



<http://www.thirdsector.co.uk/kate-sayer-decoding-finance/finance/article/1437700>

Kate Sayer: Decoding finance

26 June 2017

Finance is about transactions between people and organisations, not just about numbers, says our columnist



Kate Sayer

If you think finance is all about numbers, think again. With colleagues at Cass Business School, I just spent two whole days teaching charity finance without a calculator or a spreadsheet in sight.

Finance is about transactions between people and organisations. The relationship between those people determines the nature of the transaction. In technical language, the financial reporting standard talks about "exchange" and "non-

exchange" transactions. You need to identify which sort of transaction you are dealing with to determine the accounting and tax treatment. An exchange transaction is trading and usually underpinned by a contract and potentially subject to tax and VAT. Receipts and payments have to be coded to reflect the commercial nature of the relationship. A charity delivering services under contract can claim it has earned the income only when it has met the performance standards set out in the contract.

A "non-exchange" transaction is one where nothing is given in return: a donation or a grant. The nature of this transaction and the relationship between the donor and the charity is different. Crucially, it is driven by trust law. It is interesting to pause and consider that the word "trust" is used here. The basis of the relationship is trust. The donor is trusting the charity to use the funds for the purpose for which they were given. In some cases, the purpose may be properly defined, creating a restricted fund. The accounting system then has to track the expenditure of those funds to demonstrate that the donor's trust was warranted. And if the recipient can no longer use the funds for the given purpose, the charity must offer the funds back to the donor. You cannot make a profit from donations – you can only carry the funds forward to use for the charitable purposes in future.

These are fundamental differences. Both grants and contracts have their place and can work well for charities. One of the biggest problems we face as a sector is inappropriate use of contracts and funding agreements that seem to float somewhere between contract and grant. A contract is more suited to tried-and-tested service delivery mechanisms where the funder and the charity have reasonable knowledge about the costs and outcomes. If your charity is trying out new ways of working, developing innovative ideas and inherently uncertain about the problems and outcomes, then a grant is more likely to be appropriate.

The nature of the relationship changes as well as the paperwork. A grant is awarded because the donor and the recipient share goals and have a common understanding of the problems they are tackling. Although the funder might have more power in the relationship, the best funder relationships are partnerships. Charities delivering services on contract are delivery agents for the funder. Although charities try to influence commissioning processes, this is often not possible. This is not to say that charities should not deliver contracted services, but they should just recognise the differences, both in terms of the finance and the relationships.

Kate Sayer is a consultant at specialist auditors Sayer Vincent