



not for profit | charity reserves

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In March 2003, The Charity Commission issued a new regulatory study on reserves (RS3). The Commission states that *'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.'* This demonstrates the importance the Commission places on reserves policies.

The study was compiled from a survey together with evidence from the Commission's records and files; the following sets out a summary of the key points from RS3.

background

Reserves are defined in Charities (Accounts and Reports) Regulations 2000 as

"Those assets in the unrestricted fund of a charity which the charity trustees have, or can make, available to apply for all or any of its purposes, once they have provided for the commitments of the charity and its other planned expenditure."

There is no specific legal rule about the amount or proportion of a charity's income funds that it is allowed to hold as reserves although charity trustees are under a duty to apply the charity's income within a reasonable time of receiving it. Before trustees can use income funds in a way that does not comply with this duty they need to have a legal power that enables/requires them to capitalise the income.

Retaining income funds in reserves rather than expending them may not comply with the duty to expend charity income funds within a reasonable time of receiving them, since it will often involve the trustees delaying the expenditure of the funds beyond what the law would normally accept as reasonable. Since there is potential for a considerable degree of variation as to what constitutes 'reasonable', trustees should have a well thought out reason for retaining income for any length of time.

Whilst there is no specific legal requirement to have a reserves policy, there is a clear implication that it is necessary in order to justify the holding of any income funds in reserves. Where this is done without justification, the holding of income in reserves may amount to a breach of trust. Where trustees are obliged to prepare annual reports in compliance with the Charities Act 1993, they must provide a description of the policy they have adopted with regard to the maintenance of reserves, if they have one.



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In the year ended 31 December 2001

- over £26 billion was held in reserves which was approximately equivalent to total income
- 90% of reserves and income was accounted for by 10% of charities
- over £5.5 billion of these reserves were held by charities without a reserves policy
- many of the reserves policies were inadequate.

Despite reserves levels having fallen since then, due to the changing economic climate, it does not change the need for a reserves policy. In uncertain times properly managing reserves is even more of a priority for charities. Setting a reserves policy and, in particular, identifying free reserves helps the charity with its approach to treasury management.

findings

The main findings were:

- 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. However, many charities stated that they were in the process of developing a reserves policy or had put one in place since submitting their 2001 annual return
- most charities were committed to bringing their actual reserves level into line with their planned level where variations occurred. A number of charities were though content to retain reserves over and above the level set by their policy which is not appropriate
- the classification of a charity's resources into funds, and the terms used to describe these different funds, varied considerably which makes it hard for the users of statutory accounts. Also a number of charities inappropriately use accounting conventions such as designated funds to distort the presentation of their reserves level
- 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 found it unhelpful. However, 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.

The Commission's case work experience 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
- seek to hide reserves from their stakeholders.

recommendations for charities and trustees

The study sets out a variety of recommendations as follows:

- 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, setting an appropriate level of reserves based upon factors which impact upon their charity rather than an arbitrary figure or rule
 - their charity's reserves policy addresses all 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
 - 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
 - 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;
- 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.

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 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
- 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
- work on providing specific guidance on addressing the impact of defined benefit pension schemes on reserves policies.

about haysmacintyre

haysmacintyre, Chartered Accountants and business advisers, works with over 550 charities and not-for-profit organisations in the UK and overseas. Our services include the full range of audit, tax, VAT and comprehensive advisory services. Our multi-disciplinary specialist team has extensive sector experience working for a diverse range of charities. We are based in one location which ensures an integrated and comprehensive approach to our clients' requirements.

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