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CHARITY ANSWERS

Financial resilience during the Covid-19 pandemic

Document Data

APPLICATION what to think about when considering the financial future of your charity during the pandemic.
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1. **Covid-19 pandemic**
   1.1. Lockdown
      1.1.1. The UK government has put in place strong measures to curb physical interactions including closing retail and hospitality outlets. The population is required to stay indoors as much as possible. Manufacturing and other businesses have been severely impacted with many thousands of workers placed on furlough or losing their jobs.
      1.1.2. This impacts on charities in several ways. The most visible impact is likely to be on finances and service delivery. We have offered advice on meetings and delegation of decision making and will continue to offer topical "answers". This note focusses on the financial impact and what trustees need to do (or have in place) to best manage the situation. Detailed advice and support should be obtained from your legal and financial advisors.
   1.2. Impacts
      1.2.1. There is likely to be a drop in voluntary income and in corporate giving as incomes are squeezed in the present economic go-slow.
      1.2.2. Income from investments will be impacted by fluctuations in the stock market as company profit margins are squeezed, dividends reduced or suspended and some companies cease operating.
      1.2.3. Income from contracts to provide services may be impacted where those services cannot be delivered during lockdown or where the business ceases trading.
      1.2.4. Volunteers may not be able to offer time and home-volunteering might not be possible affecting service delivery.
      1.2.5. Employees may not be able to attend work and working from home may not be possible affecting service delivery.
   1.3. What can trustees do?
      1.3.1. There is nothing trustees can do about the lockdown itself, except to comply with the government restrictions.
      1.3.2. Trustees have a duty to protect their charity and its beneficiaries. The aim is to operate the charity in such a way that it continues to offer its charitable services into the future for the public benefit.
      1.3.3. Charities are supposed to identify risks and report on these in their Trustees' Annual Report. It is unlikely that the current crisis would

have featured in any such risk assessment. However, some charities do have resilience plans in place as part of their overall risk-management strategy, sometimes called a contingency plan or financial resilience plan.

1.3.4. Trustees should either enact their financial resilience plan or immediately develop one. A financial resilience plan provides a framework within which trustees can concentrate on the key issues during a time of financial crisis or in anticipation of a financial crisis.

1.3.5. If you have a reserves policy, you already have the beginnings of a financial resilience plan.

1.3.6. Whilst the finance director or treasurer might be asked to prepare such a plan, it is the responsibility of the trustees as a whole to ensure adequate polices and plans are in place. The Trustees as a group need to take ownership of this.

2. Financial resilience plan

2.1. What does it cover?

2.1.1. Each charity will have different levels and types of activity and income streams. In the context of your own charity you need to think about the following aspects:

- Income – where from and how reliable is it
- Activities – which are core and which are additional
- Commitments – contractual and non-contractual
- Fixed costs – staff, buildings, taxes
- Restricted and designated funds
- Reserves – how much and what for
- Available third party support – grants, government schemes etc
- Using permanent endowment or "capital"

3. Merging or winding up

3.1. Income

3.1.1. The plan should set out where the charity typically gets its income from. Is it solely reliant on income from investments? Are there regular donations? Does it have a trading arm that makes a profit? Does it rely on securing contracts?

3.1.2. Trustees should consider the need for diversification in income streams. This is not always possible, and where that is the case, the resilience plan will need to pay special attention to the impact of the single income stream diminishing. For example, a charity that relies almost exclusively on income from a shop selling donated goods.

3.1.3. Even where there are multiple income streams, one particular form of giving might be impacted more than another. For example, a faith charity that gets income from cash donations at services will not receive those funds during a lockdown. Standing orders may still be paid, but members may have to reduce giving in line with their personal financial circumstances.

3.1.4. Trustees will need to give some thought to managing requests for debts to be waived or for the non-payment/return of other contractual rights to receive income (for example, a deposit for an educational course the client has cancelled). The resilience plan should include a policy on this. Trustees' decision-making must be robust and based on what is in the interest of the charity. It may be necessary to get advice before reaching a final decision.

3.1.5. Trustees will need to estimate what their average monthly income is and compare it to running costs. This should identify income and expenditure related to core and additional activities.

3.2. Activities

3.2.1. Trustees need to capture all of their charitable activity. Such a list should be easy to compile as it is the information used in the Trustees Annual Report. Each activity needs to be assigned as either core or additional. The financial resilience plan will need to explain what a core activity is or means for that particular charity. There is no wrong or right answer. Only a well-thought out, logical one in the context of the charity. Core activities may need to be given a priority order where there is more than one. A core activity for a faith charity might be providing for public worship; an additional activity might be social gatherings for the spiritual welfare of members and or for evangelisation. It's very hard for trustees to set aside personal feelings and take "hard-hearted" decisions on what is a core activity. The reasons for allocating a designation to an activity should be recorded.

3.2.2. The cost related to core and additional activities should be assessed. This may well highlight immediate savings that could be made regardless of any external financial pressures.

3.2.3. The plan will need to set out how, if funds become scarce, choices will be made about supporting core activities and when additional activities may have to cease.

3.2.4. Additional or discretionary activities should be carried on in a way that allows for emergency cessation where at all possible.

3.3. Commitments

3.3.1. Trustees will need to understand what commitments the charity has. These might be contractual – delivering education to a child for a fee; providing services on behalf of a local authority; delivering employment opportunities. Or they may be non-contractual – offering a grant that is typically renewed each year.

3.3.2. Trustees will need to take advice on any contracts that they recognise they will struggle to comply with. When entering into contracts to provide services, advice should be taken about how to ensure the terms can be flexed in accordance with the risks in the financial resilience plan.

3.3.3. When giving grants, trustees should rarely commit the charity to repeating them. Both the recipient and the charity may have changed circumstances and the grant may no longer match the priorities or be in line with the the public benefit goals of the charity.

3.3.4. When taking on long term commitments or large financial commitments, proper financial advice should be taken.

3.4. Fixed costs

3.4.1. Part of the general financial health of the charity will be an understanding of fixed costs. These are things that the charity has to pay for regardless of what activity is carried out. These include premises costs, utility bills, wages, pensions, taxes and lease/rental (equipment and property) costs.

3.4.2. The reserves policy will rely on the assessment of fixed costs in setting out the level of reserves needed by the charity. Trustees should consider if any of these can be reduced or stopped during a financial crisis.

3.5. Restricted and designated funds

3.5.1. The charity may have restricted funds. These are funds (and sometimes property) that must be used for a specified purpose. For example, a charity which runs a theatre may have funds that donor have given for educational programmes or costume production and preservation. Those funds cannot be used for the general running costs of the charity or for some other activity (in our example, the restricted costume funds could not be diverted to costs of on-line broadcasting of performances). That would be a breach of trust. Any such change would require a formal change in purpose and is likely to need the intervention of the Charity Commission.

3.5.2. The charity may have designated funds. These are funds that the Trustees have decided to set aside for a particular project or expense. For example, the Trustees have decided that they need to set aside some funds to mark a historic milestone for the charity or to upgrade IT equipment. The funds are set aside from the general income of the charity (these are not funds raised by appeal). The trustees are free to un-designate such funds as they see fit. Designated funds could therefore be used to meet costs when other sources of income have dried-up.

3.5.3. The reserves held by a charity are usually designated funds. Even if an appeal to create a reserve has been made, making the fund a restricted fund, the purpose of a reserve fund is to provide cash when the charity needs to continue operating but has limited income.

3.6. Reserves

3.6.1. All charities should have a reserves policy. Not all charities will actually have set aside a reserve. Some will be unable to do so. Fund-raising for a reserve fund is not easy.

3.6.2. Where there is a reserve fund, the reserves policy should set out when that should be resorted. It will typically be used for fixed costs first. The Trustees need to avoid an insolvency situation or avoid the charity otherwise ceasing to operate. In some cases it may not be possible.

3.6.3. A reserve fund exists to support the charity when other income has dried-up. It should be used when necessary and not protected for a "rainy-day". The present Covid-19 crisis may well represent a downpour for many charities.

3.6.4. However, before exhausting reserve funds, trustees should consider if they can get any third party financial support.

3.7. Third party financial support

3.7.1. This might take the form of a grant specifically linked to COVID-19 impacts or a grant to build future resilience. It may be a low-interest loan. It includes assistance from the government with rates, VAT and employee costs. For example, furloughing employees.

3.7.2. Trustees need to ensure they explore all options for income or reducing fixed costs. This will help to stretch the reserves for the maximum period.

3.8. Using permanent endowment or capital

3.8.1. Where there are no reserves and no or insufficient third party support and the charity has severely reduced income to the extent that it is unable to operate to deliver its priority core activities the trustees may be able to resort to the permanent endowment or capital of their charity.

3.8.2. This is different to using restricted funds. If the charity has restricted funds that must be applied for a specific purpose they cannot be used for another purpose (see 2.6 above).

3.8.3. If the charity has permanent endowment or capital funds invested in stocks and shares or on deposit or indeed has permanent endowment land and buildings that are held for investment purposes, it is possible to apply those funds as income in certain circumstances. For many charities the intervention of the Charity Commission will be needed to do this.

3.8.4. It is important to take account of the fact that once expended, permanent endowment will be gone and will no longer produce income for the charity. This may impact on the future viability of the charity. It is important to get professional advice before deciding to expend all of your permanent endowment.

3.8.5. Another way of releasing funds into income is to adopt a total return approach to investment. All permanently endowed charities can use the statutory power to adopt this. Charities should always get legal and accountancy advice before adopting this approach.

3.9. Merging or winding up

3.9.1. When all avenues for continuing the charity have been exhausted, it might be necessary to wind-up the charity (in accordance with its dissolution provisions) or merge it with another charity operating for the same or a very similar purposes. Advice on mergers should be taken as early as possible in the process.

3.9.2. If your charity is unincorporated and can no longer operate, any residual liabilities may fall to the trustees and it is imperative that you obtain early legal advice on the position and the protections that may be available for trustees.

3.9.3. If your charity is a company the law on wrongful trading and insolvency still applies. However, trustees should monitor the Insolvency Service web sitefor updates as this is an ever changing situation.

4. Should charities prioritise staff or beneficiaries?

4.1. This is a tough question and a tough decision for trustees. It is particularly difficult for charities aimed at relieving unemployment or poverty. Laying staff off or making people redundant seems counter to that purpose. It comes down to a balancing act. A charity exists to deliver its charitable purpose. It does not exist simply to provide non-charitable employment for people.

4.2. Trustees need to consider

4.2.1. how many employees they need to deliver their core activities;

4.2.2. what the contractual rights of the employees are;

4.2.3. how the impact on employees can be mitigated;

4.2.4. how long they may need to suspend support for beneficiaries;

4.2.5. how the impact on beneficiaries might be mitigated;

4.2.6. what fixed costs savings can be made.

4.3. In the short-term, meeting your employment costs and suspending charitable support may be the best course of action if it enables the charity in the medium and long term to continue to deliver its charitable purposes for the public benefit. However, remember that a charity that simply employs people and does not deliver any charitable activity will not be operating for the public benefit. Such a situation could only be a short-term state of affairs. Balanced against that is the fact that without staff, the charitable service may not be able to be delivered.

4.3.1. There are contractual rights for employees which must be complied with. Providing a specific charitable service is often a discretionary act by the trustees (ie not under a contract for services) and more amenable to change in the short-term.

4.3.2. In the present crisis the UK government offer 80% wage support for furloughed employees (people who are in UK law "laid-off"). This will be a significant factor in trustees' decisions and they should consider whether the charity is eligible for the scheme, taking advice where necessary. Suspending operations for the short term and reducing fixed costs in this way may enable the charity to weather the storm.

5. Where to get help

5.1. LBMW has a large team of experts covering all aspects of the law relating to charities, property, employment, companies, dispute resolution and litigation. We partner with expert accountants and a network of other professional advisors, including crisis management partners.

5.2. The gov.uk website has a range of UK government guidance related to financial impacts of COVD-19.