Managing your funds and reserves:

guidance for arts and cultural organisations

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Commissioned by
Arts Council England

Contents

Background

Why develop this guidance?

Business models within arts and culture are becoming more complicated. Many organisations have developed a diversified range of income sources, often each with their own contractual terms and lifecycles. Accounting for these diverse revenue streams has become a more complicated task. Partly as a result of this growing complexity, a number of National Portfolio Organisations (NPOs) have experienced significant difficulties in managing their funds appropriately.

This guidance has been developed to help organisations manage their increasingly complicated finances with fewer headaches.

Who is this guidance for?

This guidance is for anyone who is involved in the financial and fundraising aspects of their organisation whether as a chief executive, manager, trustee or finance administrator. It has been primarily written for Band 1 and 2 organisations on the assumption that larger Band 3 organisations will have access to multiple sources of financial expertise.

The guidance deals with how different types of charitable income and costs, commonly called 'funds' must be accounted for in England and Wales; it is thus directly relevant to charities that must use this method of accounting. It should also be of use to organisations which have other corporate structures, such as non-profit distributing companies, that also receive restricted funding.

This document is not a substitute for reading the Charity Commission's guidance, which should be required reading for anyone responsible for the management of the finances of a charity whether as a staff member or a trustee. Neither is this is an accounting manual; detailed guidance on the accounting issues is readily available from professional accounting bodies and specialist publishers.

How can the guidance be used?

This guidance has been designed as a supplement to *Business planning guidance for arts and cultural organisations* that I developed with Dawn Langley. Like that guidance, this document is designed so that you can dip into it to answer a specific query or it can be read from cover to cover as an introduction for those new to funds or charity financial management.

Who has produced this guidance?

The guidance has been produced by Susan Royce who is a chartered accountant and independent consultant working in arts and culture. The guidance was commissioned by Arts Council England and is designed to provide independent advice and support.

How does this guidance work?

This guidance has four sections:

Section A: the legal and accounting basics
Section B: managing your funds
Section C: key worked examples
Section D: shared learning on funds management

The first section sets out the basic framework within which charity funds must be managed. The second section offers advice on how to manage your funds in terms of the systems that you should have in place, the knowledge people need and the roles that they play. The third section includes three sets of worked examples to show how the accounting works. The final section offers some insights into what works and what doesn't from my work with clients. In the appendices I have included a tool for assessing your management of funds and a list of further resources.

Susan Royce
January 2019

A

Section A: the legal and accounting basics

This section provides an introduction to the management of funds in three ways.

- Key concepts
- Key definitions
- Key requirements

Key concepts

Trusts

The well-established legal concept of a trust underpins how charities work and how you must manage the funds within your organisation.

A donor gives assets, usually but not always cash, to a trustee to hold and manage for beneficiaries. The trustee must use the trust assets as the donor wishes, is obliged to report to the donor on their management of the assets and can only benefit from their trusteeship in agreed ways.

Public benefit

Charities exist for the benefit of the public. This public benefit is at the heart of the contract between charities, the state and society: in return for tax concessions[1] charities work for the benefit of their communities and must report more fully on their activities than profit-making companies.

[1] Exemption from most forms of corporate taxation, business rate relief and more recently Theatre Tax Relief and Museum and Gallery Exhibitions Tax Relief

The definition of public benefit is a complex and evolving area of the law[2] but the current position can be summed up as follows.

Public benefit
• Your organisation's purpose must be beneficial in ways that are identifiable, capable of being proved by evidence and are not based on personal views.
• Any harm that results (to people, property or the environment) must not outweigh the benefit.
• Your work must benefit the public in general or a sufficient section of the public.
• Pursuing your purpose cannot give rise to more than incidental personal benefit which must be a necessary by-product of doing your work.

Key definitions

This section sets out a definition of key terms together with comments on the practical implications of these definitions together with examples.

Unrestricted funds

Definition: unrestricted funds are funds which can be spent on any activity which falls within your organisation's charitable objects.

Comment: Unrestricted funds will form the majority of most organisations' income and is, in many ways, the most useful source of revenue as it can be spent on any of your activities. If your charitable objects have not been reviewed for several years or you are considering a new kind of activity it is sensible to check that your activities and plans still fall within your objects.

Examples: core grants from public funders, trading income, interest on main bank accounts.

Designated funds

Definition: designated funds are funds set aside by the trustees for a specific purpose; they fall outside the definition of reserves.

Comment: Designated funds remain unrestricted but are not included in the calculation of a charity's (free) reserves. Designation is purely an administrative matter and is created and can be reversed or altered by a resolution of the Board. Designation can be a useful way of setting funds aside for a specific purpose. Your accounts need to explain the purpose of your designation and it helps to give them a meaningful name.

Examples: funds set aside for a major project in the next one or two years, a development fund set aside to provide seed corn or match funding for projects or a fund to support innovation within the organisation.

Restricted funds

Definition: restricted funds are funds held on specific trusts under charity law.

Comment: Restricted funds can only be used for the purposes for which they were given. These purposes are usually set out in a funding application or agreement or appeal literature. When applying for restricted funds it is worth considering how well the funder's aims align with your own so that your restricted fund project enhances delivery of your core purpose and does not distract from it.

Examples: project grants, capital funding, public appeals for restoration of a venue.

[2] https://www.gov.uk/guidance/public-benefit-rules-for-charities

Tips for determining whether income is unrestricted or restricted

- Many funders will indicate whether they view their funding as unrestricted or restricted so check the terms and conditions in the funding agreement.
- If the income is in the form of a grant, what is the grant for? If it is for general running costs then it will usually be unrestricted but if it is a contribution towards a particular programme, project or specific costs such as a salary then it will be restricted.
- If you are in doubt about the status of a grant it is always sensible to ask the funder: they are the donor to whom you are legally accountable.
- Issues can arise when you appeal to the general public for funds as the messaging is often less precise than for a funding bid. Did your appeal literature clearly ask for general support or for specific projects?
- Legacy income can be unrestricted or restricted. You may need to speak with the executors of the estate to clarify the terms of the bequest.

Links to further advice can be found in Appendix B under essential resources

Endowment funds

Definition: endowments are property, cash or other investments that are held by a charity in the long term. These assets do not have to spent on delivering your purpose but can be held to generate income. The income can be spent.

Comment: endowments can be either permanent (to be held forever) or expendable (the capital can be spent in certain specified circumstances). Endowment income can be a useful component in a business model but building up the sums necessary to generate a meaningful return is often challenging.

Examples: heritage buildings, general endowments to support ongoing costs, endowments to support bursaries, scholarships or specific posts.

Charity reserves

Definition: charity reserves comprise those unrestricted funds (excluding designated funds) not invested in fixed assets.

Comment: charity reserves used to be called free reserves. They represent the amount of cash or assets that can converted into cash quickly that you have available to invest in your organisation and to meet future liabilities; as such they are a powerful indicator of your financial resilience. Guidance on setting your reserve policy is given below. If your reserves are negative your annual report must include an explanation of how you plan to reverse this position. Negative or very low reserves frequently translate into recurring cashflow crises.

Key requirements

To meet your legal obligations you need to ensure that your accounting systems are appropriate and that you have developed a reserve policy in line with the Charity Commission's guidance.

Accounting

You need to set up your accounting systems to be able to distinguish between the different types of funds and to be able to produce fund balances for your regular management accounts. All of those involved in planning, accounting and reporting need to understand the differences between the different types of funds, the consequences of those differences and the overall approach that your organisation has decided to take to fund management.

Further advice is included in Section C.

Reserves policy

All charities must develop a reserves policy and disclose it in the trustees' annual report. It should be a key element of your financial strategy. Setting a goal for your reserves, and working towards it, can contribute significantly to your organisational resilience and ability to withstand adverse financial shocks. Increasingly public funders do not have the resources to provide emergency funding for organisations whose own reserves have been exhausted.

The Charity Commission sets out four criteria that a reserves policy should meet.

1. It must fully justify and clearly explain the keeping or not keeping of reserves.
2. It must identify and plan for the maintenance of essential services for beneficiaries.
3. It must reflect the risks of unplanned closure associated with the charity's business model, spending commitments, potential liabilities and financial forecasts.
4. It must help to address the risks of unplanned closure on their beneficiaries (in particular, vulnerable beneficiaries, staff and volunteers.

On reading these criteria it is clear that setting a reserves target of three months' core costs and hoping for the best is not an adequate response.

Tips for updating your reserve policy

- Review your reserve policy as part of your business planning process, not as a separate afterthought when signing off the accounts.
- Be honest: there is no point in setting a reserves target you know you cannot meet. It is much better to set a more modest target you can achieve and then look to increase it further in the longer term.
- Trustees and senior managers should work together to understand the risks that the organisation is running and how these might be changing as your business model and the external environment evolve.
- The organisation's leaders also need to agree what is their appetite for risk. A long established museum preserving artefacts for future generations may well have a different appetite for risk than a start-up, artist led company.
- Do the sums! What would it cost to close your organisation down solvently? How would you protect the interests of your beneficiaries, staff and volunteers and what would it cost?
- Consider whether you need your reserves to support your cashflow. This is becoming a more pressing issue for some organisations as core funding received in advance is falling as a percentage of total income and overdraft funding is not easy to secure.

Links to further advice on setting reserves policies is given in Appendix B.

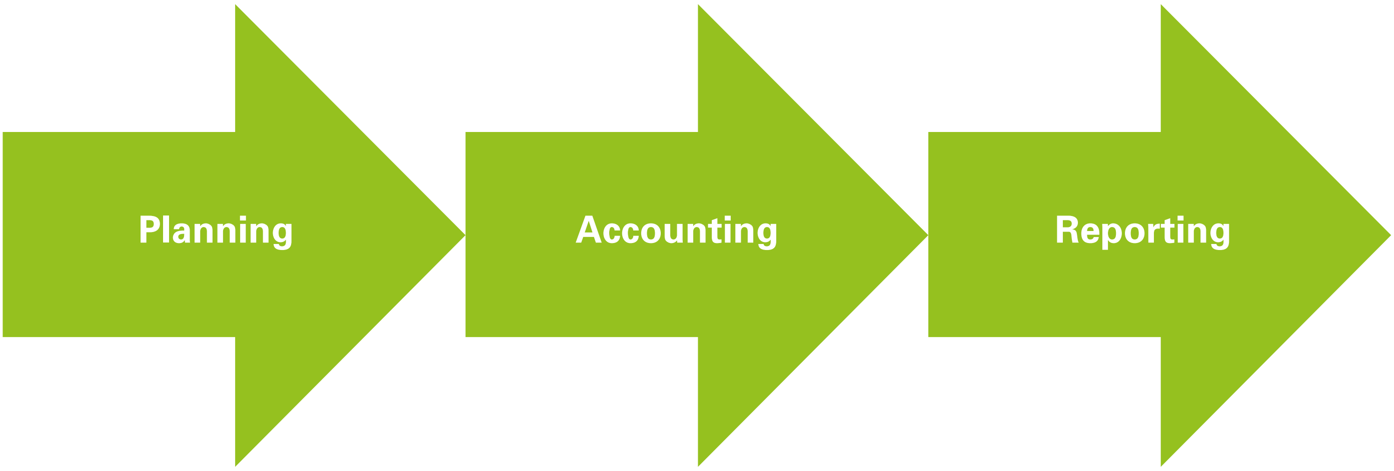
B Managing your funds

Financial management has two elements: systems and people.

- Systems: what systems do you need to manage your different funds appropriately?
- People: what skills and knowledge do different people within your organisation need to fulfil their roles properly?

What systems do you need to manage your different funds appropriately?

This question is best answered by thinking about the three stages of the financial process.



Planning

Planning covers a wide range of activities from developing business plans for several years and annual budgeting to putting fundraising bids together and planning for individual projects. However, irrespective of the type of planning that you are doing, it is really helpful to build funds into your thinking at the planning stage: it will save you time and help you to avoid some unpleasant financial mistakes.

Questions to ask when you are developing a new business plan:

- What is your reserves target and how does it compare with your current level of reserves?
- What are the implications for your financial plans? Do you need to generate more unrestricted surpluses to meet your target? Do you have surplus reserves which you need to invest?

- What is your current balance between restricted and unrestricted income? How might this change during the course of your plan as your business model evolves? What are the implications of any changes for your assessment of the financial risks you will be running and for the level of reserves that you want to hold or build?
- How have you incorporated the need to invest existing restricted fund balances in your business plan?
- Do your financial projections for both revenue and capital clearly distinguish between unrestricted and restricted funds?

Issues to consider when preparing an annual budget:

- Do you have a robust forecast of the year end position for all types of funds so you have a clear starting point?
- Do your draft budgets clearly differentiate between restricted and unrestricted income and expenditure for both revenue and capital?
- If you are relying on restricted income to support core costs, what would be the implications of not being able to secure this income on your ability to pay these costs?
- If you have posts that are funded by restricted income, what might happen when the funding is exhausted?
- What are your anticipated fund balances at the end of the budget year? How do they compare with your starting position and your plans?
- Do you understand how a change in your funding sources may affect your cashflow?

Fundraising bids and factors to consider:

- Is the funding you are applying for likely to be restricted or unrestricted?
- If the organisation is providing match funding for a project from its own unrestricted reserves is this included in the organisation's budget?

Questions to ask when developing a project budget:

- Will this project be wholly funded from unrestricted or restricted funds or from a mix of the two? If the funding is mixed how will you allocate costs between the multiple funds?
- If you are anticipating a contribution from a restricted fund project to core costs how will you ensure that you actually achieve your targeted contribution?
- If the intended project will extend over a financial year end have you prepared a phased budget so that the year-end figures can be estimated?

Accounting

To account accurately and easily for restricted and unrestricted funds you should be able to do the following:

- Allocate all income and expenditure, including asset purchases and depreciation, to the correct fund at the time that the transaction is entered into your accounting records. Restricted funds should be separately identified to ensure that the funds are being correctly applied for the purpose they were given.
- Produce fund balances on a regular basis as part of your organisation's management accounts.
- Identify how much of your cash balance at the month end relates to restricted funds. This need not be a precise number but it is important to know if, for example, what appears to be a healthy cash position is due entirely to a large restricted fund which must be spent in the coming months.

These requirements can be met either by using software designed for charities that supports fund accounting or by using project codes to identify and separate transactions.

It is not advisable to mix unrestricted and restricted transactions within the accounting records and then try to separate them out through manual changes to a spreadsheet. This approach is error prone and often fails when new finance staff are appointed who lack the knowledge of the person who set up the spreadsheet.

Reporting

Management accounts should distinguish between unrestricted and restricted funds unless the latter are immaterial; statutory accounts must disclose the funds separately[3].

Your management accounts should include a funds analysis along the following lines.

	Unrestricted	Restricted funds			Total funds
		Fund A	Fund B	Total	
	£	£	£	£	£
Opening balance	100	0	50	50	150
Income	75	25	0	25	100
Expenditure	(60)	(20)	(50)	(70)	(130)
Surplus/(deficit)	15	5	(50)	5	(30)
Closing balance	115	5	0	5	120
Forecast year-end balance	135	5	0	5	140

What skills and knowledge do different people within your organisation need to fulfil their roles properly?

This table sets out what knowledge key people within your organisation need to have in relation to funds and reserves and what they need to do to ensure that your funds are properly accounted for and managed.

[3] An example of compliant accounts for an arts trust can be found at http://www.charitysorp.org/about-the-sorp/example-trustees-annual-reports/

		Trustees	Executive & senior managers	Fundraisers	Budget holders	Finance staff
Knowledge	General understanding of the principles of fund accounting	✓	✓	✓	✓	✓
	General understanding of how your organisation manages its funds	✓	✓	✓	✓	✓
	Specific knowledge of how fund accounting relates to projects you are working on		✓	✓	✓	✓
Activities	Ensure that you have appropriate systems for recording and managing different funds	✓	✓			✓
	Incorporate your approach to funds management in financial planning	✓	✓			✓
	Think about funds when planning and delivering individual programmes		✓	✓	✓	
	Ensure that all income and costs under your control are coded by fund		✓	✓	✓	✓
	Review and approve management accounts	✓	✓			
	Review and approve annual report and accounts	✓				

Related questions

This section offers some brief guidance in relation to a number of questions that often arise when people are thinking about different kinds of funds.

What about third party funds such as ticket income collected on behalf of third parties?

This income does not belong to your organisation and any funds held, and included in your cash balances, should be shown clearly as creditors. The question of whether the funds are unrestricted or restricted does not arise as they are not your income.

What about ticket monies received in advance?

It is usual to treat these monies as creditors until the date of the performance has passed when the income can be transferred from the balance sheet to Statement of Financial Activities ('SoFA') or income and expenditure account. Such income could be unrestricted or restricted, although ticket income is usually unrestricted.

What about grants received in advance?

These grants often cause problems because there can be a conflict between how the income is treated in management accounts and in an organisation's statutory accounts prepared under the Charities Statement of Recommended Practice (FRS 102)[4]. Usually management accounts are prepared on an accruals basis which means that project income (such as grants) and project costs are matched and allocated to the same time period allowing the financial performance of the project to be monitored. However, statutory accounts are prepared on a funds flow basis so grants received in advance can only be held on the balance sheet until they can be matched to costs in very limited circumstances. You can prepare your management accounts on any reasonable basis but if you want to hold income on the balance sheet – to defer it – then you need to agree the approach with your auditors.

What can be done with small, historic restricted fund balances?

Sometimes organisations accumulate small restricted fund balances for which there is little documentation or explanation as to why they exist; the organisation may no longer have a relationship with the funder. It makes sense to discuss with your auditors how these balances could be transferred to unrestricted funds to 'clean up the balance sheet'. Small sums can be transferred without difficulty, larger sums may require additional research and disclosure in the annual accounts.

How can we develop a meaningful risk management policy?

There is considerable guidance available to assist charity boards and staff in developing and implementing useful and appropriate risk management policies. Links to a range of these resources are included in Appendix B.

[4] See http://www.charitysorp.org

C Key worked examples

This section includes three sets of worked examples looking at how accounting for restricted reserves works in practice; each set starts with a straightforward situation and then explores when happens when things get more complicated. All sums are restricted unless otherwise stated.

Accounting for restricted fund projects

Example 1.1
Funder A provides 100% of funding for a specific project. All income is received and costs spent within one financial year.

When the funding is received.

Statement of Financial Activities for month ended 30 April 2019	
	£
Income	100
Surplus for month	100

Balance Sheet as 30 April 2019	
	£
Cash	100
Restricted income fund	100

At the end of the year when the project has been completed.

Statement of Financial Activities for year ended 30 March 2020	
	£
Income	100
Costs	(100)
Surplus for the year	Nil

Balance Sheet as at 30 March 2020	
	£
Restricted income fund	Nil

Example 1.2
Funder B provides 100% of funding for a specific project. All of the income is received in Year 1 but the costs are spread over more than one year.

The position when the funding is received is the same as for Example 1.1.

At the end of the first financial year all of the income has been received but only 50% of the costs have been spent.

Statement of Financial Activities for year ended 30 March 2020	
	£
Income	100
Costs	(50)
Surplus for year	50

Balance Sheet as at 30 March 2020	
	£
Cash	50
Restricted income fund	50

At the end of the second financial year all of the costs have been spent and the accounts are the same as for Example 1.1.

Example 1.3
Funder C provides 75% of the funding and Funder D provides 25% of the funding. Funder C provides their contribution before the year end whilst Funder D provides their funding after the year end. The project is completed by the end of the next financial year end.

When the funding is received from funder A.

Statement of Financial Activities for month ended 28 February 2019	
	£
Income	75
Surplus for month	75

Balance Sheet as 28 February 2019	
	£
Cash	75
Restricted income fund	75

At the end of the first year.

Statement of Financial Activities for year ended 30 March 2019	
	£
Income	75
Costs	(25)
Surplus for year	50

Balance Sheet as at 30 March 2019	
	£
Cash	50
Restricted income fund	50

When the second tranche of funding is received in year 2.

Statement of Financial Activities for month ended 30 April 2020	
	£
Income	25
Surplus for month	25

Balance Sheet as 28 February 2019	
	£
Cash	75
Restricted income fund	75

At the end of the second financial year when the project has been completed.

Statement of Financial Activities for year ended 30 March 2020	
	£
Income	25
Costs	(75)
Surplus/(deficit) for year	(50)

Balance Sheet as at 30 March 2020	
	£
Restricted income fund	Nil

Example 1.4
Funder E provides 90% of the funding for a project costing £100; the organisation provides 10% match funding from unrestricted reserves. The project is completed within one year. The organisation has £200 of unrestricted reserves at the beginning of the project and their only asset is cash.

UR = unrestricted funds
Res = restricted funds

When the funding is received.

Statement of Financial Activities for month ended 30 April 2019			
	£	£	£
£	UR	Res	Total
Income		90	90
Costs			
Surplus for month		90	90

Balance Sheet as at 30 April 2019			
	£	£	£
£	UR	Res	Total
Cash	200	90	290
Funds	200	90	290

At the end of the financial year.

Statement of Financial Activities for year ended 30 March 2020			
	£	£	£
£	UR	Res	Total
Income		90	90
Costs	(10)	(90)	(100)
Surplus for year	(10)	Nil	(10)

Balance Sheet as at 30 March 2020			
	£	£	£
£	UR	Res	Total
Cash	190		190
Restricted income fund	190	Nil	190

Accounting for fixed assets funded by restricted grants and donations

This is the aspect of accounting for restricted funds which causes the most confusion as the approach for charities is not the same as it is for profit making organisations; making sure that you understand how the accounting works will help you understand why your accounts look as they do.

If you are planning to fundraise for capital investment for the first time, do talk this through with your auditors. Correcting mistakes several years later when staff may have changed is often time consuming and frustrating.

Example 2.1
Funder F makes a grant to cover 100% of the cost of some new equipment. The equipment will be depreciated over two years.

When the funding is received.

Statement of Financial Activities for month ended 30 April 2019	
	£
Income	100
Surplus for period	100

Balance Sheet as 30 April 2019	
	£
Cash	100
Restricted capital fund	100

When the asset is purchased.

Statement of Financial Activities for month ended 30 May 2019	
	£
Income	100
Surplus for period	100

Balance Sheet as 30 May 2019	
	£
Fixed asset – equipment	100
Restricted fund	100

Note that the cash has been spent and that purchase creates a new fixed asset. The ‘cost’ of the asset will be charged to the Statement of Financial Activities over the lifetime of the asset through depreciation.

At the end of the first financial year – the asset is depreciated by 50%.

Statement of Financial Activities for year ended 30 March 2020	
	£
Income	100
Costs – depreciation	(50)
Surplus for year	50

Balance Sheet as at 30 March 2020	
	£
Fixed asset – equipment	50
Restricted capital fund	50

Note that the net book value of the fixed asset and the associated restricted capital fund are the same; they will reduce in tandem as the asset is depreciated.

At the end of the second financial year – the asset is fully depreciated.

Statement of Financial Activities for year ended 30 March 2021	
	£
Costs – depreciation	(50)
Surplus/(deficit) for year	(50)

Balance Sheet as at 30 March 2021	
	£
Fixed asset – equipment	Nil
Restricted capital fund	Nil

Example 2.2
The organisation has net assets of £200 (fixed assets of £100 + cash of £100) and matching unrestricted funds of £200. Its free reserves are £100, being the amount of its unrestricted funds not invested in fixed assets.

Funder G makes a grant to cover 100% of the £100 cost of some new equipment. The equipment will be depreciated over two years in line with organisation's depreciation policy.

When the funding is received.

Statement of Financial Activities for month ended 30 April 2019

	£	£	£
£	UR	Res	Total
Income		100	100
Costs			
Surplus for month		100	100

Balance Sheet as at 30 April 2019

	£	£	£
£	UR	Res	Total
Fixed assets	100		100
Cash	100	100	
Net assets	200	100	300
Funds	200	100	300

When the asset is purchased the reserves position is unchanged but the restricted cash has been spent buying the equipment.

Statement of Financial Activities for month ended 30 May 2019

	£	£	£
£	UR	Res	Total
Income		100	100
Costs			
Surplus for month		100	100

Balance Sheet as at 30 May 2019

	£	£	£
£	UR	Res	Total
Fixed assets	100	100	200
Cash	100		
Net assets	200	100	300
Funds	200	100	300

At the end of the first financial year – the restricted fund asset is depreciated by 50% whilst the unrestricted assets are depreciated over four years.

Statement of Financial Activities for year ended 30 March 2020			
	£	£	£
£	UR	Res	Total
Income		100	100
Costs	(25)	(50)	(75)
Surplus/(deficit) for year	(25)	50	25

Balance Sheet as at 30 March 2020			
	£	£	£
£	UR	Res	Total
Fixed assets	75	50	125
Cash	100		
Net assets	175	50	225
Funds	175	50	225

At the end of the second financial year – the restricted fund asset is fully depreciated.

Statement of Financial Activities for year ended 30 March 2021			
	£	£	£
£	UR	Res	Total
Income			
Costs	(25)	(50)	
Surplus/(deficit) for year	(25)	(50)	(75)

Balance Sheet as at 30 Mach 2021			
	£	£	£
£	UR	Res	Total
Fixed assets	50		50
Cash	100		
Net assets	150		150
Funds	150	Nil	150

Note that the depreciation charges have no impact upon the cash held by the organisation; depreciation is a ‘non-cash’ item unlike almost all other forms of expenditure. This has important implications for the funding of future asset purchases. If all other things remain unchanged and the organisation achieves a break even result, depreciation on unrestricted assets will have the effect of building up a cash balance equal to the cost of the asset being depreciated. However, no equivalent cash balance will be built up to replace restricted fund assets as the organisation does not have the power to balance restricted income and expenditure in the same way. Other strategies must be developed to ensure that organisations can replace restricted fund assets when necessary; this could include fundraising, generating unrestricted surpluses and leasing rather than purchasing assets.

This also highlights the importance of including depreciation, both unrestricted and restricted, in budgets and management accounts so that the users of financial information are aware of the true position and are not surprised by the impact of depreciation on the organisation’s performance at the year end.

Accounting for restricted endowments

Endowments are not always straightforward. If you are looking to establish an endowment, restricted or unrestricted, for the first time do talk to your auditors in advance. You will also need to develop an investment policy; guidance on this has been issued by the Charity Commission[5] and further advice is available from a number of professional institutions and advisers.

Example 3.1
Donor H gifts £500 to create an expendable endowment to support the organisation's work with schools.

When the donation is received and invested in an interest-bearing bank account.

Statement of Financial Activities for month ended 30 April 2019	
	£
Income – donation	500
Surplus for month	500

Balance Sheet as 30 April 2019	
	£
Investment – cash	500
Restricted endowment fund	500

At the end of the first financial year when interest income is also received.

Statement of Financial Activities for year ended 30 March 2020	
	£
Income – donation	500
Income – interest	10
Surplus for year	510

Balance Sheet as at 30 March 2020	
	£
Investment – cash	510
Restricted endowment fund	510

[5] See https://www.gov.uk/government/publications/charities-and-investment-matters-a-guide-for-trustees-cc14

During year two the organisation receives further interest and decides to spend some of its interest income on its work with schools.

Statement of Financial Activities for year ended 30 March 2020	
	£
Income – interest	10
Costs	(15)
Surplus for year	(5)

Balance Sheet as at 30 March 2020	
	£
Investment – cash	505
Restricted endowment fund	505

This simple example assumes that the donation is invested in an interest-bearing bank account. The organisation might choose to invest some or all of its endowment in bonds or equities in line with its investment policy. Professional advice should always be sought before making such investments. The accounting for such investments will be more complicated as the investment portfolio will need to be valued and any changes in value included in the Statement of Financial Activities.

D Shared learning on funds management

The following are some practical do's and don'ts that come directly from real situations.

What works	....and what doesn't
Make sure that everyone with finance responsibilities understands how the different kinds of funds work and which types of funds your organisation has. Create and maintain financial systems that allow you to allocate transactions and on to report on different types of funds easily. Do think about your reserves policy when planning your business and preparing budgets. If adjustments are made to your funds balances during the audit process, do ensure that you have a copy of the adjustments and that you understand them. Consider creating designated funds for specific, strategic purposes. They can help to develop longer term planning by providing greater flexibility than just an annual budget. Consider establishing a designated fund to represent the value of your unrestricted fixed assets; it allows everyone (internally and externally) to see easily what your free reserves are. Remember that depreciating restricted fund assets does not automatically create cash for replacement in the way that it does for unrestricted assets. Plan for how you will replace funded assets.	Don't leave the job of sorting out your funds balances to your auditors. In your annual report and accounts, do not just copy the words on reserves and risk from last year; review your policies in advance. Do not allow restricted fund balances to remain unspent for several years without a clear rationale. If you have negative balances on restricted funds something has gone wrong – investigate. Do not create a designated fund just to make the balance sheet look more attractive to funders by 'hiding' general unrestricted funds; it does not deceive anyone. Instead develop a policy that sets out clearly why you are holding a given level of reserves.

Appendix A: Assess your approach to managing your organisation's funds and reserves

What works	Strongly agree	Agree	Disagree	Strongly agree	Don't know
We have a reserves policy which clearly sets out a target for free reserves and is disclosed in our annual report					
Our reserves policy is reviewed annually					
We consider our reserves policy when preparing our business plans and budgets					
We have a risk management policy that complies with current Charity Commission guidance and is disclosed in our annual report					
Our risk management policy is reviewed at least annually as part of our business planning process					
We maintain an up to date risk register that is regularly reviewed by trustees and senior staff					
All budget holders, senior staff and trustees understand the differences between unrestricted, designated and restricted funds					
We have robust systems to ensure that all types of income and expenditure are accurately allocated to their appropriate funds					

What works	**Strongly agree**	**Agree**	**Disagree**	**Strongly agree**	**Don't know**
Our management accounts clearly differentiate between unrestricted and restricted funds					
We do not use restricted income to fund unrestricted activity					

What do your answers tell you about your approach to managing your organisation's reserves?

What areas, if any, require improvement?

How will you address any gaps or weaknesses identified?

Appendix B: further resources

These resources are up to date and the web links current at the time of publication.

Essential resources

Charity Commission

CC19: Charity Reserves: building resilience is the key publication for this area. The advice has been updated recently and does include a number of significant changes from previous versions.
https://www.gov.uk/government/publications/charities-and-reserves-cc19

Charity SORP

This website provides extensive advice on applying the Charities SORP including guidance on accounting for different types of income.
http://www.charitysorp.org

Sources of advice and guidance in developing reserves policies

Reserves Policies Made Simple – Sayer Vincent

Useful guidance on setting reserves policies from a well-established accountancy firm that specialises in charities and has a number of arts clients
http://www.sayervincent.co.uk/wp-content/uploads/2015/07/ReservesPoliciesMadeSimple-SayerVincent-July2015.pdf

Beyond Reserves – Charity Finance Group, ACEVO, Institute of Fundraising and Sayer Vincent

This 2012 guidance was developed by a number of leading organisations in the charity sector and looks at the strategic management of charity reserves and includes a number of case studies.
https://www.cfg.org.uk/userfiles/documents/CFG%20resources/CFG%20Publication/SV_Reserves_Final.ashx.pdf

Sources of advice and guidance on developing risk management policies

Charity Commission – **CC26: Charities and risk management**

This is the key guidance for this area.
https://www.gov.uk/government/publications/charities-and-risk-management-cc26

The following guidance from a number of professional organisations offers practical help on setting policies and case studies. If you are thinking about this for the first time the NCVO guidance would be a good place to start.

Charities toolkit: a toolkit for effective risk management – Kingston Smith

https://www.kingstonsmith.co.uk/upload/pdf/chartiesrisktoolkitfinal.pdf

How to manage risk – NCVO Knowhow

https://knowhow.ncvo.org.uk/how-to/how-to-complete-a-risk-assessment

Rethinking risk: beyond the tick box – Sayer Vincent

http://www.sayervincent.co.uk/wp-content/uploads/2016/06/Rethinking-Risk.pdf

Risk management for charities – The Institute of Risk Management

https://www.theirm.org/media/1238690/CharitiesGuidanceV6FINAL.pdf

General advice on business planning and governance for the arts and culture

Business planning guidance for arts and cultural organisations – Dawn Langley and Susan Royce

A practical guide to business planning which was commissioned by Arts Council England and includes advice on financial planning, board involvement and compliance.
https://www.artscouncil.org.uk/sites/default/files/download-file/Business%20Planning%20Guidance%20for%20arts%20and%20cultural%20organisations.pdf

Business Survival Toolkit – Creative and Cultural Skills

A user-friendly toolkit developed by Dawn Langley that includes a wide range of creative tools and how-to guides.
http://business-survival-toolkit.co.uk

Governance in the arts and museums: a practical guide – Clore Leadership Programme

A toolkit for boards and staff who work with boards developed by Prue Skene, Tom Wilcox and Keith Arrowsmith.
https://www.artscouncil.org.uk/sites/default/files/download-file/Business%20Planning%20Guidance%20for%20arts%20and%20cultural%20organisations.pdf

All of these resources include references to further materials.

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