

CASHFACTS

Downloaded from CASH-ONLINE: www.cash-online.org.uk



Reserves policy

The Charity Commission is advising 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. Small charities typically allocate unspent money to three different types of fund in the 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 designated for a project that the charity is saving up for: such as refurbishing their building. Designation does not legally restrict the trustees, they can change their minds. But their initial decision should be a genuine one, not a method for hoarding funds.

The funds listed above can also be called a reserve. So the designated fund for refurbishing the building might be called a building reserve.

When creating a reserves policy we are particularly interested in creating a "pot of money" that is available to cover gaps in funding - cashflow and meeting costs like redundancy payments to staff if the organisation were to close. These types of items are called contingency liabilities - they are liabilities that occur if specific events like closure happen in the future, for example, your building is closed.

When looking at the level of free reserves that it would be prudent for the organisation to hold, considerations should include:

- How secure is the present funding?
- How long would it take to find alternative sources of 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 and the security of your property lease etc.
- 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?

What costs could be involved in winding up. Consider:

- Redundancy costs
- Legal and accountancy costs

- The time to the expiry of leases on property and office equipment.

Typically a charity might allocate 15% to 25% of forecast annual expenditure to contingency reserves. So a charity with a forecast expenditure of £60,000 a year would aim for a reserve of between £9,000 and £15,000.

All unrestricted funds, including designated funds, come within the definition of free reserves. Money from the restricted fund can only be called free reserves if the funder has given permission for this to happen. This may seem unfair because if a grant funds someone's post then a redundancy liability starts to build up when they have been with the organisation for two years.

But it may be relatively easy to get the funders permission. If a line for contingent liabilities has been included in the budget, submitted to the funder when the grant application was made, you (and your auditor/independent examiner) can assume that the funder has given their permission.

Some funders have a policy that organisations they fund can have reserves up to set limit i.e. 25% of income. This implies that you can transfer money from their restricted grant to the unrestricted reserve. Alternatively you will have to write to them seeking their written permission to apply part of their restricted grant to cover unrestricted expenditure. Most funders will agree, but a few may feel that they are tied by their committee decision and not want to take a small technical item back to committee. Here is an example letter to a funder.

Once the target level of reserves has been set, the policy should outline how those reserves are to be built up. One might set a target of seven years for building up the reserve and budget for a specific surplus i.e. £2,000 a year to create 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.

The trustee's 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 for which the reserves is being held. If a charity does not hold a reserve, a statement is required in the trustee's report explaining why. It also enables trustees to consider why they are holding funds; where actual reserves exceed what are needed trustees will need to show how they intend to use the surplus for the charity's benefit.

Endowment funds - capital sums given to the charity with a restriction that only interest or dividends can be spent - should not be included in the reserve, but any unspent unrestricted interest, rent or dividend should be included. Most charities do not have endowment funds.

Sample letter to funders

The Generous Trust
1 Generous Place
Generous Town
G1 GEN

Dear Ms. Euro

We are currently preparing our draft accounts. The balance of the grant that you have paid us will be held in a restricted reserve and used in accordance with the grant agreement next year.

You may be aware that charities are expected to hold reserves to meet unexpected costs such as maternity cover and redundancy. We have drawn up a reserves policy as required by the charity commission and I enclose a copy.

Whilst employing Janet Parks as welfare rights officer - with the grant you have generously provided - we have incurred a liability to pay her redundancy if we were to close. We would like to transfer £1,000 from your restricted grant to the free reserves. Would you confirm that this is acceptable?

I should emphasis we expect to continue our activities for a very long time and my reason for writing is to meet the requirements of the charity commission and provide evidence required by our auditor [or independent examiner] that we have your permission concerning this matter.

Thank you for your help.

CASH's Reserves Policy can be downloaded CASH-ONLINE: www.cash-online.org.uk/downloads.

CASH-ONLINE

Materials from CASH-ONLINE are copyright © to CASH. Anyone wishing to reproduce them – in whole or in part - is welcome to do so, but should acknowledge the source and send us a copy after publication. (It might help our fundraising!)

Published by: Community Accountancy
Self Help 1 Thorpe Close London W10
5XL

Tel: 020 8969 0747 Fax: 020 8969 5936

services@cash-online.org.uk

www.cash-online.org.uk

Charity Reg No 10356212.