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ESSENTIAL CHARITY FINANCE FOR TRUSTEES

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If you are unsure about what charity finance terms mean in this guide or other publications mean, check out CFG's free charity finance glossary which you can find on the CFG website

FOREWORD

MHA MACINTYRE HUDSON

Strong governance and bold leadership is arguable the primary safeguard to ensuring the effectiveness of any charity, and is essential to maximising beneficiary impact.

As a firm strongly committed to the sector, MHA MacIntyre Hudson has for years sought to support the development of such good practice. Finance in charities, in contrast to the commercial world, can be characterised as merely the means to deliver charitable ends. But financial considerations underpin almost all the key responsibilities of charity trustees, which the Charity Commission relentlessly and rightly reminds us.

It is well-proven that strong financial governance contributes to effective charities. And finance is possibly the most important common core competency required across the sector. Yet considerable evidence points to the charity finance skills and competencies of charity trustees being inadequate across the sector. This is seldom a result of trustees failing to want to do a good job.

So we have been delighted to work with the Charity Finance Group to put together this guide to Essential Charity Finance, focussed on the needs of trustees, though suitable for anyone wanting a greater knowledge in an accessible format. This guide is intended to provide a high level understanding of the most essential aspects of charity finance that trustees absolutely should know. It signposts where more detailed information is available, if greater depth of knowledge is needed.

I hope this guide will provide a practical resource to be used by charities of all sizes and types in building board capacity and hence their effectiveness.

Sudhir Singh, *Partner and Head of Not for Profit MHA MacIntyre Hudson*

ABOUT MHA MACINTYRE HUDSON

MHA MacIntyre Hudson is a growing and successful top-20 accountancy firm, with a long term commitment to the charity sector, focussed on providing assurance over financial health and support to develop financial fitness. We operate locally, nationally and internationally, offering Not for Profit specialists at every level – within MHA MacIntyre Hudson, our national association MHA, and our international network Baker Tilly International.

Contact details:
charities@mhllp.co.uk
www.macintyrehudson.co.uk/sectors/not-profit
+44 (0)20 7429 4100

CHARITY FINANCE CHECKLIST FOR TRUSTEES

This is a simple checklist for trustees to build confidence that they have a framework to support good financial management in their charity.

- ☐ All trustees understand the charity's objectives, understand how the charity operates, feel comfortable asking questions about the resources of the charity and are approaching decision-making with the charity's best interests at heart. *(See Section 1)*
- ☐ All conflicts of interest have been identified and managed ahead about any financial decision in the charity being taken. *(See Section1)*
- ☐ All trustees are clear of their legal responsibilities for the financial performance of their charity. *(See Section 2)*
- ☐ Trustees, staff and volunteers understand the role in ensuring good financial performance of the charity. *(See Section 2)*
- ☐ All trustees understand the legal reporting requirements of their charity. *(See Section 3)*
- ☐ Trustees have a clear financial strategy in place which is regularly measured against the charity's performance and considers risks and opportunities facing the charity. *(See Section 4)*
- ☐ Trustees have reviewed the Terms of Reference and operations of any financial sub-committees of trustees to ensure that they are working effectively and there are clear reporting lines to trustees. *(See Section 4)*
- ☐ Trustees have reviewed their charity's financial policies and ensured that they are fit for purpose. *(See Section 5)*
- ☐ Trustees regularly discuss the risks and opportunities facing the charity. *(See Section 5)*
- ☐ Trustees have considered how they report on the financial performance of their charity. *(See Section 6)*
- ☐ Trustees have reviewed their relationship with their auditor/independent examiner to ensure that it meets the needs of their charity. *(See Section 7)*
- ☐ Trustees have a clear process for identifying when and how they need to report financial incidents to regulators, law enforcement and other stakeholders. *(See Section 8)*

INTRODUCTION

1

Good financial management is the efficient and effective management of your organisation's resources (money, physical assets, people and intellectual property) in order to accomplish your charity's objectives.

Good financial management is critical to your charity's ability achieving its objectives and purposes.

It is the one of the central responsibility of trustees. It is one that all trustees share and is not the privilege of the Chair or the Treasurer of your charity.

Role of the Chair and Treasurer

Chairs and Treasurers have little formal legal recognition, although your charity's governing document may have certain provisions or powers reserves to these officers. It is important to remember that trustees are collectively responsible for all decisions and the Charity Commission will hold all trustees responsible even if decisions are made by the Chair or Treasurer on behalf of the board.

The role of a Chair is to provide leadership for the trustee board, ensuring that matters are discussed and resolved according to the charity's governing documents and best practice. The Chair's role is to ensure constructive relationships between the staff of the charity and the trustees as well as between trustees themselves. The Chair should also encourage considered and informed decision making by trustees.

The role of a Treasurer is to act as a 'financial watchdog' for the trustees and ensure that there is a regular flow of accurate financial information to the trustees. If the Treasurer has a professional background in finance or accounting, they may be able to give trustees advice about financial matters or reporting. However, it is important that trustees collectively understand the financial operations of their charity and do not rely on the Treasurer to carry out financial oversight of their own.

While financial management can be delegated, financial responsibility **cannot be delegated** to anyone else – although you should work with your staff, advisors and volunteers to improve financial management within your charity. The extent to which financial management is delegated down from trustees to staff is something that should be based on the size of the charity, skills of trustees and risks facing the charity.

There are a number of qualities that characterise a trustee who is effective in overseeing the finances of their charity.

- **Purposeful**
- **Knowledgeable**
- **Inquiring**
- **Objective**
- **Analytical**

PURPOSEFUL

The primary responsibility for all trustees is to ensure that your charity is carrying out its charitable objects and purposes as set out in its constitution. Trustees should manage their charity's finances in a way that enables the charity to most effectively carry out its charitable purposes. All financial decisions about a charity, should, come back to the impact that it will have on achieving the charity's purposes.

In developing your organisation's financial strategy, you should also think about how to balance the needs of current beneficiaries against future beneficiaries – if you do not believe that your charity's purpose is unlikely to be fulfilled within the strategy's lifetime. Developing a financial strategy for your charity will be an integral part of your strategic planning. As you set objectives for your charity trustees' need to have the confidence that the financial resources are aligned to those plans. This will involve looking at projections for a number of years into the future. The number of years will be dependent on the organisations activities. A housing charity, buying houses funded by loans may need projections going forward a decade or beyond. Three to five years maybe more appropriate for others. Your organisation's budget is about making intra-year (or just one year) decisions on how best to achieve your purposes, guided by the strategic plan and projections.

KNOWLEDGEABLE

To make effective financial decisions on behalf of your charity, **you need to understand how your charity operates and how it makes a positive impact for your beneficiaries.** This means having a clear understanding of your business model (i.e. how you generate income) and the services and activities that you undertake in order to achieve your charitable purposes. You should also understand the marketplace in which your charity operates. This means knowing whether your organisation relies on any particularly key funders, whether it has important partnerships or collaborations with other charities or other organisations or whether there are competitors for funding.

Trustees should regularly consult with their staff or volunteers to understand the operations of their charity so that they make **informed** decisions.

INQUIRING

Trustees must have an inquiring disposition. Good financial decision making is based on having the right information. Trustees must want to know what is going on in their charity. Trustees must be prepared to ask questions, potentially difficult or controversial questions, in order to get the information that they need in order to make the right decisions. It can be appropriate to have a 'positive and constructive tension' between trustees and management.

Good trustees should not rely on others to ask these questions for them, and should be clear where they have not got the level of information or assurance that they require. Good trustees should also not be complacent as the finances of a charity can change rapidly depending on circumstances.

Regular communication between trustees and executive staff is critical. Staff should respect the right and duty of trustees to ask searching questions about the finances of their charity. Equally, trustees should respect the knowledge and expertise of their staff and work with them to ensure that the right information is gathered to enable them to make the right financial decisions.

The finances of an organisation are an outcome of the activities the charity undertakes. It is therefore imperative that trustees 'triangulate' the financial information with other data. For example, high staff turnover would indicate that quality of outcomes will suffer and in itself is costly. It could indicate a management problem or the need to trade off higher salaries for lower recruiting costs. Or it may signify a change in activities – was this planned or something that Trustees should have been aware of?

Focussing solely on a financial outcome without understanding the consequences on the charity is as risky a strategy as prioritising a charitable objective without understanding the financial consequences.

OBJECTIVE

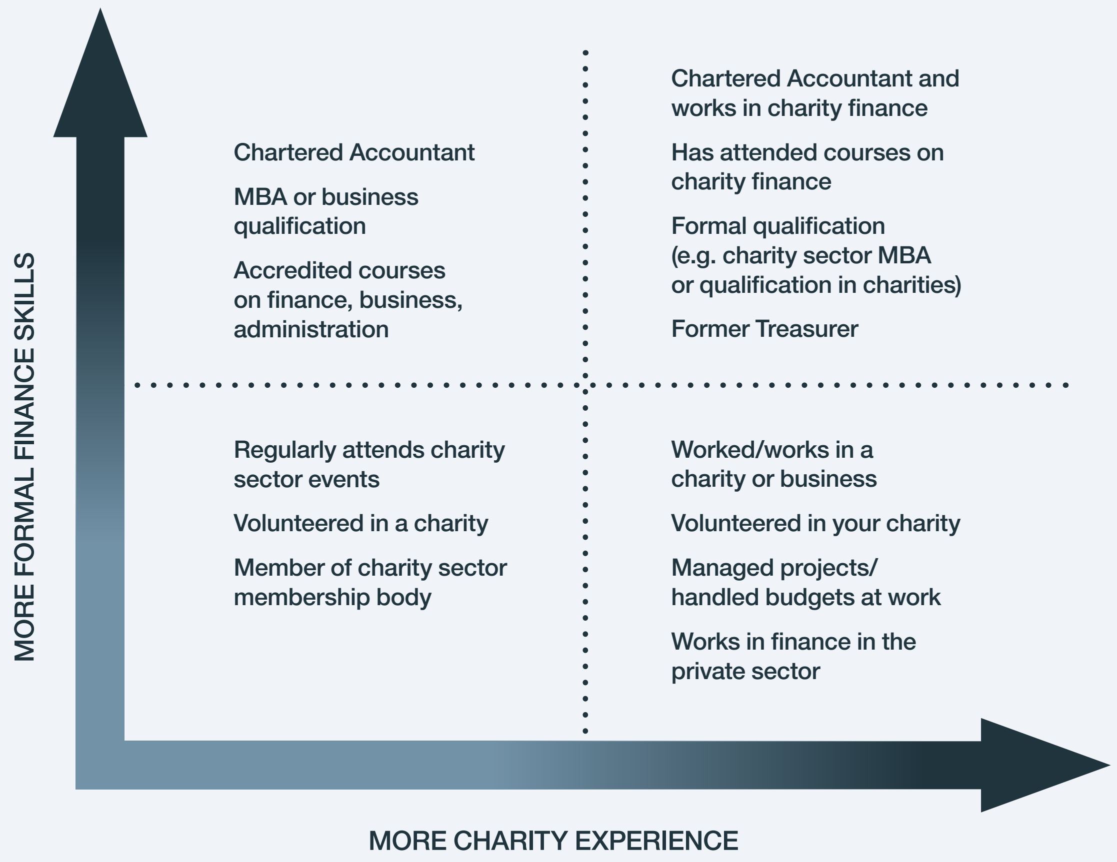
All trustees are required to put their own personal beliefs or preferences at the door and make decisions in the best interests of the charity. Trustees have a duty to ensure that there are no conflicts of interest which inhibit effective financial decision making. Trustees also need to guard against subtle factors which can prevent them from properly considering and acting upon the facts presented to them. This can include personal friendships (with other trustees or staff) or personal ethical beliefs (which do not align with the charity's values or purposes).

If trustees feel that they cannot be objective about financial matters for the charity, they should raise this with their fellow trustees and discuss means to resolve the issue.

If you would like more information on conflicts of interest, please read the Charity Commission's guidance on conflicts of interest: **www.gov.uk/government/publications/conflicts-of-interest-a-guide-for-charity-trustees-cc29/conflicts-of-interest-a-guide-for-charity-trustees**

Objectivity is one of the standards that was referenced in The Committee on Standards in Public Life First Report. It is a useful primer for trustees in understanding the values that they should carry with them in their role. You can read more here: **web.archive.org/web/20090617093701/http://www.archive.official-documents.co.uk:80/document/cm28/2850/285002.pdf**

Fig 1. Trustee Competency/Skills Matrix



ANALYTICAL

It may be obvious, but trustees are responsible for the performance of the charity, that is makes a tangible difference to its beneficiaries, and does so efficiently and effectively. Trustees must therefore have strong analytical skills to understand information and data, to asses and manipulate it, and to come to appropriately supported decisions.

One of the ways that charities can ensure that they are have strong levels of financial governance is to have the right composition of the trustee boards.

Trustees bring a range of experience and getting the right balance is important. Everyone has a mixture of skills and experiences which can be useful for the charity.

This matrix enables you to plot each of your trustees on a scale, with more formal skills higher up the matrix and more charity experience towards the right.

Those with formal skills in finance and charity experience will be at the top right, and ideally placed for supporting your charity's financial governance.

If you have lots of trustees with 'formal finance skills' but less charity experience, you may want to put them on courses or get them to meet with other charity trustees/treasurers.

If you have a gap in 'formal' skills then you may want to support trustees to acquire those skills.

THE LAW

2

Trustees' responsibilities are governed by charity law which has been set by Parliament and is interpreted by the courts. There are numerous pieces of legislation which impact on charities but the most important is the Charities Act 2011 which sets out the broad legal framework under which charities operate.

The Charity Commission of England and Wales (henceforth referred to as 'the Charity Commission') is the principal charity regulator for charities registered in England and Wales. There is a separate regulator - Office of the Scottish Charity Regulator - for Scottish charities, and the Charity Commission for Northern Ireland regulates charities registered in Northern Ireland.

Not all charities are regulated by the Charity Commission and trustees should check whether they are an 'exempt' or 'excepted charity' and thus regulated by another body (e.g. universities, academies, churches, trade unions).

The Charity Commission has broad powers to protect charities, ensure that they deliver public benefit, comply with the law, effectively use their resources and are accountable to their donors, beneficiaries and the general public.

For more information on the Charity Commission, you can check the Commission's website: **www.gov.uk/government/organisations/charity-commission**

Charities are also regulated by Her Majesty's Revenue and Customs (henceforth referred to as 'HMRC') in relation to any tax reliefs that they receive. Being a registered charity attracts a number of tax benefits, such as the ability to claim Gift Aid on donations and being exempt from Corporation Tax. HMRC has its own registration processes and policies for charities relating to these tax reliefs.

For more information on HMRC's role in regulating charities, you can check HMRC's website: **https://www.gov.uk/charities-and-tax**

As well as financial regulation trustees should also be aware of other regulatory requirements. Some of these will be common to all charities – Health and Safety for example, others specific to their area of work e.g. care or maintaining listed properties. Make sure that you discuss this at board level and with your executive team.

WHAT ARE THE LEGAL RESPONSIBILITIES FOR TRUSTEES FROM A CHARITY FINANCE PERSPECTIVE?

There are four key legal responsibilities which trustees must be aware of from a charity finance perspective.

- The duty to ensure your charity carries out its charitable purposes
- The duty to act in the best interests of the charity
- The duty to manage your charity's resources responsibly
- The duty to be comply with your governing document and the law

You can find more information on your legal responsibilities as a charity trustee, please read the Charity Commission's guidance CC3: The Essential Trustee. **www.gov.uk/government/publications/the-essential-trustee-what-you-need-to-know-cc3**

DUTY TO ENSURE YOUR CHARITY CARRIES OUT ITS CHARITABLE PURPOSES

Trustees must ensure that all the charity's financial decisions are directed towards achieving the charity's purposes and objects. This means being able to explain all financial decisions in the context of achieving your charity's purposes and, in turn, understanding how these deliver public benefit.

Financial decisions are not just about spending or not spending money but can also cover staffing, full cost recovery or reporting on activities. Financial decisions are the choices you make about how you operate as a charity, what resources you use and how you report on those decisions.

DUTY TO ACT IN THE BEST INTERESTS OF THE CHARITY

Trustees must ensure that they make balanced and adequately informed decisions, thinking about the long term interests of their charity as well as the short term. This means having the right financial information and in an understandable form. Trustees must also avoid putting themselves in a position where the duty to your charity conflicts with your personal interests. Trustees should also be vigilant to identify potential conflicts of interests of other trustees. Trustees must also ensure that they do not receive any benefit from the charity unless it is properly authorised and is clearly in the charity's interests, including partners, children or business partners.

THE DUTY TO MANAGE YOUR CHARITY'S RESOURCES RESPONSIBLY

Trustees must ensure that they make sure the charity's assets are only used to support or carry out its purposes. They must also ensure that they manage risks effectively. This includes not over-committing the charity when undertaking activities and taking special care when investing or borrowing. Trustees must also ensure that they comply with any restrictions on spending funds or selling land.

For more information about how to manage risk, you can read CFG's recent publication on 'Rethinking Risk' www.cfg.org.uk/resources/Publications/~/media/Files/Resources/CFDG%20Publications/Rethinking%20Risk%202016.pdf

THE DUTY TO BE COMPLY WITH YOUR GOVERNING DOCUMENT AND THE LAW

Trustees cannot act beyond the powers given to them either by charity law or by their governing document. Your governing document may also restrict the types of financial activities that you can undertake (for example, prohibiting investments) or require you to undertake certain additional reporting (for example, requiring an audit regardless of the size of your charity). Trustees must read their charity's governing document and ensure that they understand the law in relation to the activities that they undertake. They must also get appropriate advice when taking certain financial transactions, for example, selling land or making investments.

Financial controls

Having robust financial controls is not required by law but he lack of them will be used as evidence of mismanagement by the Charity Commission in the course of an investigation. Trustees must ensure that they have appropriate policies and procedures to monitor financial transactions made by their charity and be able to explain these policies to external stakeholders.

Financial controls are not just about ensuring that cheques or cash are appropriately managed but also cover a range of activities undertaken in your charity. Developing management accounts, budgeting for projects, cash-flow forecasting and internal audits are all examples of financial controls.

Trustees need to consider all the ways that they plan, manage, account and report on their finances when evaluating the strength of their financial controls.

FRAUD AWARENESS

Charities are increasingly at risk of becoming victims of fraud, particularly cyber-enabled fraud. Charities cannot rely on their reputation and focus on doing good as protection against fraudsters.

Trustees should ensure that their charity have robust financial controls in place in order to monitor financial transactions made by their charity and ensure that they are not at risk of fraud.

If a charity is unfortunate enough to suffer a fraud, it should report this to the Police, Action Fraud and the Charity Commission. For more information, please read the Charity Commission's guidance on reporting serious incidents www.gov.uk/guidance/how-to-report-a-serious-incident-in-your-charity

Top tips for tackling fraud

1. Action is a must – don't do nothing.
2. Understand what fraud is and is not – it is a specific problem with specific solutions.
3. Concentrate on the cost of fraud (financial and reputational) – this is where damage is greatest.
4. Focus on the outcomes to be derived from counter fraud work (primarily the reduction in that cost and safeguarding of reputation and income) not just on counter fraud activity (number of investigations and/or prosecutions).
5. Set the right tone from the top – this includes trustees, chief executives and all senior leaders within the charity – using appropriate language.
6. Remember that pre-empting fraud is better than reacting to examples when they occur (two-thirds of the financial benefits from reducing the cost of fraud come from changing human behaviour) whilst considering the reputational risks to your organisation.
7. Make sure that you have the right skills in place for your organisation, whether that is professionally accredited counter fraud available specialists (either in-house or externally) to undertake counter fraud work or training counter fraud staff.
8. Understand the importance of a real anti-fraud culture (to mobilise the honest majority) and a strong deterrent effect (to deter the dishonest minority).
9. Highlight the financial benefits of reducing the cost of fraud and the additional stability and financial health that these can bring to your organisation.
10. Performance-manage counter fraud work like any other area of work – fraud is a business cost to be measured, managed and minimised. Counter fraud work should be driven through the use of performance indicators.

SOURCE: Charity Finance Group & PKT Littlejohn, Countering Fraud, 2016

WHAT ARE THE ACCOUNTING, REPORTING AND EXTERNAL SCRUTINY REQUIREMENTS FOR CHARITIES?

3

ACCOUNTING REQUIREMENTS

All charities, regardless of whether they are registered with the Charity Commission, must prepare accounts or make them available on request.

However, the type of accounts that you need to prepare depends upon whether you are registered as a company (i.e. incorporated), your income and the assets at your disposal.

There are two forms of accounts: **Receipts and Payments** and **Accruals**.

Receipts and Payments is the simpler form of accounts and may be adopted by a non-company charity that has a gross income of £250,000 or less during the year. This consists of summarising all the money received and paid out by the charity in the financial year and giving a statement with its assets and liabilities.

Accruals is a more complicated form and must be followed by all charities which are also registered companies as well as non-company charities with a gross income of over £250,000 during the financial year. They contain a balance sheet, a statement of financial activities and explanatory notes.

All charities which are also registered companies must prepare accruals accounts that give a 'true and fair view'.

Accruals accounts must be prepared in accordance with the Statement of Recommended Practice (SORP), Accounting and Reporting by Charities – effective from 2015 – the Charities SORP. Charities SORP. This is the standard which sets out how charities are to prepare their accounts in order to give a 'true and fair view' of the charity's operation. Trustees do not need to be familiar with the SORP, but should make sure that they have access to appropriate advice and support.

The Charities SORP interprets for the sector the financial reporting standards, principally FRS 102, that is overseen by the Financial Reporting Council.

For more information about the Charities SORP, visit its website: www.charitysorp.org

REPORTING REQUIREMENTS

All registered charities must prepare a trustees' annual report and make it available upon request.

The annual report is a comprehensive narrative review of the activities of the charity prepared by the trustees for each accounting year.

Depending on your size, you will have certain information on activities, governance, policies and finances that must be included in your annual report.

For more information on how reporting information is required in your annual report, please read Section 7, CC15 – Charity Reporting and Accounting: the essentials www.gov.uk/government/publications/charity-reporting-and-accounting-the-essentials-cc15b/charity-reporting-and-accounting-the-essentials#legal-requirements-for-trustees-annual-reports

All charities in Trustee Reports must have:

1. the charity's name
2. the charity registration number, and if applicable, the company registration number
3. the address of the principal office of the charity, and in the case of a charitable company, the address of its registered office
4. the names of all those who were the charity's trustees or custodian trustees on the date the report was approved
5. the name of any other person who served as a charity trustee or custodian trustee in the financial year in question
6. information about how the charity is governed (by a trust deed, articles of association, and how the charity is constituted (unincorporated, a limited company, CIO etc)
7. how new trustees are recruited and appointed; including any constitutional provisions relating to appointments such as election and whether any other external person or body is able to appoint a trustee
8. policies on reserves or designated funds (funds that are earmarked for spending in future years)
9. a statement on why any fund is in deficit, why any fund is in deficit and how the deficit is being eliminated
10. a statement on how the charity is generating public benefit through its charitable activities (see public benefit guidance for more information)

All charities including all charitable incorporated organisations (CIOs) must submit and complete the Charity Commission's Annual Return. If your income is less than £10,000 and you are not a CIO, you may not need to complete all elements of the Annual Report but need to fill in certain details in order to keep the Commission's records up-to-date.

For charities with an income over £25,000 and all CIOs annual reports and accounts must be filed with the Charity Commission within ten months of the accounting year's end.

EXTERNAL SCRUTINY REQUIREMENTS

Depending on your size you may need to get 'external scrutiny' for your annual report and accounts. This ensures that your information is accurate and that charities are properly held to account for their activities.

There are two forms of external scrutiny for charities: **Independent Examination** and **Audit**.

Independent Examination is a simpler form of scrutiny than an audit and is carried out by an independent person (someone that cannot be influenced by the charity). It is a form of 'negative assurance' – it tells external stakeholders what has come to the attention of the examiner, rather than giving a positive view on whether the accounts are fair and accurate. If your charity has a gross income over £250,000 your independent examiner is required to have a recognised accountancy qualification from an approved professional body.

Audit is a higher level of scrutiny and is carried out by professional auditors that must be registered with a professional body. This goes into greater detail than an independent examination and provides a 'positive assurance' that the accounts provide a true and fair view of your charity's activities.

Charities with an income between £25,000 and £1,000,000 or charities which do not have gross assets over £3.26m and an income of over £250,000 may choose to have an independent examination. Charities with an income less than £25,000 are not required to have an independent examination but may choose to do so, unless they are required by their constitution.

Charities not within these thresholds will need to have an audit. Moreover, many charities are required to have an audit because it is required in their governing document or external funders (such as a charitable foundation) require them to have an audit. Any charity may choose to have an audit regardless of size because of the benefits of additional scrutiny. However they need to be able to justify the additional cost of an audit if they are not required to do so by law or by an external funder.

If you are unsure which form of external scrutiny your charity needs, then seek professional advice.

You can find more information to help you decide between independent examination and audits through MHA MacIntyre Hudson guide: **www.macintyrehudson.co.uk/sites/www.macintyrehudson.co.uk/files/independent_examination_vs._audit.pdf**

ACCOUNTING THRESHOLDS CHECKLIST

Charitable Incorporated Organisation (CIO)				
Gross income of organisation	Minimum requirement for Format of accounts	Trustees Annual Report and Accounts filed with CC	Annual Return filed with CC	Minimum External Scrutiny *
≤ £25,000	Receipts & Payments	✓	✓	✗
£25,000 – ≤ £250,000	Receipts & Payments	✓	✓	IE
£250,000 – ≤ £1M (& total assets ≤ £3.26)	accruals accounts SORP compliant	✓	✓	IE – by member of specified body
£250,000 – ≤ £1M (& total assets > £3.26)	accruals accounts SORP compliant	✓**	✓	Audit
£1M+	accruals accounts SORP compliant	✓**	✓	Audit

*unless required by governing document. Check situation for NHS charities
** additional disclosures required

Company limited by guarantee				
Gross income of organisation	Minimum requirement for Format of accounts	Trustees Annual Report and Accounts filed with CC	Annual Return filed with CC	Minimum External Scrutiny *
≤ £10,000	accruals accounts SORP compliant	✓	✓	✗
£10,000 – ≤ £25,000	accruals accounts SORP compliant	✓	✓	IE
£25,000 – ≤ £250,000	accruals accounts SORP compliant	✓	✓	IE – by member of specified body
£250,000 – ≤ £1M (& total assets ≤ £3.26)	accruals accounts SORP compliant	✓**	✓	Audit
£250,000 – ≤ £1M (& total assets > £3.26)	accruals accounts SORP compliant	✓		
£1M+	accruals accounts SORP compliant	✓**	✓	Audit

WHAT TAXES DO CHARITIES PAY AND WHAT EXEMPTIONS EXIST?

Charities receive a number of tax privileges because they are set up to deliver public benefit. Charities are, however, expected to pay taxes for some of their activities like any other employer. These taxes include National Insurance, the Climate Change Levy and, in some cases, VAT or corporation tax.

Trustees have a duty to ensure that they are paying the right taxes, but they also have a duty to ensure that they are claiming the reliefs that they are entitled to and maximising the income of their charity.

Tax exemptions and reliefs for charities depend upon the activities that charities undertake. However, there a number of taxes that trustees should be aware of and ensure that their charity is making the most of these exemptions and reliefs.

Tax can be a complex issue for charities and trustees should ensure that they have the right skills in their organisation to make decisions and have access to appropriate advice and support.

For more information about charity taxation, you can use the Charity Tax Map developed by Charity Tax Group: **www.charitytaxgroup.org.uk/tax/**

Principal tax reliefs and exemptions for charities

- **Business rates relief** – charitable business rates are the largest tax relief which the sector receives from government. Registered charities are granted a mandatory 80% relief from business rates where the property is wholly or mainly used for charitable purposes. Local councils can further top this up to 100%.
- **Gift Aid** – Gift Aid is a tax relief for donations made to charities registered with HMRC for tax purposes. This has the effect of boosting the value of donations by 25% by passing the income tax paid on the donation to the charity as well as the donation itself.
- **VAT zero rates and exemptions** – there are a number of exemptions and zero ratings for charitable activities ranging from research and education to providing social services. VAT is a complex area and trustees should make sure that they have the right skills in their organisation to handle VAT issues or have access to appropriate advice.
- **Capital Gains Tax** – charities that make a profit on land, property or investments are exempt from paying capital gains tax on these profits if it is generally applied for charitable purposes. This includes the use of funds for the general administrative purposes of the charity.

FINANCIAL STRATEGY AND GOVERNANCE

4

WHAT IS THE TRUSTEE'S ROLE IN SETTING A FINANCIAL STRATEGY?

Trustees are ultimately responsible for the financial decisions made in their charity and, as a consequence, have a central role in financial planning and financial strategy.

What is a financial strategy?

A financial strategy sets out how your charity plans to finance its overall operations to meet its charitable objectives now and in the future. A financing strategy should be clear, focused and give a framework for trustees and staff to make financial decisions over a defined time period (e.g. three years).

Depending on the size of your charity, trustees may need to craft the financial plan and strategy for their organisation themselves or this may be delegated to staff or consultants, with trustees overseeing the process and making a final decision to accept the strategy.

Only trustees have the right and responsibility to decide how the charity is best able to achieve its charitable purposes. This is critical to the formulation of an appropriate financial strategy which reflects how the charity wants to achieve its charitable purposes and the charity's values. Trustees should, therefore, pay special attention to ensuring that there is alignment between the charity's overall strategy for achieving its charitable purposes and its financial strategy.

FINANCIAL STRATEGY CHECKLIST

This is a basic checklist of questions that you should be able to answer through your financial strategy.

1. Current financial position

- ☐ Where are you now as a charity?
- ☐ What has been successful? What has been challenging?
- ☐ What are your main sources of income and expenditure?
- ☐ What are the features of the environment that your charity is working in?
- ☐ Are you using all the resources at your disposal effectively (staff, office, money)?

2. Charity goals

- ☐ What will your charity look like at the end of the strategy?
- ☐ What changes in income or expenditure do you expect to see?
- ☐ Will you be doing more, less or the same as you do currently?
- ☐ Will you have larger or smaller financial reserves at the end of the strategy?

3. Delivering the strategy

- ☐ What needs to be done to deliver your strategy?
- ☐ Will you need to invest more money in some areas? If so, where will this money come from?
- ☐ Will you need to cut back spending in some areas? If so, what impact will this have?
- ☐ If you are going to keep doing the same thing, is this sustainable?
- ☐ What are the key risks or opportunities facing your charity?
- ☐ Do you have sufficient reserves to cover you?
- ☐ Are these activities in line with your charity's values?

4. Monitoring your strategy

- ☐ What targets/information will you use to monitor your strategy?
- ☐ Who is responsible for delivering all parts of the strategy?
- ☐ Have you updated your reserves policy in line with your proposed strategy?
- ☐ Do you have a process for monitoring risks that may impact your strategy?

SHOULD THE TRUSTEES DELEGATE ASPECTS OF THE FINANCIAL STRATEGY AND MONITORING TO SUB-COMMITTEE(S), AND IF SO, HOW BEST IS THIS DONE?

Assuming the charity has an executive team, trustees will look to the Chief Executive or equivalent, of the charity to lead the development of the strategy and supporting financial strategy. Ultimately the chief executive and the team have to deliver against those plans and it is therefore important to establish clear ownership and the executive will have a greater understanding of the environment the charity operates in and the detail of the challenges it faces.

The role of the trustees, who ultimately still have the responsibility for the strategy and finances of the charity, is to challenge and support the development of the strategy:

- Has there been adequate identification and exploration of the choices available to the charity the charity to enable the trustees to make an informed decision?
- Are the recommendations of the executive consistent with the analysis that they have given and aligned with expectations of trustees?
- Are the various elements of the strategy coherent i.e. staffing plans, stakeholder engagement, IT etc.?
- Is the plan robust enough to mitigate significant risks where necessary?
- Does the charity have the people capable and with sufficient capacity to deliver the plan and financial strategy?
- Most importantly, is the plan the best way to achieve the objectives of the charity?

Strategic planning should be based on a dialogue between staff and trustees. Trustees will have to approve the strategy at a certain point in time, but this should not be the first time they are made aware of the contents.

Small charities and financial strategy

For small charities, trustees will be directly involved in strategy setting. It is likely that this will be delegated to a trustee (perhaps Chair or Treasurer). Other trustees should take on an independent scrutiny role.

The same questions for trustees in small charities hold true, but will need to be tailored to the capacities of the charity.

The larger the charity, the more likely it will be that elements of the financial strategy and monitoring will need to be delegated to sub-committee(s) within your organisation. For the largest charities, this may involve bringing in specialists to sit on these committees in order to complement the work of the main trustee board.

Examples of financial sub-committees include:

- Finance Committee
- Audit Committee
- Risk Committee
- Investment Committee

For a small charity, the oversight and monitoring of a financial strategy will often be carried out by the main trustee board. It is important in this case that trustee meetings have appropriate time set aside for this oversight.

However trustees are ultimately responsible for all financial decisions made by the charity and this responsibility cannot be delegated. Therefore, again assuming the charity has an executive team, the key task of the trustees is to ensure they obtain sufficient assurance that the finances of the charity are being run in accordance with the financial strategy, policies and procedures as agreed.

Top tips for sub-committees

- **Have clear terms of reference** – this will keep sub-committees focused on their core activities and avoid duplication of work.
- **Make sure that you have the right balance of skills** – this may involve bringing in people from outside the trustee board, particularly if it involves complex areas around audit or investment.
- **Clear and regular communication** – between the main trustee board and sub-committees is essential to ensure that information is received and appropriately acted upon.
- **Do not let committees become stale** – rotate members of sub-committee regularly and bring in fresh perspective.
- **Focus on a few key things** – do not put too much onto sub-committees. Make them focus on a few key areas which need a concentrated focus over a long period of time.

It is also important that committee decisions are not made in isolation. There are always trade-offs to be considered between delivery of outcomes, financial robustness, regulatory requirements and staff needs to name but a few, Where Trustees use sub-committees a key role of the board is to review these elements together as they will need to gain assurance that decisions are given the right priority.

WHAT ASPECTS OF CHARITY FINANCE CAN TRUSTEES DELEGATE TO CHARITY STAFF?

All trustees share responsibility as a Board for the financial decisions of their charity at all times. However, trustees have the power to delegate decision-making to staff, sub-committees or individual trustees. There are no 'hard rules' for which aspects of financial decision making trustees can delegate except for the Annual Report and Accounts which must be agreed by the trustee board as a whole.

Trustees should also keep control over the terms of reference for sub-committees, the approval of the organisation's strategy; the appointment of key personnel such as the Chief Executive or Secretary and the approval of policies such as the reserves policy, risk management policy and conflicts of interest policy.

Trustees should set out the decision-making powers of staff, sub-committees or individual trustees in a **'Scheme of Delegation'**. This should include all aspects of the charity's work including financial decisions. This sets out the responsibilities and powers of these groups and ensures that all parties (and external stakeholders such as the Charity Commission) are clear about how decisions are made within the charity.

This Scheme of Delegation and reserve powers (i.e. decisions that only the trustee board can make) should be regularly reviewed and adapted as the circumstances of the charity change.

The financial environment for a charity can change very rapidly, and trustees should ensure that they have in place a process for urgent financial decisions to be made and properly scrutinised. This may involve a telephone conference or web conference to ensure that trustees have the chance to make their views known and a decision taken quickly.

HOW CAN TRUSTEES BALANCE THE NEED FOR OVERSIGHT WITH DELEGATION TO CHARITY EXECUTIVES AND STAFF?

There is no easy answer to how trustees can balance the need for oversight with delegation. It is a continuous process of refinement and adaptation to the circumstances facing the charity.

However the best way to ensure the right balance is through clear and effective communication between staff and trustees which have been given decision-making responsibilities and the main trustee board.

A regular flow of clearly presented information from staff, sub-committees and trustees will enable trustees to understand the operations of the charity and make an informed decision about whether delegation is working in the best interests of the charity.

Trustees should insist on getting the information that they need to be assured that financial decisions are being made in the best interests of the charity.

Sometimes Trustees may not feel they are getting the information they require. This doesn't automatically mean staff are being obstructive. Trustees should consider:

- Is the information being requested relevant to the way the charity manages its affairs?
- Does the charity use different information or in a different way that achieves the same ends?
- Does the charity have the capability or systems to deliver the information?
- Do Trustees and executive share the same understanding of the question being asked?

Exploring these questions in an open and supportive way will over time build trust and confidence and a shared understanding between Trustees and the executive.

Trustees should therefore keep asking questions at trustee meetings about all matters related to the charity's operations, including those that have been delegated to others. This is in keeping with the characteristics of a good trustee being knowledgeable and inquiring about their charity.

WHAT ARE THE KEY FINANCIAL QUESTIONS THAT TRUSTEES SHOULD BE ASKING?

The right questions that a trustee should be asking about their charity depend on the financial circumstances of the charity. A knowledgeable and informed charity trustee, with a clear understanding of the charity's operations and financial strategy, will be able to ask the right questions.

No checklist or template can substitute for trustees understanding and good judgement.

However there are some questions that trustees should know the answer to, if they are effectively overseeing the finances of their charity.

- Do we understand how income is generated and the risks/opportunities associated with various income streams?
- How do we cost the work we do?
- How do we demonstrate that we using our resources effectively to achieve our charitable objectives?
- Have we got the right skills on the board, or access to the right advice and support, to adequately manage our finances?
- Have there been any events that will reduce our income or require us to increase our expenditure since the trustees last met?
- What are our income streams for the next 6 months, 12 months and 24 months?
- Do we have the income necessary to sustain our operations for the next 6 months, 12 months and 24 months?
- Do we have the right strategy to make the most of our assets (land, property, cash, intellectual property) to further our charitable purposes?
- If we have any liabilities (e.g. pensions, loans) is our strategy to reduce or manage these liabilities working effectively?
- Do we understand the charity's cash flow e.g. if we are now being paid in advance, what would happen if income became payment by results?
- Is our current level of unrestricted reserves adequate for the risks facing the charity and opportunities the charity may need to take?
- Are we confident that our charity is not being subject to fraud or being used to facilitate financial crime?

The Charity Commission has developed 15 questions on governance, finance and resilience that it would encourage trustees to ask at board meetings, you can read them on the Charity Commission's website: www.gov.uk/government/publications/charity-trustee-meetings-15-questions-you-should-ask

HOW WILL TRUSTEES KNOW THEY ARE COMPETENT AND DOING A GOOD JOB?

Trustees should regularly discuss whether they are competent and performing effectively on behalf of the charity. There is no shame for a trustee to stand down as a trustee if they feel that they do not have the right skills to do the job or if they do not have the time required to serve the best interests of the charity.

Many charities work with external consultants or advisors to improve the effectiveness of their board and if trustees feel that they need support, they should draw on external expertise.

However, if trustees carry out their duties with their charitable purposes at their heart, with a good understanding of work of their charity, asking questions where they are unsure and keeping an objective perspective on decisions, they can be confident that they are approaching decisions in the right manner.

NO CHECKLIST OR TEMPLATE CAN SUBSTITUTE FOR TRUSTEES UNDERSTANDING AND GOOD JUDGEMENT.

POLICIES AND INFORMATION

5

WHAT ARE THE MAIN FINANCIAL POLICIES THAT TRUSTEES NEED TO PUT IN PLACE?

The policies that your charity will be required to put in place depend on the activities that you undertake and the size of your organisation.

However there are a number of financial policies that all charities should have in place. These include:

- Code of Conduct for Trustees
- Conflict of Interests Policy
- Financial Controls Policy (covering budgeting, contracting, tax, authorisation of expenditure, payroll, expenses, sales, procurement, insurance, cash and banking and all financial transactions carried out by the charity)
- Reserves Policy
- Risk Management Policy
- Remuneration, Pensions & Other Benefits (e.g. season ticket loans, opticians vouchers, health insurance etc.) Policy
- Redundancy Policy (if you employ staff)
- Accounting and Reporting Policy
- Health and Safety Policy
- Fraud Policy
- Whistleblowing Policy
- Anti-Fraud Policy
- Fundraising Policy (if your charity is audited)

Your charity may need other policies (e.g. volunteering policy, investment policy) depending on your activities. If you are unsure if you have the right policies for your charity, seek professional advice.

Top tips for effective financial policies

- **Don't reinvent the wheel** – if you are a small charity you can probably use templates for policies that have been developed by other charities or professional bodies. However, if you are a larger charity, you may need to tailor your policies to work for your charity.
- **Practicality is key** – if you are a small charity that is run by volunteers, make sure that your policies reflect this. Long and complex policies may give the illusion of security, but if they are not practical or proportionate, they won't work.
- **Consult** – talk to those that will work with these policies to make sure that they work, there may be practical barriers that you are not aware of as a trustee. You may also need to draw on professional advice, particularly if it involves complex areas of law.
- **The shorter, the better** – policies should contain the information necessary for trustees, staff and volunteers to understand their responsibilities and appropriate procedures. The shorter the document, the more likely it is that it will be understood and remembered. Policies are about principles, procedures are about processes and these should be more detailed.
- **Regularly update and review** – do not leave policies on a shelf for long period of time, make sure that there is a process for regularly reviewing them.

WHAT REPORTS AND INFORMATION DO TRUSTEES NEED TO FULFIL THEIR FINANCIAL ROLES AND RESPONSIBILITIES?

Assuming the charity has developed a robust strategy with supporting financial strategy and longer term projections trustees will require regular flows of information from staff in order to oversee the finances of their charity to check they are on track. The two core pieces of financial information that all trustees should have is a **Budget** and regular **Management Accounts**.

A budget is estimate of income and expenditure for your charity over a period of time (usually a year). This should be agreed by trustees before the financial year begins and be consistent with the first year of the financial projection on the strategic plan. The budget enables trustees and executive to monitor the financial performance of the charity against initial targets.

Management Accounts are a set of summarised information (income, expenditure, assets and liabilities) produced on a regular basis within the financial year (e.g. monthly) that enables trustees to see the financial position of the charity and take informed financial decisions. Good management accounts:

- Should present the information in a relevant way, e.g. income and expenditure by activity
- Should be accurate enough to enable timely delivery
- Provide narrative explanation, not just data
- Will be forward looking, including forecasts
- Include information on cash flow as well as income and expenditure
- Easy to read
- Include information from outside the organisation's boundaries
- Doesn't overly complicate the picture
- Include relevant non-financial information

Be wary of adding schedules or additional appendices on top of your management accounts. Although trustees may want assurance that more detailed information is available and being used by management, or find it useful to review more detailed information from time to time as part of gaining any necessary assurance this may end up complicating the picture, a good set of management accounts should pull out all the key pieces of information. If trustees feel that there is a lack of information or detail, then this is something that should be addressed through the main management accounts. Charities with significant assets (such as investment or property portfolios) or liabilities (pensions or loans) may get additional reports on these particular items.

Trustees should regularly ask themselves whether they have the information needed to make informed financial decisions in the best interests of the charity. If they cannot positively answer that question, they should seek to build in additional reporting or information sharing to enable to confidently make decisions.

HOW SHOULD TRUSTEES MANAGE RISKS?

Risk management

Risks are those things which prevent the charity from achieving its objectives.

Financial risk management is making sure that the charity has the resources it needs to continue its work in the event that reality turns out to be different from that which was planned.

Part of the role of being a trustee is to identify and take decisions to avoid, reduce or mitigate against risks that may hamper the ability of your charity to achieve its charitable purposes.

Trustees of larger charities (those with an income exceeding £500,000 a year) are required to issue a 'risk statement' in their annual report that outlines the key risks that they have identified and the actions that they are taking to mitigate against these risks.

Your approach to risk management should reflect the level of risk that trustees perceive for the charity. This can be based on a number of factors including the complexity of your charity's operations, the demands of regulators (whether the Charity Commission or a sector specific regulator, such as Ofsted or Care Quality Commission) and your charity's dependence on external forces (e.g. donors, funders, government policies, market or economic conditions etc.).

Trustees should focus on a small number of 'strategic risks' that their organisation faces, whilst working with staff or volunteers to manage and mitigate against operational risks.

Examples of strategic risks include:

- Impact – are you making the desired impact for your beneficiaries?
- Financial sustainability – are you financially sound and can continue to operate in the medium to long term?
- Compliance – are you meeting your regulatory, legal and donor compliance requirements and expectations?
- Reputation – are you at risk of any reputational damage and can you manage threats to your reputation effectively?
- Governance – do trustees actions effect positively the charity of operations?

SOURCE: Charity Finance Group & Sayer Vincent, Rethinking Risk, 2016

Strategic v Operational Risk

Generally, trustees should focus on strategic risks rather than operational risks, although in a smaller charity, trustees may be forced to also consider operational risks facing the charity.

Strategic risks are those risks which your organisational cannot control or are significant enough to significantly undermine their ability to achieve their charitable objectives.

Operational risks are those risks which you can control and are part of your day-to-day operations. Effective operational risk management involves putting in place controls and procedures for trustees, staff and volunteers to effectively manage and avoid risks in their work.

The approach to managing risks should be articulated in a clear and accessible policy which enable trustees to have confidence that risks to the organisation are identified and managed.

Strategic risks facing the organisation should be regularly discussed at board meetings and trustees should ensure that they have information about these risks and how risks are being managed in their organisation.

Trustees can use a range of tools to manage risks including risk registers (which map and assign levels of likelihood and impact for risks facing the charity) and risk logs (to record risks that have been identified and dealt with. However, the most important action that trustees can undertake is to encourage an effective **risk management culture** in their charity so that trustees and staff feel empowered to identify and manage risks that they encounter.

Dealing with financial mismanagement

Instances of financial mismanagement (i.e. financial management of the charity which is careless and negatively undermines the financial position of the charity) and abuse are very rare; however, it is important for trustees to be vigilant. One of the best ways to achieve this is through having a healthy, respectful relationship between the trustees, staff and volunteers so that trustees are able to oversee and ask questions about charity operations without undermining the work of professional staff or volunteers.

Trustees should have confidence in each other and in their staff to run the charity, however, that confidence should not be blind. It should be based on regular communication, robust financial controls and up-to-date information about the financial activities of the charity.

Where mismanagement has been found to take place, trustees should seek to take action immediately and raise their concerns with fellow trustees. If action is not forthcoming, trustees should take their concerns to the Charity Commission. However, this should be evidence based and demonstrable negative impact to the charity. It should not be led by personal opinion or beliefs.

For more information on your responsibilities, read the Charity Commission's guidance CC12: Managing financial difficulties in charities www.gov.uk/government/publications/managing-financial-difficulties-insolvency-in-charities-cc12

FINANCIAL REPORTING

6

WHAT IS THE CHARITIES SORP?

Charities, like businesses and public bodies, have to publish accounts of their financial activities. In order to ensure consistency and effective comparison, the Financial Reporting Council (FRC) creates accounting standards for entities based in the UK and Republic of Ireland. However, charities do not always fit neatly within the standards that have been developed for businesses and public bodies, and so the FRC has empowered the Charity Commission and Office of the Scottish Charity Regulator to create guidance for charities on how to apply the FRC's Financial Reporting Standards in their circumstances. This guidance is called The Statement of Recommend Practice (SORP) or 'Charities SORP'.

This 'joint SORP-making bodies' (Charity Commission and Office of the Scottish Charity Regulator) are assisted by a SORP Committee which is made up of charities, representative bodies and accountants.

It is important for charities to check their accounting requirements (see page 16–17 above) to see what rules they have to follow.

You can read Charity Commission Guidance CC15d for more information on reporting and guidance www.gov.uk/government/publications/charity-reporting-and-accounting-the-essentials-november-2016-cc15d

TO WHOM ARE THE CHARITY AND TRUSTEES ACCOUNTABLE?

All charities except those that are defined as 'exempted' or 'excepted' charities are formally accountable to the Charity Commission. It is for this reason that charities submit their Annual Report & Accounts to the Charity Commission which makes these available to the public through its online register.

The Trustees are also accountable to the Charity Commission for the governance and management of their charity. However trustees' accountability should be seen as much broader than that.

Trustees have a duty to ensure that the charity achieves its charitable purposes and objects. The Charity Commission encourages trustees to interpret this to mean having to account to the beneficiaries of their charity (present and future) to achieve the maximum impact with the resources that they have at their disposal.

The Charity Commission is responsible for ensuring that public trust and confidence is maintained in charities, and is accountable to Parliament and the public. Charities can best support maintaining public trust and confidence in the charity sector as a whole by running their charities properly.

TRUSTEES HAVE A DUTY TO ENSURE THAT THE CHARITY ACHIEVES ITS CHARITABLE PURPOSES AND OBJECTS.

WHAT ROLE SHOULD TRUSTEES PLAY IN FINANCIAL REPORTING?

Trustees have an important role to play in financial reporting by charities.

Ultimately, trustees have to approve the Annual Report and Accounts that are submitted to the Charity Commission. Trustees will be held accountable if these reports and accounts are not submitted or fail to meet the required standards. It is important, therefore, that trustees are certain that financial reports made by the charity are accurate and truly reflect the position of the charity.

The Charity Commission also considers it is a key responsibility to ensure financial statements are submitted on time. Trustees should work with their staff and professional advisors (e.g. auditors) to ensure that they understand what the charity's financial reports mean and how the information is presented to give an accurate reflection of the charity's financial operations.

But it is important for trustees to have the right balance. Most trustees do not have accounting qualifications or financial reporting experience. Trustees must ensure that their accounts and reports reflect their legal obligations and standards such as the Charities SORP. Having access to the right skills and advice to support them in developing accurate financial reports is, therefore, critical.

The legal consequences and reputational impact from inaccurate reporting can be significant. Trustees must take their duty to ensure that financial reports are accurate and meet required standards.

As well as considering carefully the content of the trustees' annual report, other aspects of the financial statements that should particularly be considered by trustees are key accounting policies, significant estimates used and major judgemental areas.

WHAT DOES A GOOD ANNUAL REPORT AND ACCOUNTS LOOK LIKE?

The Charities SORP contains templates for certain aspects of the charity's financial reporting, such as the Statement of Financial Activities (SOFA), which charities must follow. Similarly, for those charities preparing accounts under Receipts and Payments format the Charity Commission produces templates for reporting.

Whilst the Charities SORP gives guidance on how the Trustee's Annual Report and Accounts should be drafted, every charity is different because every charity's activities are different.

However, there are some common features which all good Annual Reports and Accounts have:

- **Clear** – information about the charity's operations and finances are clearly presented and easy to understand. This can be done either through well drafted explanatory text or through diagrams that help to explain the charity's position.
- **Honest** – a good annual report should both highlight where the charity has succeeded in its plan and where it has failed, with explanations of the lessons of the learnt.
- **Comprehensive** – the report should cover all the significant activities that the charity has undertaken over the course of the year to fulfil its charitable objectives.
- **Forward-looking** – the report should outline the charity's future plans and strategies for how it is going to achieve its charitable objectives, enabling stakeholders to hold the charity to account in the future.
- **Focuses on impact** – the report should show how did your activities help you achieve your charitable purposes and what did that mean for your beneficiaries.
- **Understands its audience** – the report should understand its audience, not only the regulator but beneficiaries and funders, providing the information that trustees believe they should know about the charity. If your beneficiaries have disabilities or visual impairments, make sure that your annual report is in a form which is accessible.

Trustees must also ensure that they report on how their charity has carried out their charity's purposes for the public benefit. This is important, as it is not merely talking about your activities but how your activities have benefited the public as a whole, or a sufficient section of the public, to warrant charitable status.

Trustees should read the Charity Commission's guidance on public benefit for more information **www.gov.uk/government/publications/public-benefit-an-overview/public-benefit-an-overview**

You may also find helpful MHA MacIntyre Hudson's guide on "Firing up your trustees report" **www.macintyrehudson.co.uk/sites/www.macintyrehudson.co.uk/files/firing_up_your_trustees_report.pdf**

HOW SHOULD CHARITY PERFORMANCE BE MEASURED AND WHAT IS MEANT BY "IMPACT"?

Charities are different and there is no single measure of charity performance.

As a consequence, trustees have a responsibility to set the objectives and strategy for the charity, with a view to maximising their resources to best achieve their charitable objects. Trustees must then monitor the progress of the charity in respect of these objects and strategic plan. Progress should be publicly articulated through the Trustees' Annual Report and Accounts so that the charity can be effectively held to account.

Trustees should be able to explain and defend to beneficiaries, donors and the Charity Commission what their charity is seeking to achieve and what its plan for the future are. Although external stakeholders will have their own views on what an effective charity looks like or how the charity can improve, it is only trustees that can decide how the charity can best achieve its objectives.

This is a heavy responsibility and trustees should constantly question whether they are using their resources in the most effective way to achieve their charitable purposes.

Part of deciding whether resources are being used effectively is to consider the 'impact' that your charity is having on its charitable objectives.

Impact is the results that your activities have had for your beneficiaries through achieving your charitable purposes. It is different from the outputs (i.e. services or funding) that your charity has carried out over the course of the year.

An example of impact is improving the life-satisfaction of someone with disabilities, measured through a case study or a survey. An example of an output would be running an activity for five disabled people on a weekly basis.

All outputs are likely to have some impact; however, it is up for trustees to consider which outputs are achieving the most valuable impact for their beneficiaries and in achieving their charitable purposes. This is challenging as there is often no consistent measurement that trustees can use, and so trustees should use their own judgement and discuss between themselves to come to a decision on which activities are the most impactful.

CHARITIES ARE DIFFERENT AND THERE IS NO SINGLE MEASURE OF CHARITY PERFORMANCE.

7 RELATIONSHIP WITH AUDITORS AND INDEPENDENT EXAMINERS

HOW SHOULD TRUSTEES INTERACT WITH THEIR AUDITORS OR INDEPENDENT EXAMINERS TO GAIN THE MOST FROM THE RELATIONSHIP?

The foundation of a good relationship between an auditor and independent examiner is getting the appointment process right. Trustees should think carefully about their needs and what support they need from their auditor or independent examiner.

Here are some things you may wish to consider before appointing your auditor or independent examiner:

- **Charity experience or expertise –** if you are a small uncomplicated charity, you may not need someone with extensive charity expertise, though some specialist knowledge is usually valuable. If you are complex or a larger charity which needs to submit Charities SORP compliant accounts, sector knowledge and expertise is desirable.
- **References and previous work –** see if your auditor or independent examiner can provide references for other charities they have worked with and if they can present previous annual reports that they have assisted with.
- **Find out who is going to do your audit/ independent examination –** if you are selecting an auditor or getting an independent examination from a firm, it is important to know who will be working directly with your charity. This will enable you to understand whether they have the 'right fit' with your charity and see if you will be able to strike up a good working relationship.
- **Ask what else they can offer –** some audit firms or independent examiners may have experiences in a wide variety of areas that could help your charity. Make sure that you are getting the most out of your relationship by understanding the full range of services that they can provide.

A good selection process will ensure that you make the right decision for your charity.

Once the auditor or independent examiner has been selected, it is important to have regular communication between the charity and the auditor/independent examiner. In practice, this may be between the Finance Director/Manager or Treasurer and the auditor/independent examiner directly. However, it can be useful to ask your auditor/ independent examiner to come to one or two of your trustee or sub-committee meetings so that they can see how your charity works and for you to be able to ask any questions that you have.

Auditors and Independent Examiners have their own codes of conduct and legal standards that they need to apply to their work with your charity. Trustees should respect these obligations and ensure that they provide auditors and independent examiners with the information and time that they require to do their work effectively.

Every year, trustees should put in place a plan with their auditor/independent examiner for the production of the Annual Report and Accounts to ensure that there is sufficient time for the work to be carried out properly. It is also good practice to rotate audit partners on a regular basis (guidance for auditors suggests every 10 years), and tender for new auditors periodically. Renewing the performance of your auditors or examiners each year in some formal manner is good practice. This will ensure that charities get the support that they need.

You can find some more advice in MHA MacIntyre Hudson's "How to assess the performance of your auditor" **www.macintyrehudson.co.uk/sites/www.macintyrehudson.co.uk/files/how_to_assess_the_performance_of_your_auditor.pdf**

RELATIONSHIP WITH REGULATORS, LAW ENFORCEMENT AND OTHER STAKEHOLDERS

8

Trustees must take into account the guidance of the Charity Commission when carrying out their activities. Not only is this guidance helpful in understanding the legal responsibilities of trustees, it is important in safeguarding the reputation of the charity.

This guide has covered numerous pieces of Charity Commission guidance, and you can find more on its website.

You may find the Charity Commission's Charity Finance: trustee essentials (CC25) useful in understanding the expectations of the Charity Commission **www.gov.uk/government/uploads/system/uploads/attachment_data/file/602509/CC25.pdf**

SERIOUS INCIDENTS

Your charity may suffer a 'serious incident' which results in the loss of your charity's money or assets, damage to your charity's property or harm to your charity's beneficiaries, work or reputation.

It is important that serious incidents are reported to the Charity Commission and declared in your Annual Return.

Examples of serious incidents

- fraud, theft or other significant loss
- a large donation from an unknown or unverified source
- links to terrorism or to any organisation that's 'proscribed' due to terrorist activity
- a disqualified person acting as a trustee
- not having a policy to safeguard your charity's vulnerable beneficiaries
- not having 'vetting' procedures in place to check your prospective trustees, volunteers and staff are eligible
- suspicions, allegations or incidents of abuse of vulnerable beneficiaries

If criminal activity is suspected then you should also report these incidents to the police. However, reporting to the police does not mean that you should not report these incidents to the Charity Commission and a separate report should be made to the Charity Commission following the Serious Incident Reporting framework published online: **www.gov.uk/government/uploads/system/uploads/attachment_data/file/375979/Reporting_Serious_Incidents_LowInk.pdf**

You should also report any serious incident to your auditor or independent examiner so that they can make a note of it for their records and ensure that this is highlighted in your Annual Report and Annual Return.

If your charity fails to report a serious incident, the Charity Commission may consider this to be mismanagement and take regulatory action. It is important that trustees ensure that their charity reports any serious incidents to the Charity Commission.

WHEN TO REPORT

Making a decision on when to report is challenging

It is good practice for trustees to err on the side of caution when making a report. Not reporting could create further difficulties for charities and lead to more aggressive enforcement action. Reporting early, even if it does not lead to any action, will put your charity in a stronger position later should regulatory action be taken against you.

You should be particularly mindful about

Your charity may work in a sector which has its own regulator (e.g. health or education) that may require you to make further reports. It is important that trustees understand the reporting requirement for serious incidents within the sectors that they work.

Funders, donors and other stakeholders

Trustees have no legal responsibilities to other stakeholders (although there may be contracts or binding agreements which outline acceptable behaviour) but funders, donors and other stakeholders may have a significant impact on the ability of the charity to carry out its activities.

Good financial management is the bedrock of a strong relationship with these stakeholders as it increases confidence in the charity and ensures that the charity has reliable information to inform discussions with these stakeholders.

In general, it is best for charities to have an open dialogue with these stakeholders and the public at large. However, trustees should always put the interests of the charity and their beneficiaries when considering their relationships with funders, donors and other stakeholders.

It may be in the interests of the charity to terminate or refuse to enter into financial arrangements if they are no longer in the interests of beneficiaries. Trustees should review any significant relationships regularly in order to preserve the finances and reputation of the charity.

KEY RESOURCES

CHARITY COMMISSION

CC3 – The Essential Charity Trustee

CC8 – Internal finance controls for charities

CC15b – Charity reporting and accounting: the essentials

CC20: Charity fundraising: a guide to trustee duties

CC25: Charity finance: trustee essentials

CC29 – Conflict of Interest: Guide for Charity Trustees

Protecting Charities from Harm: Compliance Toolkit

Charity governance, finance and resilience:
15 questions charities should ask

CHARITY FINANCE GROUP

Rethinking Risk – Beyond the Tick Box

Countering Fraud – A Guide for the UK Charity Sector

Beyond Reserves

MHA MACINTYRE HUDSON

Keeping Your Charity on the Right Track

Firing up your trustee report

Independent examination vs audit

How to assess the performance of your auditor

Preparing effective management information for board reports

Treasurers and finance directors – making the relationship count

How to operate a charity trading subsidiary

Going concern guidance

Charities SORP Webinar

NOTES

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Charity Finance Group (CFG)

15-18 White Lion Street
London N1 9PG

Phone: 0845 345 3192
Website: www.cfg.org.uk
Email: info@cfg.org.uk
Twitter: @CFGtweets

Edited by Kate Bines, Head of Marketing and Communications, Charity Finance Group.

Designed by Steers McGillan Eves
www.steersmcgillaneves.co.uk

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