

Reserves Policies

Who is responsible for a 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 upon by the trustees acting as a board and recorded in writing.

What should it cover?

- 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); and
- 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 charity's affairs. A small charity 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 trustee's 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.

What happens if reserves are too high or too low?

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.

What if we are a newly formed charity?

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 we accept that some charities will simply have not had the resources to establish any reserves, we would still expect 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 informed by:

- 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; and
- Its assessment, on the best evidence reasonably available, of the likelihood of each of those needs etc arising and the potential consequences of not being able to meet them.

Trustees who hold reserves without making any attempt to relate their need for reserves to factors such as these will probably have great difficulty explaining in any convincing way why they hold those reserves.

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 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 2000 and are 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, 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. We set out below what is required by SORP 2000 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.

Paragraph 31(e) of SORP 2000 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.

Paragraph 9 of SORP 2000 states that “a departure (from the recommendations of SORP 2000) 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.”

