Sue Thorn Consulting Ltd
Briefings for learned and professional societies

Briefing 1 - setting a reserves policy

This briefing is intended to assist trustees and staff of charitable learned and professional societies to develop and maintain a reserves policy that will contribute to their future stability as well as satisfying the Charity Commission requirements.

All policies should flow from a strategic plan that states a clear vision for the organisation and the reserves policy is no exception to this. Many organisations write this in a hurry at the end of the financial year to meet the auditor's deadline for the Trustees Report in the financial statement, without reference to the broader picture. The reserves policy should therefore be closely linked to the strategic plan and also the risk register.

The reserves policy – or policies, if separate ones are needed for restricted or designated funds – defines how much money should be kept in reserve to deal with the risk situations identified in the risk assessments. A word of clarification is useful here – the stated required reserve in the policy is a figure *above* which the charity should not maintain reserves (unless they are taking active steps to spend them), not a figure *below* which they mustn't go. Many trustees misunderstand that. The reserve is there to spend in difficult times and many charities should have used part of it over the last few years to maintain key services to beneficiaries if income has dropped. There is no point at all in having a reserve if it is never used.

The Charity Commission says (ref 1) that 10% of all charitable assets are held as reserves with no policy covering them. Apparently 40% of charities say they have a policy, but it must be said that most of the policies I have looked at in Trustees Reports have been surprisingly poor in quality.

The Charity Commission proposes an integrated approach for larger charities in CC19, annexe 2 (ref 2):

- Understanding the nature of funds held
- Identifying functional assets
- Understanding financial impact of risk
- Reviewing sources of income
- Impact of future plans and commitments
- Agreeing a reserves policy

The nature of funds held refers to understanding how much of the assets are restricted, designated, or unrestricted. Broadly, the available reserve is equivalent to the unrestricted funds, but it is permissible to deduct functional assets, ie all or part of the tangible fixed assets without which you could not continue to operate. See CC19 for more information on designated funds, endowments and so on. CC25 (ref 3) is another useful document in this context.

Too many Trustees Reports state what the available reserve is, then state what the key risks are, but make no real attempt to tie these together. After establishing what the actual reserves are, the next step is to establish what the required reserve should be. You need, as a minimum, to state the basis of calculation of the reserve requirement, the sum that results from the calculation, how that compares to the actual reserve, and to comment on any discrepancy. Consistency over the years is also essential.

There are various different ways to approach this, but I can put the approaches I have examined into two main types.

The first approach involves maintaining enough reserves to operate for a short time or to close the charity if funding collapses completely – maybe x months' expenditure. Big 'traditional' charities such as Oxfam and Save the Children usually operate in this way. Oxfam, for example, designates a reserve of three months' unrestricted expenditure. There are two good reasons for a relatively short timeline on this. The first is that they receive money from many thousands of people by donations and legacies, so the risk of a sudden catastrophic collapse of all support is small. Also, people are dying now, so the amount held back must be minimised.

The second approach is to plan to survive for a period of time, for example two years, with a view to being able to establish new business models by the end of the period; if not, to be able to cut back dramatically or close. This will usually involve some cut-back in year 1 and more in year 2, but maintaining and supporting key services.

This second approach is probably more appropriate to learned and professional societies as they have a number of unusual features, one of which is often a rather small number of main income sources, such as a journal and a conference. In addition to being rather small in number, these income sources have particular risks associated with them. For example, if there is a big change in the journal business model, this could lead to a sudden drop in subscription income and the journals could need subsidising for some time to enable them to survive for long enough to evaluate and invest in new business models. Equally, large congress venues may be booked four or more years ahead with up to 100% venue cancellation fees.

This sort of approach enables societies to continue to provide their key support services during recessionary times – when they are most needed – whilst being able to evaluate and invest in new business models for the future.

So, how to achieve this? It works well to set up a spreadsheet that can be amended each year.

- Identify the key activities and their income and expenditure
- Identify the major risks associated with these activities
- Propose scenarios and quantify the effects of these
- Make a table of reserves required for each area
- Integrate the results of this into the policy statement
- Review it every year!

List the key income and expenditure items – don't worry about every minor one; this is broad brushstroke thinking. If everything really does flow from a clear strategic vision, then you will have no trouble identifying which activities are most important. The risks associated with them should already have been identified in the risk register. Define a set of plausible problem scenarios based on those risks, eg unfunded open access means journal subscription income drops over a short period by x%; the economic situation means that industry support of the conference drops by y%.

Model what this would mean over a couple of years for income and expenditure. How can expenditure be reduced to offset some of the income loss? Could some activities currently subsidised be cut back to be self-supporting? Could some activities be put on hold for a while? Which are most essential to maintain?

The end result will be a sum of money that would be required to see you through those years. Iteration may be required to adjust the figure to something sensible. It will still be an estimate, but an overall estimate derived from a set of detailed estimates is better than a single hand-wavy estimate. In addition, provided the scenarios and calculations are well annotated, it will be easy to identify how changes in your situation and your environment during that year affect the scenarios going forward and thus to update the spreadsheet each year.

References

1. RS13 – Tell it like it is: the extent of charity reserves and reserves policies, http://www.charity-commission.gov.uk/library/guidance/rs13text.pdf
2. CC19 – Charities and reserves, http://www.charitycommission.gov.uk/Publications/cc19.aspx
3. CC25 – Managing charity assets and resources: an overview for trustees, http://www.charity-commission.gov.uk/publications/cc25.aspx?

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