

**Imperial College Union
Board of Trustees 16th September 2020**

Reserves Policy Discussion

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Purpose: This paper sets out a new approach to a Reserves Policy for the Union, identifying the relevant risks and details the criteria we will use to quantify the required level of free reserves. It does not, however, put an actual value on the level of reserves because the 2019/20 accounts have not yet been finalised and further work is required on budgeting and cashflow forecasting for 2020/21. The new operating model is likely to require a significantly lower level of reserves due to the reduced risk from commercial activities, but the uncertainty that still exists around COVID-19 will mean that the policy will need to be under constant review during 2020/21.

Decision(s): To consider and approve the proposed revised approach to our Reserves Policy.

1. Executive Summary

The Charity Commission expect trustees to decide, publish, implement, and monitor their charity's reserves policy so that they can comply with their legal duties and give confidence to stakeholders that the charity is being properly managed.

ICU's current reserves policy originates from 2016 and recommends free reserves of between £800k and £1.5m.

Initially the reserves policy was met, but over the past two years the financial performance of the organisation has declined, and the level of free reserves has now fallen well below recommended levels. The impact of COVID-19 and the decision by the Board to address organisational performance means that ICU is currently in a significant period of change. Senior management changes, extensive restructuring, and a new operating model, combined with lower levels of free reserves mean that a new reserves policy is now required.

The Leadership Group are committed to ensuring that the organisation is run in a sustainable way, to ensure that any unexpected fluctuations in revenue or expenditure can be met within reasonable limits. However, we also recognise the importance on not holding excessive reserves because, as a general principle, charitable funds should be spent on beneficiaries, and not held unnecessarily.

For this reason, the Leadership Group are recommending a risk-based approach for the new reserves policy which is consistent with Charity Commission guidance and tailored to the new operating model. This approach is consistent with many other student unions including Bristol, Royal Holloway, Manchester and Oxford.

2. What Are Charity Reserves?

A charity's total 'reserves' is the value of all of its assets, less its liabilities i.e. its balance sheet total. Restricted reserves are those that can only be used for specific purposes that are narrower than the charity's overall charitable purposes. For example, much of the cash that ICU holds belongs to the

CSPs. Unrestricted reserves are those that can be used for whatever the charity chooses provided it is in line with its general charitable purposes.

Some unrestricted reserves are not readily available for spending because they have already been spent on fixed assets or allocated to a designated reserve for essential spending or future commitments. The reserve policy, therefore, excludes these funds and calculates 'free reserves' which represents the funds available for its day-to-day activities.

ICU needs free reserves for the following:

- i. Managing and reducing risk, to allow the charity time and resources to deal with any changes and setbacks
- ii. Working capital used for running the charity (to manage the annual fluctuations in cashflow, costs and income)
- iii. Implementing its plans for the future and meeting expected capital costs.

3. ICU Current Reserves Policy

ICU's current reserves policy states that the Union will maintain a target level of free reserves within a range of between two and four months average unrestricted expenditure which equates to between £800k and £1.5m. The policy was reviewed in June 2019 and the ideal level of reserves at that point was considered to be £1.2m. Despite a deficit of £364k for 2018/19, ICU held free reserves of £897k at 31st July 2019. However, the organisation owed £989k in payroll costs to the College at that point which, if paid before the year end would have wiped out the free reserves.

The current policy requires significant updating and revision for the following reasons:

- i. The full policy has not been updated since 2016, although the trustees have reviewed it annually.
- ii. The full policy is not adequately tailored to the organisation.
- iii. Poor financial performance over the past few years has led to declining levels of free reserves meaning that the current policy is unattainable.
- iv. COVID-19 has further impacted the financial performance and level of free reserves.
- v. The organisation is going through a significant period of change with new senior management, a major restructure, and a new operating model which means that the current policy is no longer relevant.
- vi. The organisation will set a new strategy in 2020/21.

4. ICU Free Reserves at 31st July 2020

As per the draft accounts for the year ended 31st July 2020, ICU holds the following reserves:

Total reserves	: £5.8m
Restricted reserves	: £4.0m
Unrestricted reserves	: £1.8m
Free reserves	: £437k

It is important to note that between £150k and £200k of these free reserves are required to cover the redundancy costs from the restructure as these were not included in the 2020/21 budget. However, it should also be noted that the majority of the payroll costs for 2019/20 were paid before the year end with only £235k, roughly a month's worth, outstanding.

5. Approach to setting the New Reserves Policy

Charity Commission guidance states that there is no set level of free reserves. Each charity is required to set a level that reflects the particular circumstances of that charity based on:

- Its forecasts for levels of income for the current and future years, taking into account the reliability of each source of income and the prospects for developing new income sources
- Its forecasts for expenditure for the current and future years on the basis of planned activity
- Its analysis of any future needs, opportunities, commitments or risks, where future income alone is likely to fall short of the amount of the anticipated costs
- Its assessment, on the best evidence reasonably available, of the likelihood of a shortfall arising which means that reserves are necessary, and the potential consequences for the charity of not being able to make up the shortfall

It is proposed that the total free reserves target under the new policy should be based on the estimated funds required for each of these needs. The Leadership Group is, therefore, recommending a risk-based approach to the new reserves policy.

6. Risks

All organisations face a multitude of risks and ICU is no different. In developing the new reserves policy we have concentrated on the key operational risks only.

6.1 Block Grant

ICU operates in a relatively low risk environment when compared with other charities, due to the presence of our main funder, Imperial College. Due to the impact of COVID-19, the block grant for 2020/21 has been frozen at 2019/20 levels (£1,885,213). This accounts for approximately 86% of budgeted income. In previous years, the block grant would have made up a much smaller proportion of total budgeted income due to the magnitude of the commercial income.

There is no formula-based approach to block grant setting. Until this year, the block grant has been growing steadily year on year to cover inflationary increases, including pay awards, and other agreed changes. Fluctuations in student numbers are not automatically reflected in the block grant but would need to be agreed separately with College. This is not a significant problem at present as student numbers are stable and we are confident that the College would be receptive to a case for additional funding if significant increases were forecast.

The block grant is agreed in advance of the final published budget and once agreed it does not deviate over the year. This gives us time to make changes to our planned expenditure to align with potentially revised income predictions. The College is very supportive of the Union and has recently provided assurance on their continued commitment.

Risk Assessment	Low
Suggested Requirement(s)	None

6.2 Commercial Contribution

Prior to COVID-19, ICU operated a relatively large commercial operation which was budgeted to provide a c£600k contribution to organisational overheads in 2019/20. When lockdown was introduced, all commercial outlets were closed, and all trading ceased. Despite, extensive use of the Coronavirus Job Retention Scheme, the loss of trading income significantly increased the 2019/20 deficit to around £750k.

A major restructure is currently underway with plans for wide scales redundancies in both the bars and retail. As the pandemic eases the commercial services will be rebuilt but under a different

operating model which ensures that the charity side of ICU is less dependent on commercial surpluses. The 2020/21 budget assumes only a £30k surplus. The plan is also to rebuild with a much higher proportion of casual to total staff which would allow the organisation to react quickly to changes in trading levels without incurring additional redundancy costs.

The risk to the charity has therefore, reduced significantly this year and that will be reflected in the level of reserves required.

Risk Assessment	Medium
Suggested Requirement(s)	XXXX

6.3 Working Capital

There is still a lot of uncertainty over what the commercial offering will look like in 2020/21. As this will inform the working capital requirements, we will develop a cashflow forecast over the next few weeks which will include scenario analysis for the commercial activity. There is also a plan to liquidate the Rathbones investment in the next few weeks which will bolster cash reserves.

Like most students' unions, ICU's largest single expenditure is salaries. The permanent salary costs are approximately £135k per month and will account for around 70% of budgeted expenditure in 2020/21. ICU staff are employed and paid by the College and recharged to the Union monthly. This gives us a degree of control over when the payments are made and therefore, reduces the risk. In addition, College have agreed to pay the block grant quarterly in advance during 2020/21 which will also facilitate cashflow management.

As at 31st July 2020, approx. £270k of the Union's reserves were tied up in stock. This figure is far too high for an organisation of our size. £120k relates to branded merchandise which became obsolete in June when College changed its motto. College have agreed to pay us for the stock which will help cashflow and allow us to start the process of reducing stock levels. Retail staff have been tasked with reducing stock levels further over the coming year.

It is also critical that ICU monitor and chase debts more effectively going forward to reduce the high trade debtors.

Risk Assessment	Low/Medium
Suggested Requirement(s)	XXXX

6.4 CSPs

ICU has almost 400 CSP's. Their funding comes from a combination of self-generated and Union grant income. Their funds are held as restricted reserves with a balance of over £1.8m at the end of 2019/20. If a CSP gets into financial difficulty, it is the Union who bears the responsibility rather than the individual members and therefore, there is an element of risk to consider.

However, the Union has several mitigating processes in place to reduce this risk. All event budgets and sponsorship contracts are scrutinised and signed off by the OTs or the Activities team and risk assessments are required for relevant events. COVID-19 clauses are being built into contracts where possible and a debt management process exists when required. The Union has identified the most significant risk to be with the large cultural societies who run big events but don't tend to have high reserves. We will work closely with these societies in order to minimise risk. The Union is also making a change to the way that CSP sponsorship income is administered which will ensure that income is only recognised by the club or society once it is physically received rather than just invoiced.

CSP's also benefit from one off funding from several other sources such as the Harlington Fund and the Blythe Centre for capital expenditure projects. The risk of this funding being withdrawn is low and would not automatically generate a need for the Union to replace it.

Despite the mitigating factors, an element of risk will remain, particularly due to the continuity uncertainty this year. A reserve will be set aside to cover overdrawn groups and provide exceptional COVID-19 support if required.

Risk Assessment	Low/Medium
Suggested Requirement(s)	XXXX

6.5 Implementing Plans for the Future

2020/21 will not be a typical year for ICU due to the continued uncertainties caused by COVID-19. The immediate focus will be on rebuilding the Union's core activities and setting a new strategic direction. The need for capital and revenue funding will be identified as this stage.

With the support of College, the Union is committed to working more closely with the College's estates and capital departments in the future. This will enable us to access central funds for maintenance and capex throughout the year rather than building them into block grant negotiations, which in turn, will reduce the risk of unplanned expenditure and disruption to services.

Risk Assessment	Low
Suggested Requirement(s)	XXXX

7. **Review Process**

The Charity Commission recommends that charities review their reserves policy at least annually and monitor it throughout the year. The development of a sustainable reserves policy should be a product of the charity's strategic planning, budgeting, and risk management processes. This is particularly important this year because of the uncertainty over commercial revenues and the development of a new strategic cycle.

8. **Key Questions to Consider**

- i. Do you agree with a risk-based approach?
- ii. Do you agree with the risks identified? Are there any missing?
- iii. Do you agree with the assessed levels of risk?
- iv. Do you agree with the factors to be taken into account when quantifying the free reserves required to mitigate each risk?

Once the approach is agreed, the new policy will be drafted through Finance & Risk Committee and brought to the October meeting of Board for approval.

As ICU's main funder, it is important that the College is comfortable with and supports the level of reserves set in the reserves policy. Part of the process will be to meet with the College and discuss our approach.