

**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 Charity Commission 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 the impact of defined benefit pension schemes on reserves policies.

**Reserves held by charities in England and Wales in 2001:**

	Very Large Charities <sup>2</sup>	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)	22%	43%	64%

**About the report**

The 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.

To obtain a copy of the full report **Charity Reserves (RS3)** you can either:

- view and print from the publications section of our website at [www.charitycommission.gov.uk](http://www.charitycommission.gov.uk); or
- call our Contact Centre staff on 0870 333 0123 (between 8.30 am to 6.00 pm on weekdays) or (at other times) our answer phone order line on 01823 345427 for a printed copy.

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.<sup>1</sup> 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.

**Findings**

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 reserves to those that hold substantial amounts. The £26 billion held collectively in reserves by charities in 2001 was roughly equivalent to the collective total income for that year. 90% of these 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 appropriate 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 whose charities have a reserves policy are legally required to publish that 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.

<sup>2</sup> Medium: Income £10,000-£249,999, Large: Income £250,000-£999,999, Very Large: Income £1,000,000+

<sup>1</sup> Data extracted from charities' annual returns to the Charity Commission for the year ending 31 December 2001.

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 told us that 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 into line with their planned level, where variations occurred. Nearly one in three charities reported that their reserves are below the level required by their policy, and these charities face a particular challenge in bridging the gap. A number of charities were happy to retain reserves over and above the level set by their policy, but building reserves indefinitely in this way is not satisfactory.

The classification of a charity's resources into funds, and the terms used to describe these 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 had 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.

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.

### The Commission's case work experience

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 so misrepresent their financial position in their accounts; or
- seek to hide reserves from their stakeholders.

## Recommendations

### 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, and set an appropriate level of reserves which is based upon factors which impact upon the charity rather than an arbitrary figure or rule;
  - their charity's reserves policy addresses 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 classification.