

BASIC NOTES - RESERVES

(one of a series of briefing papers for small charitable organisations)

The issue of Reserves held by organisations is very topical at the moment and is an area which must be considered as part of their own financial management. Organisations, should have some money held in Reserve, but can be criticised for accumulating too much - *should they not be spending it on achieving their objectives?* High Reserves may also affect the fundraising of the group as potential donors or funders may say - *"why don't you use up some of your Reserves instead?"* Obviously, the consequences of not having adequate Reserves are usually more acute!

Types of Reserves and why you need them

General or Uncommitted Reserves

Trustees of organisations have a duty to act 'prudently' when managing their finances. In the event of any financial crisis - cuts in funding, unexpected demands, etc., the group will have to honour its commitments. In simple terms the group needs to have money set aside for a rainy day. It may be that this is to avoid problems of cash flow or to have sufficient funds to close down the group, eg., redundancy payments, etc.

Restricted Reserves

Organisations often receive money for specific purposes. In this case, a 'restriction' is imposed by the donor, and the group is obliged to spend the money on the purposes for which it was given. In the accounts, it is important to inform the reader of the accounts of this restriction. For example, if you are given £10,000 to buy a vehicle but you have not spent it by the year end this will appear as 'reserves' but the restriction should be made clear. The accounting regulations for charities make specific reference to such funds.

Designated Reserves

Occasionally, the group may decide to set aside some of its own resources for a specific purpose. Typical examples would be a building fund or a fund to redecorate and refurbish every few years. It is important to ensure that these funds are not 'taken from' restricted funds but are generated from the group's own Income or general reserves. If, in addition, particular fundraising is to be carried out to build up these funds then these funds become restricted as the donor has given money on the understanding that it is for a specific purpose. It is important that such funds are not simply created to manipulate the figures and reduce the 'general reserve'. The need for a designated fund should be clear to see and decisions recorded in minutes of the Committee's meetings.

What level should be maintained - A Reserves Policy?

There is no figure set down which organisations must follow. The only guide is the general demand for prudence mentioned above. However, a widely accepted figure is that the general or uncommitted reserves should be maintained at a level approximately 25% of average annual expenditure of the group. Some would say that this is the minimum, and that to have less is too risky. Each organisation should consider its own situation - how secure is future income? What is the value of our obligations under any contracts? How much would it cost us to close down gracefully?

Each organisation's committee should consciously set its desired level and record the agreed policy. This should be reviewed each year - *'do we need more or less?'* An essential part of a Treasurer's role will be to keep an eye on the reserves position and guide the rest of the Committee on any actions or decisions required.

The link to the Budget

Once the group has agreed a target for its level of general reserves, the annual budget can be used to move towards the target over a number of years. For example, a new group may decide that within 5 years it wishes to have accumulated a general reserve of £10,000. In its first year, it should plan for an underspend (or 'surplus') of about £2,000. This should be repeated until the £10,000 is reached, after which, a balanced budget should be set.

Of course, it is sometimes difficult, if not impossible, to persuade funders of this need. Groups may need to look to other sources of income generation so as to have the freedom to build up reserves.

As each year passes, the actual surplus or deficit must be considered in the light of the reserves policy and adjustments made. It may be decided that a deficit budget can be set as the 'loss' during the year can be covered by the reserves. The group may decide to let the level of reserves fall below the target because it has a higher priority. Obviously, this is only a short-term possibility.

Conclusions

This is a difficult area for organisations and there are many different opinions on what is acceptable and how they should be treated in accounts. Unfortunately, although it is primarily a matter of common sense, it is an area which is usually neglected. The key questions for the committee are whether they are satisfied with the level of reserves and whether they can explain them satisfactorily to anyone who raises questions, both from inside and outside the organisation.

To summarise:

- Think about reserves
- Clearly identify different types in your accounts - Restricted, General and Designated
- Set a target and review, vote & minute this every year, before financial year-end.
- When setting the annual budget, bear in mind the reserves position and policy.
- Throughout the year, regularly review the reserves position (eg every 3 months)
- Be open about the whole issue, particularly with members and funders.