

The voice of the Voluntary Arts

Creating a financial risk policy

Briefing 72 looked at risk management in a general sense. This briefing takes this a step further and looks at financial risk – one of the most important areas to consider. It will focus on what is meant by financial risk, how to identify risks, estimate their probability and potential consequences, and how to take action against risks. It will also look at how to draw up appropriate financial policies to reduce risks, including the importance of reserves.

Why do you need a financial risk policy?

There are three main reasons that this is important for all voluntary arts groups to think about:

1. The legal issue

If your organisation is a charity with a turnover of over £250,000 a year, by law you must have a risk policy. This is a legal requirement set out by the Charity Commission, which insists that your board of charity trustees produce a statement giving “consideration to the major risks to which the charity is exposed and systems designed to mitigate those risks”.

2. For best practice

The Charity Commission also encourages smaller charities to produce a risk statement as a matter of best practice. This really applies to all voluntary arts groups, whether or not you are a registered charity.

3. For your funders

Many funding bodies now also require you to have a financial risk statement, so that they are protected against risk themselves when they offer you financial help.

Who needs to think about this?

- If you are a registered charity, your trustees are legally responsible for the risk assessment requirements, and will need to go over them on a yearly basis.
- **But it's not just trustees!**
Anyone within an organisation with any kind of financial responsibility needs to understand the financial risks associated with their activities and make efforts to manage and control those risks. Whether you are the treasurer of a local voluntary arts group, or the person in charge of the budget for a one-off event, this will apply to you at some level.



What is financial risk?

Whether you realise it or not, financial risk is an inbuilt part of nearly all the work you do. Typical financial risks for voluntary arts groups might be the loss of funding, inaccurate financial information, inadequate reserves and cash flow, inadequate diversity of income sources, increased competition for funds, difficulty complying with funding rules, fraud and theft.

The following steps will help you to identify financial risks within your group and to help you tackle them:

1. **Identify the possible risks**
2. **Estimate the consequence and probability of risks**
3. **Take action against risks**
4. **Draw up appropriate financial policies and procedures to reduce risks.**

Step 1: Identify the possible risks

The first step in all of this is to make a list of all the financial risks that your group might be exposed to. These could include:

- lack of formal or written procedures;
- lack of reporting to the trustees, so paid staff are making key decisions;
- trustees do not fully understand their financial responsibilities;
- personnel problems;
- funding issues such as failure to secure sufficient funding, to receive funding when due, to utilise restricted funding within timeframe, to complete funding bids in time or to comply with funders' requirements;
- failure to meet salary/redundancy/pension obligations;
- failure to meet creditors' demands;
- legal actions;
- theft or misuse of property;
- damage to property (such as fire or flood damage);

- any other unforeseen circumstances that could result in increase in expenditure or loss of income – such as changes in political environment, legislation or market forces.

Step 2: Estimate the consequence and probability of risks

Once you have identified the financial risks for your group, you should classify them in terms of consequence and probability. For instance, once a particular funding source comes to an end, it could have a major impact on the operation of your organisation, but it may be unlikely to happen.

Put all your risks into a table using the headings shown in the example below. The colour coding will show you how to prioritise the risks and consider what level of risk is acceptable. For instance, anything in the dark shaded area would need immediate action. On the other hand, you may decide not to take action on a risk which would have little impact on your organisation and is unlikely to happen.

DAMAGE IMPACT	Extremely unlikely	Unlikely
	Severe impact	
Significant impact / medium term		
Significant impact / short term		
Minor impact in many areas		
Minor impact in some areas		
Not critical		

 **High Priority** – urgent action needed immediately



A booklet called **Risk identification and analysis: a guide** can be downloaded free of charge from the Public Entity Risk Institute website: www.riskinstitute.org which includes forms to record and measure risk.

Step 3: Take action against risks

Once you have agreed on priorities, you will need to consider:

- what controls are already in place;
- what action you need to take.

Draw up an action plan to address the high priority risks. There are four well-recognised strategies that you can use:

a) Avoidance: this involves completely avoiding the activity giving rise to the risk (e.g. not taking up a potential grant because you would be unable to meet the funder’s reporting requirements). While avoidance is highly effective, it may not be practical as it may be inherent to your organisation’s activities (e.g. working in the community).

b) Acceptance: it can be accepted (e.g. assessed as an inherent risk that cannot be avoided if the activity is to continue). Make sure you are aware of the possible consequences so that you are prepared if something does go wrong.

c) Transference: by transferring the financial consequences to third parties or sharing it – for example:

- **insurance** – to protect you from risks of fire, theft or flooding. Also, employer’s liability insurance is compulsory for organisations with paid staff (and advisable for those with volunteers only);
- **outsourcing** – using external agencies to take responsibility for recruitment, payroll etc.;

d) Reduction: risk reduction strategies work by reducing the frequency or the impact of the risk – for example:

- **contingency plans** – working through some ‘what if...?’ questions and thinking through the consequences of possible risks;
- **diversifying income** – making sure you don’t rely on just one major source of funding but spread the range of funding sources, so that you are not so badly affected if a particular funding source comes to an end;
- **avoiding long term expenditure commitments** – at the risk that long term funding will not be there;
- **introducing appropriate financial policies** (see step 4).

It is best to find out if you can avoid or reduce the impact or occurrence of the risk. This is usually the most cost-effective option! You will then need to decide how to finance those risks which have to be accepted or transferred.

PROBABILITY LEVEL

Moderately likely	Regular occurrence	Highly likely	Extremely likely/frequent

- **Medium Priority** – action required as soon as practicable
- **Low Priority** – action not needed in the short term or no action needed



Once you have implemented the action plan, it is important to draw up a system for monitoring by ensuring there is ongoing identification, evaluation and management of financial risks. (see VAN Briefing 25: *Evaluation – how was it for you?*)

Step 4: Draw up appropriate financial policies and procedures to reduce risks

One of the most important ways to reduce the likelihood of financial risks is to introduce appropriate financial procedures. This will help to ensure financial information is accurate and reliable and clearly define areas and limits of responsibility.

The ultimate overall responsibility for your organisation's finance lies with your organisation's voluntary management committee – the trustees. Their financial responsibilities include approval of budgets, approving signatories for the bank account(s), approving exceptional items of expenditure, monitoring the financial position of the organisation based on regular reports, approving the annual accounts, auditors' report and appointment.

The following list should give you a **starting point** for drawing up your own finance policies. Various different members of staff will need to take responsibility for these:

- **accounts**

Who's responsible?

Finance Officer (FO)

All documentation needs to be retained for audit purposes;

- **annual accounts**

Who's responsible?

Finance Officer

Annual accounts will be submitted for audit as required under the Companies Act, charity regulations and grant conditions. The Board of Trustees should sign off audited accounts at the Annual General Meeting;

- **asset management**

Who's responsible?

Chief Executive & Finance Officer

Responsible for inventory and drawing up replacement and maintenance schedule for all equipment;

- **bank accounts**

Who's responsible?

Trustees

Any changes to banking arrangements to be authorised by the Trustees;

- **budget setting**

Who's responsible?

Anyone in charge of a budget ('budget holders'); Chief Executive; Finance Officer

Budgets prepared by budget holders working with Finance Officer and approved by Chief Executive before being presented to the Board of Trustees in February before the start of the financial year.

- **cash handling**

Who's responsible?

Two people should be present

For example, when opening collecting tins or counting petty cash, ticket sales etc. If you are the sort of organisation that often receives donations through the post, you might want two people to be present when opening mail. A list should be made of all cash/cheques received, and it should be banked as soon as possible.



- **ordering supplies and services**

Who's responsible?

Budget holders

Orders of over an agreed amount must be authorised by Treasurer;

- **payment authorisation**

Who's responsible?

Budget holders

Invoices to be passed to Finance Officer and paid within 14 days;

- **cheque signatories**

Who's responsible?

Finance Officer; Chief Executive;

Treasurer; Chair

You may decide for good practice that all cheques, or cheques over a certain amount, should require two signatures. Exceptional purchases could be authorised by the chair or treasurer;

- **financial reports**

Who's responsible?

Finance Officer

All budget holders to receive regular reports of income and expenditure. Detailed cash flow reports to be produced as appropriate;

- **payroll and expenses**

Who's responsible?

Finance Officer

Make sure you follow PAYE legislation. The Inland Revenue can advise you on this (see contacts at the end). There should be a proper forms system for claiming expenses, and an appropriate person needs to authorise them. Receipts should be attached to the expenses claims and a reason given for the expense.

- **petty cash**

Who's responsible?

Finance Officer; Budget holders

A cash float of up to £100 may be collected from the FO. Receipts must be submitted to the FO as soon as possible after the event;

- **reserves policy**

Who's responsible?

Trustees

Reserves are really important to provide for unforeseen circumstances such as unplanned redundancies or loss of funding and all organisations should have an appropriate level of reserves. Reserves are 'unrestricted' income (explanation at the end) that the organisation has or can make available to spend for any or all of the charity's purposes once it has met its commitments and covered its other planned expenditure;

Once you have been through this briefing's four-step 'risk assessment' process, you should be able to agree on the risks that might need to be drawn against reserves. Draw up a prediction of your income and expenditure based on your planned activities for the next year. Try to forecast any future needs, opportunities, contingencies or risks which are not likely to be met out of income. This will then allow you to calculate an appropriate level of reserves.

The Charity Commission recommends that "regardless of the size or nature of the charity, trustees should have an **appropriate** reserves policy that clearly explains what level or range of reserves the charity needs to operate effectively" and that "trustees should ensure that their reserves policy is appropriate for the charity's aims, needs and objectives and the risks it faces".



The trustees are responsible for drawing up a reserves policy which should include the reasons for needing reserves, the level and range of reserves, steps to establish and maintain that level of reserves and arrangements for monitoring and reviewing the policy.

What is 'restricted' and 'unrestricted' income?

- **Restricted funds** must be spent in accordance with the donor's stated wishes. Make sure that you identify incoming restricted funds and apply proper checks to ensure that the funds are spent appropriately. Trustees may be personally liable for a breach of trust.
- **Unrestricted funds** are 'general purpose' income, from fundraising, donations, some grants (mainly trust funds), trading income (merchandising or service fees) and contracts.

Summary

While this might seem like a lot of work, sound financial policies and a regular review of financial risks will help to ensure the safety of your organisation's funds. It is important that everyone in the organisation is aware of their financial duties and the policies that are in place to check that risks are reduced.

Further help and information

- **VAN Briefing 72: Risk management for charities – a good opportunity**
- **Charity Commission** – offers guidance on SORP 2000 requiring trustees to make a risk management statement and guidance on charity income reserves.
www.charity-commission.gov.uk or
T: 0870 3330123.
- **The Inland Revenue:**
www.inlandrevenue.gov.uk
- **Risk identification and analysis – a guide** available to download free from
www.riskinstitute.org
- **National Council for Voluntary Organisations** – www.ncvo-vol.org.uk – has good practice information on financial management for the voluntary sector.
- **A practical guide to Financial Management for Charities and Voluntary Organisations** by Kate Sayer (Directory of Social Change), **£14.95.** Order it online from www.dsc.org.uk

Disclaimer

This Briefing is by no means a definitive statement and VAN cannot be held responsible for any errors or misinformation. If you have any further queries, see contacts above.

Disclaimer: We have taken reasonable precautions to ensure that the information contained in this Briefing is accurate. However, the document is not intended to be legally comprehensive. We recommend you take legal advice before taking action on any of the matters covered herein.



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