

Deficit Budgets & Dealing with Funding Cuts

What is a Deficit Budget?

“A status of financial health in which expenditures exceed revenue”. The opposite of a budget deficit is a budget surplus, and when income is equal to or greater than planned expenditure, the budget is said to be balanced.

(Definition taken from [Budget Deficit Definition | Investopedia](#))

Any organisation running with a deficit budget could be heading towards potential funding problems.

What can an organisation do?

Dipping into the reserves

Ideally an organisation will have accumulated some reserves. It is recommended that an organisation hold three to six months running costs in reserves to cover costs associated with withdrawing from premises and any other contracts, including employment contracts. Clearly if an organisation has reserves using them to get through a period of financial difficulty might be an option.

However, an organisation needs to think this option through very carefully;

- Reverses can only be spent once.
- If the rainy day turns into a rainy month or rainy year how long can the organisation be maintained through utilising its reserves?
- How will the organisation rebuild its reserves?
- Could the organisation be using its reserves rather than facing making difficult decisions about its future direction?



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Take financial control

If an organisation is heading towards a deficit budget it is a good time to ensure that both trustees and staff have a clear understanding of the organisation's financial situation. Strong financial leadership is likely to be needed and will be key to turning the situation round.

Organisations can:

- Ensure that trustees and staff with financial responsibilities fully understand the organisation's budget and current financial position.
- Review the budget line by line to ensure that it is correct.
- Review the budget line by line to identify areas where spending might be reduced.
- Restrict spending to essential items – ensure that everyone in the organisation is aware of and adheres to this.
- Monitor income and expenditure monthly to ensure the costs are being controlled.
- Understand that “Cash Flow is King”, ensure cash flows are in place and that there is a clear understanding of what money is coming in and when and who needs to be paid.
- Check if anybody owes the organisation money and ensure that payments are made.
- **Seek financial advice.**

Finally, organisations should be cautious about setting over optimistic budgets being realistic about what income they know they have in place and realistic about what new income they might secure. Organisations can secure new income streams but the cash inflow from this is unlikely to take immediate effect.

Useful links




For more information on cash flows, budgets and financial management please follow the links to the factsheets below.

[GMVSS Cash flow forecasts and budgets factsheet](#)

[GMVSS Financial management factsheet](#)

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Financial juggling

Organisations need to be careful about juggling payments to suppliers and creditors. They need to ensure they are paying the bills that need to be paid. They may be able work with some suppliers to defer or spreads payments.

Organisations need to recognise that managing difficulties with cash flow can be very stressful.

Organisations need to be aware that becoming poor payers can damage their organisation's reputation and that being late paying bills can lead to the organisation being taken to court or being forced into insolvency.

Governance

If an organisation is heading towards financially turbulent times trustees/ directors need to fully understand their governance and structure and their liabilities and responsibilities. They should seek advice at the earliest possible opportunity.

Redundancies

For most organisations their biggest cost is staffing and the only way that they will be able to reduce their costs is by reducing staffing which is likely to lead to redundancies. Redundancy is a difficult process, particularly in smaller organisations.

However, if the redundancy process is handled well it will in the long - term benefit the organisation. A well managed process can also benefit staff both those who are being made redundant and those who are staying with the organisation.

An organisation can:

- Seek specialist Human Resources advice.
- Know their redundancy policy inside out and follow it.
- Treat people fairly.
- Demonstrate 'duty of care' towards staff and support them through the process.
- Ensure good communication.



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Useful links

There is excellent advice on the Gov UK web site:

[Making staff redundant - GOV.UK](#)

The site includes a redundancy calculator but this is only applicable if staff are only eligible for statutory redundancy payments.

Loans

Some organisations may be able to access loans to help get them through a difficult financial period. Arrangements for repayment including interest will need to be included within financial plans.

Service Users

Closing or reducing activities and services may well impact on the organisation's service users. It is important that organisations communicate with their service users to let them know how any changes might affect them.

Planning exit strategies for services may involve identifying and approaching alternative providers. Such an approach can have strong benefits for service users.

There can be considerable pressure on organisations to continue to run services despite cuts in funding. For example, paid staff may be asked to take on additional responsibilities or to consider a change in terms and conditions. The organisation may also rely more on its trustees or recruit more volunteers to support services.

It is important that the organisation thinks through the sustainability of their chosen approach over an extended period of time. It may be that the capacity to maintain a service can be developed despite a cut in funding. Alternatively this may not be sustainable and services may need to be closed in a managed way.

Diversifying income

We are living through a time where we are experiencing a huge decline in Local Authority funding. In 2014/2015 alone Salford is having to reduce its budget by £25 million. Any organisation reliant on Local Authority funding will need to consider how they would manage a reduction in this funding.



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Alternatives to Local Authority funding include trust funds and grants, fundraising from individuals or earning money through trading. As it takes time to diversify income an organisation will need to develop or review its funding plan. If an organisation has some reserves in place may be these can be used to “buy time” to allow the organisation to diversify its funding. It is advisable to avoid being over optimistic about the potential to secure new funding.

Merger

For some organisations merging with another organisation has been a successful solution to financial difficulties. Mergers can provide significant savings for example in senior management costs and other overheads. The Charity Commission recommends that:

“A Merger with another charity or charities should in any case, be considered regularly as it could be a way to continue or improve the services offered to their beneficiaries. If a charity is, or might be facing financial difficulties a merger is one of the options that should be high on the agenda at an early stage. As an alternative to a full merger, it might be possible to transfer certain operations or activities to another charity in order to provide an uninterrupted service to the charities beneficiaries.”

- Consider the values and culture of any potential identified merger partners
- Identify the business case for any merger. A financially strong organisation should only take on a financially weaker organisation if it makes financial sense.
- Any merger will take time.
- Be clear about the formal process of transferring assets and closing the existing organisation.
- Organisations will most likely need legal advice and provision needs to be made for the cost of this.
- Be clear about redundancy processes and any TUPE obligations.
- Budget for the cost of merging financial and any other systems.
- Not every organisation will be able to successfully identify another organisation they can merge with.

Useful links




There are Factsheets on both Redundancy and TUPE on the Law Works website:

[Law Works TUPE Factsheet](#)

[Law Works Redundancy Factsheet](#)

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What is Insolvency?

The Charity Commission's Guidance advises that:

"There is not a statutory definition of "insolvent" although the Insolvency Act 1986 when referring to a state of Insolvency uses the phrase "unable to pay its debts". In practice there are two separate tests for insolvency and failure of either might be an indication of insolvency:

- The charity cannot pay its debts as they fall due for payment;
- The value of its liabilities exceeds the value of its assets."

Useful links

If you think you are looking at potential insolvency there is advice on The Charities Commission Website:

[Managing financial difficulties and insolvency in charities \(CC12\) - Charity Commission](#)

Companies House Website: [Liquidation and Insolvency - GPO8](#)

The Insolvency Service Website: [BIS.gov.uk](#)

Again this is a time when an organisation may need professional financial advice firstly through the organisation's own financial advisor or auditor and then perhaps that of an Insolvency Practitioner.



For further information, guidance and support, please visit www.salfordcvs.co.uk or call 0161 787 7795



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