Cass Business School
CITY UNIVERSITY LONDON

Tools for success: doing the right things and doing them right

6. Finance

Centre for Charity Effectiveness

Enhancing performance, developing talent

About this guide

The purpose of this guide is to help you manage your financial resources. Charities are increasingly operating in a rapidly changing and competitive environment. If you are going to survive this challenging environment, you will need to ensure the best and most efficient use of your financial resources. Sound financial management will provide trustees and managers in your organisation with a basis on which to do this.

What is financial management?

Financial management is more than keeping accounting records. It is an essential part of organisational management and cannot be seen as a separate task to be left to finance staff or the honorary treasurer. Financial management involves planning, organising, controlling and monitoring financial resources in order to achieve organisational objectives.

You can only achieve effective financial management if you have a sound organisational plan. A plan in this context means having set objectives and having agreed, developed and evaluated the policies, strategies, tactics and actions to achieve these objectives. Sound financial management will involve you in long-term strategic planning, and short-term operations planning. This financial planning should become part of your organisation's ongoing planning process (see the DIRECTION GUIDE for more information).

See Copeman C, Bruce I, Forrest A, Lesirge R, Palmer P and Patel A (2008) *Tools for tomorrow: a practical guide to strategic planning for voluntary organisations* (London: NCVO)

Good financial management will help your organisation to:

- make effective and efficient use of resources
- achieve objectives and fulfil commitments to stakeholders
- become more accountable to donors and other stakeholders
- gain the respect and confidence of funding agencies, partners and beneficiaries
- gain advantage in competition for increasingly scarce resources
- prepare for long-term financial sustainability.

Good financial management has four important components:

1. A clear finance strategy
2. A plan for generating income
3. A robust financial management system
4. A suitable internal environment.

This guide explains what is involved in each of these.

Finance strategy

Your finance strategy is a plan of how you will finance your organisation and its activities, what money you will need and where it will come from. Your strategy should describe how you intend to move from your current position to your intended position.

Questions to answer when developing a finance strategy

- ☐ Where are we now?
- ☐ What are our plans for the future?
- ☐ How will we get there?
- ☐ Do we know what the risks are and how we will manage these?
- ☐ How will we manage the competing demands of spending against savings needed?

You can use this checklist to develop your finance strategy. The 'how will we get there' question of your finance strategy is its central plank; it is about generating the income you will need to finance your strategy. We look at this in more detail on the next page.

Generating income

Generating income is more than fundraising. It is about making your organisation sustainable by creating a range of funding (diversifying your sources of income), so you are not dependent on one source. Your income generation plan must ensure that:

- you are raising sufficient levels of income to enable you to deliver your organisation's purpose; it must cover *all* costs incurred.
- you have taken into account any restrictions imposed by funders on how your organisation can apply the funds received (see tip box below)
- you have a sufficiently diverse source of income to avoid the high level of risk associated with depending on one source.

Funds received from funders for a specific purpose are known as **restricted funds**: you are legally obliged to use them only for the purpose for which the funder gave them to you.

In contrast, **unrestricted funds** can be used for any purpose that helps you to achieve your charitable objects. The more unrestricted funds you have, the more freedom of action you have. You can for example, choose to cover costs that funders are reluctant to fund, like core costs.

The discipline is the same whether generating restricted and unrestricted income; funders will require the same financial information of you (see the checklist on p.6).

What funders are looking for

These are some of the basics funders look for when assessing applications for funding:

- ☐ Clarity that the organisation is seeking funding to meet a specific beneficiary need
- ☐ Financial details of your organisation
- ☐ How the funds will be used; e.g. what percentage of the funds will go towards core costs, salaries etc.
- ☐ Your organisation's ability to manage finance

A good plan for generating income will aim to achieve sustainability by stabilising your funding base, in some cases increasing your funding and diversifying your funding sources. Sustainability ideally means managing your income streams in such a way that if/when one stream comes to an end, the work can be repositioned, making it suitable for funding by another stream. Opportunities available to diversify income streams range from donations and grants to service level agreements or contracts to deliver services, to trading in good and services.

Remember **fundraising activity** has costs associated with it, e.g. fundraiser's time. It is important therefore that these are reflected in funding applications.

Diversification also has costs associated with it, such as increased management effort etc. You must therefore recognise at what point the benefits of diversification are outweighed by costs.

See the REVITALISE GUIDE for more information about developing a balanced portfolio, trading, contracts, grants, donations and repayable finance.

See the Income Spectrum Tool developed by Mission, Models, Money on their website www.missionmodelsmoney.org.uk (click on 'Reports and tools'). This tool offers a template for factoring in what resources need to be invested in order to generate different types of income.

See *Introductory pack on funding and finance: guide to sustainable funding*; downloadable free from the finance hub: www.financehub.org.uk

Also visit NCVO's Sustainable Funding Project website at: www.ncvo-vol.org.uk/sfp

Financial management system

There is no one model of a financial management system that suits all charities. But there are some basics that must be in place to achieve good practice in financial management.

It is helpful to identify certain principles when developing a financial management system. These will act as a guide to your trustees and managers when making decisions.

Guiding principles for developing a financial management system

- ☐ **Consistency**: Your financial polices and systems must remain consistent over time
- ☐ **Accountability**: You must be able to explain and demonstrate to all stakeholders how you have used your resources and what has been achieved
- ☐ **Transparency**: You organisation must be open about its work and its finances, making information available to all stakeholders
- ☐ **Integrity**: Individuals in your organisation must operate with honesty and propriety
- ☐ **Financial stewardship**: Your organisation must take good care of the financial resources it has been given and ensure that they are used for the purpose intended
- ☐ **Accounting standards**: Your organisation's system for keeping financial records and documentation must observe accepted external accounting standards

Developing a sound financial management system

Key questions to consider:

- ☐ Are we satisfied with our budgeting process and other financial planning?
- ☐ What objectives are our financial management systems designed to meet? Is the link clear in practice?
- ☐ What are our key principles for financial management?
- ☐ How does our staff respond to the system? (Do people use it? Is it a 'live' tool?)
- ☐ Does our financial management system enable effective decision making when allocating resources?

Financial procedures manual

Underpinning all financial management systems is a series of financial polices and procedures which guide operations and lay out how your organisation uses and manages its money. A financial procedures manual brings all these together in one document. It helps establish financial controls within the organisation that ensure accuracy, timeliness and completeness of financial data. The manual is generally used by finance staff, but it can also act as a reference for trustees, managers and other staff.

There is no one model of a financial procedures manual; yours will depend on the needs and structure of your organisation. Below are the content headings of each section of a typical financial procedure manual; they can act as the starting point for your own manual and can be adapted to cover the needs and activities of your organisation. Your manual may also need to include key elements of external financial regulations.

Content headings of a typical financial procedures manual

- Trustees' financial responsibilities
- Controls on expenditure (who can spend what, with whose authority)
- Controls on financial assets (for example who records cheques received and who banks these)
- Exercising budgetry control (who can spend how much on what; what expenditure needs special permission)
- Controls on human resources (who can recruit whom for what roles; what permissions are needed from whom)
- Controls on physical assets (for example, who can authorise the sale, lease of buildings, equipment etc.)

In addition to the above headings, the manual may also include key elements of external financial regulations.

See 'Guidance CC8: internal financial controls for charities' (downloadable free from the Charities Commission website: www.charity-commission.gov.uk)

Also see NCVO's 'Sample contents of financial procedures manual' at: www.ncvo-vol.org.uk

Budgets

A budget is the financial description of an action plan outlining how you will use your money, based on knowledge and assumptions against which you will measure your actual performance. It is important to be honest about what you can manage in income and expenditure, so that you develop a realistic budget that helps you weather the unexpected throughout the year.

What's involved in the budget?

Key questions to consider when developing a budget:

- ☐ What are our objectives?
- ☐ What activities will be involved in achieving these objectives?
- ☐ What resources will be needed to perform these activities?
- ☐ What will these resources cost?
- ☐ Where will the money come from?

In addition to helping you to measure financial performance, budget management can:

- stimulate your planning, helping you to coordinate and control the use of your resources
- encourage realism so that plans are achievable within available resources
- help improve the quality of plans, as staff are helped to focus on and discuss service priorities
- improve clarity of vision and staff motivation.

Preparing and controlling the budget

Budget management involves two processes: preparation and control. These should not be seen as separate processes, as one informs the other. Your organisation should regard budget preparation as the joint responsibility of both the finance and non-finance staff. Each group of staff brings their own areas of knowledge and expertise which contribute to creating realistic and informed budgets. The trustees of the organisation will need to have a say in the budget planning, as they have the legal responsibility for approving the annual budget.

Two processes involved in budget management

Preparation	Control
Calculating	Checking
Negotiating	Investigating
Revising	Projecting
Agreeing	Action

There are three key questions that underpin budgetary control:

1. How are we doing?
2. How much of the budget is left?
3. What will it look like at the end of the year?

See *Introductory pack on funding and finance: guide to financial management* downloadable free from the finance hub: www.financehub.org.uk

The regulatory framework

The way in which all charities report on their accounts is guided by the Statement of Recommended Practice: Accounting by Charities (SORP) issued by the Charity Commission in conjunction with the Accounting Standards Board. The SORP contains guidance on good practice regarding the suitable treatment and presentation of charity accounts. The SORP is regularly up dated and the latest revision is simply referred to as SORP 2005.

The SORP requires legal and accounting interpretation and you should rely on professional expertise for this, but in this guide we identify the key requirements of SORP.

See *Guidance charity accounting and reporting: the essentials*; downloadable free from the Charities Commission website: www.charity-commission.gov.uk

Also see NCVO's 'Understanding SORP' at www.ncvo-vol.org.uk

The Statement of Financial Activities (SOFA)

The SORP replaces the profit and loss account (more commonly seen in commercial sector), with the SOFA. The intention is to remove the concept of profit as a measure of success or failure, since this is not appropriate for charities. In the SOFA charities should show all **incoming resources** and all **resources expended** for the financial year.

Fund accounting

Charities are required to show all their incoming and outgoing resources, assets and liabilities belonging to specific funds in the accounts. The different types of funds are:

- permanent endowment funds
- expendable endowment funds
- restricted funds
- unrestricted funds
- designated funds
- general funds.

Annual accounting requirements for charities in England and Wales

This section sets out the format in which charities must present their annual accounts and by when they should be submitted to the Charity Commission. The basic requirement is for larger charities to prepare a SOFA and a balance sheet.

Trustees' annual report

In addition to the annual accounts, trustees of registered charities are required to prepare an annual report to be submitted to the Charity Commission together with the accounts. The content of the annual report includes:

- reference and administrative details
- structure, governance and management
- objectives and activities
- achievements and performance
- financial review
- plans for the future
- any funds that the organisation holds as custodian trustees for other charities.

Internal environment

You can achieve effective financial management only by establishing a suitable internal environment. To a large extent this depends on the size of your organisation. If your organisation is without paid employees, you will probably rely heavily on volunteers and trustees to undertake financial management; in larger charities this work will be undertaken by paid staff. Good financial management assigns discrete responsibilities to people within the organisation; the larger your organisation, the more scope there will be for people to play different roles. It is therefore essential that you plan ahead, so that as your organisation grows a structure develops in which it is clear 'who does what'.

Effective financial management is dependent on the *constantly evolving* relationship between:

- financial strategy
- financial management systems
- capable trustees, managers and staff (including non-trustee volunteers)

The role of the board of trustees

Trustees are responsible for the direction and performance of their charity. They have a legal responsibility for the management and decision making in a charity. They have a legal duty to ensure the application of the charity assets for the charitable purpose of the organisation (see the GOVERNANCE GUIDE for more information).

See *Guidance CC3: the essential trustee: what you need to know*; downloadable free from the Charities Commission website: www.charity-commission.gov.uk

Day-to-day responsibility

As the Board of Trustees only meets a few times a year it delegates authority for the day-to-day management to the director/chief executive (CE) who it has appointed. The role of the CE is to support the development of a strategy and implement it, once it has been agreed by the Board. The CE with the staff is responsible for converting the Board's intentions in to action and for managing the systems and procedures needed to achieve results.

While it is acceptable for the Board to delegate authority, it can not delegate total responsibility. The Board must therefore set up monitoring mechanisms to ensure its instructions are being carried out.

Questions to consider for a suitable internal environment

- ☐ Are the trustees, the CE and managers clear about their discrete financial responsibilities?
- ☐ Are there systems in place to enable each party to exercise its responsibilities appropriately?
- ☐ Have necessary committees been established to handle financial responsibilities
- ☐ Are the trustees fulfilling their financial accountability?
- ☐ Are there clear separations of financial responsibilities between finance and non-finance staff? For example, there should be a separation of duties between staff who place orders for goods/services and those who authorise payment.

Providing evidence of your achievements in financial management

You can use the following measurements to evidence achievements in effective financial management in your organisation:

- The Board of Trustees agrees budgets annually
- There are quarterly reports on accounts
- The Board receives quarterly finance reports comparing actual income and expenditure against the budget
- There are accurate minutes of financial decisions and action to be taken
- The financial procedures manual is kept up to date and reviewed every two years
- Ensure banking procedures are in place and up-to-date
- Ensure Inland Revenue and Charities Act regulations are complied with.

Signposts

Publications

Palmer P (2005) *The good financial management guide* (London: NCVO)

Poffley A (2002) *Financial stewardship of charities* (London: DSC)

Sayer K (2007) *A practical guide to financial management* (London: DSC)

Websites

The Finance Hub has developed a series of guides: 'Introductory pack on finance and funding' – all downloadable free from their website: www.financehub.org.uk

The Charity Commission guides on SORP and financial management are also downloadable from their website: www.charity-commission.gov.uk

KnowHow NonProfit combines expert knowledge with real-life experiences on all aspects of financial management for charities: www.knowhownonprofit.org/organisation/budgets

Courses

Cass Centre for Charity Effectiveness offers training in many aspects of management including basic financial management and basic income generation: www.cass.city.ac.uk/cce/courses/shortcourses

The Directory of Social Change runs a range of short courses on fundraising techniques: www.dsc.org.uk

Links to PQASSO

PQASSO is the practical quality assurance system for small organisations designed by Charities Evaluation Services. Independent data suggest PQASSO is by far the most widely-used quality system in the voluntary and community sector (VCS). For more information, see www.ces-vol.org.uk

Following this guide will help you to meet several of the indicators of PQASSO quality area 7 (Managing money) in the second and third editions of the framework.

Tools for success:
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Charities are increasingly operating in a rapidly-changing competitive environment. If you are going to survive, you will need to ensure the best and most efficient use of your financial resources.

This guide aims to help you to do this.

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