

Financial management

Section three Reserves

(Adapted from the Community Accounting National Network, see www.communityaccounting.org)

All organisations need to think about reserves and should ideally have some money held in reserve. However, organisations have been criticised in the past for accumulating too much in reserve and not spending it on achieving their objectives. High reserves may also affect the fundraising of your organisation 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 of more concern, particularly for small to medium charities.

3.1 Types of reserves and why you need them

A. General or uncommitted reserves

Trustees of organisations have a duty to act 'prudently' (carefully) when managing their finances. In the event of any financial crisis - cuts in funding, unexpected demands, and so on, your organisation will have to honour its commitments. In simple terms your organisation needs to have money set aside for a 'rainy day' – when things may not go to plan. This might mean avoiding problems of cash flow or having sufficient funds to close down your organization, which often includes, for example, redundancy payments.

B. Restricted reserves

Organisations often receive money for specific purposes. In this case, the donor imposes a 'restriction', and the organisation 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 (see the Charity Commission website).

C. Designated reserves

Occasionally, an organisation 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 that your organisation ensures that these funds are not 'taken from' restricted funds but are generated

from your organisation's own income or general reserves.

If, in addition, you are carrying out particular fundraising 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 your management committee's (MC's) meetings.

3.2 What level should be maintained - a reserves policy?

There is no set figure that 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 your organisation's average annual expenditure. 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 your future income? What is the value of your obligations under any contracts? How much would it cost you to close down?

Each organisation's MC should 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 monitor the reserves position and guide the rest of your MC on any actions or decisions required.

The link to your budget

Once your organisation has agreed a target for its level of general reserves, your annual budget can be used to move towards the target over a number of years. For example, a new organisation 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 to persuade funders of this need. Your organisation may need to look to other sources of income generation so that it can have the freedom to build up reserves.

As each year passes, your actual surplus or deficit must be reviewed and adjusted in connection with your reserves policy. It may be decided that a deficit budget can be set as the 'loss' during the year and 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.

3.3 Conclusion

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 your MC 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 your organisation.

Recap:

- √ Think about reserves.
- √ Clearly identify different types in your accounts - restricted, general and designated.
- √ Set a target and review, vote and 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 (for example, every three months).
- √ Be open about the whole issue, particularly with members and funders.

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