FINANCE
FACTSHEET

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ISLINGTON

INTRODUCTION

These finance information fact sheets are aimed at childminders and childcare providers who are currently operating a childcare provision or are interested in started a childcare provision in Islington.

They form an introduction to some of the financial aspects associated with running a childcare business and are aimed at assisting you in your running your financial strategies for the organisation. They are not intended to be the sole solution to any financial problems that you may encounter.

Additional financial help and guidance can be sought from various sources including your business Support Officer at Children's Services; ICCT; Business Link for London; Voluntary Sector Councils, Chartered Accountants etc.

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BUSINESS FORECAST

A business forecast is the method used by organisations to forecast income and expenditure for the year and is included as part of a business plan. The business forecast shows an informed estimate of the incomes, costs and expenses and also gives you a forward look at the business expectations for the coming year.

The figures you use should be as accurate as possible and based upon your best understanding of the likely income and expenditure for the organisation.

If you do not have figures to help guide you, then you can use catalogues or the internet to help source prices. As a minimum you should try and have budgeted figures for:

- Income – from fees, fundraising and any other sources such as grants, loans or donations.
- Expenditure – including regular costs of operating the business such as wages, national insurance, premises, utilities (bills), and insurance, as well as variable expenditure on training, printing, stationery, travel and consumables.

By using the business forecast the management team are able to make practical decisions and set processes in action that will enable the organisation to prosper and to meet its objectives.

Also an accurate forecast can show in advance any areas of concern or issues that the organisation may face, so that their management team are able to prepare the way forward.

If you do not use forecasting the organisation will not know whether it can continuously cover its costs and make money. Also without measuring the business status against the forecast, managers will have no idea whether or not things are on track and won't be in control of the organisation.

Example of a business forecast

1/4/2006 – 31/3/2007

Income		
Fees		12830
Funding		9360
Fundraising		2780
Donations		570
Loans (if any)		0
	Total income	25540
Expenditure		
Wages		13630
National Insurance Contributions		1502
Premises		2880
Utilities		436
Insurance		516
Training		650
Printing & stationery		414
Maintenance		284
Consumables		1318
Loan repayments (if any)		0
	Total expenditure	21630
	Balance	3910

Pointers
This summary position can be used as an inclusion in your business plan. It has the overall figures for the year and tends to summarise some of the budget lines under one heading. For example, consumables would include food, milk, sundries and materials.

Source

MONTHLY BUDGET REPORT

What is it?

A monthly budget report is a statement of what the business expects to spend and receive and is linked directly to the annual forecast. It details every item of income and expenditure that has actually occurred within the month (this information is taken from your cash book). It is cumulative, so it gives an instant view of the balance at the end of each month and for that point in the year. At the end of the year it provides information for your profit and loss or surplus and deficit account.

What does it do?

It is a way of keeping track of the actual income and expenditure that the organisation receives and spends, compared with the figures expected.

A budget report grows as you progress through the year. It shows your total forecast for that **point** in the year. It shows your summary position for each month to date and the cumulative total to date across all months. It also shows the 'variance' which is the difference between the 'forecasted' spend and the 'actual' spend for that point in the year. The variance can be a positive or negative figure showing that the organisation has either spent or received more or less than expected.

Reviewing an updated budget can help managers ensure that the organisation does not spend more in each period than was forecasted. It is useful to ask:

> 'Why have we spent more or less?'
> 'What can we do to prevent adverse variances in the future?'

How regularly should it be used?

There are no rules about how often a budget should be monitored or reviewed, but it is good practice to update and review budgets on a monthly basis. This will allow managers to see how well the organisation is performing against the forecast on a regular basis. With the use of computers it is easy to set up a spreadsheet to record and help manage the data.

Example of a monthly budget report

Our childcare setting – July budget report	April actual	May actual	June actual	July budget	July actual	July variance	Year to date	Year forecast to date	Year variance to date
Fees	1550	1240	1290	860	860	0	4940	**4860**	**80**
Funding	2940	0	0	0	0	0	2940	**3120**	**-180**
Fundraising	240	150	450	210	360	150	1200	**1170**	**30**
Donations	0	0	0	30	0	-30	0	**210**	**-210**
Total income	4730	1390	1740	1100	1220	120	9080	**9360**	**-280**
Expenditure									
Wages	1250	1310	1290	830	790	40	4640	**4700**	**60**
National Insurance	138	144	142	92	86	6	510	**518**	**8**
Premises	240	240	240	240	240	0	960	**960**	**0**
Utilities	0	261	0	38	63	-25	324	**183**	**-141**
Insurance	43	43	43	43	43	0	172	**172**	**0**
Training	0	160	0	0	150	-150	310	**120**	**-190**
Print and stationery	50	54	0	8	25	-17	129	**133**	**4**
Maintenance	24	42	0	0	30	-30	96	**96**	**-60**
Materials	20	30	40	18	20	-2	110	**88**	**-22**
Toys	0	0	0	50	30	20	30	**90**	**60**
Food	50	30	44	46	50	-4	174	**166**	**-8**
Milk	32	28	8	24	32	-8	100	**104**	**4**
Total expenditure	1847	2342	1807	1389	1559	-170	7555	**7270**	**-285**
Balance	2883	-952	-67	-289	-339	-50	1525	**2090**	**-565**

Pointers
Variance – year to date minus the year forecast to date

ROLLING BUDGETS

Definition

Is a method in which a budget established at the beginning of an accounting period is continually amended to reflect variances that arise due to changing circumstances.

What is it?

A rolling budget always involves maintaining a plan for a specified time period in the future for example 4 months in advance or on a quarterly basis. You then build your next quarter budget by adding a new time period in the future as the current time period that ended is dropped. This can be easily achieved by dividing the annual operating budget into four-quarterly rolling budgets.

What does it do?

Keeping financial information current permits quicker adaptation to the changing organisation's conditions that are sometimes so unpredictable that yesterday's best guess can be out-of-date today.

Rolling budgets help to set a timetable for updates based on the volatility of a market, pumping in new figures as needed e.g. quarterly, monthly or even weekly.

Example of a quarterly rolling budget

	Year x				Year x + 1			
	1Q	**2Q**	**3Q**	**4Q**	**5Q**	**6Q**	**7Q**	**8Q**
1st Review	**200**	**250**	**300**	**350**	**400**	**450**		
2nd Review	**175**	**200**	**275**	**300**	**350**	**400**		
3rd Review		**225**	**300**	**350**	**400**	**425**	**450**	
4th Review			**325**	**375**	**450**	**500**	**550**	**600**
	Forecast		**Actuals**					

Source

Beyond Budgeting Round Table

PROFIT AND LOSS STATEMENT OR SURPLUS AND DEFICIT STATEMENT

What is it?

At the end of each trading period, usually a year, the organisation needs to look back and see whether it has made a profit or a loss (surplus or deficit). An annual profit and loss statement provides this information. It is an historical summary of the organisation's financial activities.

What does it do?

The annual profit and loss statement summarises all income and expenditure in that trading year and shows whether the organisation has made a profit or loss (surplus or deficit).

How regularly should it be used?

It is usually prepared at the end of the year.

Example of a profit and loss statement (surplus and deficit statement)

Our childcare setting –
Profit and loss statement

1/4/2006 – 31/3/2007	**Actual**
Income	
Fees	12550
Funding	9440
Fundraising	3100
Donations	500
Total Income	25590
Expenditure	
Wages	13350
National Insurance	1468
Premises	2800
Utilities	525
Insurance	516
Training	720
Print and stationery	375
Maintenance	280
Materials	240
Toys	220
Food	550
Milk	320
Total Expenditure	21364
Profit/Loss	4226

BANK RECONCILIATION

As a childcare provider it is good accounting practice to do monthly or quarterly bank reconciliations for the business. This is the process of matching and comparing the figures from your accounting records (cash book) against the figures presented on your bank statement.

You should have recorded in your cash books all the amounts that you have actually received and payments you have actually made. However, the cash book may be incomplete as your bank may have put extra transactions through your account, such as:

- Bank fees or interest charges, or
- Direct debits (payments) and direct credits (receipts)

Doing regular bank reconciliations will allow you to:

- Take into account any extra transactions that your bank puts through your account, and
- To check and record any errors or omissions that has occurred.

By doing regular bank reconciliations you can be more confident that your accounting records contain all the information that you need to prepare your tax returns, your balance sheet and your profit and loss / surplus and deficit statements.

How to prepare a bank reconciliation:

Step 1
Check all entries in your cash books against those in the bank statement. You might like to keep track of each of these entries by putting a pencilled tick next to each entry in the cash books and on the bank statements that appear in both records. If there are any differences in the figures, you will need to work out which is correct.

Step 2
If there are any unchecked items in the bank statement e.g. bank fees, record these in your cash books. Once you have done this, your cash books contain details of every transaction for the period.

Step 3
If there are still any unchecked items in your cash books, these are items that the bank does not know about during the period of the statement e.g. an unpresented cheque or money received on the last day of the period but may not have been banked until the next period. Remember it can be several months before cheques are finally presented.

Step 4
Create a bank reconciliation statement, as follows:

- Record the balance as on the bank statement
- List any outstanding deposits
- List any outstanding cheques

Calculate the closing cash book balance (if you keep a running cash book balance, these figures should agree).

Bank Reconciliation Summary Example

Bank statement balance	**2546**
Less outstanding cheques:	
12/1/2008 00123	(55)
22/1/2008 00142	(6)
29/1/2008 00152	(41)
Plus outstanding receipts:	
Banked 29/1/2008	450
Banked 30/1/2008	12
Adjusted bank statement balance	**2906**

BREAK EVEN POINT

For childcare businesses knowing where the break even point lies, is of prime importance in the business planning process.

It can also be a key influencing factor in developing pricing strategies and helping both potential and existing businesses take important strategic decisions regarding their plans.

The break even point is reached when the income from the sales provides the business with enough money to cover the cost of providing the service and the cost of all overheads. At this point the business is not making a profit or a loss – it is breaking even.

The break even point can be calculated as either the number of places that a childcare business has to have filled at a particular price in order to break even, or as the value of sales that have to be made in order to break even.

The **Breakeven Point** is that point at which the service reaches capacity. New clients can only be dealt with if extra resources (human and physical) are provided.

See the following calculation showing how a break even point can be arrived at.

The number of children in the first column rises in groups of 5, to gain a broad perspective.

The second column, Fixed Cost (Staff), shows the cost of employing the number of staff needed to fulfil the regulatory requirements. The cost of employing the Leader, in this case, is £106.74 per week and the cost of employing each further practitioner is £70 per week. Therefore, when there are less than 16 children, the staff cost is £176.74. This then rises with every 8 extra children by £70.

The only unit costs are for activities. The figure of £0.85 per child per week is used here.

The total cost is calculated by adding the first two columns together, then by adding to this, the Unit Cost x Number of Children.

Income has been calculated on a full rate of £4 per session with 15% discounted, giving a total income of £16.80 per child per week. This is then multiplied by the number of children attending.

Profit / Loss is calculated by taking the Total Cost away from the Income.

Number of Children	Fixed Cost (Staff)	Fixed Cost (Staff)	Unit Cost	Total Cost	Income	Profit/ Loss
5	£176.74	£31.37	£0.85	£212.36	£84.00	-£128.36
10	£176.74	£31.37	£0.85	£216.61	£168.00	-£48.61
15	£176.74	£31.37	£0.85	£220.86	£252.00	£31.14
20	£246.74	£31.37	£0.85	£295.11	£336.00	£40.89
25	£316.74	£31.37	£0.85	£369.36	£420.00	£50.64
30	£386.74	£31.37	£0.85	£443.61	£504.00	£60.39
35	£456.74	£31.37	£0.85	£517.86	£588.00	£70.14

Based on current pricing and costs, on average the organisation needs somewhere between 10 and 15 children per session to break even.

Source

Sure Start

HOW TO CALCULATE STAFF COSTS

Unless the childcare is operated by a lone sole trader (childminder) or partnership that do not employ other workers, making an analysis of staff costs is crucial for budgeting and planning, as it is likely to be the largest area of expenditure.

The major element in staffing costs is of course, wages. But it is important to include within this the 'hidden' costs of employers National Insurance Contributions, pension contributions and holiday pay. In addition there may be administration costs associated with staffing. This includes payroll administration, recruitment costs and training.

Pointers:

NI is currently only paid on wages over £100 per week. Therefore only staff with pay over this level will be eligible for employers' contribution.

To calculate employers contribution accurately, you will need to contact Her Majesty's Revenue & Customs (HMRC) tables CA38, as NI contributions are based on a scale on which the proportion of the contributions increases with the level of salary.

The following is an example of what is entailed in calculating staff costs for an individual employed by your organisation.

	Year 1	**Year 2**	**Year 3**
FULL TIME SALARY	21993	22653	23332
ON COSTS (18%)	3959	4078	4200
TOTAL	25952	26730	27532
Add extras			
General running expenses (phone, post, room hire, insurance)	1000	1030	1061
Producing information, education & promotional materials	1000	1030	1061
Training / personal development / conference fees	1000	1030	1061
Travel expenses	250	258	265
Rent / heating / lighting	750	773	796
Management fees	1000	1030	1061
TOTAL REVENUE COSTS	30952	31880	32837
CAPITAL COSTS			
Office Equipment	1500	100	100
TOTAL CAPITAL COSTS	**1500**	**100**	**100**
RECRUITMENT COSTS	**1500**	**0**	**0**
TOTAL COSTS	**33952**	**31980**	**32937**

CASH FLOW FORECAST

What is it?

A cash flow forecast is a statement of when cash is coming into the business and when cash is flowing out of the business.

When payments for childcare are received they're classified as cash received by the business and when bills like rent and wages are paid, cash is taken from the business. The cash flow details when all monetary transactions occur, whether money is coming into or out of the business.

What does it do?

Regular update and review of a cash flow forecast allows managers to make sure that the business always has enough money at the right time to pay bills. Many businesses fail not because they're not profitable but because they don't have enough available cash.

The cash flow forecast aims to gives accurate figures exactly when money is received and spent by the business so that managers can always see what the anticipated cash balance may be at any point in the future.

By looking ahead at the exact timings of when 'money comes in' and 'money goes out', managers can plan ahead in case the forecast shows that the business may run out of cash. It's possible to take action like re-scheduling bill payments or increasing revenues to avoid any future cash deficits.

How regularly should it be used?

Cash movements within your childcare business happen daily e.g. fees from parents, rent payments, bill payments, money for consumables and petty cash. So because the picture changes rapidly it's necessary to review cash flow frequently. It's recommended that you review your cash flow situation on a weekly basis as it takes very little time.

Once your cash flow format is set up it's a quick and easy task to update it regularly when changes occur such as changes in the anticipated numbers of children or a change in fee rates. As the cash moves in and out of your business, you should make changes to your cash flow forecast.

There's an example of a cash flow forecast and a cash flow template included in this business information fact sheet. You may wish to develop your own, by including rows and headings of income and expenditure that are specific to your business.

As with all functions within the business, to make sure your cash is managed properly you need to delegate the action to one person. This person should be responsible for maintaining your cash flow forecast and all the other aspects of your financial functions.

Example of a Cash Flow Forecast

	April	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
Income													
Fees	1500	1200	1300	860	340	1160	1040	1240	460	1220	1170	1340	12830
Funding	3120	0	0	0	0	3120	0	0	0	3120	0	0	9360
Fundraising	240	120	600	210	240	170	400	320	100	40	120	220	2780
Donations	80	40	60	30	0	100	60	20	50	60	50	20	570
Total Income	4940	1360	1960	1100	580	4550	1500	1580	610	4440	1340	1580	25540
Expenditure													
Wages	1290	1290	1290	830	360	1290	1290	1290	830	1290	1290	1290	13630
National Insurance	142	142	142	92	40	142	142	142	92	142	142	142	1502
Premises	240	240	240	240	240	240	240	240	240	240	240	240	2880
Utilities	0	145	0	38	0	77	0	62	13	0	56	45	436
Insurance	43	43	43	43	43	43	43	43	43	43	43	43	516
Training	0	120	0	0	60	0	250	0	0	0	0	220	650
Print and Stationery	45	68	12	8	22	17	58	26	51	26	54	27	414
Maintenance	12	0	24	0	20	0	24	40	0	0	64	100	284
Materials	16	24	30	18	16	16	24	8	20	14	10	20	216
Toys	40	0	0	50	0	0	30	40	0	0	20	0	180
Food	40	44	36	46	18	52	40	64	52	52	64	60	568
Milk	32	28	20	24	16	28	36	40	36	42	28	24	354
Total Expenditure	1900	2144	1837	1389	835	1905	2177	1995	1377	1849	2011	2211	21630
Balance	3040	-784	123	-289	-255	2645	-677	-415	-767	2591	-671	-631	3910
Cumulative cash balance	3040	2256	2379	2090	1835	4480	3803	3388	2621	5212	4541	3910	3910

Note:
Depreciation and payment of VAT needs to be also accounted for in your cash flow forecast if it is applicable to your business. Also any marketing costs that you undertake also needs to be included in the cash flow forecast.

Controlling the cash flow

The vast majority of businesses, across all sectors, experience problems with cash flow. Small and medium sized businesses suffer the most as individual transactions, such as a customer failing to pay on time, can have a major impact on the health of the business. If you want to stay in business you must take prompt corrective action.

What to do if the cash position looks poor:

- Increase sales: you should focus on the specifics that help you get more people using your services, and therefore, more cash coming in.

- Collect money: you could review your debtors and increase your efforts to collect overdue cash from customers. Remember, a customer isn't a customer unless they pay for the goods and services you provide them with.

- Negotiate different payment methods with suppliers: changing the way you pay bills and spreading bills over longer periods all helps with your cash flow, or you could change to lower cost providers.

- Control costs: as a manager of a business, costs are the single item that you have absolute control over. You authorise the expenditure and/or sign the cheques. So, unless a cost is absolutely necessary you don't have to incur it. If you need to cut costs you can.

- Speak to your bank: nobody likes unpleasant surprises and that includes banks. If it's likely that you're going to need an overdraft facility in two months, now's the time to speak with your bank manager. It will show you're in control and if it turns out that you don't need it, great!

Source

ADDITIONAL FINANCIAL INFORMATION

Cashbook

What is it?
A cashbook is used to record all transactions that result in cash coming into or going out of the business.

What does it do?
A cashbook allows you to see at a glance when and where money has been spent, enabling you to record exactly what money has been spent on. It also allows you to record all instances when the business has received money.

How regularly should it be used?
The cashbook should be used on a daily basis and its good practice to record transactions as they occur to ensure that you have up to date accurate records.

See the following example. You can develop rows of income and expenditure that are meaningful to your business.

Cash book Example

Week beginning 7/04/2008

Income

Date	Source	£
2	Fees – Mr King	£40.00
2 1/4	Fees – Mr Wilde	£45.00
2 1/4	Fees – Ms Carter	£35.00
2 1/4	Fees – Miss Brown	£44.50
2 3/4	Fees – Mrs Todd	£44.50
2 3/4	Fees – Mr Green	£55.00
2 3/4	Fees – Mrs Singh	£40.00
2 3/4	Fees – Mr Smith	£72.00
2 3/4	Fees – Miss Cryer	£55.00
	Total	**£431.00**

Expenditure

Date	Stationery	Travel	Materials	Food	Milk	Gas
1 3/4		£8.00		£20.00	£8.00	
2			£10.00			
2 1/4						
2 1/2					£4.00	
2 3/4	£5.00					£41.00
	£5.00	**£8.00**	**£10.00**	**£20.00**	**£12.00**	**£41.00**

Petty Cash

What is it?

Many businesses have a petty cash system that's available to staff for the purchase of small items and sundries such as books, crayons, milk, stamps and so on.

What does it do?

A petty cash system allows you to manage the money spent on small items necessary for the business.

A member of staff will manage the petty cash system ensuring a locked box is kept safe, together with the receipts and vouchers and making sure all petty cash spending is monitored and accounted for.

How regularly should it be used?

You need to decide on a limit or 'float' for the petty cash system. This would usually be enough for sundry spending over a two-week period. Every time money is taken out, a petty cash receipt or voucher is written out and signed when the money is handed over. This procedure should be followed no matter how much money is withdrawn. The receipt for the goods is then attached to the petty cash voucher. The vouchers are subsequently recorded in the petty cash book in chronological order.

The petty cash will need to be topped up every now and then. When the float is low, the vouchers are added up and cash, equal to the sum of vouchers, is made out to bring the float back to the original amount. Again, this action is recorded in the cashbook.

When keeping a petty cash float, there are a few golden rules that will help to make sure that money doesn't go unaccounted for. These are:

- Set an upper limit (float) to how much money is kept in the petty cash box
- Vouchers + cash should always equal the original amount
- Petty cash is kept in just the one place and locked at all times

You can use the cashbook analysis columns to record what the money is being spent on. However, it's not necessary to make lots of small entries into the cashbook as long as all money is accounted for in terms of a signed receipt and voucher.

A member of staff will manage the petty cash system ensuring a locked box is kept safe together with the receipts and vouchers and making sure all petty cash is monitored and accounted for.

Electricity	Advertising	Activities	Petty Cash	Sundries	Other	Total
						£36.00
			£20.00			£30.00
£36.00					£12.00	£48.00
						£4.00
						£46.00
£36.00			**£20.00**		**£12.00**	**£164.00**

Keeping Records

By law you have to keep up to date, accurate records of your business income and expenditure. This is a good habit to get into anyway because keeping records will also help you manage your business more efficiently. After all, if you know the precise financial status of your business, you're in a good position to take appropriate action to improve it or respond to potential problems.

Your records will help you to complete and submit your end of year tax return to Her Majesty's Revenue & Customs (HMRC). If you run a Limited Company, you're also required to submit your accounts to Companies House.

Childcare providers generate income from a number of different sources. You may find that your own income includes:

- Invoices raised by the business
- Details of any grants or funding – you may also have to keep specific records under the terms of the grant or funding
- Donations

Your expenditure will vary depending on the service you provide. Your records of expenditure will include:

- Receipts of anything purchased by the business for the business
- Details and receipts of costs such as rent, rates and utility bills
- Details of wages and NIC paid to employees
- Invoices for repairs or replacements
- Invoices for any travel expenses incurred
- Invoices for training expenses

Additionally retain

- Bank statements
- Loan statements

It's very easy to lose, misfile or throw away receipts. Most people have first hand experience of wanting to return goods to a shop only to find that they have mislaid the receipt. This may be a nuisance in your private life, but in business it's important that you can demonstrate all expenditure.

Legally you have to keep receipts for at least six years. During this period you may have to show them to HMRC. They will not look kindly on any business that fails to produce records when requested so make sure you file receipts, bills and invoices in date order in a safe place.

Source

Financial Questions to Ask

Is the childcare business aware of all its cost?

The following ten costs are ones that are often under-estimated or simply ignored:

1. Start up costs
2. Slow start costs
3. Marketing costs
4. Costs of democracy and governance
5. Research and development costs
6. Cash flow costs
7. Management and administration costs
8. Replacement and repair costs
9. Contingency costs
10. Close down costs of fixed-term projects or monitoring costs of funded projects

Are costs broken down under workable cost-headings?
The more cost-headings used, the greater the organisation's ability will be to make a financial analysis.

Is the true cost of employing staff represented?
Staff costs need to include NI contributions, pension contributions, payroll costs, recruitment costs etc.

Does the business make strategic decisions regarding pricing?
The price at which a childcare service is provided at needs to be calculated taking into account a number of factors.

Does the organisation know what its break even point is?
Without knowing where the break even point is, other financial decisions are difficult to make.

What are the 'Break Points' that the organisation faces and are they aware of them?
Knowing what Break Points exist will help in planning expansion.

Does the childcare business make accurate and realistic forecasts of income?
Without an estimate of income, planning cannot take place.

Does the organisation publish regular profit / loss forecasts?
All businesses need to plan to make a profit or surplus from their activities to remain viable.

Does the organisation understand the importance of cash flow forecasting and manage their cash flow?
All organisations handling cash need to be aware of the movement of cash in and out of the business.

Does the childcare business produce a budget that includes occupancy targets, income targets and expenditure forecasts?

If the business provides a number of services, do they take a cost centred approach to budgeting?
Complex organisations need to be able to sub-divide their budgets to enable both monitoring and review to take place.

Source

Sure Start

INTERNAL FINANCIAL CONTROLS

This business fact sheet is dealing with some of the internal financial controls that a voluntary or charity organisation should endeavour to have in place so as to show prudence and as a safety measure. The guidelines come from the Charity Commission.

Segregation of duties

One of the prime means of control is the separation of those responsibilities of duties which if combined would enable one person to record and process a complete transaction. If duties are segregated, this reduces significantly the scope of errors and oversights, as well as deliberate manipulation or abuse, and builds in additional checks. For example, if the person who records incoming cash is the same person who checks that cash paid in is recorded on the bank statements, it would not be easy to detect any dishonesty. Mistakes are more likely to go undetected if a person checks their own work. The principle of segregation is important with regard to both income and expenditure, and capital transactions. We appreciate that the degree of segregation of duties that can be achieved will vary according to the size and nature of the charity concerned.

Qualification of staff and advisors

We recommend that trustees where necessary have access to independent professional advice. They need to also ensure that their staff and any volunteers are competent, properly trained and qualified for the tasks they have to perform. The relationship between the charity's trustees, accountant and independent examiner or auditor ought, where possible, be one of ongoing dialogue, rather than simply an annual exchange of records and information. Any general or specific advice from the accountant, independent examiner or auditor must be brought to the attention of all of the trustees.

Budgetary controls

If the internal controls described in this guidance are put in place, trustees will have gone a long way to ensuring that they have taken good precautions to protect the charity's funds. However, in order to achieve full control over the charity's finances, it is necessary to work within an agreed budget and to undertake full financial planning. Proper and realistic estimates of expected income and expenditure need to be made for each financial year. We advice regular reviews are made to ensure that the charity's budgets are not stretched beyond their limits.

Approval of the budgets and accounts can only be done after discussion at trustee meetings. The discussions need to be fully minuted. It is important that trustees understand the financial information which is given to them. They may therefore need to consider recruiting trustees with particular financial expertise, and in any event need to ensure that full explanations and training are provided for those who are not so familiar with financial matters.

In larger organisations some of the budgetary work could be delegated, but the trustees still have the overall responsibilities.

Controls over incoming funds

Trustees are under a duty to take control of and to safeguard all funds to which the charity becomes entitled.

Postal receipts

It is important to take all possible action to bring all funds sent to the charity by post into its control as soon as possible. Circumstances will vary from one charity to another but the controls to be considered include the following:

- Incoming post opened at the earliest opportunity and in the presence of **two** responsible people.
- All incoming cheques and cash need to be recorded immediately and entries verified by someone other than the person who has made the entry. (This is particularly important for cash). It is appreciated that there may well be problems in this respect where charities have neither premises nor paid staff. In these circumstances, trustees ought to ensure that all donations are sent to a central point and that a book is kept to record receipt of all mail with money enclosed.
- Rotation of post-opening staff ought to be considered where practical
- The security of unopened mail needs to be ensured.

Fund-raising events

The responsibilities of the trustees is to make sure that the charity is in control of the funds raised on its behalf so that it receives all the money to which it is entitled from such events.

We recommend that the following controls be in place:

- Records be maintained for each fund-raising event, in sufficient detail to identify gross receipts and how they have arisen, and all costs incurred; and
- For all events for which there is ticket income or gate money:

  1. That tickets all be pre-numbered;
  2. A record be kept of all persons who have been issued with tickets to sell, and of which ticket numbers have been allocated to each;
  3. A record be kept of which tickets have been sold; and
  4. Reconciliation is made of receipts against tickets sold.

Similar records needs to be maintained for sponsored events

Where external fund-raisers are engaged, care needs to be taken to comply with the requirements of Part II of the Charities Act 1992.

The Gift Aid Scheme

Donations through the Gift Aid Scheme are increasingly encouraged by trustees as a tax-efficient way of raising funds. This is an important area as encouraging donors to give in a tax-efficient way is good financial management. It is important that accurate records are maintained in order to ensure that the charity receives all that is due to it from both the donor and HMRC, and that all money due is brought within the control of the charity without delay.

To ensure that the charity receives all the money to which it is entitled, we recommend that trustees:

- Make regular checks against records to ensure that expected amounts have been received from the donor;
- Make regular checks to ensure that in the case of Gift Aid donations from individuals all reclaimable tax has been obtained from HMRC (there is nothing for the charity to reclaim in the case of Gift Aid payments from companies); and
- Are careful not to over claim tax repayments – particular care needs to be taken to avoid making tax repayment claims in relation to Gift Aid payments which have not in fact been received from the donor.

For more information on the Gift Aid Scheme, please see HM Revenue & Customs Guidance Note Getting Britain Giving, obtainable along with other advice and guidance by ringing 08453 02 02 03 or online at www.hmrc.gov.uk

Banking and custody procedures

Care always needs to be taken to ensure that, once funds are received into the control of the charity, their continued security is maintained. Following the guidelines listed below will provide a basic level of protection for the charity's funds, but additional controls may be necessary depending on the individual circumstances of the charity.

- Incoming receipts be banked regularly and as soon as possible – at least weekly. Frequency of banking will depend on the amount of cash received. Keeping cash in a locked cash box is really only suitable for small amounts of money, say less than £100.
- Cash or cheques are placed in a safe or locked cash box if they cannot be banked on the day of receipt. The keys to any safe or cash box should be held by a nominated officer. We advise that they are signed for whenever they are used. We recommend that insurance cover is obtained to cover cash held in the safe or cash box up to a specified limit.
- All incoming money be banked gross – no amounts be held back for "feeding" petty cash. Without banking incoming money intact it is impossible to trace particular receipts into the charity.
- Charities have a written statement of policy and practice covering banking and custody procedures which is available to all trustees and staff.
- It is important that the money of the charity is kept quite separate from any individual's personal money. For example, charity treasurers should not use their own bank accounts for the charity's finances.
- We recommend that trustees consider the safety of getting money to the bank, e.g. two people might be required if the amounts are large, particularly if significant sums of cash are involved. Insurance cover needs to be considered to cover cash in transit.
- Controls are also maintained over receipt books issued by the charity – both in terms of accounting for all receipts issued, and for stocks of receipt books.

Checks of income records

It is important that trustees make regular checks to ensure that records are being accurately maintained (so that money and other assets received can be traced through the accounting system), and that there are no discrepancies in the accounting records. This is an elementary control, which is often ignored. If performed regularly, it will serve as an early warning of anything going wrong. In larger charities some of these checks may be delegated to employees but the trustees still have the responsibilities. We recommend that frequent, random spot checks are made to ensure (as a minimum) that:

- Records of cash and cheques received agree with bank paying-in slips;
- The paying-in slips equate with the bank statements, both in terms of amount banked and date of credit; and
- All transfers or other direct payments into the bank can be identified and verified against paperwork.

These checks should be made by someone other than the person concerned with the original recording of the transactions.

Care needs also be to taken to identify and administer separately any funds received where the donor has placed restrictions upon their use, and to ensure that they are only used in accordance with these restrictions.

Records need also to be checked to ensure that there has been no unauthorised credit extended (e.g. through an overdraft facility) and that the finances of the charity are not placed under any strain by credit which has been approved.

Controls over expenditure

It is important for trustees to bear in mind that they are responsible for all expenditure of charitable funds and have to account for how the charity's funds have been applied. The basic rules of proper record-keeping, segregation of duties, and safekeeping of valuables are all vital. In larger charities, some of the duties may be delegated to employees, but the trustees still have the overall responsibility.

When making payments, we recommend that the following rules are followed:

- All expenditure and investment of charitable funds be properly authorised and it is essential that there is supporting documentation (e.g. itemised receipt, share certificate or invoice) for all items of expenditure.
- Instruments of payment (such as cheque book, building society passbook and bank mandate forms) need to be kept in safe custody, with access limited to nominated persons.
- The preparation of documentation for authorisation be undertaken by someone other than the persons authorising the payment.
- Charities have a written statement of policy and practice covering payment procedures, which is available to all trustees and staff. This would include instructions on who is authorised (and in what circumstances and up to what limit) to place orders or contracts, or to incur any liability on behalf of the charity.

Controls over purchases

Trustees have a responsibility to ensure that adequate checks are made to both confirm that purchases have been properly authorised, and that goods for services ordered have actually been received. We recommend the following controls are in place (and are operated):

- Invoices received need to be checked against orders made.
- Records are kept of orders placed but not yet carried out.
- The quality and quantity of goods supplied ought to be inspected in order to ensure they correspond with orders placed and those invoiced for. Services supplied need to be similarly checked.
- Regular stock taking be undertaken.
- Authorisation levels for the placing of orders to be documented.
- Payments only be made against **original** invoices.

Payment by cheque

Although payment by cheque is generally considered a safe method of payment, there are still basic controls which we recommend are exercised in order to prevent any misuse of charity funds (these are set out below). If any particular control is delegated to employees, the trustees still have the overall responsibility.

- Trustees must abide by any relevant clause in their governing document which specifies who are the people authorised to sign cheques. Employees cannot be allowed to sign cheques if the governing document only permits trustees' signatures.
- If there is no provision in the governing document which relates to the operation of bank accounts, the bank mandate must specify at least two trustees as signatories, unless the charity trustees can reasonably claim that some other regime must be followed as a matter of operational necessity. In the governing documents of larger charities there will often be explicit provision regarding the operation of banking accounts, but, if not, it may be reasonable for trustees to claim that it is operationally necessary for employees to be able to sign cheques, perhaps up to an agreed limit. One form of reporting back on the use of this delegated powers is for all payments made under delegated authority to be summarised regularly for inspection by the trustees.
- It is always advisable to have a "pool" of people authorised to sign cheques which is greater in number than the minimum number of signatories required on the mandate. This can prevent a situation arising where insufficient signatories are available, e.g. during popular holiday periods. All people in the "pool" must, of course either be trustees or be otherwise qualified to sign cheques.

- Cheques made payable to a nominated signatory should not be signed by that person. This is another reason why it is important to have a "pool" of mandated signatories.
- Close control should be exercised over access to the cheque books.
- It is preferable to avoid a situation where related trustees are able to sign cheques together.
- It is a dangerous breach of financial control over expenditure from charity funds if blank cheques are signed in advance. The practice of signing blank cheques would be regarded as neglecting the duty of care owed by trustees.
- The agreed limits (if any) for individual signatories be recorded in the bank mandate and circulated amongst the trustees.
- All cheque expenditure be recorded in the cash book and cross referenced to the cheque number, with the nature of the payment and the payee clearly identified.
- All cheque book stubs (or equivalent) be completed at the time of payment, and retained (they form part of the charity's accounting records).
- Regular spot checks be made of the expenditure records against primary documents such as invoices. No cheques be signed without a corresponding invoice, or other documentary evidence as to the nature of the payment. Expenditure be regularly summarised for inspection by the trustees with exceptionally large items highlighted.

Payment by cash

Dealing in cash represents an extra degree of risk, so a greater degree of care needs to be exercised. We recommend that:

- Every effort be made to reduce the need for cash payments to an absolute minimum.
- All cash payments be made from a cash float of a fixed amount that is regularly replenished from the bank or building society account and not by the retention of incoming money.
- All claims for replenishment of the cash float should be backed up by supporting documentation and signed by the cashier.
- The supporting documentation be authorised by someone other than the cashier or claimant.
- Regular spot checks of the petty cash float are made by an authorised person independent of the cashier. This involves counting the balance of cash in hand and reconciling the float by totalling the vouchers for amounts paid out and not yet reclaimed by the cashier.

Wages and salaries

This is often a major item of charity expenditure, and therefore warrants particular care to avoid any misuse of funds. Trustees need to ensure that the charity is not exposed to additional liabilities by a breach of statutory regulations, for example through failing to deduct and account for PAYE. We recommend that:

- Personnel records are kept for each member of staff separately from the pay records. Checks of one against the other be made in order to prevent the payment of fictitious employees. Actual physical checks of an employee's existence are carried out on a random basis. These checks may not be necessary if the charity is small with a few employees. Trustees need however to ensure that they are fully aware of staff employed by the charity and that appointments have been properly authorised; also that salary payments have been properly authorised and paid in accordance with that authorisation. Trustees need to satisfy themselves that staff are actually carrying out the duties for which payment has been authorised.
- Where (if absolutely necessary) payments are made in cash, these be paid out by someone other than the person making up the payroll, with the employee signing as evidence of receipt.
- Trustees need to ensure that employees have a proper contract of employment and that individuals are not incorrectly classified as self-employed. Guidance may be sought from the Inland Revenue in any case of doubt. Trustees ought to avoid, at all costs, failing to deduct and account for PAYE and national insurance contributions, as they may be unable to recover the over payment from the employee, and have to meet the Revenue's claims themselves. In such a case, they would not normally be able to indemnify themselves out of the charity's assets.

- Proper procedures need to be in force for payment of expenses to trustees, employees and volunteers. Systems need to be in force to ensure that costs have been necessarily incurred in the course of carrying out the charity's business. We recommend reimbursement needs to be a straight payment of actual cost incurred rather than round sum payments. Evidence should also be produced of the actual costs incurred, e.g. bills or receipts. Where this would cause a considerable administrative burden, charities may wish to consider whether this requirement may be waived for very small sums. If the charity employs a system where travel costs are paid at a mileage rate then they ought to ensure that this does not run the risk of incurring any tax or national insurance liability for the charity or its trustees. Advice on tax and national insurance matters can be obtained from the Inland Revenue.

We also recommend that procedures be in place to ensure that control systems are not threatened when a member of staff is absent or leaves.

Checks on expenditure records

As with controls over incoming funds it is essential to check regularly that records of funds applied for are being accurately maintained. Similarly we recommend that random spot checks are made to verify that:

- Records of payments made agree with cheque stubs, paid invoices or other authorisations and are in accordance with budgets;
- Cheques have been presented for payment by the bank or building society as shown by the statement; and
- Standing orders and direct debit payments are in accordance with valid instructions given to the bank or building society.

These checks need to be made by someone other than the person concerned with the original recording of the transactions. Care also needs to be taken to verify that payments are made out of the correct fund wherever the charity administers restricted funds of any kind, e.g. a special appeal fund or an endowed fund.

Control over assets

As well as ensuring that they have control over the charity's incoming and outgoing funds, trustees also have the duty of ensuring the safe keeping of the charity's assets so that they can be effectively used to promote the charity's objectives.

Fixed assets for use by the Charity

This term includes such items as land, buildings, vehicles, fixtures and fittings, and equipment (e.g. computers and the data contained in them, fax machines) which are used in the charity's activities. We recommend that the following guidelines be observed:

- A list of fixed assets be held and updated regularly. This needs to include all assets donated for continuing use by the charity.
- All fixed assets be checked at regular intervals to ensure they remain in good repair and of use to the charity.
- Trustees give due consideration to the need for insuring assets, and to the extent of cover which is appropriate.
- The use made of fixed assets be reviewed annually to ensure they are put to best use and effectively serve the interests of the charity.

Investments

Investments (including stocks, shares, land and buildings) are normally held in order to generate income for the charity and to protect its capital. It is therefore vital to make sure that they are safeguarded. New powers and duties relating to investments have been introduced by the Trustee Act 2000, and in order that trustees comply with these we recommend that the advice given below be observed:

- The trustees ensure that full records are kept of all investments held (including details of all those sold or purchased) by the charity, and that these are kept in a secure place.
- The formulation of an investment policy is the responsibility of trustees. The detailed implementation supply of suitable reports or otherwise, must ensure that their policy is being implemented. This will also allow them to review properly the performance of their investments.
- Trustees need normally to take professional advice before selecting or disposing of investments. Where statements of investments are sent to a nominated trustee they need to be inspected at regular intervals by the trustee body as a whole.
- Controls be put in place to ensure that all dividends or interest payments due are promptly received and all purchases and sales of investments are properly authorised and accounted for.
- Wherever possible, investments need to be diversified so as to ensure that the failure of one investment does not have a major impact on the charity. Trustees have a general legal duty to have regard to the need for diversification of investments of the trust in so far as is appropriate to the circumstances of the trust.

Bank or building society deposits

In the case of bank or building society deposits, we recommend that:

- A record (other than the passbooks) of all bank and building society deposits be held in a safe place. Regular bank reconciliations take place, and if carried out by delegated employees, the trustees need to ensure that this is being done. (If employees are delegated to undertake bank reconciliations we recommend that they are not the same people who maintain the cash book records). Any discrepancy should be fully explored and resolved.
- Instructions to open or close deposit accounts be authorised by the whole trustee body, or if delegated to a finance subcommittee or finance officer, the trustees be kept informed of all developments.
- Accounts are not allowed to remain dormant.
- Statements to be sent to a nominated trustee and made available for inspection by any trustee.

Further Information

Further information can be sought by contacting the **Charity Commission** directly at:
http://www.charity-commission.gov.uk or telephone no: **0845 3000 218**.

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