THE GREIG TRUST
Incorporating

THE HS & SV AND D & M GREIG FUNDS
THE DAVID GREIG EDUCATIONAL TRUST
RESERVES POLICY

The reserves journey

Before embarking on any journey a couple of vital facts are required. Where is the starting point and what is the destination? The use of a map to show the route between these two points is handy and this is effectively what any good reserves policy will do – it will explain the level of reserves currently held (the starting point) and the future target level (the destination).

How did we get here?

More than a decade ago, the Charity Commission completed a regulatory study (RS 3 – Charity reserves) into charities' reserves by reviewing annual returns filed for the year ended 31 December 2001. As well as establishing that £26bn was held in reserves by registered charities it also found that over £5.5bn of these reserves were held by charities that did not have a reserves policy. Many of the policies that were in place were insufficient and of poor quality.
This was followed by a further study (RS 5 – Small charities and reserves) in 2002 looking at 1,200 small charities with similar conclusions being drawn. In 2010 the Charity Commission issued detailed guidance – CC19 Charities and reserves. This guidance is essential reading for any trustee to fully understand the financial judgements that need to be made in their charity.

In early 2015, *The current and future state of charities*, found that nearly half of 120 charities were using reserves to manage costs and cash flow, and perhaps unsurprisingly almost half anticipated that their reserves would be lower over the next 12 months.

Unfortunately 2015 became a difficult year for the sector with a number of high-profile charities failing, while one high-profile charity which folded in 2014 admitted that it had experienced problems by not following its own reserves policy. The general public has become increasingly concerned about fundraising practices and charities have generally been criticised for having weak financial reserves or pension deficits that are not attractive to donors.

Therefore, despite the issue being firmly on the Charity Commission's radar for some time, the best practice of trustees having a well-thought-through policy on reserves – agreed by all trustees – is now more important than ever before.

The starting point

Reserves are those unrestricted funds that are freely available to spend on any of the charity's purposes. This definition excludes restricted income funds and endowment funds.

However, the existence of restricted funds should be considered in developing a charity's reserves policy. The term reserves also usually excludes tangible fixed assets held for the charity's own use and amounts designated for essential future spending. Any trustee should be able to establish this starting position by using the following table:

I have used the figures from the consolidated balance sheet of The Greig Trust as at 31st March 2016 – see below:

	£
Total funds of the charity	18.384,271
Less: restricted funds	0
Less: endowment funds	0
Unrestricted funds	18.384,271
Less: unrestricted tangible fixed assets held for charity's own use	18.796,907
Less: amounts designated for essential future spending	(537,500)
Available reserves - the starting point	124,864

Amounts designated for essential future spending will have required a previous judgement by trustees in arriving at any such designation. The judgement required by trustees is to quantify the potential future spend. Funds designated for essential future spending could include a future capital project or unrestricted funds set aside to meet any funding shortfall for a project that has received restricted income. Any designation of funds for essential future spending will require a formal decision and under the Charities SORP (FRS 102) this designation will need to be approved by the trustees prior to the end of the financial year. This is vital for trustees to consider in their year-end financial timetable. Any resultant designation has an administrative purpose only and does not legally restrict the trustees' discretion in how to apply the unrestricted funds that they have earmarked. At a later date, the designation can however be reversed by the trustees, if required.

At this stage, the starting point, or available reserves, has now been quantified and it allows the charity's trustees to meet many of the trustees' report narrative disclosure requirements of the SORP:

Current Reserves Policy (as at 31st March 16) of HS & SV Greig Trust Fund, D & M Greig Trust Fund, DGET

The total funds of the charities are unrestricted with the historical accumulations of the original gift, including investment gains net of investment management costs, being designated as the capital account.

It is the policy of the Trustees to maintain the invested capital and distribute substantially all the income derived from it, after deducting the costs of administering the charity.

Excerpt from Charities SORP (FRS 102)

The review of the charity's reserves should:

- 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.

The destination

The next stage is a matter of opinion and judgement and where the trustees will need to arrive at a consensus. It is to define the destination, ie the charity's target level of reserves. This can be expressed as a single monetary amount or a target range and should be informed by its forecasts for levels of income and expenditure for the current and future years. This should take account of the certainty and reliability of each source of income and expenditure considering the prospects for developing new income sources and planned activities. It is quite possible that a charity will need some reserves in order to generate a certain source of income to fund its activities, for example, an investment fund to provide an annual investment return.

There is a fundamental need to align the reserves policy to the future strategy of the charity. Similarly, the reserves policy will have some relevance to the going concern assessment that trustees are required to make each year in approving statutory financial statements. The Financial Reporting Council has produced guidance for directors of entities that are required to follow the UK Corporate Governance Code in its September 2014 publication Guidance on risk management, internal control and related financial and business reporting. Although produced for the corporate sector it is equally applicable to trustees of charities. This guidance requires an assessment of the entity's ability to continue to adopt the going concern basis of accounting and to disclose any material uncertainties identified. In performing this assessment, the board should consider all available information about the future, the possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to the board. The code states that the board should identify in the financial statements any such material uncertainties over a period of at least 12 months from the date of approval of the financial statements. This fits well with the trustees making an assessment of future risks and opportunities when determining the reserves policy.

The link between a going concern assessment and reserves policy is well-illustrated using the recent example of Kids Company. Its reserves policy for the year ended 31 December 2013 stated: "We are happy to report that Kids Company has been able to maintain its free reserves position of a surplus of £434,282 in 2013." This crudely represented about one week of the charity's total annual expenditure at that time. Having a relatively low target level of reserves is not necessarily a problem in itself, but having a clear awareness of levels and the long-term viability of such an approach needs to be considered. Ultimately the policy was found to be wanting in the context of going concern. Conversely trustees are open to criticism if they hold relatively high levels of reserves without attempting to explain the underlying need by reference to risks and opportunities and future financial forecasts.

Larger charities are likely to have a formal risk management process and strategic and operational plans. However all charities should consider the uncertainties being faced in the future and the need to hold some reserves to meet an unexpected call on funds or opportunities that may present themselves. It is recognised that sometimes future projects or spending plans cannot always be met from the income of a single year hence the need for reserves.

For a prudent approach, trustees may also consider having an aspirational target for building longer-term reserves. Having defined the destination or target level of reserves trustees will then be able to meet the remaining narrative disclosure requirements for the trustees' report in Charities SORP FRS 102.

"The review of the charity's reserves should 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."

Are we there yet?

Once a reserves policy is set, it should not be regarded as a static policy. The circumstances of a charity will change with time and the Charity Commission recommends that the policy should be reviewed at least annually. The amount held in reserves should also be monitored during the course of the year as part of a charity's financial processes.

The resultant reserves policy should then be consistent with the overall strategic plan and clear to those both within the charity and externally as part of a clear communication strategy for future intentions.