditure

- Process on major purchases
- Processing Payments – back to approval levels
- Debit Cards – accounting for spend

- Bank Account reconciliations
  - When they take place and how differences are picked up
- Staff Expenses including advance of expenses/cash
- Petty Cash

Again - Essential Info

- Date of Transaction
- Amount
- Name of person involved
- Brief Description of transaction

Planning a Budget

Discussion

- Do you produce Management Accounts?
- What challenges have you had with this?
- Or any Questions

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Financial Controls

Additional Headers to consider

- Payroll
- Pension
- Declaration of Interests / Conflict of Interests
- Insurance – level maintained and why
- Fixed Assets
    - Inventory
    - How they are shown on the accounts
    - Funder requirements
- Data Retention
- Funding bids protocol
- Investments
- Anti Fraud
- Trading Arm

Accounts - Requirements

<table>
<tr><th>Charitable companies and unincorporated organisations</th><th>Charitable incorporated organisations (CIOs)</th></tr>
<tr><td>Income under £10,000
You only need to report your income and spending.</td><td rowspan="2">You must answer questions about your charity in an annual return and include PDF copies of your:
• trustee annual report
• accounts</td></tr>
<tr><td>Income between £10,000 and £25,000
You must answer questions about your charity in an annual return.
You do not need to include any other documents.</td></tr>
<tr><td colspan="2">Income over £25,000
You must answer questions about your charity in an annual return.
You will need to get your accounts checked and provide PDF copies of your:
• trustee annual report
• accounts
• independent examiner’s report

You also need a full audit if you have:
• income over £1 million
• gross assets over £3.26 million and income over £250,000</td></tr>
</table>

Accounts - Requirements

Questions in annual Return – Charity Commission	Charitable Companies
The questions you will be asked depend on your income, the type of charity and what the charity does. You may be asked about: • financial information, like income and spending • income or contracts from central government or local authorities • income from or work done outside the UK • trading subsidiaries • trustee payments • staff salary bands and benefits	If you are a charitable Company and are registered with Companies house you also need to submit your accounts with them.

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CVS Cheshire East webinar – Financial difficulties in charities

Tuesday 17 November 2020

Graeme Hughes, Partner, Charities

Introduction and content

- Serious incident reporting
- Trouble ahead..?
- Insolvency, pitfalls and personal liability
- COVID-19 special measures

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Serious incident reporting (1)

Definition

- https://www.gov.uk/guidance/how-to-report-a-serious-incident-in-your-charity

A serious incident is an adverse event, whether actual or alleged, which results in or risks significant:

- harm to your charity's beneficiaries, staff, volunteers or others who come into contact with your charity through its work (who are collectively referred to throughout this guidance as people who come into contact with your charity through its work);
- loss of your charity's money or assets;
- damage to your charity's property;
- harm to your charity's work or reputation.

For the purposes of this guidance, "significant" means significant in the context of your charity, taking account of its staff, operations, finances and/or reputation.

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Serious incident reporting (2)
What to report - examples

- Sudden loss of 20% or more of charity’s income (e.g. due to termination of major donor contract); charity has no reserves, meaning staff will be laid off and services stopped.

- The charity has lost a substantial portion of its income during the pandemic, for example due to the enforced cancellation of fundraising events. As a result of this, the charity is:

    - unable to deliver vital services to at risk beneficiaries; and/or
    - insolvent and/or forced to close permanently; or
    - highly likely to be insolvent and/or forced to close permanently within the next 12 months.

Serious incident reporting (3)
Why report

- The Commission needs to ensure trustees comply with their duties.
- The Commission may need to provide regulatory advice or guidance or use its statutory powers.
- The Commission can assess the risk to other charities – to measure the volume and impact of incidents within charities, to identify trends and to understand the risks facing the sector as a whole.
- If the media contact the Commission about an incident and it has been properly reported, we will be able to say that the trustees handled the situation responsibly and this will help protect the charity's reputation.
- Because the regulator tells you to…

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Trouble ahead (1)
Trustee duties

- A significant financial problem should not ordinarily come as a surprise to the trustees.
- Trustee duties and responsibilities - regularly assess and monitor the overall financial position of the charity, receive and consider robust, up to date financial management information.
- Professional advice - via the audit or independent examination, management accountants, external review, etc?
- Minutes.

Trouble ahead (2)
Understanding funds

- Trustees must understand the nature of the funds they hold. When considering the tests for insolvency an understanding of the funds of the charity and how and when they can be applied is crucial.

- *Unrestricted funds*: Available for general use for any or all of the charity's permitted activities. Includes funds that have been designated for particular purposes by the trustees of a charity. These funds can be allocated against any potential liabilities of the charity.

- *Restricted income funds*: Can only be expended in accordance with specific restrictions. These arise either by the wishes of the donor or by the nature of the appeal. These funds can only be used for the purposes of the special trust that created the restriction. Possible to seek clearance from the Charity Commission or the original donors to vary the terms of the restriction.

- *Restricted capital funds*: Not for direct application. Where the trustees have no power to apply capital as income it will be permanent endowment. Where the trustees have a power to expend it if necessary, this will be expendable endowment. An expendable endowment should be treated as capital until the right to expend it is exercised in which case it should be transferred to income prior to application. Permission can be sought from the Commission to use endowments in certain circumstances.

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Trouble ahead (3)
Options

- Review and restructure your organisation – Trading subsidiaries making losses? Redundancies? Leases? Contractual obligations?

- Stop some activities – Check funding agreements. Check objects? Mon-“core” services that eat into surpluses? Could lead to redundancies.

- Find new sources of income…

- Merge or collaborate.

- Close the charity – an early but orderly winding up of the charity could be the best solution.

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Trouble ahead (4)
Merger

"*For organisations with their backs against the wall, the merger proposition now may be: the preservation of something versus the potential disappearance of everything*"

- Starting point is always what is in the charity's best interests and in the best interests of its beneficiaries.

- "Full" merger by asset transfer - A and B transfer their staff, assets and activities to a new organisation C with similar objectives. Organisation C continues as the operating entity; or A transfers its staff, assets and activities to B, with B continuing as the operational entity. A then winds up or is kept as a shell.

- Merger by change of control / group structure – A takes control of B. This happens by them becoming the sole member or trustee of the other, but without any transfer of assets and liabilities.

Trouble ahead (5)
Closure

- A solvent winding up, settling all liabilities and realising all assets before transferring the surplus for charitable purposes the same as or similar to those of the closing charity.

- Redundancies? Pensions issues?

- Termination of existing contracts.

- Sale of property / termination of leases – Charities Act restrictions.

- Consult with / inform beneficiaries – overriding trustee duties will still apply.

Insolvency (1)
What is insolvency

- There is no statutory definition of "insolvency". However, the Insolvency Act 1986 adopts the concept of "*inability to pay debts*“.

- Broadly speaking, a charity is deemed to be insolvent where either:

  - It is unable to pay its debts as they fall due (*the cash flow test*);
  - The value of its assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities (*the balance sheet test*).

- Charity trustees who are concerned about the financial position of their charity must consider their actions carefully and take specialist advice.

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Insolvency (2)

Structures – unincorporated trusts and associations

- Charitable trusts and charitable unincorporated associations are not legal entities; they have no separate legal personality. This means that contracts and other obligations cannot be entered into by or with, and property cannot be held by, the unincorporated charity itself.

- Trustees therefore (i) hold the legal title of an unincorporated charity's property on trust for the charity's specific charitable purposes; (ii) enter into contracts and other obligations on behalf of the charity in their personal capacity; and (iii) are responsible (as charity trustees) for managing and administering the affairs of the charity.

- Where the trustees are individuals, they are personally jointly and severally liable for fulfilling the charity's obligations. This means that day-to-day liabilities (such as, in contract or tort) incurred in the normal course of the unincorporated charity's activities are the personal liabilities of the trustees.

- The trustees are entitled to be indemnified out of the assets of the charity for all debts and other liabilities properly incurred in the performance of their duties.

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Insolvency (3)

Structures – unincorporated trusts and associations

- However, if the charity's assets are insufficient to meet those liabilities, the charity's trustees will potentially have unlimited liability to meet any shortfall from their personal assets (subject to any contractual limitation on their liability they may have been able to negotiate).

- If the assets held on trust for the charity's purposes are insufficient to discharge those liabilities, together with their own liabilities, then the trustees will be insolvent.

- In the case of a charitable unincorporated association, the members may be liable to contribute towards the payment of the charity's debts and the expenses of winding up and similar considerations of personal insolvency may apply.

- In an insolvency situation, the potential risk of personal liability is therefore much higher for a charity trustee of an unincorporated charity than for a charity trustee of an incorporated charity.

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Insolvency (4)
Structures – incorporated charities

- An incorporated charity has a separate legal identity. It owns assets, holds property, employs staff, enters into contracts and other obligations, and can sue and be sued in its corporate name.
- Liabilities incurred in the normal course of its activities are entered into by the corporate body, and not its charity trustees personally.
- If the corporate body's assets are insufficient to meet its liabilities, it (and not the charity trustees) will be insolvent.
- Insolvency of an incorporated charity is therefore much less likely to impact on the solvency of its charity trustees, as they would not ordinarily be required to contribute towards the incorporated charity's debts.
- However, charity trustees of incorporated charities do not have blanket protection and can face potential personal liability in limited but important circumstances when their charity becomes insolvent.

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Insolvency (5)
Other risks for trustees

- Once a charitable company or CIO (or CCBS) becomes insolvent, the charity trustees risk personal liability if they allow the charity to continue to trade when it is insolvent – wrongful trading.

- Wrongful trading arises if the trustees knew or ought to have known before the commencement of liquidation or administration that there was no reasonable prospect that the charity would avoid going into insolvent liquidation or insolvent administration.

- The liquidator or administrator of the charity can seek a court declaration that the charity trustee contribute to the assets of the charity.

- This, in effect, means that the charity trustees of an insolvent charity have a duty to protect creditors, which overrides their usual duty to further the purposes of the charity.

Insolvency (6)
Other risks for trustees

- Similarly, if during the liquidation or administration of a charitable company or CIO (or CCBS) it appears that any business of the charity has been carried on with the intent to defraud creditors, or for any other fraudulent purpose, the liquidator or administrator can seek a court declaration that anyone who was knowingly party to the fraudulent business make a contribution to the assets – fraudulent trading.

- The fraudulent trading provisions apply more widely than the wrongful trading provisions in that they extend to any person who was knowingly party to the fraudulent business and so could apply to persons other than the charity trustees.

- In addition, anyone who was knowingly party to the fraudulent activities commits a criminal offence.

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Insolvency (7)

Other risks for trustees

- Reviewable transactions.
- Disqualification orders.
- Trustee disqualification.
- Breach of trust – Irrespective of the legal form a charity takes, all charity trustees are vulnerable to claims by their fellow charity trustees, the charity itself (if it is incorporated), the Commission or the Attorney General acting on behalf of the charity, if they have acted in breach of trust or breach of duty and loss has been caused to the charity as a result. The claim is likely to be for restitution, to recover the loss caused to the charity by the charity trustee's breach of trust or duty but generally speaking, the courts and the Commission are slow to require restitution from charity trustees unless they have acted knowingly or recklessly in breach of their duties.

Insolvency (8)
If insolvency is a concern…

- Take advice and be very aware of potential for personal liability.
- The availability of formal insolvency procedures depends entirely on the type of legal structure of the charity.
- However, trustees should aim to be taking advice before insolvency arises. The earlier trustees recognise and understand the financial challenges, the more options will be available to them.

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COVID-19
Special measures

- Corporate Insolvency and Governance Act 2020.

- Restrictions on winding-up petitions.

- To assist companies and CIOs to continue trading during the COVID-19 pandemic, liability for wrongful trading was been suspended during the period 1 March to 30 September 2020. Much publicised but it was not extended so normal rules are back in force.

Q & A

Thank you

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