

# Stewardship Forum

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### Stewardship Tools for Fundraisers : Giving Matters

**Title: How can charities best manage reserve funds?**

**Author: From “Third Sector” magazine**

***Saving money for a rainy day is a good idea. But how much should a charity keep in reserve and when should it dip in? asks John Plummer***

The RSPCA has experienced some pretty bad weather in recent months with £16million of investments wiped out in the wake of 11 September. However, it said last week that the conditions were not inclement enough to justify touching its £34million of reserves, opting instead for a two-year pay freeze and a 12-month halt on building projects.

Mark Watts, the RSPCA’s director of finance and support, explained that protecting its investments was a priority. “As well as trying to maintain animal welfare we re trying to maintain our investments”, he said.

His sentiments are in sharp contrast with the approach taken at Barnardo’s, which has withdrawn more than £79million over the past seven years to meet planned increases in its work. Its finance director, Ian Theodoreson, says: “Our commitment to growing and continuing our work with disadvantaged children is clearly evidenced by the considerable use of reserves over the past years. Our intention is not to accumulate funds unnecessarily but to use them in a prudent and efficient manner that will enhance the future lives of the many children and families with whom we work.”

That two charities can adopt such vastly different reserves policies illustrates what a grey area this is. Trying to calculate how much should be kept in a charity war chest is an imprecise and ever-changing science, but many organisations are grappling with it in the wake of the 40% decline in the FTSE 100 in little more than two years.

The Charity Commission urges charities to adopt reserves policies, but they are not statutory requirements. The commission says it is up to each board of trustees to determine its own level of reserves according to how much they feel it takes to “absorb setbacks” and “take advantage of change and opportunity”. But each charity ought to be able to justify the path it has chosen. “Underlying much public discussion of charity reserves is the belief that holding significant amounts of reserves is tantamount to hoarding”, the commission’s guidelines state. “This belief is likely to persist unless charities justify and explain their reserves position.”

Howard Smith, a partner at Kingston Smith, a specialist charity accounting firm, says some organisations don’t have a clear reserves policy but sympathises with their plight. For instance, they may have to sorry about the negative implications of being seen to have a huge stockpile of reserves. “If you are heavily grant-funded and appear too wealthy, a

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potential funder might look at your balance sheet and say, “you don’t need more money”. Donors might feel the same”, he says.

According to Smith, charities should not be sitting on unspent funds except to the extent that they can demonstrate a need to do so. He says a good reserves policy should not only demonstrate where reserves might be allocated, but also outline the circumstances under which they should be touched. “You should never be tempted to just dip into it; you should always know why you are doing it”, he adds.

Simple in theory, but given the volatility of stock markets, which have ruined investment portfolios, and the uncertainty of fundraising revenue, it can be difficult to know whether to adopt short-term or long-term thinking. The RNLI has been heavily criticised for a supposedly over-cautious reserves policy which holds back enough funds for between one and three years. At the end of 2001 the organisation had enough stored away to survive for 22 months without any income.

For a charity to have so much stashed away can look bad, but organisations like the RNLI operate in uncertain seas. It receives no state funding and relies on legacies for two-thirds of its funding. “We are a capital intensive charity with a relatively fixed service commitment”, says finance director Charles Watton. “We can’t open and close lifeboat stations and turn our services on and off according to whether or not we’ve taken much money in a particular week.

As the stock market has fallen, so too has the level of criticism directed at the RNLI. Watton says the decline of the FTSE has confirmed the wisdom of its approach, adding, “It’s been a savage and painful reminder to all of us that things go down as well as up. A lot of people were lulled into a false sense of security. There was some temptation that we should reduce our reserves level but if we had done that we would be in a very difficult position today.”

Deciding how to keep reserves is another dilemma. Cash is instantly accessible but doesn’t perform well. Equities are risky. Some charities may want to tap into their reserves now but if they are stored in equities they might not be getting nearly as much as they would have expected two years ago.

Clive Paine, charity development manager at Close Wealth Management, says: “They either take the hit and switch to a safer fixed interest environment or decide equities will come back and, providing they don’t need the money at the moment, they keep going.” But he admits: “The worst case scenarios are horrendous. Some charities will be wound up.

Given the variable market conditions, Paine urges charities to strike a balance between reserve accessibility and performance. Reserve policies, he says, should sometimes be reviewed as often as every three months to enable charities to bend with the wind and take advantage of the latest policies. But ultimately, he says: “There are no hard and fast rules. It boils down to how good the trustees and finance director are.”

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