Reserves – the Goldilocks principle

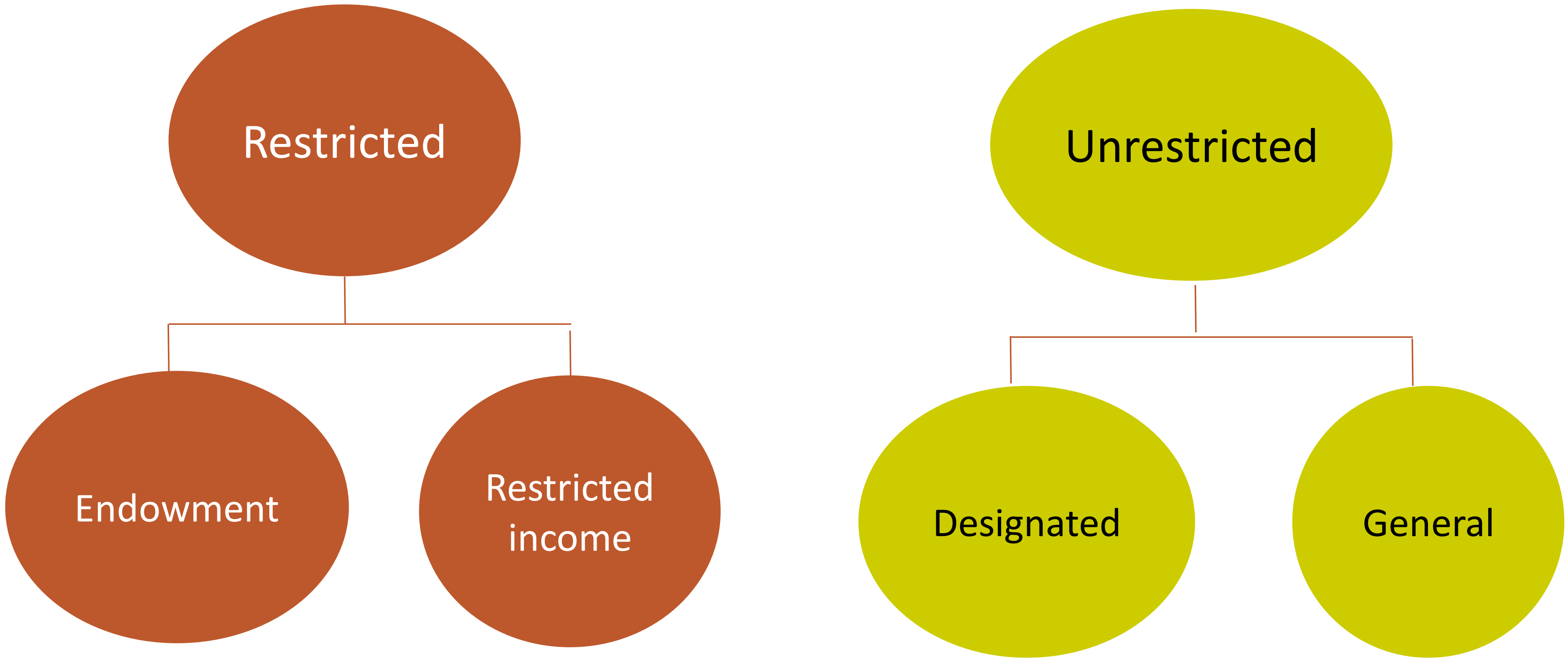
24 SEPTEMBER 2019

Introduction

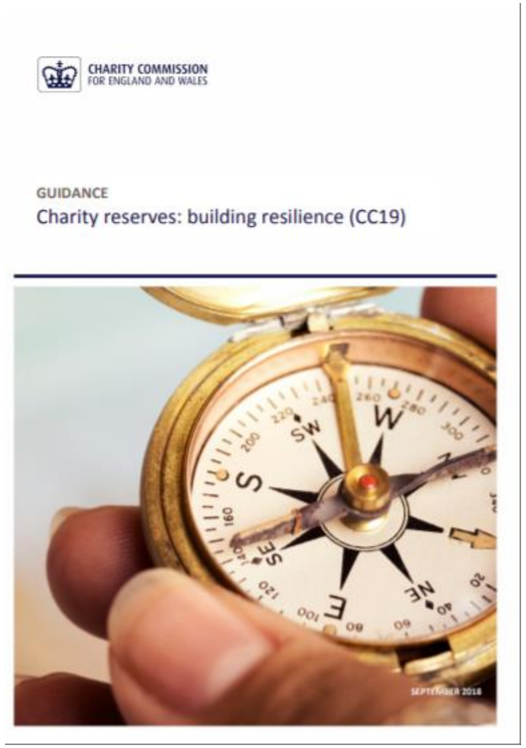
Plan to cover:

- What are reserves?
- How do you create a risk-based reserves policy?
- What about the costs of closing down?
- How to show that your charity is a going concern
- Your questions

Reserves are unspent unrestricted funds



Reserves policy – CC19



"Trustees should develop a reserves policy that:

- fully justifies and clearly explains keeping or not keeping reserves
- identifies and plans for the maintenance of essential services for beneficiaries
- reflects the risks of unplanned closure associated with the charity's business model, spending commitments, potential liabilities and financial forecasts
- helps to address the risks of unplanned closure on their beneficiaries (in particular, vulnerable beneficiaries), staff and volunteers"

What should policy contain?

- At a minimum:
  - reasons why reserves needed
  - level or range of reserves needed
  - action to achieve desired level
  - arrangements for review
- SORP requires actual £ at year end
- Should balance the needs of current and future beneficiaries

Approaches

- Justify the status quo
- Armageddon approach
- Actuarial liability method - endowment
- Risk identification approach

"A charity should hold reserves for only one reason. That is to ensure, as far as is reasonably possible, that the charity's future expenditure objectives can be met, given certain assumptions made about future income streams."

Andrew Hind, *The Governance and Management of Charities 1995*

Using reserves to manage risks

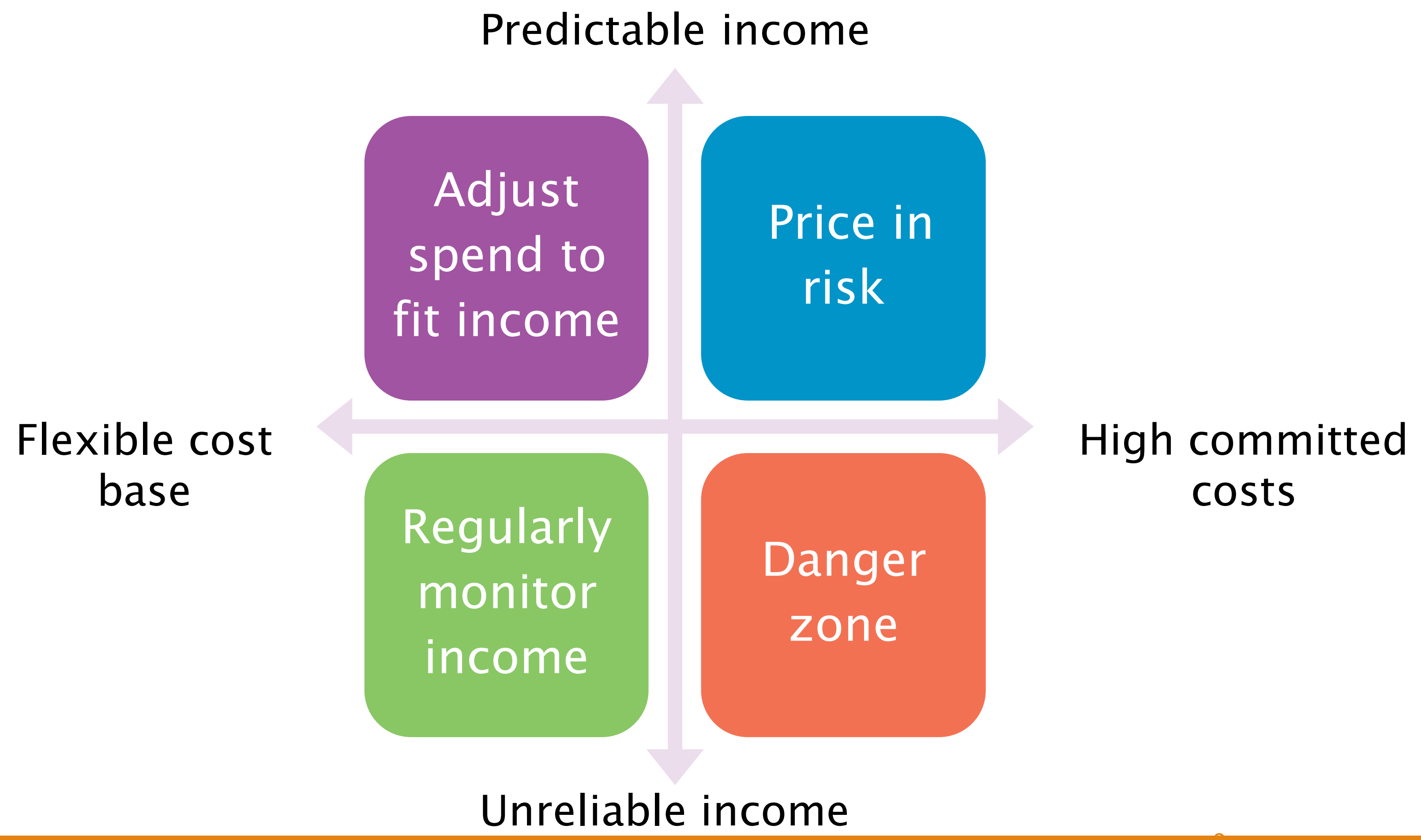
Inherent risk

Risks arising from the business model

- Understand the key drivers for income
- Key drivers for costs
- Links between income and costs
- Constraining factors
- Competition
- Pressures on prices

- Include it in your pricing
- Get funders to share the risk
- Collaborate to reduce the risks e.g. set up a partnership with an organisation that can help with your constraining factor
- Consider the impact on reserves

What’s your business model?



External risks

Events in external environment:

- Political changes
- Shifts in public attitudes
- Technological developments
- Changes in public service provision
- Funding changes
- New competitors or old competitors close

- Monitor the risks e.g. PESTLE analysis
- Build in a way to regularly report
- Look for early warning signs
- Develop response plans
- Reserves buy you time to respond

Operating risks

Are these even risks?

- Things that might go wrong
- Risks that we know about

Well designed and implemented

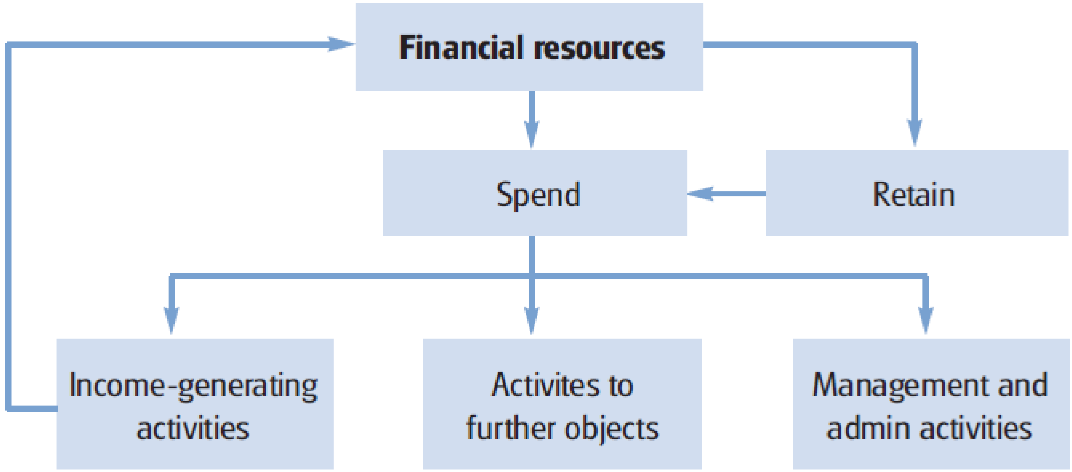
- Policies and procedures
- Checks and controls

Continuity of charitable activity – fluctuation in income

Working capital – cashflow profile

General reserves

Spend or save or invest?



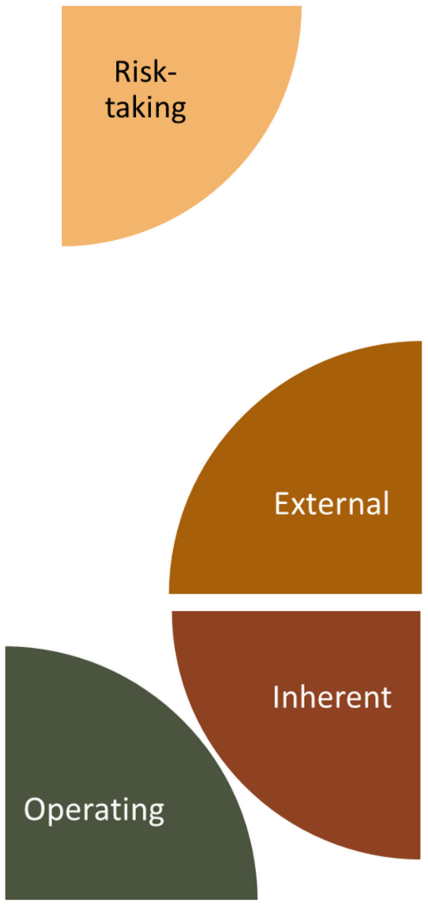
'The steward's finance strategy must explain how the organisation intends to manage its finance resources optimally so that it both maximises its impact today while maintaining the organisation as a going concern so that it can have impact tomorrow. The aim is to maximise impact over time not just today.'

Is it legitimate to use reserves to invest in:

- New activities?
- Fundraising?
- Taking risks e.g. innovating?

From "Income to Impact" by Adrian Poffley

Why hold reserves?



Finance for expansion and new projects

Provisions for known liabilities e.g. pensions

Continuity of charitable activity – fluctuation in income

Working capital – cashflow profile

Designated funds

General reserves

What level do we need?

Provisions for known liabilities e.g. pensions	How well have we defined the risk or liability? Do we know the probability, timing and amount needed?
Continuity of charitable activity – fluctuation in income	How good is our income forecasting? How diverse is our income? Reliability?
Working capital – cashflow profile	How well do we match incoming to outgoing resources? Timing of funding

Going concern

"An entity is a going concern unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so."

FRS 102 Glossary

"The trustees must make their own assessment of the charity's ability to continue as a going concern to assure themselves of the validity of this assumption when preparing their accounts. In making this assessment, a charity's trustees should take into account all available information about the future for at least, but not limited to, 12 months from the date the accounts are approved."

Charities SORP 2015 paragraph 3.14

In practice

All charities should include an accounting policy explaining whether there are fundamental uncertainties and whether the going concern assumption is appropriate

If there are doubts:

- Need to include a statement in the trustees’ annual report if there are uncertainties
- Trustees and managers need to draw up a paper to show how they have considered going concern:
  - Explain planning and forecasts, and how these have been prepared
  - Measures in place to manage uncertainty
  - Contingency plans e.g. to make savings

Only necessary to show that you will not close within 12 months of signing – not that you will be operating at a certain size.

Auditor's statement

"We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- The trustees' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- The trustees have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the charitable company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue."

Questions

Further reading

CC19 Charity Reserves: building resilience

Reserves policies made simple

https://www.sayervincent.co.uk/resources/made-simple-guides/

Beyond Reserves: how charities can make their reserves work harder

The Honorary Treasurer's Handbook

https://www.sayervincent.co.uk/resources/publications/

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