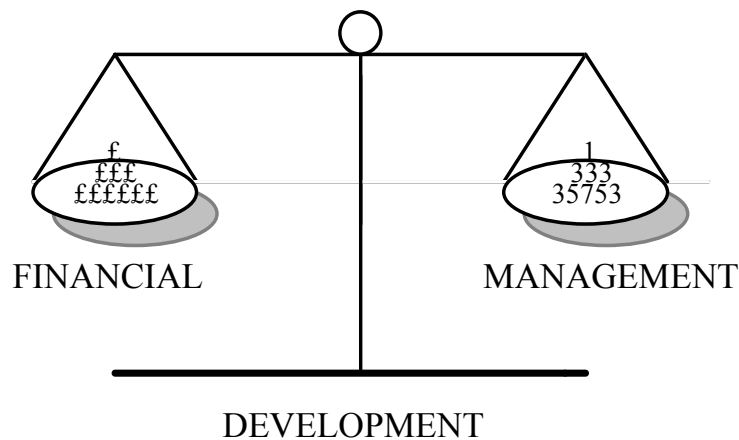


# FINANCIAL MANAGEMENT DEVELOPMENT

## CHARITY MANAGEMENT

NO 701

### MANAGEMENT REPORTING ISSUES



ONE OF A SERIES OF GUIDES FOR  
FINANCIAL MANAGEMENT DEVELOPMENT

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This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

# MANAGEMENT REPORTING ISSUES

## OVERVIEW

Charities and other Not For Profit organisations face similar financial and reporting issues to ordinary businesses. However in certain respects they also have to contend with specific problems which are unique to their way of working. This document sets out six key areas which those responsible for Charities and Not For Profit organisations may find helpful to consider when deciding upon the most appropriate reporting and management systems for their activities.

Other papers cover some specific Financial Issues relevant for Charities. Throughout these documents the word Charity is used to cover the whole range of Not For Profit organisations and Trustees used for those responsible for them. The comments generally are aimed at entities with income of over £100,000 and paid staff. For those running small charities, or with no employees, your time may be better spent pursuing the charitable objectives rather than reading this. Inevitably in a document of this length covering diverse topics, there will be some glossing over technical points. Like St Paul I am offering milk until you are ready for solid food (1 Cor 3:2) Those requiring full details should take advice from professionals, if you can, on a "Charitable" basis.

## OBJECTIVES (If "Not for Profit" then for what?)

Most Charities will have fairly broad objectives "The provision of assistance to the homeless of London" The problem is that these are often difficult to measure in terms of "outputs" e.g.- more than 90% of the homeless in London will say yes to the question "Did we help you last month?"- is difficult to organise. Therefore charities tend to rely on the measurement of "inputs" e.g. during the month of September 30 bed spaces were provided and the occupancy rate was 90%. This of course says little about the quality of the provision or the fact that people might have been turned away.

The task for good Charity managers is to turn the Charitable objectives into SMART (Specific, Measurable, Achievable, Relevant and Timely) objectives. These then need to be communicated to the relevant personnel and monitored in a way which is meaningful and helps achieve the objectives. Any fool can achieve 100% occupancy by providing too few beds. It is easy to reduce cost per bed by having too many, or by never filling them. It is better to let the staff consider what would be sensible monitoring statistics or Key Performance Indicators to help them manage and then summarise these into management reports. Thus a Hospice may have number of deaths per month and average length of stay as indicators of workload, not with the intention of motivating staff to improve the numbers, but with a view to identifying trends to help future decisions.

**What are the objectives of your Charity and are these expressed as SMARTs?  
Are Key Performance Indicators consistent with the objectives and with each other?  
Do workers in all areas of the Charity know, understand and agree with theirs?**

**OWNERSHIP AND MANAGEMENT (Who is in Charge?)**

In Companies the Shareholders own the Company and they delegate to the Management, whom they appoint as Directors, the task of using the money they have invested in the Company to make more money by selling goods and services for more than they pay for them. The Shareholders pay management for this activity. Whilst the Company will have Governing Documents (The Memorandum and Articles of Association) these tend to concentrate on legal niceties and normally allow the Company to do almost anything, as long as it is in the interests of making a profit. In owner managed companies the shareholders may appoint themselves as Directors but in essence they still have two distinct roles - one as owner, one as manager. There is no question of who is in charge. You cannot fire a shareholder, however incompetent. The law attempts to protect the public, employees and customers from excessive incompetence, but the most the Shareholder can suffer is the loss of their investment in the Company.

Charities have a Governing Body, responsible for the pursuance of the Charitable objectives. Their name and nature will depend on the legal form of the Charity, which may be a Government created Body or Corporation; a Trust with Trustees, which has its own legal personality; or a Company Limited by Guarantee, where "nominal" shareholders agree to contribute in the event of the Company being wound up (normally a nominal amount such as £1). These Council Members, Governors, Trustees, or Directors do not own the Charity. They are custodians of it. They may decide to pay managers to carry out the work of the Charity, they may decide to do it themselves for free. They are responsible, but have no ownership. They may have invested time and money in the Charity but have no right to receive anything back. If they wish they can leave.

This gives rise to an interesting problem. Who is responsible for the Charity? The default is the Charity Commissioners. Thus if a Charity is set up and after a time the Trustees leave and no one wants to replace them the Charity Commissioners will have the task of doing the best they can with any assets remaining. In effect they will seek to act in the interests of the public or a defined section of it, in accordance with the Charity's objectives since to gain charitable status the key test is that the body should provide public benefit. Thus no one really "owns" the Charity. However "nature abhors a Vacuum" and in the absence of ownership problems are likely to arise between Trustees and Managers as to who is in charge and this can manifest itself in difficulties for the employees. "No man can serve two masters" (Matthew 6:24).

Charities start as purely voluntary activities. If they grow they need to employ professional full time staff to carry out the charitable objectives. The founders or their successors continue as managers. If there is further growth, a need develops to employ professional full time managers. The founders then move to becoming "Trustees" whose role changes from involvement in operations to a purely review activity. Whilst as individuals they may supply specific skills as volunteers, their Trustee role is to ensure the health of the Charity by employing managers who manage according to the overall guidelines set by the Governing Document as interpreted by the Trustee body.

Normally, but not necessarily, this will involve the appointment of a Chief Executive who will report to the Trustees on past activities and discuss proposals for the future. If there is a management group reporting to the Governing Body it is still likely that one person will be designated "Chief Executive" even if they have operational responsibility as well. In essence the Trustees role then ranges between the protection of the Charity from a poor Executive to the provision of support and advice to a good Executive. It is not easy being a Trustee but the key to doing it well is to consider how will the long term interests of the beneficiaries be best met, even if this means taking hard decisions in the short term.

A clear statement of responsibilities is vital. Mixed representation of Trustees and Staff on key committees will help. The Trustees are responsible for Direction, the Managers are responsible for Action. It will only work if there is broad agreement between both groups on what is to be done and why. The Budget (short term) and Strategic Plan (long term) are much more important documents than in most organisations. Without agreement on both their letter and spirit, the smooth running of the Charity and therefore the achievement of its objectives are imperilled.

**Are the respective roles of Trustees and Management clearly defined?**

**Do all concerned know, understand and agree with them?**

**When were they last reviewed and revised to cope with operational changes?**

### **INCOME NOT SALES (What do we do to get money?)**

Most commercial organisations have simple equations to monitor to survive:

The selling price needs to be more than the cost per item; the volume of sales needs to provide sufficient gross profit to cover overheads; and cashflow needs to be reasonable. Charities are different. Charities raise money in various ways: some have trading entities to raise money e.g. charity shops, some receive payment for services e.g. Schools and Universities, some rely entirely on Donations, some may have a mix of all three.

#### 1. Trading Activities

The running of trading activities is primarily to provide funds to support the charitable objectives. All actions should therefore be driven by the same commercial motives, and use the same financial evaluation techniques, as any normal business. If there are "publicity" benefits these should be estimated in the form of additional donation income from the generation of Goodwill. Similarly if Trustee, management or volunteer time is absorbed, the cost should be estimated and charged for. Whilst it may be fun for someone to spend a week making marmalade to be sold at the Annual Fair, the cost is what could they have done instead (counting donations and banking them), and they may make more for the Charity doing it. No entries need go in the books for these incomes and charges but estimations help when it comes to decisions like: How many shops to have, or what level do sales in the shop need to be to be viable? Just because someone gives their time for free does not mean they should spend it unwisely.

**Are all Trading Activities covering their true costs (including management time)?**

**What is the minimum level of net income for each activity to be worthwhile?**

## 2. Payments Received for Services

The objective of Government is simple: The collection of monies through the tax system to fund activities which are best paid for other than at the point of sale e.g. education and health. The mechanisms for this should be simple, transparent and aim to minimise collection and distribution costs. They rarely are. The role of the Charity is to establish which services are likely to receive funding, how much, what the rules are and which forms etc have to be completed. Then the charity should consider whether the funding justifies the effort. If it does, the charity should ensure it carries out the services in conformance with the rules and claim the payment as speedily and efficiently as possible.

An individual should be appointed to manage the relationships and in particular to carry out risk assessments of all potential changes to the nature and basis of the funding, since Government Departments in particular, have a track record of changing the rules with minimum consultation and notice. Management control includes applying accruals accounting concepts to ensure that the inconsistencies inherent in the peculiar methods of cash provision in the Government sector do not corrupt the proper accounting for the charity. For example the government may pay an annual fee based on estimates in advance, the charity should recognise this as income based on real provision monthly, holding the rest as a creditor until it is earned.

**Are the rules for the provision of funds understood by all?**

**Has the risk of the basis being changed been considered?**

**Is this "earned income" properly accounted for?**

## 3. Donations

This includes all fundraising, legacy and grant income received with no obligation being incurred in return. Some donations e.g. Lottery and other grants may be for specific purposes. In which case they should be considered as 2. above. It is in the nature of Charitable income that it is freely given and no benefit accrues to the donor, other than the satisfaction of knowing that the money will be used for the charitable purpose.

The Charity's objective is to maximise the net benefit from this income i.e. gain maximum income, whilst spending minimum time and money to obtain it. This leads to considering if paid or professional fundraisers should be employed and the ethical nature of the tactics used. The former can be considered on purely financial grounds; "Will the additional cost of the fundraiser be more than covered by the **additional** funds they raise?" The latter is beyond the scope of this paper. However it is reasonable to calculate the net benefit (i.e. income less costs including time of volunteers) from the various potential approaches: mailshots, lotteries, street collections, advertising and compare them with each other. Firstly to assess whether they are worth doing at all and secondly to assess which should be done if they cannot all be undertaken at once for reasons of practicality or resource constraints. Target setting for fundraising has to be sensitively done. There is no point in upsetting donors with too many requests at once, and there is a danger of short term goals being achieved at the expense of long term relationships.

**Have all existing Fundraising activities been reviewed for cost effectiveness?**

**Are potential new initiatives evaluated and ranked against existing practices?**

**Is volunteer and management time costed in to help make decisions?**

**EXPENDITURE DEPENDS ON INCOME (What if there is no money?)**

For most charities the constraint on their activities is not the marketplace. Since their services are subsidised or free the market is often effectively limitless. The constraint is the income available to provide those services. In some cases this can lead to problems with budgeting for unpredictable income streams e.g. legacy income or one off requests to grant making bodies. Whilst it is reasonable in one year to have an imbalance between income and expenditure, a continuing deficit is likely to lead to the disappearance of the Charity and a continuing excess is likely to result in the disapproval of the Charity Commissioners (See Reserves policies the financial paper on SORP 2000).

The best approach is to use flexible budgeting, based on sensible income forecasts. "We will continue to maintain current staff levels but if legacy income is more than £25,000 in the first quarter we will take on two more nurses." This approach should be based on some simple statistical data. It requires reasonably up to date and accurate management accounts. A rolling 12 month graph of specific erratic income streams can often help to calm the fears of those who say "but what if we get nothing" and also restrain the ambitions of those who say "the money will come in somehow". God asks us to live by Faith but he also gave us brains and calculators. Priority based budgeting is also helpful in this regard. Some spending is essential for the charity to continue in operation, but all discretionary spending should be listed in order of priority, so that all concerned can identify what might or might not be done - income permitting.

**Are erratic sources of income monitored to iron out fluctuations?**

**Are all agreed on what will be done/not done if income is more/less than budget?**

**Is there a sensible policy on deficits and transfers to reserves in any one year?**

**VOLUNTEERS NOT STAFF (I don't want money)**

In many cases the people working for a charity do so at less than commercial market rates, in some cases for nothing. The volunteers may even support the charity through giving money as well as time. This has numerous impacts, one of which is the consideration of issues like employment contracts, notice periods, minimum wage, etc which are beyond the scope of this paper. Another is the difficulty of managing volunteers, particularly if they are underperforming. It is difficult to issue a formal warning, let alone fire someone who works for free.

Here it is merely important to note that the normal rules of employee/employer bargaining may not hold good when working in a charity. Thus people will work in an evangelising community for £2,000 per year. They do it for the love of God and if offered more they might take it or refuse it. They may be quite happy to know that someone else who does the same gets paid £20,000 because they have a family to support. A good Trustee or manager will have to consider whether letting people be so generous is fair to the individuals and balance their needs with the need to perform the charitable work and the other resources available. "Do not muzzle the ox while he is treading the corn" (Deuteronomy 25:4 and 1 Timothy 5:18) is a good example that the labourer is worthy of his hire.

This particularly applies to Trustees themselves. If you find you are neglecting your family, your work or your business in order to do things for Charity, you may need to consider whether you are being fair to yourself, and to others. The Church is like a Body and it believes all parts are valuable and need exercise. It is wrong to try to do it all yourself. It may deprive your neighbour of much-needed exercise.

Another area of concern is that volunteers have no contract and may leave at any time. You need to consider how this would impact on the organisation. Some Charities have the reverse problem in that people refuse to give up the work that they have been doing for the last 60 years. This is fine if they are being helpful and productive, but difficult to deal with when they insist on typing everything rather than using a word processor.

**Are Volunteers cared for as effectively as staff?**

**Is there a sensible succession plan for volunteers and their activities?**

### **DONATED ASSETS, GOODS AND SERVICES**

Donated assets are straightforward. Bring them in as a donation at a valuation and account for the depreciation of the asset as normal. Donated goods should be on a similar basis, although very often they do not appear in the accounts at all. Thus someone may print the annual accounts for free, which is wonderful but can cause problems of management when reviewing the cost against budget. Goods donated for sale in charity shops are frequently ignored until sold when the sales proceeds then come in as a donation. Fine, but the Balance Sheet then understates the value of the assets.

Donated Services, e.g. Trustees time is a more difficult area. Frequently this is ignored and this can lead to poor management decisions internally (considerable time is spent keeping unnecessarily complicated records by hand - because the volunteers do it for free and a computer would cost money) and misunderstandings externally. The UK Government claims to fund one third of the cost of Hospices as the amount paid equates to one third of the disclosed costs. However the Hospice movement receives vast support from unpaid volunteers so its true costs are considerably higher than stated in the Accounts. One Treasurer has estimated that the amount the Government contributes is less than one tenth of the costs when taxation is properly accounted for.

**Are donated assets and goods properly accounted for and valued?**

**Is the value of donated time considered at opportunity cost when making management decisions?**

Managing a Charity is not like running a business. The objectives are different, there are no obvious owners, the income stream is different (if you have a bad year, people may want to give you more money!), the expenditure is what you can afford, not the minimum you can get away with, the workers are not motivated by money, and many costs fail to be recorded. In essence it is more like being head of a family. We all need to broadly agree what we are doing, we are all in it together, what we get in and what we spend vary with effort and over time, and we all give our time and effort to make it work. Like being in a family the rewards are spiritual rather than monetary.

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David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development.

He has worked as a Financial Controller and Company Secretary in the Finance Industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over thirty major organisations including Arla Foods, Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, The Post Office, Rothmans and Zeneca. International training experience includes work in Denmark, Kenya and the Czech Republic for Unilever, in Dubai for Al Atheer, in Holland and the U.S. for Avecia and Zeneca and in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. A key output from the training is demonstrable use of the knowledge and skills acquired to enhance corporate profitability. In addition he has run courses in acquisition evaluation (The Economist, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). He has also developed material for delivery by in house personnel (Royal Mail, Lloyds Bowmaker and Conoco), computer based training packages (The Post Office, Unilever and BP) and post course reinforcement workbooks (CSC and Zeneca). He has also produced a training video on Cashflow Management.

He is a prolific writer of case studies, role plays and course material, he has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants and the need for taxation awareness training for general managers. He is also an active promoter of the need for the demonstration of the benefit of Christian values in the workplace, as a founder member of the Christian Institute of Training and Development.

He is married with one grown up daughter and his outside interests include being a Trustee of Crew Trust (Catholic Charismatic Renewal in England and Wales), a Trustee of the Sion Community for Evangelisation, The Treasurer of the Hospice of St. Francis (Berkhamsted), a Governor at Dunstable College and a member of the Catholic Evangelisation Services Team (producing video series on the love of God for His people expressed through His Church) and the Catholic Alpha Training Team (Promoting the Alpha course on Basic Christianity). He was a Governor of Luton University for nine years and a school Governor for four years.

**This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared with all (Matthew 10:8).**