



An Rialálaí  
Carthanas  
Charities  
Regulator

# Guidance on Charity Reserves

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# About this guidance

This guidance is issued by the Charities Regulator pursuant to section 14(1) of the Charities Act 2009, to encourage and facilitate the better administration and management of charitable organisations (charities).

The following are some **key terms** which will be useful to understand when reading this guidance.

## Restricted funds:

are those funds that the charity trustees are obliged to spend in a specific way or for a specific purpose as set out in a funding letter of offer, or services contract, as specified by the grant maker or donor, but which are still within the wider objects of a charity. Restricted funds may be **either endowment funds** or **restricted income funds**, depending on the nature of the restrictions. Where the fund is not an endowment fund and is held for spending on specific purposes, it is known as a **restricted income fund**.

## Endowment funds:

are funds which the charity trustees are legally required to invest or to keep as capital. Income generated from the capital can be spent at the discretion of the charity in line with its objects. Normally these funds will be held in the form of financial investments but they may also be a property held for use by the charity. The term endowment applies to **permanent endowment**, where the charity trustees have no power to convert it into income and apply it, and to **expendable endowment** where the charity trustees do have this power.

## Unrestricted funds:

are those funds which the charity trustees are able to spend at their discretion for any of the charity's purposes.

## Designated funds:

are part of the unrestricted funds which charity trustees have earmarked for a particular project or use, without restricting or committing the funds legally, for example, to fund a project that could not be met from future income alone. The designation may be cancelled by the charity trustees if they later decide that the planned project is not going ahead.

## General funds:

are those funds which are not assigned to a specific purpose. They are unrestricted and may be used to further the charities purposes, for the day to day activities of the charity and to pay for administrative and operating expenses that are not covered by restricted income or grants received.

# 1

## Introduction

Charity trustees are the people who exercise control over, and are legally responsible for, the management and control of a charity. The term 'charity trustee' can include:

- > committee members;
- > council members;
- > board members; or
- > directors of a charity.

Although they are volunteers, the role of a charity trustee carries significant responsibility. The board of trustees of a charity is collectively responsible for the oversight of that charity.

Charity trustees have a legal duty to act with reasonable skill and care and in the best interests of their charity and its beneficiaries. Where a charity is facing challenging financial circumstances, it may also need to take into consideration what is in the best interests of its creditors. Decisions around a charity's reserves policy form an important part of that duty of care and are particularly important during economically uncertain times.

Principle 4 of the Charities Governance Code, which relates to the principle that charity trustees must exercise control of their charity emphasises the following:

***"Charity trustees are also responsible for a charity's funds and any property or other assets that it holds. As much as is possible, they must also consider and reduce risks to which their charity is exposed."***

The Core Standards, which fall under the principle of exercising control, provide that charities are required to do a number of things to apply that principle including the following:

***"Make sure you have appropriate financial controls in place to manage and account for your charity's money and other assets."*** (Core Standard 4.4)

***"Identify any risks your charity might face and how to manage these."*** (Core Standard 4.5)

As such, identifying and managing risk is an important part of good governance. Certain risks will have a financial impact and should be considered as part of the annual planning process. Identifying financial risk will also influence and inform a charity's reserves policy.

This document is aimed at charity trustees and explains the following:

- > What is meant by the term reserves?
- > Why have a reserves policy?
- > Key points to consider when developing a reserves policy;
- > How to determine appropriate levels of reserves;
- > Monitoring of reserves; and
- > How to use charity reserves during a crisis.

# 2

## What are reserves?

Usually reserves are built up over time by generating an unrestricted surplus and intentionally designating a portion of the excess cash as a reserve fund. Reserves help to maintain financial stability and allow a charity to meet its commitments, continue to undertake work, and deliver services, even when unexpected events or costs arise.

Reserves exclude restricted 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 usually used by the charity to deliver its activities or services and as such cannot be sold to meet a funding deficit.

Amounts already set aside for essential future spending (i.e. designated funds) are also excluded from reserves. Typically, the designation of unrestricted funds is something that would be discussed and agreed at charity trustee meetings and formally recorded in the minutes. Very often the funds set aside to meet future commitments and plans will be held as designated funds. For example, charity trustees could agree that the purchase of a property would better serve the interests of the charity long-term and designate a certain amount of funds for a future deposit.

Generally, a charity is expected to spend its income on advancing its charitable purposes, unless there is a specific reason for keeping it. Accumulating a high level of reserves without a clear explanation or justification may adversely affect the public's perception of a charity. Unjustifiable stockpiling of reserves may also cause concern that charitable assets are not being used for a charitable purpose. In general, reasons why charities hold reserves can be summarised as follows:

- › to meet a charity's commitments when expenditure overruns or unplanned events occur;
- › to fund shortfalls in income, for example when income is delayed or does not reach expected levels;
- › to fund unexpected events calling on the charity's service (such as a natural disaster requiring extra services with little warning);
- › to fund a future specified commitment or project;
- › to respond to unexpected difficulties or crisis.

By holding appropriate reserves, charity trustees can demonstrate that they are acting to protect the charity from future challenges and uncertainties and changes in economic circumstances.

# 3

## Should a charity have a reserves policy in place?

Having a board approved reserves policy is part of the recommended internal financial management of a charity and will help charity trustees to better manage charity resources.

A reserves policy will help charity trustees explain to their donors, beneficiaries and other stakeholders why a charity is holding a particular level of reserves and how they plan to use them. Where appropriate, the policy will also outline how the reserves will be built up to the level agreed by the charity trustees. It may help donors and funders to see where funding gaps are and how they can help the charity meet its funding requirements. Equally, a charity may use its reserves policy to explain why, because of its size, aims and activities, it is in the best interests of the charity not to hold any reserves. For example, a small organisation with a stable pattern of income, without any commitments and little exposure to external influences may be able to survive without any reserves. However, this should be the result of a considered decision as demonstrated in the reserves policy.

Where the reserves are unacceptably low, it may be necessary for a few years to budget for general fund income to be greater than expenditure, until reserves have reached the required level, but charity trustees need to get supporters to understand the need for this. Equally, some charities may have realised that their reserves have become unnecessarily high and are now spending them by increasing their activities, so that for a period of time their expenditure will be more than their income.

# 4

## What should be included in a reserves policy?

The amount of detail contained within a reserves policy will be unique to each charity and will depend on the size and complexity of its activities. It is for the board of charity trustees to decide on the matters contained within the reserves policy and on the levels of reserves required. A reserve policy should clearly state:

- › **The reasons for having or not having reserves.** This will explain the reasons why the charity trustees believe reserves are required or not required. Each charity will have its own reasons for holding reserves. These reasons will depend on the charity's activities, risks and plans for the future.
- › **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.** The level of reserves required will be unique to each individual charity.
- › **A strategy for building an appropriate level of reserves.** This will set out how the charity aims to achieve the appropriate level of reserves.
- › **Arrangements for monitoring and reviewing the reserves policy.** 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 monitored and reviewed on a regular basis, particularly if the charity is facing strained financial circumstances and there is a concern that the charity may not be able to discharge sums that become due and owing to any creditor that it engages.
- › **A communications strategy for explaining the charity's reserves to the public.** A charity should clearly explain to its stakeholders what it considers to be an appropriate level of reserves and why. This statement should be updated to reflect any changes in the charity's reserves or its reserves policy.



# 5

## How should charity trustees determine an appropriate level of reserves?

Defining the amount a charity should have in reserves is unique to each individual charity. The amount varies between charities and there are multiple factors which influence the appropriate amount a charity should have at hand. Charity trustees should consider the following:

- › the size of the charity;
- › contractual obligations to suppliers and general creditors that it might engage;
- › whether it has obligations as an employer; and
- › how its income is generated.

For example, a small volunteer only grant funding charity that only issues one-off grants and has no long-term commitments may be able to manage with almost no or very little reserves. However, a charity which is running a number of complex projects with uncertain income streams or a charity with seasonal income or long-term commitments (for example, a charity funding medical research) would require much higher reserves. The views of a funder on the level of reserves a charity should hold can be taken into account, but it is ultimately the responsibility of the trustees to decide the appropriate level of reserves.

In order to calculate a charity's reserves figure, the starting point is to take the total funds of the charity minus restricted funds and designated funds (i.e. money already set aside for future activities). If the charity's accounts are prepared on an accruals basis i.e. where revenues and expenses are recorded when they are earned, regardless of when the money is actually received or paid, and if your general fund balance includes fixed assets, you will need to deduct these from the fund balance to get the reserves figure.

If you are trying to establish whether funds are restricted, you need to identify whether there are restrictions on the use of the funds which are more limited than the overall objects of your charity. There is a difference between formal, legally binding restrictions, and mere wishes, and it may be necessary to obtain legal or other professional advice if the nature of any restriction is not clear.

You may find that the restrictions or conditions imposed by a funder or donor are set out in some documentation such as a will or a contract, but this may not always be the case. For example, where funds have been raised in response to a public appeal there may be no surviving documentation and the only remaining clue will be in the fund's name (for example – 'the Community Centre Fund'). In some cases there will be a minute of a meeting, an extract from a will, a letter or some other similar documentary evidence.

Other examples of restricted funds are:

- › If a charity receives a donation of €5,000 on condition that it is used to purchase medical equipment, the donation is then a restricted fund.
- › A charity holds a collection to raise funds to fund a medical research project. All funds received as part of this collection would be restricted for that research project.
- › A legacy is received which states it must be used for maintaining a building. All income from this legacy would be restricted for maintaining the building.

Once the starting point has been established, the charity trustees can start looking at what level of reserves they want to retain.

## Consider the financial position of your charity

To assess what level of reserves is appropriate for your charity, charity trustees should understand their charity's financial position and how this links to the charity's activities. Budgets, cash flow forecasts and annual/strategic plans need to be considered, and in particular any uncertainty over future income or the risk of unexpected expenditure needs to be taken into account. When you review your annual/strategic plans you should consider whether expenses can be met from annual income or whether reserves may be needed to meet certain costs.

Particular areas to consider are:

- › Funds to allow for unforeseen emergencies or other unexpected needs, for example an unexpected repair bill or funding required 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 were to be the case.
- › Funds to allow for increased beneficiary need - external changes may mean your charity receives additional requests for support.
- › The need to fund short-term deficits in a cash budget, for example money may need to be spent before funding is received.

## Consider the amount you need in reserves

Exactly how reserves are used is ultimately a decision for charity trustees. The reasons why you need reserves will determine the level of reserves and how this is reflected in your plans. In some cases reserves will be a specific amount; in others it may reflect a number of months' or weeks' expenditure which could fluctuate.

For example:

- › If you are planning for **unforeseen emergencies**, you will need to judge what amount of expenditure may be required. You might want to hold back an amount as a contingency against unforeseen costs.
- › If there is **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. You should also be careful to ensure that the charity does not contract a debt if you do not honestly believe on reasonable grounds that the charity will be able to discharge the debt when it becomes due and owing.

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. However, you should review the level of required reserves regularly to make sure it is still fit for purpose.

# 6

## What should the charity trustees do to monitor the reserves?

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.

# 7

## Using charity reserves during a crisis

Managing charity reserves during a crisis or economically uncertain times can be challenging. In the first instance, trustees should consider their short, medium and longer term priorities, and see if they need to amend their financial planning given their current situation. Charity trustees are encouraged in particular to think about whether or not certain projects, spends or activities can be stopped or postponed in order to focus on essential spending if they are facing financial challenges during uncertain times.

Reserves can be spent to help cope with unexpected events. However, charity trustees should identify which funds or assets have limits on their use. If these limitations are internal only - for example your charity has decided to earmark certain funds for a particular purpose - you may be able to re-prioritise these. If they are restricted funds, meaning they cannot be spent at the discretion of the charity trustees, then they may only be used for a particular and defined purpose. For example, a fundraising appeal may restrict funds to a specific purpose, or if you have a permanent endowment, there may be restrictions on selling the endowment asset to release funds.

Charities are legally required to adhere to the terms of any restrictions that apply to their funds. Accessing or releasing restricted funds should only be considered if other options, such as utilising reserves, are not possible. The first step is to consider the terms of the applicable restrictions very carefully and then to approach the donor or the funder with a view to getting the restriction lifted which would give the charity the flexibility they need. Appropriate professional/legal advice should be taken in relation to any proposed changes to restrictions.

If you are unable to access restricted funds or it is not possible to re-designate internal funds to finance the ongoing operations of the charity, careful consideration will need to be taken to ensure that the charity does not contract a debt if you do not honestly believe on reasonable grounds that the charity will be able to discharge the debt when it becomes due and owing. In such circumstances, it is important that you carefully consider the financial status of the charity on an ongoing and regular basis to ensure that no steps are taken that will prejudice the interests of creditors.

In the interests of being accountable and transparent, charities should make all stakeholders such as funders, donors, employees and volunteers, aware of any changes made in relation to restrictions on accessing restricted funds, or the use of restricted funds in advance of any such changes. It is important that a charity is clear on the reasons why restricted funds are being accessed, and that these reasons are communicated in an appropriate and timely manner. This will allow any interested parties to have their say as to how the charity is being run.

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