

# XYZ Charity

## Pro-forma Reserves policy



This pro-forma is provided to help charity trustees and executives to establish their own policy for their charity. It is intended to be illustrative only of the matters that would normally be included in such a policy but will not necessarily address all issues nor be in the form that is most suitable for each individual charity. Nevertheless it should help demonstrate the approach to adopt and the level of scrutiny required for most charities. For some charities their circumstances will require other factors to be considered even if the core principles still apply. Useful guidance is available from the Charity Commission in their publication CC19 Charities Reserves and Operational Guidance OG 43.

In this example, XYZ Charity is a service providing organisation which has low requirements for working capital. It has a well developed approach to risk management. It has restricted funds and holds tangible fixed assets and fixed asset investments.

### Definition of Reserves

The Charity Commission has provided a specific definition for “reserves” as “that part of a charity’s unrestricted funds that is freely available to spend on any of the charity’s purposes. This definition excludes restricted income funds and endowment funds, although holding such funds may influence a charity’s reserves policy. Reserves will also normally exclude tangible fixed assets held for the charity’s use and amounts designated for essential future spending.”

This definition is intended to provide the charity with a way of identifying those reserves that are readily available in relatively liquid form if required by the charity. For XYZ charity free reserves which are necessary for operational matters are also provided by external bank borrowings and significant advance payments by service users. The free reserves of XYZ charity for which a policy is needed are represented by unrestricted general funds of the charity and exclude both the restricted funds held and funds that have been designated by the trustees, the latter including a Tangible Fixed Asset Fund representing the net book value of tangible fixed assets held at the balance sheet date. The reserves held by the charity’s subsidiary are not immediately available for application hence are not considered to form part of the charity’s free reserves.

It is recognised that charities are under a general duty to apply charity funds within a reasonable time of their receipt subject to any specified rules in the governing document, although there are no such requirements in XYZ’s memorandum and articles of association. Similarly, whilst the Charity Commission requirements only require consideration of free reserves, it would be inappropriate to not apply restricted funds within a reasonable time period. For XYZ Charity this is not relevant as restricted funds represent major projects funded by third parties and typically funds are expended over the period of the funding agreement or are donations made for specific campaigns hence are utilised during the timeframe of the relevant project.

### Legal Authority to hold reserves

The Charity Commission has identified that all charities have legal authority to hold reserves. Specifically they state: “Trustees of every charity must ensure that the charity’s funds are used appropriately, prudently, lawfully and in accordance with the charity’s purposes for the public benefit. The general principle of trust law is that funds received as income should be spent within a reasonable period of receipt.

The holding of reserves will be authorised either by using an express or implied power to hold reserves. Trustees are justified in exercising their power to hold income reserves, whether express or implied only if, in their considered view, it is necessary in the charity’s best interests.” For XYZ Charity there is no explicit legal authority to hold reserves set out in its Memorandum and Articles of Association, but the implied authority is deemed sufficient. Specifically the charity has no need to formally accumulate reserves.

### Why does XYZ Charity hold free reserves?

The charity is required to consider what level of reserves it is appropriate for the charity to hold in order to demonstrate appropriate financial management, stewardship and sustainability. The trustees wish to do this to provide assurance to all the charity’s stakeholders that the charity is being managed in a prudent manner for the best interests of its beneficiaries. The trustees also want to provide confidence that there is a strong justification for the reserves held by the charity, and that they wish to be open and transparent on all aspects concerning the charity’s reserves policy. In doing this XYZ Charity has considered the following areas.

#### Working Capital

Any organisation needs working capital to allow it to meet its liabilities as they arise – this is a key going concern requirement. Cash or other liquid assets are required to meet normal operating expenditure. For XYZ Charity its cashflow is strong due to the profile of its incoming resources. In particular the receipt of core grant funding at the start of the financial year means that reserves are not required for working capital purposes.

#### Financial risk management

All charities are subject to a wide range of risks, many of which have financial implications. “Rainy day” funds are appropriate to be held as mitigation against the affect of such risks. XYZ Charity has a formalised approach to risk management which identifies major risks that it faces, assesses their severity in terms of impact and likelihood, and identifies mitigating actions

For example, as a service providing charity XYZ Charity is reliant on subscription income as a significant source of unrestricted income. Should service demand drop the charity will require a period of xx months to restructure its operations and to implement any necessary staff redundancy plans.



**The financial risks that are mitigated by the holding of reserves include:**

[Include appropriate matters arising from current future scenario planning. e.g.

- Variability of income – trading activities based on sensitivity analysis of activity levels, project funds including expected termination of funding, membership numbers based on recruitment and retention statistics, investment income projections based on investment portfolio profile
- Variability of expenditure – inherently little expectation of significant variation given that staff costs are a significant proportion of overall expenditure, and other areas of expenditure are relatively “fixed”; core and restricted fund project expenditure is typically accurately budgeted or subject to good budgetary control, also very low likelihood of significant unplanned expenditure that is not addressed by other risk mitigation such as insurance.
- Risk of closure and costs associated in winding up
- Risks noted in risk register – those identified as high or medium/high that have financial significance. For example charity services – may require a scenario of loss of say 10% of service users and equate that to a financial measure requiring reserves to be held.]

**Future development**

As part of their strategic planning all charity Trustees should also consider the need for funds to develop their charity’s activities or to consider new opportunities to assist their beneficiaries. [Include appropriate matters from strategic plan – resources to support development of future activities.]

**Reserve fulfilment**

By their nature free reserves are deemed to be readily available for application, however they are not required to be held in either cash or “near cash” assets. As a result there may be a need to convert underlying assets into cash in order to fulfil a reserve utilisation. Since XYZ Charity holds some of its free reserves in the form of fixed asset investments an impairment allowance of XX% of the market value of such assets is included in the calculation of the free reserve requirements of the charity.

**Explanation of the Policy in the Accounts**

The Charities Statement of Recommended Practice (SORP) 2019 requires disclosure of XYZ Charity’s policy on reserves in the Trustees’ Annual Report – stating

- the amount of the total funds the charity holds at the end of the reporting period;
- the amount of any funds which are restricted and not available for general purposes of the charity at the end of the reporting period;

- any material amounts which have been designated or otherwise committed as at the end of the reporting period;
- the likely timing of the expenditure of any material amounts designated or otherwise committed at the end of the reporting period;
- identify the amount of any fund that can only be realised by disposing of tangible fixed assets or programme related investments;
- state the amount of reserves the charity holds at the end of the reporting period after making allowance for any restricted funds, and the amount of designations, commitments (not provided for as a liability in the accounts) or the carrying amount of functional assets which the charity considers to represent a commitment of the reserves they hold; and
- compare the amount of reserves with the charity’s reserves policy and explain, where relevant, what steps it is taking to bring the amount of reserves it holds into line with the level of reserves identified by the trustees as appropriate given their plans for the future activities of the charity.

A summary of this policy will therefore be included in the TAR as required each year. The wording shall be considered by the Finance and Audit Committee and Board as part of their consideration of the annual financial statements. Where actual reserves held are significantly different to the required policy level an explanation will be included how the charity is seeking to resolve this disparity. The notes to the accounts will identify any designated funds, the purpose of each fund and the expected date of future application of those funds.

**Reserves policy and Going Concern considerations**

The charity’s policy for reserves is linked to and part of its formal consideration of the charity’s going concern presumption. An appropriate level of reserves underlies the forecasts and cashflow projections that are used by the Board to confirm that XYZ Charity is a going concern and is able to meet its liabilities as they arise.

At the year end the reserves policy, actual reserves held and future business planning forecasts are used to confirm the going concern principle applies for at least 12 months from the date that the statutory accounts are approved by the board.

**When does the charity consider its reserves policy?**

Monitoring and oversight of the reserves held by the charity is undertaken throughout the year. This is achieved through monthly management accounts, cashflow monitoring and regular financial forecasts. At least on an annual basis the reserves policy is reviewed formally by the trustees as part of its strategic and business planning process.

**Approved on behalf of the board:** .....

**Date:** xx/xx/xx/

**Next review date:** xx/xx/xx

If you would like to discuss any matter arising from this example policy please contact MHA on info@mha-uk.com or your usual MHA contact.

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