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What are charity reserves?
For the purposes of this document reserves can be understood as income that becomes available to the charity and is to be expended at the discretion of the Board of Directors (or Trustees) in furtherance of any of the charity's objectives ('general purpose' income), but which is not yet spent, committed or designated - it is 'free'.

This excludes the following:
- Permanent endowment
- Expendable endowment
- Restricted funds
- Designated funds
- Income funds that could only be realised by disposing of fixed assets held for charity use.

Why have a reserves policy?
There are a number of reasons why charities may hold reserves and these will depend on the type of activity undertaken by the charity and how it operates and funds its operations. In general, reasons why charities hold reserves can be summarised as follows:

- to fund working capital
- to fund unexpected expenditure, for example when projects overrun or unplanned events occur
- to fund shortfalls in income, when income does not reach expected levels

A helpful way for charities to view reserves is to see them as the funds they will use to cover expenditure to "buy some time" in the event of reduced income or changes in circumstances. In this way, a charity may foresee that there is a chance that funding from a particular source will be cut. The charity will need reserves to fund the committed expenditure whilst they source alternative funding. The judgement of how long they will need to find alternative funding will help to inform the size of the reserve needed for this purpose. For example, the charity may assess that it would need six months to replace a major source of funding. The reserves level to cover this contingency would therefore need to be the equivalent of six months' funding or expenditure.

The benefits of developing a reserves policy:
- It is a key element of the strategic plan – without a clear idea of the reserves you need you may not be able to meet your commitments or start new activities.
- It feeds into the budgeting and decision-making process – the policy will act as a benchmark to ensure that you use your funds to good effect. Without this the danger is that if you have high reserves you may take on projects without detailed planning and with low funds you may be forced to be reactive rather than plan constructively.
- It focuses the fundraising activities – the reserves policy will identify your level of need for funds and what they are needed for. This can be fed into the fundraising plans as it is often easier to fundraise for specific items or amounts.
- It is necessary for communication with those external to the charity – the reserves policy helps to demonstrate that the charity's money is being used to good effect. Funders, beneficiaries, members and the wider public are entitled to know this and that you have good reasons for maintaining or seeking the certain levels of reserves.

Is there a problem with a charity having reserves?
Charity reserves can be a controversial issue. The media has criticised some large charities for apparently accumulating large reserves while at the same time conducting additional fundraising appeals.

The Revenue Commissioners have the view[1] that the income raised by a charity with a CHY number should be spent by the charity on furthering its charitable purpose. Accumulation of income is possible (for example, to save funds for a future project like construction of a building or to save money in accordance with a reserves policy). In principle, however, income needs to be spent in a particular year unless there it has already been agreed with the Revenue Commissioners as to why it will not be spent in that particular year. Generally, the Revenue Commissioners will take the approach that a charity needs to think through its reasons for accumulation of funds, it needs to articulate clearly what it is doing and why and it needs to communicate this to the Revenue Commissioners. Once they see evidence of these things happening, and if they agree with the analysis, they tend not to put obstacles in the charities way.

Charities should therefore devote their attention to providing accounts that are clear and transparent and also ensuring that they include a reserves statement that conveys to donors what the position is and why the charity needs reserves. This is particularly important because many funders automatically look at the fund balances shown in annual accounts when deciding whether to approve applications for funding.

It is generally assumed that voluntary organisations should not hold onto charitable funds for a long time since the organisation was granted those funds to provide services. This holds true for charities that are raising funds for meeting these immediate needs, but some charities raise and are given funds for current and longer term beneficiaries and need to plan and balance how they spend funds for both today and the future. These competing needs should be seen as part of the risk management process that all Board's should engage in.

Reserves policy
Whilst the situation may well change with the advent of a Charity Regulator in Ireland, the Revenue Commissioners take the view that voluntary organisations need to explain and justify to them the level of reserves they hold. Therefore, in order to make the discussions with the Revenue Commissioners as easy as possible, even the smallest of organisations that aspire to financial security should have a reserves policy.

There is a temptation to say "We have got enough reserves to carry us through three months activities; let's make that our reserves policy", rather than stepping back and making a genuine estimate of needs and then making efforts to achieve those levels.

A policy on charity reserves should cover:

- The reasons why the charity needs reserves
- The level (or range) of reserves the Board believes the charity needs
- What steps the charity is going to take to establish or maintain the reserves at the agreed level (or range)
- Arrangements for monitoring and reviewing the policy

[1] The Section 207 Taxes Consolidation Act under which charities seek tax exemption is only applicable to income applied for a charitable purpose only. If a charity has income which is not applied for a charitable purpose, it is theoretically eligible for tax.

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Fixing a reserve level

There is no absolute level of reserves that an organisation must have and it may help to benchmark against other organisations. To determine the right size of reserves, Board members need to look at their current and future incoming and outgoing resources and ask:

- How likely is it that our main source of income will change?
- How would we cope if it did?
- How would our beneficiaries be affected?

Research conducted in the UK discovered that the most popular techniques used to establish an appropriate level of reserve were:

- Through a cash flow analysis
- Discussions with the management team, treasurer or members of the finance committee
- Through an examination of past trends

As a minimum the organisation should:

- Forecast its income (this should in any case be done as the most basic part of financial planning)
- Forecast planned activities and their associated costs
- Consider future needs and opportunities, for example, expansion possibilities
- Consider various scenarios - asking "What if…" for example, there was a change in government policy affecting their area of operations.

Once the organisation has an idea about what level of reserves it should have, it can compare these with current actual reserves. Most organisations are likely to be facing a shortfall, but it is possible that a long established charity might have, quite literally, an embarrassment of riches.

Summary

The essential steps in developing a reserves policy are as follows:

1. Review existing funds
2. Analyse income streams
3. Analyse expenditure and cash flows
4. Analyse the need for reserves
5. Calculate the reserves level
6. Formulate reserves policy
7. Presentation of reserves policy

The Revenue Commissioners are mostly concerned with "free reserves" (that is, not permanent endowments or restricted funds) and they require a justification for their level. This must be agreed in advance.

Example of a reserves policy
A formal policy on reserves was agreed at the ____________ meeting of the executive committee/ Board / etc.

It states:

The Board has set a reserves policy which requires:

- Reserves be maintained at a level which ensures that ________________ organisation's core activity could continue during a period of unforeseen difficulty.
- A proportion of reserves be maintained in a readily realisable form.

The calculation of the required level of reserves is an integral part of the organisation's planning, budget and forecast cycle.

It takes into account:

- Risks associated with each stream of income and expenditure being different from that budgeted
- Planned activity level
- Organisation's commitments

The following headings could be used in the policy:

- Introduction
- Current policy: (as outlined above)
- Risk assessment: against each category of income and expenditure
- Future activity level: likely requirements on reserves
- Organisational commitments
- Current reserves level

Sources
The following documents provided the source material for the development of this guideline document:

'Reserves: an overview', NCVO,
www.ncvo-vol.org.uk/askncvo/index.asp?id=2586

'Reserves policies for smaller charities', NCVO,
www.ncvo-vol.org.uk/askncvo/index.asp?id=2585

'Drawing up a reserves policy', Sayer Vincent,
www.sayervincent.co.uk/render.aspx?siteID=1&navIDs=1,7,64

Irish Revenue Commissioners
www.revenue.ie