Financial governance – what do Trustees need to know?

Jonathan Orchard of charity accountants Sayer Vincent looks at the financial responsibilities that charity Trustees face.

By Jonathan Orchard
Partner at Sayer Vincent

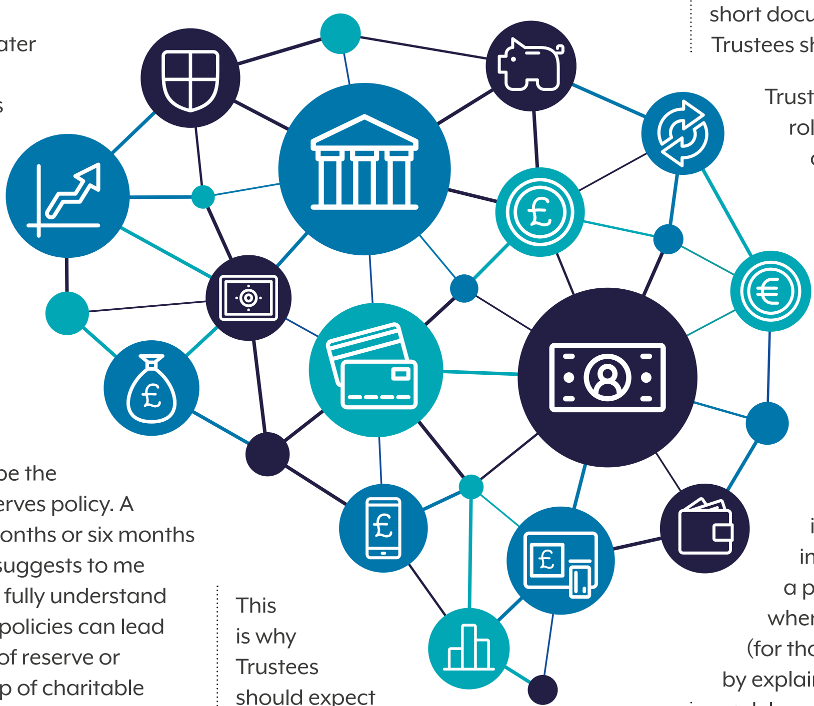
Jonathan Orchard works with a broad portfolio of external and internal audit clients. He has dedicated his career to building the effectiveness of social purpose organisations. He speaks regularly on subjects including charity risk management, internal audit & assurance and fraud prevention. He is a qualified chartered accountant and treasurer of INTRAC.

The Charity Commission guidance – CC25 – gives chapter and verse on the financial responsibilities that rest with Trustees. It is important reading for any Trustee and a helpful reminder for experienced Trustees. But, in practice, for charities with more than a handful of staff, the day-to-day practical implementation of many of those responsibilities will rest with the CEO and their finance team. I want to focus on those areas that I would expect to be at the forefront of the Trustee board at the current time.

Charities are facing greater pressures than ever and many of these pressures are giving rise to increased financial risk. And, in my view, it is aspects of financial risk and an understanding of the charity's business model that should be focusing Trustee attention. Financial risk arising out of a charity's business model should be the key driver behind its reserves policy. A bland policy for three months or six months of income/expenditure suggests to me that the Trustees do not fully understand the financial risks. Such policies can lead to either too low a level of reserve or the unnecessary tying up of charitable resources. The kinds of financial risks that should form the basis of a reserves policy include:

- income security
- nature of cost base
- level of long-term commitments
- future strategic investments
- other risks that may draw on unrestricted funds (foreign exchange, matched funding, donor clawbacks)

Reserves help to secure medium term financial viability. Working capital management secures short-term survival. Reserves and working capital are often considered together and while they are related it is perfectly possible to have strong working capital and no reserves and vice versa. The funding environment is increasingly requiring pre-financing or sufficient working capital to absorb funding in arrears. Headline income growth can mask working capital difficulties which, if combined with high fixed costs, can bring a charity down.



This is why Trustees should expect management accounts to include balance sheet trends and cash flow forecasts as well as an income and expenditure account.

Trustees should therefore ensure that they know their charity's business model and the key financial risks that arise. They also need appropriate assurance mechanisms in place to give them the confidence in how those risk are being managed.

Charity fraud is very much in the Charity Commission's spotlight – a high proportion of serious incident reports relate to fraud. Nothing harms a charity's reputation more than the risk that donor funds are lost through fraud. Yet in too many cases, fraud risk only hits the Trustees' radar after an incident has happened. To help Trustees, the Charity Commission has produced a short document on the 10 questions that Trustees should ask in relation to fraud.

Trustees also have an important role in setting the policy for how a charity's finances are reported on externally. Obviously, the annual Trustees' report and accounts are one aspect of this. I read many Trustees' reports and am often disappointed at the quality of the financial commentary. There is a real missed opportunity to use the Trustees' report to tell the story of how a charity converts its financial inputs into social impact. This is ultimately what a potential donor is looking for when they read a set of accounts (for those that do). This can be done by explaining more about the financial model and how critical resource allocation decisions are made.

But there are other ways in which charities communicate their finances. Simplistic use of cost ratios – eg x% of income goes on 'charitable expenditure' – might strictly be true per SORP definitions but be misleading in the eyes of the general public and result in reputation risk. The question of what messaging is and isn't appropriate is a valid one for Trustee consideration.