



Accounts Monitoring Review

Reserves policies: demonstrating and building resilience

Why are we reviewing charities' reserves policies?

Reserves are that part of a charity's unrestricted funds that is freely available to spend on any of the charity's purposes. We are reviewing reserves policies because setting and monitoring a policy is an important part of maintaining a charity's financial resilience. This is because establishing a reserves policy requires an understanding of both the financial risks faced by the charity and of the funds that the trustees can draw on in case of need. However, reviews of reserves reporting by the largest charities have identified a lack of transparency about reserves held and the basis of charities' calculations. For example, see the Civil Society article [largest charities overstating free reserves by almost 20 per cent](#).

All registered charities must explain their policy on reserves in their trustees' annual report, stating the level of reserves held and why they are held. Charities with incomes over £500,000 should expand their review of the charity's reserves, for example by comparing the level of reserves with the charity's policy and explaining what steps are being taken to bring them into line with it, where relevant.

How did we carry out the review?

In January 2018, we selected a random sample of 106 sets of accounts of charities with an income of over £500,000, for period ends in the year ended 31 December 2016. There are just over 11,500 charities of this size on our register and they account for approximately 90% of the sector's income.

We reviewed each trustees' annual report and accounts to assess whether:

- the charity had explained its reserves policy, as required
- the charity's stated level of reserves was correct, based on our guidance

The sample size means that our findings are statistically representative of the accounts filed with us for this period by this group of charities. However, as with all samples, there is a margin of error.

What did we find?

Whether the charities had explained their reserves policies

Nearly all, 97%, of charities in our sample included at least a reference to their reserves policy in their trustees' annual report. However, more than a third of the charities' explanations of their reserves policies did not provide all of the basic information required. The level of reserves held was the most common omission.

Does the trustees' annual report:	% of charities
Explain the charity's policy on reserves?	92%
State the level of reserves held?	67%
State why reserves are held?	90%
Meet all three requirements?	64%

Trustees took a wide range of approaches to their reserves policy disclosures. At one end of the range were cursory statements of one or two sentences that gave little insight into the trustees' thinking. At the other end of the range were lengthy discussions of various funds, which were difficult to grasp. The best reserves policy disclosures gave confidence that the trustees had assessed both the risks that their charity faced and the charity's ability to manage their financial impact.

Whether the charities had calculated their level of reserves accurately

We used the information in each charity's reserves policy and accounts to assess whether their stated level of reserves was accurate. Where the figures differed, we attempted to work out why.

Our guidance [Charity reserves: building resilience \(CC19\)](#) sets out a process for calculating the level of reserves. The starting point is the total of unrestricted funds. From this, the trustees should deduct tangible fixed assets held for charity use, such as land and buildings and programme-related investments. Fixed asset investments should not be deducted. The trustees should also deduct amounts designated for essential future spending. These deductions recognise that disposing of these assets or releasing these funds may impact on the charity's ability to deliver its aims.

Based on our calculation, less than a quarter of the charities in our sample had stated the correct figure in their trustees' annual report. This was in part because a third of the charities in our sample did not include a figure for reserves.

The reserves figure in the trustees' annual report:	% of charities
Was not stated	33%
Did not deduct fixed assets held for charity use and/ or designated funds	30%
Deducted fixed asset investments	3%
Included restricted funds	3%
Was shown as net current assets or cash held	5%
Did not appear to relate to the figures in the accounts	4%
Was calculated in accordance with our guidance	22%
Total	100%

The main underlying reason why the reserves figures were incorrect appears to be that many trustees believe that reserves are the same thing as total unrestricted funds. There were a few instances where an incorrect reserves figure may have been due to a pragmatic decision to leave small items out of the calculation, in particular low value fixed assets held for charity use. Conversely, the trustees of charities that do not hold fixed assets and that have not set aside designated funds will have all of their charity's unrestricted funds available as reserves. They may therefore have stated the correct reserves figure in their trustees' annual report even if they did not fully understand what reserves are.

Charities with an income over £500,000 are required to provide their reserves figure in their annual return. For the charities in our sample that did not state their level of reserves in their trustees' annual reports, we used their annual return figure to gain an insight into their understanding of how to calculate reserves. Only 17% of the figures given in the annual returns were correct, indicating that the trustees of this section of our sample do not fully understand what reserves are.

Trustees that have an incomplete understanding of reserves may assume that their charity has more unrestricted funds available to draw on than is in fact the case, particularly where significant amounts of funds are tied up in buildings. This may therefore lead the trustees to make poor decisions about the charity's finances.

In addition, all the charities in our sample are required to prepare their trustees' annual report and accounts in accordance with the Charities Statement of Recommended Practice (SORP) (FRS 102). This requires trustees to consider whether their charity is a going concern and to identify any uncertainties as to going concern. We would expect the reserves policy and the level of reserves held to form a key part of the trustees' assessment of going concern, alongside a review of cash balances and likely cash flows. It is therefore a significant concern that so few larger charities appear to fully understand what reserves are or disclose them correctly.

What action did we take?

With our guidance

We have updated our guidance on reserves, [Charity reserves: building resilience \(CC19\)](#), to bring it into line with the [Charities SORP \(FRS 102\)](#). We are also considering whether a more wide ranging review of our guidance is needed.

With the Charities SORP

The Charities SORP is periodically updated to take account of changes in financial reporting requirements. The four charity regulators across the UK and Ireland will begin developing a new Charities SORP from 2019.

We will use the findings from this review to inform the Joint Chairs of the SORP-making body. We will recommend that the SORP-making body considers being more directive about how the new Charities SORP defines reserves and the information that charities are required to provide in their trustees' annual reports and accounts.

With individual charities

We will send a copy of this report and our updated guidance to all of the charities that did not provide the required reserves policy disclosures and/or had not calculated their level of reserves in accordance with our current guidance.

Lessons for other charities

Providing a clear explanation of the reasons why reserves are needed, setting out the basis for working out the level of reserves required and stating the level of reserves held is more than just meeting a reporting requirement. The process of developing a reserves policy and then explaining it in the trustees' annual report gives confidence that the trustees have assessed both the risks that their charity faces and the charity's ability to manage their financial impact.

Our guidance, [Charity reserves: building resilience \(CC19\)](#), explains what reserves are and sets out the steps that trustees should follow in developing and explaining a reserves policy.