

# Reserves policy

February 2021



## Document control

<b>September 2011</b>	<b>Policy approved by Council</b>
<b>October 2013</b>	Policy reviewed and updated - approved by Council
<b>October 2016</b>	Policy reviewed and updated - approved by Council: To ensure that the policy was in line with the Charity Commission guidelines. The guidelines were updated in Jan 2016 and there were no changes to the approach. Reduction in functional assets following the sale of Grosvenor Hall Reserves level amended to £7mm +/- £1.5mm
<b>October 2018</b>	Policy reviewed and updated: Ensure policy in line with Charity Commission Guidelines that were reformatted in February 2017 Reserves level amended to £7.5mm +/- £1.5mm Investment asset quantum within the reserves target range rather than targeted at the bottom end of the range Inclusion of new appendix showing actual reserves level against planned reserves since 2013 and outrun financial surplus/deficit against plan for the same period
<b>October 2020</b>	Policy reviewed and updated: Reviewed Charity Commission Guidelines for updates Impact levels reviewed and amended Reserves level amended to £8.0mm +/- £1.5mm Recognition of cybercrime as a risk

Investment Committee will review reserves requirements and reserves policy on an annual basis on behalf of Council. Any changes to this policy must be approved by Council. Pension Fund Trustees will be formally consulted as part of any policy change process.

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## 1. Background and objective

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Reserves are that part of a charity's unrestricted funds that is freely available to spend on any of the charity's purposes. Where the Trustees have a reserves policy, this policy must be set out in the Trustees' annual report.

The Charity Commission for England and Wales' guidance notes (Refer Appendix 1) lay out key points for charity Trustees when setting or reporting on their charity's reserves policy:

- Charity law requires any income received by a charity to be spent within a reasonable period of receipt. Trustees should be able to justify the holding of income as reserves
- A reserves policy should take into account the charity's financial circumstances and other relevant factors. It should demonstrate the charity's resilience and capacity to manage unforeseen financial difficulties
- Trustees should regularly monitor and review the effectiveness of the policy in the light of the changing funding and financial climate and other risks

A reserves policy explains to existing and potential funders, donors and other stakeholders why a charity is holding a particular amount of reserves. A reserves policy should give confidence to stakeholders that the charity's finances are being managed and can also provide an indicator of future funding needs.

The objective of this policy is to set out what Sightsavers is seeking to achieve through the maintenance of reserves, the planned level of reserves, and process of reserve monitoring.

## 2. Responsibilities

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Trustees must ensure that the charity's funds are used appropriately, prudently, lawfully and in accordance with the charity's purposes for the public benefit. The general principle of trust law is that funds received as income should be spent within a reasonable period of receipt. The holding of reserves will be authorised (generally) by an implied power to hold reserves. Trustees are justified in exercising their power to hold income reserves if, in their considered view, it is necessary in the charity's best interests.

## 3. Approach to developing reserves policy

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The Charity Commission guidelines lay out an integrated approach to developing a reserves policy for a charity with complex activities and structures.

1. Understanding the nature of charitable reserves held
  2. Identifying functional assets
  3. Understanding the financial impact of risk
  4. Reviewing sources of income
  5. Impact of future plans and commitments
  6. Agreeing a reserves policy
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## 1. Understanding the nature of charitable reserves held

Reserves are that part of a charity's unrestricted income fund that is freely available to spend on any of the charity's purposes. In setting a reserves policy it is vital to understand any restrictions on the use of the charity's funds. In certain circumstances holding restricted funds may reduce the need to hold reserves, for particular purposes.

Sightsavers holds restricted funds which are to be used in accordance with specific restrictions imposed by donors or which have been raised by the charity for a specific purpose. In addition, Sightsavers holds one endowment fund comprising monies to be held as capital.

Restricted funds and endowment funds are excluded from the calculation of free reserves.

Group accounts show the activities and resources of the charity and its subsidiaries. The amount of reserves stated takes account of the net assets of subsidiary organisations.

## 2. Identifying functional assets

Where the Trustees consider functional fixed assets to be essential to the delivery of the charity's aims then the value of such assets can be designated and excluded from the calculation of reserves.

Sightsavers designates its cash held internationally in its accounts. However, the designation has an administrative purpose only and does not legally restrict the Trustee's discretion to apply the funds. The market value of the balance of cash held internationally is included in the calculation of reserves alongside general funds.

## 3. Understanding the financial impact of risk

Sightsavers updated its risk management framework during 2009; identifying risks, prioritising them and setting out mitigation approaches and accountabilities for the highest priority items. These risk processes have now been consolidated into a risk management policy which was approved by the Board in April 2018. Risks are reviewed at every audit committee meeting and at least annually by Council. In 2020 the impact of covid-19 was considered as a risk.

Key risks have been identified with potential to impact reserves. In reviewing financial impact of these risks, it is the short term under consideration; the potential drawdown of reserves to give time to undertake additional mitigation activities and adjust to changed financial circumstances.

### **Financial loss due to currency volatility:**

Sightsavers is exposed to exchange rate risk. Most income is denominated in Sterling, Euro and USD, whilst most overseas charitable expenditure takes place in Africa and South Asia. When Sterling depreciates in value, particularly against the USD, then the ability to maintain funding of overseas expenditure is impacted. Foreign exchange hedging was introduced in 2009 to partially mitigate short term movement in exchange rates.

A 10 cent depreciation (un-hedged) in GBP/USD rate impacts funding by around £0.4mm per annum and a sustained depreciation damages the ability to support charitable activity. However, there is time to explore cost mitigation options in response.

The financial impact of currency volatility risk on reserves in the short term is estimated at £300k-£600k.

### **Inability to raise voluntary income**

Inability to raise voluntary income could have many root causes including recession in fundraising markets, penetration of new international markets failure to demonstrate impact, or a reputation event such as a significant programmatic failure.

Voluntary income levels are forecast around £51mm in 2020. Income sources are not concentrated to any single donor and a significant portion of voluntary income from individuals is committed through monthly direct debit or standing order.

Voluntary income levels have held up despite the covid-19 pandemic in 2020. Sightsavers has moved to monthly forecasting and introduced scenario planning in order to anticipate any potential challenges in relation to voluntary income.

Our planning systems for predicting voluntary income and fundraising investment are robust. Over the last five years actual voluntary net income has tracked planned totals with an average variance of 1.7%. In 2018 and 2019 voluntary income benefitted from grants that were not part of the financial plan at the beginning of the year.

An unplanned decline in voluntary income of around £2mm - £4mm is estimated as a prudent view of the impact of this risk on reserves. If required, it would be possible to liquidate some investments within a very short timeframe.

Legacy income can be uneven and one risk is that the pipeline of legacies starts to run down. We have a reasonable view of legacy pipeline in the UK and we would have some warning if legacy activity in the round started to decline.

### **Inability to replace or grow institutional income**

Inability to replace institutional income is not as big a risk to reserves financially as the funds are primarily restricted. Significant new grant income is in the plan for 2020 relating to disability and NTD work. There have been some impacts due to the global pandemic in 2020, but some income has been re-purposed to support covid-19 activities and plans are in place to resume activities safely.

If we are unable to replace institutional income there is a risk to our ability to cover costs that were built into those grants. This impact is estimated at £1.5mm - £2.5mm.

### **Inability to manage large and complex programmes**

Income from grant funding has increased significantly in recent years with potential for more growth. There are risks associated with these income streams notably around poor cost and budget estimates, failure to recover associated costs, as well as mitigating quality issues with suppliers and partner organisations. The grant contracts themselves do not hold us legally to financial account for delivering outcomes, but there is the potential for contract termination with associated costs of exit that would bring.

Pre financing arrangements have been negotiated on a number of grants and contracts that mitigates a significant drawdown on working capital and liquidity as a result of taking on

grant funding. This is not the case for all contracts and a significant change in the overall grant financing mix could result a need to finance short term liquidity from reserves.

In 2018 a £3mm liquidity reserve was established as formal recognition of the need for operating liquidity and cash to facilitate financial operations. This is in addition to our general reserves holding.

Holding some reserves against these risks is prudent. An impact of 2-4 % of grant planned income levels in 2020 would impact reserves by £1.5mm - £3mm.

### **Financial loss due to fraud, cyber or partner misuse of funds**

Cyber risk presents increasing challenges to the organisation. Some of this risk resides with suppliers. It is an area that we are keeping under review.

Given the spread of countries in which Sightsavers operates financial loss due to fraud is a risk. There is ongoing effort to refine and improve the control framework, but investment levels in controls are balanced against operational risk. With the spread of activity internationally and programmatically it is unlikely that any single instance of fraud would be material.

The financial impact of fraud risk on reserves is estimated at £100k - £400k.

### **Credit events leading to financial loss**

The material credit risk to Sightsavers would be a failure of one of our lead banks, HSBC, SCB, or AIB. This is unlikely to mean a complete loss of deposit funds, but there would be significant impact on short term liquidity, as well as overall economic and market confidence consequences that would follow.

HSBC and SCB are systematically important institutions and the financial impact of this risk on reserves, based on holding around 3% of our cash holdings against a credit event risk is estimated at £750k - £1mm. It is worth noting that we see the risk of a credit failure in our lead banks as extremely unlikely.

### **Other**

There are other risks Sightsavers faces that could have a financial impact, such as stranded assets as a result of an international governance breakdown issue, a significant legal claim perhaps as a result of a medical incident with a partner or poor quality of programmes, or a significant business discontinuity event. However, the short-term financial impact of these is less tangible.

Overall, given the risks Sightsavers faces, and unlikelihood that all risks impact at the same time, a prudent case estimated financial impact of risk events on reserves could be in range of £6.1mm - £11.5mm on an additive basis.

## **4. Reviewing sources of income**

Voluntary income sources are diverse with limited reliance on any one donor or donor group. Over half of voluntary fundraising income from individuals comes from committed giving. Voluntary income levels have grown in recent years.

Income generation is concentrated in Western economies, primarily UK and Ireland. Additional investment in diversifying income sources is ongoing notably in India, Italy, and USA.

Grant funding has increased substantially in recent years. DFID is now our single biggest funder. We continue to invest in managing funder relationships effectively and in experienced project management resources to mitigate delivery risks.

## 5. Impact of future plans and commitments

### Expenditure

Expenditure is significantly diversified, across multiple geographies and programmes. Unrestricted expenditure is forecast in range of £46mm inclusive of fundraising, governance and support costs.

Managing forward expenditure within existing commitments is done by regular monitoring of programmes. Any issues are highlighted at review meetings and if there is an issue on the availability of funds, programmes can be adjusted to manage this.

Fundraising investment can be reduced in the short term but this would impact income plans and revenue growth ambitions.

Our employee base is almost 700 people at a salary cost per annum of £21mm - £22mm. A headcount reduction of 20% would cost around £1.2m - £1.5mm to deliver (average of 5 years' continuous service) but lead to a reduced cost base of around £4mm - £4.5mm per annum. Any reduction in headcount needs to be managed alongside a reduction in associated activities and would impact ability to deliver organisational and operational objectives.

By reducing investment in fundraising, cutting headcount and related expenditure and, if required, reviewing the unrestricted programme, an expenditure reduction of more than £7mm could be accessed within a twelve-month period.

There are no material projects or capital spending plans that cannot be met from anticipated future income. All programmes funded from unrestricted monies include the clause 'subject to funding' so can notionally be reduced, albeit with potential reputational consequences.

### Defined Benefit Pension Scheme

Sightsavers has a defined benefit pension scheme deficit estimated at £2.4mm in the scheme triannual actuarial valuation prepared by the scheme actuaries in December 2018. The 10-year deficit recovery plan consists of annual real contributions of £360k, in 2017 money, until the end of 2026. Annual indexation is agreed to be 3% per annum. Actual contributions for 2020 are £405k in nominal terms, continuing to so index annually until the end of the recovery period.

The discount rate applied by the actuaries in the December 2018 valuation was 2.55%. Given recent decline in yields on long dated UK gilts it is likely the actuarial liabilities in the scheme will increase. However, these reduced yields may not sustain, there is risk asymmetry in the future direction of travel for rates, and funding for the scheme in the future needs to be considered alongside other liability management opportunities, investment



strategy and reducing scheme management costs. There will be ongoing discussions with Pension Fund Trustees to review strategic options.

Sightsavers remains confident it can provide required pension contributions from projected future income without significantly impacting on its planned level of charitable activity. Free reserves are calculated without setting aside designated reserves to cover any pension liability.

## 6. Agreeing a reserves policy

Sightsavers has good diversification of income sources and expenditure commitments. Voluntary income has grown in recent years and expenditure levels can be materially adjusted within a twelve-month period to fit revised funding levels if needed.

The reserves policy seeks to balance spending the maximum amount of income raised as soon as possible after receipt with maintaining the minimum level of reserves to ensure uninterrupted operation and provide time to adjust to a change in financial circumstances.

A prudent assessment of the financial impact of risk events on reserves is estimated at £6.1mm - £11.5mm and there is a recognition that £7mm can be accessed by cutting unrestricted expenditure in a 12 month period.

A target reserve level of £8.0mm +/- £1.5mm is assessed as striking an appropriate balance between the need to spend income when it is received and maintaining operational integrity. This level of reserves is consistent with Sightsavers' business model and financial impact of key risks. It is important to retain some flexibility in the range from median due to variation in actual overrun vs. plan and potential for uneven cash-flow on working capital.

When considering overall reserve levels, both general and liquidity, an alternative non risked approach would be to reserve a % of total cash income or a % of unrestricted expenditure. Based on plans for 2020, 10% of total cash income is around £12.5mm and 20% of unrestricted expenditure is around £9.2mm. These are proxy indicators and neither measure is materially out of line with the overall level of reserves indicated.

## 5. Links to investment holdings

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Sightsavers holds around £6.5mm of investment assets which are managed by UBS. It is intended to maintain investments within the reserves range with the remainder of reserves held in cash. These investments managed by UBS can be considered as a specific asset holding that is designed to asset back the targeted level of reserves.

Maintaining an investment holding at or around £6.5mm provides some investment risk buffer (a decline in equity values of 25% would impact the portfolio value by around £1.5mm).

Investment levels will be maintained with reference to reserves policy. Maintaining investment levels around the reserves policy target means any instruction to liquidate investment holdings is a lead indicator that core reserves are being drawn down.

## 6. Reserves monitoring

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Reserves are reported monthly in the management report.

Business plans will be set with intent to maintain reserves around the target range. Given operational issues, changes in economic circumstances and short term investment needs it is possible for reserves to fall outside of the target range. However, it is expected that management will seek to calibrate business activities across the medium term such that reserves are maintained within range.

Over the last five years Sightsavers has run reserves in excess of policy target. It is worth noting our planning bias has tended towards a consistent small favourable outcome in actual net surplus/deficit versus plan. (See Appendix 2).

If reserves fall below target range (£6.5mm) then a recovery plan will be prepared by the CEO and COO in conjunction with the Treasurer for consideration by Trustees. Specifically, in the situation where reserves fall below £5mm (10% of voluntary income), written notification will be provided to Pension Fund Trustees and the Pension Fund Trustees will be formally consulted as part of the process of formulating the recovery plan.

## Appendix 1

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**Charity Commission: Charity reserves: building resilience (CC19)**

<https://www.gov.uk/government/publications/charities-and-reserves-cc19/charities-and-reserves>

We work with partners in low and middle income countries to eliminate avoidable blindness and promote equal opportunities for people with disabilities.

[www.sightsavers.org](http://www.sightsavers.org)