



8.0 Managing Money

Reserves

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This information sheet should be read in conjunction with the information sheet entitled "Ensuring you have a good reserves policy"

Introduction

Firstly what are reserves?

Reserves are that part of a charity's unrestricted funds that are freely available to spend on any of the charity's purposes.

Therefore, to initially calculate what reserves you already have available you need to exclude restricted funds and endowment funds, as well as tangible fixed assets held for operational purposes and any amount deemed to be designated by the trustees.



Image: Small stacks of coins

Once you have considered all these factors you will arrive at the unrestricted reserves figure. How you determine whether this amount is the amount that you need, however, is a more complex question.

Holding Reserves

Can You Legally Hold Reserves?

Charities do have a legal duty to spend income within a reasonable time of receipt. In contrast, trustees need to hold income in reserves.

Occasionally a charity's governing document will explicitly allow trustees to hold income in reserves, but more often the trustees will rely on an implied power to hold reserves.

This power won't be found in the governing documents but will be implicit as part of their role as trustee, allowing them to make decisions and take actions that allow the charity to function properly on a sound financial basis.

This means that trustees have to assess and conclude whether the charity does, in fact, need reserves and whether holding such reserves are in the charity's best interests.

Why Would You Hold Reserves?

There are numerous reasons why a charity may need to hold reserves:

- To protect core services and expenditure (e.g. rent and salaries) should there be an unforeseen and/or severe drop in income .
- Unexpected expenditure may arise that hasn't been budgeted for, creating a need for funds that hadn't been anticipated.
- Expenses can fluctuate for reasons out of the charity's control e.g. long term sickness cover, legislation changes to pensions.
- Income streams can fluctuate or timescales can be extended e.g. grant reductions or legacy issues.
- The charity may need to invest in assets such as IT servers or even new premises, the recovery of cost only being seen in later years.
- There may be a need to match-fund new projects from reserves.
- Funds may be paid in arrears and therefore the charity requires reserves for cash flow funding.

Trustees need to think through the reasons why such events may occur and rationalise the need within the organisation for a pot of funds as free reserves.

How Should Trustees Calculate Required Reserves?

There is no single method for calculating reserves, and neither is there a right or wrong answer for the level of reserves that are held.

What trustees are required to do is adopt a sensible approach to their calculations, which shows that a robust and thorough process has been undertaken.

Factors to Consider When Calculating Your Required Reserves

There are a number of issues that trustees should first consider:

- It is important to analyse and understand the income streams received by the charity.
 - Are they restricted or unrestricted funds?
 - Are they received in advance or arrears?
 - What factors will cause them to fluctuate? – you must consider both internal and external issues.
- What risks and uncertainties does the charity face in the future? These risks should be found within the charity's risk register and should be linked to the reporting requirements of the **SORP (Statement of Recommended Practice)** which all charities are bound to comply with. These risks and uncertainties allow trustees to consider the likely need for funds.
- What strategic plans does the charity have in place? Will these plans require an amount to be spent to cash flow an initiative?
- What costs does the charity have that are committed and for how long?
- What redundancy costs are inherent within the team and how would these be funded?

All of the above will allow trustees to make informed calculations on the likely need for reserves and the level to be held.

Is There Such a Thing as Too Much?

Can your organisation ever have too much in reserve?

Well yes, if you have calculated how much is needed and you have an excess then that excess should form part of a strategic planned spend or investment for the future.

Having an excess of reserves can impact an organisation's ability to attract grant funding in instances where trusts, foundations and other grant making bodies review reserves when making assessments on applications.

Unreasonably high reserves could imply that the organisation does not need the funding it is applying for.

Or Too Little?

If trustees find that there should be a higher level of reserves at any given time, they can plan activities and policy or procedure changes to build them back up.

This could include reviewing expenditure to identify savings which are then added to the reserves, increasing prices to improve margins or carrying out additional fundraising activities to increase the amount of unrestricted income coming into the organisation.

How Should We Manage Our Reserves?

Not only should a charity have reserves, but it should also have an appropriate reserves policy which is documented and included every year in the Annual Report.

This is a requirement of the **SORP (Statement of Recommended Practice)** which all charities are bound to comply with and will help the charity to monitor their reserves.

A Good Reserves Policy Would Have the Following Characteristics:

1. A clear explanation of why reserves are needed.

This would include some comment on the risks the charity faces and the uncertainties it is subject to. It would be informed by forecast levels of income and expenditure and an analysis of future needs, opportunities, commitments and exposures.

2. A statement as to the level of reserves needed.

Having considered the issues in 'Can you legally hold reserves?' above, the trustees need to decide the level of reserves needed. This might be expressed as an absolute figure (e.g. £100,000), a range of figures (e.g. £80,000 to £120,000) or in some other way (e.g. a sum equivalent to 4 months normal operating expenses).

3. An explanation of current reserve levels including comment as appropriate on designated funds.

This would explain from the figures in the Annual Report how the charity has calculated their reserves and also the reason for setting aside designated funds.

4. An explanation of how the charity plans to move from their actual reserves to their desired reserves.

In an ideal world the actual reserves will be in line with the policy. If that is the case then this should be stated. However, in many cases, the actual reserves will either fall short of or exceed the desired level of reserves. If the reserves fall short, some comment should be made on how the trustees plan to build up reserves, e.g. by retaining planned surpluses for a number of years. If the reserves are higher than the ideal, then the trustees must address this as well through strategic spending. A charity should not be in a position of continually retaining income funds (sitting on cash) that should be paid out in the fulfilment of its objectives.

5. An explanation of the plans to monitor and review the policy.

Trustees should keep their policy and the level of reserves held under review. The monitoring process should not just be a year-end procedure, but something that is monitored as part of normal finance monitoring. Fluctuations of reserves should be discussed to assess whether it is a short-term or longer-term issue. Changes in income streams and risks should also be monitored, with trustees considering the changes these impacts have on reserves.

Bad Reserves Policies

The following approaches are discouraged by the Charity Commission.

- **The 'status quo' approach:** Look at the current level of reserves and create a policy to justify them. This approach is often used if reserves are on the high side.
- **The 'Armageddon' approach:** Assume that the worst will happen and calculate the reserves needed to fund closure of all activities, redundancy for all staff, settlement of lease commitments etc.

Further Resources

Charity Reserves: Building Resilience (CC19)

Charity Commission for England & Wales

Tel: 0845 3000 218

<https://www.gov.uk/government/publications/charities-and-reserves-cc19>

Charities SORP

Charities SORP

<http://charitycorp.org/>

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Cefnogi Trydydd
Sector **Cymru**

Third Sector
Support **Wales**

Third Sector Support Wales is a network of support organisations for the whole of the third sector in Wales.

It consists of the 19 local and regional support bodies across Wales, the County Voluntary Councils (CVCs) and the national support body, Wales Council for Voluntary Action (WCVA).

For further information contact
<https://thirdsectorsupport.wales/contact/>

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