

# Wales Council for Voluntary Action

Supporting charities, volunteers and communities

## 8. Managing money

### 8.9 Reserves



#### What are charity reserves?

The Charity Commission defines reserves as income that becomes available to the charity and is to be expended at the trustees' discretion in furtherance of any of the charity's objectives ('general purpose' income), but which is not yet spent, committed or designated - it is 'free'.

This excludes the following:

- permanent endowment
- expendable endowment
- restricted funds
- designated funds
- income funds that could only be realised by disposing of fixed assets held for charity use

#### Controversy over reserves

Charity reserves have been a controversial issue for some time. The media has criticised many large national charities for apparently accumulating large reserves while at the same time conducting additional fundraising appeals. Furthermore, many funders automatically look at the fund balances shown in annual accounts when deciding whether to approve applications for funding.

It is generally assumed that voluntary organisations should not hold onto charitable funds for a long time since the organisation was granted those

funds to provide services. However, the existence of reserves is a sign of good resource management. Any organisation requires a minimum level of reserves to fund the working capital requirements and contingencies identified at the planning stage.

#### Reserves policy

The Charity Commission takes the view that voluntary organisations should 'explain and justify' the level of reserves they hold. In order to meet this requirement, even the smallest of organisations that aspires to financial security must have a reserves policy.

A policy on charity reserves should cover:

- The reasons why the charity needs reserves.
- The level (or range) of reserves the trustees believe the charity needs.
- What steps the charity is going to take to establish or maintain the reserves at the agreed level (or range).

Even small organisations should have a reserves policy that helps demonstrate:

- transparency and accountability to supporters
- good financial management
- justification of the amount of reserves

## Contents of reserves policy

Many charities already have reserves policies, but 'genuine' policies are rather fewer. There is a temptation to say 'We have got enough reserves to carry us through three month's activities; let's make that our reserves policy', rather than stepping back and making a genuine estimate of needs and then making efforts to achieve those levels.

The issues that a reserves policy needs to address are:

- The reasons why the charity needs reserves.
  - The development of a new function?
  - To underpin long-term commitments?
- What arrangements for monitoring and reviewing their policy will be put in place.
- What levels of reserves the trustees believe the charity needs.
- What steps the charity is going to take to maintain reserves at the agreed level.

## Fixing a reserve level

There is no absolute level of reserves that an organisation must have. If it is a member of any sort of group (such as an umbrella body), it may help to benchmark against other members.

To determine the right size of reserves, trustees need to look at their current and future incoming and outgoing resources and ask:

- How likely is it that our main source of income will change?

- How would we cope if it did?
- How would our beneficiaries be affected?

The Charity Commission research on small charities and reserves discovered that the most popular techniques used to establish an appropriate level of reserve was:

- through a cash flow analysis
- discussion with manager, treasurer or members of the finance committee
- through an examination of past trends

As a minimum the organisation should:

- Forecast its income (this should in any case be done as the most basic part of financial planning).
- Forecast planned activities and their associated costs.
- Consider future needs and opportunities, for example, expansion possibilities.
- Consider various scenarios - asking 'What if?' for example, there was a change in government policy affecting their area of operations.

Once the organisation has an idea about what level of reserves it should have, it can compare these with current actual reserves. Most organisations are likely to be facing a shortfall, but it is possible that a long established charity might have, quite literally, an embarrassment of riches.

The Charity Commission is mostly concerned with 'free reserves' (that is, not permanent endowments or restricted funds). It does not question their existence, but does require a justification for their level. A very large amount of reserves may not be serving the charity's objectives.

## Further information

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