

How to set a Reserves Policy



The Charities SORP (Statement of Recommended Practice) defines reserves as part of a charity's 'unrestricted' funds (ie not designated for a specific purpose), that is **freely available to spend on any of the charity's purposes**. Reserves therefore exclude endowments or restricted income funds which have particular restrictions on how the funds may be used, or tangible fixed assets held for the charity's use and amounts designated for essential future spending, and restricted income funds and endowment funds. **Because Charity law requires any income received by a charity to be spent within a reasonable period of receipt, trustees should be able to justify the holding of income as reserves.**

Why is a reserves policy important?

A reserves policy plays an integral part of the internal management of a charity, by assisting in strategic planning. For example, when considering how new projects will be funded, it will inform the budget and risk management process ie is it a balanced budget, or do the reserves need to be drawn down or built up? The budgets will identify peaks and troughs in cash flow and the reserves policy will need to ensure the troughs in funding can be met from reserves held. Therefore, a reserves policy needs to be developed so that it is integrated with the charity's organisational and finance strategy.

A reserves policy also explains to existing and potential funders, donors and other stakeholders, why a charity is holding a particular amount of reserves. It gives confidence to stakeholders that the charity's finances are being managed and can also provide an indicator of future funding needs. Reserves levels which are higher than necessary may tie up money unnecessarily, limiting the amount of money spent on charitable activities. However, if reserves are too low then the charity's solvency can be put at risk.

The Charities SORP requires a statement of a charity's reserves within its annual report: and if a charity operates without a reserves policy, SORP require this to be stated in the annual report.

How should a reserves policy be developed?

Because a reserves policy needs to be developed in the context of a charity's strategic planning, there is no single method to setting it. In order to do this, Trustees need to:

- understand the nature of any restrictions on the use of the charity's funds they hold: ie are the funds unrestricted or restricted income, or expendable or permanent endowment? This process will allow trustees to identify unrestricted funds which can be spent on any purposes of the charity
- think about uncertainties they may face in the future and the need to hold some reserves to meet an unexpected call on funds or opportunities that may present themselves
- think about their future budgets and future projects or spending plans that cannot be met from the income of a single year.

By working through these steps, Trustees will be able to identify why reserves might need to be held and to quantify the amounts of reserves needed to operate effectively. Because the charity's circumstances change over time, the Charity Commission recommends that, once it has been set, a reserves policy should be reviewed at least annually as part of the charity's planning process.

What level of reserves is required?

It follows from the above, that there is no single level or even range of reserves that is right for all charities – this will depend on the particular circumstances of the individual charity.

Having identified why the charity should hold reserves and its needs, the trustees should then consider *how much* should be held to meet them. It follows that a charity's target level of reserves will be informed by:

- its forecasts for levels of income for the current and future years, taking into account the reliability of each source of income and the prospects for developing new income sources
- its forecasts for expenditure for the current and future years on the basis of planned activity
- its analysis of any future needs, opportunities, commitments or risks, where future income alone is unlikely to be able to meet anticipated costs and
- its assessment, on the best evidence reasonably available, of the likelihood of each of those needs that justify having reserves arising and the potential consequences for the future of the charity not being able to meet them.

The process of relating the charity's need for reserves to these factors, will inform its explanation for its level of reserves (ie in its annual report, to funders etc). However, it is generally considered to be financially prudent for an organisation with an income of up to £100,000 to hold reserves to cover three months: and for organisations above this amount to hold reserves to cover six months.

Maintaining and monitoring reserves

Having set the reserves level or range within which it is desirable to operate, it is important to monitor the reserves held to establish the reason for any significant difference within the target level set. If they are below target or exceed target, the trustees should consider whether this is due to a short-term situation or a longer term issue.

In particular, trustees should:

- identify when reserves are drawn so that they can understand the reasons and can consider any corrective action that needs to be taken
- identify when reserves levels rise significantly above target so that they can understand the reasons, and consider any corrective action that needs to be taken
- identify where the reserves level is below target, and consider whether this is due to short – term circumstances or longer term reasons which might trigger a broader review of finance and reserves

How the level of reserves changes during the year can be a good indicator of the underlying financial health of the charity. Therefore monitoring and reviewing reserves levels, target and policy should not just be an end of year procedure – it should be undertaken throughout the year as part of the normal monitoring and budgetary reporting processes. Trustees need to ensure that the reserves policy continues to be relevant as the charity develops or changes its strategy and activities. They must remember to review the statement on reserves in the trustees' annual report when there have been significant changes in the reserves policy or the level of reserves held.

Resources

- Charity Commission Guidance: [Charities & Reserves](#)
- Charity Commission: [Charity Financial Reserves](#)
- Sayer Vincent: [Drawing up a reserves policy](#)
- Know How Non Profit: [Finance strategy and reserves policies](#)
- Broomfield & Alexander: [How should I set my charity's reserves policy?](#)
- Charity Finance Group: [Beyond Reserves: How charities can make their reserves work harder](#)
- Charity Times article: [Balancing the Equation](#)

Support

If you would like any support with governance or any other issues facing your organisation, please contact the Development Team at Community Southwark: development@communitysouthwark.org.uk or 020 7358 7020.