Leaflet F07: Charity Reserves

This explanatory document aims to provide guidance to Baptist Church Treasurers in developing a reserves policy for the church.

F07: Charity Reserves

1 What are reserves?

The Charity Commission in their booklet CC19 defines reserves as follows: "Reserves are that part of a charity's unrestricted funds that is freely available to spend on any of the charity's purposes". This definition excludes restricted funds and endowment funds (see leaflets F02 and F03 for guidance on what comprise restricted and endowment funds). Reserves will also normally exclude funds that have been designated for essential future spending and tangible fixed assets held for church use.

2 What is a reserves policy?

Churches that are registered charities are required to publish a reserves policy in their annual report. However, although many Baptist Churches are not registered charities, it is good practice for a church, to formulate and disclose its policy on reserves.

The reserve policy should cover as a minimum, the following four areas:

- the reasons why the church needs reserves
- what level of reserves the church needs
- what action the church proposes to take to reduce or increase its free reserves to match the required level of reserves
- arrangements for monitoring and reviewing the policy

The Charity Commission stress the detail within the policy and the time spent on it need only be in proportion to the scale and complexity of the charity's affairs. Where a church's financial affairs are comparatively simple, it should be possible to arrive at a policy quickly and easily. At the end of this document there are comments about what happens when a church does not have the reserves it calculates are necessary.

3 What amount of reserves should be held by a church?

Trustees are under a general legal duty to apply charity funds within a reasonable time of receiving them. Therefore, a church should not "hoard" charity funds but use them for the purposes of the church. However, this needs to be balanced against the requirement that if the church is to be maintained as a continuing going concern, it needs to retain "reasonable" reserves to ensure it can cope with financial challenges. The purpose of holding reserves is to ensure the church has sufficient funds available to cope with financial issues that might arise, such as the need to fund an urgent property repair, an issue with staffing, or loss of income if a number of members stopped supporting the church or rental income from a tenant ceased.

There are no simple answers to how much a church should hold, since each charity's circumstances are different, and each set of Trustees has a duty to consider in detail their own situation. For example, a church that does not own a building will not need to consider the risk of a substantial property repair bill.

The amount of reserves should be appropriate to cope with a reasonable range of possible situations. However, it does not need to allow the church to cope with extreme scenarios (e.g. all members resigning at once).

The adoption of a policy on reserves will help to identify situations where a church may need to consider either reducing or increasing the level of reserves that it holds. For example, the church may be in receipt of reliable income streams that more than cover all its running costs, in which case holding relatively modest reserves may be acceptable as the church could cope with a reduction in income or an increase in costs. Alternatively, there may be churches where the income and expenditure are quite erratic and therefore more significant reserves are necessary to cope with periods of high cost and/or low income without running out of funds.

The principal steps in formulating a reserves policy are set out in the following sections of this leaflet.

Step 1: Review of risks to income

Trustees need to assess the risks to their income. It is unlikely that the church's income would cease completely without a reasonable period in which decline would be apparent. It could however reduce under particular circumstances, so the Trustees must consider the Church's income and assess how far they can depend on it to meet their planned expenditure. If the income is from a lot of different sources, it will be more reliable than if it comes predominantly from one source.

Some considerations for types of income:

- **Freewill Offerings:** Regular monthly giving is generally lower risk than occasional one-off gifts. How dependent is the church on a small number of donors? If the most significant one or two donors stopped giving, how would the church cope? Are givers reliant on a single employer?

- **Rental Income:** How would the church cope with a void between tenants and how easy it would be to re-let the property? A residential property in a popular area might be much quicker and easier to re-let than commercial premises that are only suitable for a particular business.

- **Investment Income:** What would happen if there was a sudden drop in the stock market? Is investment income reliant on dividends from one or two companies that might change their dividend policy?

- **Legacies:** These are by their nature very erratic and a church relying, to any significant degree, on legacies for its ongoing expenditure would need to hold substantial reserves to cover years when no legacies are received.

The church might have financial difficulties if its income dropped suddenly or consistently. If the fall were of a temporary nature, the reserves would need to cover the income lost during the temporary period, less any savings that could quickly be made from the expenditure. If the fall is a long-term loss of income, then permanent cuts in expenditure would need to be made.

The outcome of this step should be an understanding of the level of reduction in income that the reserves policy needs to be able to cope with.

Step 2: Assessment of risk of unplanned expenditure

Trustees should also consider the risk of having to pay significant unplanned, urgent costs.

For Baptist churches the most likely source of this would be a major building repair, but there might be other potential costs that a church wishes to consider, depending on their circumstances. In relation to a building expenditure, it is important to consider what really would be urgent as, for example, some risks would likely be covered by insurance (e.g. a fire).

Such an appraisal will allow Trustees to understand the likely exposure to a sudden cost.

Step 3: Review committed expenditure profile

Trustees need to consider the pattern of the church's expenditure and the need for reserves to cover expenditure in the event of a shortfall of income or a substantial unplanned cost arising.

The church will need to consider how long it would take to reduce its expenditure to cope with a financial challenge. It may be helpful to review the major items of budgeted expenditure and classify it into the following categories

1. **Uncommitted expenditure:** This is expenditure that could be stopped more or less immediately if there were insufficient funds available. This might include giving to other charities that is not legally committed (although a church may wish to consider the impact that suddenly stopping giving might have on that charity). It would not be necessary to hold significant reserves against this sort of expenditure.

2. **Short-term commitments:** These are costs that can be reduced if needed but would take time to do so. This would likely include staffing costs as staffing can be reduced but there will be notice periods and possibly redundancy costs that mean this expenditure cannot be stopped quickly. This sort of expenditure requires reserves to be held to see the church through any period of adjustment that would be needed.

3. **Long-term commitments:** These are costs that cannot easily be reduced for some years, such as loan repayments, pension deficit contributions, or a long-term commitment to fund a mission project or ministerial training. Such expenditure requires reserves to be held to ensure the church is in a strong position to meet these commitments. However, this does not mean that the full value of such commitments need to be held in reserves, just an amount that would allow time for adjustment and renegotiation of such commitments, or sale of assets to cover the liability.

From this analysis, a church could assess how quickly it would be able to adjust its expenditure down by a percentage, and how much expenditure might be required to achieve such reductions (e.g. redundancy payments, termination penalties). Where uncommitted expenditure is a high proportion of the budget, this would indicate that only modest reserves are necessary as the church can cope with a financial issue by stopping this at short notice. If long-term commitments are a significant share of expenditure, larger reserves will be needed.

Step 4: Assessment of appropriate level of reserves

Having carried out the steps above, Trustees then need to make a decision about the level of reserves required to allow the charity to cope with a reasonable level of unforeseen expenditure or reduced income. They also need to consider what other funds might be available at any given time to supplement reserves. For example, members could give interest free loans to cover the Minister's notice period, to be repaid when there is no longer a stipend to be paid, or an emergency Home Mission Grant could be obtained to help during that period.

Having decided on a figure for the reserves needed, Trustees need to think about that figure carefully. For example, if the result of the assessment is £100,000, but the church has never had more than £10,000 in reserves and has managed well enough, then there is no need to panic. The calculation may have understated the reliability of the income or not fully considered alternative ways of meeting expenditure. Alternatively, the church may have been blessed with an absence of crises over the years. It is not a legal obligation to hold reserves, and the Charity Commission recognise that many charities can properly demonstrate the need for a greater level of reserves than they actually hold, but the acquisition of reserves should not be a greater priority than fulfilling the other charitable objects of the church.

For the reserves policy, a reserves level might be most appropriately stated as a certain number of months of expenditure as this will naturally adjust in line with changes in costs.

While the Charity Commission are anxious that charities should have sufficient reserves to allow their affairs to wind down in an orderly manner (if that is what has to happen), they are particularly anxious that charities do not hold excessive reserves, which would amount to hoarding money that should properly be used for furthering the charitable objects of the charity. Most churches are not in the position of having excessive reserves.

What the Charity Commission requires is that the Trustees recognise the issue, assess the needs of the charity, plan to reach an appropriate level in an appropriate timescale, and report their reserves policy in the annual report accompanying the accounts. Although most churches are currently excepted charities which are not required to publish a formal annual report, this does not mean that there should not be a reserves policy.

Step 5: Produce a reserves policy

Considering the advice above, a church should produce a written reserves policy. It should only be a few sentences in most cases. This would typically be agreed by the charity trustees and put to the church meeting for consideration. It should be included in the annual report of the church along with an assessment of the church's position against the policy, what it is doing to address any divergence from the policy and when the policy will be reviewed again.

Example 1: A typical reserves policy might be:

The reserves policy of Anytown Baptist Church is to hold three months of all expenditure plus a further three months staff costs to allow the church to adapt to any changes in the income or expenditure of the church.

The associated statement in an annual report might be:

The reserves policy of Anytown Baptist Church is to hold three months of all expenditure plus a further three months staff costs to allow the church to adapt to any changes in the income or expenditure of the church. The trustees currently believe this amount to be £23,000, compared to £12,000 in free cash reserves held at the year-end. The trustees have budgeted to run a surplus in the coming year to start to build up reserves to meet the policy. This policy will be reviewed annually.

Example 2: A further example for a church that has significant concerns about risk in relation to property repairs:

The reserves policy of Othertown Baptist Church is to hold six months of all expenditure to allow the church to adapt to any changes in the income or expenditure of the church plus a further £10,000 to allow for emergency building repairs.

The associated statement in an annual report might be:

The reserves policy of Othertown Baptist Church is to hold six months of all expenditure to allow the church to adapt to any changes in the income or expenditure of the church plus a further £10,000 to allow for emergency building repairs. The trustees currently believe this amount to be £45,000, compared to £60,000 in free cash reserves held at the year-end. The trustees are working with the church members to identify ways to use the surplus reserves to further God's mission in the local *community.*

4 What should a review of reserves encompass?

In a typical situation, good practice would be to review the reserves policy and compliance with it on an annual basis, although in some circumstances a more frequent review might be needed (e.g. if funds are very tight).

If the level of reserves is below the level described in the policy, this should be seen as a serious warning sign by Trustees, and they should consider why this has arisen. Has there been a trend in income or expenditure that should give them cause for concern and puts the sustainability of the church at risk? If they don't consider that the situation is at all troubling, then that is likely to indicate that the policy is wrong and needs review. However, if they consider it to be a real issue then they would be failing in their duties if they ignore it and should take action to resolve the situation by reducing costs or increasing income. There is no fixed period in which they are required to resolve the situation, but if challenged they need to be able to demonstrate a plan to meet the reserves policy in a reasonable period.

If assessment of reserves finds that the reserves are close to the policy level but above it, then no action may be needed as a reasonable margin above the policy might be accounted for by natural variation in patterns of income and expenditure. However, if the reserves level is substantially above the policy level, then the trustees need to consider whether they are meeting their legal obligation to put charitable funds to work in a reasonable period, and take any appropriate action.

5 Where does faith come into this?

We are taught to believe that God will provide, and we all know that this is true and that there are many instances large and small in which it can be demonstrated. However, God does not expect his people to be foolhardy, but to count the cost of a project before they proceed with it. The Trustees need to balance their faith in the ongoing provision of God through his people, with the contractual obligations they have to their Minister, other staff and other suppliers. If the church is not a CIO, Trustees need to be aware of, though not unduly anxious about, the fact that in certain circumstances they could become personally liable for debts contracted by the church which cannot be met.

There will undoubtedly be times when churches are called on to make specific commitments in faith. This is fine where there is a widely held conviction that this is the route that God is demanding, but not where the concept of faith is shorthand for failure to consider, plan and rearrange. In these circumstances prior consideration needs to be given to a contingency plan in the event that faith is not realised – what other good things will need to be stopped or sold if the finances do not work out as planned? Where building work is being planned it is important to assess whose faith is being tested – is it the faith of the church or is it the faith of the builder who has every right to expect full payment on the due dates? A church that is not contemplating a new project should also be considering its reserve position carefully.

It would also be detrimental to the advance of the Kingdom of God for a significant proportion of churches to defer their evangelistic and social work in order to build their reserves beyond the point which has traditionally proved to be appropriate. The issue of the reserves must be kept in proportion. Nevertheless, the church should consider the issue in relation to its own circumstances, formulate a policy, and review it regularly.

6 Further guidance

Treasurers may also make use of the guidance available from the Association of Church Accountants and Treasurers (ACAT). Membership of ACAT is funded by Baptists Together for all treasurers of member churches. You may access their website member area at https://acat.uk.com using the username "Baptist" and password "Didcot".

Also the team at Baptist House are always happy to deal with queries.

This is one of a series of Guidelines that are offered as a resource for Baptist ministers and churches. They have been prepared by the Baptist Union of Great Britain and are, of necessity, intended only to give very general advice in relation to the topics covered. These guidelines should not be relied upon as a substitute for obtaining specific and more detailed advice in relation to a particular matter.

The staff at the Baptist Union of Great Britain at Baptist House will be very pleased to answer your queries and help in any way possible.

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