Covid Bounce-Back Programme - **Building Financial Resilience**

Will Carruthers & Agata Miskowiec

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Housekeeping

- Cameras on a microphones off when not speaking
- We want this to be an interactive session – the more we hear back from you the more helpful we can be
- There are no stupid questions – if anything doesn't make sense or you want to understand more, let us know!

Aims of the session

- Understand the basics of day-to-day financial management
- Some key tools and practical tips for building financial resilience
- Is there anything you particularly want to understand?

A bit about you

- What is your involvement in financial matters in your organisation?
- Does financial management frighten you or are you comfortable talking finance?
- If you don’t feel confident, what are the main reasons for this?

Building financial resilience – principles

- Building resilience takes time – there is no quick fix, but simple tasks done well over a prolonged period.
- Events like COVID are almost impossible to predict – we can't always rely on a stable external environment.
- There are some key principles and elements of good practice you can put in place that will help you in the short, medium and long term.
- We know you are busy and might not have time to do everything – some of this may even feel daunting, but small changes can go a long way.

Your current financial position

Your current financial position

'Organisational resilience is the ability of organisations to anticipate, prepare for, adapt and respond to incremental change and sudden shock in order to survive and prosper.'

- How would you assess your position currently?
- What tools would you use to make that assessment?
- How has COVID impacted your finances?

Tools for financial resilience

- Today we will discuss some tools and techniques that could be useful in helping with your financial management:
- **Income and expenditure forecasting:** Forecasting and understanding the mix of income and expenditure for your organisation. The longer term you can do this, the better.
- **Cash flow forecasting:** Regular (rather than always 100% accurate) cash flow forecasting is a valuable tool. It allows you to track early warning signs of reducing income, for instance direct debit mandates being cancelled.
- **Sensitivity analysis and active risk management:** identifying the 'what if?' and mitigating against the key risks through active planning.

The importance of good financial planning and management

Why is finance important?

- Whatever the size of your organisation, sound financial management is essential for sustainability.
- Rather than being seen as a separate function (just 'doing the books'), the finance function should be integrated within, and add value to, your organisation’s fundraising and overall planning activities.
- Being able to read your financial statements and financial reports is critical!

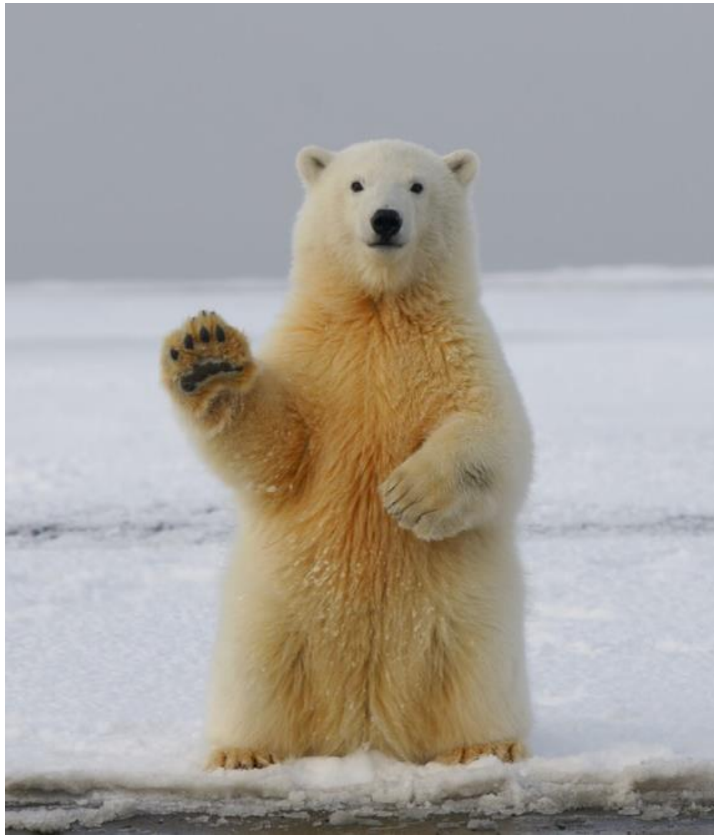
Let’s do the test!

Watch this video and follow the instructions on screen:
https://www.youtube.com/watch?v=1_UuZQhlZ5k

What does this video tell us?

The bears are the risks that hide in plain sight!

- When you know it’s there, it’s obvious.
- But when people are engrossed in the highs and lows of the basketball game, many fail to notice the bear.
- Most risks to your organisation’s financial stability are obvious when looking at your financial statements and reports.
- But you may miss them if you don’t know where to look and focus on day to day operations.



Case study – Kids Company

MUTUAL VENTURES

Company profile

KIDSCOMPANY

Establishment

Founded in 1996 (registered as a charity in February 1998)
Won the Ernst and Young 'Social Entrepreneur of the Year 2005' award

Purpose

Charitable purpose was to provide support to deprived inner city children

Services

Operated 11 children's centres and delivered services through about 40 schools

Funding

In 2013, turnover was £23.1million, with most funding provided through central and local government grants

Collapse

In 2015 it was first reported that the company was in significant financial difficulty and it ceased operations. In February 2022, the Charity Commission published its long-awaited report into the closure of Kids Company, six years after the charity closed its doors.

The headlines

Alleged mismanagement of funds by charity — BBC

Charity suffered from inadequate governance — Third Sector

Demand-led operating model led to collapse — PACAC Report

Ministers ignore report of issues at Charity — Huffington Post

Case study – Kids Company

Finances and employees (financial years 2008 – 2013)

Year	Income (£ million)	Spending (£ million)	Employees (full-time equiv.)
2008	11.2	11.0	176
2009	13.0	13.3	231
2010	14.2	14.2	244
2011	15.6	15.5	330
2012	20.3	19.0	356
2013	23.1	23.0	496

Questions:

1. How would you assess the financial situation of the company based on the above information?
2. Can you see any red flags?

Case study – Kids Company

MUTUAL VENTURES

Finances and employees (financial years 2008 – 2013)

KIDSCOMPANY

Year	Income (£ million)	Y/Y income growth	Spending (£ million)	Y/Y spending growth	Employees (full-time equiv.)	Income per FTE (£)
2008	11.2	*16%*	11.0	*21%*	176	*63,636*
2009	13.0	*9%*	13.3	*7%*	231	*56,277*
2010	14.2	*10%*	14.2	*9%*	244	*58,197*
2011	15.6	*30%*	15.5	*23%*	330	*47,273*
2012	20.3	*14%*	19.0	*21%*	356	*57,022*
2013	23.1	*16%*	23.0	*21%*	496	*46,573*
		Total: 52%		Total: 52%		

Positives

1. Income growing year on year
2. Profit or break even point in all years (except for 2009)

Potential red flags

1. Between 2008 and 2013, both income and spending increased by 52%, in 2012 and 2013 spending growing faster than income - limited reserves, overinvestment?
2. Decreasing income per FTE ratio – decreased efficiency / overstaffed?

Case study – Kids Company

MUTUAL VENTURES

What went wrong?

KIDSCOMPANY

Serious cash-flow problem	The charity operated on a financial knife-edge. Without improving the cash position, it was not possible to build reserves and safely invest in new activities and locations.
Financial management	Poor budgeting process and review of spend against budget, and failure to build sufficient financial reserves.
Record keeping	Poor record keeping of how finances were spent, whether taxes were paid, and appropriate accounting.
Internal controls	Poor controls over who spent money, how much money was spent, sticking to budgets, and ensuring funds were used for the correct purposes.
Strategic planning	Lack of clear strategic planning on the priorities for the organisation and the resources needed to achieve its priorities.
Outcomes measurement	Lack of clear measurement of the impact the organisation was making and the number of users it served.
Governance	Not enough (if any) scrutiny by the board of trustees on the services provided, the use of funds, and the effectiveness of the services.

What can we learn from this case study?

MUTUAL VENTURES

1. Importance of cash flow and reserves

- **Cash flow is king** – even a profitable organisation can go bankrupt.
- **Reserves are vital**. If you relied on reserves to stay afloat during the pandemic, you should be looking to rebuild them to help resist future shocks.
- Different organisations will need to take different approaches to reserves, but you should generally aim to hold **three-to-six months of operating costs in reserves**.

USEFUL RESOURCES

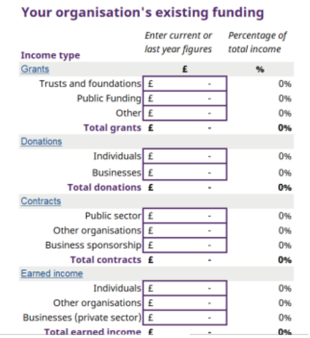
Do you have a reserves policy in place? If not, this practical guide by Sayer and Vincent can help you develop one.

2. Diversifying funding

- Many organisations will recognise Kids Company's **reliance on a small number of sources of funding** and difficulty to secure funding that isn't tied to service delivery.
- You need to **closely manage the relationships with funders** and plan for sustainable income.
- Consider **diversifying your revenue** (new clients, new markets, new sources of funding – corporate donations, fundraising, etc.)

USEFUL RESOURCES

Do you analyse how sustainable your income is? Use a free NCVO funding and income planner to do it.



Your organisation's existing funding

Income type	*Enter current or last year figures*	*Percentage of total income*
Grants	£	%
Trusts and foundations	£ -	0%
Public Funding	£ -	0%
Other	£ -	0%
Total grants	**£ -**	**0%**
Donations		
Individuals	£ -	0%
Businesses	£ -	0%
Total donations	**£ -**	**0%**
Contracts		
Public sector	£ -	0%
Other organisations	£ -	0%
Business sponsorship	£ -	0%
Total contracts	**£ -**	**0%**
Earned income		
Individuals	£ -	0%
Other organisations	£ -	0%
Businesses (private sector)	£ -	0%
Total earned income	**£ -**	**0%**

3. Reviewing your governance arrangements

- Even if you are not directly responsible for record keeping, accounting and development of financial statements, you need to **stay on top of your financial information**.
- If you have a **board of trustees** / supervisory board, review their **skills and experience** to ensure that they have strong levels of financial governance.

USEFUL RESOURCES

This Essential Charity Finance for trustees provides useful materials for the board skills audit.

Financial Forecasting

Financial Forecasting

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The lack of planning and control of finances is the reason most businesses fail. Reasons for long term financial forecasting include:

- Gives you confidence your business plan is achievable
- Allows you to measure the actual financial position against what you forecast
- Identifies potential risks and cash shortfalls
- Gives stakeholders confidence in your business plan
- A forecast is only as good as the data you have and the time you spend on it

Key financial forecasts:

  - Expenditure forecast
  - Income forecast
  - Cashflow forecast

Forecasting and planning for the future

- **Start with your strategy – what do you want your organisation to achieve? How can your finances help you get there?**
- Structuring your funds by timeframe could help you achieve your goals – the larder/fridge/freezer approach:
- **Larder:** Your day to day operations – cash flow forecasting is a big part of this, including reviewing your day to day operations
- **Fridge:** Quick access to funds that are working for you (investment accounts)
- **Freezer:** Your long term planning to ensure your future.

Income forecast: two approaches

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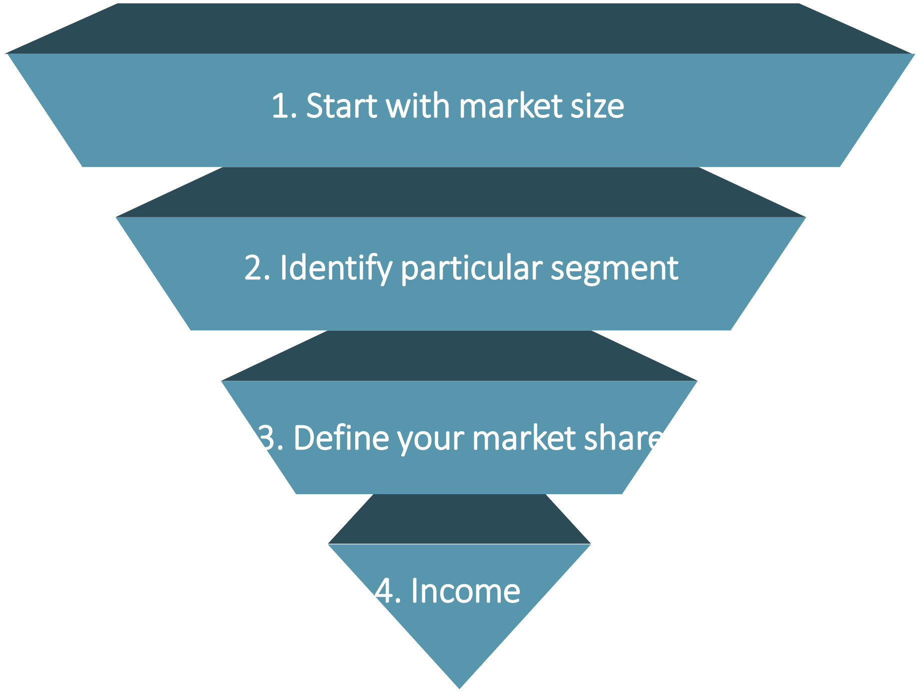
Top down projections

New products / services



Bottom up projections

Existing products / services

In either case, ensure the forecast matches the level of resource that will be available to deliver the service.

Most common errors in forecasting include underestimating costs and overestimating income.

Expenditure Forecasting

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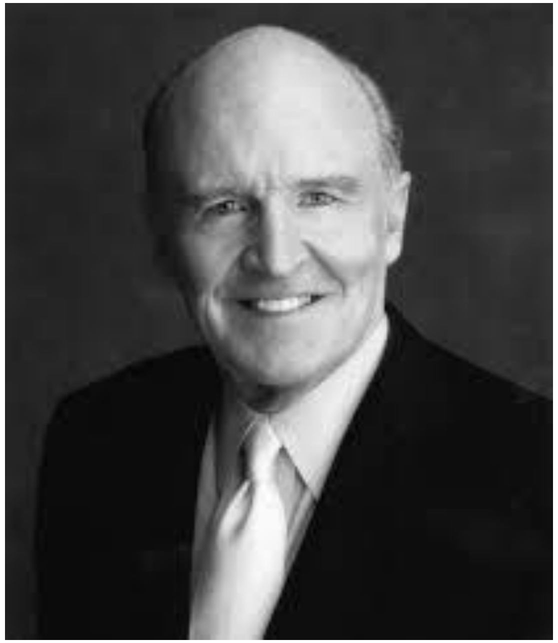
- What costs do you incur in your organisation?
- How would you categorise the costs in your organisation in terms of:
  - Working Capital Costs (recurring expenditure)
  - Capital Purchases (One-off or non-recurring high value expenditure)

Development Capital *One off or non-recurring expenditure*	**Working capital** *Recurring expenditure*	**Capital purchase** *One-off/ non-recurring high value expenditure*
Brand & logo development	Salaries & employee costs (PAYE, training, etc)	Buildings/ property
Website development	Rent & rates	IT equipment
Legal costs associated with start- up	Utilities	Machinery
Advisor costs associated with start-up	Phone & internet charges	Motor vehicles
Furniture	Insurance	
Fixtures & fittings	Marketing	
	Print, postage, stationery	
	Accountancy fees	

Cash flow statement

MUTUAL VENTURES

If I had to run a company on three measures, those measures would be customer satisfaction, employee satisfaction, and cash flow.



General Electric

Statement of Cash Flows

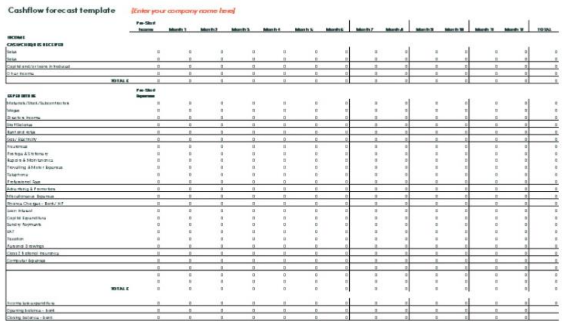
- This shows the cash amounts entering and leaving a company in a period (income statement and balance sheet include items which do not involve actual cash).

- Cash is KING! Poor cashflow management is the main reason small businesses fail.

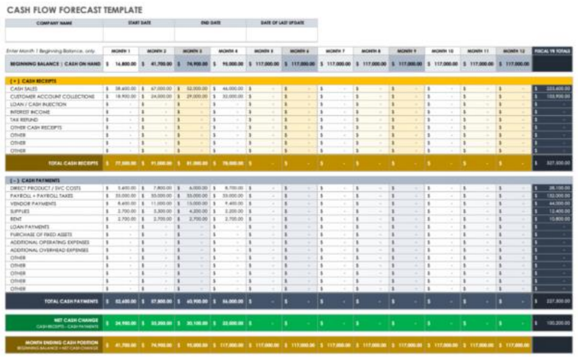
- Good financial planning involves estimating not only how much income you will receive or expenditure you will incur but vitally ***when*** you will receive payment and ***when*** you will need to pay your bills.

USEFUL RESOURCES

Online you can find a number of cash flow templates in excel to download and use for your organisation free of charge. Here are a couple, but find what works for you!



Wenta – a very simple template, good at the beginning for a small organisation



Smartsheet - templates available for a variety of forecasting needs, depending on the organisation size. Also templates that provide short or long-term insights (daily, monthly, quarterly, yearly, 3-year).

Differences between Cash Flow and Income statement

MUTUAL VENTURES

While the two are very closely linked, they show different things, and you should be producing both in order to understand the financial position of your business.

What happens?	Impact on income statement	Impact on Cash Flow
Sales of goods / services	When you make a sale, it shows up on your income statement straight away – no matter when the payment is due.	Sales will be recorded in cash flow when it arrives in your account (may be later, depending on the payment terms).
Purchase of equipment	The cost of equipment is spread over its useful life (several years) – this is called depreciation.	The cost of purchase is reflected in a cash flow in a single chunk the moment you make the payment.
Taking a loan	On the P&L you haven't gained anything – there is no profit from taking out a loan because it must be repaid. Only the interest paid on the loan is a cost to the business. As the balance goes down, the interest charge often decreases, so the impact on the P&L starts high and goes down with it.	By taking out a loan you immediately have more cash. This is reflected as cash in. However, repayments will affect the cash flow negatively.
VAT	VAT doesn't affect your profits. VAT isn't actually your money (you just act as a kind of tax collector for the government)!	VAT passes through your business – so it does affect your cash flow. If you're VAT registered, you will be collecting an extra 20% in payments from your customers, which will go into your bank account. But at some point that money will need to go back out. Forgetting to set aside the VAT trips up a lot of startups and small businesses!

Because of these differences, a profitable organisation can go bankrupt!

Cash flow forecasting

- How could you improve your organisations cash flow?

Causes of poor cash flow

- Collection of payment is too slow
- Not enough sales
- Not following up on sales leads
- Paying suppliers too quickly
- Undisciplined spending
- Poor stock management

Ways of improving cash flow

- Speed up receipt of payment (send invoices promptly)
- Consider longer-term financing
- Make your unique selling point known
- Negotiate favourable payment terms
- Spending guidelines
- Scheduled stock purchases

Sensitivity analysis and risk management

Sensitivity analysis

What is a sensitivity analysis?

- The process of estimating how target variables change in relation to changes in input variables.
- This allows to accommodate uncertainty in forecasts: assessing the best case (bullish) and worst case (conservative) scenarios, and the impact to the organisation.

Main benefits:

- Increased understanding of the revenue or cost drivers influencing financial returns
- Uncertainty reduction: identifying model inputs that cause significant uncertainty in the output and should therefore be the focus of attention if the robustness is to be increased (perhaps by further research).
- Enhancing communication from modellers to decision makers (e.g. by making recommendations more credible, understandable, compelling or persuasive).

The key to sensitivity analysis is to identify the most significant assumptions that affect the forecast.

Sensitivity analysis example

MUTUAL VENTURES

Income Statement	Base Case
Revenue	£1,000,000
- Variable costs	£600,000
- Fixed costs	£200,000
Operating margin	£200,000

What question would you ask to conduct the sensitivity analysis of this forecast?
Which assumption would you test?

Revenue?

Common mistake:
Performing sensitivity analysis at a too high level variable.
Not every type of change in revenue has the same effect on operating margin!

Sensitivity analysis example

Income Statement	Base Case	Volume -10%	Price -10%
Revenue	£1,000,000	£900,000	£900,000
- Variable costs	£600,000		
- Fixed costs	£200,000		
Operating margin	£200,000		

90,000 units at £10 per unit

100,000 units at £9 per unit

Sales forecast – base case:
100,000 units at £10 each

Sensitivity analysis example

MUTUAL VENTURES

Income Statement	Base Case	Volume -10%	Price -10%
Revenue	£1,000,000	£900,000	£900,000
- Variable costs	£600,000	£540,000	£600,000
- Fixed costs	£200,000		
Operating margin	£200,000		

If there is a drop in volume, both revenue and variable costs drop by 10%

Revenue drops but variable costs stay the same

Sales forecast – base case:
100,000 units at £10 each

Sensitivity analysis example

Income Statement	Base Case	Volume -10%	Price -10%
Revenue	£1,000,000	£900,000	£900,000
- Variable costs	£600,000	£540,000	£600,00
- Fixed costs	£200,000	£200,000	£200,000
Operating margin	£200,000	£160,000	£100,000

10% drop in volume = 20% drop in operating margin

10% drop in price = 50% drop in operating margin

Sensitivity analysis example

MUTUAL VENTURES

Income Statement	Base Case	Volume -10%	Price -10%	V&P – 10%	
Revenue	£1,000,000	£900,000	£900,000	£810,000	90,000 x £9
- Variable costs	£600,000	£540,000	£600,00	£540,000	90,000 x £6
- Fixed costs	£200,000	£200,000	£200,000	£200,000	
Operating margin	£200,000	£160,000	£100,000	£70,000	

"One assumption at a time"

10% drop in volume AND price =
65% drop in operating margin!

Common mistake:
Assuming that input and output variables are linked in a linear way. The impacts could however be exponential!

Intentional risk management

Do we really understand and manage our long term strategic risks?

Scenario: Your organisation has high fixed costs and low income certainty

Could you allocate more cash to reserves now to mitigate the risk in the future?

Could you reduce fixed costs for a period to bring costs in line with income forecasts?

- Forward planning and a realistic discussion to risk is easier when things are good – it's harder when things are tough
- Building in indicators around your key organisational risks helps build a shared risk tolerance and helps your to adapt to and respond to change in a timely manner.

Questions?

Feel free to get in touch with me or the PMO team

Thank you!

This is your last workshop of the Covid Bounce Back Programme!

Thank you for engaging with all the workshops throughout the programme. As with the other workshops, the recordings and slides will be available via the Slack Channel.

Remember, you can still receive support from coaches until the end of March – make use of any deep dives or one-to-one sessions you have!

We looking forward to seeing you at the End of Programme Network and Learning Event on the 8th March – held at Barnsley Civic.