



not for profit | designations and 'free' reserves under SORP 2005

the team



Bernie Watson
Partner
020 7969 5510
bwatson@haysmacintyre.com



Richard Weaver
Partner
020 7969 5567
rweaver@haysmacintyre.com



Murtaza Jessa
Partner
020 7969 5551
mjessa@haysmacintyre.com



Noble Hanlon
Partner
020 7969 5548
nhanlon@haysmacintyre.com



David Sewell
Partner
020 7969 5568
dsewell@haysmacintyre.com



Adam Halsey
Partner
020 7969 5657
ahalsey@haysmacintyre.com



Tracey Young
Partner
020 7969 5654
tyoung@haysmacintyre.com

A subtle but important change of emphasis has occurred between SORP 2000 and SORP 2005 concerning 'free reserves'.

SORP 2000 defined 'free reserves' as income which becomes available to spend at Trustees' discretion but which is not yet spent, committed or designated (earmarked for a defined purpose). This definition excluded:

- permanent endowments;
- expendable endowments;
- restricted funds;
- designated funds; and
- income funds which could only be realised by disposing of fixed assets held for charity use i.e. tangible fixed assets that formed part of the unrestricted fund.

SORP 2000 also considered arguments for designated funds or expendable endowments being 'free' although in practice most charities have defined 'free reserves' as stated above. Charities which through time had managed to accumulate a large unrestricted reserve were obviously keen to designate a high proportion of reserves in order to reduce 'free reserves' to give the impression that they were not perhaps as wealthy as first thought. This was certainly true of charities who were fundraising or required grant or trust funding to supplement their other streams of income.

SORP 2005 defines freely available reserves slightly differently stating that they normally exclude:

- permanent endowment funds;
- expendable endowment funds;
- restricted funds and
- any part of unrestricted funds not readily available for spending, "specifically income funds which could only be realised by disposing of fixed assets held for charity use and performance related investments."

The 'normal' definition does *not* therefore automatically assume that designated funds should be excluded although glossary 51 of SORP 2005 in defining Reserves states that: "Individual charities may have more or less reserves than the simple calculation suggests because:

- (a) expendable endowments may be readily available for spending; or



Kathryn Burton
partner
020 7969 5515
kburton@haysmacintyre.com

(b) unrestricted funds may be designated for essential future spending and reduce the amount readily available."

Point (a) is clear cut: if a charity is reliant on the income generated by the expendable endowment it should probably be excluded from free reserves, although it will under certain circumstances be able to apply the capital of the endowment to cover the costs of the purposes for which it was originally set up.

Point (b) is, however, the key change. The SORP 2005 says that free reserves 'normally' exclude designated funds not that it must exclude them; the inference in the glossary is that they may be excluded. There is also an additional disclosure requirement that the Trustees' report should provide an explanation of how designations have arisen. The SORP states:

"where material funds have been designated, *the reserves policy statement* should quantify and explain the purpose of the designations" (our italic).

The apparent relaxation of the strict 'Free reserves' calculation is a welcome one. It is still of concern that the definition still makes a mockery of the free reserves disclosure for those charities which own their building. Often this leads to negative free reserves figures which are meaningless. Additional guidance for such charities would be useful to ensure a consistent approach.

There is a clear push to force charities and their Trustees to be more publicly accountable and transparent in justifying designations and a more explicit linkage is made in SORP 2005 between designations and free reserves. Charities will now be required to define in much more detail the reasons for the designations and funding bodies will be able to scrutinise their policies and decide for themselves whether such designations appear reasonable in their eyes. The Reserves Policy will need to include a clear and justifiable explanation of all reserves held by the charity, in particular the designations made by the Trustees.

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