

# Finance for Non-Finance Managers

14<sup>th</sup> July 2016

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# Introduction and Objectives



## **I hope you will get:**

- A good understanding of some key finance-based concepts
- Why they apply to you and your role
- And thus how you can make a difference in your organisation's financial management

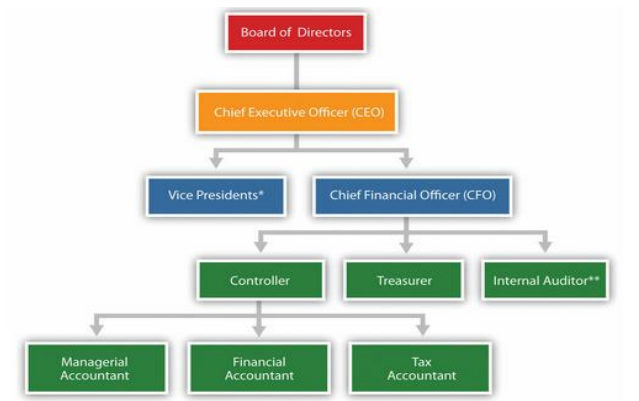
# Contents

- **Key finance concepts**
- **The difference between cash and profits**
- **Costs and costings**
- **Budgets and cash flows: why and how**
- **Management and financial information**



# The why of finance

- Statutory obligations (Charity law, Company Law etc)
- Managers need to report to stakeholders (owners)
- enabling external stakeholders to understand and compare results
- Produce reports that can be used for internal decision making



# The why of finance



## Statutory Duties

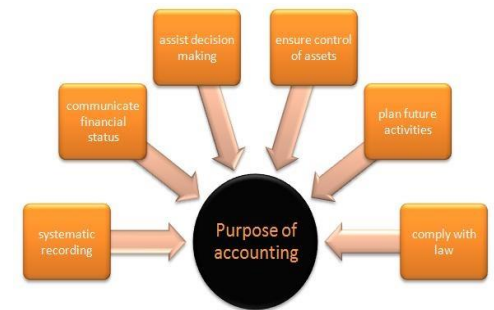
- Maintain accounting records
- Prepare and submit statutory accounts
- Audit responsibilities
- Maintain statutory registers
- File returns and reports
- Meetings and other administrative matters

# Financial Reporting

ASSETS		LIABILITIES		EQUITIES	
Debit for Increase	Credit for Decrease	Debit for Decrease	Credit for Increase	Debit for Decrease	Credit for Increase
↑	↓	↓	↑	↓	↑
+	-	-	+	-	+

Accounting books and records would show:

- summary of all financial transactions
- The resulting surplus/deficit (profit or loss)
- The financial state of affairs at a given date
- Explanations



# Financial Reporting



Hence

- **Income and Expenditure Account**
- **A Balance Sheet-** list of assets and liabilities the organisation has at a particular date
- **Notes to the accounts-** explanation of the figures and the policies used
- **Trustees (Directors)' Annual Report**

# Financial Reporting

- The law requires summary of finances to be produced
- So that stakeholders can understand the organisation's financial position
- Organisations can be compared
- Managers can be called to account
- Relevant decisions can thus be made going forward





# Financial Reporting

## The Trustees (Directors) Report

- Explains financial performance
- Puts into context activities /achievements against plans and objectives set
- Outlines plans for the future



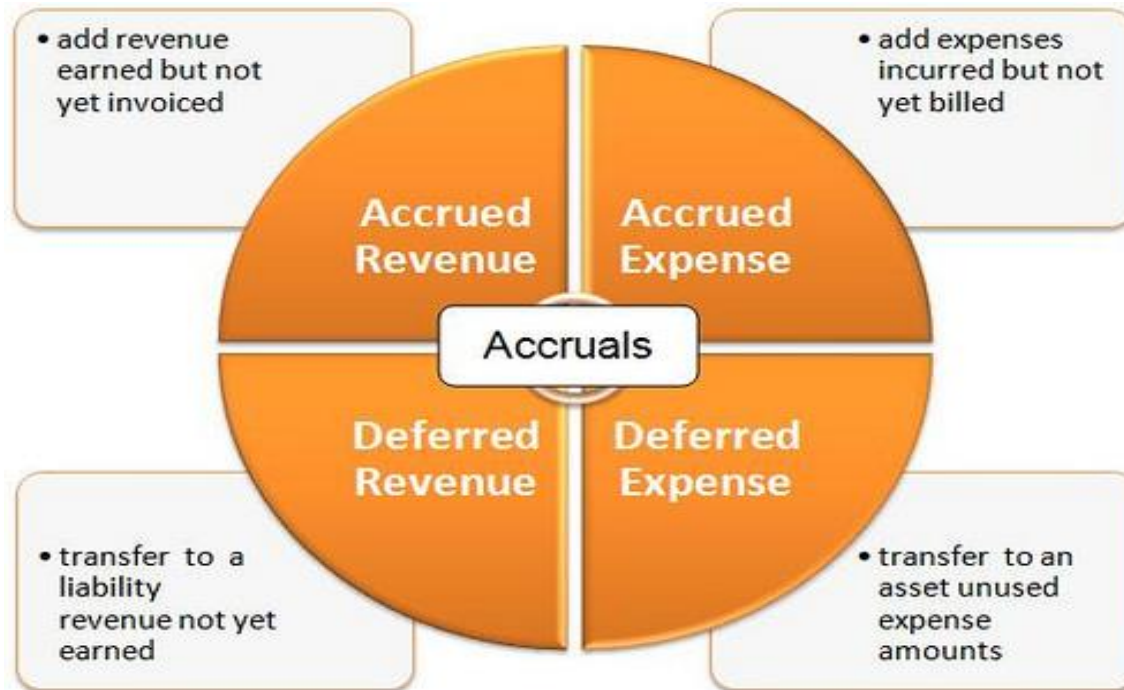
# Financial Reporting

## The Income and Expenditure Account

- Income
- Expenditure
- Surplus (profit) or Deficit (Loss)
- Brought forward
- Carried forward



# Basic Terminology: Accruals



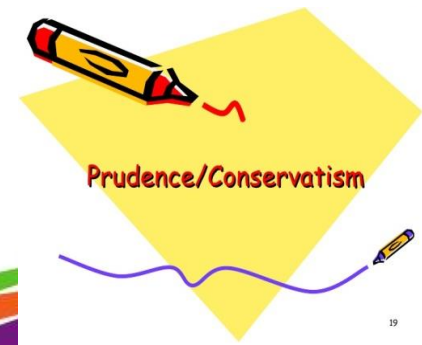
# Basic Terminology

*The **Accruals concept** which subject to prudence, brings the relevant transactions into the same period of account, without regard to the actual dates of receipt and payment;*



# Basic Terminology

- *The "**consistency**" concept of treating like items alike within the accounts and from one year to the next; and*
- *the "**prudence**" concept of making provision for all actual and probable liabilities, but only including assets as incoming resources when they are definitely realisable.*





# Balance Sheet

- Fixed Vs current assets
- Depreciation of tangible assets
- Valuation of current assets- stock write offs, bad debts
- Importance of debtors and creditors
- Accruals, prepayments and deferred income



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# Accounting policies

- **Basis of preparation** of accounts
- **Treatment of incoming resources**- accounted for only when received or definitely receivable (gross of related expenditure)
- **Resources expended**- reported when incurred (gross of related income)
- **Capitalisation of fixed assets** e.g only where purchase price is greater than £X
- **Investments**- stated at market price at balance sheet date





# Financial Reporting

## Accounting books and records

- **Nominal ledger**
  - Cash records
  - Records of all sales and income receivable
  - Records of all purchases and expenses
  - Details of capital expenditure
- **Sales ledger** (accounts receivable)
- **Purchase ledger** (accounts payable)

## ACCOUNTS



## SOFTWARE

# Audit/Independent Examination

## CC63-Independent Examination of Charity Accounts:

*“Charities’ Act embodies the concept that some form of independent scrutiny is required for the accounts of all but the smallest charities, but ....(may not be) a full requirement for an audit”*

A



# Independent Examination



## CC63:

- Unincorporated charities with gross income and total expenditure under £250,000 may elect for independent examination
- Unincorporated charities with gross income and total expenditure under £10,000 do not need to have an independent examination
- **Except**
- If governing document stipulates audit
- Other statutory requirement (e.g. Company Law) stipulates audit
- Audit is a requirement of donor etc



# Audit/Independent Examination

## CC63:independent examination

- Review of the accounting records kept by the charity
- A comparison of the accounts presented with those records
- Review of the accounts
- Consideration of any unusual items or disclosures identified
- *No true and fair view opinion needed*

# Basic Terminology

**GOING  
CONCERN**

The importance of

- **Liquidity**- assets in cash or near cash form
- **Solvency**- enough assets to cover liabilities, to continue to be a
- **Going concern**- able to meet debts as they fall due

**Budgets and budget management enables this to be done effectively!**

# Basic Terminology

**GOING  
CONCERN**

## Going concern

- *“concept used for valuing assets and liabilities on the basis that activities will continue uncurtailed for the foreseeable future ~ (in particular, the following year) and that there is therefore no need to use liquidation valuation principles”*

# Basic Terminology



**A true and fair view of:**

- **Incoming resources** for the financial year;
- **Application of resources** in the financial year;  
and
- **State of affairs or financial position at the end of the financial year**

# Costs and costings

## Variable costs

- These are costs that change with activity, so that each time something is done there is a cost associated with it

## Fixed costs

- These are costs that are incurred even where there is no activity

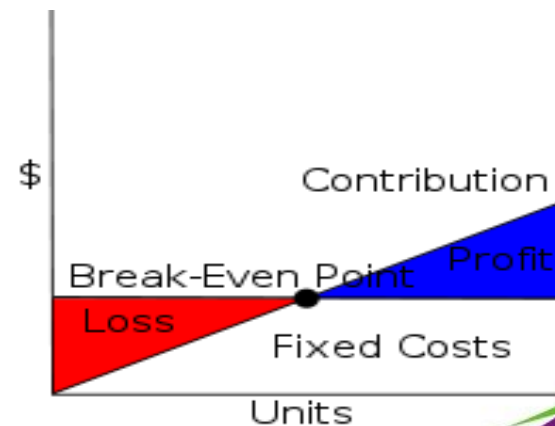


# Costs and costings

## Breakeven

**The point (level of activity) at which fixed costs are covered exactly**

- So contribution = fixed costs
- Contribution = selling price – variable costs

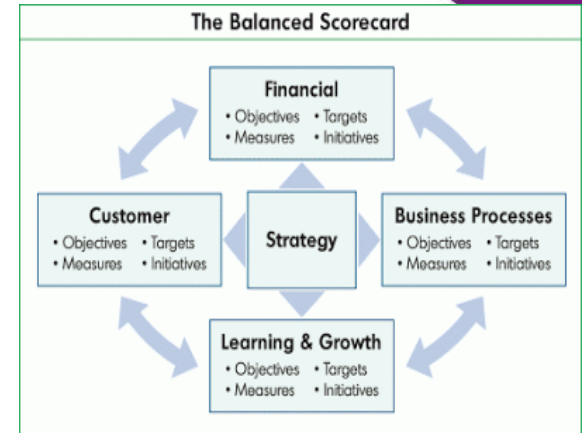


# Costs and costings



## The break point

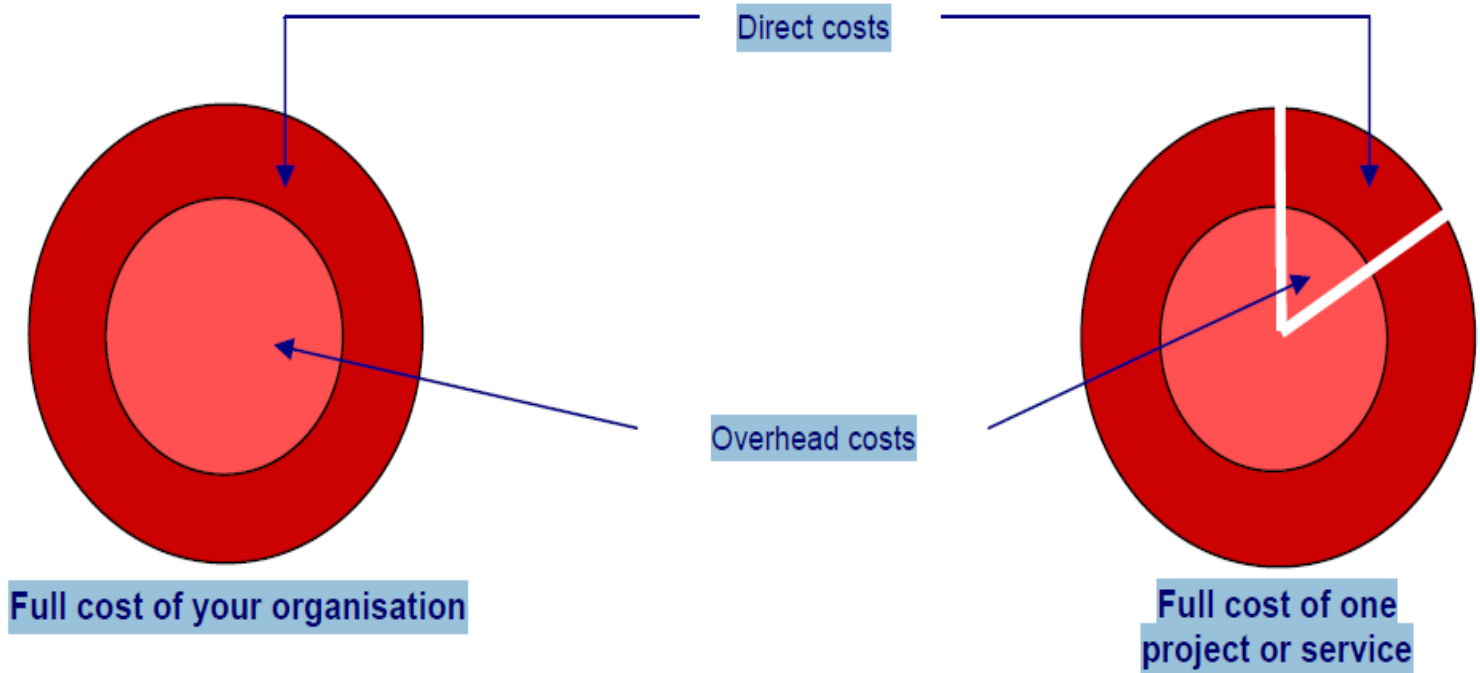
- The point at which the service reaches capacity (viable)
- Given the resources the organisation has currently
- Beyond which the service is past capacity and
- Will simply be responding or crisis managing
- Unless extra resources are provided



# Cost Recovery: How



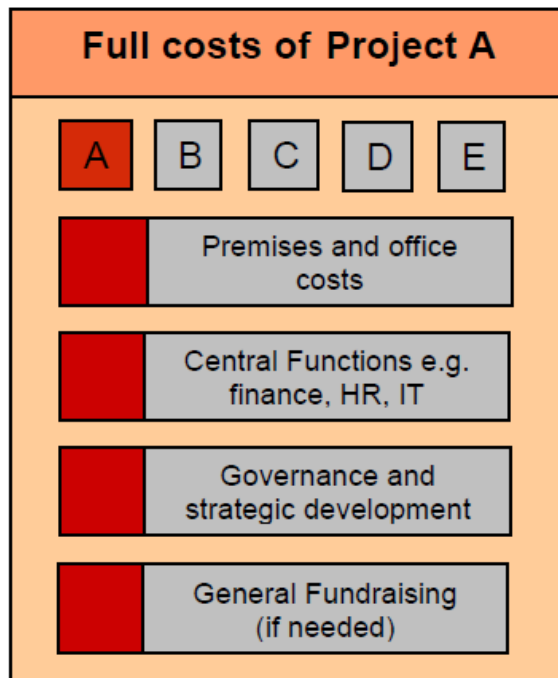
# Cost Recovery: How



# Cost Recovery: How

## ***Full Cost Recovery: A guide and toolkit on cost allocation***

This guide contains a template to help organisations calculate the full cost of a particular project or service, including an appropriate share of all relevant support services and other overheads.

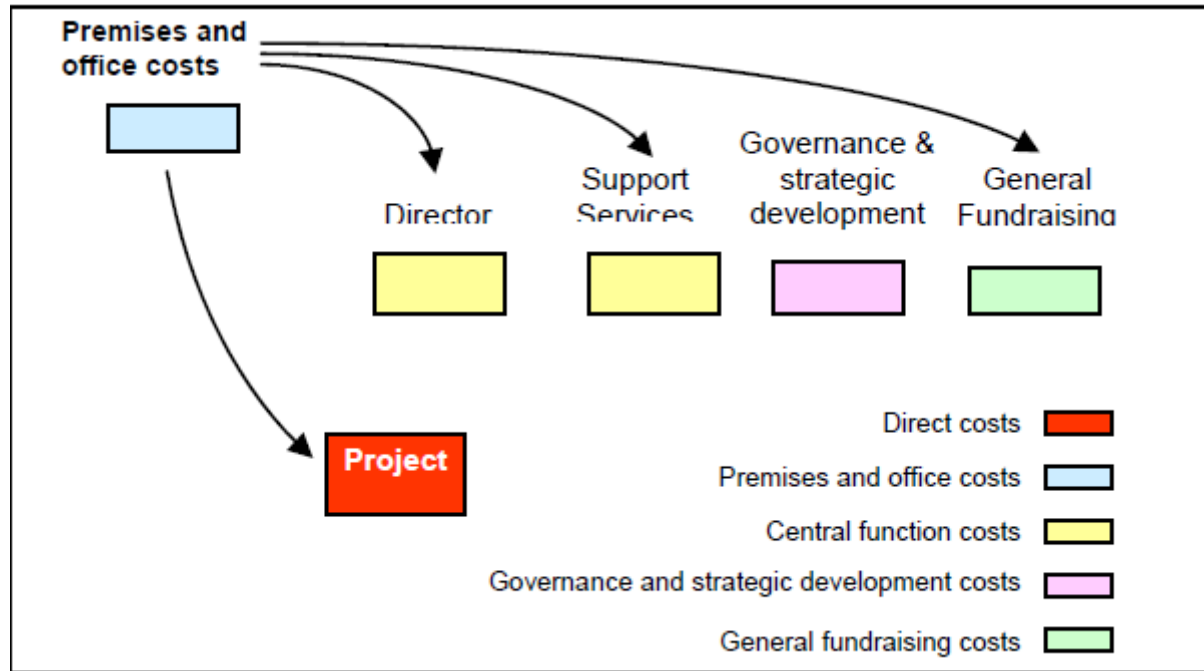


*The full cost of an activity or output or project =*

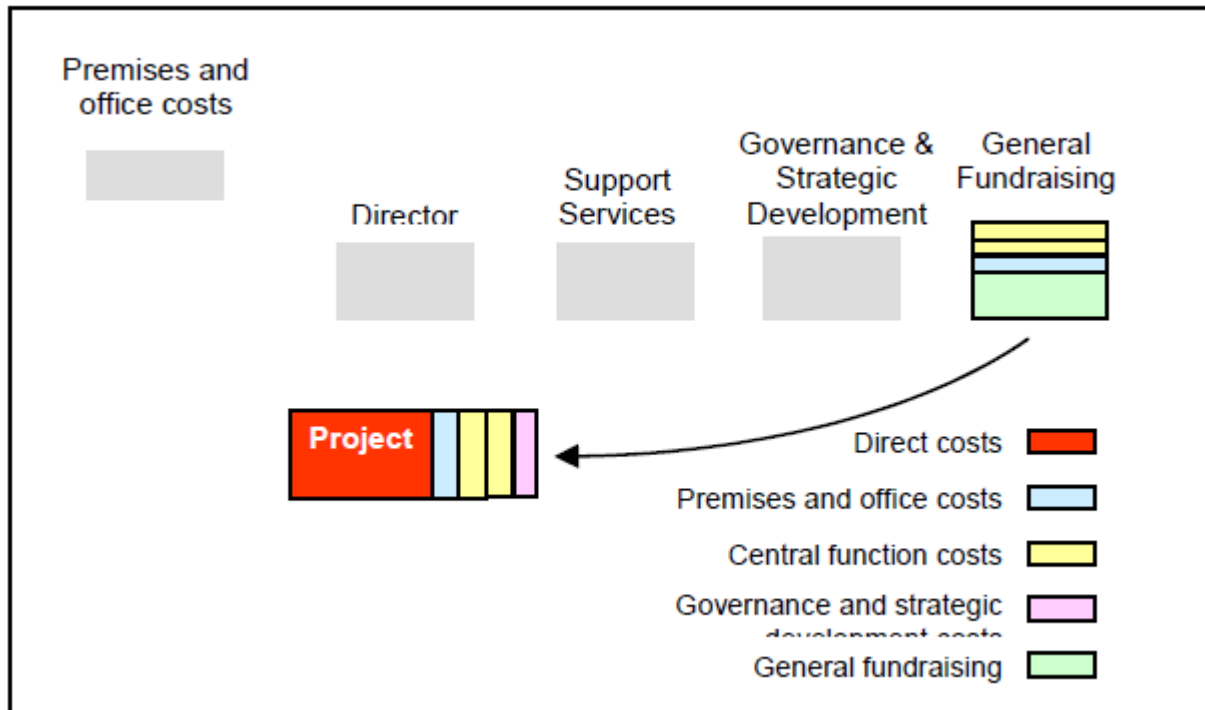
*The direct costs of the activity +*

*The appropriate portion of all other costs in the organisation*

# Cost Recovery: How



# Cost Recovery: How



# Cost Recovery: How

## Full Cost Recovery

Overheads can be broken down into:

- ⑩ Premises and office costs
- ⑩ Central function costs
- ⑩ Governance and strategic development costs
- ⑩ General fundraising costs



# Cost Recovery: How

## Full Cost Recovery

Cost allocation basis (Cost drivers):

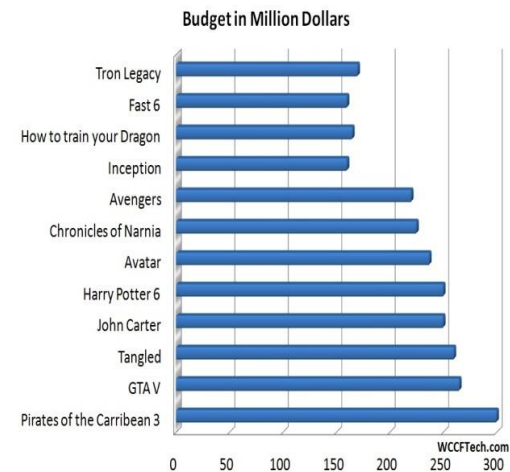
- ⑩ Premises and office costs- **headcount, desk space or floor space**
- ⑩ Central function costs-**time**
- ⑩ Governance and strategic development costs-**expenditure**
- ⑩ General fundraising costs- **income or income shortfall**

# Budgets- as a Tool

Establish a mission or strategy

•Budgeting used to:

- Allocate/ maximise resources
- Implementing plan
- Identify financial/ resource prob
- Indicator for employee performance
- Actions required to fulfil goals

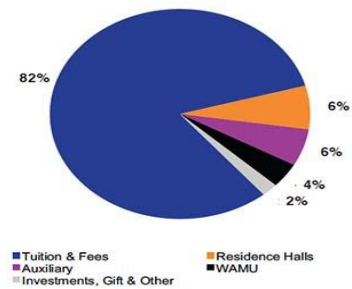


# Budgetary Control:

- *financial control exercised*
- *using budgets for income*
- *and expenditure for*
- *each function of the organisation in advance of an accounting period.*
- *These budgets are compared with actual performance to establish any variances.*
- *managers are made responsible for the controllable activities within their budgets*
- *and are expected to take remedial action*







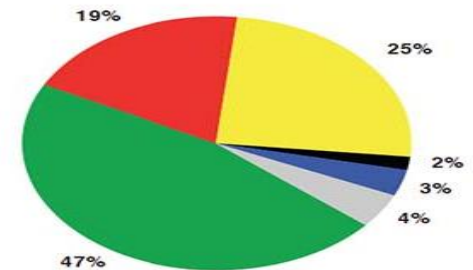
# Budgeting: Revenue/Income

- Grant aid from statutory bodies
- Service agreements and contracts
- Grants from trusts and companies
- Public fundraising
- Sponsorships
- Legacies
- Subscriptions and donations from members
- Profit from trading operations
- Earned income from the sale of services
- Hire of resources
- Investment income
- Management fees
- Consultancy fees
- Income from users(e.g rent)

# Budget assumptions and contingency planning

- **Start up costs**, such as moving in, recruitment of staff-often underestimated
- **Slow start costs** - services slower than planned
- **Marketing costs**
- **Working capital** - used to develop new projects and to experiment
- **Research and development costs** e.g user consultation
- **Cash flow costs** - funding periods of cash shortages
- **Management and administrative costs** e.g payroll, volunteer management
- Replacement and repair costs
- **Contingency costs** e.g maternity, sickness cover
- **Close down costs**

FY2015 EXPENDITURE BUDGET



# Cash-flow forecasts: what

Cash-flow forecasts provide estimates about:

- Income when realistically expected
- Expenditure: when payment would be made
- And the impact of these timings on the overall cash position



# The purpose of a cash flow forecast

- Identify cash critical points
- Based on cash receipt dates
- And cash payments outflows
- Plan accordingly





# Cash-flow forecasts: What

Expenditure shown when due to be paid

- In accordance with credit terms negotiated with suppliers
- And applied appropriately to enable a good relationship to be maintained
- Taking account of regular (monthly) items which cannot ordinarily be delayed e.g wages.



# Cash-flow forecasts: why

- Because **Cash is King**
- the budget will show
- whether there is enough
- overall income To cover
- Overall expenditure
- But the “when” of the receipts and payments becomes more critical in the short to medium term
- Especially in an adverse financial climate

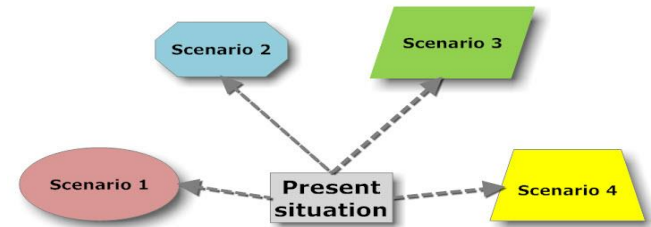


# Using cash-flow forecasts

- Having established income and expenditure on a monthly basis,
- Can work out any surplus or deficit of income over expenditure in that month
- Can determine how to “finance” any deficit
- Can also decide what to do with surplus



# Using cash-flow forecasts



- Having determined likely surplus/deficit, could look at different scenarios:
  - What if income was higher/lower?
  - What if (less) income came in earlier or more came in later?
  - What if expenditure was more or less?
  - could expenditure be paid earlier (less amount), or (more) later?

# Management Accounts

## Financial accounts

- Statutory compliance
- Charity Law
- Companies Act

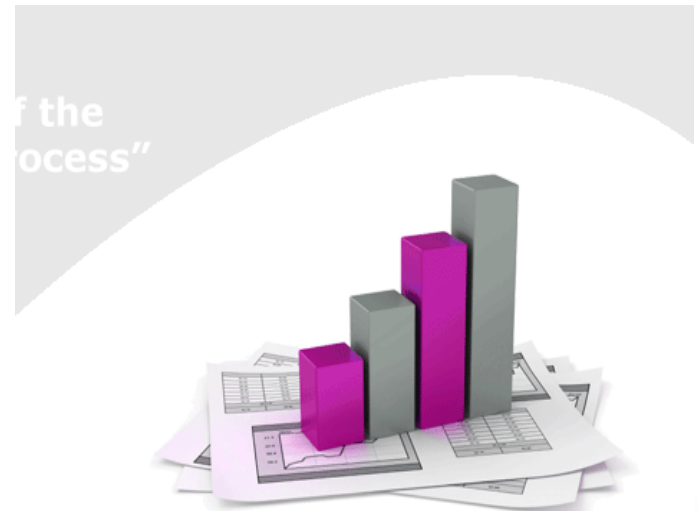
## Management accounts

- internal decision-making
- forms the basis of financial accounts.



# Management Accounts- Format

- No prescribed format
- There will be many different types of information
- Depends on audience
- What they need to know



**Management Accounts**

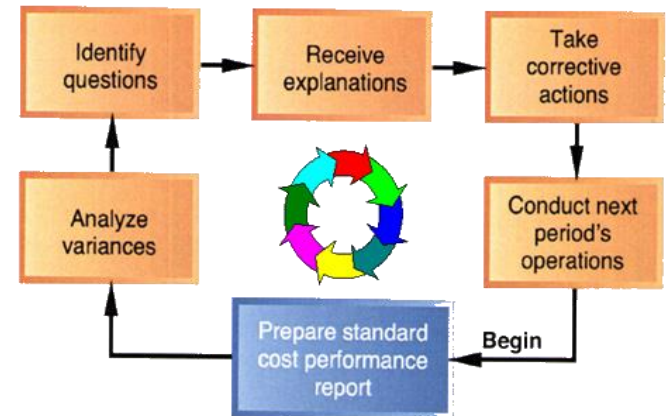
# Management Accounts- Variance Analysis

**Budget-Actual= variance**

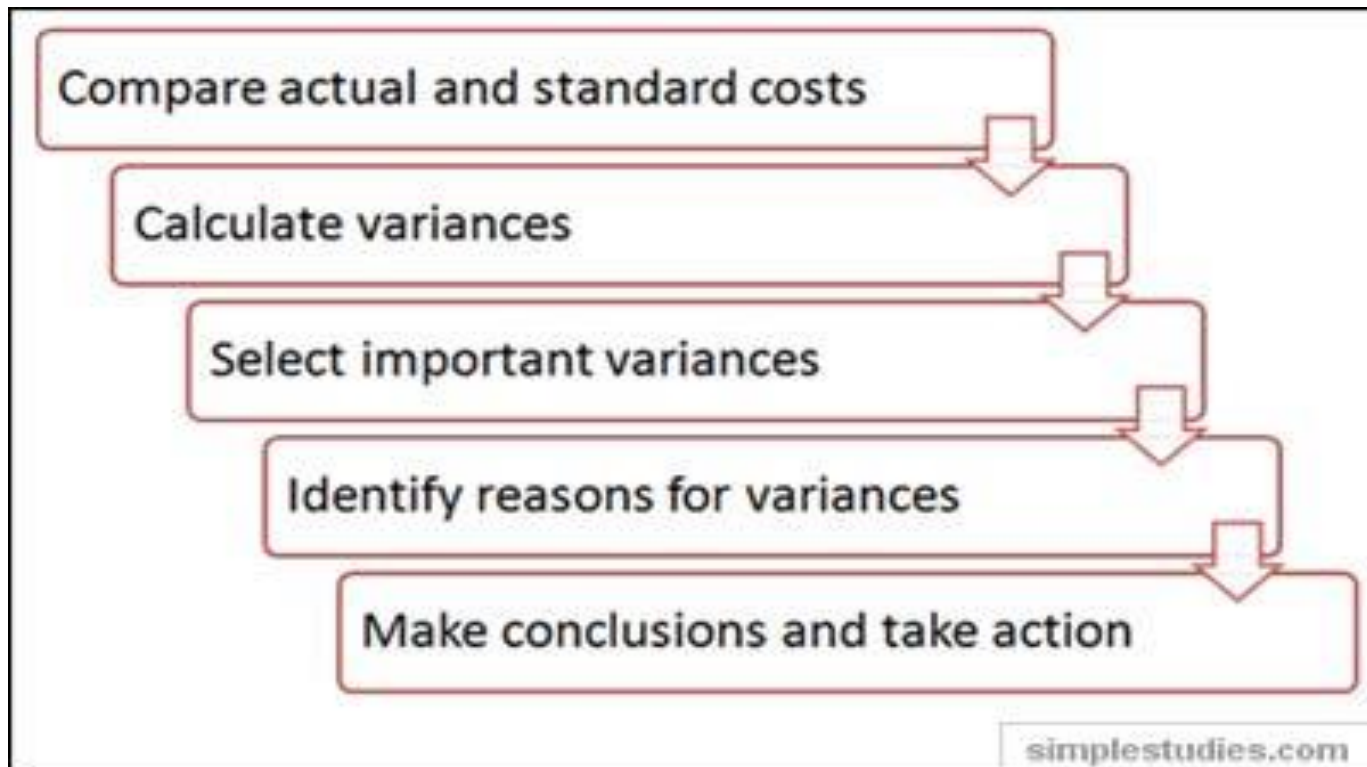
**Variances:**

- highlight areas where assumptions are incorrect and
- areas where there is potential for improvement

Variance Analysis Cycle



# Management Accounts- Variance Analysis





# Management Accounts

## Operating Statements for board reporting

- Analysing (key) variances
- Favourable variances:
  - Actual (sales) income exceeds budget
  - Actual expenditure is less than budget
- Adverse variances:
  - Actual (sales) income is less than budget
  - Actual expenditure exceeds budget



# Management Accounts- Variance Analysis



- Good budgetary control ensures
- That significant variances are explained
- Questions answered about impact on budget
- That year-to-date information is made available to get the overall picture
- Budgets are revised/reforecast to enable more realistic future estimates to be made



# Management Accounts

## Operating Statements for board reporting

- (Re) forecasting
- Actual turnover/income
- and expenditure against budget
- Actual against forecast
- Update on sales and income
- Summary of year-to-date position



# Further readings

- Further reading:
  - A practical guide to financial management for charities and voluntary organisations: Kate Sayer (DSC)
  - A practical guide to charity accounting: Kate Sayer (DSC)
- Reference points: [www.charity-commission.gov.uk](http://www.charity-commission.gov.uk)
  - CC3: the essential trustee, what you need to know
  - CC15a - Charity Reporting and Accounting: The essentials
  - CC8- Internal financial controls for charities
  - Accounting and Reporting by Charities: Statement of Recommended Practice- (revised 2005)