



COMMUNITY ACCOUNTANCY PROJECT - GUIDANCE NOTES

Reserves

The Charity Commission advises all charities to have a reserves policy. This is to help charities secure their viability beyond the immediate future and provide reliable services over the longer term. The Charity Commission have a leaflet CC19 “Charities Reserves” available free – tel. 0870 333 0123

Or it can be downloaded (about 9 pages) from their website:
www.charity-commission.gov.uk

It is quite a comprehensive leaflet, but we will discuss the main points below.

Charities and voluntary groups typically allocate unspent money to three different types of fund in their accounts at the end of the year.

Restricted Funds

This relates to unspent money from restricted grants. The donor has specified what the money must be spent on and the trustees (normally) do not have the power to spend the money on anything else. A grant for child day care could not be spent on health advice.

Unrestricted Funds

This is money that can be spent on anything which furthers the objectives of the charity.

Designated Funds

If part of an unrestricted fund is earmarked for a particular project it may be designated as a separate fund. Funds could be for a project that the charity is saving up for. A Fund for refurbishing a building could be a designated fund. Designation does not legally restrict the trustees – they can change

their minds. But their initial decision should be a genuine one, not a method of hoarding funds.

Normally the reserves are the unrestricted funds that have not been designated for special purposes. When deciding the size of the reserves, the organisation should consider:

- £ How secure is the present funding
- £ What risks and opportunities might arise which could not be met out of income? Consider – staff sickness, maternity leave, staff leaving and recruitment costs, the security of your property lease etc.
- £ How long would it take to find alternative sources of funding
- £ If the charity had to close, how long would it take to transfer clients to other organisations, and wind up in an orderly manner causing least hardship to users

When considering the costs of winding up, you should consider:

- £ Redundancy costs
- £ Legal and accountancy costs
- £ The time to expire of leases on property and office equipment

Justifying reserves

The SORP 2005 requires trustees to include a statement in their annual report about the level of reserves held and the reasons for this. To justify their holding of reserves, trustees should have a **reserves policy** based on a **realistic assessment of their reserves needs**.

Reserves Policy

In some (larger) charities the policy will be proposed by senior employees or by a sub-committee of the trustee body, but it should be formally agreed by the trustees acting as a board and recorded in writing. The policy should cover as a minimum:

- £ The reasons why the charity needs reserves
- £ What level (or range) of reserves the trustees believe the charity needs
- £ What steps the charity is going to take to establish or maintain reserves at the agreed level (or range)
- £ Arrangements for monitoring and reviewing the policy.

The amount of time spent preparing the policy, and the detail with which it is set down, should be in proportion to the scale and complexity of the organisation's affairs. A small organisation with a simple, stable pattern of receipts and payments, few if any commitments, and little susceptibility to outside influences should be able to cover the matters above relatively quickly and to record briefly the trustees' conclusions.

Without a reserves policy trustees cannot be confident that their reserves level matches the charity's needs at the time. The charity could be holding reserves that are too high or too low for its needs. If a charity's reserves are too high, it is retaining income funds without justification. Those funds ought to be expended for charitable purposes. While the funds remain in the trustees' hands the charity's current users or beneficiaries - actual or potential - are not being as well-served as they could be.

If a charity's income is volatile or insecure, it has high commitments, and its state of affairs is highly susceptible to factors outside its own control, it may find that its reserves are too low to protect it from the risk of insolvency or serious disruption to its charitable work.

Some charities will be able to justify holding a certain level of reserves but will be unable to build up reserves to that level, or perhaps to any level at all. Many recently established charities, in particular, will be in that position. While it is accepted that some charities will simply not have had the

resources to establish any reserves, it is still expected that a charity in that position to have given thought to a reserves policy even if it currently has no reserves.

Realistic assessment of reserves needs

A charity's reserves policy should be based on:

- £ Its forecasts for levels of income in future years, taking into account the reliability of each source of income and the prospects for opening up new sources
- £ Its forecasts for expenditure in future years on the basis of planned activity
- £ its analysis of any future needs, opportunities, contingencies or risks the effects of which are not likely to be able to be met out of income if and when they arise
- £ Its assessment, on the best evidence reasonably available, of the likelihood of each of those needs etc arising and the potential consequences for the charity of not being able to meet them.

Explaining reserves

Any charity could find its reserves subject to scrutiny and comment in the public arena. Charities which are likely to attract the most attention, especially if they hold sizeable sums as reserves, are those:

- £ which operate in areas where there is clear evidence of immediate human need; or
- £ which rely on a strong emotive appeal involving vulnerable groups or animals; or
- £ which are running public appeals emphasising the urgency of their own need for donated funds.

There is a risk that charities in that position could be seen as self-indulgent, because they are retaining funds which could be used with immediate effect to alleviate acute need. Compliance with the requirements in SORP 2005 and providing a clear and positive explanation of the reasons why reserves are held will greatly reduce this risk.

Once a charity has taken the trouble to explain its reasons, it is likely that the great majority of its donors, supporters and users/beneficiaries will be quite prepared to accept that it should hold appropriate reserves

Charities applying to statutory or voluntary funders are also likely to have their reserve levels closely assessed.

Commentators, funders, charities and the Charity Commission all have a part to play in promoting a better-informed treatment of the subject of reserves. The following paragraphs are concerned with charities' reporting of their reserves. Set out below is what is required by SORP 2005 and how trustees should set about complying with those requirements.

Reporting of reserves

A charity's purpose in reporting on its reserves is to disclose the level of them and to explain convincingly why it needs to retain them at that level.

The SORP 2005 requires trustees to include in their annual report information about their charity's reserves policy and the level of reserves held. In particular, trustees should:

- £ Describe their charity's reserves policy
- £ Explain why they hold or do not hold reserves and, if they do, in respect of what future needs, opportunities, contingencies or risks; and
- £ Give the level of reserves at the last day of the financial year to which the report relates.

SORP 2005 states that "a departure [from the recommendations of SORP 2005] is not justified simply for the purpose of presenting to the reader a more appealing picture of the financial position or results of the charity."

Fund-raising

Every charity is responsible for ensuring that its appeals do not misrepresent the charity's financial position. This is the case whether the appeals are for voluntary public donations, corporate donations, legacies, grants, or any other form of income, and whether they are made by advertising, direct mail, in person, or by any other method.

If a charity is widely believed to have large reserves, appeals for further funds may provoke resentment against the charity for apparently seeking funds which it does not need. In wording its appeals, and in dealing with any reaction to the appeals, it should take care not to give anyone the wrong impression about the extent or urgency of its need for funds.

Once the target level of reserves has been set, the policy should outline how those reserves are to be built up. The organisation might set a target of seven years for building up the reserve and budget for a specific surplus e.g. £2,000 a year to achieve it. In seven years this fund would have built up to £14,000.

The policy should allow the organisation to draw on the reserve in emergencies and to take advantage of unexpected opportunities. The trustees would then seek to rebuild the fund.

A written policy helps to explain to funders and the public why reserves are necessary, and makes it easier to secure reserves from funders.

The trustees' annual report should state the level of reserves on the last day of the financial year, and for what future needs, opportunities, contingencies and risks the reserves are being held. If a charity does not hold reserves, a statement is required in the trustees' report explaining why.

Example Reserves Policy

Reserves policy

1. Objects of charity

To provide reading materials to overseas countries

2. Approximated figures from SOFA				
		Unrestricted	Restricted	Total
		£	£	£
	Incoming resources	3 200 000	1 100 000	4 300 000
	Resources expended	3 100 000	1 100 000	4 200 000
	Net incoming resources	100 000	-	100 000
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	Fund balances carried forward to next year	725 000	160 000	885 000
NB	Much of the charity's resources arise from gifts in kind which are distributed.			
	*This figure includes tangible fixed assets.			

3. Stated reserves policy

The Anywhere Community Association believes that the charity should hold financial reserves (the "Emergency Operating Reserve" - EOR) because

- i. it has no endowment funding and is entirely dependent for income upon donor funding from year to year which is inevitably subject to fluctuation and
- ii. it requires protection against, and the ability to continue operating despite, catastrophic or lesser but damaging events

The trustees believe that the minimum level of the EOR should be the equivalent of six months' operating costs calculated and reviewed annually and believe that the EOR should be built up to the desired level in stages consistent with the charity's overall financial position and its need to maintain and develop its charitable activities.

After the transfer of £25,000 at the end of 1999 the level of EOR stands at £165,000 With essential operating costs currently amounting to approximately £60,000 per month this falls short of the above-mentioned target. Efforts to build it up will continue in line with the policy.

This information sheet is based on material produced by Cash online and the Charity Commission.