

## RESERVES POLICY GUIDE FOR CHARITIES<sup>1</sup>

This guidance is to assist Board members of charities and IPCs to develop and disclose a reserves policy as recommended by the Code of Governance.

### 1. DEFINITION OF RESERVES

The Code of Governance for Charities and IPCs (Guideline 6.3.1) states that ***“While all charities should maintain some level of reserves to ensure long-term financial sustainability, the charity should disclose its reserves policy in the annual report.”***

The term "Reserves" is used to describe that part of a charity's income funds that is freely available for its operating purposes not subject to commitments, planned expenditure and spending limits. Reserves do not include endowment funds, restricted funds and designated funds.

### 2. WHY DO YOU NEED A RESERVES POLICY?

- a) Having a reserves policy helps inform the way in which a charity manages its cash, liquid assets and debt, that is, its treasury management approach.
- b) A comprehensive reserves policy will assist charities when planning and explaining their approach to stakeholders. It contributes significantly to the Board's ability to balance the needs of current and future beneficiaries, to provide stakeholders with assurances that the charity is well managed and that it has, where appropriate, a strategy for building up reserves.
- c) Without a reserves policy, the Board cannot be confident that their reserves level matches the charity's needs at the time. The charity could be holding reserves that are too high or too low for its needs.

### 3. WHAT DOES A RESERVES POLICY COVER?

***A Reserves Policy should cover as a minimum: (Refer to Annex)***

- a) The amount of reserves as at report date;
- b) What reserves level (expressed in the ratio of reserves to annual operating expenditure) the Board agrees the charity needs, together with the reasons why the charity needs this level;

---

<sup>1</sup> The term includes Institutions of a Public Character (IPCs)

- c) What steps the charity is going to take to establish or maintain reserves at the agreed level; and
- d) Arrangements for monitoring and reviewing the policy on a regular basis.

#### **4. HOW DO YOU SET A RESERVES LEVEL?**

***An appropriate level of reserves could be set through:***

- a) discussion with your manager, treasurer or member of the finance committee;
- b) analysis of cash flow;
- c) analysis of existing funds and reserves;
- d) review of future income streams with an assessment of their reliability;
- e) review of committed expenditure and how far this is controllable;
- f) examination of past trends;
- g) examining the likely changes in the main source of income;
- h) assessment of how your charity may cope with changes in the main source of income;
- i) studying the likely effects on the beneficiaries;
- j) assessment of the risks facing the charity, and how likely these are to materialise;
- k) forecasting levels of income in future years (taking into account the reliability of each source of income, and the prospects for opening up new sources);
- l) forecasting expenditure in future years on the basis of planned activities;
- m) analysis of any future needs, opportunities, contingencies or risks; and assessment of the likelihood of each of those needs arising, and the potential consequences for your charity not being able to meet them.

## SAMPLE TEMPLATE OF RESERVES POLICY TO BE DISCLOSED IN ANNUAL REPORT

Our reserves position:

	Current Year	Previous Year	% Increase / (Decrease)
<b>Unrestricted Funds (Reserves)</b>			
Restricted / Designated Funds:			
- Building Fund			
- Education Fund			
- Others			
Endowment Funds			
Total Funds <sup>2</sup>			
<b>Ratio of Reserves<sup>3</sup> to Annual Operating Expenditure<sup>4</sup></b>			

The reserves that we have set aside provide financial stability and the means for the development of our principal activity. We intend to maintain our reserves at a level which is at least equivalent to XXXX (a set range, amount or manner of calculation, with justification/ reasons). We intend to use the reserves in the following manner in XXXX (state timeframe):

- a.
- b.
- c.

The Board regularly (state regularity like quarterly, etc) reviews the amount of reserves that are required to ensure that they are adequate to fulfil our continuing obligations.

<sup>2</sup> Total funds include unrestricted, restricted, designated and endowment funds.

<sup>3</sup> Unrestricted Funds.

<sup>4</sup> Charitable Activities and Other Operating and Administration Expenses.

**CHECKLIST TO DISCLOSE RESERVES POLICY IN THE ANNUAL REPORT**

- a) Disclose the amount of reserves as at report date in the following manner:

Our reserves position:

	<b>Current Year</b>	<b>Previous Year</b>	<b>% Increase / (Decrease)</b>
<b>Unrestricted Funds (Reserves)</b>			
Restricted / Designated Funds:			
- Building Fund			
- Education Fund			
- Others			
Endowment Funds			
Total Funds			
<b>Ratio of Reserves to Annual Operating Expenditure</b>			

- b) What reserves level (expressed in the ratio of reserves to annual operating expenditure) the Board agrees the charity needs, together with the reasons why your charity needs this level?
- c) What steps your charity is going to take to establish or maintain reserves at the agreed level?
- d) What arrangements are made for monitoring and reviewing the policy on a regular basis?

## POSSIBLE REASONS & IMPLICATIONS FOR RESERVE LEVELS

Reserve levels expressed in the ratio of reserves to annual operating expenditure (therefore resulting in number of years of operating expenditure):

Years of Reserves	≤ 1 year	2 – 5 years	6-10 years	> 10 years
<b>Possible Reasons for Level of Reserves</b>	<ul style="list-style-type: none"> <li>○ A newly set-up charity.</li> <li>○ Charity is a self help charity with no staff and therefore wants to use up all its income each year.</li> <li>○ Charity's income is volatile in nature, and it has high expenditure commitment.</li> <li>○ Charity is working on some financial difficulties that it is facing.</li> </ul>			<ul style="list-style-type: none"> <li>○ Prudent hedge against fluctuations in income.</li> <li>○ Well endowed charity with a steady reliable income from donors who believe in its cause and from investments.</li> <li>○ A charity which responds to costly and unpredictable emergency situations.</li> <li>○ Retention out of habit or unwarranted caution.</li> </ul>
<b>Implications</b>	<ul style="list-style-type: none"> <li>○ May threaten a charity's continued existence, presenting a risk of insolvency.</li> <li>○ May deter potential donors from donating if its viability is under threat.</li> <li>○ May hamper proper planning of the charity.</li> <li>○ May create insecurity</li> </ul>			<ul style="list-style-type: none"> <li>○ Conflict with charity's implied duty to apply income within a reasonable time to further its objects.</li> <li>○ Charity fails in its duty to treat current and future beneficiaries fairly.</li> <li>○ Public may be put off by perceived</li> </ul>

Years of Reserves	≤ 1 year	2 – 5 years	6-10 years	> 10 years
	<p>amongst beneficiaries, supporters and employees.</p> <ul style="list-style-type: none"> <li>○ May cause charity to spend much time and effort dealing with the problems of insufficient working capital rather than getting on with the main purposes of the charity.</li> </ul>			<p>'nest egg'.</p> <ul style="list-style-type: none"> <li>○ Hoarding at the expense of obvious immediate needs.</li> </ul>