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FACULTY

Positive impacts in challenging times

Audit insights: charities

ABOUT THE ICAEW AUDIT AND ASSURANCE FACULTY

The ICAEW Audit and Assurance Faculty is a leading authority on external audit and other assurance services. It is recognised internationally by members, professional bodies and others as a source of expertise on issues related to audit and assurance. *Audit insights* is one of several initiatives launched by the faculty.

AuditFutures is a thought leadership initiative of ICAEW's Audit and Assurance Faculty, established in 2012 in partnership with the Finance Innovation Lab. As a catalyst for new thinking and fresh perspectives, it aims to inspire collaborative innovation and constructive dialogue about the evolving role of audit and the accountancy profession in modern society.

The faculty is at the cutting edge of the developing assurance market, offering practical guidance for practitioners and clients – both internal and external – as they move into this new area, sharing examples of best practice and promoting dialogue about the future of assurance services.

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For more information on the Audit and Assurance Faculty, the current work programmes and how to get involved, visit icaew.com/audit. To learn more about *Audit insights* contact Henry Irving at henry.irving@icaew.com, or on +44 (0)20 7920 8450.

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Support for a vital sector

Charities play a significant role in the fabric of our national life but they are being scrutinised more closely than ever. In this report we set out a series of recommendations for different stakeholders to play a constructive role in helping charities to demonstrate their positive impact and become more resilient and transparent.

To increase public understanding and instil confidence, charities and the sector as a whole need to get better at communicating their ethics, culture, achievements and the positive impacts they make. They need to ensure that they are accountable and transparent in describing their activities, outputs, outcomes and impact.

UNDERSTANDING CHARITIES

Charities deliver a wide range of services, from working with disadvantaged groups and the poor to alleviate poverty and social distress to contributing to the promotion of the arts, education and amateur sport and tackling medical conditions. They are also increasingly active in providing public services. Because they are often rooted in their communities, they can draw upon a pool of willing volunteers and are uniquely based to reach those who are hardest to reach.

There are more than 167,000 charities registered by the Charity Commission in England and Wales, and charities are held in high regard by the general public. They continue to have strong public support because of the work they do, which is why we give in large numbers to support them. More than 35m adults in the UK gave to charity in 2015 with an average monthly donation of £40, according to the Charities Aid Foundation *UK Giving 2017* report.

Unlike private organisations, charities exist to fulfil a specific social purpose rather than creating profits for shareholders. The public has high expectations of charities because they are often stewards of the public's funds that have been entrusted to them to achieve their mission.

However, various surveys show that the charity sector, what it comprises, what it does and how it does it, is poorly understood. This may have something to do with the structure of the sector, where nearly 40% of charities (nearly 66,000) are small in scale and receive annual income up to £10,000 only. This contrasts with 1.3% (more than 2,000) who receive income in excess of £5m.

CHALLENGES FOR CHARITIES

Charities need to demonstrate that they act with integrity and learn from their mistakes. They must take responsibility for their decisions and show how they have fared against the targets they have set themselves, and they must be able to answer for an action they have taken or avoided. To succeed, charities need to have policies and frameworks in place to show that they are operating in a way that they and others find acceptable. This includes not only seeking and providing feedback but also acting on it. When the public knows more about a charity, their trust and confidence in charities generally increases.

The public's perception that workers in charities should not be paid, or paid only at minimum levels, can be inconsistent with charities' contemporary role. While charities are not corporate businesses seeking to make a profit, they need to make surpluses to build up their level of reserves for financial sustainability and investment and they will not survive if they make recurring deficits. Charities are often complex organisations with multiple activities and different income streams, and they have to be run professionally and efficiently if they are to use the public's money wisely. Larger charities will require not only effective boards but also well-qualified staff to deliver their charitable activities, generate income and to govern and manage the charity. This is necessary to ensure they are sustainable and are able to continue to work for the causes they support.

Many of ICAEW's members are engaged with the charity sector in a wide range of roles – as employees, as volunteers including trustees, as auditors and independent examiners and as donors. *Audit insights: charities, positive impacts in challenging times,* is an opportunity for external auditors and ICAEW specialist staff to share some of their expert knowledge of the charity sector with a wider audience. They bring many years' experience of both independently examining and auditing charities and acting as trustees themselves. They offer unique insights into key issues facing the sector. Individual contributors and representatives from the following firms formed the *Audit insights* working group that produced the report: BDO, Crowe Clark Whitehill, Deloitte, James Cowper Kreston, Kingston Smith, KPMG and RSM.

The issues and recommendations in this report are equally applicable irrespective of whether the charity has been audited.

Charity register statistics: 31 December 2016 (Charity Commission in England and Wales)

Annual income bracket	Number of charities	%	Annual income (£bn)	%
£0 to £10,000	65,842	39.4	0.218	0.3
£10,001 to £100,000	56,853	34.0	2.007	2.7
£100,001 to £500,000	21,956	13.1	4.826	6.6
£500,001 to £5,000,000	8,972	5.4	13.409	18.4
£5,000,000 plus	2,201	1.3	52.647	72.0
SUBTOTAL	155,824	93.2	73.107	100.0
Not yet known	11,285	6.8	0.000	0.0
TOTAL	167,109	100.0	73.107	100.0

Four areas of focus

There is a disconnect between what charities do and how they are managed and operate, and what the public thinks they do and how they should be managed and operated. Charities have a critical role in bridging this gap by demonstrating how they are delivering positive impact.

It is crucial for charities to be honest and transparent about the difference and impact they are making, and also where they have not achieved their objectives. But as well as being open, charities will only succeed if they are also financially sustainable.

Trustees alone cannot achieve these objectives. The recommendations in this report are directed at trustees, regulators/standard-setters, auditors, supporters/funders and commentators on the charity sector. We describe four key areas for charities to focus on but this inevitably includes issues that are linked, so we also consider how these issues relate to each other in delivering positive impact.

DEMONSTRATE IMPACT, TRANSPARENCY AND ACCOUNTABILITY

Charities need to be more proactive in explaining the outputs, outcomes and impact of their work. The failure to provide this information is creating a deficit gap which is being filled with flawed commentary about cost and expenditure ratios, reinforcing confusion over performance.

One way to address this is for charities to improve their engagement with stakeholders by being more open and discursive in their reporting. They should provide information about their governance and their risk environment, and be honest about activities that are successful and are having a positive impact, as well as activities that are not working or new endeavours that have not been as successful as anticipated and the lessons learnt. More dialogue and explanations would reassure stakeholders that stewardship obligations are being properly observed and that charities are being managed well.

Trustees and management need to show effective leadership by making sure that charities are transparent about what they do, how they do it, what it costs and what is being achieved. Financial statements mainly show inputs, income raised, funds expended and staff costs. There is a need for more useful information on activities and achievements. Figures in financial statements are often a poor measure of the effectiveness of charities and, because charities often fail to provide other vital information and key performance indicators on a consistent basis, these figures are often used as a spurious measure of effectiveness.

INVEST IN LEADERSHIP AND INFRASTRUCTURE TO RETAIN PUBLIC TRUST

Trustees are ultimately responsible for their charity, and appropriate knowledge of their roles and responsibilities is vital if they are to provide effective stewardship. Charities need to focus more on the selection, induction and training of all trustees to ensure they have the right skills and experience to fulfil their roles and deliver better governance. All trustees should be able to confirm that, before taking up their appointment, they have received sufficient information about the activities of their charity and their role as a trustee, and that they understand the responsibilities that come with being a trustee.

Different charities will have different needs and the level of involvement by trustees will differ according to the size, nature and life cycle of each charity. Trustees of charities with strong management teams need to be ready to delegate to management without abdicating their oversight and monitoring responsibilities.

Charities, like any other successful organisation, require the necessary infrastructure to ensure that they have the right IT, financial systems, skills, income generation processes and effective governance and management. Trustees need to assess whether their charity's infrastructure is fit for purpose and be ready to prioritise their decision-making to tackle any level of underinvestment that has occurred in these vital areas.

Some charities have been reluctant to incur higher overhead expenditure because they believe it will impact negatively on how they are perceived by stakeholders. Charities should be ready to spend more on their infrastructure and support functions if it will ultimately improve their efficiency and effectiveness. Investments in training, evaluation, internal systems and fundraising are important as they enable charities to improve their performance. The risk is that underinvesting in infrastructure can actually lead to a deterioration in a charity's performance and the resilience needed to be able to sustain effective delivery. Funders and the public need to recognise this.

Cost ratios and measures of how, and where, funds are distributed are often used as a proxy for effectiveness and efficiency. The fact is that in almost all cases such measures are flawed and lead to inaccurate conclusions. Stakeholders and supporters should not focus on the percentage of charity expenses that go on administrative and fundraising costs. While ratio analysis can help charities to identify problems and serve as part of their dashboard of financial management data, it tells us very little about the impact of a charity's work.

BE RESILIENT AND ENSURE FINANCIAL SUSTAINABILITY

Charities often operate in a difficult funding environment. They sometimes have to match unpredictable income with fixed costs. This means that they need to have reserves to act as a buffer and to allow necessary expenditure when required.

While there has been guidance from the regulator on reserves policies, some trustees continue to pay lip service to the recommendations. Charities need to consider relevant guidance and how this applies to their circumstances. There is no one-size-fits-all yardstick for charity reserves but, importantly, trustees must ensure that in developing an effective and carefully thought-out reserves policy, they link it with the charity's risk management strategy and their appetite to take risks.

MAXIMISE CHARITY RESOURCES

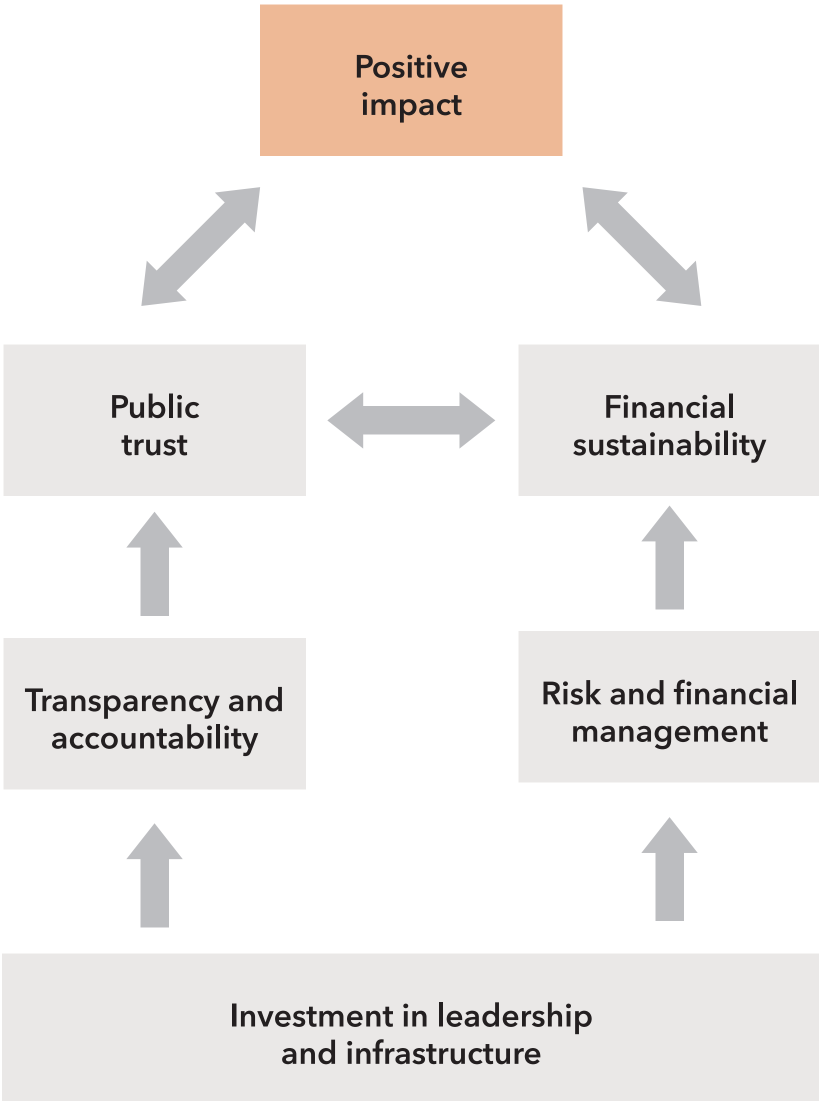
Charities need to become more proactive in identifying their current and future growth and development needs, and seek help where necessary. This requires an understanding that the environment facing charities is constantly changing. More could be done through collaboration with other charities and with the corporate sector to share costs and risks. But some are reluctant to take this route even when the benefits could prove vital to the continued successful delivery of services. Trustees and management need to put preconceptions aside and ensure that the interests of their beneficiaries are central in all the decisions they take.

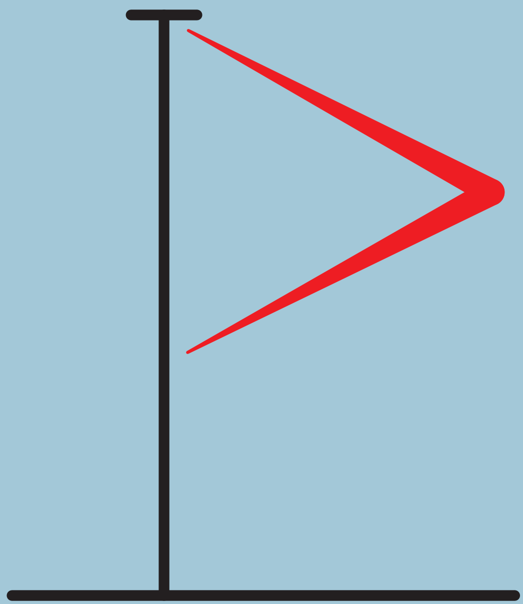
Charities need to ensure there is effective financial monitoring of their operations and that trustees are receiving timely, relevant and accurate information frequently enough to understand when things are on track or whether concerns are emerging that need to be addressed.

The commissioning process of public services can leave smaller charities at a disadvantage. They may lack the reserves to manage deficits arising from start-up costs or to weather a period of structural change when taking on new contracts. In addition, they may not have the business skills and infrastructure to assess the viability of contracts or to manage the transfer of assets and staff under new contracts.

The commissioning process needs to be improved to create a level playing field for smaller charities. Commissioners need to be realistic about what it costs to deliver services, and they should fund key support costs that are a necessary part of the services they are commissioning. Charities need to actively collaborate more and use consortia to share costs, improve delivery and enable funds to be spent more efficiently.

ACHIEVING A POSITIVE IMPACT: KEY LINKAGES





1. How can charities demonstrate they are making a positive impact?

The public holds charities in high regard, with 14m (27% of adults) volunteering once a month or more to support their work. This charitable ethos is held across the age range with 35% of 16–24 year-olds reporting that they volunteered at least once a month in 2014–15. As well as providing their labour, the public also gives generously.

But a succession of negative media stories has shaken public trust in charities. The failure of a few charities was unrepresentative of the charity sector. Such cases lead to an over focus on what did not work in isolated cases, while forgetting about the vast numbers of charities that every day demonstrate good practice and have a significant positive impact in their fields.

BE TRANSPARENT AND ACCOUNTABLE

Some charities do a great job of explaining their impact, while others provide only patchy information about their performance. Supporters want to know that the charities they support are having a real impact. There is an opportunity for charities to better demonstrate what is being achieved rather than focusing on costs. This includes being honest about: activities that have worked and are working; activities that are not working or new endeavours that have not been as successful as anticipated, and the lessons that have been learnt. Charities also need to be less reticent about explaining that they need to spend money to raise funds and to provide the necessary infrastructure.

More dialogue and explanations will help to address the divide between how charities are perceived and the reality of how they operate. Transparency and clear explanations will reassure stakeholders that stewardship obligations are being properly observed and charities are being managed well.

However, transparency does not necessarily mean even more information. As it is, annual reports are becoming longer and more cluttered. There is an opportunity for collective action by preparers of charity annual reports, regulators, auditors and standard-setters to reduce their complexity and volume. The focus should be on providing meaningful and relevant information that demonstrates a charity's impact. Regulators and standard-setters should provide more examples of good practice and reassess their requirements to try and make disclosures clear, concise and more relevant.

Auditors can guide charities in cutting through some of the complexity and clutter that is often present in their annual reports and financial statements. In our experience, although auditors have largely embraced the value that better reporting brings, there are still a number of examples where boilerplate, less specific or meaningful descriptions are used and there is plenty of room for continued improvement.

IDENTIFY THE DIFFERENCE CHARITY WORK HAS MADE

The perception of aggressive fundraising techniques, a perceived lack of accountability and transparency, alongside negative media coverage, has led to a decline in overall trust and confidence in charities, according to the *Public Trust and Confidence in Charities* research by the Charity Commission for England and Wales. The challenge for all charities is to demonstrate the positive impact of their work because there is still a rich reservoir of public goodwill towards charities. According to the same Charity Commission research, although public trust may have declined it has had little impact on the importance that the public places on the role of charities. The public wants to see charities making a positive difference to the cause they are working for. But it is no longer enough to do good. Charities must also uphold the highest standards.

Many charities already have good systems for capturing the positive nature of their work but not necessarily the positive outcomes and impacts their work leads to. Impact measurement is often difficult and sometimes cannot be assessed in the short term. But at the very least charities should provide more information on their activities, their outcomes and an honest assessment of the impact they are making. For some, this may mean early planning of how to assess their performance, then putting the processes in place that show the difference they are making.

Charities cannot solely rely on their annual report when communicating information about the good work they do. The format of the accounts can be hard to follow and there are a multitude of other channels that are more effective in reaching both their donors, beneficiaries and the public. These include the use of social media and their own websites. Charities should also consider increasing the use of case studies to illustrate their achievements.

Much of the criticism levelled at charities in the media has been on support functions and the proportion of income not going directly to the cause. Such a focus is often misleading and concerns about these types of spending sometimes lead charities to make suboptimal spending decisions rather than focusing on what they need to do to succeed. This can result in charities being less than transparent about such costs rather than considering whether they are appropriate and then being ready to explain them. Trustees should clearly communicate how the charity applies its funds and how this makes a difference to their charity's work.

Charities are rightly keen to celebrate their successes. To be transparent, the public needs to know not only how charities are performing but also how they are making a difference. Any overview of performance should also include an explanation of where objectives have not been achieved without fear of negative repercussions.

2. How can charities retain public trust?

Running a charity is hard work and it is not always easy to achieve the intended outcomes and make ends meet. As well as raising money for a particular cause, funds are needed to pay staff salaries, bills and other general running costs. There is a strong argument for more charities to learn from their peers and from other sectors: applying the methods, technologies and approaches demonstrated from other sectors to help improve operational effectiveness by embracing better ways of working.

PROVIDE MORE EFFECTIVE LEADERSHIP

Stakeholders need to understand how vital it is that many charities have paid staff as well as volunteers if they are to achieve their aims. For example, a skilled and experienced finance director can manage revenue and plan resources, allowing more resources to be devoted to the charity's objectives. An effective CEO can provide the leadership required to navigate the challenges and risks that many charities face. Charities face difficulties in attracting and retaining talent. This is exacerbated in certain areas of the country and for certain roles, and remuneration policies need to take account of this.

Effective leadership is crucial. Trustees are often chosen because of their deep knowledge of the area the charity operates in. However, in addition to this knowledge charities need trustees with governance, financial management, strategic and stewardship skills. Charities need to ensure that trustees have the right skills and experience to fulfil their roles and ensure better financial management and operational effectiveness. All trustees and senior management should undertake training, where necessary, to meet the increasing demands of regulation, the higher expectations and the new challenges facing charities.

While many trustees have a great deal of knowledge and experience, there are often particular issues that are relevant to charities that require special knowledge. Failure to understand the special issues increases the risk of breaches of trust, conflicts of interest, financial mismanagement or governance failure occurring, resulting in further erosion of public trust. To counter this, trustees should continually evaluate the skills that are needed on the board and their knowledge and training needs.

Before taking up their appointment, all trustees should be able to confirm that they have received sufficient information about the role of their charity and understand the responsibilities that come with being a trustee. Trustees of charities with strong management teams need to be ready to delegate to senior management without abdicating oversight and monitoring responsibilities.

ADDRESS SKILL GAPS AND DIVERSITY

Many charities still have skill gaps on their boards. The concern among charities is that fewer people are willing to volunteer to be trustees because of the perceived risks and increased regulation which demands more from them. This is not likely to affect the charities with high profile brands who, because of their national and international public image, are still able to attract trustees with significant skills and experience. However, these organisations are a minority in the sector. Smaller charities are more likely to experience difficulties in attracting board members who have the collective experience and skill sets that are required to be an effective trustee board.

A number of charities have rules and structures that can prevent them from attracting all the skills they need. For example, the rules may require that the board is elected from a particular constituency and, while this can be important, it needs to be recognised that good representation is not necessarily the same as good governance. If the election process does not lead to the right mix of skills, then it should be supplemented by selection.

Charities also need to ensure there are fresh perspectives on the board. One way to address this is to diversify the board with the involvement of all sections of society. Charities should do more to attract trustees from under-represented sections of our communities including young people, people with disabilities and members from black and ethnic minority groups. Studies suggest that too many of our trustee chairs are white and male.

A diverse board can help to increase public confidence through accountability and engagement between charities and the public they serve. They can also bring expertise and generate new ideas that can help to boost the impact of a charity's work.

Some people are daunted by the obligations and responsibilities of trusteeship and can be nurtured into learning about the role and responsibilities of being a trustee by being co-opted on to subcommittees and panels before progressing on to boards.

INVEST IN VITAL OPERATIONAL AREAS

The desire to try and show that expenditure is channelled towards direct charitable activities has led to underinvestment in vital infrastructure. Reducing expenditure on infrastructure and management does not mean that a charity is more effective.

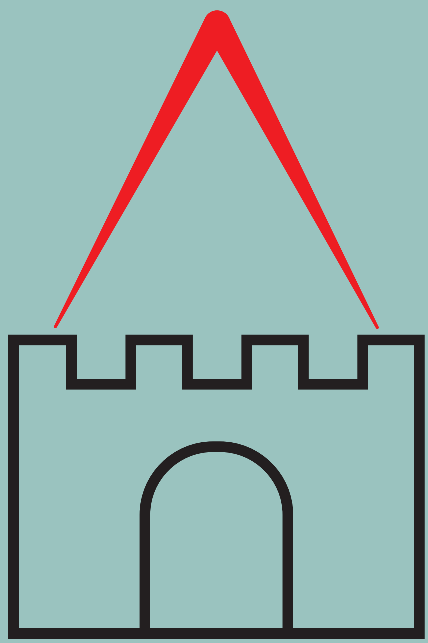
There continues to be a wholly misleading belief that charities can be measured and compared by looking at their expenditure, such as fundraising or staff costs, and comparing it to their income raised. This adds little value as a performance measure, as income is often unpredictable and not easily linked to the amount spent in a given year. Some charities may be trying to build up reserves and budgeting for surpluses, while others may be planning deficits to make investments in the future or run down excess reserves. Each charity is different and matters such as the type of charity, the stage in the lifecycle, the cause, the way of operating and the fundraising mix will all impact on expenditure ratios.

Any move towards a greater focus on an expenditure-ratio-based approach will be a retrograde step. This has been tried before and has been seen to be confusing, even damaging. There are simply too many issues to factor in, which can make such comparators unworkable.

To move stakeholders away from crude cost ratios, charities need to focus on what they are achieving and improve how they tell their story. Trustees and management have often shied away from making good investment decisions because they believe that it will impact negatively on how they are perceived. This has resulted in underinvestment in vital areas such as information technology, skills training, income-generating processes and governance and management. Charities are also to blame by perpetuating the myth that reduced overheads mean the charity is more effective. This leads to a vicious cycle of underinvestment and the belief that more can be done with less.

Charities should be ready to make the necessary investment in infrastructure based on what is needed rather than how it may be perceived. Expenditure decisions should be governed by what is in the best interests of achieving objectives effectively, which may require more investment in infrastructure.

Regulators and standard-setters will need to do more to get this message across and to support charities in building sustainable and resilient infrastructures.



3. How can charities become more resilient?

BE CHANGE READY

Charities today are operating in uncertain times and the need for effective financial monitoring of their operations has never been greater. Trustees or the appropriate subcommittee need to receive timely, relevant and accurate information frequently enough to understand whether things are on track or whether concerns are emerging that need to be addressed. The narrative should include key financial and performance indicators and other relevant information that will aid decision-making.

Trustees need to have confidence to ask questions and to challenge the information they receive if they do not believe it is what they need. Trustees should also ensure that they ask for information that is needed and useful rather than information for information's sake. Getting the right balance is important.

Charities will need to refresh strategy and planning and be ready to re-examine some of their operations and how they manage and govern themselves. In challenging and turbulent times it is often too difficult to predict the future, and the external and internal environment for charities is changing very fast. Forecasting what may happen three to five years ahead is more guess work or based on expectations from a changed past. This may require a shift from reviewing strategic plans on typical three-to-five year cycles by adopting the use of more flexible strategic frameworks that adapt to the constantly shifting environment, responding to both opportunities and threats in a timely way.

Successful charities are the ones that are innovating and are ready to seize opportunities. To do this, charities must be nimble, agile and ready to be courageous in their actions and planning. There will not be innovation if charities are only allowed to undertake initiatives that are guaranteed to succeed.

Outcomes are often different to earlier predictions and strategies and plans may need to be realigned. This means regular monitoring and measurement of progress against the strategy – many organisations are now doing this monthly. Boards and management need to think hard about indirect, as well as direct, implications of unfolding events, new funding landscapes, changes to laws and regulations and the wider implications of new and changing stakeholder expectations. They need to take into account events beyond typical horizon planning and be ready to manage the change that may be necessary.

A charity's strategy must be able to deal with uncertainty and at a time when predicting the probable is difficult to say the least, strategies and tactics have to be developed on the premise that several different outcomes are possible.

MANAGE RISK EFFECTIVELY

Charities that are succeeding are not the ones avoiding risk but the ones that are seeking new opportunities and taking appropriate risks through effective risk management. They are re-examining every aspect of their traditional delivery model to identify new ways of driving increasing cost effectiveness, which is not always the same as cost cutting.

Charities should communicate to donors and the wider public the case for their level of reserves, to ensure that they retain their trust and confidence. Holding a high level of cover for risks and unforeseen events may appear sensible, but a charity will need to explain why they need to hold reserves and what their target level is. Charity funds need to be spent in support of beneficiaries, and charities should be able to provide solid, considered reasons for keeping funds back as reserves and not spending them.

Trustees are usually remote from day-to-day operations and reliant to a great extent on executive management to provide them with information on the state of risk within their charity. They should have assurance that risks are being monitored and managed effectively. A culture of sound risk management should be embedded throughout charities. Trustees should also regularly review their charity's approach to risk management.

DEVELOP A ROBUST RESERVES POLICY

All charities should have a robust reserves policy in place and they should critically evaluate the level of reserves they need to hold. They should also explain the longer-term trends in their reserve levels, for example over five years. This will give stakeholders a better view and understanding of the charity's policy. The policy should also be reviewed to guide charities when they might need to draw down on their reserves.

There are many factors that a charity needs to consider when deciding what level of reserves is necessary:

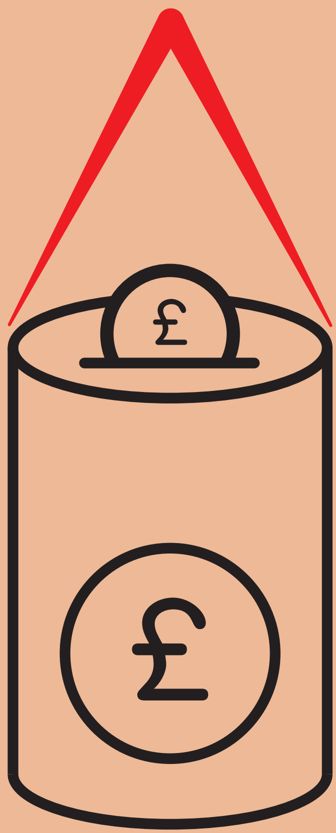
Income – how volatile is it and what is the level of income at risk?

Expenditure – what is the nature of their spending commitment and how easily can it be reduced?

The nature of the reserves – how easily can it be realised and what will be the impact of doing this?

How sensitive is the charity's income and expenditure to factors which are outside its control?

Too many charities have reserves policies to justify their existing reserves rather than really considering what reserves are needed. A charity's reserves policy should not be developed in isolation and should be part of its risk management strategy. Many charities have some risk management in place but it is often ad hoc and unstructured. There is also a reluctance to invest in fundraising for fear of failure and that it will attract criticism. While in some cases trustees will need to minimise risk as a priority, in other situations they will need to take risks to be innovative to help them succeed.



4. How can charities maximise their resources?

Charities have been operating in a climate where government spending cuts have widely affected the sector, increasing the funding pressure on frontline services. While bigger organisations have been coping better by taking advantage of new funding opportunities as government increases the outsourcing of public services, many smaller and medium-sized charities have struggled to shift their funding from traditional public support to new ways of working. To manage the squeeze on their funding some are finding it necessary to reduce staff and the level and range of services that they provide.

BE MORE SELECTIVE IN ACCEPTING CONTRACTS

Government funding has shifted radically from grants towards competitive commissioning, payment by results (PbR), pre-financing and outsourcing. But these changes have failed to create a level playing field for smaller charities, which has exacerbated their vulnerability. Large organisations, including some large charities, are dominating the market for providing public services.

Certain parts of the charity sector have been more affected by these trends. For example, the Local Government Association in its funding outlook estimates that there will be a £2.9bn annual funding gap in social care by the end of the decade. The introduction of the National Living Wage will add another £1bn to the costs of care homes between now and 2020. Some charities who specialise in these areas have been forced to close as a result, while others are fighting hard for their survival.

Government has highlighted its plans to expand on funding models using PbR. The underlying principle of PbR is that service providers are paid according to the outcomes they achieve, as opposed to the activities they undertake. Charities are finding it more difficult to adapt to the use of PbR in the delivery of public services and are reluctant to get involved because PbR offers no guarantee of payment and will have a negative impact on cash flow. In these circumstances charities are likely to be better off bidding as part of a consortium. Funds can also be spent more efficiently if charities are able to share logistics and infrastructure.

A National Audit Office report, *Outcome-based payment schemes*, said that PbR is a technically challenging form of contracting and has attendant costs and risks that government has often underestimated. More recently, the *Commissioning in Crisis* report, published by the Lloyds Bank Foundation, found that current commissioning processes are a major threat to the survival of smaller charities. Some funders refuse to recognise the need for proper cost recoveries and are not ready to fund the support costs that are necessary to deliver the services they are commissioning.

Funders and commissioners of services need to be aware of these challenges and they need to be realistic about what it costs to deliver services. They should also recognise that they need to engage with smaller charities. This will require a rethink of the commissioning process and the awarding criteria that are being used at present.

In addition, charities should be more discerning in accepting unviable contracts. The practice of winning the contract at any price can be harmful to charities and the causes they serve.

RECONSIDER OPERATING MODELS

Charities need to become more proactive in identifying and seeking help, if needed, with their growth and development needs. More could be done through strategic alliances, mergers and collaborative working to share costs, risks and opportunities. But some are reluctant even when the benefits could prove vital to the continued successful delivery of services. This may be due to their limited resources, the reluctance of trustees to take opportunities that carry a financial risk, or a concern that their own charity may ultimately be subsumed into another. Charities should put preconceptions aside and ensure that the interests of achieving their objectives are central in all the decisions they take.

Sourcing new funding streams to compensate for reductions in government support is one of the biggest challenges facing charities but competition for funds is making it more difficult to fulfil this objective. Many charities rely on unpredictable income streams such as donations or legacies, which have come under pressure and in some cases are restricted in how they can be used.

New fundraising and data protection regulations will lead to significant changes in how fundraising charities interact with the public. Most charities have recognised that this could lead to reduced income and/or increased fundraising costs. These factors, combined with demographic changes, economic pressures, increasing demand and general uncertainty have led many charities to conclude that the status quo is no longer an option.

There are many aspects of good practice in other sectors that can be adopted by charities, but they need to make sure they retain their core vision, mission and values. Charities that manage to keep the crucial connection to their values and their beneficiaries, while finding new sources of income and investing in infrastructure, will be the charities that are most effective. Charities also need to take a good hard look at processes and activities – are they being done in the right way? Are all the activities needed? Can they be done more efficiently and effectively?

Glossary of terms

Term	Definition
Beneficiary	A person or a group of people who benefit from a charity's work. The beneficiary group(s) will be defined in the charity's governing document. Beneficiaries are sometimes called clients or service users.
Board	A group of people who are responsible for the overall governance of a charity. In the charity's governing document they may be called trustees, managing trustees, committee members, governors or directors or they may be referred to by some other title.
Charity Commission	The registrar and regulator of charities in England and Wales. It is an independent, non-ministerial government department accountable to parliament.
Impact	These are all the changes resulting from an activity, project or organisation. It will include intended as well as unintended, negative and positive, and short-term and long-term effects.
Outcomes	These are the benefits or changes for intended beneficiaries. They are usually planned and are set out in a charity's objectives. The trustees' report should highlight outcomes.
Public support	Any combination of gifts, grants, contributions and membership fees from the general public (donors), foundations and corporations. We do not include government funds when highlighting public support.
Registered charity	A charity must register with the Charity Commission if it is based in England and Wales and has more than £5,000 income per year. The Commission will take action to secure compliance if it identifies a charity which is not registered but should be.
Reserves	That part of a charity's income funds that is freely available to apply or spend.
Trustee	A member of the board or management committee. They are legally responsible for the work of the charity and accept ultimate responsibility for everything the charity does. They must act in the best interests of the charity.

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