OSCR
Scottish Charity Regulator

Charity Reserves Factsheet

What this guidance covers

This factsheet is aimed at charity trustees of small to medium sized charities looking to produce or update a reserves policy.



Charity Reserves Factsheet

This factsheet is aimed at charity trustees of small to medium sized charities looking to produce or update a reserves policy. It explains:

- What is meant by the term reserves.
- The charity trustee's responsibility to consider whether their charity needs reserves.
- Key points to consider when developing a reserves policy.

Having a reserves policy is not a legal requirement but it can help you to meet your legal responsibilities and fulfil your **charity trustee duties**.

1. **What are reserves?**
2. **Why should you have a reserves policy?**
3. **How should charity trustees set a reserves level?**
4. **What should a reserves policy say?**
5. **What steps should charity trustees take to maintain and monitor reserves?**
6. **What happens if our charity has no need of reserves or has excess reserves?**
7. **Where to get help and advice**

1. What are reserves?

Reserves are the funds that your charity has which can be freely spent on any of its **charitable purposes**.

This definition excludes **restricted income funds** and **endowment funds** as these must be spent in a specific way. Reserves will also normally exclude tangible fixed assets held for the charity's own use. This is because these assets are used by the charity to deliver their activities and as such cannot be sold to meet a funding deficit. Amounts already set aside for essential future spending (**designated funds**) are also excluded from reserves.

To get your reserve starting point figure take the total funds of the charity minus any restricted funds, fixed assets and money already set aside for future activities. The calculation can be split in two:



Restricted funds and **endowment funds** will not be included in your reserves as these cannot be freely spent.



Reserves don't include tangible fixed assets or designated funds.

Once you have your starting point the **charity trustees** can start to look at what level of reserves you want to hold back.

2. Why you should have a reserves policy?

A good reserves policy can help you show donors, funders and **beneficiaries** how you, as **charity trustees**, are managing the charity's money. It also shows how you make sure that the charity continues to be financially sustainable.

A reserves policy will help explain to donors and funders why you are holding a particular level of reserves and may help donors and funders to see where funding gaps are and how they can help you meet your funding requirements.

Having a reserves policy is part of the internal financial management of the charity and will help you to manage your resources better and plan ahead for your needs.

3. How should charity trustees set a reserves level?

A reserves policy will be very specific to your charity. All charities have different funding streams and activities so the amount of money you need to hold in reserves will probably be different to other charities. It is important that you carefully consider the level of reserves your charity needs.

- **Why you might need reserves**

To understand why you might need **reserves** you first need to understand your charity's financial position and how this links with your charity's activities. Budgets and future plans need to be considered, in particular any uncertainty over future income or the risk of unexpected expenditure. When you review your future plans you should consider whether expenses can be met from annual income or whether reserves may be needed to meet costs.

Particular areas to consider are:

- Funds to allow for unforeseen emergencies or other unexpected needs, for example an unexpected repair bill or requiring funding for an urgent project.
- Unforeseen day to day operational costs, such as cover for long-term sick absence.
- Grant income not being renewed, and how much notice you would get if this is the case.
- Planned commitments which may need higher levels of reserves.
- Funds to allow for increased beneficiary need - external changes may mean your charity receives additional beneficiaries.
- The need to fund short-term deficits in a cash budget, for example money may need to be spent before funding is received.

- **How much do you need in reserve?**

You need to think about the reasons you might need **reserves** and the amount you would need for each reason. It might not be practical to consider holding reserves for all eventualities, so you need to consider the likelihood of events happening, as well as how much money it could cost.

Things to consider are:

- **Are you planning for unforeseen emergencies or day to day operational costs?** You will need to judge what amount of expenditure is required. You might want to hold back an amount as a contingency against unforeseen costs.

- **Is there uncertainty over future income?** You may want to hold funds to meet expenditure for a period to allow for any gaps in funding. For example: having reserves equivalent to a number of weeks or months expenditure to allow time to develop new sources of income or consider the future of the charity's activities.

- **Has a specific cost been recognised, such as an improvement to facilities?** Reserves may need to be built up to meet this future cost.

The reasons why you need reserves will determine the amount of reserves and how this is reflected. In some cases reserves will be a specific amount; in others it may reflect a number of months or weeks expenditure which could fluctuate.

It is important to recognise that there is no formula or one size fits all approach to reserves and you need to consider what is relevant for your charity.

How much you need may vary. If one year you have a specific project planned you may need a higher level of reserves that you won't need the next year. You should review the level required regularly to make sure it is still fit for purpose.

4. What should a reserves policy say?

A reserves policy will be unique to your charity and its complexity may well depend on the size and nature of your charity's transactions.

Your reserves policy should clearly state:

- **A brief description of the charity, its beneficiaries and its funding streams**. This will help the reader to understand the context behind the policy.
- **The rationale behind the reserves policy.** This will explain the reasons that the charity trustees believe reserves are required. It will outline areas where there may be shortfalls in funding and how these shortfalls will be met.

- **Steps taken to establish the level of reserves.** This will be a more detailed description of how charity trustees have considered the overall financial position of the charity leading to their conclusion about the level of reserves needed.
- **The level of reserves required**.
- **How and when the reserves policy will be reviewed**. A reserves policy is not a static document, needs will change, the financial position of the charity may change or plans may alter. It is important that the reserves policy is actively monitored and reviewed.

5. What steps should you take to maintain and monitor reserves at target level?

Once the reserves policy has been set it is important that you understand how your current financial position compares with the required level of reserves.

You need to actively monitor the level of reserves that the charity is actually holding to make sure you are aware of reserves going up or down unexpectedly.

If reserves during the year are below target or exceed target you should consider whether this is a short term situation or an indicator of a long-term issue. You may need to take action to replenish or spend reserves. Where reserves fall below target this may be an indicator of financial problems within the charity and you should consider any issues arising. Changes should be made as necessary and the reserves policy kept up to date.

6. What happens if our charity has no need of reserves or has excess reserves?

It would be unusual for a charity, of any size, to operate without any **reserves**. There are, however, some charities where charity trustees deliberately choose to hold no reserves. These charities spend the budgeted income in the year on activities. This can present a financial risk if unforeseen costs may arise. If you are considering not holding reserves you should make sure that you have considered all the financial and other risks.

If you have excess reserves you should consider whether these need to be spent. Charities should spend the money they have to advance their **charitable purposes**. If you hold excess reserves then you may not be

fulfilling your charity trustee duties. If the charity has reserves that cannot be spent on their purpose, because their purpose is too narrow, then you could think about changing your purposes. Do this you need to **apply to OSCR for consent**.

7. Where to get help and advice

- **Scottish Council for Voluntary Organisations (SCVO)**
- **Small Charities Coalition**
- **Charity Commission's guidance on charity reserves**
- **Guidance and Good Practice for Charity trustees: Charity Finances**
- **Charity finance group**
- If your charity is part of an umbrella organisation, such as **Early Years Scotland** or the **Development Trusts Association Scotland**, the umbrella organisation or parent charity may be able to give you support.

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