

FINANCIAL RESERVES POLICY AND CURRENT TARGET RESERVE LEVELS



1. Background

- 1.1 The Charity Commission guidance booklet CC19 Charities' Reserves stipulates *"to justify their holding of reserves, trustees should have a reserves policy based on a realistic assessment of their reserves needs"*. The Charity SORP requires charities to provide a summary of their Reserves Policy and explain the actual levels held.

2. Principles

- 2.1 Reserve levels need to be managed in response to identified needs and the Trust's circumstances.
- 2.2 Resources at the Trust's disposal should be applied as effectively as possible, within the terms of its Memorandum of Association.
- 2.3 Income should be applied as soon as possible after receipt for the purpose for which it was given.
- 2.4 Reserves should not be held without a positive justification.
- 2.5 The needs of present and future beneficiaries should be balanced.
- 2.6 The size of reserves should be appropriate to the purposes for which the reserves are maintained.
- 2.7 It is preferable to have reserves with as few restrictions as possible.

3. Structure and Definitions

- 3.1 The Trust's funds are classified between Unrestricted and Restricted Funds. Unrestricted funds include Designated Funds and the General Funds, and Restricted Funds include Permanent Endowments. These terms are defined in Appendix 1 and the actual funds in existence are illustrated in Appendix 2 (REMOVED).
- 3.2 "Free" reserves are unrestricted funds excluding Designated Funds and operating fixed assets because in the short-term they cannot be converted into cash. The Strategic Investment Fund, being a Designated Fund is thus excluded.

4. **Purposes of each fund**

UNRESTRICTED FUNDS

General Funds

(a) The General Operating Fund

4.1 The General Fund represents working capital and operating fixed assets and includes:

- tangible fixed assets
- cash
- debtors
- creditors

(b) The Contingency Fund

4.2 The purposes of holding a contingency fund include:

- providing a degree of protection against shortfalls in future income;
- enabling unexpected expenditure to be financed;
- enabling future financial commitments to be met.

Designated Funds

4.3 The Strategic Investment Fund is a Designated Fund to provide initial funding to enable the initiatives within the strategic plan to be developed. Many of these initiatives will require significant additional funding to proceed.

RESTRICTED FUNDS

4.4 The purposes of the Trust's restricted funds include:

- indicating that woodland and land owned by the Trust is not intended for resale;
- demonstrating appropriate segregation of funds received for specific purposes, (eg permanent endowments);
- carrying forward unexpended funds to match them against future expenditure.

5. **Target Reserve Levels**

Free Reserves

5.1 Free reserves consist of the General Funds excluding operating fixed assets.

5.2 The policy of the Directors is that the level of free reserves should be sufficient to cover operational expenditure commitments in the short term (excluding expenditure on acquisitions and other funded projects). This is to be reviewed during every budget cycle with consideration of operational risks and external factors.

- 5.3 The most important dimension is unrestricted cash projections. The year end target for opening and closing free reserves cash for 2010 is £5m with £3m being in the Contingency Fund and £2m being in working capital.

Contingency Fund

- 5.4 The current position for the Contingency Fund appears in Appendix 2. The target level is reviewed periodically, (normally annually), to reflect changing circumstances. The most recent assessment is in Appendix 4 (REMOVED) and this supports an increase from £2.5m to £3m.
- 5.5 If the Contingency Fund is below its minimum target level the objective will be to reach minimum level, as soon as is practicable subject to competing interests.

General Fund

- 5.6 The requirement for the general fund working capital cash is reviewed periodically and as part of the budgeting cycle. The £2m working capital cash balance reflects the amount required to ensure that the peaks and troughs of cash flow requirements during the course of the year can be met. An additional loading of £1m has been added to reflect the enhanced external economic risks and the exceptional number of change management projects being undertaken during 2010.

Strategic Investment Fund

- 5.7 The level of the Strategic Investment Fund will be reviewed annually. The budget for 2010 will cause it to be reduced from £7m to £0.9m.

6. Investment Considerations

- 6.1 The Trust will invest its financial reserves prudently with a view to enhancing their real value over time. The investment considerations are covered by the Trust's Investment Policy and the level of liquidity will be amended over time to meet operational circumstances.

7. Monitoring and Reviewing the Policy

- 7.1 The policy is monitored and reviewed as part of the annual budgeting cycle. In addition, a key event may trigger a review, for example, the cessation of a material source of funding.

DEFINITIONS USED BY THE CHARITY COMMISSION

1. **Designated Funds**

Designated funds are unrestricted funds which have been allocated or designated for specific purposes by the trustees themselves, as an administrative decision, (which the trustees are free to overturn if they wish). The purpose of designation is to identify those unrestricted funds which have been earmarked by the trustees for specific purposes but which have not been contractually committed.

2. **Restricted Funds**

Restricted funds are ones which are subject to trusts which prescribe some specific use for the funds within the wider objects of the charity. Restricted income funds are expendable by the trustees only in accordance with those specific trusts and, by definition, are not available for general purposes.

3. **Permanent Endowment**

Permanent endowment is property which may not be expended. Assets representing permanent endowment must generally be held indefinitely and either used in connection with a charity's work or invested to produce an income.

4. **Expendable Endowment**

Expendable endowment is property held as capital, with the trustees having power to convert the capital to income and to expend the income. The trustees' power is discretionary, and they are under no obligation to convert the capital to income.

Expendable endowment should normally be taken into account when calculating available income funds and reserve needs. As a first step, trustees should include expendable endowment as part of the charity's expendable funds. Only where expendable endowment genuinely cannot be released for expenditure on the purposes of the charity, (for example, when it is an indispensable source of income), should it be excluded from the calculation of income funds.

Trustees should make an annual review of any expendable endowment to ensure that their decision to keep the funds as capital is appropriate in view of the charity's current financial needs.

**FINANCIAL RESERVES POLICY
PUBLIC RELATIONS CONSIDERATIONS**

1. Reserves are a topical issue for the media, supporters and the public. The Trust needs to be able to respond swiftly to present and defend its reserve policy.
2. The key issues to articulate are:
 - the differentiation between unrestricted and restricted funds;
 - that it is only the unrestricted funds over which the Trustees have full discretion as to their use;
 - that the unrestricted funds have been structured to support an ambitious and continuous conservation programme and to provide a modest reserve against sudden shortfalls in income or the need for unplanned expenditure;
 - The Trustees review the target minimum balance for the Contingency Fund annually in the light of perceived operating risks and current conservation opportunities.
3. A summary of the Trust's financial reserves policy is contained in its full annual accounts.

[Appendix 3 – Financial Reserves Overview link](#) (REMOVED)

[Appendix 4 – The Risk of an Operating Deficit](#) (REMOVED)