Charity Reserves

CHARITY COMMISSION

The Charity Commission is the independent regulator for charitable activity. This is one of a series of reports that draws upon independent research that we have commissioned, as well as our own internal data, knowledge and experience of working with charities.

The purpose of these reports is to help increase understanding of an issue. They are part of our mission to help charities maximise their impact and comply with their legal obligations, to encourage innovation within the charitable sector and enhance effectiveness.

This report presents our findings from research into the ways in which charities are taking environmental responsibility. It contains ideas that you may wish to consider adopting, taking into account your charity's own particular situation.

Contents

Introduction

For trustees, consideration of the level of reserves their charity needs to hold, and how to acquire them, is an important part of planning and of sound financial management. It is also a key issue for the Charity Commission as the regulator. Reserve levels that are set too high tie up money which could and should be spent on charitable activity. If they are too low, the future of the charity may be put at risk.

In the year ending 31 December 2001, over £26 billion was held in reserves by registered charities.[1] Over £5.5 billion of these reserves were held by charities that did not have a reserves policy, and many of the policies that were in place were insufficient and of poor quality. Whilst the changing economic climate means that the values of reserves quoted by some charities will have fallen since then, the principle of developing a well thought out reserves policy, with a level of reserves that is right for the charity and is clear to its stakeholders still holds good.

Each charity's position is different and it is impossible to set a formula for reserves levels that will suit all charities at all stages of their development. Deciding how much money to hold in reserve, or how to build up reserves, is not an easy task for any organisation. But donors, beneficiaries and the Charity Commission should be able to expect that charities will have a reserves policy, and that it will be robust and fit for purpose providing clear accountability. This report explores these challenges and makes recommendations to enable trustees to address them.

[1] Data extracted from charities' annual returns to the Charity Commission for the year ending 31 December 2001. For details see Table 1, Annex A.

Executive Summary

Income funds that could be spent, but are instead held back from expenditure, known as reserves, play a significant role in balancing the needs of future and current beneficiaries of a charity. Most charities will try to build up a reserve, but amounts and specific practices vary considerably and there is a wide spectrum from charities that have no funds in reserve to those that hold substantial reserves. At a macro level, the £26 billion held collectively in reserves by charities in 2001 was roughly equivalent to their total income in that year. 90% of reserves and income was accounted for by 10% of charities.

There is no specific legal rule dictating the amount or proportion of a charity's income funds that can be held as reserves. Areas of activity, funding sources, future needs, opportunities, economic conditions, contingencies and the risks being faced are factors which determine a charity's reserves level. A risk assessment is an important step in helping a charity to identify the right level of reserves.

Setting a reserves policy and, in particular, identifying free reserves helps inform the way in which a charity manages its cash, liquid assets and debt: its treasury management approach. A comprehensive reserves policy will also assist trustees when planning and explaining their approach to stakeholders. Trustees are legally required to publish their charity's reserves policy in their annual report.

Many charities have thought very carefully about what level of reserves they need to continue to operate effectively, and have in place good quality, clear reserves policies. However, the policies of some charities in our study did not offer sufficient detail about their approach to building up reserves, or for how they managed their reserves in practice. For example, some charities simply copied a power to accumulate funds from the charity's governing document and called it a reserves policy.

Too many charities gave little or no thought to managing their reserves. Nearly 70% of charities with an income over £10,000 did not have a reserves policy when they submitted their annual return for 2001, despite many of these charities having substantial funds held back from expenditure. This position is unacceptable. However, on the positive side, many charities responding to our survey said they were in the process of developing a reserves policy or had put one in place since submitting their 2001 annual return, and the Charity Commission expects to see this process accelerated.

In the majority of cases, charities were committed to bringing their actual reserves level into line with their planned level where variations occurred. Charities whose reserves are below the level required by their policy face a particular challenge in bridging that gap. A number of charities were happy to retain reserves over and above the level set. It is not satisfactory to build reserves indefinitely in this way.

The classification of a charity's resources into funds, and the terms used to describe different funds, varies considerably and this can make it difficult for stakeholders to see the true level of a charity's reserves. A number of trustees inappropriately use accounting conventions such as designated funds to distort the presentation of their reserves level.

Some charities believe that they need to 'hide' their true level of reserves because the reserves might adversely affect the charity's ability to seek donations or grants. However, in our study, most charities found that a comprehensive and transparent reserves policy positively helped them to avoid problems with donors and funders. Only 6% of charities with a reserves policy found it unhelpful.

Nevertheless, some charities met problems because they were perceived to be 'rich', and a key message for potential donors and funders is to look beyond the headline figure of how much a charity has in reserves to examine why the charity is holding these reserves.

This report on charities' reserves has been compiled using evidence from the Charity Commission's records and an examination of our case files. We have also spoken to numerous charities and surveyed both charities that have a policy in place and those that do not. As a separate exercise we have looked at the experiences of small charities. The findings from this research will be published separately. Details of the research methodology can be found in Annex A.

Our case work experience in dealing with reserves related cases shows that charities get into difficulties when trustees and the charity:

- build up reserves without a policy or a clear understanding of what the money is for;
- operate with insufficient reserves and then experience financial difficulties;
- treat reserves as a 'bolt on' task to be dealt with by those who compile the accounts rather than as an essential element of strategic planning;

- have a reserves policy but do not explain this policy to their stakeholders;
- retain money in reserves and treat it as an endowment when the funds originate from an income appeal;
- incorrectly describe the funds that the charity has and thus misrepresent their financial position in their accounts; or
- seek to hide reserves from their stakeholders.

Recommendations arising from the research are summarised below. Further information on each point made can be found in the findings section of this report on pages 6-38.

Since the submission of Annual Returns 2001, the changing economic climate and stock market conditions will have reduced some charity's reserves. The core messages of this report are unchanged however and, in uncertain times, building up and properly managing reserves is even more of a priority for charities.

Recommendations for charities and their trustees

- Regardless of the size or nature of the charity, trustees should have an appropriate reserves policy that clearly explains what level or range of reserves the charity needs to operate effectively.
- Trustees should ensure that:
    - their reserves policy is appropriate for the charity's aims, needs and objectives and the risks it faces;
    - they understand and formally agree the principles behind their charity's reserves policy, setting an appropriate level of reserves based upon factors which impact upon their charity rather than an arbitrary figure or rule;
    - their charity's reserves policy addresses all the issues raised in the Charity Commission's publication *Charities' Reserves* (CC19);
    - their reserves policy, investment policy and governance framework are periodically reviewed to take account of changes to the environment in which the charity operates;
    - realistic plans are in place for maintaining the charity's reserves at the level or within the range set out in the policy, and for managing the impact of any change; and
    - they carefully consider the risks and action that can be taken where the charity's reserves are significantly below the level needed to run the organisation effectively.
- Charities which have a reserves policy **must** disclose it in their annual report.
- Trustees should not:
    - use restricted funds to provide reserves for general funds;
    - attempt to hide or reduce the appearance of reserves in their accounts; or
    - retain resources received to be spent as income in, for example, a designated fund or in reserves for the *sole purpose* of generating future income.
- Trustees should ensure that charities accounting and reporting (SORP) requirements are consistently used when presenting reserves in their annual accounts and should be able to give, on request, an explanation for the classification of their resources and division of funds between reserves and designated funds.
- When making appeals, trustees should ensure that they make the purpose for which they intend to use the resources clear. If they intend to use the funds as reserves, they should state this in the appeal.

Recommendations for grant-making bodies

- Grant makers should:
    - publish their policies on grant giving and their policy towards applicants' reserves;
    - seek to develop grant application assessment procedures that allow charities to explain (where relevant) their reserves policy and reasons for their level of reserves; and
    - take a charity's reserves policy and reserves level into account when determining grant awards.

Recommendations for donors

- To maximise a charity's effectiveness, donors should be encouraged to make general donations. Where donors do have a clear preference over the use of the gift, for example whether it can be treated as income or to create an expendable endowment, they should give clear instructions so that the charity can make the correct fund classifications.

Action for the Charity Commission

- The Charity Commission will:
  - continue to monitor charities' reserves management, taking action to ensure compliance with the accounting and reporting regulations and promoting best practice;
  - revise Operational Guidance *Charity Income Reserves* (OG43) and other relevant documents to include more worked examples of reserves policies, and give greater publicity to this on-line guidance; and
  - conduct further research in 18 months time, when improvements in reserves management and policy disclosure are anticipated.
- The Charity Commission, in conjunction with the SORP Committee and professional bodies will:
  - consider further the status of designated funds and their inclusion or exclusion from the definition of reserves; and
  - work on providing specific guidance on addressing the impact of defined benefit pension schemes on reserves policies.

Findings

Extent of reserves

In the year ending 31 December 2001, over £26 billion was held as reserves by charities in England and Wales. This sum was roughly equivalent to charities' total income for that year. Almost 90% of those funds are held by only 10% of charities.

Reserves levels and policies differ widely. Some charities are happy holding no reserves at all; others feel that they need a number of years' worth of expenditure held as reserves. The table below shows the highest reserves level found in each income group, the average amount held and the number of charities with no reserves.

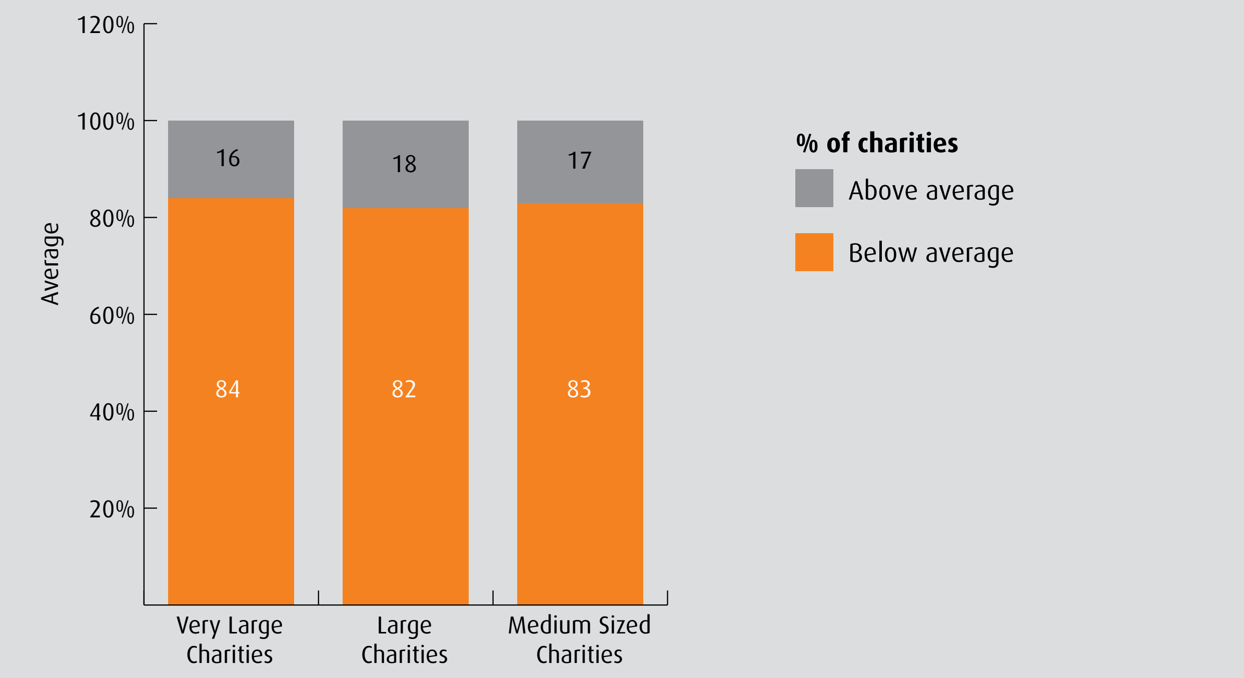
Whilst the highest reserves to expenditure ratio was found in the medium sized charities group, this group also had the largest proportion of charities whose current reserves level would not cover their expenditure for 2001 (ie a ratio of <1:1). Medium sized charities were also the highest proportion (65%) of charities that did not have a reserves policy (see page 14 for details).

In all three income groups roughly 80% of charities have less than the average amount of reserves for their group.

	Very Large Charities	Large Charities	Medium Sized Charities
Sample size - charities who answered 'Please state the total amount of reserves held by the charity' on the 2001 Annual Return	3305	-4985	26772
Total reserves	£18.7 bn	£3.8 bn	£3.9 bn
Total expenditure	£19.4 bn	£2.3 bn	£1.6 bn
Average amount held in reserves for these charities	£5.6 m	£760 k	£146 k
Average expenditure	£5.9 m	£465 k	£61 k
Highest level of reserves (2001 Annual Return)	£537 m	£31 m	£27 m
Number of charities who had no reserves (% of total)	267 (8%)	412 (8%)	4387 (16%)
Average reserves: expenditure ratio	3.3: 1	2.9: 1	8.2: 1
Number of charities who have a ratio of less than 1:1 (ie less reserves than expenditure for 2001)[2]	22%	43%	64%

[2] The ratios are derived from charities' answers given to Q10C (reserves amount) divided by answer given to Q2(ii) (total expenditure) on annual returns 2001. As such these only offer a comparison with one year's expenditure that may include for example restricted expenditure and may not be representative of a charity's usual expenditure.

Amounts held in reserves



The area in which a charity operates or the service it provides does not appear to have any impact upon its ratio of reserves to expenditure. An examination of 30 charities with the highest reserves to expenditure ratio, 30 charities with the lowest and 30 selected at random revealed no significant pattern. No one type of charity or area of operation was prevalent in any of these groups. Nor does the type of charity affect whether or not it has drawn up a reserves policy.

The amount of reserves needed depends heavily on the charity's aims and beneficiaries. A charity serving beneficiaries with an ongoing need may place more importance on the long term viability of their charity. If, on the other hand, beneficiaries do not rely on the charity long term, a much lower level of reserves may be required.

Some charities distribute only the money that has been raised in the year and it may be entirely appropriate for such a charity to have little or no reserves. For others with no reserves, the issue is how to identify and build up reserves.

"We are a dynamic organisation which is able to respond quickly to change so six months would be too much for us."

Charity trustee

Reserve levels should be set after consideration of the risks and opportunities that the charity faces. The factors that should be considered are discussed on page 20.

Our review visit team had concerns about a very large charity because it held no reserves at all.

During the visit the reserves level was explored in depth and the trustees were given an opportunity to explain their policy. The trustees told the visit team that the decision to have no reserves was based on both their moral principles and the fact that they had planned other measures that they could deploy in an emergency, such as selling certain assets.

The trustees believed that the risk of disaster for their charity was slight and therefore contingency plans could be equally as radical.

The review visit team was satisfied that the charity had thought carefully about their approach and taken appropriate decisions.

Charities that choose not to keep reserves must be sure that they fully consider the pitfalls of having low reserves, as described on page 18, and that they manage risks properly.

The Charity Commission does not prescribe a 'correct' level of reserves, although reserve levels are monitored in comparison to expenditure levels using charities' annual returns. Charities with an income over £10 million have their management of reserves scrutinised in more detail, during the normal review of large charity accounts and as part of a risk based regulatory approach.

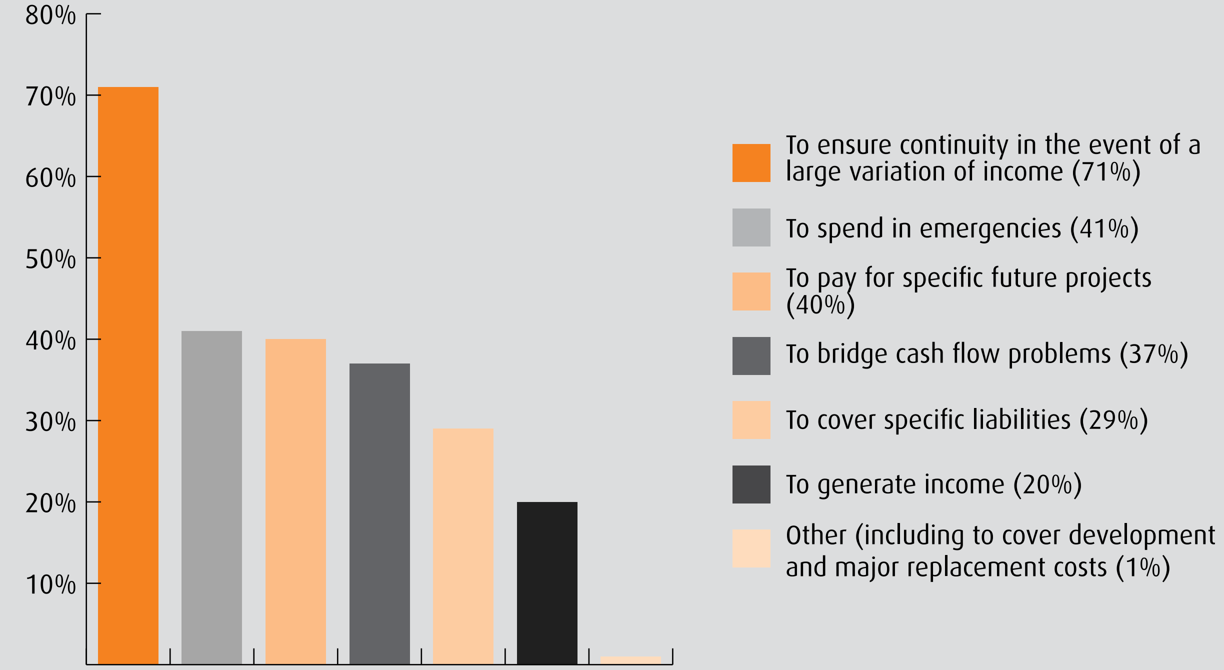
Where high levels of reserves in relation to a charity's expenditure are found, or where reserves issues contribute to a wider pattern of concern, the Charity Commission will draw the trustees' attention to the requirements and provide standard guidance to help the charity meet the requirements.

Charity Commission staff will also ask trustees to explain and justify their position. In most cases the charity's explanation will be satisfactory. However, if a charity's reserves level cannot be explained, that might indicate serious mismanagement and an investigation may be opened.

Monitoring of the annual returns 2001 showed poor performance by charities with high reserves in managing these reserves.

- The Charity Commission will continue to monitor charities' reserves management, taking action to ensure compliance with the accounting and reporting regulations and promoting best practice.

What charities' reserves are for



Note: total adds up to more than 100% as respondents could give more than one answer.

Why charities have reserves

There is nothing wrong with charities holding some funds as reserves. For many charities reserves are vital to support their ability to operate.

Trustees need to be sure of their reasons for keeping reserves and should state those reasons clearly. Without this clarity, trustees are unlikely to satisfy stakeholders that they are using their income in the best way.

The graph above shows the reasons the surveyed charities gave for holding reserves.

Reserves to absorb setbacks....

Of the charities surveyed, the most common reason for having reserves (71%) was to ensure 'continuity in the event of a large variation of income'. Reserves to 'spend in emergencies' also featured highly (41%) indicating that reserves are mainly kept as a 'shock absorber'.

Reserves for regular, short term fluctuations...

Reserves were used to bridge cash flow problems by 37% of survey respondents. Instances include cases where charities use reserves instead of borrowing to bridge the gap where there is a mismatch between the timing of income and expenditure, for example where grant finance for an activity is paid in arrears.

Reserves to help plan for growth...

Reserves were also used by a small number of charities to allow them to plan for growth or to grasp opportunities when they arise. This is often additional to the need for reserves to absorb setbacks. It is common for charities to have reserves for more than one reason.

A large charity has established three layers of reserves to reflect the different risks it must respond to and its motives for holding reserves.

The first level of reserves is held for short-term tactical reasons. The charity keeps two months' worth of expenditure to cover any short term setbacks in funding or cash flow difficulties.

Second are 'opportunistic reserves', set aside to enable the charity to evolve and take advantage of strategic development opportunities.

A third, long term reserves level is intended to reduce risks posed by large external changes in the environment the charity operates in. This could include a large fall in stock market values or a major decline in donors' empathy to the cause. These risks, if realised, would dramatically affect the charity's funding streams.

In parallel, the charity ensures that if reserves are called upon, they can be replenished.

By dividing the reserves into these levels the charity is confident that it has considered all the different risks that the charity may face and has adequate money in reserve to deal with them.

Reserves for specific future projects...

Survey data revealed that a number of charities hold reserves to finance a specific future project (40%). Resources kept back to cover the costs of a future project could be placed in a designated fund, removing them from the reserves definition. Trustees should be able to explain the purpose of these resources whether they are held in reserves or a designated fund. Pages 25-27 provide more information relating to designated funds.

Reserves for power...

A few charities reported that one of their motivations to build up reserves was to be able to exert influence or power over other charities within their area of activity or sub-sector.

"Those with reserves have the power in the area, a charity that has no reserves is now ignored in group decisions."

Charity finance director

Whatever a charity's motives for retaining funds in reserves, the basic principles for the application of funds must be complied with. These are discussed in more detail in the section 'Classification of funds'.

Reserves for generating income[3] ...

Some 20% of charities reported that one of their reasons for having reserves was to generate income.

It is not always clear whether these charities merely receive income as an additional by-product of investing reserves or whether their sole reason for having reserves is to generate income.

In the first case, making income from reserves is entirely appropriate, and retained income should normally be invested in some way. Where the income is potentially within a charge to tax, there will be no charity relief unless it is so invested.

However, trustees who hold income in reserves solely to generate future income are not complying with their duty to expend income on the charity's purposes within a reasonable period of receipt. In effect, they are converting income into capital, when they are not entitled to do so without an express power.

Charities often rely on the investment return from reserves, particularly where, for example:

- it is not possible to generate income from elsewhere;

[3] 'Income' is defined in Annex B.

- getting funds from alternative sources is costly;
- trustees want to generate income to fund a charitable activity that lacks popular appeal; or
- generating income from investment is the only way to ensure independence.

"[Reserves] enable us to enjoy a degree of independence from the state sector, and from funders in general, in setting the agenda for the work we carry out."

Charity finance director

However, an alternative or additional income stream can only be created through investment in two ways:

1. Trustees who possess a power to accumulate can add income to an endowment. If this power is exercised properly, this action satisfies the duty of trustees to apply their income.
2. Trustees can create an endowment if money is given for that purpose or by making a specific appeal to their donors or funders.

Charities unsure whether they have the power to accumulate should read their governing document and contact the Charity Commission if they are still unclear. In some circumstances, trustees may ask the Charity Commission to authorise them to accumulate. If it is appropriate to do so, the Commission will authorise this power by making an amendment by Scheme or Order under Section 26 of the 1993 Act.

When trustees exercise their power to accumulate, the income is converted into endowment, thus taking it out of the scope of reserves. As with all powers, it must only be exercised in the interests of the charity and subject to statutory restrictions. Trustees cannot eliminate the need for this power by creating a designated fund (with the purpose of generating future income). (More information can be found in our Operational Guidance *Charity Income Reserves* (OG43)).

Investing funds is not the only way for a charity to gain some independence. The regulatory report *Milestones: managing key events in the life of a charity* (RS5), to be published later this spring, examines the issue of funding and independence. Our publication The Independence of *Charities from the State* (RR7) also explores the issue.

Reserves for...?

"For a number of small charities the existence of a pot of money somewhere is very tempting. Charities panic and go into them [reserves] and have not ring fenced their policies appropriately so are not clear what they are for and not for."

Charity advisor

The ability to justify a reserves level hinges on trustees' understanding why their reserves are needed. Some reserves will always be held for contingencies, although carrying income forward as a buffer against unspecified or unquantified contingencies is an ineffective and unacceptable use of charitable assets.

- Trustees should not retain resources received to be spent as income in, for example, a designated fund or in reserves for the sole purpose of generating future income.

The legal position

Income reserves are defined in the SI 2000/2868 *Charities (Accounts and Reports) Regulations 2000* as:

> "Those assets in the unrestricted fund of a charity which the charity trustees have, or can make, available to apply for all or any of its purposes, once they have provided for the commitments of the charity and its other planned expenditure."

There is no specific legal rule about the amount or proportion of a charity's income funds that it is allowed to hold as reserves.

Charity trustees are under a duty to apply the charity's income within a reasonable time of receiving it.[4] This derives from Section 13(5) of the Charities Act 1993, which clearly implies that charity property must be effectively used, from Section 1(4) and also by analogy with the corresponding duty which applies to the trustees of private trusts.[5] Before trustees can use income funds in a way that does not comply with this duty they need to have a legal power that enables (or requires) them to capitalise the income (ie a power of, or trust for, accumulation).

[4] Annual Report 1992 para 98.

[5] See In re Peel [1936] Ch. 161; In re Gourju's Will Trusts [1943] Ch. 24; In re Allen-Meyrick's Will Trusts [1966] 1 All ER 740.

Retaining income funds in reserves rather than expending them may not comply with the duty to expend charity income funds within a reasonable time of receiving them, since it will often involve the trustees delaying the expenditure of the funds beyond what the law would normally accept as reasonable. Since there is potential for a considerable degree of variation as to what constitutes 'reasonable', trustees should have a well thought out reason for retaining income for any length of time.

A charity may have an express legal power (or duty) in its governing document to accumulate income instead of expending that income within a reasonable period of receipt. The precise effect of such a power or duty is dependent upon its terms. This will, for example, affect whether the accumulated income constitutes permanent or expendable endowment. There is a statutory maximum period for which accumulation may be permitted or directed; in the case of charitable trusts that is normally 21 years.

Where trustees are not exercising a power (or executing a trust) to accumulate, they need to be able to justify the retention of income as reserves on the basis of what is 'reasonable' for the charity's operational needs. Whilst there is no specific legal requirement to have a reserves policy, there is a clear implication that it is necessary in order to justify the holding of any income funds in reserves. Where this is done without justification, the holding of income in reserves may amount to a breach of trust.

Where charity trustees are obliged to prepare annual reports in compliance with Section 45(1) of the Charities Act 1993, they **must** provide a description of the policy they have adopted with regard to the maintenance of reserves, if they have one. (SI 2000/2868 *Charities (Accounts and Reports) Regulations 2000*, regulation 7(4)(k)(i)).

These principles equally apply to all charitable trust property administered by charitable or other companies as trustees. So far as the corporate property of charitable companies is concerned, there is no explicit duty under company law requiring such a company to apply its corporate property within a reasonable period of receiving it.

However, the members of a trading company have a legitimate expectation that the profits of the company will be distributed to them as dividends, insofar as the retention of the profits by the company is not considered necessary for the company's business needs. In the Commission's view the parallel expectation of the stakeholders of a charitable company is that the company's corporate property will be used or applied in furtherance of its objects, and will not simply be retained without a proper justification for doing so. The duty is thus substantially similar to that which applies to trustees in relation to trust income. For more details see our Operational Guidance *Charity Income Reserves* (OG43 B2).

The directors of charitable companies should, in the Commission's view, make the annual report disclosure which is required by regulation 7(4)(k)(i) of the 2000 Regulations on this basis.

Extent of reserves policies

Reserves policies enable charities to justify keeping some money back instead of spending it without delay. The creation of a comprehensive reserves policy contributes significantly to trustees' ability to balance the needs of future and current beneficiaries and to provide stakeholders with assurances that the charity is well managed and, where appropriate, have a strategy for building up reserves.

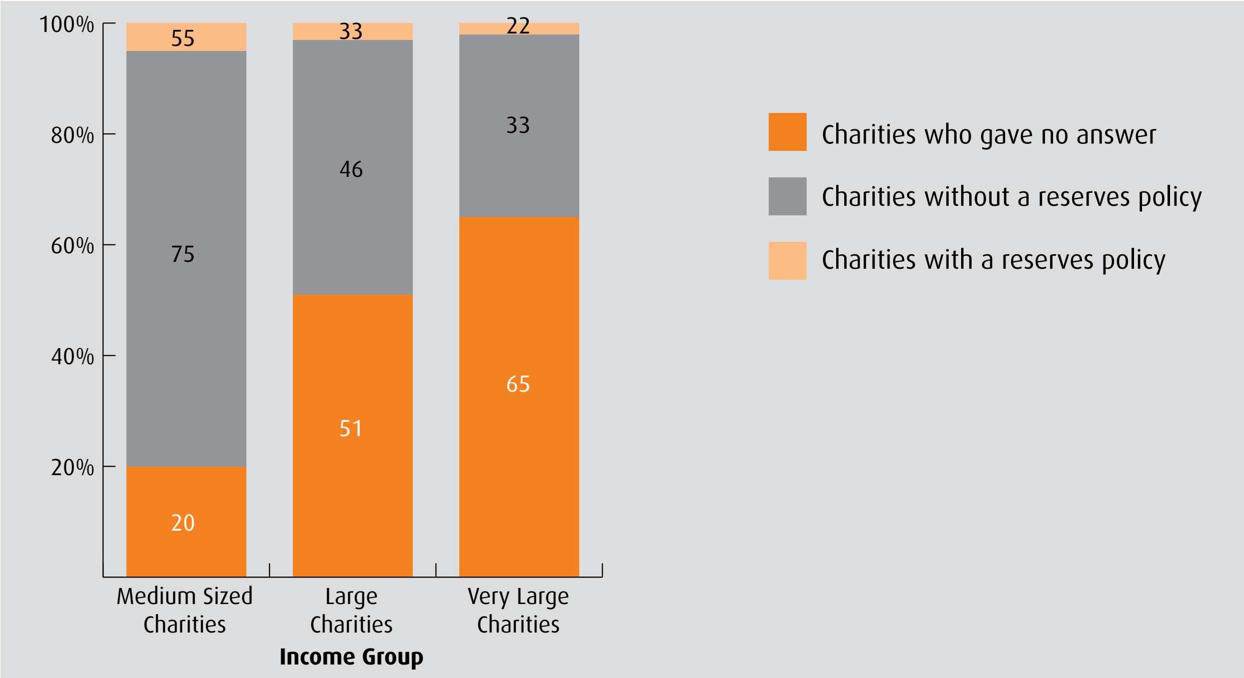
Analysis of the Charity Commission's Annual Return 2001 presents a disappointing picture. Too many charities do not have a policy to explain their level of reserves - 75% of medium sized charities and 46% of large charities said that they did not have a reserves policy. Even very large charities are falling short; 33% did not have a policy (see Annex A, Table 1 for details).

Aside from income band, the characteristics of charities with or without a reserves policy are not dramatically different. (See Annex A, Table 14)

Both groups - those with a reserves policy and those without - have roughly the same number of service providing, grant awarding, or resource providing charities, and there was no variation according to charities' income source or any statistically significant difference in the age of charities within each group.

Almost half (49%) of survey respondents who had a policy had created it in the last two years.

The extent of reserves policies



Reserves policy issues have featured in several Section 8 inquiries carried out by the Charity Commission.[6] Contact centre and charity support staff give advice on the matter and our review visit teams recommend that all charities without a policy develop one as a matter of priority. The development of a reserves policy is also one of the key areas the Commission examines when assessing whether a charity is complying with the accounting and annual report regulations (SORP requirements), or one of the **SORP** golden rules.[7]

- Regardless of the size or nature of the charity, trustees should have an appropriate reserves policy that clearly explains what level or range of reserves the charity needs to operate effectively.
- The Charity Commission will conduct further research in 18 months time, when improvements in reserves management and policy disclosure are expected.

Charities without a reserves policy

Of those charities surveyed that did not have a reserves policy in place in 2001, 20% of respondents said that they are now tackling the issue.[8]

A common assumption is that charities do not have a reserves policy because they do not have funds to keep in reserves. Our findings suggest that this is not entirely true. 'No funds to keep as reserves' was a common explanation for not developing a policy (33%) but 64% of survey respondents without a policy did have some funds that could be described as reserves. Charities with no funds to keep in reserves should still make a statement describing their situation and their intentions (if any) to try to establish a reserve.

Some of the charities without a policy reported having only relatively small amounts in reserves, but 9% have over £1 million. Worryingly, over £5.5 billion was held in reserves by charities that do not have a reserves policy.[9]

Other reasons charities gave for not having a reserves policy included 'never considered having one' (29%) and 'did not realise obliged to have one' (20%).

Complexity is clearly not a significant problem as only 7% of respondents said that they had not created a policy because it was too difficult. Likewise, charities with a policy found the process relatively easy; only 9% described the process as quite or very difficult.

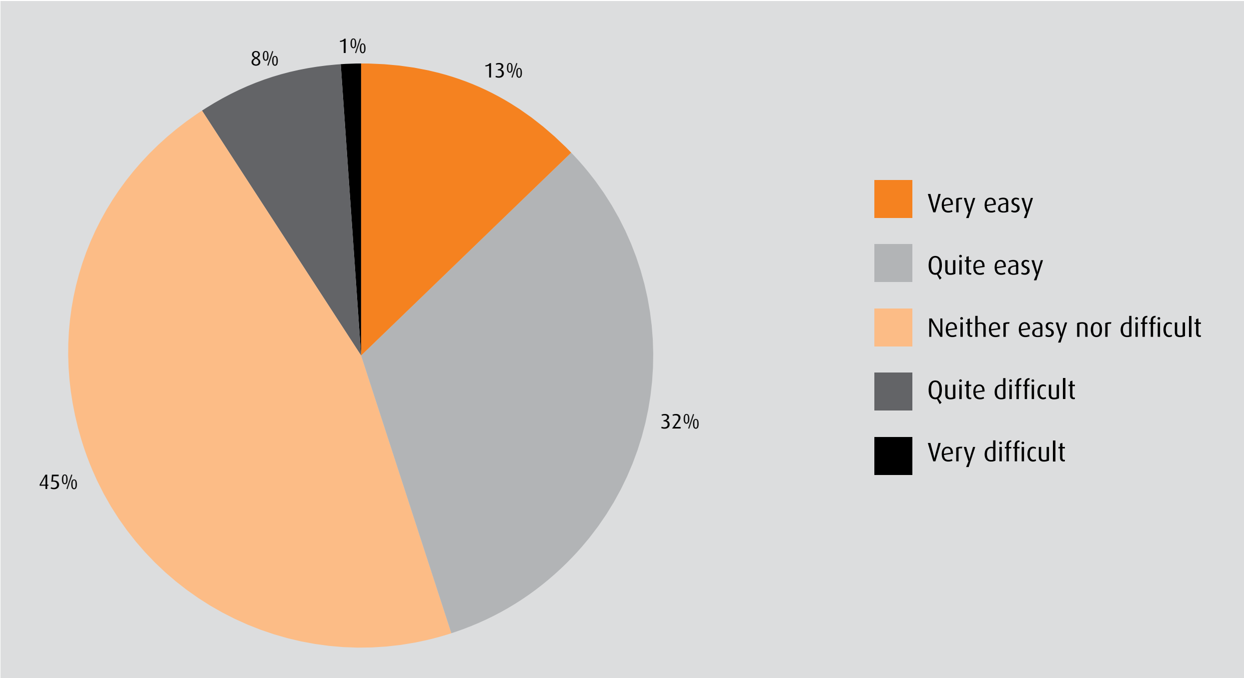
[6] A Section 8 is the power that the Charity Commission has to formally investigate a charity or group of charities where there are concerns regarding misconduct or mismanagement of charity resources and to take action to rectify abuse or poor practice where possible. The results of these inquiries are published on our website.

[7] The **SORP** golden rules is a list of six of the most significant areas Charity Commission staff examine when assessing compliance with **SORP 2000**.

[8] Charities which answered 'no' to Q10C on the 2001 annual return.

[9] As reported in the 2001 Annual Returns, Q10A and Q10C.

Ease with which policy was created



Many charities without a policy are familiar with the concept of having reserves and are already managing the balance between incoming resources and resources expended without calling it 'reserves management'. In these cases, explaining what they already do and developing the concept further should be a simple next step.

Charities that had asked for advice about reserves, but said in the 2001 Annual Return that they did not have a policy, gave a variety of reasons for this. The most frequent comment was that they now had a policy or were in the process of developing such a policy (45%). Other reasons included it being a low priority (6%) and having insufficient funds to need a policy (6%) (see Annex A, Table 20).

Our survey findings confirm the benefits of having a reserves policy. Roughly half (46%) of respondents thought that having a reserves policy had helped their charity, whereas only 6% said that it had not helped.

Determining the Reserves Level

Getting the reserves level 'wrong'

The risks associated with getting the reserves level 'wrong' make it essential that this issue is considered by trustees and that a proper policy is created.

Charities with reserves that are too high...

Where reserves are too high, trustees risk acting in conflict with their duty to apply income within a reasonable time, or failing in their duty to be even-handed to future and current beneficiaries.

The reputation of a charity and charities in general could be damaged if the sector is seen to be 'sitting on' or 'hoarding' large sums of money where there is an obvious, immediate beneficiary need.

"Better spent on worthy beneficiaries than rotting in a bank."

Survey respondent

Grant funded charities may find that a reserves level which is considered 'too high' has a detrimental effect on their ability to obtain funding (see page 21 for more details).

However, many of those making smaller donations will be unaware of a charity's reserves level or, indeed, what reserves are. Nonetheless donors expect their donations to be used to further the purposes of the charity and most would not expect those funds to be retained, unspent, for no good reason.

"Despite some claims to the contrary, the charity has no evidence that 'excessive' reserves have affected levels of support. Throughout the late 90's in particular the charity has seen a steady and sustained growth in most forms of voluntary giving."

Finance director of a charity

A charity experienced public criticism because of its reserves level, which was perceived to be too high.

As a result there was a drop in receipts and enquiries about leaving legacies, their primary income source. Although the charity did have significant long-term commitments to its beneficiaries, it became clear that a new expenditure programme was needed.

The charity undertook a major strategic review and as a result has been spending more than their income for a number of years.

The trustees are aware, however, that this is not sustainable in the long term and are putting measures in place to address the issue and bring income and expenditure into balance.

High reserves levels may not be immediately or visibly detrimental to income but trustees should not risk acting in conflict with the duty to apply income within a reasonable time, or risk media criticism which can damage the perceived integrity of the charity.

Charities with reserves that are too low...

Low reserves can threaten a charity's continued existence. They can also deter potential funders from donating to a charity if its viability is under threat.

"A funder who likes to take risks with innovative ideas may not view a low level of reserves as a problem. Another which was set up to support a certain client group, for example, young people, may want to see a healthy reserve which ensures a certain longevity."

Charity advisor

A risk of insolvency may create insecurity among beneficiaries, supporters and employees. If an unincorporated charity becomes insolvent, the trustees may be personally liable for the costs.

A charity had to change its organisational structure in response to severe financial difficulties.

The charity had previously operated with a negative balance on its unrestricted funds and had never been able to build up reserves. The charity was predominantly funded through project grants and administration costs were raised through public fundraising. In lean times the charity fell back on bank overdrafts and loans.

The charity existed as a 'hand-to-mouth charity' and successfully undertook a lot of good work. However, significant interruptions to more than one of its income streams left it in severe financial difficulties. Unable to continue in its current form, the charity sought a 'rescue merger' to protect its beneficiaries.

Whilst it is impossible to say whether adequate reserves could have allowed the charity to continue in its original form, its lack of reserves allowed no slack in their financial situation, forcing them to seek an immediate resolution.

Reserves would have bought the charity valuable time to readjust its finances and given the trustees more options for the continuation of their work.

Rescue mergers will be discussed in more detail in our forthcoming regulatory report *Collaborative Working and Mergers* (RS4) due March 2003.

In less extreme cases, low reserves can still cause problems. A charity may be forced to cut or abandon aspects of its work as a result of a temporary or small drop in income or an unexpected expense.

A charity with a high level of commitment, or whose income is insecure and susceptible to factors outside its control, should examine ways in which it can build sufficient reserves to protect it from insolvency or serious disruption to its charitable work.[10]

Setting the reserves level

Of the charities surveyed, 49% said that the hardest part of creating a reserves policy was deciding on the right level to have and 23% of charities said that the many 'unknowns' made setting a reserves level difficult.

How did you decide on the level of reserves to keep?

"[There was] considerable argument between the 'hawks' (spend, spend, spend) and the 'doves' (save, save, save). We raised it at numerous committee meetings and finally achieved a compromise."

Survey respondent

Trustees take different approaches to determining the right level (or range) of reserves for their charity. For some setting a 'range' of reserves was the most practical approach, for others combining reserves planning with a risk assessment of the charity's activities helped to quantify an appropriate level of reserves.

Details of further guidance on this issue can be found at Annex C to this report.

[10] The term 'insolvency' and its applicability to unincorporated charities is defined in Annex B.

A survey respondent detailed the process that they went through in deciding on their reserves level:

1. Considered Charity Commission Guidance.
2. Surveyed similar charities and reviewed/benchmarked accounts.
3. Restructured reserves in to line with best practice per **SORP** and Charity Commission.
4. Consulted finance advisory group and selected supporters.
5. Sent draft to trustees.
6. Final amendments followed by approval.
7. Annual review built into planning cycle.

Many of the charities we spoke to found it useful to compare their reserves level against other charities in a similar situation. Such benchmarking is a useful 'reality check' for charities. However, as comparisons cannot take account of each charity's unique position they should supplement, rather than act as a substitute for, developing a reserves policy.

"We try to benchmark against other organisations but it is extremely difficult to find a natural comparison."

Charity finance director

A number of factors should be considered by all charities when setting reserves levels and *Charities' Reserves* (CC19) explains that 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;
- forecasts for expenditure in future years on the basis of planned activity;
- 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
- 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.

While many charities consider these factors, there are still some charities who arbitrarily determine reserve levels. This approach is not sustainable as the resulting policy may not enable the charity to serve its purpose or to operate effectively.

How did you decide on the level of reserves to keep?

"Originally an ad hoc decision, I believe."

Survey respondent

- Trustees should ensure that they set an appropriate level of reserves, based upon factors that impact upon their charity, rather than by using an arbitrary figure or rule.

Reserves and risk management

Reserves planning inevitably involves consideration of risk and should be developed in conjunction with a risk management policy. Trustees of large and very large charities (annual income over £250,000) are required to include in their annual report a statement as to whether they have considered the risks the charity is exposed to and whether they have developed systems to mitigate those risks.[11]

The **SORP** requirement goes further, recommending that all charities include a statement in their annual report confirming that the major risks to the charity have been identified and reviewed and that systems have been established to mitigate those risks.[12]

[11] Regulation 7(3)(b)(ii) of the *Charities (Accounts and Reports) Regulations 2000*.

[12] SORP 2000 paragraph 31g.

Trustees should be realistic when undertaking a risk assessment and balance the likelihood of all possible risks materialising at once against the risks of holding excessive reserves. Our publication *Charities and Risk Management* published on our website discusses the relationship between reserves and risk in more detail.

Grant funding and reserves

Many grant funded charities reported a lack of clarity in what was expected from them by grant awarding institutions. Their experience was that some funders insisted that applicants had reserves as assurance of future financial viability, whilst others considered that a charity with reserves did not require funding.

Our casework experience indicates, and many charities reported, that some grant making bodies operate blanket policies, automatically refusing grants where reserves exceed a certain amount. In these circumstances, charities were often left thinking about how much money their funder considered 'acceptable' rather than whether the level was appropriate to meet the needs of the charity.

"One of our funders insisted that we keep our reserves to an absolute minimum, and made this a requirement of our grant. Our level of reserves was decided on this basis."

Survey respondent

In contrast, many of the grant makers we consulted reported that they assessed each charity on an individual basis, and on the merits of the proposal rather than on the application of an arbitrary rule. Some grant makers had also recently revised their previously prescriptive policies on reserves to allow more flexibility.

"Our members usually assess the reserves of an organisation in relation to its application on a case by case basis. They take into account the nature of the organisation's work, its track record, its age, what it wants to fund, financial sustainability etc. The organisation's reserves are put into that context."

Charity advisor

Grant making bodies can encourage better and more transparent reserves management by publishing how and why the level of reserves that they consider appropriate has been set.

- Grant makers should publish their policies on grant giving and their policy towards applicants' reserves.
- Grant makers should seek to develop grant application assessment procedures that allow charities to explain (where relevant) their reserves policy and justify the level of reserves they have.
- Grant makers should take a charity's reserves policy and reserves level into account when determining grant awards.

Responsibility for reserves policies

Our survey revealed that the most common architect of reserves policies was the 'trustee body as a whole' (39%). We welcome this finding as it suggests a healthy attitude towards the importance of reserves and indicates good governance.

'A member of staff' was responsible for the reserves policy in 25% of charities. Provided there are mechanisms for ensuring that the trustees are involved in setting the guiding principles of the policy, understand the issues involved and take their involvement seriously, this approach can work well with responsibility resting on an individual such as the finance director. Where trustees' delegate working out the details of how a charity should manage its reserves, they must still formally agree the charity's overall reserves policy and record this agreement, for example in the minutes of a trustee meeting.

The charity's auditor was responsible for creating the policy in 8% of charities surveyed. Auditors are an appropriate source of advice for trustees but neither they, nor any other third party, should be solely responsible for writing the reserves policy since it is not their role to justify the reserves level.

- Trustees should ensure that they understand and formally agree the principles behind their charity's reserves policy.

Guidance used

Trustees turned to a number of sources to help them write their reserves policy and decide upon an appropriate reserves level.

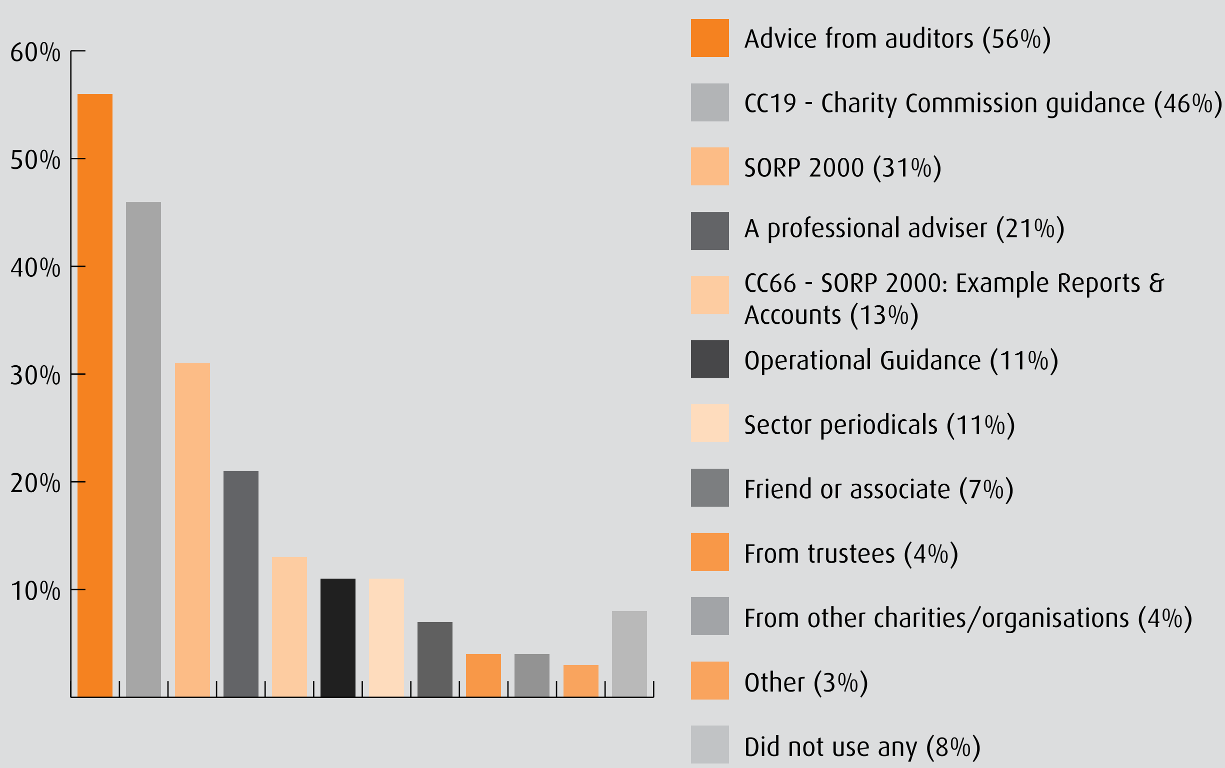
Auditors were the most popular source of information, used by over half of respondents (56%). Charity Commission guidance (*Charities' Reserves* (CC19)) was also popular (used by 46%) as was *SORP 2000* (31%).

Whilst *Charities Reserves* (CC19) was considered by charities to be practical and useful as a starting point, 12% of charities surveyed specifically asked for more guidance from the Charity Commission. Many charities said that they would welcome a case study approach within Charity Commission guidance, illustrating a variety of charity's policies and methods. A significant number of charities also said they would welcome a model reserves policy or proforma wording that they could modify.

Our Operational Guidance *Charity Income Reserves* (OG43) (available on the website) was far less widely used (11% of respondents had referred to it). It does include worked examples with a commentary giving guidance on how Charity Commission staff should assess charities reserves.

- The Charity Commission will revise *Charity Income Reserves* (OG43) and other relevant documents to include more worked examples of reserves policies and give greater publicity to this on line guidance.

Sources of advice/information used



Note: total adds up to more than 100% as respondents could give more than one answer

Getting to the Agreed Level and Maintaining it

Nearly one in three (29%) of charities said that they had less in reserve than they had planned whereas only one in ten charities (with a reserves policy) had more than their planned level. For some, the difference between the planned and actual level or range may be relatively small and inconsequential; for others it may be significant. It is only the correction of 'material' differences that are of concern.

Medium sized organisations were most likely to be on target with their reserves level (67% compared to an average of 58%). Very large organisations were most likely to have less than their planned level (40% compared to an average of 29%). There was no connection found between the type of activity that the charity undertakes and whether they maintain their desired reserves level.

Charities with more than their agreed level

Common reasons given by charities as to why they had more than their planned level in reserves included receiving unexpected income or donations (7%) and expenditure being less than expected (2%).

When asked how trustees planned to remedy the situation, dispersing excess funds to other causes and planning capital projects were common responses. (Annex A, Table 11 provides further details)

A few trustees with reserves over their planned level had no intention of reducing them. They saw the reserves level as a minimum which they would happily increase. This is not acceptable as it potentially ties up assets which should be used for charitable activities, thus treating future and current beneficiaries unfairly.

Reducing reserves by increasing expenditure...

Increasing expenditure is a good way to reduce reserves as it leads to increased benefit for the beneficiaries, but trustees should ensure that if they increase expenditure they have the capacity and organisational structure to cope with the resulting extra activities, and have properly assessed the risks. The forthcoming regulatory report, *Milestones: managing key events in the life of a charity* (RS5), examines this issue in more detail.

A grant making trust took a simple and straightforward approach to reducing reserves.

The trust had more reserves than planned due to a decline in grant applications. Realising that the charity had funds that could be spent, the trustees decided to proactively seek to increase grant applications.

This task was relatively straightforward; details of the trust were circulated to bodies with links to potential beneficiaries, raising awareness of the funds available and increasing the potential for successful grant applications.

If the trustees cannot spend all their incoming resources on the purposes set out in their governing document, they have a duty to contact the Charity Commission to discuss possible options. If the Commission agrees that the trustees would have difficulty in applying all their income on their current objects, it may be possible to widen the charity's objects, for example, by making a Scheme or giving authority under Section 64 of the Charities Act 1993.

Reducing reserves by decreasing income...

Trustees should think carefully before stopping or reducing fundraising to reduce or maintain reserves at a certain level. Once donors or grant making bodies perceive that the need for funds has diminished it may be very difficult to re-establish that income stream. To avoid misunderstanding, trustees should ensure that they are open and transparent about their financial position in all their fundraising.

"Some people seem to be under the illusion that fundraising is a mechanism that can just be turned on or off. This is not the case; once you increase or decrease fundraising effort it takes years for this to translate into actual income increases or decreases."
Charity finance director

Reducing the appearance of reserves...

Our research has revealed a certain amount of 'window dressing' to reduce the reserves levels shown in the accounts. Designated funds are used by several charities without any real intention of using the funds for the designated purpose. Designations can be established then later retracted with relative ease because designation is an administrative task which does not involve any legal definition of the funds.

"Some charities engage in 'churning', meaning that finance directors move money around in designated funds yearly, which renders them useless."
Charity finance director

Keeping larger reserves than the charity needs, then trying to hide the excess in a designated fund, misrepresents the charity's true financial position to donors and stakeholders. Equally, if charities' accounts are not seen as authentic and reliable, the integrity of the charity and the sector as a whole comes into question. The Charity Commission will intervene where these practices are identified.

The designation of income funds does not, by itself, discharge the duty for trustees to be able to justify the retention of those funds. If trustees set up a designated fund they are required to provide reasons for this.[13] Circumstances in which it is appropriate to set up a designated fund are detailed in our Operational Guidance, *Charity Income Reserves* (OG43).

The Charity Commission sees problems when trustees propose to finance out of the designated fund projects which:

- are extremely vague and ill defined;
- are so far in the future as to be unrealistic; or
- will use so much of the charity's future resources that it is debatable whether the trustees are properly balancing their legal responsibilities towards both present and future beneficiaries.

This case highlights the need for charities to clearly state their project proposals.

A large grant making charity had unrestricted funds of several million pounds. The charity had increased its investments year on year with the stated intention of undertaking a major project in the future.

The charity had not provided any comprehensive plans relating to the project. They did not give details about when or where the project was planned or how much it would cost.

Despite incoming resources for a recent financial year totalling over £150,000 the charity spent only a tiny fraction of this (less than £4,000) on direct charitable expenditure.

Cases like this come to light as a result of our monitoring programme and we will work with the trustees to ensure that they review their programme of expenditure.

In this case the trustees have been made aware that they must either spend the funds or provide a satisfactory explanation of why they need to retain them. They now have a copy of our guidance leaflet Charities' Reserves (CC19) and are considering their options.

The Charity Commission is becoming increasingly concerned about the number of charities whose designations are ill defined and we are examining ways to ensure charities properly disclose their planned projects.

[13] *SORP 2000* paragraph 129.

The Charity Commission comes across 'disclosure problems' when trustees fail to tell their stakeholders the full extent of their plans. The Commission expects trustees, on request, to be able to show relevant stakeholders proposals for planned projects. These may include a business plan, estimated costs, planning documents, timetables or any other details showing why it is necessary for that amount to be set aside in a designated fund.

Designated funds are currently excluded from the definition of reserves for practical administrative purposes. There is some debate, however, as to whether they should be included in the reserves definition since they are available to be used should the need arise.

"We should exclude restricted funds and fixed assets but designated funds are woolly and difficult as in some respects they are often part of the contingency because you can use them if you want to."

Charity finance director

Changing the current reserves definition (see Annex B) to include designated funds may reduce the temptation for charities to designate to remove funds from reserves. However, this may simply compound the confusion surrounding the terminology used in accounts. It would, in any case, be unnecessary if trustees fully disclosed their reasons for designations and provided details of the amounts in each fund.

- Trustees should not attempt to hide or reduce the appearance of reserves in their accounts.
- The Charity Commission, in conjunction with the **SORP** Committee will consider further the status of designated funds and their inclusion or exclusion from the definition of reserves.

Charities with less than their agreed level

For many charities the notion of too many reserves is a luxury, and they have difficulty in building up reserves to the level they have set in their reserves policy.

"There is no difficulty in developing a reserves policy but there are difficulties in building up the funds for reserves."

Survey respondent

Reasons given by charities for having less than the planned level of reserves included: experiencing an income drop or fluctuation (14%); a phase of high capital expenditure (9%); wanting to maintain or expand their level of services or activities (8%); and stock market movements which had reduced their investment income and the value of reserves.

The fact that a charity had only been in operation for a short period or had only recently developed a reserves policy also featured as a reason for having less than the planned level of reserves (5%) (see Annex A Table 10 for full details).

"The implementation of our planned policy is a gradual process. We have identified financial targets in the year's budget and work to them."

Survey respondent

Where trustees' current reserves level was lower than adequate, they were prepared to take a range of corrective steps. Over a quarter (28%) of those with less than their planned level said they were aiming to build up or rebuild their reserves in the future. A further 16% reported that they would plan strategically to achieve their financial objectives.

Many charities state both their actual and ideal level of reserves in their annual report, regardless of whether the current level is significantly lower than the target level. A small number of charities felt, however, that this could be seen as showing weakness or as a potentially damaging 'confession'.

"Charities may feel that by including the fact that they would like a reserve but can not get one in their annual report they are baring their soul. I think that this will be a stumbling block for many."

Charity trustee

There is no advantage in falsely stating that reserves are at an ideal level, or omitting a commentary on reserves because reserves are lower than projected. It is entirely legitimate for charities which have been unable to build up reserves to the desired level to fundraise for the specific purpose of adding to reserves, and this approach can often be successful. Trustees who take this course of action should ensure that donors are fully aware of the purpose for which the funds are required.

Charities unable to establish reserves to the desired level should consider ways of reducing the risk of a disrupted income stream, for example by diversifying their funding base or by developing alternative contingency plans.

Some of the charities surveyed had contingency plans that would serve in the place of reserves. These included an overdraft or other financial cushion (32%) or help from members or patrons (23%). However, 26% of charities without a reserves policy had no contingency arrangements. These charities had no means of ensuring that a sudden drop in income would not translate into a contraction of their charitable activities.

"Many charities don't know enough about sustainability. It is the responsibility of both grant makers and charities to change the cycle."

Spokesperson of a charity resource body

Research uncovered a few charities that had become adept at using liquid funds from different parts of the balance sheet as part of managing their reserves. One charity reported using restricted funds as part of its reserves policy. This was possible because the charity had a large number of restricted funds which were unlikely to all be called on at once. This gave some cover, allowing the charity to keep a lower balance of reserves in their unrestricted funds. However, such practice is potentially unlawful. Trustees who use restricted funds to support work outside that restriction may be in breach of trust as they will be unable to use these funds for their intended purpose, if called upon to do so. Any deficit on a fund must be explained in the annual report, together with plans to rectify it.[14]

- Trustees should ensure that realistic plans are in place for maintaining the charity's reserves at the level or within the range set out in the policy and for managing the impact of any change.
- Trustees should carefully consider the risks and action that can be taken where the charity's reserves are significantly below the level needed to run their organisation effectively.
- Trustees should not use restricted funds to provide reserves for general funds.

Reviewing the policy

Charities should periodically re-examine their approach to reserves management to make sure it meets their current needs. As good practice, this review should be carried out at least once a year, alongside a review of the charity's financial and organisational performance. Key events, such as one material source of funding ceasing or changing, may trigger more frequent reviews.

Our research showed that most charities review their policy, although nearly one in four (23%) do so irregularly or not at all. Without this review, charities cannot be confident that they are taking into account any changes in the environment in which they operate.

Investment strategy

Where to invest reserves is a key decision to be taken in the context of the charity's wider financial strategy and should be regularly reviewed. A number of factors should govern where it is appropriate to invest, including:

- the level of risk or volatility of the investment;
- the need for a good income return; and
- the need for liquidity (ease with which the asset can be converted into cash).

[14] SORP 2000 paragraph 31(f).

This case study illustrates how a very large charity selected the most appropriate way to invest its reserves:

The charity developed a 'financial framework', combining all elements of its financial planning and covering both conceptual and practical elements of decision making within the organisation. The charity then developed policies for risk, investment and reserves which all interrelate within this framework.

In making investment decisions, the trustees can refer back to the framework and work through a series of questions, such as:

- Why do we have funds to invest?
- Who should we invest with?
- What should we invest them in?
- When do we need to take the decision?
- How much do we have to invest?
- What information do we require?
- How long do we need to invest for?
- What are the implications of the policy?

One factor may point toward a low risk option while another points toward a higher risk option to generate a better return. The charity's investment decision making involves weighing these factors against each other in the context of the financial framework.

Through this process the trustees can be confident that they have chosen the course most suitable for their present needs.

As with any investment decision, it is essential that trustees discharge their general duty of care, take proper advice and have regard to standard investment criteria set out in Section 4(1) of the Trustee Act 2000.[15]

Full guidance on charities and investment can be found in *Charities and Investment Matters: A guide for trustees* (CC14).published on the Charity Commission's website.

Changes in stock market conditions

An anticipated fall in investment returns as a result of poor stock market conditions, as currently experienced, should trigger a reserves policy review for those charities with significant stock market investments.

Charities that have lost a large proportion of their investment portfolio will need to carefully consider their options to ensure the long-term continuation of their charitable work. Some charities have anticipated the effect of a decline in stock market values, planned their reserves accordingly and can now deploy funds to maintain current levels of service. Others may have decided to reduce their expenditure and others may have identified new activities or sources of income. The mix and best solution will vary for each charity.

Total Return

Under the standard rules of investment the return on the investment is labelled as either income or capital depending on the form in which it is derived (dividends, interest, capital gains). Under the rules of Total Return the investment return is not labelled as either.

[15] The Trustee Act 2000 only applies to property held on trust not the corporate property of charitable companies.

In order to adopt a Total Return policy, trustees will need to apply to the Charity Commission for a power. This will normally be in the form of an Order under Section 26 of the Charities Act 1993.

Total Return works through the allocation of a proportion of the 'total return' (see definitions in Annex B) to the 'trust for application' when the trustees think it necessary, but subject to an overriding duty of fairness towards present and future beneficiaries. Once money is in the trust for application it should be applied within a reasonable time and has the properties of income.

Trustees will not normally need to retain funds for any length of time in the trust for application (income) since they are free to convert unapplied Total Return into income at any time, subject to the above-mentioned duty of fairness. If funds are retained in the trust for application (income) this should be done in accordance with a proper policy on the maintenance of reserves.

Detailed guidance on Total Return can be found in our Operational Guidance, *Endowed charities: A Total Return Approach to Investment* (OG 83).

Retirement benefits

A significant number of charities participate in defined benefit pension schemes. The introduction of a new accounting standard - *FRS 17: Retirement Benefits* - by the Accounting Standards Board has focused attention on how the accounting treatment should influence the reserves policies adopted by charities. On full adoption of the standard, charities participating in such schemes will be required to make an additional disclosure in their balance sheet. They must disclose the recoverable assets or likely liability arising from any actuarial surplus or deficit of the scheme measured in accordance with the principles set out in the standard.

Currently only a few charities have adopted the standard in full and therefore the impact of the new accounting treatment on reserves policies adopted cannot be assessed.

The accounting treatment adopted in statutory accounts will not, of itself, impact on the cash flows of a participating charity. The contributions required of a charity, as employer, will generally be arrived at through negotiations with pension trustees or through statutory requirements, either of which may involve different computations than used for accounting disclosure purposes. FRS 17 has, however, focused attention on the funding of such schemes particularly in the context of significant deficits and how the resulting cash flow impact should be addressed when formulating reserves policies.

- The Charity Commission in consultation with the SORP Committee and professional bodies will work on providing specific guidance on addressing the impact of defined benefit pension schemes on reserves policies. As the issues involved relate to financial management rather than accounting disclosures this guidance will be provided separately from SORP.
- Trustees should ensure that their investment policy and governance framework is periodically reviewed to take account of changes to the environment in which the charity operates.

Explaining the Reserves Position

Charities can only be confident that they have explained their reserves position to stakeholders if they publish an adequate reserves policy. The level of detail of the reserves policy is therefore extremely important and should provide a range of information covering the management of reserves in relation to the overall management of the charity.

To explain their reserves position successfully, trustees need to understand the nature of their funds as a whole and describe them using the correct terminology.

Classification of funds

There is a degree of uncertainty for some charities as to the correct way to classify resources. Charities' resources fall into one of three categories: permanent endowment, expendable endowment or income. Resources must be accounted for in accordance with this analysis.

This case illustrates the problems that can occur if funds are mis-classified in charities' accounts.

A large charity had over £2 million represented as unrestricted income funds on its balance sheet.

The money came from the sale of land a number of years earlier. Due to the nature of the land sold, the money actually constituted permanent endowment. It was, therefore, subject to a trust for investment, and should have been accounted for as such; it should not have been classified as unrestricted income.

The trustees found fundraising difficult and were accused of being 'cash rich' because donors thought that this money could be spent on their beneficiaries.

A review visit gave trustees the opportunity to assess the funds they had. With the help of Charity Commission staff, they established that the money was in fact permanent endowment, leading to the correct classification on the balance sheet.

Correctly classifying the money will have the effect of dispelling the belief held by donors and funders that the charity is cash rich.

To ensure that resources are classified correctly, trustees should follow a number of ground rules. A brief overview of which is included here and full guidance is available in **SORP**.

The correct funds in which resources should be placed is dependent on the way in which the resource was acquired by the charity. Establishing the original source of the funds can be difficult and complicated, and sometimes it has to be a matter of the trustees' best guess. But it is essential that trustees should, so far as they reasonably can, in relation to any particular resource know whether:

- they have to invest it (permanent endowment);
- they may invest it or spend it (expendable endowment); or
- they should spend it within a reasonable period of receipt (income). Whether income is restricted or unrestricted, it still has to be spent for the purposes of the charity, or, in the case of restricted income, for the relevant purposes of the charity, within a reasonable period of receipt.

Where resources have come from the sale of goods or services they should normally be classified as income.

Where the resource is an investment return, its treatment will depend on the nature of the return. Certain rules of trust law normally determine which returns from the investment of endowment are income, and which are to be added to the endowment. These rules can be modified by the founder of the charity when a charity is set up, or by us (as in the implementation of our Total Return policy). Where investment returns arise from the investment of unrestricted income funds, the return is normally unrestricted income.

Where money has arisen from an appeal for income, trustees must act in accordance with the terms under which the funds were raised and classify them as income. (This may be restricted or unrestricted income, depending on the specific terms of the appeal). On the other hand, if an appeal was made for endowment (either permanent or expendable), the funds raised should be classified as endowment.

On receipt of a direct gift to a charity, trustees first need to assess whether the gift was intended as permanent endowment. If there is a specific direction by the donor to invest the gift, and there is no power to convert the gift into income, the position is clear. Otherwise careful analysis may be needed to decide whether the donor did, nonetheless, intend to create a trust for investment. In a hospital context, for example, the expression 'endowing a bed' has been treated as amounting to a direction that the gift should be invested. If trustees are unsure, they should contact the Charity Commission who can help with legal advice.

If the gift is not permanent endowment, trustees need to establish whether it is expendable endowment or income. In order for the trustees to treat the gift as being held on a trust for investment, with a power to convert the endowment into income (expendable endowment), there should be some evidence to suggest that this was the donor's intention. Donors' wishes are paramount in identifying whether the money constitutes expendable endowment or income. Establishing the donor's intention may prove difficult but, difficult or not, it must be done in order to classify resources as expendable endowment. It is not simply a matter of choice for the recipient trustees.

To establish the donor's intention, trustees should use both direct and circumstantial evidence. The Commission's position on this is reflected in our Operational Guidance *Charity Income Reserves* (OG43).

Where trustees are satisfied that the gift was intended as expendable endowment, it is important that they then represent the fund in the endowment column of the charity's accounts (the analysis between permanent and expendable endowment should be made in notes to the accounts).

Where direct gifts to the charity are not permanent endowment, trustees ought to be able to provide clear reasons why they believe the gift to be expendable endowment, if they are treating it as such. Trustees should be able to produce an 'audit trail' of the evidence they used to determine that classification. This should detail their efforts to establish the nature of the gift and the evidence on which the final classification was made.

Where there is no evidence that the resource was intended by the donor as either permanent or expendable endowment, it should be assumed that they intended the gift to be used as income. It must therefore be classified as income in the accounts and applied for the purposes of the charity within a 'reasonable' period of receipt.

- To maximise a charity's effectiveness, donors should be encouraged to make general donations. Where donors do have a clear preference over the use of the gift, for example whether it can be treated as income or to create an expendable endowment, they should give clear instructions so that the charity can make the correct fund classification.
- Trustees should ensure that charities accounting and reporting (SORP) requirements are consistently used when presenting reserves in their annual accounts and should be able to give, on request, an explanation for the classification of their resources and division of funds between reserves and designated funds.

A grant making trust was identified by our monitoring system because their accounts showed reserves in excess of 60 years of direct charitable expenditure.

Charity Commission staff contacted the trustees and it then became clear that the fund was in fact expendable endowment, which had clearly been created by the wishes of the donor and added to through the application of their power to accumulate.

As such, this fund was outside the definition of reserves and was being managed appropriately in accordance with the trust.

The accounts could have been much clearer in identifying the type of funds the charity had, especially as the trustees were already confident that the resources were expendable endowment.

- When making appeals, trustees should ensure that they make the purpose for which they intend to use the sources clear. If they intend to use the funds as reserves, they should state this in the appeal.

Terminology of reserves

Trustees should be clear about the nature of the funds they hold and ensure that they describe these funds in a way which is consistent with **SORP** terminology. In a number of cases, charities are not using the classification for funds that **SORP** describes.

In some cases charities use 'reserves' instead of 'fund' as recommended by **SORP**. Charity balance sheets sometimes refer to 'restricted reserves', 'endowment reserves' and 'designated reserves' rather that describing them as funds. The terms 'free reserves' or 'liquid reserves' are then used to describe 'reserves' as defined in **SORP** and the 2000 Regulations (see Annex B for details).

In the context of **SORP** accounts, the use of the term 'reserves' may on occasions lead to some confusion for stakeholders and their ability to accurately assess a charity's financial position. This can occur even if trustees and staff understand exactly what they mean. **SORP** terminology should be consistently used in statutory accounts, even in the context of incorporated charities where the Companies Act 1985 allows the use of the term 'reserves' to disclose the balance sheet funding of a company.

- Trustees are encouraged to consistently use **SORP** terminology in statutory accounts, even in the context of incorporated charities.

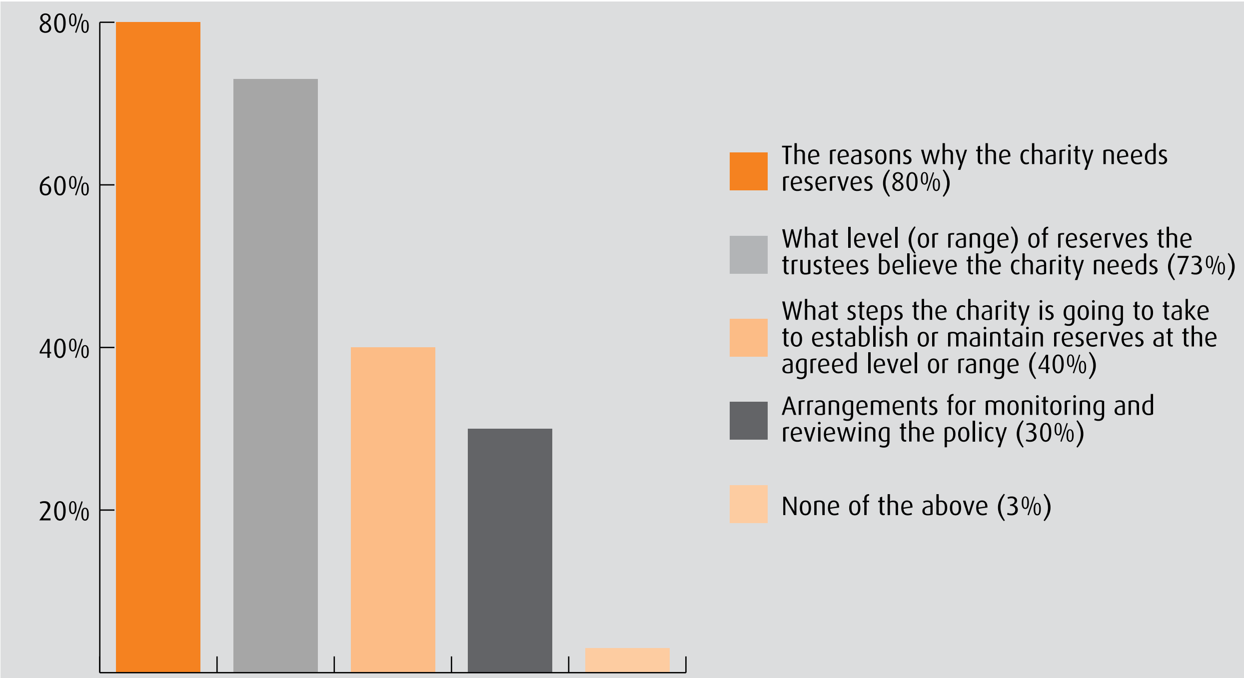
A good reserves policy

Trustees who have gone through the policy-making process properly will be able to justify their reserves level. They should then take positive steps to explain it to parties with a legitimate interest. Some of the policies we examined as part of our review were not comprehensive enough to explain why reserves were being kept. For example, a number of charities' reserves policies stated only that they had the power to accumulate and gave no details whatsoever of their plans or reserves levels.

Charities' Reserves (CC19) sets out four areas that a policy should cover. Despite the fact that this is widely read, we have found that most charities do not cover all four of these points in their written statement. In particular, few charities included a statement about how they established an appropriate level of reserves or how they reviewed their reserves policy.

The areas a policy should cover, and compliance with that, is shown in the following graph:

What areas does your written policy set out?



A reserves figure alone gives only limited information to stakeholders. Placing a figure in perspective, for example expressing reserves as 'month's direct charitable expenditure' gives a feel for proportionality and enables the actual sum to be compared to the size of the charity.

- Trustees should ensure that their charity's reserves policy addresses all the issues raised in the Charity Commission's publication *Charity Reserves* (CC19).

Policy disclosure

Encouragingly, our survey found that 84% of trustees with a reserves policy publish it in their annual report. This is in keeping with positive feedback we have had about charities' understanding of the need to be open, accountable and transparent in all aspects of their work.

The annual report is seen by some as an opportunity to communicate the aims and achievements of the year, not just as a narrow technical report on financial issues. However, there are still some who feel that minimum disclosure is the way forward.

"We publish as little as you have to and tell our clients to do the same."

Charity trustee

Only 12% of charities with a reserves policy do not publicise it anywhere. However, we see no reason why there is not 100% disclosure of reserves policies. Indeed, where charity trustees are obliged to prepare annual reports, they must provide a description of the policies they have adopted.[16] This includes the disclosure of a reserves policy if they have one.[17]

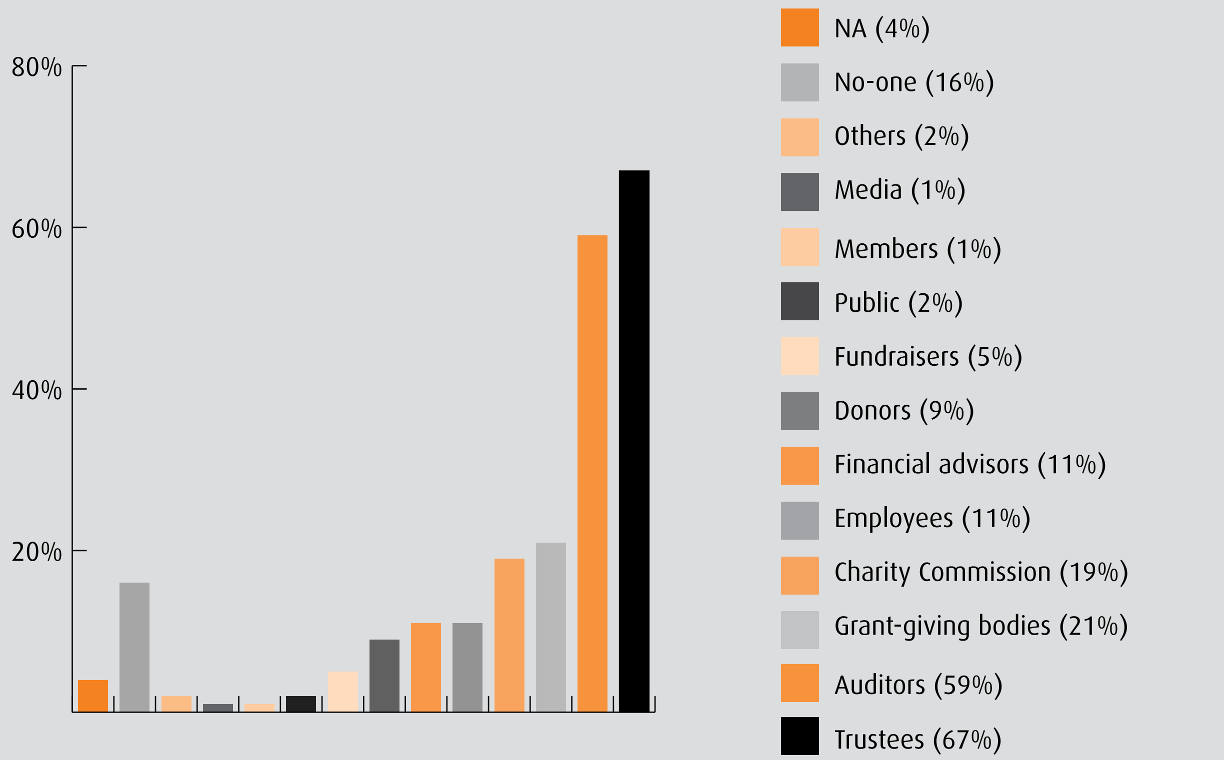
Interest in reserves policies

There are a number of stakeholders who have a potential interest in a charity's reserves policy. Charities told us that trustees were most likely to express an interest (67%), with auditors also featuring highly (59%). Almost all grant funded charities surveyed said that grant-giving bodies had shown interest in their reserves policy. The Charity Commission and charity employees were also cited frequently as showing interest in the policies (see Annex A, Table 23).

[16] Section 45(1) of the Charities Act 1993.

[17] SI 2000/2868 *Charities (Accounts and Reports) Regulations 2000* paragraph 7(4)(k)(i).

Who had expressed an interest in reserves policies



Note: total adds up to more than 100% as respondents could give more than one answer

"I think that it is important to articulate this [reserves policy] as fully as possible as questions about the level of our reserves are becoming so frequent."
Charity finance director

Trustees should recognise that people have a right to question their level of reserves and will do so.

Good practice therefore requires trustees to:

- disclose fully their level of reserves;
- explain (fully and convincingly) why they need that level; and
- ensure that any fundraising in their name does not misrepresent the financial position.

Charities which have a reserves policy must disclose it in their annual report.

Annex A - Research Techniques

The data used in this report was derived from seminars with Charity Commission staff, meetings with individual or groups of charities and examination of the Charity Commission's extensive casework archive.

In addition the data provided by charities on the Annual Return 2001 was closely analysed and an independent research company undertook a survey on behalf of the Charity Commission.

Annual Return Data

Data was derived from charities' answers to the following questions that appeared on the Annual Return 2001:

Q10a Has the charity had in place during the financial year a policy that sets out the level of reserves needed to effectively meet the needs designated by the charity's trusts? (Yes/No)

Q10b If the answer to Q10a is 'Yes', does the charity's annual report contain a description of the policy? (Yes/No)

Q10c Please state the total amount of **reserves** held by the charity.

The charity 'type' classifications used are derived from the answers charities gave on their Register Check Form 2001.

Survey Techniques

In August 2002, the Charity Commission commissioned Martin Hamblin (GfK) to conduct a postal survey of 3,600 charities in England and Wales with an income over £10,000 to investigate the issue of charity reserves. The research achieved a response rate of 56% which is very high for a survey of this type.

The sample was stratified by income according to whether or not charities had a reserves policy.

Charity size classification

Small[18]	Income less than £10,000
Medium	Income £10,000 - £249,999
Large	Income £250,000 - £999,999
Very Large	Income £1,000,000+

[18] Phase two of the research examined these charities' experiences and will be published separately.

Table 1: Number of charities who stated that they had or did not have a reserves policy in their Annual Return 2001.

	Estimated main charities on the register	Number of charities who have completed their Annual Return[19]	Number of charities with a reserves policy[20]	Amount charities with a policy have in reserves[21]	Charities without a reserves policy	Amount charities without a policy have in reserves	Number of charities who did not answer	Amount charities who did not answer have in reserves
£10,000 - £249,999	51717	44371	9026	£1.9 billion	33236	£1.9 billion	2109	£60.5 million
£250,000 - £999,999	6638	6001	3044	£2.7 billion	2788	£1.1 billion	169	£46.5 million
£1m and over	3966	3661	2381	£16 billion	1203	£2.6 billion	77	£74 million
Total	**62321**	**54033**	**14451**	**£20.6 billion**	**37227**	**£5.6 billion**	**2355**	**£181 million**

Table 2: Charity Type and Reserve Ratios

	Charities with highest reserves	%	Charities with lowest reserves	%	Charities in the random sample	%
General charitable purposes	7	24	2	4	5	14
Education/training	10	34	12	21	12	34
Medical/health/sickness	3	10	8	14	0	0
Disability	1	3	6	11	6	17
Relief of poverty	0	0	4	7	1	3
Overseas aid/famine relief	0	0	1	2	2	6
Accommodation/housing	1	3	5	9	1	3
Religious activities	1	3	4	7	5	14
Arts/culture	1	3	4	7	0	0
Sport/recreation	0	0	3	5	1	3
Animals	0	0	0	0	0	0
Environment/conservation/heritage	5	17	4	7	1	3
Economic/community/development/employment	0	0	3	5	1	3
	29	**100**	**56**	**100**	**35**	**100**

[19] As at 10/01/03.
[20] As stated in their AR01, Q10A.
[21] As stated in their AR01, Q10C.

Table 3: Has having a policy helped the charity?

	Size of Income			
	Total %	Medium %	Large %	Very large %
Yes	46	41	44	54
Neither helped nor hindered	45	50	44	39
No	6	5	7	7
Base	**1042**	346	331	365

Table 4: When reserves policies have been created

	Total	
	%	Number
Pre-1980	2	24
1980 - 1989	4	37
1990 - 1999	32	337
2000	21	215
2001	23	242
2002	5	49
NA	13	138
Base	**1042**	

*Table 5: What charity's reserves are for**

	Total	
	%	Number
To ensure continuity in the event of a large variation of income	71	740
To spend in emergencies	41	425
To pay for specific future projects	40	411
To bridge cash flow problems	37	383
To cover specific liabilities, eg pension/contractual commitments	29	297
To generate income	20	206
Other	1	11
Base	**1042**	

* Respondents could give more than one answer so table may add up to more than 100%

Table 6: The main architect of the reserves policy

	Total	
	%	Number
Trustee body as a whole	39	411
Member of staff	25	264
Specific member of trustee body	19	193
Auditors	8	78
Professional advisor	6	61
Committee/group members	3	35
Others	0-1	4
Base	**1042**	

*Table 7: Why people found creating the Reserves Policy difficult**

	Total	
	%	Number
Setting the levels of reserves	49	43
Difficulty in dealing with so many unknowns	23	20
Limited income or lack of guaranteed income	18	16
Explaining the need for reserves	13	11
Need more specific directions/advice from the Commission	12	10
Do not have any reserves	3	3
Other	19	16
Base	**1042**	

* Total number equals more than 87 as respondents may have written more than one reason

Table 8: Sources of advice/information charities use

	Total	
	%	Number
Advice from auditors	56	585
CC19 - Charity Commission guidance	46	483
SORP 2000	31	323
A professional adviser	21	223
SORP examples - CC66	13	140
Operational Guidance from Charity Commission Website	11	113
Sector periodicals	11	110
Friend or associate	7	76
From trustees	4	45
From other charities/organisations	4	45
Other	3	36
None of the given suggestions	8	88
Base	**1042**	

* Respondents could give more than one answer so table may add up to more than 100%

Table 9: Is the current amount that you hold in reserves ...?

	Size of Income			
	Total %	Medium %	Large %	Very large %
Less than the planned level	**29**	17	31	40
Consistent with the planned level	**58**	67	54	52
More than the planned level	**10**	11	12	7
Base	**1042**	346	331	365

Table 10: Why some charities have less or more than the planned level of reserves

	Total	
	%	Number
Income drop/fluctuations	14	58
Phase of high capital expenditure	9	35
Wanted to maintain/expand level of services/activities	8	32
Stock market movements have reduced investment income	8	32
Unexpected income/donations	7	29
Cost of ongoing maintenance/repair/refurbishment	6	25
Building projects/bought/rent new project/relocation	6	23
Staffing issues	5	20
Only been running a short time/couple of years/reserves policy in place for short period	5	18
Difficulty attracting funding/aid/sponsorship	5	18
Expenditure lower than expected	2	6
Base	**403**	

Table 11: The steps that charities are taking to remedy the situation

	Total	
	%	Number
Build up/rebuild reserves in future	28	113
Strategic planning to achieve financial objectives	16	64
Monitor/reduce expenditure	12	50
Continue/increase fund-raising	12	47
Capital projects planned	11	45
Review reserves policy and required level during budget planning	8	31
Attempt to obtain lottery/multi-year research and other grants	3	12
Set aside surpluses, as and when they become available	2	9
Make changes/review investment policy	2	9
Temporary bank overdraft/loans/continue trends of reducing net borrowing	2	8
Charge/increase fees	2	8
Disperse excess funds to other causes	2	8
New work coming on stream/carry out consultancy work/contract work/ commercial activities	2	7
Base	**403**	

Table 12: Does your charity have any of the following 'contingency plans'?

	Total	
	%	Number
Overdraft or other financial cushion	32	309
Help from members or patrons	23	226
Insurance	23	223
Use of other charity's facilities	9	89
Spend reserves	5	45
Only spend income as available/expenditure control	4	43
Local authority funding	2	15
Fund-raising	2	20
Re-negotiation of contracts/salaries	1	8
Closure	1	6
No contingency plans	2	15
Others	3	27
NA/Don't know	24	230
Base	**969**	

* Respondents could give more than one answer so table may add up to more than 100%

*Table 13: When charities review their reserves policy**

	Total	
	%	Number
When producing annual report/at Annual General Meeting	64	671
In conjunction with strategic planning	34	357
Irregularly - as and when necessary	19	198
Others	7	68
Do not review it	4	36
When budget setting	3	28
At trustees meetings	2	24
Don't know/NA	2	26
Base	**1042**	

* Respondents could give more than one answer so table may add up to more than 100%

Table 14: Profiles of respondents

		With Reserves Policy %	Without Reserves Policy %
Income	Medium (£10,000 - £249,000) Large (£250,000 - £999,999) Very large (£1 million +)	33 32 35	35 33 32
Age of charity	0 - 5 years 6 - 20 years 21 - 100 years 101 years +	7 34 45 13	10 40 42 7
Main activity	Providing financial assistance Providing services/support Acting as umbrella/resource body Sponsoring or undertaking research Other/not applicable	18 64 6 3 9	17 69 4 1 9
Source of income	Contract Donors Grants Investments Members Trading subsidiary Other/not applicable	19 15 21 13 9 2 21	18 14 25 8 9 2 24
Provision in Governing Document that refers to reserves?	Yes No Don't know/NA	22 67 9	11 70 19
Base		**1042**	**969**

Table 15: Reserves held by charities without a policy

	Size of Income			
	Total %	Medium %	Large %	Very large %
Yes	**64**	59	68	65
No	**34**	39	30	34
Don't know	**1**	1	2	1
NA	**1**	2	1	1
Base	**969**	334	324	308

Table 16: Amounts that charities without a policy have in reserves

How much money do you have that could be described as 'reserves'?

	Size of Income			
	Total %	**Medium %**	**Large %**	**Very large %**
£1 - £10,000	**21**	48	11	6
£10,001 - £50,000	**26**	32	33	13
£50,001 - £250,000	**29**	14	38	35
£250,001 - £1 million	**14**	5	13	25
More than £1 million	**9**	1	5	21
Base	**969**	334	324	308

Table 17: Why charities had not developed a reserves policy

	Total	
	%	**Number**
No funds to keep in reserves	33	315
Have not considered having one	29	280
Not obliged to have a policy	20	191
Reserve policy agreed/in progress	18	173
Don't know how to create the policy	6	59
No time to consider the issue of reserves	6	53
Informal reserve policy	5	47
All income spent/income balanced with expenditure	4	36
No reserve policy	4	34
Do not want to disclose this information to others	2	22
Reserve policy to be set at year end	2	17
Too difficult	1	11
Others	2	14
Base	**969**	

* Respondents could give more than one answer so table may add up to more than 100%

Table 18: Ease with which policy was created

How easy or difficult did your charity find creating your reserves policy?

Ease/difficulty found in creating reserves policy	Size of Income			
	Total %	Medium %	Large %	Very large %
All those who found it easy	**44**	52	41	40
All those who found it difficult	**8**	5	11	9
Very easy	**13**	20	13	7
Quite easy	**31**	32	29	33
Neither easy nor difficult	**45**	40	44	50
Quite difficult	**8**	5	11	8
Very difficult	**1**	-	-	1
Base	**1042**	346	331	365

Table 19: Advice that charities without policy had sought

Have you consulted any of the following for advice on how to set up a Reserves Policy?

	Total	
	%	Number
Auditor	29	282
CC19 - Charity Commission Guidance	22	216
SORP 2000	17	165
A professional advisor	13	130
SORP examples - CC66	12	114
Operational Guidance from Charity Commission Website	9	91
Friend or associate	4	39
Sector periodicals	2	21
Trustees	-	4
Others	1	12
No, none of the above	48	468
Nothing/NA	7	66
Base	**969**	

Table 20: Reasons for not developing a policy after having sought advice

	Total	
	%	Number
Policy in process of being formulated	24	121
Policy now in place	21	105
Policy low priority/not seen as necessary	6	33
Insufficient funds	6	31
Funds fully utilised/sufficient for our needs	4	21
Do not have reserves	4	21
Lack of time	3	14
No requirement until now	2	10
Funding from elsewhere	1	7
Undergoing major changes	-	2
Others	2	10
NA	33	167
Base	**501 (all who sought advice)**	

Table 21: Areas set out in written policies

What areas does your written policy set out?*

	Total	
	%	Number
Reasons why your charity needs/doesn't need reserves	80	608
The level or range the trustees believe the charity needs	73	553
Arrangements for monitoring and reviewing the policy	40	304
Steps the charity is going to take to establish reserves at agreed level	30	223
None of above	3	20
Base	**761**	

* Respondents could give more than one answer so table may add up to more than 100%

*Table 22: Where charities publish their policies**

	Total	
	%	Number
In the trustees' annual report	84	640
Financial accounts/statements	2	18
Fund-raising literature	2	14
Charity's website	1	11
Trustee minutes	1	9
Newsletter	1	8
Committee minutes/reports	1	8
Business plan/strategy document	1	7
Meetings of members	1	5
Annual report	-	3
Policy and procedures document	-	3
Others	4	27
We do not publicise the policy	12	94
Base	**761**	

* Respondents could give more than one answer so table may add up to more than 100%

*Table 23: Parties that have expressed an interest in charities' reserves policies**

	Total	
	%	Number
Trustees	67	695
Auditors	59	619
Grant-giving bodies	21	215
Charity Commission	19	193
Employees	11	116
Financial advisors	11	119
Donors	9	95
Fund-raisers	5	53
Public	2	16
Members	1	14
Media	1	5
Others	2	18
No-one	16	167
NA	4	37
Base	**1042**	

Annex B - Glossary of Terms

Reserves. The term "reserves" has a variety of technical and ordinary meanings, depending on the context in which it is used. As in SORP 2000, here we use the term 'reserves' (unless otherwise indicated) to describe that part of a charity's income funds that is freely available for its general purposes.

Reserves are therefore the resources the charity has or can make available to spend for any or all of the charity's purposes once it has met its commitments and covered its other planned expenditure.

More specifically SORP 2000 defines reserves as income which becomes available to the charity and is to be spent at the trustees' discretion in furtherance of any of the charity's objects (sometimes referred to as 'general purpose' income); but which is not yet spent, committed or designated (ie is 'free'). This definition of reserves therefore excludes:

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

Income funds are all incoming resources that become available to a charity and that the trustees are legally required to apply in furtherance of its charitable purposes within a reasonable time of receipt (the proper exercise of a power of accumulation is an application).

Unrestricted funds (including designated funds) are expendable at the discretion of the trustees in furtherance of the charity's objects. If part of an unrestricted fund is earmarked for a particular project it may be designated as a separate fund, but the designation has an administrative purpose only, and does not legally restrict the trustees' discretion to apply the fund.

Restricted funds are funds subject to specific trusts, which may be declared by the donor(s) or with their authority (eg in a public appeal) or created through legal process, but still within the wider objects of the charity. Restricted funds may be restricted income funds, which are expendable at the discretion of the trustees in furtherance of some particular aspect(s) of the objects of the charity. Or they may be capital (i.e. endowment) funds, where the assets are required to be invested, or retained for actual use, rather than expended.

Endowment funds. An endowment fund where there is no power to convert the capital into income is known as a **permanent endowment fund**, which must generally be held indefinitely. This concept of 'permanence' does not, however, necessarily mean that the assets held in the endowment fund cannot be exchanged (though in some cases the trusts will require the retention of a specific asset for actual use eg a historic building), nor does it mean that they are incapable of depreciation or loss. What it does mean is that the permanent endowment fund cannot be used as if it were income (ie to make payments or grants to others).

Trustees may have the power to convert endowment funds into expendable income; such funds are known as **expendable endowments**. (Expendable endowment is distinguishable from 'income' by the absence of a positive duty on the part of the trustees to apply it for the purposes of the charity, unless and until this power to convert into 'income' is actually exercised.) If such a power is exercised the relevant funds become restricted or unrestricted income, depending upon whether the trusts permit expenditure for any of the purposes of the charity, or only for specific purposes.

Total Return is the whole of the investment return received by a charity, regardless of when it has arisen and how it has arisen.

Un-applied Total Return is the Total Return less any that has already been applied for the purposes of the charity (income).

Insolvency. Charitable companies are 'legal persons' and so can incur liabilities, and can become 'insolvent'. Such a charity can be deemed insolvent either:

- when it is unable to pay its debts as they fall due; or
- when the value of its assets is less than the amount of its liabilities taking into account its possible and prospective liabilities.

These two tests have a legal basis for **charitable companies**, as they are aspects of the definition of inability to pay debts in s.123 of the Insolvency Act.

Unincorporated charities are not 'legal persons' and cannot technically incur liabilities, which are instead incurred by their trustees, acting on their behalf. Unincorporated charities cannot, therefore, technically become insolvent. However, a charity may reach the financial state where the value of the assets in the trust which are available to the trustees to settle their liabilities are insufficient. In the context of unincorporated charities 'insolvency' is used to describe this situation.

For more information on insolvency please refer to our leaflet; *Managing Financial Difficulties and Insolvency in Charities* (CC12).

Must is used to refer to actions that trustees are obliged to take, most of these are legal requirements.

Should is used to suggest actions which we consider to be good practice and which we expect trustees to follow.

Annex C - Resources for Trustees

There are many resources which charity trustees can tap into to help them with managing Charity Reserves. Whilst this is not a definitive list of all the sources of information available it does offer a useful starting point. The publications listed in Annex D may also be useful.

Organisations

The Charity Commission for England and Wales

Responsibility for charities is split between our four offices. Further information can be obtained from the Commission at:

London
Harmsworth House
13-15 Bouverie Street
London EC4Y 8DP

Liverpool
3rd & 4th Floor
12 Princes Dock
Princes Parade
Liverpool L3 1DE

Newport
8th floor
Clarence House
Clarence Place
Newport
South Wales NP19 7AA

Taunton
Woodfield House
Tangier
Taunton
Somerset TA1 4BL

Tel: 0845 300 0218
Minicom: 0845 300 0219
Email: feedback@charity-commission.gov.uk
Website: www.charitycommission.gov.uk

Association of Chief Executives of Voluntary Organisations (ACEVO)

ACEVO provides good practice resources and information on sector issues.

83 Victoria Street
London SW1H 0HW

Tel: 0845 345 8481
www.acevo.org.uk

Association of Charitable Foundations (ACF)

ACF promotes and supports the work of charitable grant-making trusts and foundations.

Central House
14 Upper Woburn Place
London WC1H 0AE

Tel: 020 7255 4499
www.acf.org.uk

Charities Aid Foundation (CAF)

CAF helps non-profit organisations in the UK and overseas to increase, manage and administer their resources.

Kings Hill
West Malling
Kent ME19 TA

Tel: 01732 520000
Website: www.cafonline.org

Charity Finance Directors' Group (CFDG)

CFDG provides information for its members and others on a range of issues and specialises in helping charities to manage their accounting, taxation, audit and other finance related functions. Benefits of membership include regular members' meetings, monthly mailings and access to information and services.

3rd Floor
Downstream Building
1 London Bridge
London SE1 9BG

Tel: 0845 345 3192
Email: info@cfdg.org.uk
Website: www.cfdg.org.uk

Directory of Social Change (DSC)

The Directory promotes positive social change and provides a wide range of resources for trustees.

London
24 Stephenson Way
London NW1 2DP

Liverpool
Federation House
Hope Street
Liverpool L1 9BW

Tel (books): 020 077 7777
Tel (training and events): London 020 7391 4800 & Liverpool 0151 708 0117
Website: www.dsc.org.uk

Inland Revenue (IR)

For information on tax issues relating to charities.

IR Charities
Room 140
St John's House
Merton Road
Bootle
Merseyside L69 9BB

Tel: 0845 010 9000
Website: www.hmrc.gov.uk

Institute of Fundraising

The Institute of Fundraising aims to promote the highest standards of fund-raising practice.

Park Place
12 Lawn Lane
London SW8 1UD

Tel: 020 7840 1000
Email: enquiries@institute-of-fundraising.org.uk
Website: www.institute-of-fundraising.org.uk

Management Accounting for Non Governmental Organisations (MANGO)

MANGO provides specialist accounting support to humanitarian organisations working in developing countries.

97a St Aldates
Oxford OX1 1BT

Tel: 01865 423818
Email: enquiries@mango.org.uk
Website: www.mango.org.uk

National Association for Councils for Voluntary Service (NACVS)

The NACVS network provides a wide range of information and support for charities.

National Association for Councils for Voluntary Service
3rd Floor Arundel Court
177 Arundel Street
Sheffield S1 2NU

Tel: 0114 278 6636
Email: nacvs@nacvs.org.uk
Website: www.nacvs.org.uk

National Council for Voluntary Organisations (NCVO)

Information available on fund-raising and governance issues and a range of general support services.

National Council for Voluntary Organisations
Regent's Wharf
8 All Saints Street
London N1 9RL

Tel: 020 7713 6161
E-mail: ncvo@ncvo-vol.org.uk
Website: www.ncvo-vol.org.uk, www.askncvo.org.uk

VolResource

This internet only resource for charities offers quick links to useful organisations concerned with the effective running of charities.

Email: info@volresource.org.uk
Website: www.volresource.org.uk

Wales Council for Voluntary Action (WCVA)

WCVA supports charities and the voluntary sector in Wales.

Baltic House
Mount Stuart Square
Cardiff Bay
Cardiff CF10 5FH

Tel: 029 20431700
Email: enquiries@wcva.org.uk
Website: www.wcva.org.uk

Journals, magazines and newspapers

Charity Finance

3 Rectory Grove
London SW4 0DX

Subscriptions - Tel: 020 7819 1204
Email: sshabiolegbe@charityfinance.co.uk
Website: www.charityfinance.co.uk

Charities Management

Mitre House Publishing
The Clifton Centre
110 Clifton Street
London EC2A 4HD

Subscriptions - Tel: 020 7729 6644

Charity Times

Subscriptions - Tel: 020 7426 0636
Website: www.charitytimes.com

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