

Southend Education Trust

Reserves Policy 2011 - 2014

This paper has been compiled using guidance produced by Sayer Vincent (Consultant and Auditors) in "Drawing up a reserves policy" November 2007

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- **Why do we need reserves?**
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What are reserves?

Reserves are unrestricted funds held as the general funds of the charity, often described as free reserves. In SORP 2005 (Statement of Recommended Practice 2005), the term reserves are defined as follows:

*"In this SORP the term "reserves" (unless otherwise indicated) describes that part of a charity's income funds that is freely available."*¹

Designated funds should be considered when considering the charity's reserves, although these are not part of the *general* reserves. Funds need to be properly designated for a defined purpose, which should be explained in the notes to the accounts. Charity Commission guidance in C19 makes it clear that charities may not designate funds in order to present their reserves levels as lower than they really are.

*"We expect charities to follow this recommendation and to ensure that the amount of any funds held as designated funds is appropriate to the purpose or use for which the funds have been designated. A charity will not be justified in creating, or transferring resources to a designated fund where the main purpose of doing that is to allow the charity to show a reduced level of reserves."*²

Trustees are under a duty to balance the needs of current and future beneficiaries of the charity. A charity needs to have sufficient reserves to allow it to cover known liabilities and contingencies, absorb setbacks and take advantage of change and opportunity. However, charities holding reserves that are greater than their needs will be subject to scrutiny and possible investigation by the Charity Commission.

¹ SORP 2005 Appendix 1 GL51

² CC19 – Charities' Reserves

Why do we need reserves?

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.

- **Justify the status quo**
In this approach to setting a reserves policy, the trustees look at the actual level of reserves (usually relatively high) and create a reserves policy to justify the actual amounts held
- **The “Armageddon” approach**
The trustees assume the worst will happen and calculate the level of reserves needed to fund the closure of the charity’s activities, including redundancy pay and the full cost of leases and commitments which would crystallise
- **The “actuarial liability” approach**
The charity assesses its future expenditure commitments and actuarially computes the fund needed to generate sufficient income to cover the expenditure commitments, similar to an endowment fund
- **The risk identification approach**
This approach is based on an understanding of the income streams and their risk profile, the degree of commitment to expenditure and the overall risk environment in which the charity operates

The last approach is the one recommended by Hind and now most commonly adopted by charities. The steps to developing a reserves policy on this basis are described in more detail below.

What level of reserve do we need?

The reserves required have been agreed following a review of:

- Analysis of existing funds
- Review of future income streams with an assessment of their level of reliability
- Review of committed expenditure and the extent to which this is controllable
- Risk assessment, to identify potential commitments and contingencies, together with the likelihood that these risks will materialise and give rise to new commitments

How will we set up or keep reserves at the agreed level or range

The trustees will ensure that an amount of funding agreed as reserves is maintained annually.

Arrangements for monitoring and reviewing the policy

The reserves policy will be reviewed annually along with the annual risk assessment

Reserves required 2011/12 - 2012/2014

This analysis uses the scoring criteria outlined in Appendix 1

1. Analysis of existing funds

The organisation has no fixed assets and all restricted funds have been identified. Existing reserves at 31 March 2010 were £279k.

2. Review of future income streams

	£k	Proportion of income	Likely change (1 low 4 high)	Number of sources	Certainty	Reliability score
Consultancy	10k	3%	2	10	2	120
Services	10k	3%	2	4	2	40
Workforce Development	10k	3%	2	10	2	100
Partnerships agreement	Nil	0%	2	4	4	32
National Associations	3k	1%	2	100	2	400
Premises	Nil	0%	2	4	2	16
Designated funds	267k	90%	2	1	4	720
Total	300k	100%				

3. Review of committed expenditure for core costs

	£k	Proportion of expenditure	Operational significance (1 low 4 high)	Number of people	Source of funding	Commitment score
Salaries	130	4.2%	4	2	4	1344
Running costs	170	58%	4	0	4	928
Total	300	100%				

4. Risk assessment

Suggested Reserve Fund with 2.5% growth

	2011/12	2012/13	2013/2014
Running costs (21 weeks)	68k	69.7k	71.4k
Core salaries (6 months)	65k	66.6k	68.3k
Redundancy costs	50k	51.3k	52.6k
TOTAL	183k	187.6k	192.3k