



# CHARITY RESERVES

SEPTEMBER 2020

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## YOUR PRESENTER



### Jill Halford, BDO Partner Head of Charities

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- ▶ Over 20 years' experience advising charities
- ▶ Specialises in audit and advisory work (especially governance reviews)
- ▶ ICAEW charities committee, member of the Charity Finance Group (CFG)
- ▶ Experienced tutor and runs training courses for charity finance professionals including Civil Society and CFG
- ▶ Volunteer roles:
  - Treasurer of Association of Chief Executives for Voluntary Organisations (ACEVO)
  - Trustee of the School for Social Entrepreneurs

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## AGENDA

- ▶ Importance of reserves
- ▶ BDO reserves research 2020
- ▶ Trustees' responsibilities
- ▶ Reserves policy and good financial governance
- ▶ Charity Commission CC19
- ▶ Good practice examples
- ▶ Going concern
- ▶ Next steps



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# IMPORTANCE OF RESERVES



# COVID-19 - CHARITY SECTOR

£4BN LOSS OF INCOME OVER THE 12 WEEK  
LOCKDOWN PERIOD

- ▶ Increased demand for services
- ▶ Significant uncertainty around funding
- ▶ Cancellation of fundraising events
- ▶ Closure of over 9,000 charity shops
- ▶ Uncertainty in value of investment portfolios
- ▶ Uncertainty of legacy timings and estates value
- ▶ Pressures on reserves and cash flow

RESERVES AND LIQUIDITY INCREASED IMPORTANCE

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## IMPORTANCE OF RESERVES



**Free reserves** - the most important figure in the accounts, most difficult to manage and to calculate!

### Why?

- ▶ Survey by Charities AID Foundation (April 2019) 14% struggling financially.
- ▶ Trustees and exec use this to judge solvency of the charity and what they can spend
- ▶ Funders use it to assess the need for funding requests
- ▶ Regulators use this to ensure the charity is spending funds in a reasonable time.

**COVID-19 has brought uncertainty - time to review reserves**

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## 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

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# BDO CHARITY RESERVES RESEARCH 2020



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## BDO RESERVES RESEARCH



### The UK's biggest charities' free reserves were falling before COVID-19

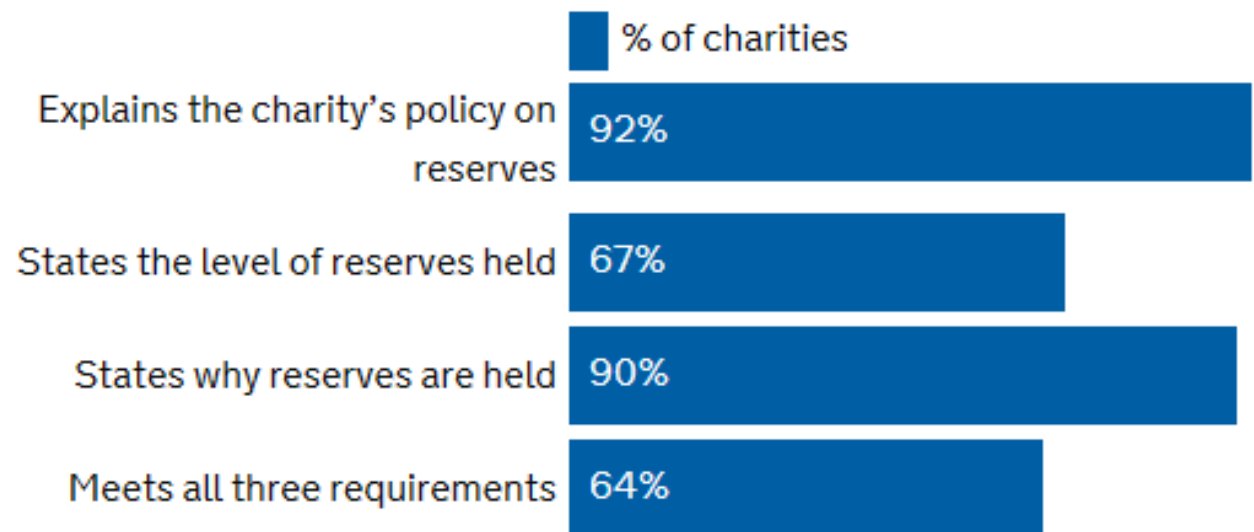
- ▶ July 2020 released results of our third reserves study. Based on 2019 published accounts.
- ▶ Average charities were found to hold only two months of operating expenditure in free reserves, down from three months in 2017.
- ▶ Charities are struggling to accurately report their reserves.
  - ▶ 48 reviewed hold total funds of £19.7bn (£6.7bn unrestricted, £973m fixed assets) - stated general free reserves at £3.8bn.
  - ▶ Recalculated at £1.5bn - worryingly £2bn less than reported.

# CHARITY RESERVES POLICIES: DEMONSTRATING AND BUILDING RESILIENCE

PUBLISHED: 21 NOVEMBER 2018

- ▶ Review of the trustees' annual report and accounts to consider whether:
  - ▶ the charity had explained its reserves policy, as required
  - ▶ the charity's stated level of reserves was calculated correctly

Lack of transparency - why reserves held and the basis of charities' calculations.

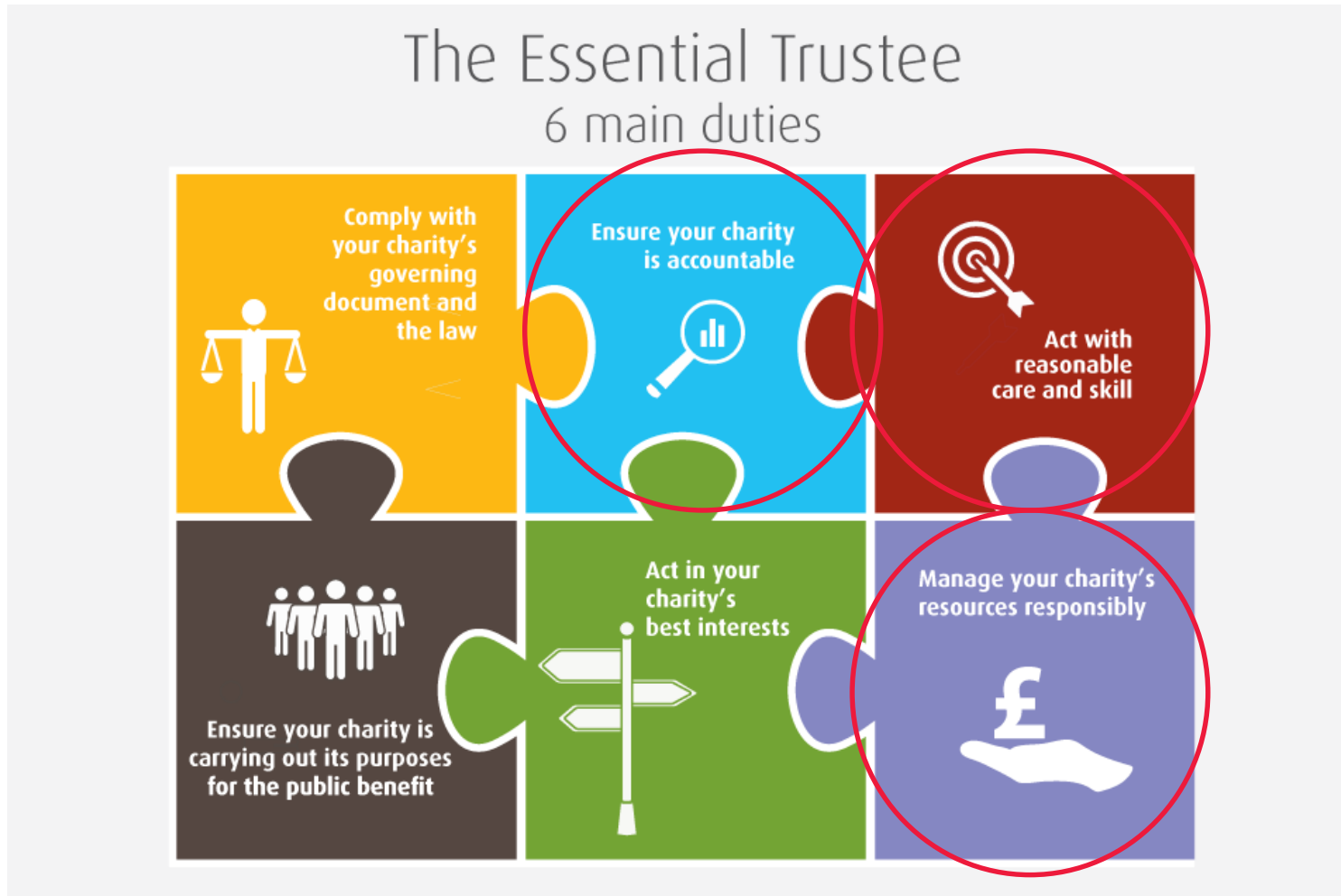


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# TRUSTEES' RESPONSIBILITIES AND RESERVES

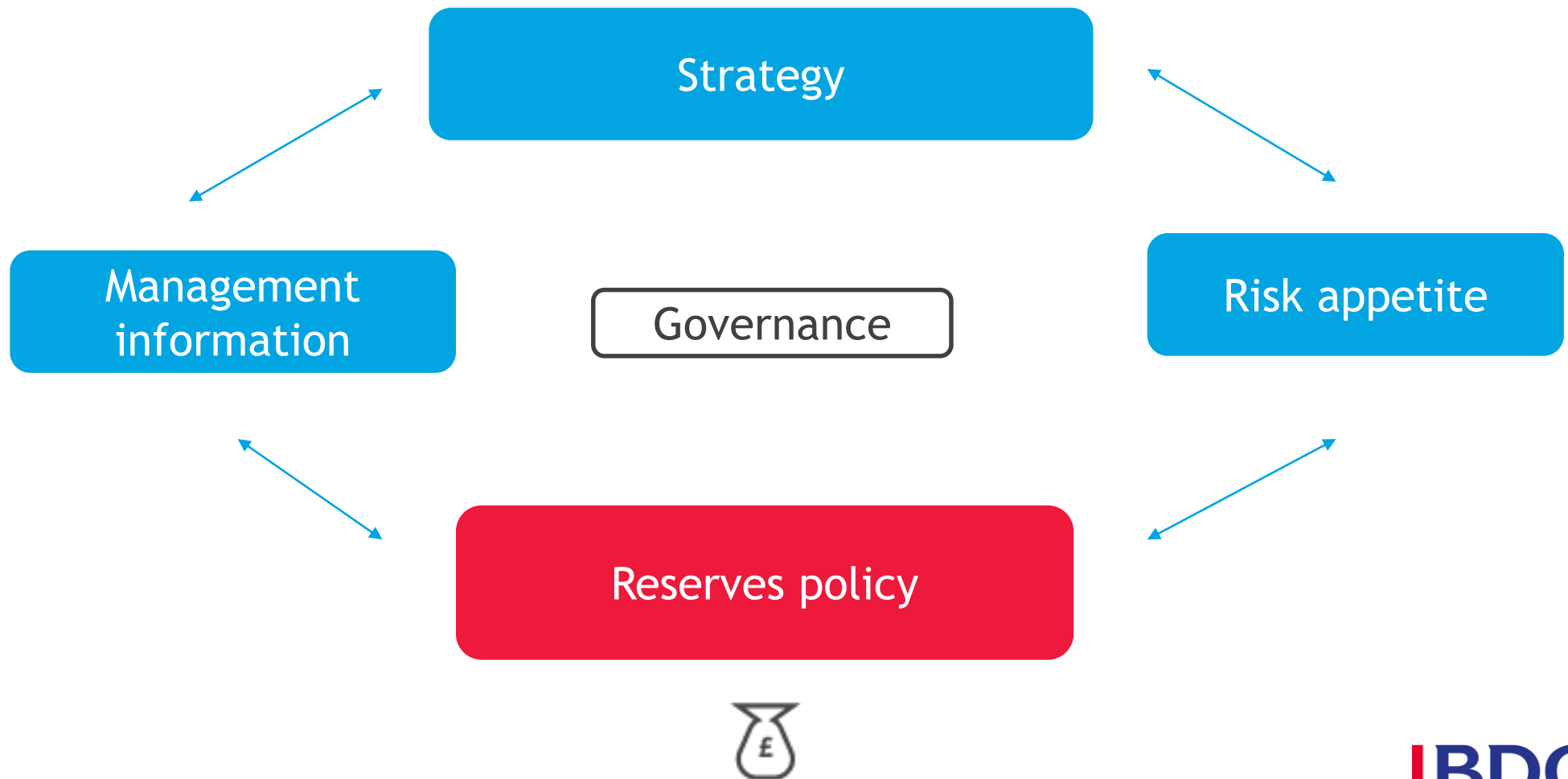
# TRUSTEES RESPONSIBILITIES



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# RESERVES POLICY IS KEY TO GOOD FINANCIAL GOVERNANCE



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## RESERVES POLICY

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

*BDO reserves study (July 2020)*

Current beneficiaries

Future beneficiaries



Sustainability

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# CHARITY SORP 2015 AND CC19 AND SECTOR BEST PRACTICE

## SORP/CC19 requirement

State the amount of the total funds the charity holds at the end of the reporting period

Identify the amount of any funds which are restricted and not available for general purposes of the charity at the end of the reporting period

Identify and explain any material amounts which have been designated or otherwise committed as at the end of the reporting period

Indicate the likely timing of the expenditure of any material amounts designated or otherwise committed at the end of the reporting period

Identify the amount of any fund that can only be realised by disposing of tangible fixed assets or programme related investments

State the amount of reserves the charity holds at the end of the reporting period after making allowance for any restricted funds, and the amount of designations, commitments (not provided for as a liability in the accounts) or the carrying amount of functional assets which the charity considers to represent a commitment of the reserves they hold

Compare the amount of reserves with the charity's reserves policy and explain, where relevant, what steps it is taking to bring the amount of reserves it holds into line with the level of reserves identified by the trustees as appropriate given their plans for the future activities of the charity

# CHARITY RESERVES POLICIES: DEMONSTRATING AND BUILDING RESILIENCE

How to calculate reserves

Not just the level of unrestricted reserves but:

Unrestricted  
reserves

—  
(less)

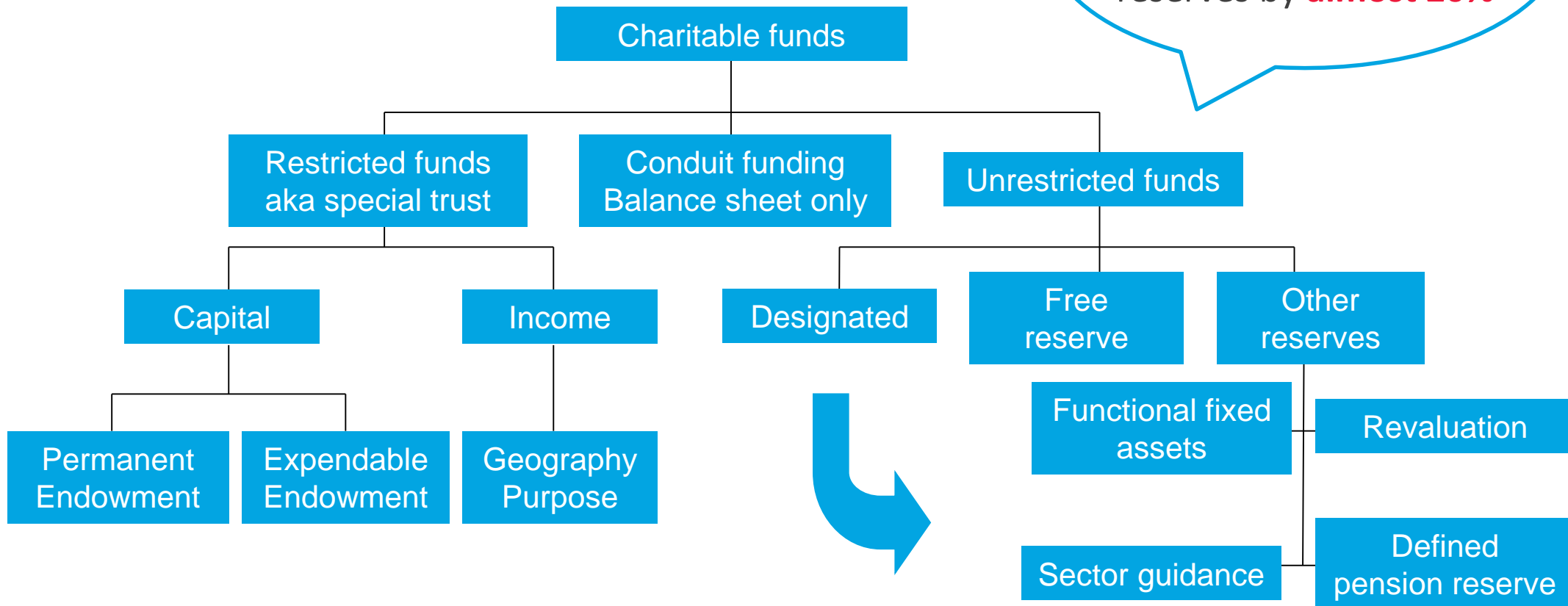
Any unrestricted fund not  
readily available for spending



Source: PwC reserves: the essential buoyancy aid for charities in stormy seas

**DO YOU UNDERSTAND YOUR FUNDS?**

## THE SORP - TYPES OF FUNDS



# RETHINKING CHARITY RESERVES

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## IMPACT OF COVID-19 ON RESERVES



Charity reserves have been brought in sharp focus by COVID-19.

- ▶ Pandemic took us all by surprise
- ▶ No charity expected such large changes to cash flow and funding
- ▶ Highlighted the need for robust reserves
- ▶ Those with strong liquid reserves bought more time to react and respond
- ▶ Essential reserves used to assist charities rebuild and rethink business models

**COVID-19 has brought uncertainty - time to review reserves**

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# TARGETING AND HOLDING THE RIGHT LEVEL OF RESERVES



## Why hold reserves?

- ▶ **Income risk reserve** - protect against a fall in income levels and protect expenditure until income recovers or adjustments can be made
- ▶ **Cessation reserve** - liabilities can be discharged in the event of cessation
- ▶ **Working capital reserve** - provide working capital if expenditure is needed before income is received
- ▶ **Opportunity reserve** - funding for new initiatives or opportunities
- ▶ **Adversity reserve** - protect against unplanned adverse events, such as losing key staff, theft, fire, adverse publicity etc.

Understanding the business...Insurance cover?...Risk appetite? Apply a COVID lens

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## REVIEWING YOUR RESERVES LEVEL AND POLICY



### COVID-19 has brought uncertainty - time to review reserves

- ▶ **Risk based approach** - income risk has changed and will continue to over the coming months and years
- ▶ **Investments** - low risk strategy - is reserve needed for this? Forecasting drawdowns?
- ▶ **Working capital requirements** - has this changed?
- ▶ **What is your RED LINE?**
- ▶ **Liquidity** - review property strategy
- ▶ **Pension scheme** - negotiations with trustees

Sense check - does the level feel right for your organisation now?

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## COVID-19 - CHARITY SECTOR

### RECOVERY AND RETHINK

- ▶ Events are fast moving, difficult to horizon scan
- ▶ Many are moving into the second phase
- ▶ Rethinking operational model
- ▶ Building resilience consideration beyond initial impact
- ▶ BDO three stage approach



### THREE STAGE PROCESS TO MANAGE BUSINESS PRIORITIES AND LEVERAGE THINKING

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# GOOD PRACTICE EXAMPLE

# CANCER RESEARCH UK

## RESERVES POLICY AND MANAGEMENT

Reserves are maintained at a level that enables the Charity to manage financial risk and short-term income volatility. They allow the Charity to sustain optimal levels of research over the long term, ensuring that financial commitments can be met as they fall due.

Our reserves policy takes into consideration that we commit expenditure over the medium term, since our research commitments span many years, whilst recognising that, as we are a fundraising charity, we are subject to the effects of short-term volatility in income. We therefore hold funds in reserve to ensure that we can meet our research commitments in the face of such fluctuations. We use a rolling five-year plan to model how we will fund the delivery of our strategy, ensuring reserves remain at an appropriate level.

We have a single reserves measure. This measure mandates that the Charity holds a minimum level of cash and investments to ensure that the Charity will be able to discharge its financial commitments as they fall due over the course of the five-year plan.

We monitor 'managed cash and investments', which includes all amounts available to finance the general activities of the Charity, net of any overdraft or credit line which has been drawn upon. Council have agreed that 'managed cash and investments' should exceed a minimum of three months but is not expected to exceed five months annualised forecast cash outflow.

Our reserves measured at 31 March 2015 are as follows:

	31 March 2015 £m	31 March 2014 £m
<b>Managed cash and investments</b>		
Cash and investments	318	293
Less: funds under separate management <sup>1</sup>	(11)	(11)
<b>Managed cash and investments</b>	<b>307</b>	<b>282</b>
<b>Months of annualised forecast cash outflows</b>	<b>Months 5.7</b>	<b>Months 5.7</b>

<sup>1</sup> Consolidated endowments and charities.

At 31 March 2015, although the 'managed cash and investments' level is nearly six months of forecast cash outflows, the Charity's five-year plans include projections for reserves to reduce as the Charity increases charitable expenditure and completes its funding contribution for construction of the Crick. The indicative shape is shown below.

## INDICATIVE FUTURE RESERVES (£m)



\*CRUK 2014/15 accounts, page 23

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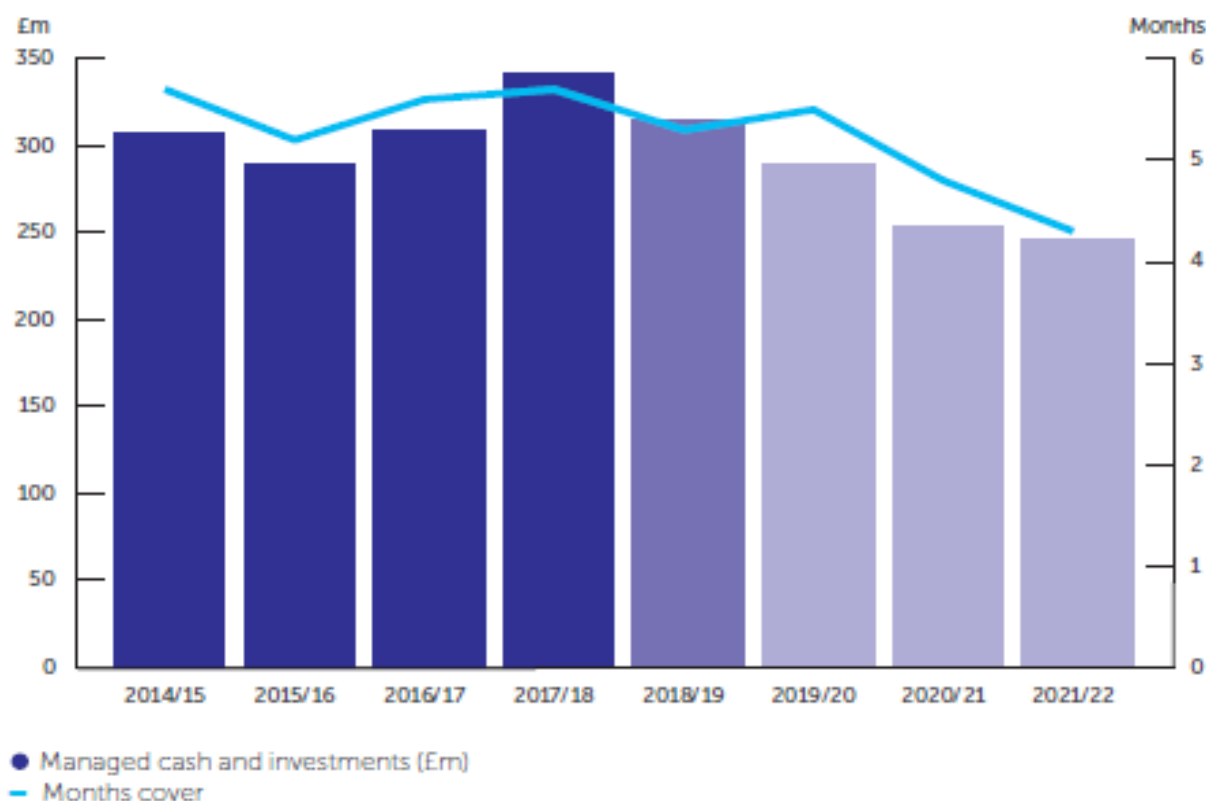
# CANCER RESEARCH UK

## RESERVES POLICY AND MANAGEMENT

Reserves are maintained at a level that enables the Charity to manage financial risk and short-term income volatility. They allow the Charity to sustain optimal levels of research over the long term, ensuring that financial commitments can be met as they fall due.

Our reserves policy states that managed cash and investments should exceed three months but are not expected to exceed five months' forecast cash outflows. Although since 2016 levels have been greater than five months' cover, the Charity's medium-term plan includes projections for reserves to reduce as we increase charitable expenditure, bringing the anticipated cover to four months, as shown diagrammatically opposite.

## HISTORIC AND INDICATIVE FUTURE RESERVES



\*CRUK 2017/18 accounts

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# GOING CONCERN

## 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

*Auditors role in robustly challenging an organisation's own assessment of "going concern"*

WHAT'S NEXT?

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## WHAT'S NEXT?

-  Review your reserves level and policy - is it fit for purpose in the current environment?
-  Regulator and press interest
-  Increased focus and guidance
-  Liquidity reserves policy
-  Endowments and restricted funds
-  Clarity in decision making

# ANY QUESTIONS?



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