Reserves

Introduction

Firstly what are reserves? Reserves are that part of a charity's unrestricted funds that are freely available to spend on any of the charity's purposes.

Therefore, to initially calculate what reserves you already have available you need to exclude restricted funds and endowment funds, as well as tangible fixed assets held for operational purposes and any amount deemed to be designated by the trustees.

Once you have considered all these factors you will arrive at the unrestricted reserves figure. How you determine whether this amount is the amount that you need, however, is a more complex question.

Holding reserves

Can you legally hold reserves?

Charities do have a legal duty to spend income within a reasonable time of receipt. In contrast, trustees need to hold income in reserves.

Occasionally a charity's governing document will explicitly allow trustees to hold income in reserves, but more often the trustees will rely on an implied power to hold reserves.

This power won't be found in the governing documents but will be implicit as part of their role as trustee, allowing them to make decisions and take actions that allow the charity to function properly on a sound financial basis.

This means that trustees have to assess and conclude whether the charity does, in fact, need reserves and whether holding such reserves are in the charity's best interests.

Why would you hold reserves?

There are numerous reasons why a charity may need to hold reserves:

- To protect core services and expenditure (e.g. rent and salaries) should there be an unforeseen and/or severe drop in income
- Unexpected expenditure may arise that hasn't been budgeted for, creating a need for funds that hadn't been anticipated
- Expenses can fluctuate for reasons out of the charity's control e.g. long-term sickness cover, legislation changes to pensions
- Income streams can fluctuate or timescales can be extended e.g. grant reductions or legacy issues
- The charity may need to invest in assets such as IT servers or even new premises, the recovery of cost only being seen in later years
- There may be a need to match-fund new projects from reserves
- Funds may be paid in arrears and therefore the charity requires reserves for cash flow funding

Trustees need to think through the reasons why such events may occur and rationalise the need within the organisation for a pot of funds as free reserves.

How should trustees calculate required reserves?

There is no single method for calculating reserves, and neither is there a right or wrong answer for the level of reserves that are held.

What trustees are required to do is adopt a sensible approach to their calculations, which shows that a robust and thorough process has been undertaken.

Factors to consider when calculating your required reserves

There are a number of issues that trustees should first consider:

- It is important to analyse and understand the income streams received by the charity.
  - Are they restricted or unrestricted funds?
  - Are they received in advance or arrears?
  - What factors will cause them to fluctuate? You must consider both internal and external issues.
- What risks and uncertainties does the charity face in the future? These risks should be found within the charity's risk register and should be linked to the reporting requirements of the SORP (Statement of Recommended Practice) which all charities are bound to comply with (if their income in over £250k, if they are a charitable company or they are preparing accruals accounts e.g. where income and expenses are recorded when they are earned or incurred, rather than when money is actually received or paid). These risks and uncertainties allow trustees to consider the likely need for funds.
- What strategic plans does the charity have in place? Will these plans require an amount to be spent to cash flow an initiative?
- What costs does the charity have that are committed and for how long?
- What redundancy costs are inherent within the team and how would these be funded?

All of the above will allow trustees to make informed calculations on the likely need for reserves and the level to be held.

Is there such a thing as too much?

Can your organisation ever have too much in reserve?

Well yes, if you have calculated how much is needed and you have an excess then that excess should form part of a strategic planned spend or investment for the future.

Having an excess of reserves can impact an organisation's ability to attract grant funding in instances where trusts, foundations and other grant making bodies review reserves when making assessments on applications.

Unreasonably high reserves could imply that the organisation does not need the funding it is applying for.

Or too little?

If trustees find that there should be a higher level of reserves at any given time, they can plan activities and policy or procedure changes to build them back up.

This could include reviewing expenditure to identify savings which are then added to the reserves, increasing prices to improve margins or carrying out additional fundraising activities to increase the amount of unrestricted income coming into the organisation.

How should we manage our reserves?

Not only should a charity have reserves, but it should also have an appropriate reserves policy which is documented and included every year in the Annual Report.

This is a requirement of the SORP (Statement of Recommended Practice) which all charities are bound to comply with and will help the charity to monitor their reserves.

A good reserves policy would have the following characteristics:

1. A clear explanation of why reserves are needed.

This would include some comment on the risks the charity faces and the uncertainties it is subject to. It would be informed by forecast levels of income and expenditure and an analysis of future needs, opportunities, commitments and exposures.

2. A statement as to the level of reserves needed.

Having considered the issues in ‘Can you legally hold reserves?’ above, the trustees need to decide the level of reserves needed. This might be expressed as an absolute figure (e.g. £100,000), a range of figures (e.g. £80,000 to £120,000) or in some other way (e.g. a sum equivalent to 4 months normal operating expenses).

3. An explanation of current reserve levels including comment as appropriate on designated funds.

This would explain from the figures in the Annual Report how the charity has calculated their reserves and also the reason for setting aside designated funds.

4. An explanation of how the charity plans to move from their actual reserves to their desired reserves.

In an ideal world the actual reserves will be in line with the policy. If that is the case, then this should be stated. However, in many cases, the actual reserves will either fall short of or exceed the desired level of reserves. If the reserves fall short, some comment should be made on how the trustees plan to build up reserves, e.g. by retaining planned surpluses for a number of years. If the reserves are higher than the ideal, then the trustees must address this as well through strategic spending.

A charity should not be in a position of continually retaining income funds (sitting on cash) that should be paid out in the fulfilment of its objectives.

5. An explanation of the plans to monitor and review the policy.

Trustees should keep their policy and the level of reserves held under review. The monitoring process should not just be a year-end procedure, but something that is monitored as part of normal finance monitoring.

Fluctuations of reserves should be discussed to assess whether it is a short-term or longer-term issue. Changes in income streams and risks should also be monitored, with trustees considering the changes these impacts have on reserves.

Bad reserves policies

The following approaches are discouraged by the Charity Commission.

- The ‘status quo’ approach: Look at the current level of reserves and create a policy to justify them. This approach is often used if reserves are on the high side
- The ‘Armageddon’ approach: Assume that the worst will happen and calculate the reserves needed to fund closure of all activities, redundancy for all staff, settlement of lease commitments etc

Further resources

This information sheet was originally produced by Broomfield and Alexander Limited (now trading as Baldwins). It was updated by WCVA in June 2024.

Tel: 0845 894 8966 or contact them here

Below is an example template risk assessment for a charity,

Instructions for use:

1. Risk description: clearly describe the risk, e.g. 'reduction in grant funding from key sources.'
2. Impact: rate the potential impact of the risk on a scale of 1 (low) to 5 (high)
3. Likelihood: rate the likelihood of the risk occurring on a scale of 1 (low) to 5 (high)
4. Risk score: multiply Impact by Likelihood to calculate the risk score (higher scores indicate more critical risks)
5. Mitigation actions: outline steps to reduce the risk or its impact
6. Responsible person/team: assign accountability for managing the risk
7. Review date: set a date for the next review of the risk

ID	Risk Description	Impact (1-5)	Likelihood (1-5)	Risk Score (Impact x Likelihood)	Mitigation Actions	Responsible Person/Team	Review Date
1	Reduction in grant funding from key sources.	4	3	12	Diversify income streams by applying to multiple funders. Build reserves to cover shortfalls.	Fundraising Team	Quarterly
2	Unexpected increase in operational costs (e.g., utilities, rent).	3	4	12	Review contracts for better rates. Build a contingency fund for such events.	Finance Team	Monthly
3	Delay in receiving pledged donations or grants.	3	2	6	Establish clear agreements with funders. Monitor cash flow regularly.	Finance Manager	Monthly
4	Loss of major donor or corporate sponsor.	5	3	15	Develop a donor retention strategy. Engage with multiple high-value donors.	Development Team	Bi-annually
5	Non-compliance with financial regulations leading to fines.	4	2	8	Regular financial audits. Staff training on compliance requirements.	Compliance Officer	Annually
6	Reduction in unrestricted reserves below safe levels.	5	4	20	Monitor reserves monthly. Set reserve targets and adjust spending accordingly.	Board Treasurer	Monthly
7	Fraud or misuse of funds.	5	1	5	Implement strong financial controls. Conduct regular audits and whistleblowing training.	Finance Team	Annually

8	Economic downturn reducing public donations.	4	3	12	Increase marketing efforts to maintain donor engagement. Focus on digital fundraising.	Fundraising Manager	Quarterly
9	Key financial staff leaving unexpectedly.	3	3	9	Maintain detailed handover notes. Ensure robust documentation of financial procedures.	HR Manager	Annually
10	Failure to meet restricted funding requirements.	4	2	8	Track restricted funds usage closely. Train staff on grant-specific reporting requirements.	Finance and Project Leads	Quarterly