

Reserves

Determining the appropriate reserve level can sometimes feel like walking the tightrope. Too much in reserves and you find that you are unattractive or ineligible for funding. Too little in reserves and you find that you are unattractive to funders because of questions over your financial sustainability. But having the 'perfect' reserves is not a linear solution nor is it a formulaic process which can be replicated from one charity to the next

Understanding context

Setting your reserves policy should not be something that is considered in isolation but should instead take account of factors such as your strategic plan, budgets and risk management considerations. If you are a charity that knows it will have a significant capital expenditure in the future then you may be looking to build your reserves over a number of years to ensure that you can meet these costs. If you are a charity that relies very heavily on a single income stream then your policy may want to factor in a reserve that would allow you to meet legal commitments for a specified period of time to mitigate the risk if the funding stream were to cease. Equally however, an important part of your reserve requirements might be to facilitate growth and new opportunities or to allow you to be agile and adaptable in responding to growing needs in your beneficiary class.

Defining reserves

The Charity Commission guidance identifies reserves as unrestricted funds which are freely available. This would generally mean that restricted and endowment funds are not included but also that fixed assets which are not readily available would also be excluded. Designated funds would usually also be excluded but that might be dependent on their nature – the funds earmarked for that required capital project should be excluded but an 'opportunity or rainy day fund' might be more readily diverted. Reserves does not generally refer just to cash in the deposit account but again, this might be something to factor into your reserves policy as a component of the policy.

Informing decision making

Having a clearly defined reserves policy should provide accountability, give confidence in times of uncertainty and demonstrate sustainability in the charity's objects. It should also evidence the trustees' management and governance skills and their understanding of the charity's strategy and budget.

It should be remembered that the policy is not a one-off exercise or a fixed framework that should hamper or restrict action. Nor should it be an excuse for inaction. Instead, it should facilitate decision making. The policy is informed by the starting position of where reserves actually stand. By understanding the needs of the organisation for its reserves any decision making about future opportunities or challenges can consider what the impact might be on reserves. Would that decision result in a need to draw on existing reserves and if so does that have a detrimental impact on other areas of activity? Is this a short-term impact that will be reversed as the new opportunity starts to generate a contribution to the organisation. Is this an appropriate use of surplus funds? Does fulfilling the charitable purposes/ beneficiary needs related to this decision actually need to override the short-term impact on the reserves policy or does it put the organisation at too greater risk?



Telling your story

Whilst the reserves policy should be an integral part of the internal considerations of the board there is also an external focus as this should be reported in the annual statutory accounts. It is also often the starting point for funders when reviewing a grant application. It is a requirement that the trustee's report refers to the actual reserves held by the charity at the year end but in many ways the most important aspect of the reporting is then to include a clearly expressed explanation of what your aspirations are for your reserves levels and where this differs from the actual position, what the plan of action is to address the difference between the two whether that be distribution/application of excess reserves or generating additional reserves.

There is a perhaps a tendency to focus on situations where the actual reserves are below the policy levels but this explanation is just as important where actual reserves exceed the policy. You do not need to be apologetic about having had a good financial year – we know that the way in which charities are required to record income can mean that the following year will see the spend exceed the income. Instead you should celebrate the successes – especially if it is as a result of careful stewardship of resources and good governance – but go on to explain how this impacts on the reserves in the year and how this will then translate for the future plans and activities.

Did you know?

- There is no legal minimum requirement for reserves
- The principles of charity law require that charitable funds should be spent within a reasonable period of receipt
- OSCR's [Charity Reserves Factsheet](#) is a useful guide for small and medium charities determining a reserves policy
- [Charity Commission guidance on reserves refers to 'building resilience'](#)

How we can help

We recommend that your reserves policy should be reviewed on an at least an annual basis and should align with your strategic plans and risk register. For an objective review of your policy or support in formulating a policy please contact a member of your local MHA firm.

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

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