

Reserves

1. Introduction

1.1. This discussion paper presents a framework for deciding on the Union's appropriate reserves level.

2. Background

2.1. The total funds held at the end of the financial year are known as reserves. These funds are built up over time and are normally held in the form of assets with the majority of the Union's funds being held in the form of longer term tangible fixed assets. A significant part of the reserves are held in cash deposits.

2.2. Reserves are held for a variety of reasons, which for the Union includes the need to provide a measure of safety against volatility in social enterprise trade, fund replacement of fixed assets, and provide resources to allow for development of the Union's services to its members and mitigate against any catastrophic events.

2.3. Total funds held are normally split into a number of categories and the Charity Commission requires that Trustees disclose in the annual report specific information about the reserves policy. Even though the Union has over £6m in reserves, only the general reserves are freely available to spend on any of the Union's objects and therefore the focus of the disclosure. A draft statement about the reserves policy is included in appendix 1.

2.4. It is important to remember that Charity law requires any income received by a charity is to be spent within a reasonable period of receipt. Trustees are required to be able to justify the holding of income as reserves.

3. How much reserves are currently held in the various fund types?

3.1. Total funds of £6,664,661 held as at 31 July 2016 are split into three categories, being restricted funds of £3,890,671, designated funds of £2,039,493 and the general reserve of £734,497 (the latter two comprise the Union's unrestricted funds).

3.2. Restricted Funds

3.2.1. The restricted funds are split between capital grants and student activities/halls balances and are therefore not available for general use. Capital grants represent historical grants to the Union specifically for the refurbishment works in Metric, SK Bar, level 2M, installation of the second lift and development of the Concert Hall. The capital grants balance of £3,040,862 is being used to offset the depreciation charge for these assets and will reduce over the remaining life of the assets which is estimated to be over 13 years.

3.2.2. Student Activities & Hall Amenity funds are the residual of the relevant unspent restricted funds income which has built up over time. During the course of the year, this overall fund has declined as students spent more self-generated income than was collected in year. The joint fund balance of £846,809 can only be used for club and hall amenity activities.

3.3. Unrestricted Funds

3.3.1. The surplus or remaining funds generated from the block grant, social enterprise activity, mini bus hire, events and advertising less all the associated expenditure constitute the unrestricted funds of the Union and as such are freely available to spend on any of the charity's purposes.

3.3.2. Designated Funds

3.3.2.1. Designated funds are part of the unrestricted funds which trustees have earmarked for a particular project or use, without restricting or committing the funds legally. The designation may be cancelled by the trustees if they later decide that the charity should not proceed or continue with the use or project for which the funds had been designated.

3.3.2.2. Funds have been designated for the provision of tangible fixed assets and are therefore not readily available for general use. (Tangible fixed assets of £4,878,624 less the capital grant funding of £3,040,862 = £1,837,762). £82,000 has also been designated for the imminent purchase of 3 mini buses.

3.3.2.3. The Union's investment fund of £119,731 is also not readily available in cash, therefore this reserve is treated as a designated fund.

3.3.3. The level of free reserves readily available to spend as directed by the trustees as at 31 July stands at £734,496.

4. How much in reserves does the Union need?

4.1. There is no single level or even a range of reserves that is right for all charities. Any target set by trustees for the level of reserves to be held should reflect the particular circumstances of the individual charity.

4.2. Base Line Needs

4.2.1. Even though the Union has a robust budget setting process, it remains exposed to the uncertainty associated with whether or not its annual targets will be achieved. In recent years this risk has been managed by use of an operating contingency based on a modest percentage of social enterprise income.

4.2.2. The operating contingency has been useful towards:

4.2.2.1. encouraging aspirational financial target setting, by making it possible for potential shortfalls to be centrally mitigated.

4.2.2.2. providing a safeguard that has helped demonstrate the credibility of Union's leadership at a time of increased focus on financial mismanagement

4.2.2.3. accelerating the rate of recovery of a depleted balance sheet

4.2.3. There is an opportunity now to move away from operational contingencies and insulate the Union by having adequate free reserves. Social Enterprise gross profit is around £2.1m, and its various sources are highlighted in appendix 2.

4.2.4. Each of the income streams has a different level of volatility and an initial provision of 15% (**£314k**) would give consideration to the various levels or risk and also go some way towards a contingency for a fall in other income sources outside of the Social Enterprise.

4.2.5. College block grant has been excluded from this assessment as in recent years the Union has been in a position to secure increases in funding by being increasingly seen as a vital partner in delivering an essential part of the students' experience.

4.3. Capital Funding – Replacement Strategy

4.3.1. Having a robust capital investment plan is essential for the sustainability of the Union. The 10 year capital plan presented to Finance and Risk in June 2016 provided a detailed trajectory for first year capital expenditure of £323k. The remaining 9 year profile is built on a simple replacement strategy of existing assets. While this plan helped to inform what level of expenditure is needed in the short-term, a much more detailed capital replacement model now needs to be developed.

4.3.2. The first 5 years of the plan had an estimated value of **£930k** while the full 10 year profile had an estimated cost of £1.8m. A prudent provision would be to have reserves to cover a five year period so as to encourage longer term thinking.

4.4. New Initiatives

4.4.1. A sample list of new initiative is shown in appendix 3. This is not considered to be an exhaustive list but merely presents a number of ideas that have not yet been fully explored and consequently have not been added to the 10 year capital plan.

4.4.2. A detailed investment appraisal will need to be undertaken for many of the initiatives so that their viability can be more clearly understand. Such a study is necessary in order to be able to clearly articulate the benefit to our members.

4.4.3. Historically major capital investments have been underpinned by capital grants. It is therefore expected that partnership funding would be sought and obtained as part of a decision making process. However, the Union is not seeking to rely exclusively on external funding to fulfil its strategic aims.

4.4.4. The new initiative reserve should also provide initial funding for new service enhancements.

5. Possible questions for discussion

5.1. To what extend is the Union prepared to fund increased reserves in order to shift the risk of income volatility to the balance sheet? On the other hand, how comfortable is the Union with the potential exposure to reputational damage if we miss our operational targets?

5.2. By what processes and criteria should the Union prioritise any new initiatives?

6. Recommendation

6.1. The operating contingency is removed and financial risk is now managed by the free reserves held in the balance sheet.

6.2. The Union adapts a reserve range from £1.2m to £1.8m being:

6.2.1. A base line reserve of £1.244m (£314,000 for social enterprise volatility and £930,000 for a five year provision of capital spending)

6.2.2. Plus a half of the above (£622,000) for new initiatives

Malcolm Martin
Head of Finance and Resources

Appendix 1

Wording to be published in the Annual Report of the Trustees.

The Trustees of the Union have reviewed the organisation's needs to generate free reserves in accordance with Charity Commission's guidance.

In the trustees' view the Union needs free reserves in order to:

- Ensure that the Union has sufficient cash during periods of volatile trade, enabling the Union to meet its short term financial liabilities as they fall due. A provision of 15% (£314,000) will ensure the Union has sufficient funds to accommodate trading uncertainties.
- Provide the financial resources to enable investment in premises, facilities and equipment to enhance and maintain the range of services provided to members. A long term capital plan has been established and a short term five year provision of £930,000 is needed to replace and enhance existing capital resources.
- Provide sufficient funds to allow the Union pursue new opportunities for service development.

The trustees consider the ideal range of free reserves as at 31 July 2016 to be between £1.2m and £1.8m, where the lower limit is intended to accommodate the baseline needs of the Union and the upper limit is intended to enable potential new service initiatives.

The Union has £734,496 of free reserves as at 31 July 2016 and plans to reach the upper limit within the next seven to ten years depending on the level of capital resources needed over the intervening period and the extent to which new service initiatives are adopted. The trustees have reviewed a longer term financial model and consider that given the Union's operational investment budget in 16/17, providing the Union achieves a breakeven position for 17/18, then makes modest surpluses for the next five years and spends capital resources in line with the current capital investment plan, the target range of reserves can be achieved within the stated period.

The Union holds restricted reserves of £3,040,862 for capital grants and £849,809 for student activities and halls funding. Both of these reserves are fully allocated and are not available for general use by the trustees.

Designated funds of £2,039,493 are part of the unrestricted funds which trustees have earmarked for particular projects or specific use. These funds have been allocated to fixed assets and are not available for general use. The value of £82,000 has been included with designated funds which represents the commitment to purchase 3 new mini buses. The Union's investments have also been included within designated funds as they are not readily available to the trustees.

Appendix 2

Social Enterprise Income Volatility

Gross Surplus Risk Profile

Social Enterprise Income
(Gross Profit)

	Budget 16/17 Gross Profit		Budget 16/17 Net Profit	
	£'000's	Proportion	£'000's	Proportion
Beit Venue	237	11%	144	31%
Retail	501	24%	134	29%
CX	98	5%	(23)	-5%
H Bar	141	7%	14	3%
SK Bar	862	41%	215	46%
Catering	220	11%	1	0%
Ents	36	2%	(16)	-3%
	<hr/>		<hr/>	
	2095		469	

5% 105

10% 210

15% 314

Note:

excluding Union income from the following sources:

	£'000's
Summer Ball & Foundry	25
Memberships	50
Marketing Fairs (net)	66
Marketing Advertising	59
Bank deposit interest	16
Mini Buses	140
Total	<hr/> 356

Appendix 3

New Capital Initiatives, not yet encapsulated
in the 10 year capital plan

1. Current service challenges:

1a Replacement flooring - activity spaces

1b Replacement flooring - dining area

1c Major systems developments

2. Social Enterprise Opportunities:

2a Catering service development

2b Retail - development

2c Concert Hall - development

2d Metric development

3. Other:

3a Refresh the media centre

3b Club developments

3c Initial funding for new service initiatives

3d Exceptional unforeseen developments

3e Catastrophic event