**Introduction**

The level of reserves that charities hold is seen as an important measure of their resilience (Mohan et al, 2022). As Kim and Mason (2020) demonstrate, extant research consistently finds that reserves help organisations navigate periods of financial uncertainty or crisis (Kim and Mason, 2022, p.2; Booth et al, 2017; Cortis and Lee, 2019; Irvin and Furneax, 2021). Furthermore, Pascoe (2017) suggests that the maintenance of reserves increases the chances that a charity will remain sustainable in the medium- to long-term. Charity reserve levels are therefore widely used as a key measure of financial risk (Cortis and Lee, 2018). Given the importance of the voluntary sector for both public service delivery and democratic pluralism (Tuckman and Chang, 1991) – as well as the challenges raised in the UK as a result of the Covid-19 pandemic, uncertainties after Brexit, and high inflation - the financial sustainability of UK charities is of particular concern.

*What are reserves?*

Conceptually, Sloan et al (2015, p.417) define reserves as money set aside by charities to “stabiliz[e] periods of fiscal stress by providing a cushion against unexpected events, an opportunity to seize a strategic opportunity, or even the ability to smooth cash flow problems”. The precise nature of what counts as ‘reserve’ money is, however, contested and context-dependent. In their study of US nonprofits, Irvin and Furneaux (2021, p.2) suggest a difference in definition between emergency reserves, operational reserves, and cash reserves. However, in the UK, reserves are generally considered to be all of “that part of a charity’s unrestricted funds[[1]](#footnote-1) that is freely available to spend” (Charity Commission for England and Wales (CCEW), 2016).

Reserves do not, however, equal a charities’ total unrestricted funds, as some or all of these monies may not be freely able to spend. The CCEW and the Office of the Scottish Charity Regulatory (OSCR) therefore define reserves more precisely as a charity’s unrestricted funds, excluding:

* “tangible fixed assets used to carry out the charity’s activities, such as land and buildings
* programme-related investments those held solely to further the charity’s purposes
* designated funds set aside to meet essential future spending, such as funding a project that could not be met from future income
* commitments that have not been provided for as a liability in the accounts” (CCEW, 2016, updated 2019).

The OSCR *Charity Reserves Factsheet* (OSCR, 2017) provides a simplified diagram for charities to use to calculate reserves, as shown below (figure 1).

Figure 1 about here

While reserves are therefore a contested concept, in this paper we use the above CCEW/OSCR definition of reserves, as this is the standard against which English, Welsh and Scottish charities should be reporting.

*English, Welsh and Scottish charity reporting of reserves data*

In England and Wales, larger charities (those with incomes of £500,000 and above) must report their reserve levels in two places: in their Annual Returns, and in their Trustees’ Annual Reports. Annual Returns consist of an online form into which charities manually submit certain required information. Trustees’ Annual Reports are narrative reports submitted to the CCEW in concert with the charity’s Annual Accounts. Charities with an annual income of less than £500,000 are required to report their reserves in their Trustees’ Annual Report, but not their Annual Returns. This paper therefore focuses on charities that reported annual incomes of £500,000 or above for financial years ending in 2019.

Scottish charities are not required to report reserves data in their Annual Returns, but – as for English and Welsh charities - are required to publish this information in their Trustees’ Annual Report. These Trustees’ Annual Reports are submitted to OSCR along with the charity’s Annual Accounts.

*The reliability of reserves data*

To understand the health of the charity sector, as well as of individual charities, it is essential that researchers, policy-makers and practitioners have access to accurate and reliable data on financial vulnerability, such as levels of reserves (Dayson, 2013). While regulatory data has the potential to provide such evidence for the voluntary sector at a large scale (Author’s own, 2017; McDonnell and Rutherford, 2022, p.134), pressures exist on charities to inaccurately report financial statements, and reserve levels in particular (Krishnan and Yetman, 2011; Mahmood, 2020).

In the UK, prior small-scale studies (such as by the CCEW (2018) and BDO (2020)) have identified challenges with the reliability of reserves data published in Trustees’ Annual Reports and Accounts. Beyond this, however, there has been limited academic scrutiny of the way in which charities report reserves in their Trustees’ Annual Reports and Accounts, nor of the reserves data published in charity Annual Returns.

This policy and practice paper draws on a large sample of data from English and Welsh charity Annual Returns, as well as English, Welsh, and Scottish Trustees’ Annual Reports and Accounts, to present evidence that: 1) Many charities are reporting ‘reserves’ figures that do not match the definition of reserves given by the CCEW/OSCR; 2) There is a substantial within-year and year-on-year inconsistency in the methods used by charities to calculate their reported reserves; and 3) There is substantial variation between charities regarding how they report their reserves.

The findings of this paper suggest that there is important work needed by the regulators, sector bodies, and charities themselves, to improve understanding and management of reserve levels. Given that the English and Welsh context has (arguably) been seen to “set the standard” (Hogg, 2018, p.73) in charity regulation, we believe that this also raises interesting questions for international debates on the reliability and effectiveness of regulatory reporting requirements.

The rest of the paper is laid out as follows: the next section describes the methods employed in this paper. The key findings of the study are then presented, followed by a discussion of recommendations and implications, and a conclusion.

**Methods**

*Data sources*

As described above, current charity regulation requires English, Welsh and Scottish charities to report their reserves in different places, according to charity size and jurisdiction. All charities in England, Wales and Scotland are required to report on their reserves in their Trustees’ Annual Report, stating their reserves policy and the size and purpose of their reserves. Larger English and Welsh charities (those with income exceeding £500,000 per year and which are the subject of this paper) are also required to report their reserves in their Annual Returns.

The specific information required to be reported in the Trustees’ Annual Report is delineated within the Charity SORP (Statement of Regulatory Practice). Since the late 1980s, reporting and accounting guidance for UK charities has been outlined in a series of charity SORPS. The current SORP – which is mandatory for those charities to which it applies – has been in place since 2015, with an updated edition published in 2019, and is known as SORP FRS 102 (as it is based on the relevant International Accounting Standards Board’s (IASB) relevant Financial Reporting Standard (FRS)). Alongside stipulations as to the format and content of charity Trustees’ Annual Reports and Accounts, the SORP also outlines which charities must have their accounts audited: in Scotland, an audit is required if the charity has income of £500,000 or more or its gross assets exceed £3.26 million and the charity has prepared accruals accounts. In England and Wales, the updated 2019 edition of SORP FRS 102 states that an audit is required if the charity’s gross annual income exceeds £1 million or its gross assets exceed £3.26 million and its gross income exceeds £250,000. This represents a change from the first (2015) edition of SORP FRS 102, when charities with incomes of £500,000 or more were required to have an audit.

*Sampling framework*

For the English and Welsh charities, a random sample of 400 charities was gathered from those charities that submitted Annual Returns with non-missing reserves data for financial years ending in 2019 (the most recent year for which full reporting data was available at that time). For each of these 400 English and Welsh charities, available Trustees’ Annual Reports and Accounts were then collected from the CCEW registry database for each year between 2016 and 2021.

For the Scottish charities, a random sample of 400 charities was gathered from the population of charities with incomes of £500,000 or more and which were active in 2019. While the CCEW publishes Trustee’s Annual Reports and Accounts for five years, OSCR only publishes the most recent available charity Trustees’ Annual Report and Accounts. For Scottish charities, therefore, this most-recent Trustees’ Annual Report and Accounts was collected and, as above, analysed to collect the figure given (if any) for reserves and to identify, where possible, whether this figure matched the definition of reserves as stated by CCEW/OSCR.

*Data collection*

For the purposes of this paper, charities’ statement of their level of reserves’ was recorded from each charities’ Trustees’ Annual Report and Accounts, and their Annual Return, where available. While, as noted above, the current SORP states that charities must state their reserves level in their Trustees’ Annual Report, occasionally, this figure is instead stated only in the accompanying Accounts. Therefore, the entirety of charities’ Trustees’ Annual Report and Accounts was reviewed to gather the figure that charities explicitly stated equalled reserves.

The authors then assessed these reported reserves figures in reference to other relevant financial information given in the Trustees’ Annual Report and Accounts. Each figure was assessed based on the following criteria:

**Match**: The figure given **matches** - is equal to - the CCEW/OSCR definition of reserves, as given above.

**Overestimate**: The figure given **overstates** reserves in comparison to the CCEW/OSCR definition of reserves. For the longitudinal analysis as detailed under Finding 2, this figure was further differentiated between:

* + Those that stated a figure that matches total unrestricted funds.
	+ Charities that stated a figure that overstated reserves in comparison to the CCEW/OSCR other than by stating a figure that matches total unrestricted funds.

**Underestimate**: The figure given **understates** reserves in comparison to the CCEW/OSCR definition of reserves.

Some reported reserves figures were then excluded at this stage as there was insufficient information given in the Trustees’ Annual Report and Accounts to verify the stated reserves figure.

Appendix 1 provides worked examples of assessments that were deemed to *match*, *overestimate*, or *underestimate* reserves in line with the CCEW/OSCR definition of reserves.

This data was collected and scored by two of this paper’s authors. Prior to data collection, the two authors worked together to ensure a clear understanding of the coding scheme. After initial data collection, a random of sample of 10 reported reserves figures in Trustees’ Annual Reports and Accounts was analysed independently by both authors to assess inter-rater consistency, which was confirmed with 90% consistency between the two raters. Disagreement occurred as a result of inconsistency in analysing charity or group accounts, where both are reported; the authors reconfirmed that group accounts would be used, in line with SORP guidance. All data were collected between January and March 2022.

**Findings**

The findings below present data from: 1,528 English and Welsh charity Annual Returns between 2016 and 2021; 1,322 reported reserves figures given in English and Welsh charities’ Trustees’ Annual Reports and Accounts between 2016 and 2021; and 355 reported reserves figures given in Scottish charities’ Trustees’ Annual Reports and Accounts between 2019 and 2021. As described above, in each year the data excludes a small proportion of observations for which there was insufficient data in the Annual Accounts to accurately analyse the reserves figure reported in the Annual Return or Trustees’ Annual Reports and Accounts.

The breakdown of observations by year is shown in Table 1, below.

Table 1 about here

**Key Finding 1:** **Analysis of both Annual Returns (for England and Wales) and Trustees’ Annual Reports and Accounts (England, Wales and Scotland) reveals a notable proportion of charities are reporting reserves figures that do not match the definition of reserves given by CCEW/OSCR. Annual Returns submitted by English and Welsh charities are particularly unreliable.**

The findings detailed in Table 2 below suggest that, on average, just 37.0% of all verifiable 1,528 reported reserves figures in English and Welsh charities’ Annual Returns match the CCEW/OSCR definition of reserves.

The figure stated in charities’ Trustees’ Annual Reports and Accounts has a higher degree of consistency with the CCEW/OSCR definition of reserves, however, a notable minority of charities report a figure that does not match this definition. On average, 63.0% of verifiable figures given in English and Welsh charities’ Annual Reports and Accounts match the CCEW/OSCR definition of reserves (Table 3), while on average 72.7% of verifiable figures given in Scottish charities’ Annual Reports and Accounts match the definition (Table 4).

*Annual Returns: English and Welsh charities only*

As Table 2 below shows, between 2016 and 2021, only 35.5% - 38.9% of charities reported in their Annual Returns a figure that matches the definition of reserves as given above. A majority of charities (between 53.4% and 57.7%) give a figure that overestimates their reserves level.

Table 2 about here

*Trustees’ Annual Reports and Accounts: English and Welsh charities*

Table 3 below provides the figures for English and Welsh charities reporting on reserves figures in their Trustees’ Annual Reports and Accounts. While the majority of charities (61.1% - 63.8%) report a figure that matches the CCEW definition of reserves, over a third of charities are reporting a figure that overestimates their reserves figure.

Table 3 about here

*Trustees’ Annual Reports and Accounts: Scottish charities*

Table 4 below provides the figures for Scottish charities reporting on reserves figures in their Trustees’ Annual Reports and Accounts. While the majority of charities (72.7%) again report a figure that matches the OSCR definition of reserves, over a quarter of charities are reporting a figure that overestimates their reserves figure. As for England and Wales, only a small minority of charities are reporting a figure that underestimates their reserves level.

Table 4 about here

**Key Finding 2: Within English and Welsh charities there is a substantial within-year and year-on-year inconsistency in the methods used to calculate reported reserves. This is again particularly notable within Annual Returns data.**

*Within-year inconsistency: Comparing reserves figures reported in Annual Returns and Trustees’ Annual Reports and Accounts*

Table 5 below provides the figures for the proportion of charities reporting the same reserves figures in their Annual Returns and Trustees’ Annual Reports and Accounts. In total, there were 1,218 observations in which charities reported verifiable reserves figures in the Annual Returns and Trustees’ Annual Reports and Accounts in the same year. The same figure was reported in 52.5% of cases. This means in nearly half of cases, different figures were reported for reserves in their Annual Returns and Trustees’ Annual Reports and Accounts by the same charity in the same year.

Table 5 about here

*Year-on-year inconsistency: Annual Returns*

As shown in Table 6, below, of those charities for which we have verifiable reserves figures from Annual Returns for two or more years (n=357), just 38.4% report a figure that corresponds with a consistent definition. Therefore 61.6% of charities change the definition used to report their reserves between 2016 and 2021.

Of those charities that do report against a consistent definition, 45.3% are consistently reporting a figure that matches the definition of reserves. 51.8% are consistently overestimating reserves (either by reporting total unrestricted funds, or otherwise overestimating reserves). This means that of all those charities for which we have two or more years of data, just 17.4% are consistently reporting a figure that matches the CCEW/OSCR reserves definition.

*Year-on-year inconsistency: Trustees’ Annual Report and Accounts*

In the figures reported in English and Welsh charity Annual Report and Accounts, there is greater consistency in the definition of reserves used across the years. Of those charities for which we have verifiable reserves figures from Trustees’ Annual Reports and Accounts for two or more years (n=302), 61.9% report a figure that corresponds with a consistent reserves definition. Of these, 74.3% report a figure that matches the CCEW/OSCR definition of reserves. This means that of all those charities for which we have two or more years of data, 46.0% are consistently reporting a figure that matches the CCEW/OSCR reserves definition.

Table 6 about here

We therefore see notably greater consistency in the reporting of data in Trustees’ Annual Reports and Accounts than for Annual Returns, and consider this in our recommendations below. Despite this greater consistency, however, nearly 40% of charities are reporting against an inconsistent definition of reserves in the Trustees’ Annual Report and Accounts, while over 60% of charities are reporting against an inconsistent definition of reserves in their Annual Returns. This means that using such reserves data for longitudinal assessments of the changing financial vulnerability of charities is particularly problematic – at both a sector level and for individual charities.

**Key Finding 3: There is substantial variation between charities regarding how they report their reserves in their Trustees’ Annual Reports and Accounts.**

As noted above, larger charities in England, Wales and Scotland are required to report their reserves in their Trustees’ Annual Reports and Accounts, alongside providing information about their reserves policy. These textual summaries reflect a wide variation in both the level of detail reported, and in use of the term reserves. They are often hard to interpret and can only be understood alongside a detailed reading of the associated Annual Accounts.

In many cases the Trustees’ Annual Reports state the charities’ general approach to reserves, rather than the quantified amount of reserves currently held. For example, rather than stating actual reserves levels, one charity states:

The trustees will maintain reserves at a level which is at least six months operational expenditure. The trustees will review the level of reserves required at quarterly intervals.

As suggested by the Findings above, most charities overestimate their reserve levels. This is often due to these charities explicitly including fixed assets within their stated reserve levels. For example, a community development trust lists its reserves as totalling £1.2m, despite a detailed reading of the accounts showing that £0.8m of this is held in fixed assets. For many of these charities it is unclear if the organisation could continue operating if it were to sell its fixed assets, meaning such assets cannot be considered reserves. For example, an educational college states in its 2020 Annual Report:

At 31 August 2020, the Trust’s Unrestricted Fund reserve amounted to £14,293,215 (2019: £14,001,178) (note 17) and is represented in the main by the fixed assets of the School and its investment in the [redacted] sports centre.

Other charities include within their reserves statement text that suggests a misunderstanding of the need for reserves. In the example below, a heritage charity relies on the value of those heritage assets for its sustainability, and does not otherwise intend to build up reserves:

Given the scale of the rebuilding and refurbishment project and its continuous demand on funds, it is not possible to maintain reserves. Despite that, the trustees remain confident that given the strength of [redacted]'s balance sheet, with a combined value of £ 10,406,956 of net assets, a dependable network of donors sympathetic to [redacted]'s vision, and the introduction of new revenue streams, there is no need to build up a reserve. The trustees are confident the organisation will continue to be able to meet with its obligations as they fall due.

Finally, there are numerous situations in which Annual Reports include confusing or muddled terminology. This is perhaps unsurprising given the contested definition of reserves as outlined in this paper’s introduction. For example, the term reserves may be used to mean unallocated funds, represent an organisation’s total cash-in-bank, or be broken down into multiple constituent parts using undefined terms such as ‘free reserves’ or ‘contingency funds’.

**Implications and Recommendations**

We believe the above findings have implications for both users and preparers of charity Annual Returns and Trustees’ Annual Reports and Accounts, including regulators, researchers, policy-makers, those served by charities, donors, and charities themselves. These implications are discussed below, followed by some key recommendations.

For the regulators, the findings suggest a continued need for greater collaboration between themselves and the voluntary sector to increase sector-wide understandings of reserves, as well as the need for attention to be paid to regulatory reporting requirements. Whilst a smaller sample than the English and Welsh data, the Scottish data presents a higher degree of conformity with regulatory definitions of reserves. Further research to explore the difference in findings between the jurisdictions would be valuable.

As noted above, larger English, Welsh and Scottish charities are required to have their accounts audited. Smaller charities (but with incomes of £25,000 or more) must have their accounts independently examined. This audit process is seen as an essential oversight mechanism for charity accounts, however prior work by the CCEW (2019) suggests that some auditors and examiners were failing to identify significant failings in the accounts they reviewed. The findings presented within this paper also raise potential questions as to the oversight provided by the auditing process, which may be worthy of further consideration by the CCEW and OSCR, and by auditors and accountancy bodies themselves. Further research to specifically examine the role of auditors in the reporting of reserves would again add value to this discussion.

For researchers and policy-makers, these findings introduce a significant caveat into work that relies on aggregate or sub-sector analysis of reserves, impacting our collective understanding of the health of the voluntary sector. At an individual charity level, the findings around inconsistent reporting of reserves further means that users of these charities’ accounts, including donors, may find it impossible to gain a true understanding of changes in the financial health of that charity over time.

This paper demonstrates that inconsistent reporting of reserve levels, both within and between charities, as well as the mischaracterisation and misuse of terms, means that extant data on charity reserve levels is unreliable. Furthermore, it raises questions around whether charities are appropriately managing their financial risk. Therefore, we highlight the importance of future qualitative research, to complement the findings presented here, and to explore the possible reasons underlying the misreporting of reserves data.

Our key recommendations are therefore:

* To encourage greater dialogue between the regulatory bodies, the SORP development committee, and charities regarding the meaning of reserves and standardisation of the presentation of certain information in Trustees’ Annual Reports and Accounts. This may require changes to the current wording of the CCEW/OSCR reserves definition and greater guidance at the point of data preparation.
* For the regulators and sector bodies to further invest in sector-wide training and communications regarding accounting terms and practices. Given that the data suggests Scottish charities are more accurately reporting their reserves, there may be specific learning that can be gathered from OSCR.
* That researchers and policy-makers exercise caution regarding the claims and decisions made based upon analysis of charity reserves data drawn from Annual Returns and Trustees’ Annual Reports and Accounts.
* That researchers, policy-makers, and sector bodies invest further resource into understanding the challenges with reporting charity reserve levels, and the practices and motivations that influence such reporting.
* For charities, we recommend greater attention be paid to understanding and accurately communicating their reserves levels and financial risks and vulnerabilities.

**Conclusion**

This paper has presented the findings of the largest study to date that assesses the accuracy of charity reserves reporting in England, Wales, and Scotland. It shows that a notable proportion of charities are reporting reserves figures that do not match the definition of reserves given by CCEW/OSCR, with Annual Returns submitted by English and Welsh charities being particularly unreliable. We see year-on-year inconsistency in how charities come to count their levels of reserves, and a substantial variation between charities in the summaries provided in Trustees’ Annual Reports and Accounts. These findings matter for both policy and practice as charity reserve levels are widely used as a measure of financial vulnerability, both of individual organisations and the wider sector.

To provide greater accuracy and clarity of individual and aggregate financial vulnerability, we recommend that regulators and sector bodies engage in greater dialogue with charities and invest in sector-wide training and support. For charities, we recommend greater attention be paid to clear and consistent reporting of reserves levels and financial risks and vulnerabilities.

This study has focused on the use of the reserves data by English, Welsh, and Scottish charities. However, we believe it also brings attention to possible wider challenges in reported regulatory data. We suggest that similar attention be paid to the use of other reported data in charity Annual Returns and Trustees’ Annual Reports and Accounts. Further, we also suggest that regulators, researchers and practitioners outside England, Wales and Scotland can learn from this study in terms of the challenges of mandating accurate regulatory data reporting.

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1. In the UK, fund accounting is a key feature of charity accounting: “Fund accounting distinguishes between two primary classes of fund: those that are unrestricted in their use, which can be spent for any charitable purposes…and those that are restricted in use, which can only be lawfully used for a specific charitable purpose” (CCEW/OSCR (2014)). [↑](#footnote-ref-1)