Finance from a governance perspective

Dorothy Dalton outlines the minimum financial knowledge that all trustees should have in order to start to properly discharge their duties.

Many trustees feel that they do not know enough about finance generally, and charity finance in particular, to fulfil their responsibility for sound financial governance. Most boards have at least one trustee who is strong financially. It is important however that all trustees play their part in financial decisions and financial monitoring. For the trustee who is not strong on finance, I list below what I believe are the minimum requirements for all trustees.

The basics

It is important for trustees to understand fully what the different fund types are and exactly what they mean. This should be part of their induction.

All trustees need to know about:

- restricted,
- unrestricted, and
- designated funds.

If the charity has endowments, then make sure trustees understand:

- permanent endowments, and
- expendable endowments.

Also trustees need to be introduced to Sorp (Statement of Recommended Practice – revised in 2015 and coming into effect now) and its key requirements.

The budget

Trustees should ask about:

- How the budget ties in with strategic priorities and the business plan;
- For this year's budget, the assumptions on which the budget is based;
- The major risks relating to the current budget and how they are being managed.

Measuring financial performance

Management accounts

Trustees need to understand why management accounts are a key financial tool (ie measure progress against budget) and what to expect by way of documentation ie:

- compare this year's monthly 'actuals' with the same set of figures for the previous year;
- compare the year to date with the budget;

- provide forecasts of what the end-of-year figures might look like; and
- significant variations from budget, or the same period in the previous year, are explained in the introductory narrative.

Financial ratios and other key performance indicators (KPIs)

Trustees should be aware that each board has a responsibility to decide on the financial ratios or other financial KPIs that they would like to monitor and the importance of tracking these statistics over time.

Examples of ratios and figures that might be tracked:

- for each type of fundraising (eg voluntary donations, legacy, shops) the most common ratio monitored is cost of raising funds to funds raised;
- charities delivering residential care (eg care homes, hospices, hotels) will almost certainly want to monitor and track occupancy rates at each residential base;
- service delivery charities may wish to measure the cost of delivering one unit of care eg one hour, one day or one week;
- charities using temporary agency staff might want to monitor numbers and cost of agency staff and compare these with the cost of an employee doing the same job for the same period of time.

Use of graphs to illustrate trends or to compare ratios can also be helpful.

The SOFA, balance sheet and cashflows

Trustees who are unfamiliar with charity finance need to be talked through the *Statement of Financial Activities (SOFA)* and explained why charity accounts are different (ie the importance of columns showing restricted and unrestricted funds). They need to know that the SOFA is essentially the income and expenditure account.

The balance sheet might need to be explained and how it gives a picture of the charity's assets, liabilities and reserves on the day that it was drawn up, ideally giving:

- designated funds,
- restricted funds;
- unrestricted funds (including fixed assets),
- unrestricted funds (excluding fixed assets)
- free reserves (ie all funds minus fixed assets, endowments and restricted and designated funds)

Cashflow projections are also valuable. They give a picture of receipts and payments in each period and anticipate cashflow for the rest of the year by looking at income over expenditure and opening and closing balances. When looking at the closing balance for each period (usually month), I like to see the figure split into restricted and unrestricted funds.

Insolvency

Trustees need to be aware that:

- Under charity law trustees put themselves at risk of personal liability if they (in the case of unincorporated charities) commit the charity to debts which amount to more than its assets; or, in the case of charitable companies, continue to operate when they know or ought to know that they cannot avoid insolvent liquidation.

Insolvent liquidation

It is essential:

- for trustees to ensure that restricted funds are only used for the purposes for which they were given (remember you cannot without relevant consent – from donor or Charity Commission – 'borrow' from restricted funds to pay for activities that fall within unrestricted funds); and
- as soon as you think your charity might be insolvent or very near the point of insolvency, trustees must then act solely in the interests of the charity's creditors. Trustees need to speak immediately to professional advisers (eg auditor/independent examiner and insolvency practitioner). The board must meet frequently and regularly. Careful minutes need to be kept of each meeting so that there is a record showing that the trustees were acting solely in the interests of creditors.

Key issues for the board and every trustee

Relationship with auditors

Issues that all boards need to consider pro-actively. Often this goes by default with trustees unaware of these documents and the part that trustees should play.

- Will the board or a board committee (eg audit or finance) meet annually with the auditor to discuss their audit and the annual report and accounts? And will there be some time during this meeting for trustees to speak to the auditors without the executive present?
- Before the audit, will the board or a board committee consider the audit planning letter? If a committee, is there to be any input by the board?
- If a charitable company, each director is required to give certain undertakings to the auditor such as there is no relevant audit information of which the auditors are unaware. These declarations are made via a letter of representation which is drafted by the auditors. Trustees need to consider what assurances they need in order to give similar guarantees to the auditor. The chair of trustees normally signs the letter on behalf of every director.
- Will the board or one of its committees consider the audit findings report which is always addressed to the trustees and often called the 'management letter'? Management's response to the audit findings report should be considered alongside the report.

Internal financial controls, fraud and whistleblowing

Issues that all boards need to consider:

- How and how often does the board check the robustness of financial controls? The charity's annual return[1] must confirm whether or not the charity has reviewed its financial controls during the reporting period. As a matter of good practice, the Commission recommends that a charity reviews its financial controls annually to ensure that they are up to date and effective.
- What are the charity's anti-fraud policies and procedures and are they sufficiently robust and known throughout the charity?
- Is there a good whistleblowing policy and procedure which are known to all staff, volunteers, service users and contractors etc?

Understanding risks attached to different types of income

For example: Public service delivery contracts

Issues that all boards need to consider:

- Does the board require all public service delivery contracts to be on the basis of fullcost recovery? Will contracts covering more than one year also cover salary increases? If not full-cost recovery, how is any shortfall to be funded?
- What is the board's risk appetite regarding public service delivery contracts? Who has delegated responsibility to check contracts prior to signing, to ensure the charity does not accept risks and liabilities that the board finds unacceptable?
- Is there any risk of 'clawback' ie the commissioning body demanding partial repayment because the charity has only delivered partially (eg only 79 per cent of unemployed people trained by the charity found employment so local authority demands refund of 21 per cent)?

Understanding your charity's position with regard to taxes

These should include:

- direct tax
- gift aid
- VAT
- business rates

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[1] The Annual return now requires the following declaration:
The person submitting the annual return on behalf of the charity must certify that:
• they have understood all of the requirements associated with the submission of the annual return and all of the statements contained within it
• the information provided in the relevant parts of the annual return is correct and complete to the best of their knowledge and belief and has been brought to the attention of the ***charity trustees who have each individually verified this and given their informed express consent to this submission*** *with full knowledge, understanding and acceptance of the contents of the privacy notice.*
Charities with an income of over £25,000 must also confirm that there are no serious incidents or other matters that should have been brought to the attention of the commission that have not already been reported.

These are, I believe, the financial basics for all trustees whether they are financially knowledgeable or not.

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