

# Charity reserves and investment policies

Charity Chairs of Audit Committee virtual roundtable



# Introduction

On 22nd June 2023, Grant Thornton held a Chair of Audit Committee (or equivalent) virtual discussion focusing on the charity sector and how reserves and investment policies are selected and monitored. Held under Chatham House Rules, the discussion raised a number of key themes and considerations which are outlined on the next page.



## Frequency of policy review

To begin with, we asked participants how often their organisations review their reserves policies and received a wealth of responses. One charity we spoke to reviewed on a quarterly basis due to ‘tightness’ in achieving targets. Others reviewed at key operational milestones: at the time of the audit and annual report and again when setting the budget. Organisations with a long-term strategy were content to review on a longer cycle of 3 years due to a strict plan of projects and ambitions being in place.

## Key factors in policy setting

This part of the discussion covered a number of themes including:

- Risk assessment
- Number of months’ expenditure
- Possible reduction in income streams
- Existential threats

All participants suggested that they perform some form of risk assessment, referring to the number of months’ expenditure that they would need to be able to cover for their organisations in winding them up (including redundancy costs). There was general consensus that charity trustees need to determine an ‘acceptable range’ of reserves that would cover a determined number of months’ expenditure. Whilst risk factors are considered, the main focus related to the level of operational costs. There was some uneasiness around very high reserve levels, with one participant observing, “I would find it hard to say that we should always be conserving money for what we’d like to do in three or five- or ten-years’ time aligned with our strategic aims... If it means we won’t be able to help so many people this year.”

As part of the risk discussion, there was lengthy consideration of existential threats. COVID-19 affected all of the participants in some way, and one participant observed that the significant funding received from central government meant that their charity survived this period. Others noted that another future pandemic-esque event was not beyond the realms of possibility, but the extent to which they should prepare for such catastrophic events was uncertain. Attention turned to the possibility of cyber-attacks and one participant observed that the costs would likely not be insurmountable. However, another participant noted that ransomware attacks can be very costly, and, in some circumstances, charities might choose to pay ransoms to restore services promptly. A further voice noted that the cost of cyber insurance itself was both expensive and not necessarily guaranteed to provide results, causing some charities to question, ‘is it worth it?’

We asked the group to what extent reserves were considered in line with climate targets and net zero. Most had not considered this at all, as their charities did not have specific environmental links. One participant noted that environmental considerations were a key part of their overall purpose and so climate impact was a main focus of their work. Whilst the group considered that environmental risks are important in a general sense, one member of the group observed that environmental issues means “invest[ing] charitable resources in areas which aren’t relevant to our beneficiaries.” Another participant echoed this, commenting, “there are much greater risks to [our beneficiaries] than climate change, which we would focus our attention on.”

### Grant Thornton perspectives

We noted that climate change was not at the forefront of our participants’ minds when considering reserves and investment strategies for their charities. Whilst there are undoubtedly numerous factors at play for different organisations, we were surprised at the apathy towards this area. The pace of change on climate disclosures in particular, has been rapid, most recently with a government commitment to ensure that very large organisations report on key metrics. Consequently, charities will need to turn their attention towards environmental issues in the near future and consider the how reserves and investments can be best planned to meet with these challenges.

We also recognised the variances in approach to setting reserves. Charity Commission guidance explains that ‘there is no single method or approach to setting a reserves policy,’ and it was helpful to see this in practice. In our discussion we saw consideration given to a range of areas including risks, long-term strategic plans and responses to external factors. Our participants also understood the need to have a responsive policy which can adapt to changing circumstances, a feature mirrored in the Charity Commission guidance.

## Investments

Reserves policies often go hand in hand with investment strategy. We turned our attention to investing, opening with a question regarding the main objectives of the investment policy.

One participant summarised that their investment policy was designed to “maintain capital of the charity in the medium to long term,” and this was echoed by others. Overall, the investment pot was thought to be part of a longer-term strategy, rather than a short term, reliable source of income. One member commented that there is a balance between retaining a secure level of investment and using investments to hedge and drive growth. Any income generated by investments was used to support charitable purposes more generally. One participant explained a more complex policy where a target growth percentage of the charity is agreed over a 5-year period. This is reflected in the investment strategy which, “allows our investment committee to make different decisions... if they want to hold investments for a shorter term.”

Links were made between investment and reserves policies with one participant noting that, “we had a reserves policy which said if our investments fell 15%, we’d hold reserves against that... when they fell 15%, we had a very interesting discussion. But there is something to me about reserves is that when the crisis happens, that’s what they were for.” However, those working with smaller investment portfolios noted that their investment and reserves strategies were less detailed due to some reliance on the investment manager. One participant observed, “we tend to accept that there will be market fluctuations and sometimes you win, sometimes you lose... For a small charity, I don’t think you can get into too much further detail than that. You have to rely upon your investment manager, and you put your trust in them and that’s the way we approach it. It seems to work.”

Another topic that was raised was that of ethical investments. For charities with specific purposes, such as advancing mental health, there was reluctance to invest in areas which may be detrimental to those aims (such as alcohol producers). However, one group member referred to “ethical conundrums,” citing one example that, “arms providers actually tend to be quite good sponsors from a financial point of view. So sometimes you have to sort of work your way through those conundrums as to what’s more important.”

## The relationship between investments and reserves

Few participants had good examples of how they link their policies together cohesively. One participant noted that they have an objective for this year to bring the policies together, “but I think it is difficult to find examples of best practice of how that’s done.” This generated a discussion on longer term assets, specifically property, and how these are valuable investments, and contribute to reserves. One participant noted, “there is a link in that particular circumstance between investments and reserves... to have this asset or lump of assets available if you really need it, but it’s not necessarily labelled reserves... it’s intrinsically linked.” Another participant drew on considerations that their audit committee had discussed around, “whether, if you could, for example, borrow more money against your freehold assets, if could that be considered reserves? And in the end, we decided it couldn’t. But obviously in a real emergency, you could actually raise more money by effectively leveraging property you’ve got if [they are] unencumbered assets.”

### Grant Thornton perspectives

We noted that there was some uncertainty in how to bring investments and reserves together and the need for some best practice examples. The Charity Commission guidance encourages investment of reserves with due consideration to liquidity requirements and timing of when reserves may be needed. Guidance also reflects the difference in investment strategies for smaller charities with fewer reserves available: participants noted that there is more reliance on investment managers when setting investment strategies in smaller charities. Whilst this may be practical, it remains the responsibility of trustees to understand, set and approve any investment policy and so over-reliance on third parties should be cautiously avoided.

## Summary

In short, we can see that there is progress to be made in aligning reserves and investments (where appropriate) and some divide between larger charities who might have more complex or longer-term plans, compared to smaller charities who operate on a more straightforward, annual cycle. Risk factors are present in decision making but some of the bigger ‘what if?’ crises (such as cyber attacks or another pandemic-esque event) are too large and too unpredictable to propose meaningful changes to the reserves policy.

If you have any questions or thoughts for future topics for discussion please contact us:



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