Communicating your charity's reserves position and policy

Did you know?

From 1 November 2023, ICAEW's revised Continuing Professional Development (CPD) Regulations bring in new CPD requirements, including a minimum number of hours and an ethics requirement.

This webinar could contribute to up to 1 hour of verifiable CPD, so long as you can demonstrate that the content is relevant to your role.

Find out more about how these changes affect you at icaew.com/cpdchanges.

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Communicating your charity's reserves position and policy

ICAEW presentation

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Your presenters

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Agenda

The background to reserves reporting - Trustees' responsibilities and related guidance

Jill Halford

BDO's Reserves research

Peter Lewis

Dispelling myths

Fiona Condron

Trustees’ responsibilities and reserves

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Trustees’ responsibilities

The essential trustee six main duties

Comply with your charity’s governing document and the law.

Ensure your charity is accountable.

Act with reasonable care and skill.

Ensure your charity is carrying out its purposes for the public benefit.

Act in your charity’s best interests.

Manage your charity’s resources responsibly.

Charity Financial Reserves

CHARITY COMMISSION
FOR ENGLAND AND WALES

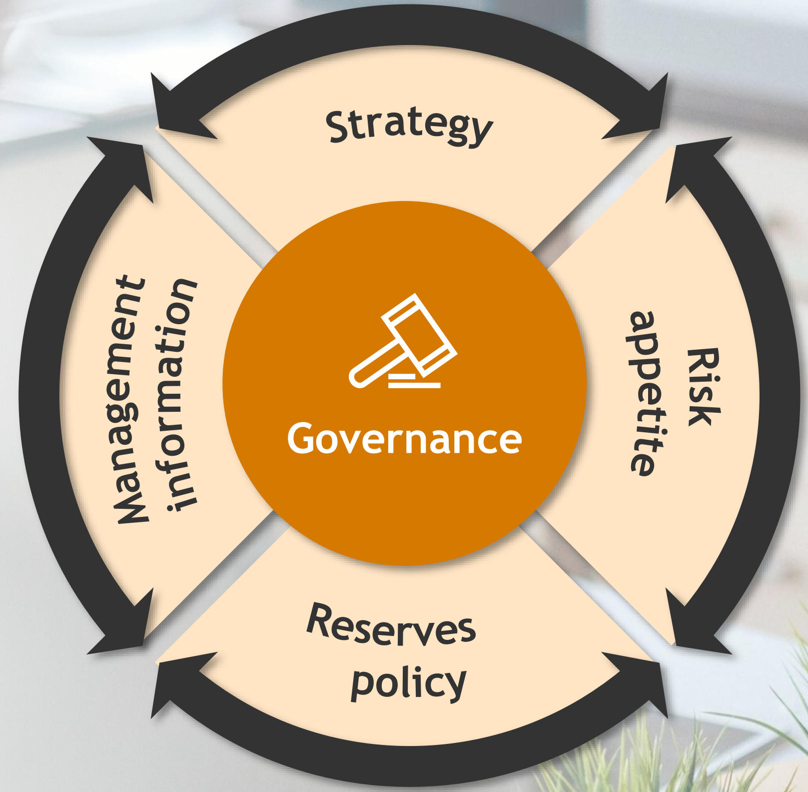
It's important to keep money aside as a reserve to protect your charity against drops in income or allow it to take advantage of new opportunities. Your charity's reserves can be spent on any of its aims.

Write a reserves policy to explain to others why you are setting money aside rather than spending it on your charity's aims.

Your reserves policy should set out:

- How much your charity needs to hold in reserve and why
- How and when your charity's reserves can be spent
- How often the reserves policy will be reviewed
- GOT, WANT and EXPLAIN THE DIFFERENCE

Reserves policy is key to good financial governance



Reserves policy

Top 50 UK charities on average have three months unrestricted expenditure cover.

BDO reserves study (2023)

Current beneficiaries | Future beneficiaries

Sustainability

Charity reserves policies: demonstrating and building resilience

How to calculate reserves

Not just the level of unrestricted reserves.

Calculated as - Unrestricted reserves less any unrestricted fund not readily available for spending.

The items that should be excluded from unrestricted reserves are:

- Tangible fixed assets
- Programme-related investments
- Designated funds
- Commitments.

www.gov.uk/government/publications/charity-reserves-policies-demonstrating-and-building-resilience

Do you understand your funds?

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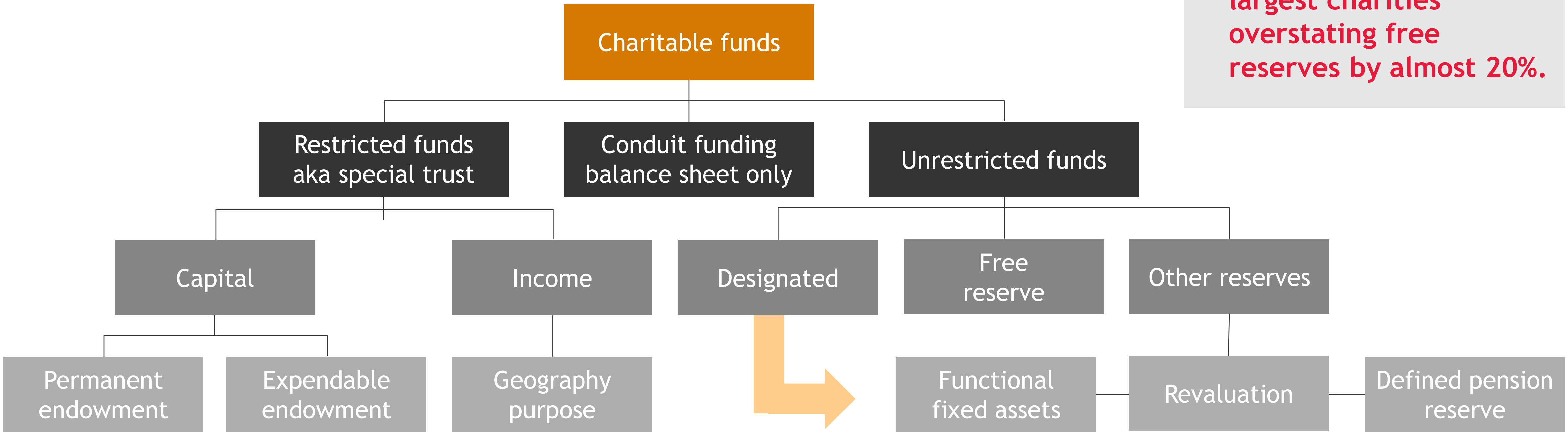
The SORP - types of funds



Civil Society article largest charities overstating free reserves by almost 20%.

Reserves policy

Targeting and holding the right level of reserves

A charity needs to hold reserves for the following reasons amongst others:

Income risk reserve

To protect the charity against a fall in income levels and to protect expenditure until income recovers or adjustments can be made.

Working capital reserve

To provide working capital in the event that expenditure is needed ahead of income being received.

Adversity reserve

To protect the charity against unplanned adverse events such as losing key staff, theft, fire, adverse publicity etc.

Cessation reserve

To ensure that all liabilities can be discharged in the event of cessation.

Opportunity reserve

To provide funding for new initiatives or opportunities.

**Understanding the business…
Insurance cover?.....Risk appetite?**

Going concern

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Going concern

Trustees required to prepare the financial statements on the going concern basis unless it is inappropriate to presume that the charity will continue in business.

Best practice

Regular monitoring throughout the year.

When financial statements are approved

- Trustees consider the going concern basis **for at least 12 months** from signing – paper
- Consider – free reserves, forecast cash flows, commitments, loan covenants, any significant uncertainties relating to timing of income and expenditure
- Scenario planning
- Trustees robustly challenge the plans and assumptions.

FRC revising rules so auditors more robustly challenge an organisation's own assessment of 'going concern.'

Charity reserves: building resilience

CC guidance updated 14 June 2023

01
Understanding the nature of charitable funds held

02
Identifying functional assets

03
Understanding the financial impact of risk

04
Reviewing sources of income

05
Impact of future plans and commitments

06
Agreeing a reserves policy

BDO reserves research

BDO reserves research

Background to the research

- Reviewed the top 50 charities (by expenditure levels)
- Certain charities were excluded:
  - Due to nature (such as universities)
  - Due to size (such as Welcome Trust).
- Considered their collective compliance with the recommendations of the SORP.

BDO reserves research

Figure 1: Meeting the requirements

	Compliant	Difficult to tell	Non-compliant
What have you got?	42	2	6
How much do you want?	39	2	9
What will you do about the difference?	23	6	21

Figure 2: Designated funds

Explanation of designated funds	£m
Retained in subsidiary	25.5
Revaluation reserve	351.9
Fixed asset reserve	1,006.3
Pension reserve	-155.8
'Operating' / 'contingency reserves'	42.1
Companies Act equity reserves	645.1
Other designations	1,011.8

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Other designations

Good examples:

- To fund future capital projects
- To fund specific future projects and one-off investments
- Time specific.

Bad examples

- No information provided to a reader of the accounts.

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Figure 3: Over and under statements

	Number of instances	Value given in the annual report	Apparent mis-statement £m	Our calculation £m	% difference
Overstatements	22	1,612	670	943	42%
Understatements	14	413	488	901	118%

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An alternative approach

- A minority of charities report on liquidity levels rather than free reserves
- Examples include British Heart Foundation, Macmillan Cancer Support and Guide Dogs
- Benefits:
  - More focused on liquid assets
  - Avoids future grant commitment liabilities giving the impression of very low free reserves.
- Disadvantages:
  - Potential to manipulate working capital at the year end to influence the reported figures
  - Liquidity created by restricted funds might be included
  - Not in line with the recommendations of the SORP.

Key takeaways

01 Understand your designated funds and free reserves.

02 Understand your reserves policy.

03 Consider cash implications of free reserves versus policy.

04 Consistency in the financial statements.

Dispelling common myths about charities

Charities should not make a surplus or build up cash reserves

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Common misconceptions about charities

01
Charities spent too much money on fundraising.

02
Charities should not make a surplus or build up cash reserves.

03
Charities spend too much on executive pay.

04
Charities should not undertake commercial activities.

05
Charities should be run and staffed cost-free by volunteers.

06
Charities spend too much money on overheads.

07
Charities don’t have to pay tax so need less money.

08
You need professional qualifications to become a charity trustees.

09
Charities are less vulnerable to fraud than other organisations.

10
Charities should not engage in campaigning and political activity.

Dispelling common myths about charities | ICAEW provides more analysis

The myth about reserves

Charities face challenges in reporting surpluses or deficits as these can attract critical, but often, flawed headlines over whether their assets are being managed in the charity's best interests.

Two myths about reserves:

01

They should be measured in weeks of expenditure. That is a useful mechanism for benchmarking, but never recommended as a method for deciding reserve levels.

02

The 'right' figure is between three months and two years of expenditure. The Charity Commission guidance (CC19) is clear that there is no 'right' level of reserves: the overriding principle is that income should be spent within a reasonable period of receipt of funds.

The myth about reserves

Can be hard to interpret a surplus one year and a deficit in another due to:

Mismatches between income and expenditure and restricted versus unrestricted funds.

Reserves can be a function of:

Timing differences.

Surpluses retained to mitigate unexpected fluctuations or unpredictable charitable need (for example humanitarian disaster).

Working capital requirements.

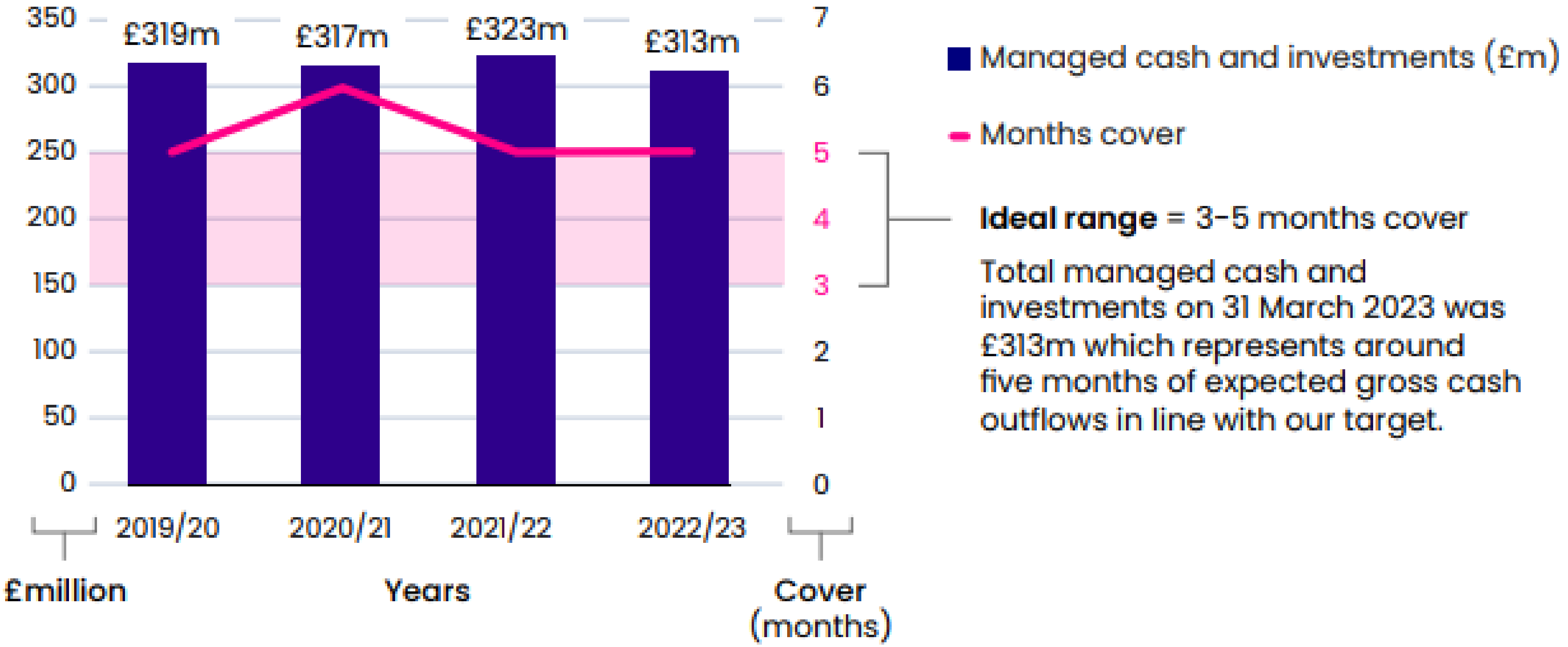
Surpluses built up to cover significant one-off investments.

Need to deliver charitable objectives over a longer period of time.

Reserves policy is key to good financial governance

Examples

Cancer Research 2022/23



Ideal range = 3-5 months cover

Total managed cash and investments on 31 March 2023 was £313m which represents around five months of expected gross cash outflows in line with our target.

Examples

RNLI annual report and accounts 2022

Free reserves (£137.0m)

These are sums that are freely available for general use. They are held at a level to withstand any short-term financial risks, the main ones being in in investment markets, pension scheme funding, key sources of income (such as legacies) and inflation.

Most of these funds are held in investments, but they also include any unrestricted legacy values accrued (£34.9m), which will take time to be received. The trustees have a policy of maintaining a range of 4-10 months of charitable expenditure. This range was determined using risk modelling techniques to determine the value of our financial risks, in conjunction with our investment advisers.

At 9.3 months of charitable expenditure, free reserves are currently at the upper end of the Trustees' range. The RNLI is planning to reduce this in the coming years because of essential investment in our lifesaving services and infrastructure, while also managing inflationary pressures through rigorous financial planning.

Recommendations

Ensure your reserve policy is easy to understand and linked to the strategic plan and risk management strategy.

Review your reserves policy regularly not just as part of the statutory accounts cycle.

Liquidity and treasury management need to go hand in hand with the reserves policy.

Communicate effectively internally and externally to help all stakeholders understand the current position, financial strategy and future fundraising needs.

Thank you

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