PKF

Accountants &
business advisers

Managing risk
Keeping in control

CFDG PROMOTING BEST PRACTICE IN CHARITY FINANCE

PKF Charities Risk Survey 2009 in association with the Charity Finance Directors' Group

Foreword

Given the profound impact of the economic downturn on all sections of society, it is appropriate that these challenges form the centrepiece of this year's PKF/CFDG Risk Survey. The survey's findings chime in many ways with the Charity Commission's own research, and reinforce my belief in the robustness and resilience of the sector. The 2009 Risk Survey is an essential read that will prove both an encouragement and a tutorial to trustees, charities and professional advisers alike.

In terms of resilience, the survey finds that a quarter of charities believe the recession provides an opportunity to thrive and 70% will thrive or cope. This is despite half of charities expecting their income to fall during the downturn. Our own latest survey of over 1,000 charities confirms that almost 60% of charities having experienced a fall in income. The response of charities to this problem is an encouraging strategy of actively managing the downturn, with almost three-quarters revisiting their priorities and communicating with stakeholders, especially with their funders.

In June this year, the Commission published the Big Board Talk, an economic downturn 'checklist' of 15 questions for all trustees to ask to ensure that their charity is fit for the challenge. Against this backdrop it is encouraging to see that the PKF/CFDG survey shows almost 90% of trustees have a good appreciation of the overall financial position of their charities. In fact, almost half of those surveyed had reserves of at least six months; allowing them the flexibility to manage change and maintain services to beneficiaries whilst strategic decisions are made.

As always, the survey is a practical tutorial with useful tips on handling a range of issues from benchmarking to retrenchment. Whilst almost three-quarters of charities are reviewing their activities, only a fifth of those communicating with stakeholders are engaging with their beneficiaries. With the focus of annual reporting on clearly demonstrating public benefit, beneficiaries should be a key focus of communication. It is, after all, their needs which charities exist to meet.

Finally, a key area I think all charities should be considering in these difficult times is the potential for collaboration with others, to gain synergies and build effectiveness. We have developed collaboration and merger checklists to help. Now, more than ever, there is much charities can learn from working together to help ensure the sector continues to thrive in a cooler economic climate.

Andrew Hind
Chief Executive,
Charity Commission
September 2009

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Introduction

Welcome to our eighth annual risk management survey, Managing risk – keeping in control. Produced by accountants and business advisers PKF, in association with the Charity Finance Directors' Group (CFDG), it is designed to help you to refine your risk management processes and to help to keep your risks under control as far as possible in these difficult times.

It is inevitable that risk management systems will one day be put to the test, and over the last year this has happened in dramatic fashion. In the wake of the downturn, many of the feared circumstances have materialised, while new risks have emerged. For charity managers, the challenge is to manage their organisations so that they stay in control, rather than being at the mercy of circumstances. This year we have explored the impact of the credit crunch and economic downturn to date, the extent to which risk management has helped the sector so far, and what is making the difference between effective and less effective risk management. We have also looked at how charities are dealing with some of the emerging issues, and the strategic options for surviving these tough times. The goal for every organisation, of course, is to weather the recession successfully and emerge stronger and wiser at the end.

As in previous surveys, the report highlights areas of strength, common difficulties and issues that are emerging and looks forward as to how the sector needs to develop. In order to assist charities further in dealing with some of the issues raised, we have included practical tips on some of the key areas for managing through the recession.

Where appropriate we have included our perspective on the root causes and wider implications of some of the issues and on best practice, which we hope you will find a useful guide for your own organisation. Following on from this report there will be a series of seminars taking place to consider the issues raised and focus on how to address them.

Once again we would like to thank everyone who took part in the survey, and hope that you find the results informative, illuminating and useful in managing your charity.

Charles Cox
Head of Charities team, PKF

Keith Hickey
Chief Executive, CFDG

Emerging issues

The recession is hurting… and is going to hurt more

The survey shows how the recession is affecting the sector, with many charities reporting falls in income already and almost half projecting falls in income of more than 5% over the next year. Although few are reporting concerns over their ability to remain solvent, most are reviewing their cost base and many are including staffing levels and pay levels within that review. Of those receiving public sector funding as their major source of income, 70% reported that they had experienced increased pressure on their contract income. If anything the surprise is that more than half of charities are not predicting a significant fall in income over the next year. Given the pressure on corporate donors, falls in investment returns and the predictions of major cuts in public sector spend, it appears likely that the income reductions will be more widespread and potentially more significant than the sector predicts.

As well as the problems of actual income reductions, there is the equally big issue of the increased level of uncertainty. A number of charities recognise that income levels are too uncertain to predict and a significant proportion are building a greater degree of caution into their financial and operational management. Although this must be the right thing to do, it is likely to mean that service levels reduce, and the level of investment in the capability to deliver services also reduces. At the same time almost half of the charities are predicting a rise in demand for their services. The outcome must surely be that a smaller proportion of the demand for services is met.

Almost two thirds of charities indicated that they were seeking to increase fundraising activity. This is a natural and possibly essential response, but the likelihood is that in many cases it will merely help to reduce the fall in funding rather than provide growth. Fundraising is already competitive and will become increasingly so, with the funders becoming increasingly selective about the causes that they support. This means that those dealing with emotive issues such as health, environment and animal charities may be able to do well, but other charities may find fundraising more difficult.

Risk management has helped… but there is scope for enhancing its role

Charities were encouragingly positive about the extent to which risk management has helped them to deal with the recession, with 58% considering it effective in identifying the main issues, the potential severity and the speed of impact, and all but 4% considering it helpful to some degree in spotting the risks. If this is an accurate reflection, it puts charities ahead of most other sectors in anticipating what has happened over the last year or so. The message was less positive about the extent to which risk management has led to effective risk mitigation, with only 28% feeling their mitigations were as effective as they could have been. It is one thing to spot a problem, but that does not mean that you can resolve it.

Major lessons have been identified about why risk management was not as effective as hoped in some cases. Many cite lack of knowledge of the external environment, lack of rigour in the process, or mitigations being put in place and either not being effective or not operating. It is important that the sector learns from this and that charities revise their arrangements accordingly. For some it could be as basic as preparing a risk register and identifying the risk mitigations; for others, it may involve broadening the access to external knowledge through networking, selection of trustees or advisers, devoting additional time to reviewing risks and mitigations, or introducing mechanisms to check that the most important controls actually operate. A key feature of this recession has been the speed and breadth of change, which has demanded regular scrutiny of emerging risks, changes in control arrangements and quick decisions on policies (particularly relating to investments) that not all were geared up to take.

Given that after a number of false alarms the UK is now facing a pandemic (swine flu), it is worrying how few charities have business continuity arrangements in place, with almost half having no plan. The adequacy of the arrangements is likely to be tested imminently for a number of charities. It is hoped that they will work.

And yet, despite the need to get risk management right, charities must be careful not to become over cautious. It would be disastrous for the sector to stifle innovation and no longer push the boundaries in delivering for beneficiaries. As ever, the balanced approach is to take calculated risks, while understanding them fully.

Getting the basics right

Organisations must have sound financial management and controls in order to run effectively. The need for this increases in times of uncertainty and tighter financial margins, such as during a recession, when the risk of attempted fraud also increases. Preparation of management accounts is fundamental to good governance, controlling spend, being able to make informed decisions and spotting fraud or error. Cash flow forecasting and liquidity is important for ensuring the charity can meet its financial commitments through resources that are appropriate to be used.

The survey showed that although many charities are producing cash flow forecasts at least quarterly, there is a significant number that do not, and almost half make no differentiation between restricted and non-restricted funds. While in some cases the charity holds high reserves and therefore arguably does not need to monitor the cash position closely, this is not the case for all those with infrequent or nonexistent cash flow forecasting.

Most charities have adjusted their financial planning and their arrangements for cost control to take account of the new circumstances. This is not confined to those that anticipate or have experienced a fall in income, which is encouraging. The survey shows that many in the sector went into this recession with high unrestricted reserves which had the potential to provide a buffer against uncertainty and to allow restructuring investments. Many are seeking to use their reserves in this way. However, there is a danger that the existence of reserves will be used to delay difficult, but clearly required, restructuring decisions. This should not be the case; if something can and should be improved, there is no merit in deferring the change just because you can live with the inefficiency for a bit longer.

One very encouraging area was debt collection. Here it appears that the charities that are likely to have the greatest reliance on collecting debtor income are generally taking the appropriate actions to monitor their recovery.

Limited range of strategies by some

60% of respondents felt that their charity was geared up to survive the recession and recover or thrive thereafter. The other 40% were not so sure, feeling that their future depended on funder decisions or that they would need to make changes to survive. A small number doubted that they would survive. Most had reviewed or intended to review the strategic options that were available to them to help them cope.

It was notable that the majority of charities which did not expect their charity to experience a fall in income were also taking the opportunity to review their strategy. This included considering stopping or reducing activities, changing staffing levels, reviewing overhead costs, improving governance and revising funding strategy. This is sensible, as it is a way of protecting the relative position of the charity, and the recession environment can make some difficult change decisions more acceptable to implement.

Many charities are considering the cost and activity levels as part of their strategies, with a focus on efficiency. Some are looking further afield, for example exploring mergers or combinations or shared services, but the numbers doing so are relatively small. The potential gains of working together or merging can be significant in the longer term, so even though such arrangements are often perceived as problematic and expensive to set up, they are certainly worth exploring.

Whatever the strategy being adopted, it is essential that trustees have a full understanding of it and that stakeholder confidence is not dented by it. The survey shows that, in the vast majority of cases, trustees are felt to have that understanding, which should help them make the right decisions for their charity. However, it appears that many charities are not seeking to engage their funders and other stakeholders in what they are doing. Particularly where changes are taking place, it is easy for confidence in charities to be dented, which can also damage the willingness to provide funds and to take up services, and can leave staff unsettled. It is important that a positive and realistic message is consistently put out, showing that the position is under control.

Opportunities as well as threats

Many charities have recognised that, despite its negative effects, the recession can also present opportunities for them to strengthen their position. Some charities benefit through additional income as the work they do is linked directly with public initiatives to combat the impact of the recession, or is given a higher profile because of it. For those that do not benefit in this way, the most cited opportunities relate to the strengthening of bonds with other organisations through the need to work more closely together, the ability to demonstrate resilience to build confidence for future working together with funders, the ability to acquire other charities or assets at lower cost, and the stimulus to make difficult changes that will make the organisation fitter. It is important that these opportunities are grasped.

For those that did not see opportunities it is worth looking again. Implementing changes for positive rather than purely negative reasons is more satisfying, builds confidence within a team and with those with whom the charity works, and consequently improves the chances of success.

Governance

Governance will play a significant role in determining how successful a charity can be. The processes will need to be right to ensure that charities can reach decisions when they need to, fast enough to respond to emerging needs. Deferral of decisions may in some cases prove as harmful as taking the wrong decision. This may mean that some need to look at the timetabling of meetings, arrangements for handling matters away from Committees, or even at increasing the degree of delegation. At the same time, the level of scrutiny needed on key decisions will need to be of high quality. Also, charities must look closely at the skills and knowledge base across their senior management team and trustees, and consider options for bringing in any elements that are missing to support their strategy. This could include recruitment of new trustees or managers, co-options, teaming up with others in similar positions, or utilising advisers.

Prognosis for the sector

The recent survey Managing in a Downturn – An update of expectations six months on* illustrated that the view of the sector was becoming less optimistic as the actual results proved worse than anticipated. This trend is likely to continue, with income levels in particular being lower than many planned, and remaining so for a number of years; meanwhile, expenditure levels are not reducing at the desired rate. The level of public sector funding is unlikely to return to current levels for five years or more, particularly outside of health and environment, and other types of funding are likely to be depressed for at least three years.

There will need to be changes within the sector. Non-core activities must be stripped out to focus on the highest priority areas. A wider range of options should be applied to service delivery and particularly back office services, with more joint working and possibly more outsourcing. Some rationalisation will be necessary with mergers combinations or collaborations acquisitions. Management and governance systems will need to develop to operate under greater uncertainty and within tighter margins.

If these things do happen, the sector will emerge stronger, more focused and more efficient, and able to provide better services to its beneficiaries.

Partner Richard Weighell leads PKF's business risk services team. He has been delivering risk-based services to public, private and charity sector bodies for more than twenty years as an auditor and consultant. Since the early drafts of SORP 2000 he has been working with a wide range of charities to help them develop and embed their risk management systems, identify risks and deal with specific risk issues. He also acts in a personal capacity as a charity trustee. Richard is the author of this series of reports.

* Published in August 2009 by CFDG, the Institute of Fundraising and PriceWaterhouseCoopers

Summary of key findings

Coping with uncertainty and threats to income

- 74% of charities are dependent upon one main source of income to fund their activities
- Over 50% of charities expect their income to fall during the recession, 12% expecting a fall of more than 10%. A further 15% consider their income to be too uncertain for them to predict. The impact of this will be mitigated by the high levels of reserves held by many. Those with low reserves will be in a more difficult position.

Managing the cost base

- 99% of charities reported taking some action to assess their cost base, most commonly reviewing overheads and staffing costs and prioritising activities and projects. 74% have changed the ways that they manage their spend to ensure tighter control.
- Cost constraints have impacted activity at 57% of charities, involving restructuring, reducing, delaying or even stopping activities altogether.

Managing charity finances

- Management accounts are prepared by 97% of charities for both trustees and managers. Typically managers receive management accounts monthly and trustees either monthly or quarterly. However, some trustees and managers receive management accounts less frequently and some do not include the balance sheet position.
- The production of cash flow forecasts is more varied. Although 15% do not produce cash flow forecasts at any level, most charities produce organisation level forecasts or detailed level forecasts over a period. In 54% of cases this recognises the split between restricted and unrestricted funds. Almost half the respondents indicated that they had changed their approach to cash flow forecasting during the last year.

Communicating with stakeholders

- Although most charities have sought to increase the level of communication with their stakeholders, 23% indicated that they had not, and in some cases the level of communication had been reduced. Less than half had increased their communication with their funders.

Support from trustees

- 87% of charities consider that their trustees have a good understanding of the financial position of their charity.
- Most charities have not changed the information provided to their trustees despite the changes and greater uncertainties in the external environment and the degree of strategic change being considered.

Effectiveness of risk management to date

- Most types of charity income have been reduced through the impact of the recession, including investment returns, donations and subscriptions. Cost pressures have also increased on contracts.
- 46% of charities expect their income to fall significantly in the next year, with a number also anticipating write-offs. As a result most charities are expecting to need to make cost savings. 16% consider cash flow difficulties to be likely. At the same time, 45% anticipate demand for their services to increase.
- 58% consider their risk management to have been fully effective in identifying the risks and 20% consider it to have been substantially successful. The success of mitigations is lower with only 28% considering them to have been fully successful. However, the degree of success of risk management varies significantly between different types of risk issues.
- Factors identified as making risk management less effective include lack of knowledge of the external environment and limited scenario planning (55%), not putting sufficient rigour into the process (47%) and failures in risk mitigations (45%).

Strategic options

- 25% of respondents believe that they can cope through the recession if it lasts to the final quarter of 2010 and thrive post recession. A further 35% believe that they can cope through the recession and get back to normal. 22% have identified that they will need to make changes to survive with a further 18% dependent on their funders maintaining support.
- Most charities have carried out a review of strategic options or plan to do so. Common likely options include review of overhead costs (adopted by 87%) and reviewing activities (74%) with the most probable outcomes including reducing overheads or staffing costs (identified by 34%), revising the funding strategy (31%) and improving governance (27%).
- 40% of respondents indicated that they did see opportunities within the recession. The most popular included becoming a fitter organisation by restructuring or reducing costs, diversification, or achieving growth/additional funding, each at 7%.

Risk management progress

- The frequency of review of risks and controls has increased again, with 57% of managers and 34% of trustees now reviewing them at least quarterly, compared with 34% and 28% two years ago. More frequent review is appropriate in the current circumstances.
- The influence of risk management on decision making has also increased slightly in all categories, reflecting a long term trend. Few charities do no use risk management at all to inform major decisions.
- The proportion of charities considering their risk management to be fully embedded and working effectively is 26%. In 2008 this was 24%.

Methodology

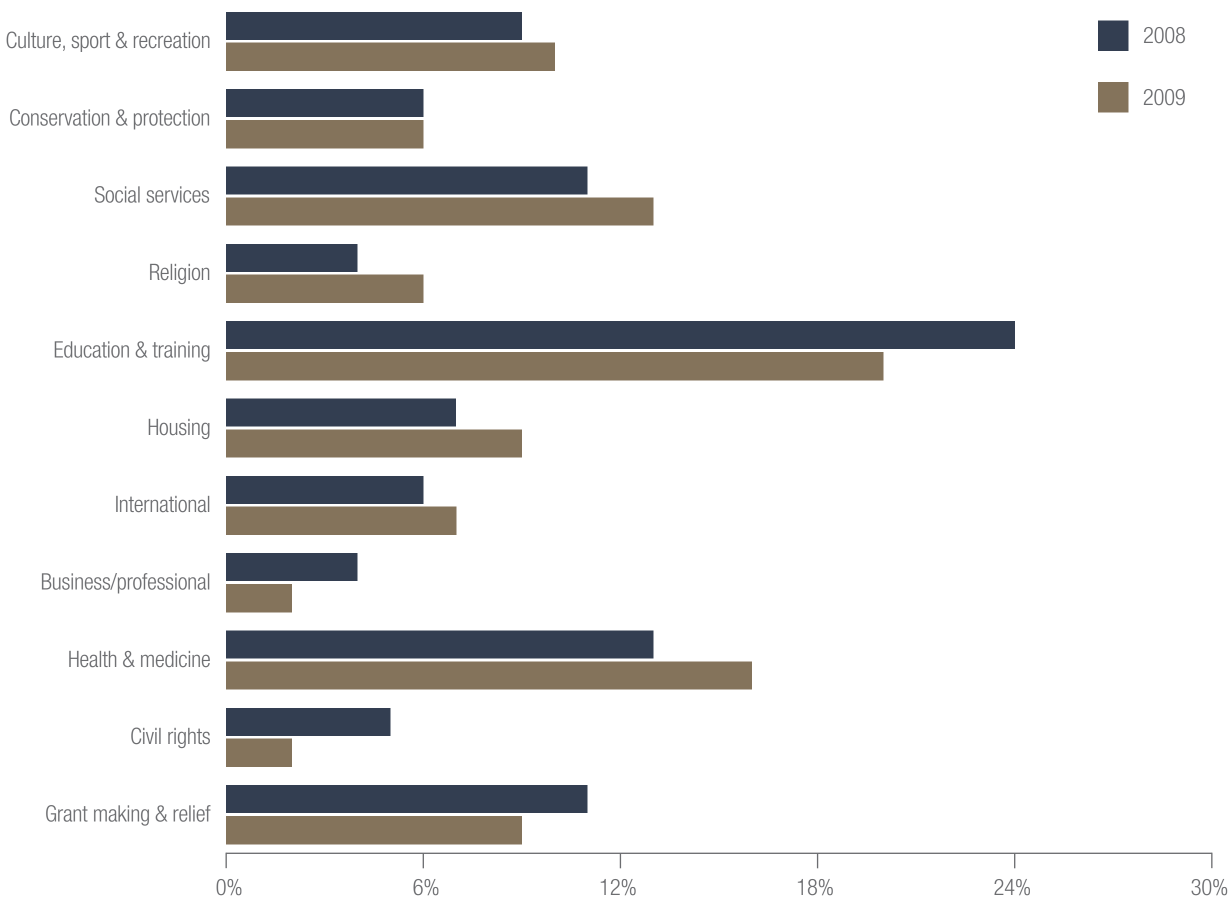
The survey was carried out jointly by PKF (UK) LLP and CFDG in May and June 2009. Like the seven previous surveys, charities across the UK were questioned to give a broad cross section of views on the key areas reviewed. This year the focus of the survey was on the impact of the credit crunch and economic downturn to date, the extent to which risk management has helped charities so far, what is making the difference between effective and less effective risk management, and how charities are dealing with some of the emerging issues. We also included a small number of broader based risk management questions to allow tracking of progress since the previous survey.

466 responses were received in total, the highest level yet, with increased numbers for all income sizes of charity. By far the largest group of respondents were those with finance director responsibilities, up from 39% to 54%, probably reflecting the dominance of financial issues amongst the risks, but chief executives, trustees and other senior managers are still well represented. The charities operate across England, Scotland, Wales and Northern Ireland, with a number also operating internationally.

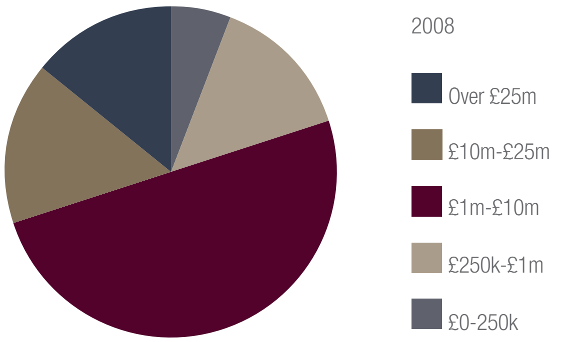
The survey covered representatives from each of the charity subsectors, although some are more strongly represented than others and some respondents chose not to disclose their subsector. Where a charity reports more than one subsector (up to a maximum of three) it has been included in the analysis for each of those subsectors, so in some cases the totals may exceed 450, the number of responses our analysis is based on. Particular care has been taken in reaching conclusions where the number of respondents in a subsector is small.

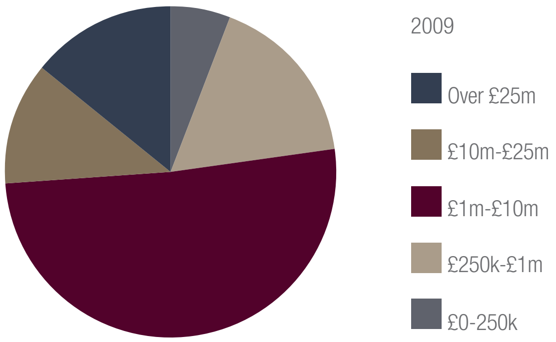
Responses have been received from the full spectrum of sizes of charities. However, given that risk management requirements apply to only those charities with turnovers of greater than £500,000 the greatest focus has been on charities above that size.

Respondents by sub sector compared to 2008

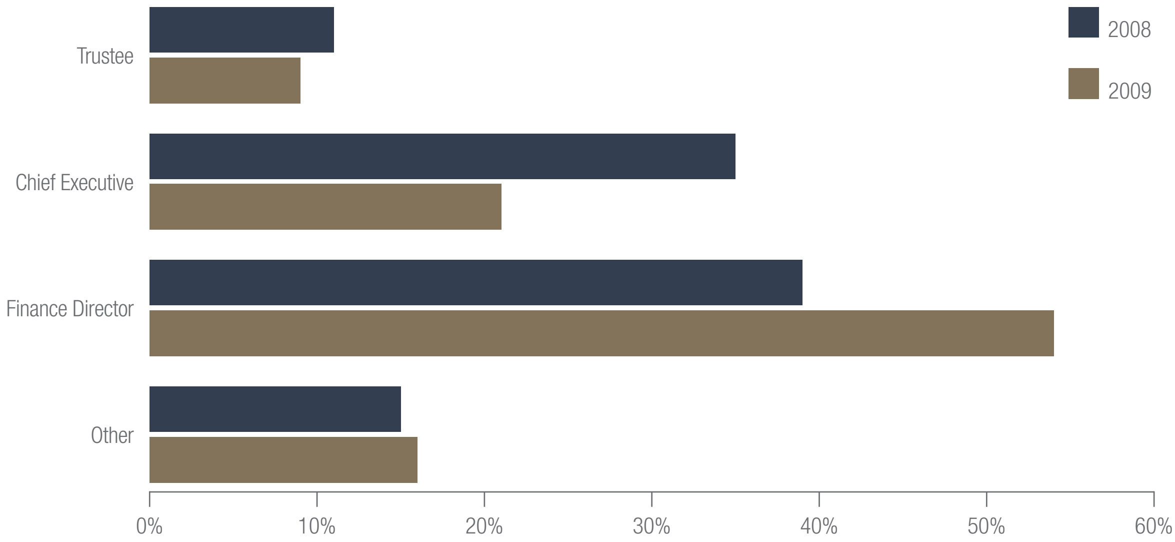


Respondents by income size compared to 2008

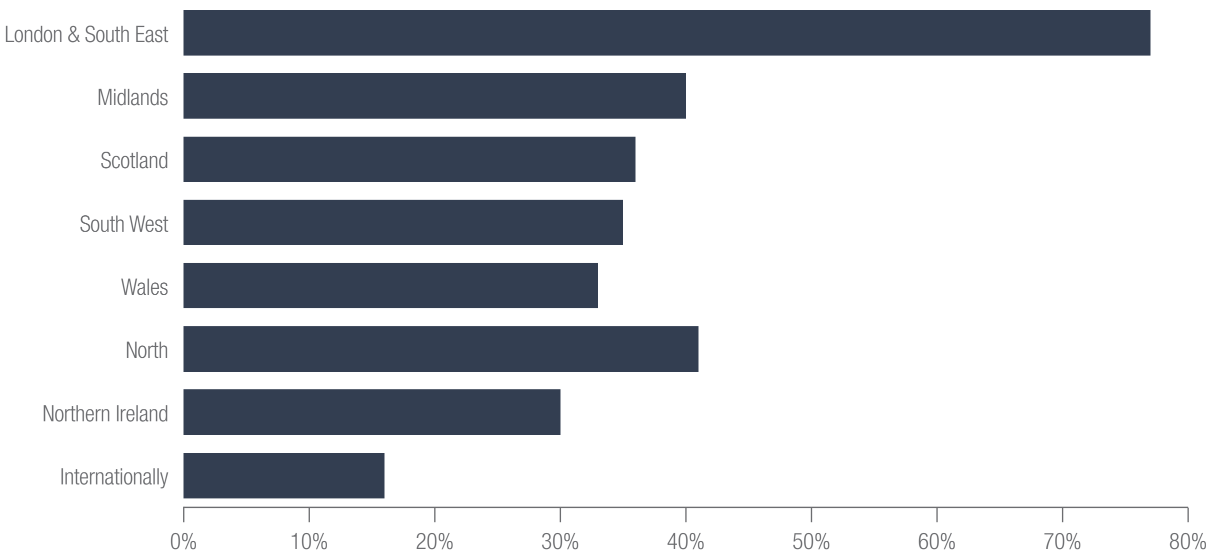




Respondents by role (i.e. trustee, chief executive etc.) with comparisons against 2008



Regions in which respondents operate



Coping with uncertainty and threats to income

Which of the following best describes your charity's income position? (Most income is from a small number of major funders; Most income is through public sector contracts; Most income is through donations from the public, appeals and legacies; Most income is from subscriptions/ membership fees; Most income is through trading; Most income is from endowed assets; Income is diversified across a number of sources)

The findings

- 26% of charities receive their income from a number of sources. This is most common in Conservation & Protection and Culture, Sport & Recreation, applying to 38% of each; it is least common in Civil Rights (0%).
- The other 74% are dependent upon one main source, of which public sector contracts (21%) and public donations, appeals and legacies (19%) are the most prevalent.
- Public sector contracts are most prevalent for Civil Rights (67%), Social Services (58%) and Housing (41%).
- Relying on endowed assets is most common in Grant Making & Relief (24%) and Religion (21%).

How certain do you consider your income? (Most income will be sustained throughout a recession; Total income is likely to be reduced by up to 10 per cent; Total income is likely to be reduced by more than 10 per cent; Income is too uncertain to predict)

The findings

- 37% of charities are confident that their income will be maintained throughout a recession. The sectors reporting being least affected were Grant Making & Relief and Housing, both with 49% expecting no reduction, and Religion with 46%. Only 26% of Health & Medicine charities and 28% of Conservation & Protection charities expected their income to be maintained.
- 12% of charities expect their income to fall by more than 10%. The subsectors most expecting such a fall were Conservation & Protection (22%) and International (18%).
- 15% consider their income too uncertain to predict. This was most common in Health & Medicine (17%) and Social Services (15%) and 20% of those not specifying their subsector.

To what extent can your expenditure be flexed? (Most expenditure can be reduced within 6 months; Most expenditure can be reduced within 12 months; Most expenditure is fixed for the current year)

The findings

- 43% of charities consider that most of their expenditure is fixed for the current year. Of these, 17% consider their income too uncertain to predict and 12% have reserves cover of less than one month.
- Considering their expenditure fixed for the current year is most prevalent in Civil Rights (56%), Social Services (51%), Education (50%) and Religion (50%). It is least common in Business/Professional Associations (22%).

What is your level of unrestricted reserves compared to your typical spend? (Cover of 1 year or more; cover of between 6 and 12 months; cover of between 3 and 6 months; Cover of between 1 and 3 months; Cover of less than 1 month; In negative reserves)

The findings

- 2% of charities reported that they had negative unrestricted reserves. This was most common for Religion (7%), Conservation & Protection (6%) and Culture, Sport & Recreation (4%).
- A further 6% had reserves of less than one month's expenditure. This was most common for Culture, Sport & Recreation (18%), Conservation & Protection (9%) and Religion (7%).
- 46% of charities reported that they had unrestricted reserves cover of more than 6 months' expenditure. This was most common in Grant Making & Relief (78%), Religion (61%) and Business/Professional Associations (55%). This compares to only 14% of Civil Rights charities and 21% of International charities.
- 51% of Grant Making & Relief charities reported having reserves of greater than 1 year's expenditure.
- Generally the smaller the charity, the higher the reserves that are held; 26% of charities with income of over £25m have reserves of the equivalent of over 6 months' expenditure compared with 57% of those with income under £1m and 73% of those with income under £250,000.

How are you dealing with the increased uncertainty in your financial planning? (Using general reserves to provide flexibility; Planning for a range of different scenarios; Seeking to apply more cautious assumptions; Allowing more contingencies in budgets or reducing costs; Identifying activities that can be deferred if necessary; Developing a recovery plan; No change in approach; Other)

The findings

- Most charities (71%) are using a range of different methods to cope with the increased uncertainty that they face. 22% are relying on one of these approaches only.
- The most common approaches are planning for a range of scenarios (58%), seeking to apply more cautious assumptions (50%) and allowing more contingencies in budgets or reducing costs (49%).
- 7% of charities reported no change in their approach. Of these almost three quarters were charities that expected their income to be maintained. In each case the charity held at least 3 months worth of expenditure in unrestricted reserves.
- Development of a recovery plan was reported by 14% of charities. This was most prevalent in Business/Professional Associations (22%) and Religion (18%).
- A high proportion of charities confident that their income will be maintained, were also making changes to their approach. 51% are planning for a range of scenarios, 48% seeking to apply more cautious assumptions and 42% allowing more contingencies in budgets or reducing costs.

Our analysis

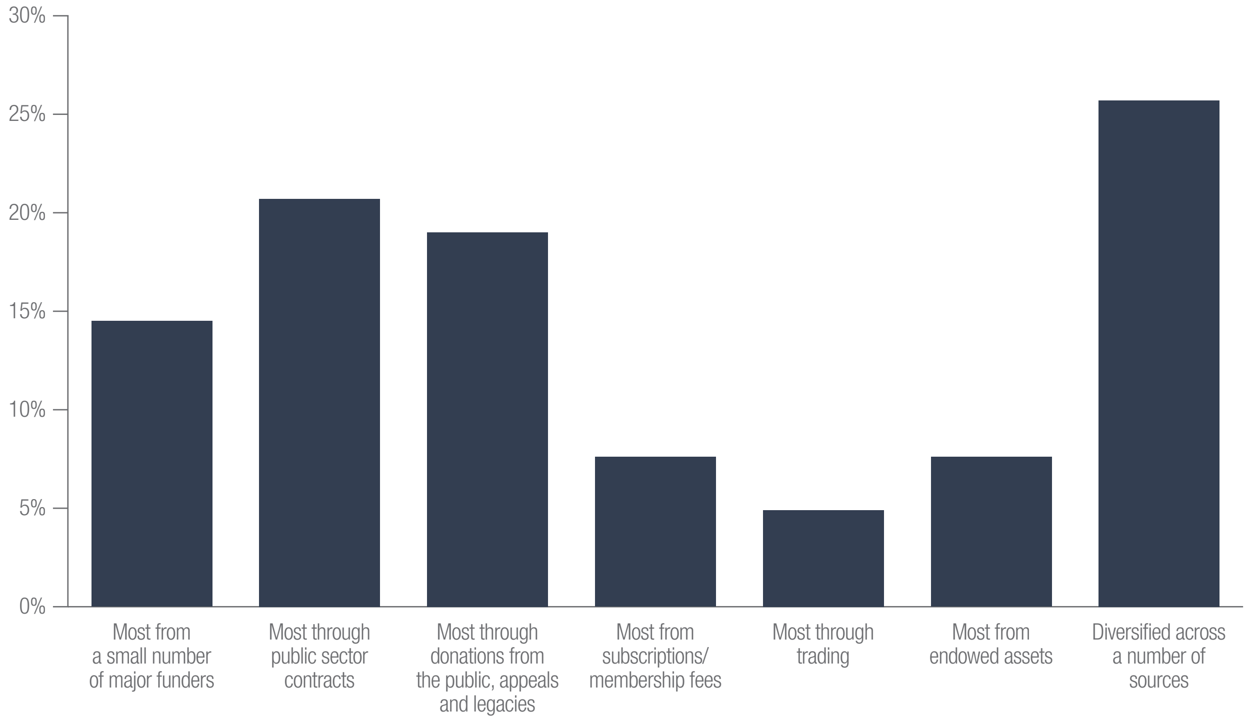
The traditional approach to safeguarding income levels has been to diversify the sources of income so that falls in any one area have a limited impact. However, currently most potential income streams appear to be affected and as a result there is virtually no difference between the level of diversification and the perceived levels of future income. Although one third of charities report here that they expect their income to be maintained through a recession, the responses to later questions indicate that almost a quarter of these may be uncertain as they also report significant reductions in income from last year being likely, and identify reductions in some of the aspects of their income.

The importance of public sector contracts is emphasised by the responses, being the major source of income for a high proportion of Civil Rights, Social Services and Housing charities and a significant component of the income of many of the charities with diversified income. It has become increasingly clear that public spending is going to be reduced to a large degree and for a number of years. Although spending may be maintained in stated priority areas such as health and environment, this means that other perceived lower political priority areas will be cut more severely. If the sector is to retain its position in delivering public services, it needs to be able to justify its use by offering a demonstrably better value for money option than the public sector can achieve alone.

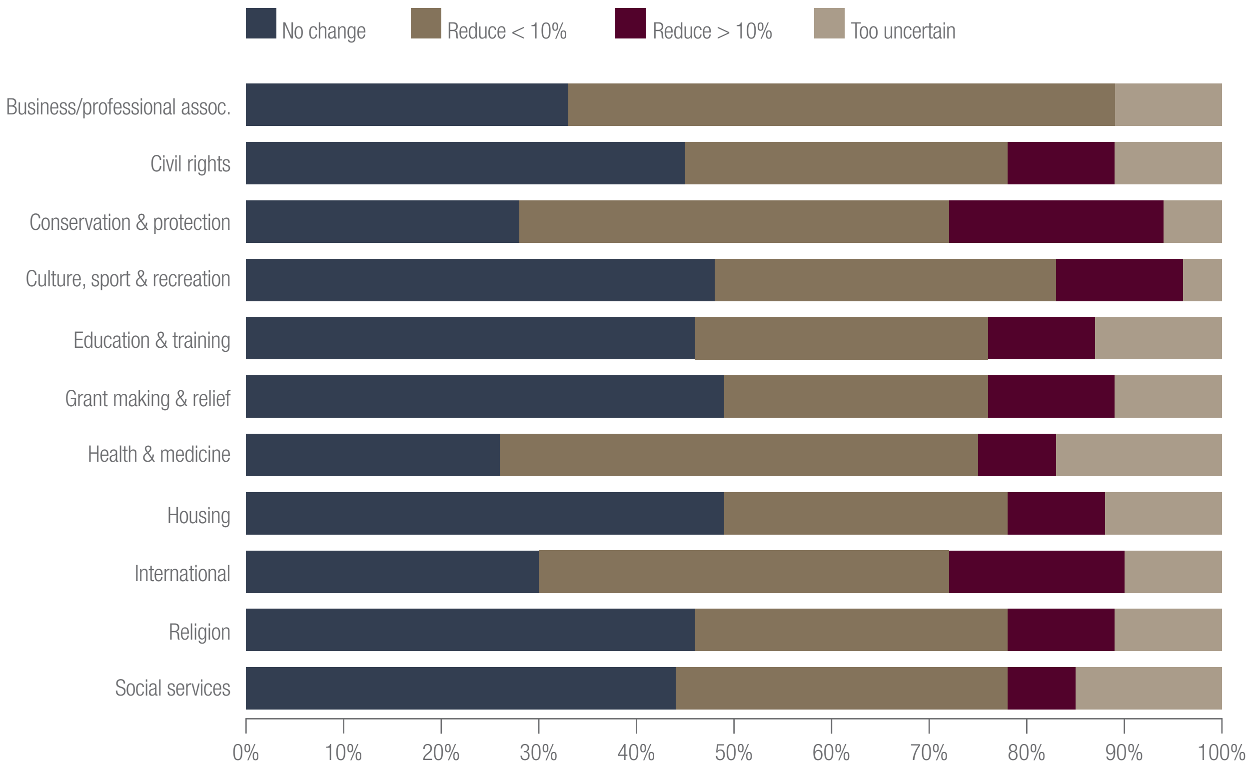
Most respondents recognise the increased income uncertainty and have taken steps to adapt their financial planning accordingly, be that by reviewing different scenarios or seeking to provide additional leeway. It is encouraging that many of those that do not expect their income to be affected are still adjusting their planning approach.

Many in the sector entered the recession with the buffer of holding very high levels of unrestricted reserves, with more than a quarter having reserves of over one year's expenditure and almost half holding more than six months' expenditure. The rainy day that the reserves were built for has arrived – but it is going to be a long one. Even the most reserve-laden charities are unlikely to get by on reserves alone, but such buffers do provide the resources for the sector to adjust its way of operating to the altered circumstances. What must not happen is that the reserves merely provide an excuse for delayed action on difficult issues. Some charities, of course, have little in the way of unrestricted reserves, and for them the change options will be fewer.

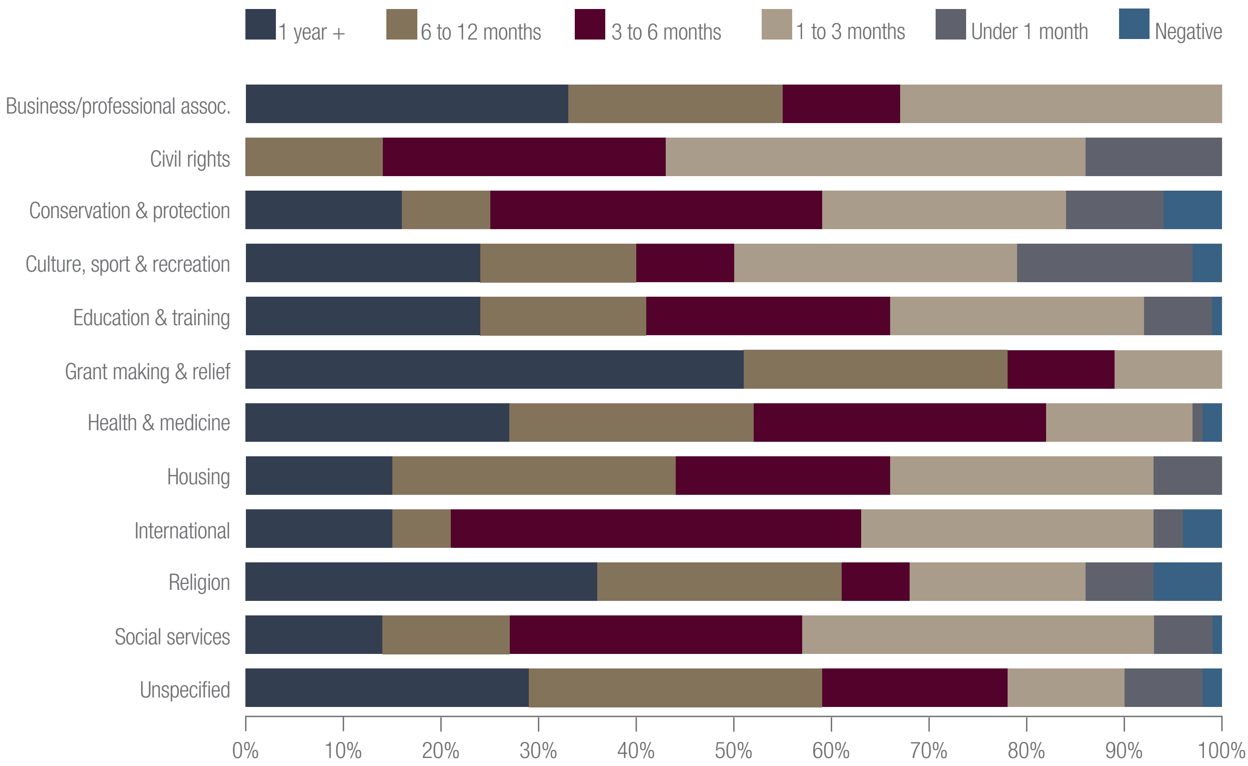
Charity income position



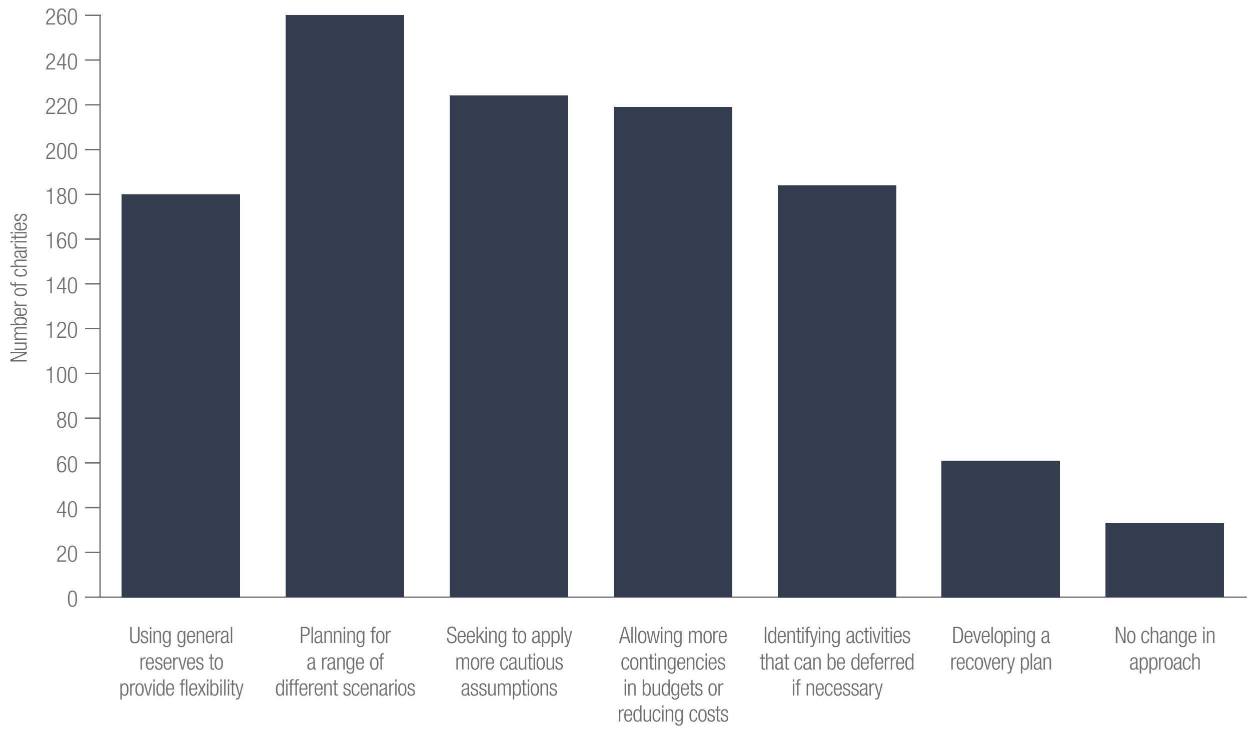
Income changes in recession by sector



Unrestricted reserves by sector



Approaches to dealing with increased uncertainty



Control tips

Financial and strategic planning

- Successful planning requires a target. Without a clear goal opportunities may be missed and mission drift can set in.
- Before starting to make plans for the future it is essential to take stock of the charity's current position. Only once this is understood can a plan be put in place to move the charity towards its goal.
- Who is responsible for determining direction? The trustees have ultimate responsibility for the charity's strategy and need to approve the plans, but are unlikely to have time to work on the detail. This is best left to the senior management team, with the Chief Executive, along with the Finance Director, working on vision and strategy and the Finance Director working on securing the necessary resources.
- Be realistic. If your charity is fighting for survival the immediate focus is on finding income and cost savings to stay in operation, not on devising a long-term plan for ten-fold expansion.
- Being realistic is not the same as being over-cautious. If you set ambitious targets then even if they are not met you are likely to achieve more than if your targets are easily reachable.
- Some of the best plans have both long and short term elements, for example a five-year strategy with targets for each individual year. Ultimate achievement is broken down into manageable chunks, and reaching the intermediate goals can generate a sense of progress.
- Never forget the importance of operational staff in achieving your aims. Some people can be resistant to change, so early consultation is vital to identify any resistance and overcome fears. There is always a chance that some good ideas will come to light at the same time. Working with the staff team on developing strategy leads to common ownership and better implementation.

Managing your cost base

To what extent is your charity assessing its cost base? (Benchmarking or review of all activities; Benchmarking or review of some activities; Categorising activities/projects into essential and desirable; Review of overhead levels; Review of major supply and service contracts; Review of pay levels; Review of staffing levels; Other)

The findings

- 71% of charities reported that they were taking at least one of the actions specified above as part of managing their cost base, with most carrying out a number of these actions and others together.
- The most common actions from this list were review of overhead levels (46%), review of staffing levels (35%), review of pay levels (31%) and categorising activities/projects (30%).
- Benchmarking was most common in Social Services (48%) and International (45%) and least common in Business/Professional Associations (11%).
- Review of staff levels is most common in Business/Professional Associations and Social Services (both at 44%) and least in Grant Making & Relief (16%).
- All but 1% of charities reported taking some action. The most common actions other than those specified in the answers above were related to coping with uncertainty rather than assessing the cost base, for example using reserves or seeking to be more cautious in planning.
- A high proportion of charities confident that their income will be maintained were also reviewing their cost base. 39% are reviewing overhead levels, 29% are reviewing staffing levels and 27% benchmarking some activities.

Has the management of spend changed? (Increased investigation before authorising new activities; Increased investigation before authorising major purchases; Changes in levels of delegated authority; Increased scrutiny over staff recruitment; Increased use of tendering or quotations; No change; Other)

The findings

- 74% of charities have changed the way that they manage their spend, many in a number of ways. The most common are increased investigation before authorising new activities (45%), increased investigation before authorising major purchases (40%) and increased scrutiny over recruitment (38%).
- 26% have not. Lack of change is most common in Grant Making & Relief (33%), Civil Rights (33%) and Conservation & Protection (33%) and least common in Health & Medicine (16%) and International (15%). Very small charities have changed least.
- The pattern of changes varies by size. Larger charities are more likely to have increased authorisation before taking on new activities or recruiting staff. Smaller charities are more likely to change the level of delegated authority or the investigation before major purchases.
- Changes in the way that spend is managed are not confined to those expecting income to fall or uncertain about its level. More than half of charities confident that their income will be maintained have taken some action.

Has your charity changed its operations on cost grounds? (Some activities stopped; Some activities reduced or delayed; The method of delivering some activities changed; Major restructure of the approach to activity; No changes in activity driven by cost)

The findings

- 45% of charities have adjusted their activities on cost grounds. In most cases this involves reducing or delaying activity but almost one third of these charities have stopped some activities. Those adjusting activities include 33% of those that expect their income levels to be maintained yet only 44% of those predicting a fall in income of more than 10%.
- Reducing activity is most common in International where 82% have reduced activity, including 33% that have stopped activity.
- 33% of charities have changed the way that they deliver their activities on cost grounds; in 8% of cases this follows a major restructure of the approach.
- 43% have made no changes to their activity driven by cost. This includes 61% of Housing charities and 51% of Grant Making & Relief but only 18% of International and 22% of Business/Professional Associations.

Our analysis

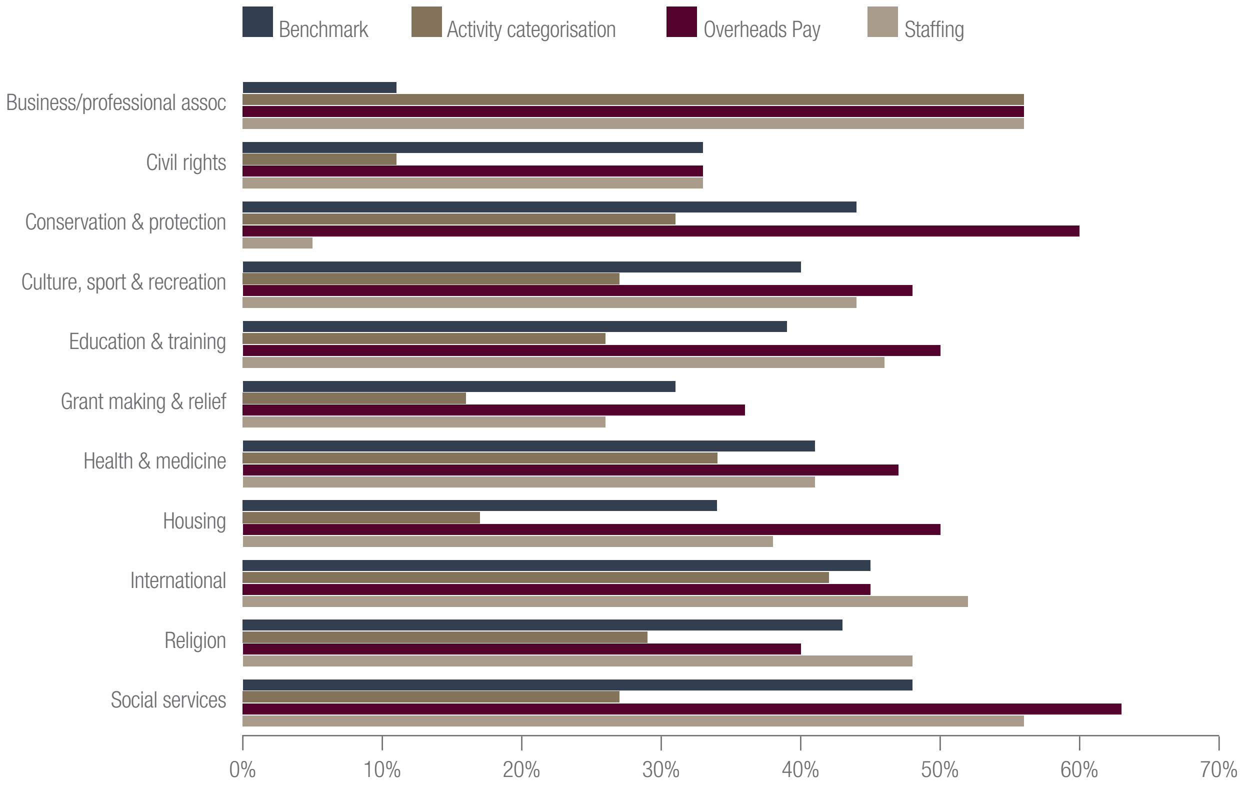
Costs are clearly under scrutiny, with the greatest emphasis on those that are not directly involved in service delivery. However, many charities are looking at staff costs too. Over time the needs of organisations will change and there is merit in carrying out periodic reviews to ensure that redundant activities/services are weeded out. It is encouraging to note that many of those not expecting income reductions are reviewing their costs as well as those with the added impetus of needing to make cost savings.

Although most organisations that have identified a likely income fall are doing some things to assess their cost base, in many cases it appears to be limited. The ideal would be to benchmark all major areas of spend to inform the review process and reduce the chances of making reductions that result in an unsustainable arrangement. Of course in many cases this will not be feasible, due to a lack of access to meaningful benchmarks or other pressures on resources prohibiting the investment. Even so, it should be feasible at least to give some consideration to all of the major cost areas to identify which activities incur the costs and what elements are essential. This will be uncomfortable for many charities, as a high proportion of their costs relate to employing people and reductions have a direct personal impact on the people concerned. It is therefore better to focus attention on the less sensitive costs first.

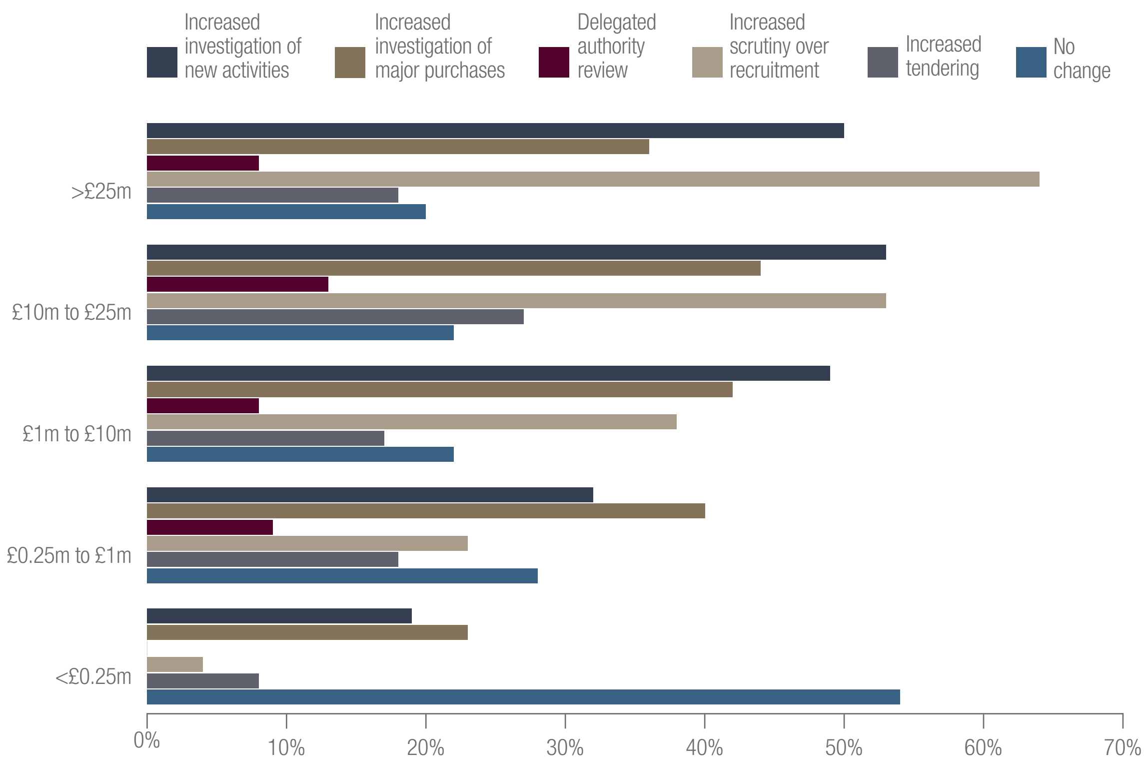
The survey shows that Grant Making & Relief charities are among the least likely to be making changes to their approach to financial planning, spend management, or operations on cost grounds. However, this is likely to reflect the nature of such charities rather than an inflexible approach by their managers. These charities often have a small staff base and the main variable cost is the grants themselves. These can be reduced (in size or in number) if income falls without any change in activity or in method of planning.

The uncertainty and income reductions do appear to be having an impact on the operational activity of the sector, with more than two thirds of charities adjusting what they do, and more than one third reducing and/or delaying some aspects of what they do. Although this should be targeted on the least important aspects of their work, it is likely that beneficiaries will begin to notice the impact.

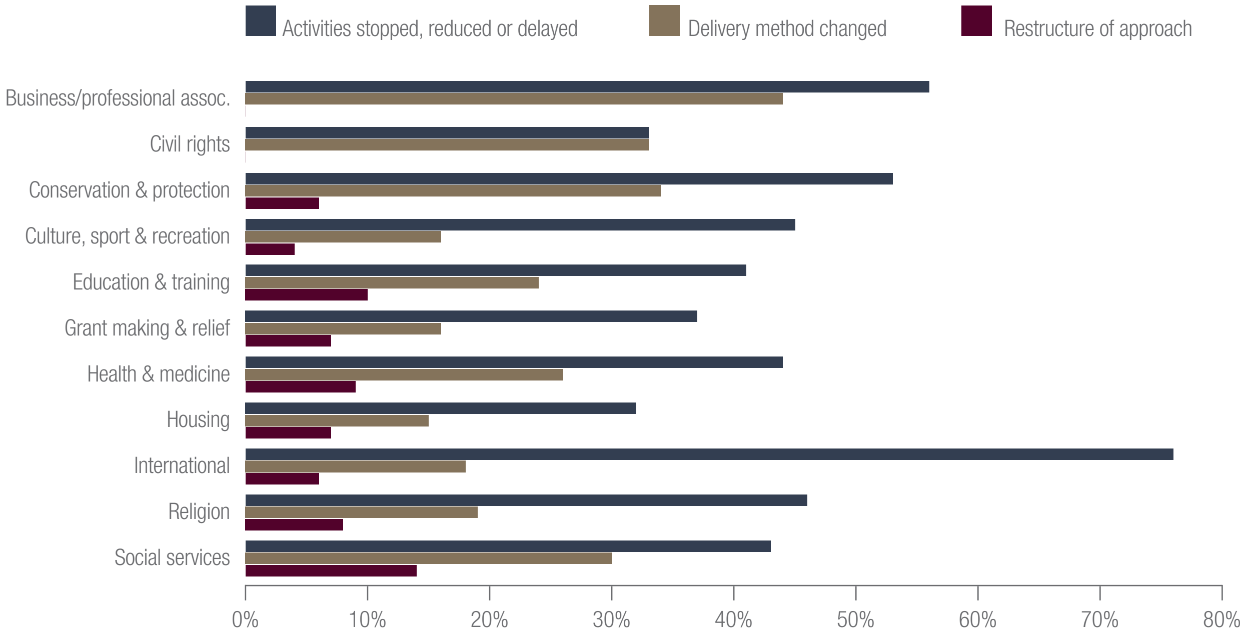
Assessment of cost base by sector



Management of spend by charity income



Change in operations by sub-sector



Control tips

Benchmarking

Benchmarking is a useful tool for identifying where a charity may be able to make cost savings. However, it is important that the right benchmarks are used for it to be meaningful.

- In most cases there will not be other organisations that are exactly the same as your own, but you can select comparators that appear to be broadly similar in size and as close in nature as you can get. You can then access more information about them to see how comparable they are and understand any differences in costs. Benchmarking clubs, where a group of charities agree to share cost/activity information with one another on a confidential basis, are a good way to do this.
- Cost benchmarks can be affected significantly by the approach to cost recording, particularly overhead allocations. It is often best to focus on staff numbers and skills, pay levels, contract costs and so forth, rather than the costs shown in the management accounts.
- Beware of looking at individual functions in isolation, as costs/inputs are likely to be affected by other parts of the charity. For example the level of resource needed within a finance function will be affected by the extent to which operational areas do their own inputting and analysis.
- Remember that benchmarks are indicators only. Just because your costs/inputs are higher does not necessarily mean that you can or should reduce your inputs to the lower level, merely that this area is worth exploring further. It might be that there are good reasons for the variation, perhaps related to service levels demanded, or it could be that the other organisations are taking bigger risks than you would be comfortable with.

Managing charity finances

How often do you produce management accounts for trustees and for management?
(Monthly, Quarterly; Less frequently)

The findings

- More than 97% of charities produce management accounts for their trustees and managers at least quarterly. All but one of the charities that do not prepare at least quarterly management accounts for management do not provide them for trustees either.
- 40% of charities which do not prepare at least quarterly accounts for management have income of under £250,000 annually, but one has income of over £25m.
- Management accounts are produced more often for management, with 80% receiving them at least monthly, than for trustees (37%).
- Trustees of charities with income over £10m receive monthly management accounts more frequently (46%) than those of smaller charities (36%).
- Management of charities with income over £10m do not receive monthly management accounts in 9% of cases.

Do the management accounts include the current balance sheet position? (Yes; No)

The findings

- 81% do include the balance sheet position. This includes 87% of those with income over £25m and only 67% of those with income under £1m.
- Compared with 2% of all charities in the survey, and 9% have unrestricted reserves of typical spend of under l month, compared with 6% of all charities.

How often does your charity produce cashflow forecasts (monthly; quarterly; yearly; over a period of years) **and to what degree of detail?** (at organisational level; at detailed level; not produced)

The findings

- 55% of charities produce cashflow forecasts on a monthly basis. Of these the majority produce them at organisational level only.
- 35% produce cashflow forecasts on a quarterly basis. 33% produce them on an annual basis. Less than 10% produce a cashflow forecast looking more than one year ahead.
- 25% do not produce a cash flow either monthly or quarterly and 17% do not produce any form of cash flow forecast. Of those not producing any form of cash flow forecast, 43% have unrestricted reserves of less than 6 months expenditure and 66% either expect their income to fall or consider it too uncertain to predict.
- There is little difference in the proportion of larger charities producing cash flow forecasts compared to smaller ones. 83% of charities with income over £10m prepare cash flow statements at either monthly or quarterly level compared with 74% of smaller charities. However, larger charities are more likely to produce cash flow forecasts on a monthly basis instead or as well (66%); for smaller charities this figure is 49%.

Is your cashflow split between restricted and unrestricted funds? (Yes; No)

The findings

- 55% of charities produce cashflow forecasts split between restricted and unrestricted funds.
- This happens least frequently in the largest charities, with 39% of those with income over £25m, 48% of those with income between £10m and £25m and 57% of smaller charities.

Has your approach to cash flow forecasting changed in the last year? (Yes, now more detailed: Yes, covering more or different time horizons; Yes, now reviewed at a higher level; No, no change)

The findings

- 53% of charities have made no changes to their cash flow forecasting in the last year. Of the 47% who have made changes, the prevalence of change increases with size ranging between 27% of those with income under £0.25m to 52% of those with income over £25m.
- 35% have increased the detail of cash flow forecasts; 13% have introduced a review at a higher level.

How often do you review the recoverability of your debtors? (Weekly; Monthly; Quarterly; Less frequently)

The findings

- 65% of charities review the recoverability of their debtors at least monthly. 16% review them quarterly; the rest less frequently.
- Those monitoring less frequently tend to be those with income below £1m (30%) compared with 16% of larger charities.

Our analysis

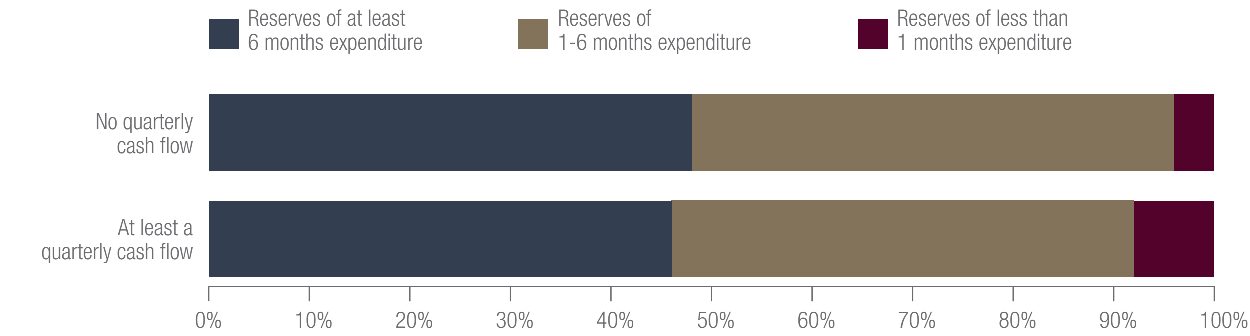
The vast majority of charities prepare management accounts at least quarterly. The infrequency of management accounts for the remaining charities does not seem to affect how optimistic they feel about the future; among this group, the same proportion expect to at least cope and get back to normal after a recession. It is likely that this is because 50% of the charities that do not prepare at least quarterly accounts for management are endowed charities, so although income and the value of the endowment may fluctuate with the market, the long-term future of the organisation is reasonably secure and income should recover when the market recovers. All the charities with infrequent management accounts have unrestricted reserves of at least 3 to 6 months' equivalent of spend. It appears that these charities do not prepare management accounts frequently because on the whole they believe they are in a healthy and stable financial position, rather than because of lack of monitoring or management.

The same cannot be said of those charities that do not include the balance sheet in their management accounts. Here there are almost four times as many in a position of negative reserves, compared to those that do include balance sheets, and one and a half times as many having reserves of under one month's spend. Lack of a balance sheet can allow reserves to be depleted without sufficient warning. For charities with restricted funds it is particularly important to prepare a balance sheet in order to monitor asset cover for the restricted funds; we have known cases where overall reserves are positive but unrestricted reserves are negative, meaning that restricted income is covering core activities. Trustees of these charities may then find themselves in breach of trust, with potentially serious implications.

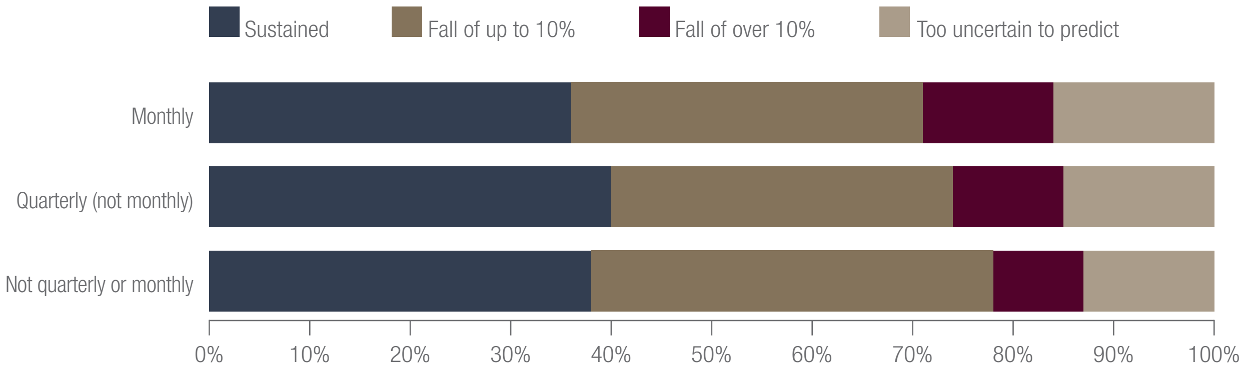
Given the importance of managing cash flow for organisational survival, it is surprising to reveal the relatively low proportion that produce regular cash flow statements and that split out restricted from unrestricted funds. Although some of these charities clearly have a reserves buffer for coping with unexpected variations, some do not. Where income is falling or difficult to predict, preparation of a reliable cash flow forecast can prove vital in ensuring debts can be paid when they fall due, and in preventing a charity from becoming insolvent. As can be seen from the graphs below, those that do not prepare at least a quarterly cashflow are not generally any different from those that do when it comes to reserves buffers or income stability.

For debtor recoverability it is unsurprising that there is a correlation between sources of income and review of debtors. Those least likely to review at least quarterly are endowed charities and those receiving most of their income from public donations, appeals and legacies; those most likely are charities receiving the majority of their income from public sector contracts (for which in our experience payments are often delayed) or trading. But, as ever, there are some exceptions that do not fit this pattern, probably reflecting either the type of contract or trading that they do, or smaller strands of their activity not captured in the income source in this survey.

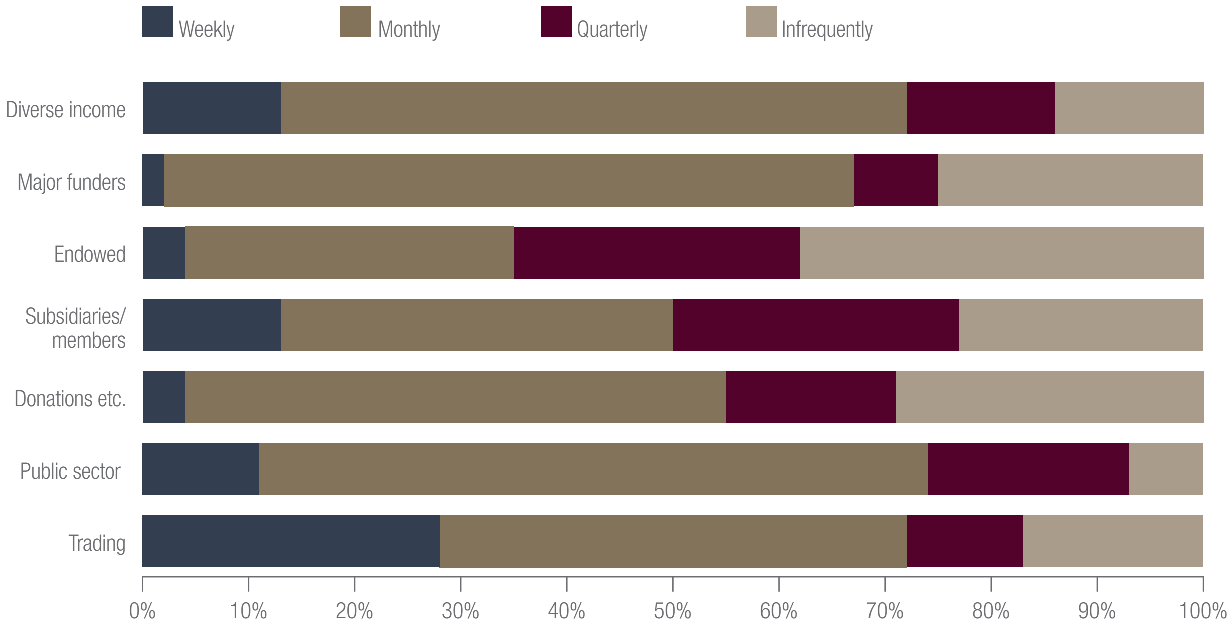
Relationship between reserves levels and cash flow forecasting frequency



Relationship between income expectations and cash flow forecasting frequency



Frequency of debtor recoverability review by income type



Control tips

Cash flow

- A key purpose of cash flows is to identify months / periods when there will be a net cash outflow. If this would result in an organisation going overdrawn it may lead to problems. It is therefore important to:
  - Include anticipated opening and closing bank balances at the foot of each cash flow to identify any overdrawn months.
  - Prepare the forecast for as far in the future as possible. This will highlight problem months soon enough to take mitigation steps, such as applying for additional income streams, negotiating payment terms with creditors, discussing overdraft facilities with the bank, or chasing for early payment from debtors.
  - Where there is uncertainty over income, prepare a cash flow excluding any income that is not certain to ensure the charity can remain solvent in a worst-case scenario.
- Think of your target audience. Presenting a very detailed cash flow to trustees may distract them from their strategic decision making. Managers, however, may need figures on a weekly rather than monthly or quarterly basis, and which show the detail behind the headline income and expenditure figures.
- Remember to look at management accounts and cash flows for individual subsidiaries as well as the group, where applicable.
- Build scenario planning into cash flows to assess their sensitivity to change.

Communicating with stakeholders

Has your charity's communication with its major stakeholders changed? (More communication with funders to build confidence in charity; More communication with funders to establish funder intentions; More communication with beneficiaries to build/retain confidence; More communication with trustees; More communication with staff; Less communication because of uncertainty: Less communication to save cost)

The findings

- 77% of charities have increased the amount of communication that they have with their stakeholders. The most common are increases in communication with funders (48%), communication with trustees (43%) and communication with staff (40%), whereas only 21% have increased communication with beneficiaries.
- Those who have increased communication with funders are more likely to receive income from a small number of sources (18% of those who have communicated to build confidence, and 22% of those who have communicated to establish funder intentions, compared with 15% of total respondents), or to receive their income from public sector contracts (25% and 28%, compared with 21% of total respondents).
- 43% have increased communication with trustees, but the majority of these (60%) have not changed the information they provide to trustees (72% of total respondents have not changed the information they provide).

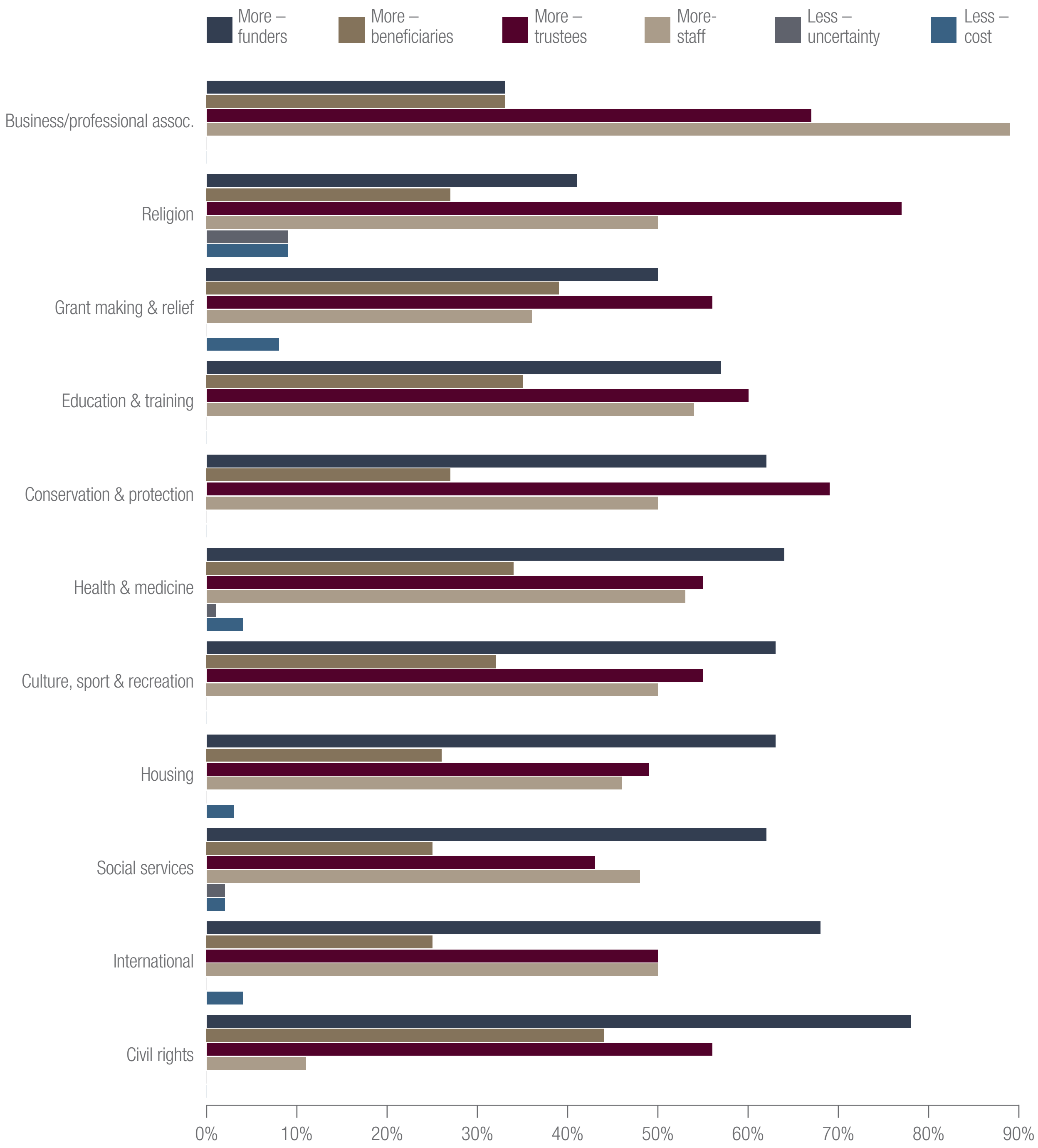
Our analysis

Although the majority of charities have increased communication with at least one of their stakeholders, no one category of stakeholders has seen an increase in communication from a majority of respondents (funders come the closest, with 48% of respondents increasing communication). Only 36% have communicated with funders to maintain confidence in their organisation.

These are difficult times for all. Charities have already hit the headlines with the loss of millions of pounds through the collapse of the Icelandic banks. Unless conditions improve soon it may be only a matter of time before we witness our first high-profile failure. A handful of well-publicised charity collapses could seriously undermine confidence in the sector as a whole. Lack of confidence could threaten giving levels, as potential donors will not want to see their donations swallowed up in redundancy and other such costs; subscribers and members will want to be certain they will receive the full benefits of membership over the relevant time period; and major contractors such as local authorities may consider bringing activities in-house rather than sub-contracting to an organisation that may fold. For charities reliant on these sources of income, communication to provide reassurance and maintain confidence could prove critical to their survival. The results of this survey suggest that more thought needs to be given to this area.

Only one in five charities have increased communication with beneficiaries, and there is no significant difference between those that are adjusting service levels and those that are not. This is surprising as, particularly for those that rely on the charity on an ongoing basis, general media coverage of financial difficulties, or hearing of staff reductions within the charity, must make for worrying times. Increasing communication is most common in those listing Education & Training and Health & Medicine as an area of operation, both of which are likely to provide services to beneficiaries on an ongoing basis. Communication to stakeholders is an important aspect of any change strategy, and this sector must not neglect it.

Change in communications to stakeholders by subsector



Support from trustees

How well do trustees appreciate the financial position of your charity? (Good appreciation of the position overall; Do not understand the scale of threats that you face; Believe that the financial position is much worse than it actually is)

The findings

- 87% of charities consider that their trustees have a good appreciation of the overall position of their charity.
- The sectors that least feel their trustees have a good appreciation were Civil Rights 78% and Religion 81%.
- There is no notable difference in perceived understanding between those charities facing significant difficulty and those less affected; nor does the frequency of risk information provided to trustees appear to influence the findings here.

Has the information provided to trustees changed as a result of the recession?
(No change; Yes *(please specify)*)

The findings

- 73% of charities have not changed the information provided to trustees as a result of the recession. This includes 81% of those that expect their income to be sustained throughout a recession and 69% of those predicting a significant fall in income, or significant income uncertainty.

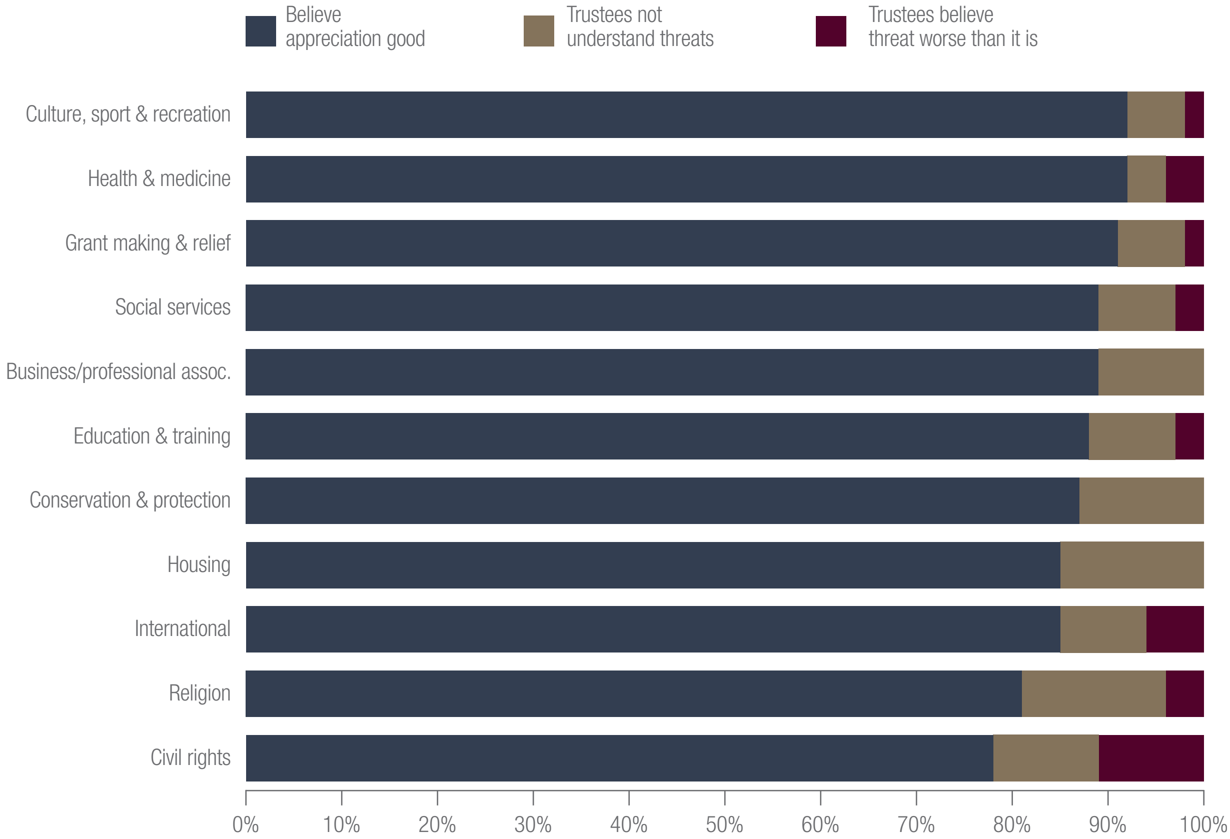
Our analysis

The feeling across the sector appears to be that the trustees generally have a good understanding of the position of their charity. The pressures of the recession do not appear to have had any impact on the perceived level of understanding (a similar question was asked two years previously). This is important as understanding the environment is fundamental to being able to make appropriate decisions within it, and a common understanding with management must be helpful. This assumes of course that managers' understanding of the environment is accurate, and given the extent of uncertainty this must always be in doubt.

Although many of the charities reporting good trustee understanding provide their trustees with regular management accounting and risk information, a significant number do not. For these, it is difficult to see how they can be in a position to evaluate the position of the charity for themselves; it is more likely they are dependent upon the views expressed to them by management. Even allowing that the views of management are important, the lack of information to validate these views limits the effectiveness of governance. For some of the smaller charities infrequent reporting can work effectively, but for those with a range of ongoing activities it is important that trustee scrutiny is at least quarterly.

It is surprising how few charities have changed the information provided to trustees, particularly where there is significant income uncertainty or a need to implement cost saving measures. This suggests that the changes in the method of operation illustrated in Question 2 are taking place away from trustees.

Trustee appreciation of financial position of their charity



Control tips

Relationship between the Finance Director and the Treasurer

- In order to provide the balance of support and scrutiny, the Treasurer needs to set out clear parameters about what they should be informed of and those matters that they expect to be consulted on. This mix will vary depending on the circumstances of the charity and the skills and experience of those involved. To be effective the Treasurer must be in a position that they can consider and agree financial decisions of strategic importance and understand the ongoing financial risks.

The effectiveness of risk management to date

What has been the impact on your organisation of the credit crunch and economic downturn to date? (Reduction in subscriptions, public donations and legacies; Reduction in corporate donations; Reduction in investment income; Increased cost pressure on service contracts; Increased need for your charity's services; Bad debts or investment write-offs; Reduced investment in new projects or improvements)

The findings

- 70% of charities have experienced a significant reduction in investment income, with 40% experiencing a reduction of more than 20%.
- 25% of charities have noted a significant reduction in corporate donations.
- 20% of charities have experienced a significant reduction in subscriptions, public donations and legacies. This is most significant for Health & Medicine (33%) and International (23%).
- 18% have experienced increased pressure on public contracts. This reflects 70% of those identifying public service contracts as their major source of income.
- 26% have experienced an increased demand for their services. Of these, 27% have also reduced investment in projects and improvements.

What do you expect to be the impact on your organisation over the next year?
(Significant reductions in income from last year: Reluctance to take on new commitments; Need to identify cost savings or stop projects; Need to reduce staff levels; Need to dispose of assets; Increased fund raising activity; Cash flow difficulties; Insolvency of your charity ; Inability to fund capital projects by borrowing; Bad debts or investment write-offs; Increased need for your charity's services)

The findings

- 46% of charities expect to have a significant reduction in their income over the next year.
- 71% of charities have identified the need to make cost savings or stop projects. This increases to 82% of those where income is expected to reduce significantly.
- 31% of charities have identified the need to make staff reductions. This increases to 43% of those where income is expected to reduce significantly.
- 16% of charities consider cash flow difficulties to be likely. 2% consider insolvency to be likely.
- 18% consider it likely that they will need to write off bad debts or investments.
- 63% are seeking to increase fund raising activity.
- 45% anticipate an increase in demand for their services.

To what extent has your risk management anticipated these issues as potential threats? (It identified the main issues and the potential severity and speed of impact; It identified the main issues but underestimated either the severity or speed of the impact; It identified most of the main issues but missed some and underestimated others; It identified most of the main issues but significantly underestimated them; It did not identify many of the main issues)

The findings

- 58% of charities consider that their risk management was effective in identifying the main issues, the potential severity and the speed of impact. A further 20% consider their risk management to have identified the threats but underestimated the speed or severity.
- Only 4% of charities felt that their risk management had failed significantly.

To what extent have the mitigations that you identified been effective in reducing the potential impact of the economic downturn on your charity? (The mitigations have consistently had a positive benefit on the charity, putting us in as good a position as we could have hoped to be in, given the overall UK and international circumstances; The mitigations have generally had some positive benefit on the charity, helping us to deal with the circumstances that we face; The mitigations have had a limited impact, either working only in some areas or only having a small beneficial effect; The mitigations have proved to be entirely ineffective; No mitigations were identified)

The findings

- 28% of charities consider that their risk mitigations were as effective as they could have been.
- 54% felt that the mitigations had some positive impact. 10% felt that the mitigations had a limited impact.
- 7% of charities reported that they had no mitigations in place.

In which areas has your risk management proven most effective? (Anticipating potential changes in income streams; Managing impact of changes in income streams; Anticipating potential losses in asset values; Managing impact of potential losses in asset values; Anticipating increased pressures on cash flow; Managing increased pressures on cash flow; Anticipating fall in value of £; Managing impact of the fall in value of £; Anticipating risk of loss of financial investments; Managing risk of loss of financial investments; Anticipating failure of suppliers or partners; Managing impact of failure of suppliers or partners; Risk management has had no effect)

The findings

- Risk management is considered to be most effective in respect of anticipating and managing changes in income streams (84% and 80%), anticipating and managing increased pressures on cash flow (85% and 82%) and anticipating and managing risk of loss of financial investments (57% and 60%).
- Risk management is considered least effective in anticipating and managing the fall in the value of the £ (35% and 50%) and anticipating and managing losses in asset values (46% and 56%).

If there are areas where your risk management has not been effective, why do you think that this is the case? (Insufficient knowledge about the external environment or scenario planning; Ineffective operational planning; Insufficient rigour put in to assessing risks and keeping up to date; Insufficient leadership or direction within your organisation; Links between risks not recognised; Mitigations were insufficient to address the identified risk; Mitigations did not operate quickly enough; Mitigations did not operate; Other)

The findings

- 55% of charities identified insufficient knowledge about the external environment and scenario planning as a reason for their risk management not being fully effective. 47% identified not putting sufficient rigour in to assessing risks and keeping risk management up to date as a factor. 30% identified links between risks not being recognised.
- 45% identified failures in risk mitigations as a factor. This comprises combinations of mitigations being insufficient to address the risk (25%), mitigations relied upon not operating (21%), and mitigations not operating quickly enough (17%).
- 20% identified ineffective operational planning and 17% insufficient leadership as factors.

Has the risk appetite of your charity changed? (Yes, both trustees and managers are more willing to accept risk; Yes, both trustees and managers are less willing to accept risk; Yes, trustees wish to be more cautious but managers do not; Yes, managers wish to be more cautious but trustees do not; Yes, attitudes to risk have become confused or unclear; No, no change in attitude; Don't know)

The findings

- 33% of charities reported that their risk appetite remained unchanged. A further 5% reported that they did not know whether it had changed or not.
- 36% reported that the willingness of trustees and managers to take risk had reduced. 11% reported that it had increased.
- 16% reported either differences in the attitude to risk between trustees and managers or risk appetite having become confused.

Our analysis

The last year has been a difficult one financially for most charities. Inflation was initially high and then fell away, and income levels were also under pressure across most sources. The future anticipated by the majority of charities is challenging, with pressure on most sources of income, and many charities needing to draw on reserves or reduce costs. Many are also planning to increase fund raising activity, although how fruitful this will be is unclear. Within this there is a significant minority of charities that seem optimistic about their income prospects and their ability to avoid cost cutting measures.

The sectors with the most pessimistic expectations are Business/Professional Associations and International, where 86% and 64% respectively thought that they would experience a significant reduction in income. The most optimistic subsector was Social Services, but even in this case more than one third (37%) expected significant reductions. The surprise is that overall so many charities expect that their income will be maintained.

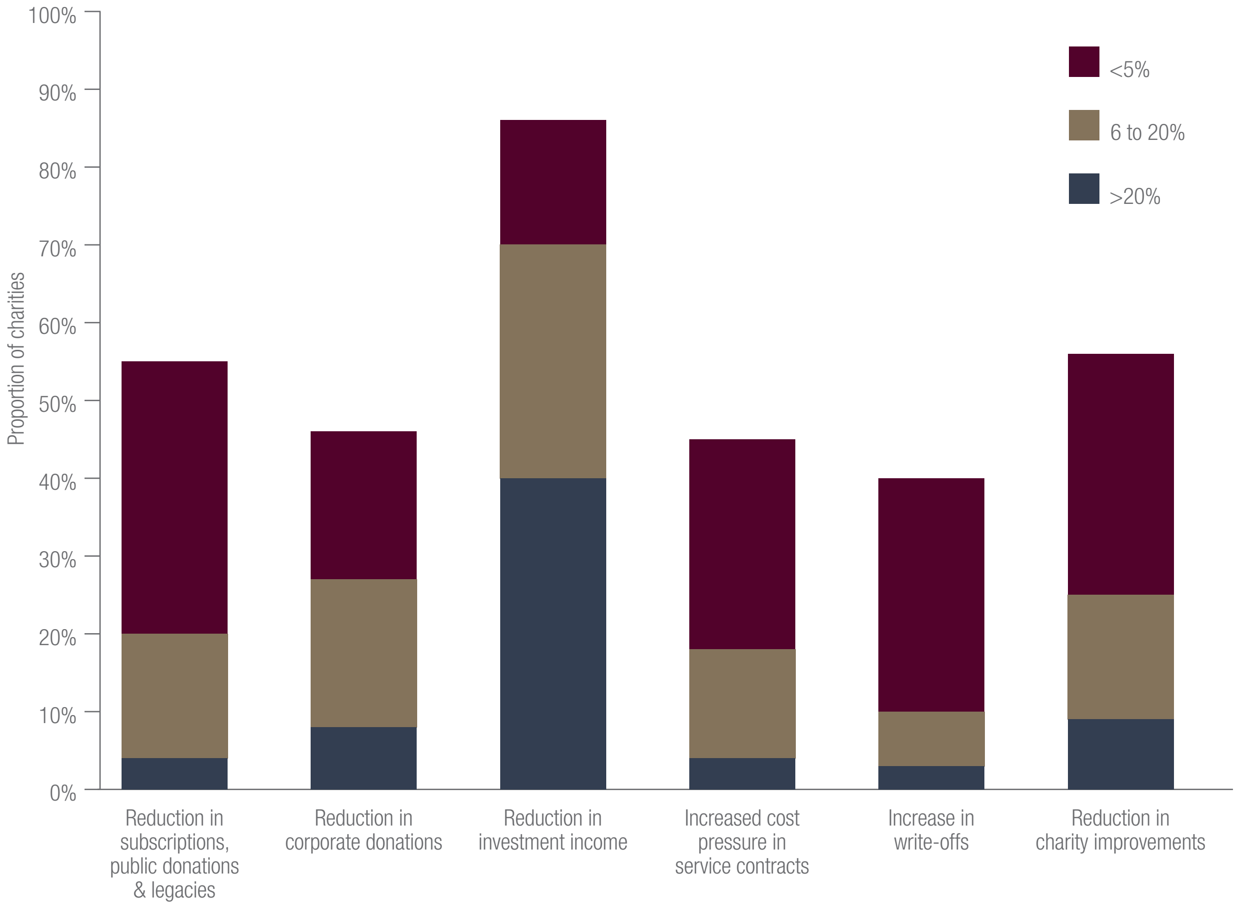
The sector appears very positive about the benefits of risk management. The most distinctive features of this latest recession are the suddenness and speed with which it took hold, and the shift from the impact being primarily inflationary to deflationary. It is therefore not surprising that a number of charities felt that their arrangements did not predict the speed or severity of impact – and therefore all the more remarkable that so many charities feel that their risk management did get it right.

In the 2008 survey I reported that, 'given the current environment that UK based charities are operating in, risk management will need to work better … The next two years will test even the best risk management processes. Those risk management processes that are reactive rather than pro-active are likely to be found wanting, with new risks emerging quickly that existing mitigations are not set up to deal with. Charities will need to look ahead, anticipate the emerging issues, develop contingency plans and be ready to act quickly. The once a year risk considerations is likely to prove of very little benefit.'

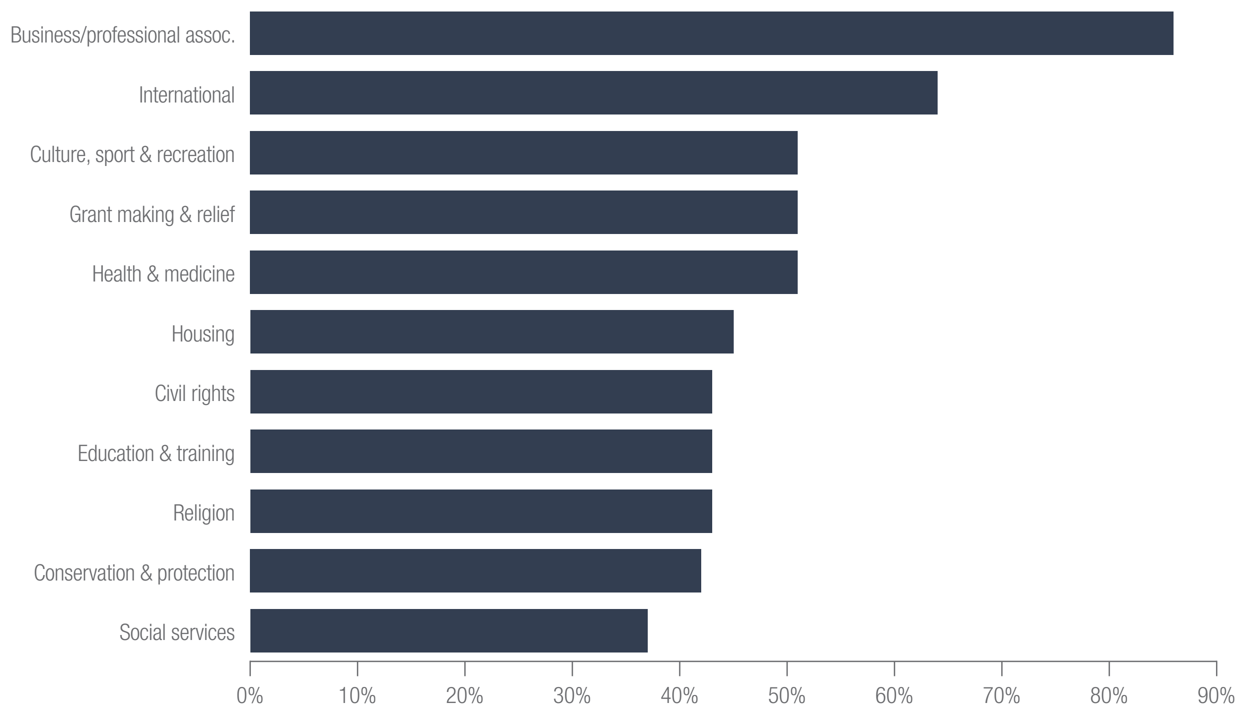
This has been borne out by this year's survey results. The prime reasons identified for risk management failures are those relating to making risk management proactive, e.g. failure to gather knowledge, or exercising insufficient rigour and leadership. Another cause of failure is the reliance placed on mitigations that are either ineffective or do not work. Typically I find that where things do not work in risk assessment it is because it is too formalised and stifles breadth of thinking, and failures in risk mitigation come about because the mitigations are not formalised enough, so are either insufficiently well designed or their operation slips. Having said that, risk management does appear to have worked well for the sector, with a high proportion of charities reporting risk management as more effective in both anticipating issues and managing the impact of them. Despite all of the difficulties, few charities are anticipating cash flow issues, and still fewer fear imminent insolvency.

The 2008 survey indicated that the risk appetite of charities was very low compared with other sectors. This year's results indicate that the level of caution has increased further, with twice as many charities becoming more cautious compared to the number seeking to take more risks. This increase in caution spans all sizes of charity to a similar degree.

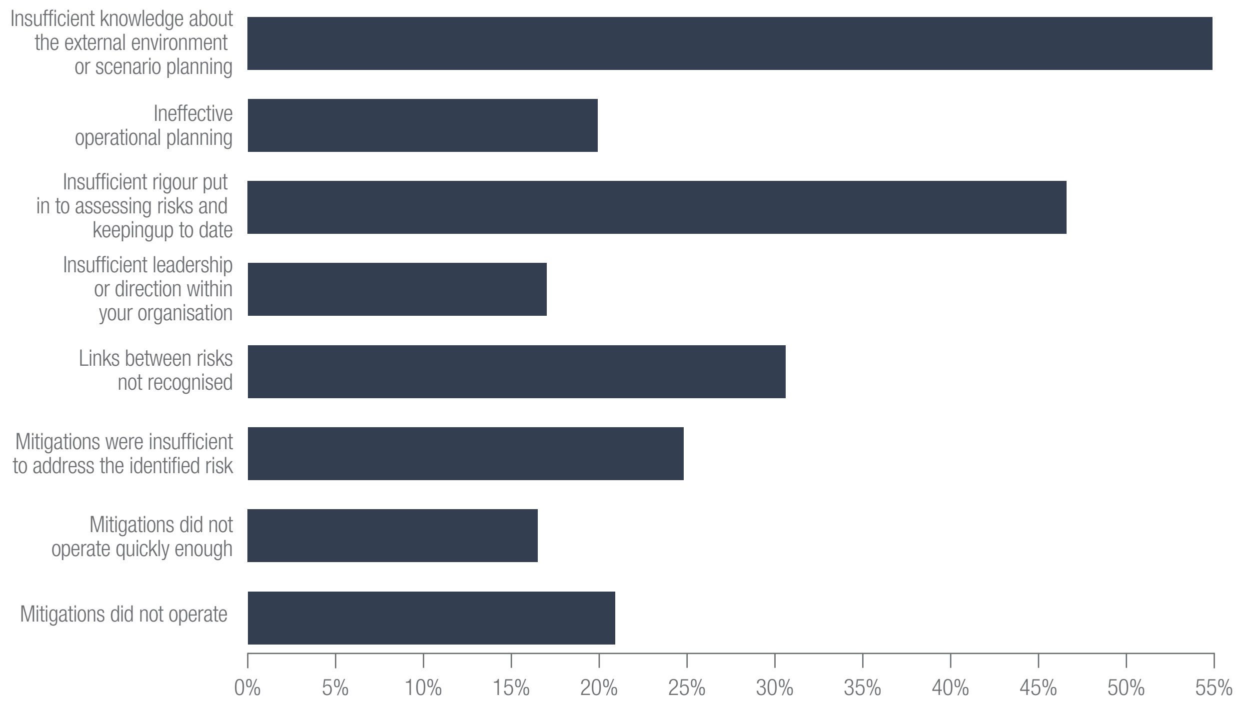
Impact of credit crunch and economic downturn



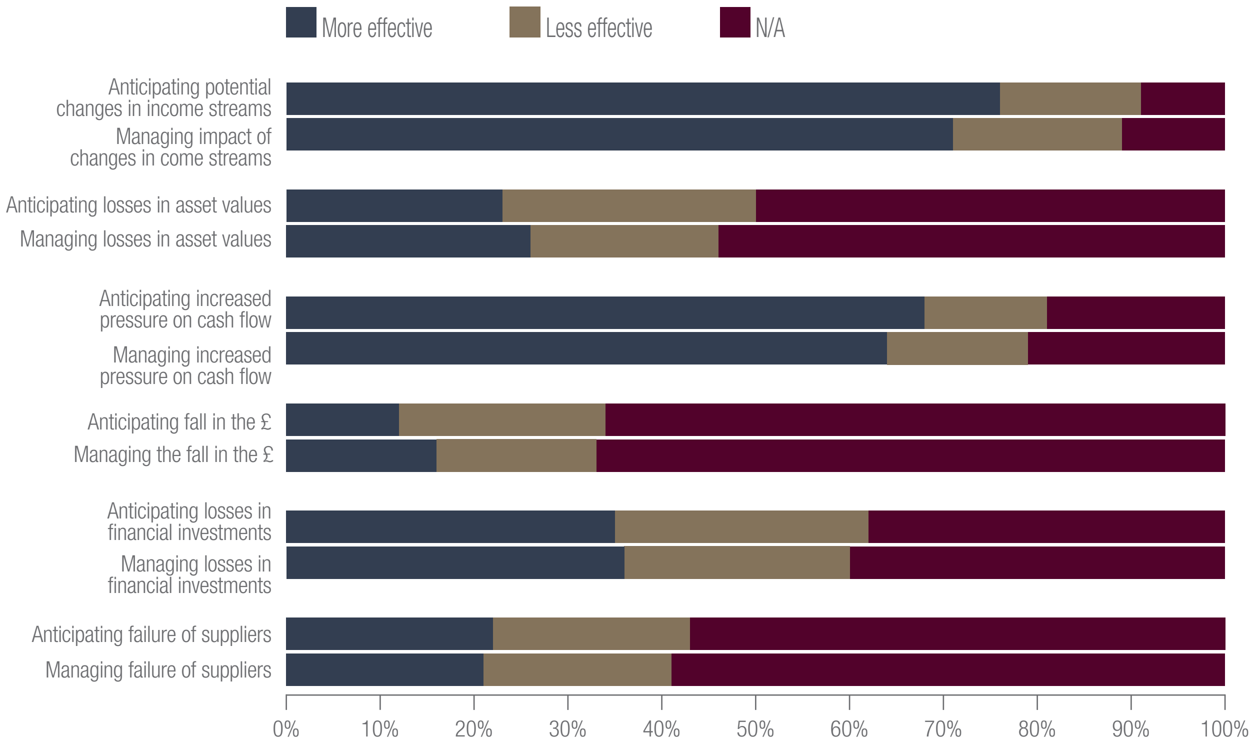
Those expecting income to be reduced significantly



Causes of risk management weaknesses



Areas where risk management is most effective



Control tips

Risk management under increased uncertainty and change

- External uncertainty tends to affect a relatively small proportion of risks. The risks themselves tend not to change; what changes is their possible magnitude and their perceived likelihood at any point. These need to be reflected within the risk register.
- The approach to managing risks stemming from uncontrollable external events that are uncertain needs to be threefold:
  - Actions that can be taken in advance to reduce the potential impact on your charity should the risk event arise.
  - Planning responses to the risk event that can manage the impact, should it arise at different levels of magnitude.
  - Monitoring the external circumstances to seek to give early warning of the risk materialising, to allow as much time as possible for implementing the responses.
- Internal change can affect the management of all risks through detracting from the risk detection or risk management activity, and can create a risk in itself.
- Where changes are made to areas involved in managing significant risk, it is important that the ongoing risk management is considered as part of the planning of the change and is implemented alongside the change. In some cases interim arrangements may be needed during the change process.
- Risk management will pick up standard issues, e.g. loss of income, but also needs as far as possible to pick up the exceptional issues, such as the collapse in pension scheme values in 2003 or the collapse in banking in 2008. To attain high standards in risk management the trustees have to ask the question, 'What would have a catastrophic effect on our organisation?' and be willing to think outside the box – it is the catastrophes that really hurt.

Strategic options

How well do you believe your organisation will cope if the downturn continues until the last quarter of 2010? (Charity is geared up to cope and is expected to thrive post recession; Charity is geared to cope and get back to normal post recession; Charity's ability to cope is dependent on major funder(s)/contracts; Some changes will need to be made to survive a lengthy recession; Major changes will need to be made to survive a lengthy recession; The charity is unlikely to survive a lengthy recession)

- 25% of charities consider that they can cope and thrive post recession. This comprises charities operating in a variety of sectors, broadly in line with the spread of all respondents. The most positive subsector is Grant Making & Relief, with 36% of these charities expecting to cope and thrive post recession. This compares with just 12% of Housing charities and 11% in the Business/Professional Associations subsector. Health & Medicine charities form the largest group, comprising 20% of all organisations expecting to cope and thrive.
- A greater proportion of the charities expecting to cope and thrive (34% compared with 26%) have diversified income streams, with a smaller proportion (7% compared with 15%) reliant on just a few funders. These charities are also more positive about maintaining income levels through a recession, with 35% predicting a fall in income from last year, compared with 46% of total respondents.
- 35% of charities consider that they can cope and get back to normal post recession. Grant Making & Relief charities are the most positive overall, with 80% expecting either to cope and thrive or cope and return to normal. The least positive subsector is Civil Rights, with just 22% of charities expecting either to cope and thrive or cope and return to normal. Conservation & Protection (47%) and Social Services (46%) are the only other subsectors where less than half do not expect to at least return to normal after a recession.
- The role of those completing the survey has a bearing on confidence in the future. While 70% of Chief Executives and trustees believe their organisations will either cope and thrive or cope and return to normal, only 55% of Finance Directors and 56% of 'others' believe this.
- 18% have identified their ability to cope as being dependent on major funders or contracts.
- 22% have identified that changes will be required to survive a lengthy recession. For 5% these will be major changes.
- 0.5% believe that their charity is unlikely to survive a lengthy recession. All charities in this category have a cost base that is fixed for at least a year.

Has your charity reviewed its strategic options in response to the recession?
(Yes, review completed or currently in progress; No, but such a review is planned; No, a review of strategic options is not considered appropriate at this time)

The findings

- 65% of charities have reviewed their strategic options in response to the recession. A further 17% intend to do so. This is most common the Business/Professional Associations subsector, where all nine organisations who indicated this as one of their subsectors of operation have either carried out a review or plan to do so. Around 80% of all other sectors (between 75% and 84%) have carried out or intended to carry out a review.

  The proportion of those who have already started or completed a review varies from 44% of organisations involved in Civil Rights (these charities also have the lowest level of confidence in their ability to cope and thrive or return to normal post recession) to 71% of organisations in Housing.

Have you considered, or do you intend to consider the following strategic options?
(Redefining charity objectives or mission; Merger with another organisation; Breaking up of current organisation; Restructuring of current organisation; Use of shared back office services; Outsourcing of activities; Bringing outsourced activities back in house; Rationalisation of properties; Curtailment or cancellation of activities; Rationalisation of costs or overheads; Revised funding strategy; Wind up of charity; Increasing marketing spend; Improving governance; Other)

The findings

- Options most commonly considered are rationalisation of costs and overheads (87%), curtailment or cancellation of activities (74%), revised funding strategy (71%) and improved governance (67%).
- The options most often identified as probably emerging are rationalisation of costs and overheads (34%), revised funding strategy (31%), improved governance (27%), restructuring (15%) and curtailment or cancellation of activities (15%).
- The options most often not considered at all were breakup of current organisation (76%), bringing outsourced activities back in house (77%) and windup of charity (75%).

What new opportunities do you see for your charity in the current climate?

The findings

- 40% of respondents indicated that they did see opportunities within the recession. The most common being becoming a fitter organisation by restructuring or reducing costs, diversification or achieving growth/ additional funding, each at 7%.
- 6% see opportunities for combining or merger.
- The subsectors identifying opportunities most are Civil Rights (78%) and Education & Training (44%). The subsector identifying least was Religion (29%).

Our analysis

As noted above, a higher percentage of charities classed as Grant Making & Relief expect to cope and thrive post recession compared with other subsectors. These charities often have high levels of reserves or endowment funds which generate the income to make the grants, and so they are not reliant on external funders. In addition a recession means there may be more demand for grants – these charities also have a higher percentage expecting an increase in demand (69% of those who answered this question consider it likely, compared with 44% of total respondents) – so there is an ongoing need for their services.

The subsector comprising the greatest proportion of those expecting to cope and thrive was Health & Medicine. More of the health charities say their income is mainly from donations, appeals and legacies than total respondents; this could be an indication that these charities expect greater loyalty because of the personal nature of their relationship with donors (for example with those who donate because of personal experience of a particular illness or condition).

Something that stands out is that the charities with the most positive outlook have a far more positive view of their risk management than respondents in general. 72% claim that their risk management identified the main issues and the potential severity and speed of impact, compared with 58% of total respondents. 53% claim that risk mitigations have consistently had a positive benefit and put the charity in as good a position as could be hoped, compared with 28% of the total, and 43% claim that risk management is fully embedded and effective, compared with 26% of the total. This highlights the importance of the risk management process in understanding your organisation and helping to place it on a firm footing.

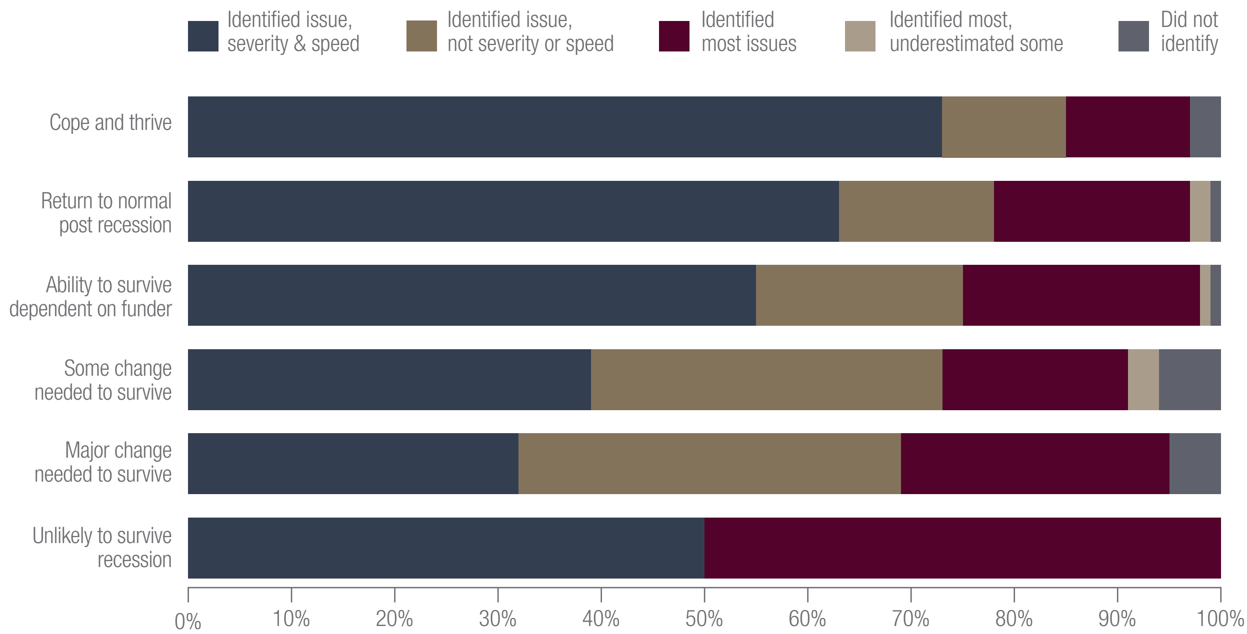
Both the charities expecting to cope and thrive, and those expecting to cope and get back to normal, have a lower percentage reliant on public sector contracts or a small number of major funders. This is unsurprising; charities reliant on these income sources often have less scope to negotiate increases in contracts and may be forced to accept funders' cuts or freezes as the funder adjusts to the recession. Where contracts are cut there is no guarantee that they will be restored post recession as priorities may have changed.

As noted above, around 80% of respondents indicated that they had either carried out a strategic review or were planning to do so. The options most often not considered at all were breakup of the current organisation (76%), bringing outsourced activities back in house (77%) and windup of charity (75%). This suggests that the majority of respondents believe that there is still a place for their charity and that they will work to keep it going throughout the recession. A reluctance to bring outsourced activities back in house may reflect an unwillingness to commit to the increase in staff costs that would probably follow.

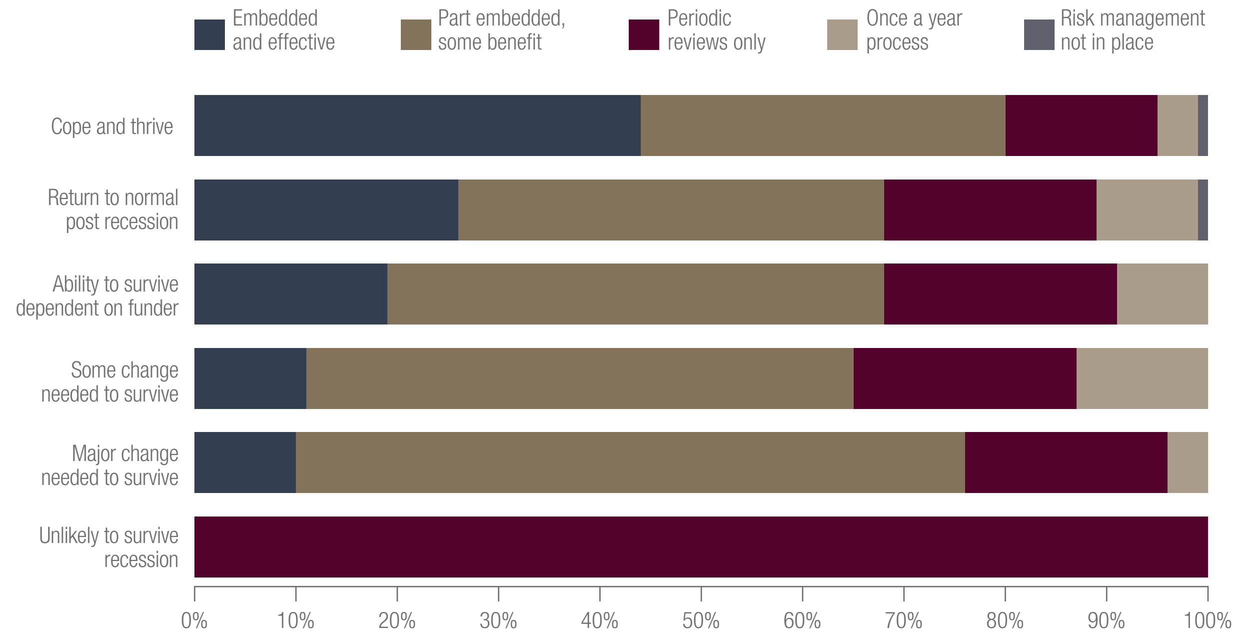
Merger with another organisation was not a popular strategic option, with only 3% considering it probable and 27% possible. Two hypotheses were presented as to which organisations were most likely to consider merger: those in a sound position looking to acquire cheap assets from struggling organisations, or struggling organisations looking to merge their way out of trouble. Unfortunately for the theorists, neither of these hypotheses is borne out by the analysis. Merger was most likely not to have been considered by those with reserves covering over 1 year of expenditure, and by those with reserves of less than one month / negative reserves. It was least likely to have been considered by charities with income of over £25m and with income under £250,000. Charities with income of £250,000 to £1m were most likely to consider it, with 43% of these charities considering it possible and 8% considering it probable. Rather than being seen as an option for those at the extremes, then, it is more likely to be considered by mid-range charities with some but not substantial reserves, perhaps seeking to build on and consolidate their position.

For those charities able to weather the storm, opportunities will be there to be found. Based on the results of this survey we would anticipate an excess of demand over supply for services. 171 respondents indicated that they thought it likely they would see an increase in demand for services, but of these charities 42% stated that they had stopped, reduced or delayed activities on cost grounds. 11% stated that a curtailment of activities was a probable strategic option; 43% think it possible.

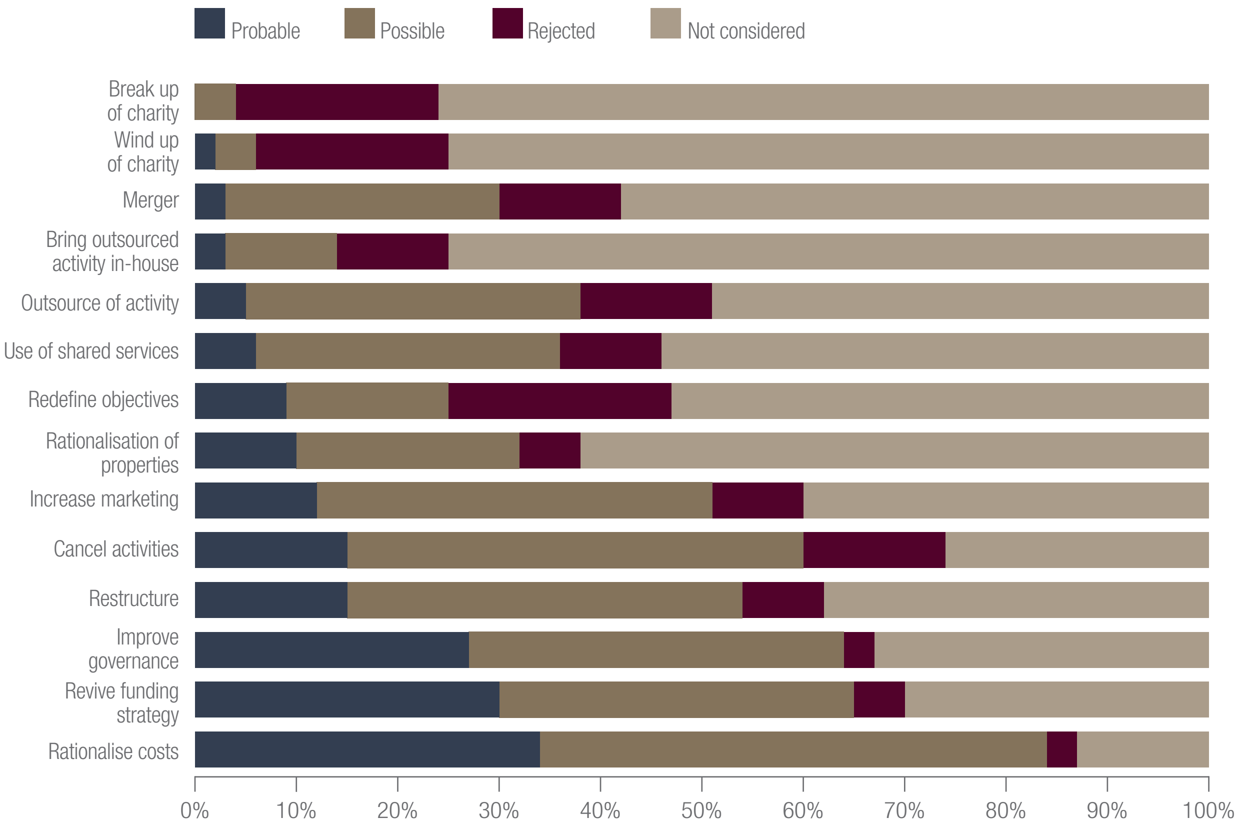
Success of risk management by charity outlook



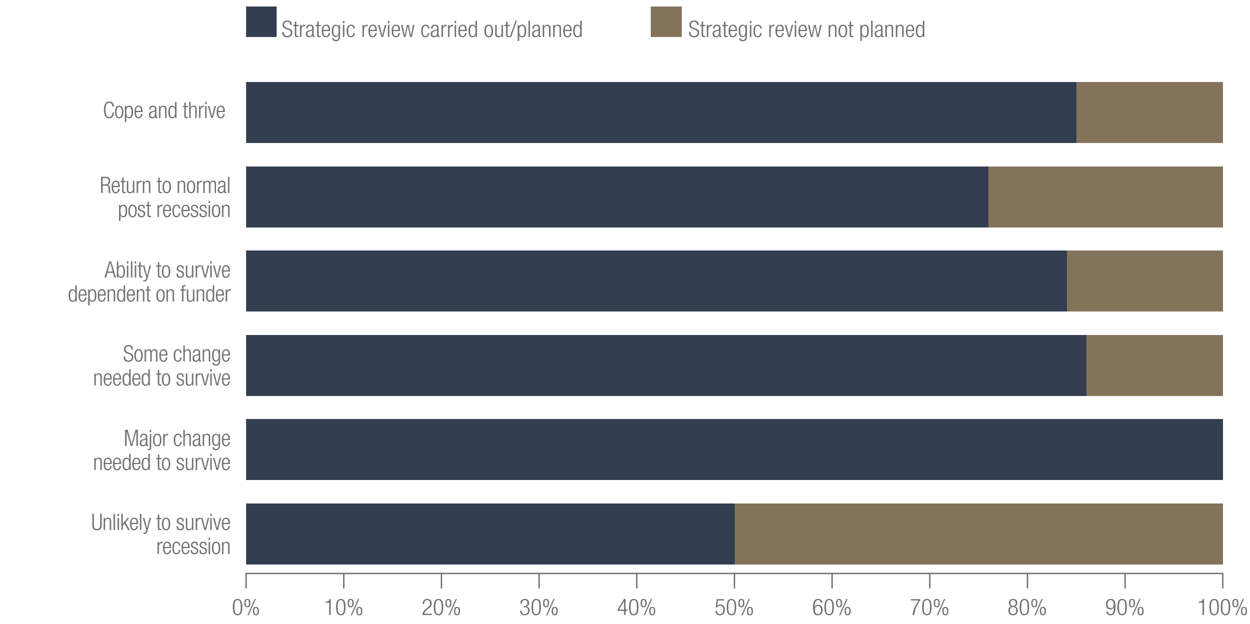
Risk management embedding by charity outlook



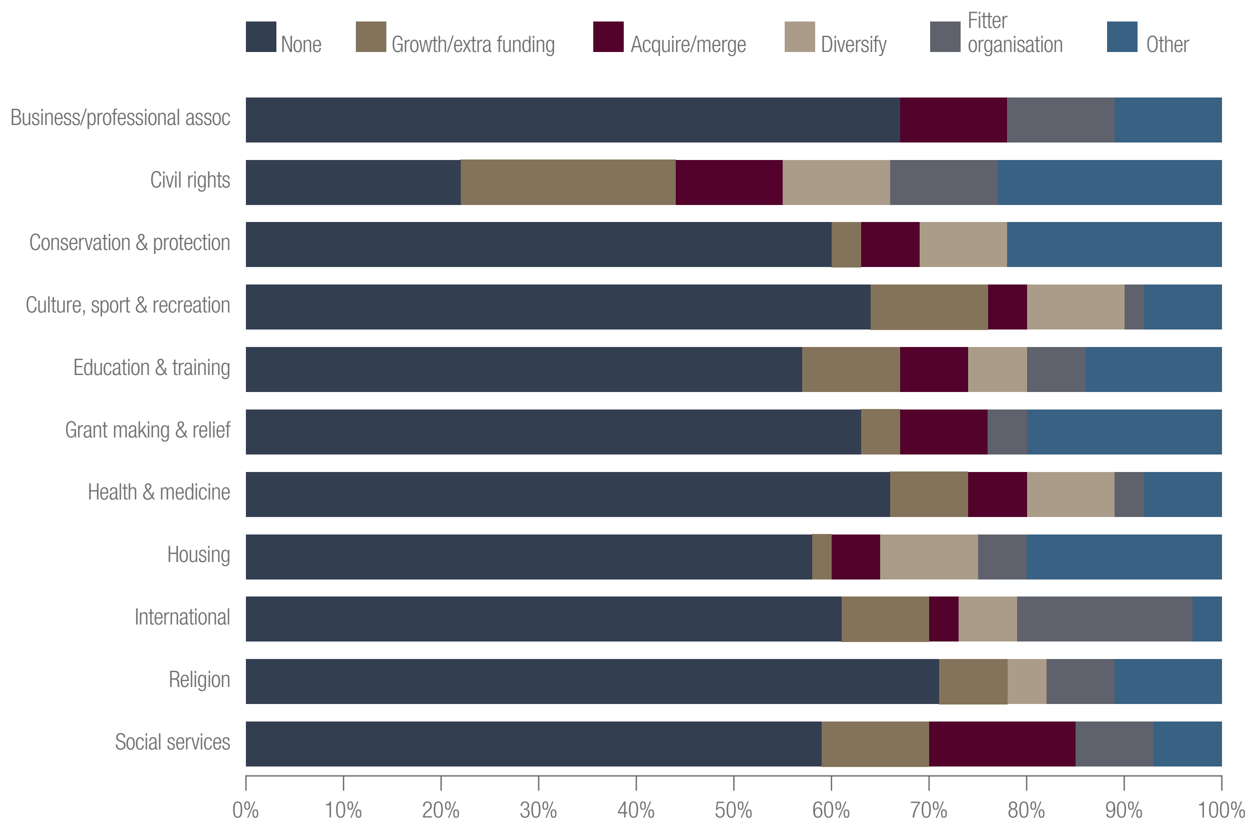
Strategic options assessment



Strategic review by charity outlook



Opportunities perceived from the recession



Control tips

Managing cost reductions

- Try to avoid the rumour mill. Far more damage can be done to morale if staff are left to speculate. Being honest and explaining decisions, even tough ones, can have a far more positive effect by reducing uncertainty and generating trust.
- Timing is everything. Cost reductions need to be carefully considered, not rushed into as a knee-jerk reaction to a downturn in circumstances, or put off by managers unwilling to take unpopular decisions.
  - Cuts, particularly redundancies, need to be thought through to ensure that remaining staff do not come under undue pressure and that the charity does not lack capacity to take on new projects if funding becomes available.
  - On the other hand, prevarication and delay can also cause long term damage to an organisation, especially one which is running a deficit. The old adage, short term pain for long term gain, holds a great deal of truth at times like these. Making those tough decisions will result in a leaner, fitter organisation well placed to take advantage of future opportunities.
- Do not underestimate the importance of staff consultation. Operational staff may already be aware of areas where efficiencies can be found. Consultation helps staff buy in to a cost reduction programme as they feel they have had some say in the decisions, rather than having them imposed from above.
- Some measures will incur an initial cost (such as negotiating with a funder to withdraw from a loss-making programme, or making redundancies). This should not be a deterrent – the long term benefits may far outweigh the short term costs. Cost projections and analysis can identify areas where an initial outlay will result in substantial savings.
- Look at allocating resources where they are most needed rather than applying cuts across the board. It is important that resources are allocated where they maximise delivery of a charity's objectives. Unfocused cost cutting can damage areas of greater importance.
- Plan for the charity's future – ensure that when allocating limited resources you do not forget future investment.
- Nor should you forget the public profile of the charity. News of cutbacks can worry beneficiaries and scare off potential donors and funders. If this is a threat, then communication is vital, e.g. through targeted letters to specific stakeholders, newsletters, websites and press releases. As in the case of staff, communicating to stakeholders with honesty will reduce speculation and help maintain confidence in the charity.

Risk management progress

How often do the management team and trustees review and confirm that your risk and control assessment is still appropriate?

The findings

- The frequency of review of risks by both management and trustees has increased further, with 57% and 35% respectively reviewing risks and controls at least quarterly, compared with 34% and 28% two years ago.
- For many trustees risk assessment is still an annual process, with 46% of charities reporting that trustees review their risks annually or less often.
- 6% of respondents indicated that their trustees did not review their risks even annually, and 5% reported that managers did not. Many of these were the same charities, yet a number of these indicated that risk management was a strong or limited influence on their decision making.
- Managers of larger charities appear to review their risks more frequently than smaller charities. 63% with income over £10m review risks and controls at least quarterly, compared with 43% of smaller charities. For trustees the difference is less, with 35% of larger charities and 30% of smaller charities.

Which of the following does your charity have in place? (risk policy; risk register showing controls; business continuity plan; fraud policy; whistleblowing policy; testing of internal controls)

The findings

- There are still a number of gaps in the basic risk management components for many charities but in all cases there has been further improvement.
- 30% of respondents reported that they did not have a risk policy. This has reduced from 37% in 2008.
- 20% reported that they do not have a risk register showing controls. This has reduced from 23% in 2008.
- 46% reported that they do not have a business continuity plan. This has reduced from 47% in 2008.
- 51% reported that they do not test the operation of their internal controls. This has reduced from 56% in 2008.
- 57% reported that they do not have a fraud policy. This has reduced from 61% in 2008.
- 41% reported that they do not have a whistleblowing policy. This has reduced from 45% in 2008.

In which areas does risk management have an influence?

The findings

- Overall there is little change in the use of risk management. It is used for most key decision areas by most charities at least to some degree.
- Over 95% of respondents reported using risk for strategy and priority setting.
- Over 90% reported using risk for project appraisals, operational plans, investment decisions and reserves policy decisions.
- Over 80% reported using risk for contract renewals, recruitment decisions and funding bids. Contract renewals is the only area where use has fallen significantly, from 92% to 87%.

How would you describe risk management at your charity?

The findings

- 26% of respondents described their risk management as embedded in the charity and working effectively. This is increased slightly from 2008 (24%).
- 45% described their risk management as part embedded and giving some benefit, up from 44%.
- 20% described their risk management as just involving periodic reviews of risks and controls.
- 8% described their risk management as a once a year process.
- 0.5% reported that risk management was not in place and they had no intention to introduce it.

Our analysis

Overall the use of risk management has continued to increase, with growth in the risk tools, frequency of review and the extent of influence that it has upon decision making. This is consistent with many charities stating that their risk management has helped them handle the recession.

The proportion of charities considering that risk management is embedded has also increased slightly, for the first time exceeding one quarter of respondents, and more than two thirds consider that risk management is part embedded. Although in some respects it is disappointing that these proportions are so low eight years after the SORP requirement, it does reflect an honest reality: few organisations of any type manage to embed risk management fully in everything that they do.

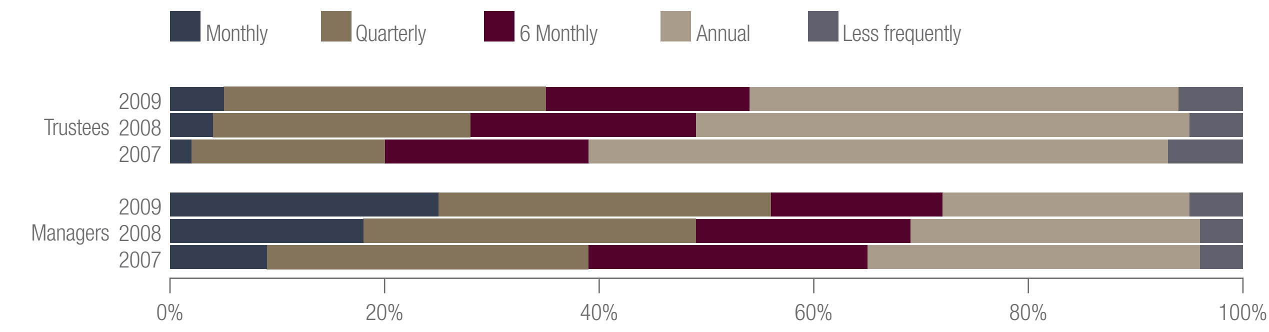
However, many still do not have some of the basic components of risk management in place. The lack of a risk register showing controls means that, in all but the smallest of organisations, it is difficult for the management team and trustee group to be confident that the arrangements for managing the risks are sufficient and have kept pace with the changing circumstances. Not testing the operation of internal controls means that the management team and trustee group cannot be confident that the most important controls are working as was intended, and there is an increased danger of an important control not working when it really matters.

The need for business continuity planning remains high. Although terrorism threats have declined and bird flu never took off, there are always ongoing threats both new and old. Swine flu or other illnesses may cause staff loss, buildings and records may be lost due to flooding or fire, and systems can be lost due to data corruption, system provider loss or just pure bad luck. For the 54% that have business continuity plans, it is important that they cover the right issues, are kept up to date, and are tested to ensure that they will work. For the other 46% that do not have plans, it is to be hoped that they have some informal arrangements to deal with continuity issues. If they do not, they should address the question of continuity threats as a matter of urgency.

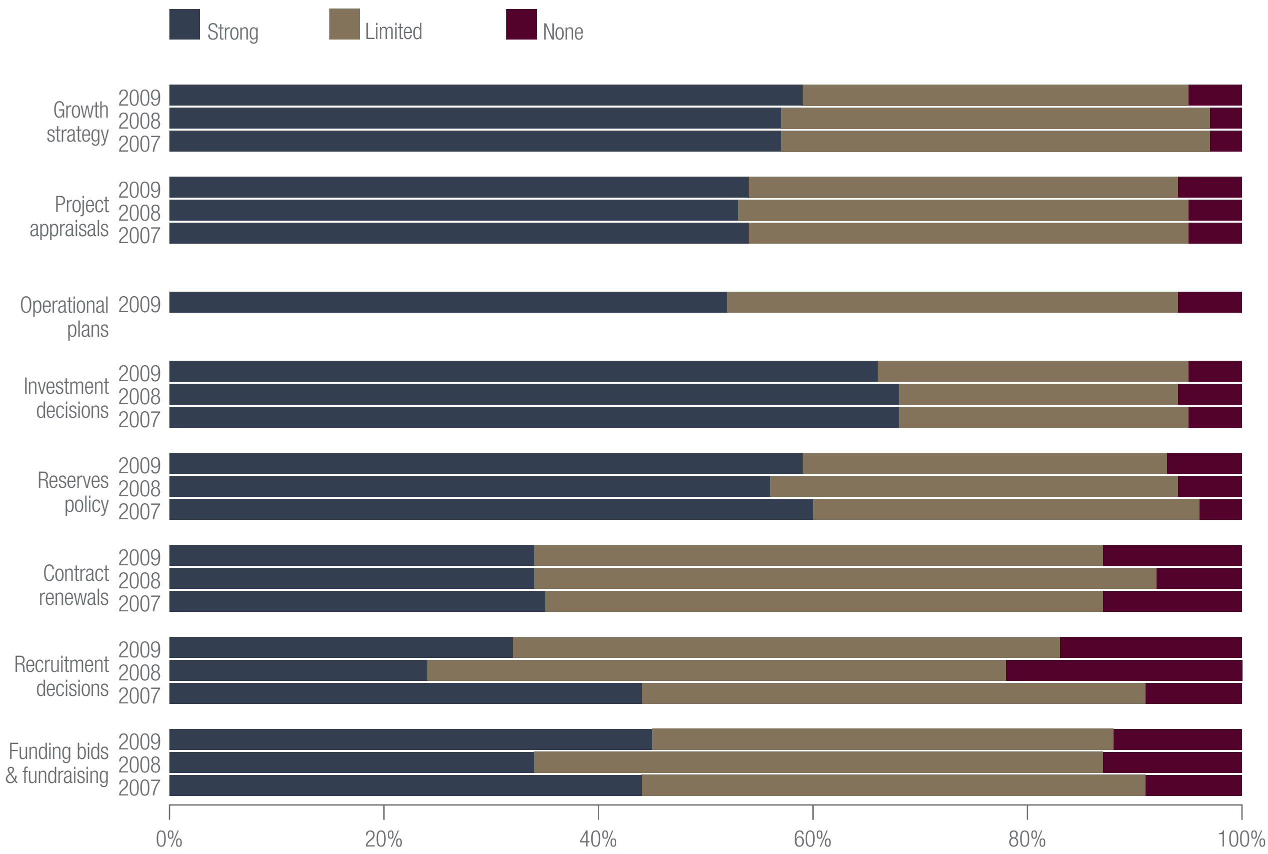
Recession brings increased attempts at fraud, and the organisations and people that suffer it are often those who do not take the basic precautions. Fraud policies and whistleblowing policies are two elements for deterring and detecting internal fraud, but they also need to be coupled to robust internal controls and regular monitoring by management – especially the review of detailed management accounts. Many charities are leaving themselves unnecessarily vulnerable by not having these basics in place.

It is difficult to see how risk management can be bringing any benefit for the group of 32 charities for which risk management is a once a year process, given the extent and speed of recent change in the external environment, even if the internal environment has remained stable. In ten cases other responses indicate that in practice there is much more active review taking place, and that this reflects the trustee involvement only. Of the remainder, approximately half recognise that risk management has little influence. More concerning are the others which reported that risk management had a strong influence in some areas.

Frequency of risk review



Use of risk management



Services to charities

PKF charities team

PKF is a leading firm of accountants and business advisers with more than 1,800 partners and staff providing services to our clients through our 23 offices in the UK mainland firm.

We work with more than 500 charities, ranging from large and diverse national organisations to small charities. Many of our team act as trustees or have worked as accountants in charities, giving them first-hand understanding of the issues they face. We are committed to helping charities and not-for-profit organisations excel at what they do best – helping others. We offer:

- In-depth sector knowledge and supportive relationships that deliver long-term value for money
- Understanding of, and empathy with, your organisation's culture and objectives
- Practical solutions to help you achieve your goals, tailored to the requirements of both executive management and trustees
- Effective communication to ensure issues are dealt with promptly and efficiently
- Easy access to partners and staff whenever it is required.

As well as audit, internal audit, tax, accounting and risk management, we also advise on pensions, trustee development, mergers, fundraising, strategic planning, governance and management of change.

Risk management is an area in which we specialise. Tailored to our clients' sector, size, objectives and stage of development, our services are designed to provide practical support where charities need it most. These include: setting risk policies and framework; identifying, assessing and prioritising risks; evaluating existing risk mitigation controls and monitoring; reducing risks outside the charity's direct control; embedding risk management and implementation to maximise its benefits and staff and trustee training.

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The Charity Finance Directors' Group

The Charity Finance Directors' Group (CFDG) is an umbrella charity with the aim to advance public education in and promote improved standards of management in charities. Our vision is a transparent and efficiently managed charity sector that engenders public confidence and trust. With this aim in sight, CFDG delivers services to its charity members and the sector at large which enable those with financial responsibility in the charity sector to develop and adopt best practice.

Founded in 1987, CFDG today is a dynamic network of professionals in charity finance. Started initially by a group of finance directors of large charities who felt they would benefit from sharing information and cooperating in some areas, the organisation has grown to currently over 1,600 members. As of early 2008, CFDG's membership manages a total of £14.7 billion of charity income.

The culture of sharing and contributing to the wider sector beyond the individual charities has remained the same and builds the strong backbone of CFDG's activities today.

CFDG is active in the policy arena as well as in education and training and provides information and support for members and the wider charity sector on different levels.

We work with other organisations, regulators and charities to input charity expertise into the regulatory process, and to develop best practice in charity management. In this quest, CFDG is represented on many committees and working parties established by professional bodies and government departments, including the SORP Committee.

CFDG members benefit from a variety of services, such as a regular newsletter, free members' meetings and a lively networking framework. Most importantly members can contribute through CFDG to regulatory consultations, share knowledge with peers through the electronic CFDG document library, and share some of the financial expertise of their organisation with others, for the wider benefit of the charity sector.

CFDG holds a number of annual conferences including a Risk Conference in November which consolidates expertise in risk planning and prevention and ensures that delegates attending leave with a clear understanding of the implications involved. In 2009 the annual Risk Conference is on 18th November at the Royal College of Surgeons.

Although administered from London, CFDG has a number of Regional Groups, run by a Committee of members who arrange a series of meetings each year. The Regional Group in the South West and Wales is supported by PKF.

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