INTERNATIONAL PLANNED PARENTHOOD FEDERATION **BoT/12.21/DOC 6.1c**

Board of Trustees
02 - 03 December 2021

Refers to
agenda item 6.1

Agenda Item 6.1: Background paper on reserves policy

Action Item
C-FAR recommended the reserves policy, based on deliberation following presentation of the following background paper by the management.

1. Introduction

This paper provides background information on why IPPF requires a reserves policy, the role of the Trustees in approving and overseeing the reserves policy and provides guidance and best practice from the Charities Commission. The existing reserves policy is reviewed to assess its continued applicability and a recommendation is made for 2021 onwards. Some comparative data from other charities is provided for context.

2. What are reserves?

Reserves are that part of a charity's unrestricted funds that is freely available to spend on any of the charity's purposes.

The Charity Commission for England and Wales' guidance note ("Charity reserves: building resilience") sets 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 time of receipt. Trustees are justified in holding income reserves only if they believe it is in the charity's best interests.
- A reserves policy should take into account the particular circumstances of the charity and should not be regarded as a static policy. 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.

Deciding the level of reserves that IPPF needs is important in order to avoid reserves levels that are either:

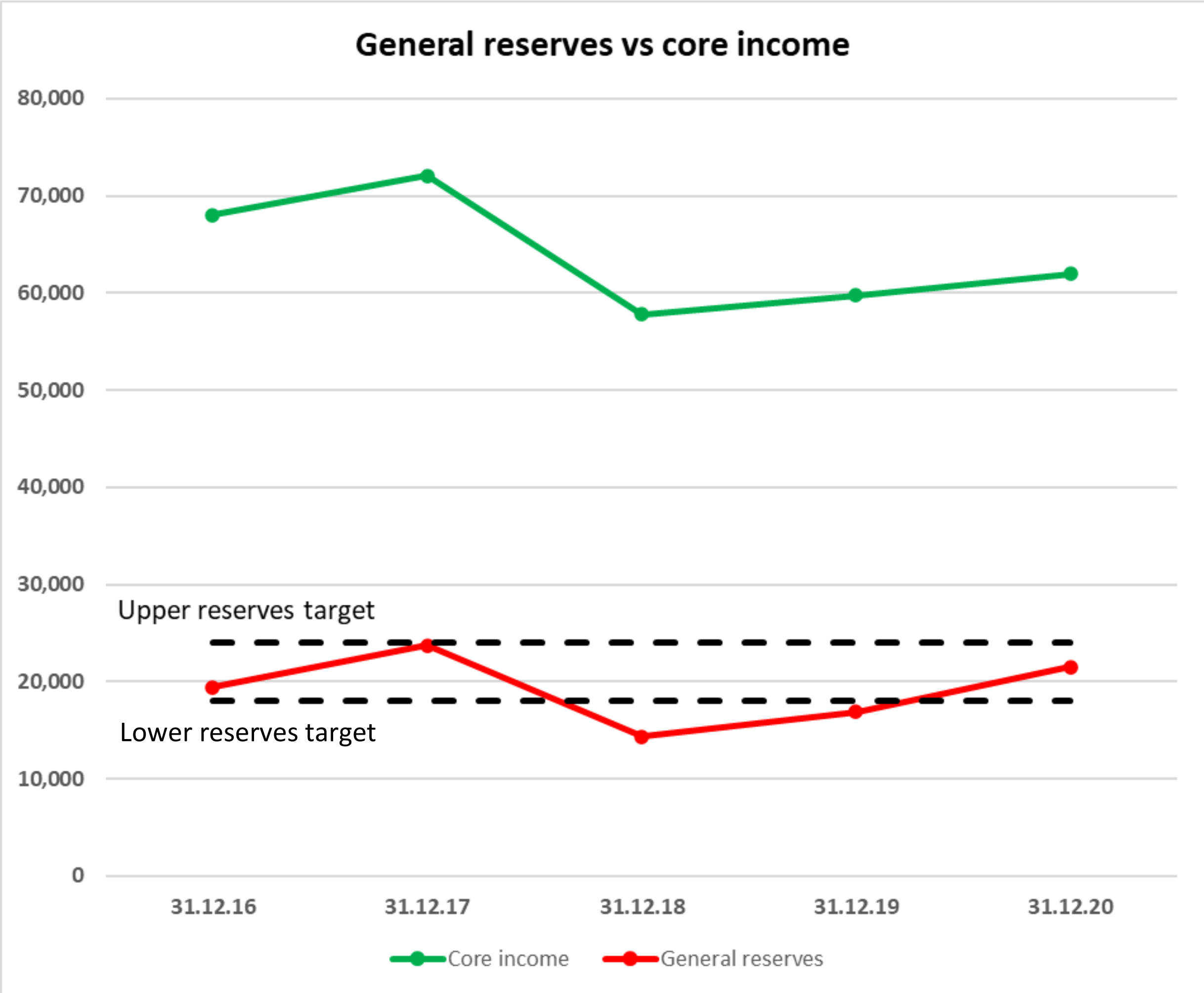
- **higher than necessary** – which would limit the amount spent on charitable activities, or
- **too low** – which would increase the risk of IPPF not being able to carry on its activities in the event of financial difficulties in the future.

3. IPPF's current reserves policy

In May 2013, the Governing Council (predecessor of the Board of Trustees) approved a risk-based target general reserve level of between **US$18 million and US$24 million**, which ensures IPPF has the resources in place to manage financial risk and short-term income volatility and continue to invest in initiatives to meet its goals set out in the current Strategic Framework.

IPPF still uses this target whilst assessing its optimum level of reserves.

The chart below shows the level of general reserves over the last five years:



The general reserves have stayed at a level of between 25% and 35% of core unrestricted income over the last five years.

4. Approach to developing a reserves policy

The Charities Commission acknowledges that there is no single method or approach to setting a reserves policy but suggests the following steps should be followed:

(i) Understand the nature of the charitable funds held
(ii) Identify functional assets
(iii) Understand the financial impact of risk
(iv) Review sources of income
(v) Assess the impact of future plans and commitments
(vi) Agree a reserves policy

(i) Understanding the nature of the charitable funds held

IPPF's consolidated charitable funds at 31.12.20 were as follows:

		US$'000
Unrestricted funds and reserves		
General reserves		21,510
Designated funds:		
- Asset revaluation fund	12,000	
- Fixed asset fund	7,798	
- Other designated funds	20,812	
- Innovation fund	277	
- Pension liability	- 12,424	
		28,463
Total unrestricted funds and reserves		**49,973**
Restricted funds		**30,997**
Endowment		**1,394**
Total funds and reserves		**82,364**

At 31st December 2020, the Designated Regional Funds[1] were transferred to IPPF's general reserves and are included in the US$21,510k figure above.

IPPF holds restricted funds that are to be used in accordance with specific restrictions imposed by donors or that have been raised for a specific purpose. In addition, it holds one endowment on behalf of the Member Association in Cape Verde (which currently is held by WHRO and is in the process of being negotiated to be returned to IPPF).

As part of a standard process, IPPF's Board of Trustees, from time to time identify strategic areas of investment and approve the draw down of funds from the general reserves, earmarking them for these strategic areas. Generally these funds are allocated to areas where specific funding from donors is not available. These funds are utilised over the next couple of years and reported back to the Board on a regular basis. This includes investment in creating centres, funds and systems strengthening.

Designated funds, restricted and endowment funds are excluded from the calculation of free reserves, as these cannot really be spent freely in the eventuality of unforeseen materialisation of risks.

(ii) Identifying functional assets

[1] Designated Regional Funds were accumulated over time by regional offices through their local income generation, savings made from the unrestricted core allocated to regional offices and clawback of unrestricted core allocated to Member Associations. This funding was utilised to fund technical assistance to MA's / collaborative partners ("CP's") and/or participation of MA's and CP's in activities organised by MA's.

IPPF's fixed assets are held in a designated fixed asset fund (US$7,798k above) and are excluded from general reserves. These assets are primarily freehold property and are considered to be essential to the delivery of the charity's aims.

However, in a worst case scenario of significant financial difficulties, IPPF could sell or mortgage various properties:

- London office building
- London investment property (residential flat)
- Land in Nairobi
- Property in Kuala Lumpur
- Property in Brussels.

However, under normal circumstances, the sale of any property takes some time and in times of distress when a quick sale might be needed, the organisation may not get a good price for its property. In this context, the potential proceeds from such property sales, will be excluded from the reserves policy consideration.

(iii) Understanding the financial impact of risk

IPPF's risk register is current for the period October 2020 to September 2021 and was completed as part of a consultative process in August/ September 2020 across the senior employees in the Secretariat. It was approved by the Board of Trustees in November 2020.

The key risks which have the potential to affect reserves have been identified. In reviewing the financial impact of these risks, it is the short term impact which is under consideration and the extent to which reserves could potentially be drawn down to give time to undertake additional mitigation activities and to adjust to changed financial circumstances.

- **Loss of funding from donors due to reprioritisation, shrinking economies and the rise in fraud/ mismanagement incidents across the Federation etc**

In 2020, 95% of IPPF's unrestricted income and 84% of its restricted income was donated by governments. As global economies shrink in the aftermath of the COVID-19 pandemic, there is a possibility that overseas aid budgets will proportionately reduce or, in the worst case, be cut as in the case of the UK (FCDO cuts).

It is too early to determine what the impact may be on IPPF in the medium term, but as 97% of IPPF's core unrestricted income is already committed for 2021, there is unlikely to be any impact in the short term.

Since IPPF rolled out its confidential external incident reporting service (SafeReport), several complaints have been raised relating to suspected frauds which have led to investigations and significant findings. Whilst IPPF considers this to be a good thing as it enables it to get to grips with these issues and implement appropriate counter-fraud strategies, there is a risk that donors may be deterred.

IPPF has been engaging with donors proactively to inform them of the actions it is taking to address these risks and to strengthen financial oversight of the Member Associations through its new global assurance framework. At this stage, feedback from many donors is supportive and encouraging. However, whilst there is no evidence at this stage that the incidents of fraud reported at IPPF are out of alignment with other INGO's operating under the same conditions and in the same jurisdictions, there are signs that some donors are giving this serious consideration (eg Norway has indicated that the current fraud case may impact on the timing of the 2021 core payment).

On top of this we have examples where donors such as Japan reduced their core funding in 2021 from US$3.9m from to US$2.9m, due to the fact that most of their health related ODA is being channelled to GFATM and GAVI/COVAX with a relative de-prioritisation of SRHR and proof of it is that they have equally affected UNFPA.

In light of the above factors, IPPF has reviewed its core funding projections for the period 2021-2023 and has determined three potential scenarios compared to the budgeted 2021 core income as follows:

Scenario	2021	2022	2023
Worst case	10% drop (very unlikely at this point)	15-20% drop	25-27% drop
Most likely	Remain as forecast	6-10% drop (approx 65% of contracts are confirmed)	10% drop from 2021 figures. Many contracts will be reviewed in 2023 so there is higher uncertainty.
Best case	Remain as forecast (97% by value already committed by donors)	5% increase	10% increase

If unrestricted donors were to default on 10 - 20% of existing commitments in ways that the Secretariat were unable to react quickly, the impact on reserves would be around US$6 - 12 million in a year.

- **Reduction of restricted projects**

The effect of the reduction of restricted income is already being felt by IPPF with the UK government's reduction in ODA spend from 0.7% to 0.5% of GDP in order to prioritise domestic economic needs. This has led to the cancellation of the ACCESS restricted project and uncertainty over future phases of the WISH programme. Some other donors (eg the large anonymous donor "LAD") have also reduced their funding.

The knock on effect is a reduction in overhead recovery (which funds core costs), the funding of salaries of some key individuals (spread across multiple projects) will be impacted and there will be redundancy and other exit costs.

Holding some reserves against these risks is prudent. The impact of losing the ACCESS project in 2021 and Wish1 and WISH2 moving to a no cost extension phase is estimated to be a potential overhead loss in 2022 of US$3.8 million and a loss of US$842k towards institutional secretariat staffing costs.

- **Strained employment relations in the context of C19, MeToo & BLM lead to rise in employment cases**

Settlements paid to employees at CO up to 30.6.21 total US$194k, although these will be covered by the budget for contingency. The impact of the restructuring is still being felt in some Secretariat offices. Extrapolated for a full year and for all secretariat offices, it is estimated that the potential impact on reserves could be US$0.5-US$1.0m.

- **Upfront drawdown of working capital for funds paid in arrears**

There may be a temporary need to fund the set up costs of new restricted projects where the donor pays in arrears. In the case of WISH2, a temporary loan has been negotiated with CIFF, but this is not the case with all contracts. A significant change in the overall grant financing mix (eg if IPPF were successful in a bid for a USAID contract) could result in the need to finance short term liquidity from reserves.

Holding some reserves against these risks is prudent. An impact of 5% of grant income levels in 2020 would impact reserves by US$1.3 – US$2.6 million.

- **Financial loss due to fraud or misallocation of funds**

Given that IPPF operates in many jurisdictions with a high Transparency International country risk score, financial loss to fraud is a risk. There is an ongoing effort to embed a global assurance framework but the risk remains.

The financial impact of fraud risk on reserves is conservatively estimated at US$0.5 – US$1 million.

- **Member Associations' needs**

In the event of a reduction in unrestricted income from donors, one of the knock on effects would be a reduction of core grants to Member Associations. To enable the MA's to finalise the implementation of programmes and make any adjustments that might be needed to their own operating models (eg restructuring costs, fundraising costs etc), it is prudent to hold reserves in order to be responsive to their needs.

The financial impact of MAs' response requirements on reserves is estimated at 5 - 10% of total unrestricted core grants to MAs, which ranges between US$2 – US$4 million.

- **Other**

There are other risks that IPPF faces that could have a financial impact, such as penalties due to non-compliance with specific legal requirements (eg GDPR), a significant legal claim perhaps as a result of a medical incident with a partner or poor quality of programmes, but the short-term financial impact of these risks is less tangible.

Overall, given the risks IPPF faces, and the unlikely prospect that all risks would impact at the same time, a prudent estimated financial impact of risk events on reserves could be in the range of US$14.9 million to US25.2 million, as summarised below:

Risk	**US$'m Low**	**US$'m High**
Loss of unrestricted donor income	6.0	12.0
Impact of losing restricted projects – overhead loss	3.8	3.8
Impact of losing restricted projects – salary contribution	0.8	0.8
Employment relations	0.5	1.0
Working capital for projects	1.3	2.6
Fraud or misallocation of funds	0.5	1.0
Member Associations' needs	2.0	4.0
Total potential impact (worst case)	**14.9**	**25.2**

(iv) Reviewing sources of income

95% of IPPF's unrestricted income derives from governments and as noted above there is a degree of vulnerability to the general economic situation. However, IPPF is not reliant on any one donor and is investing in diversifying its income sources in the US. The rescinding of the Global Gag Rule in January 2021 paves the way for IPPF to become eligible in the US for funding opportunities. In addition, IPPF has plans to engage a consultant in the US to develop an individual giving programme to capitalise on fundraising opportunities, recognising that the knowledge base for this has previously resided within the Western Hemisphere Regional Office. Individual giving activities will extend beyond the US as it is a potential fundraising opportunity that is currently untapped by IPPF.

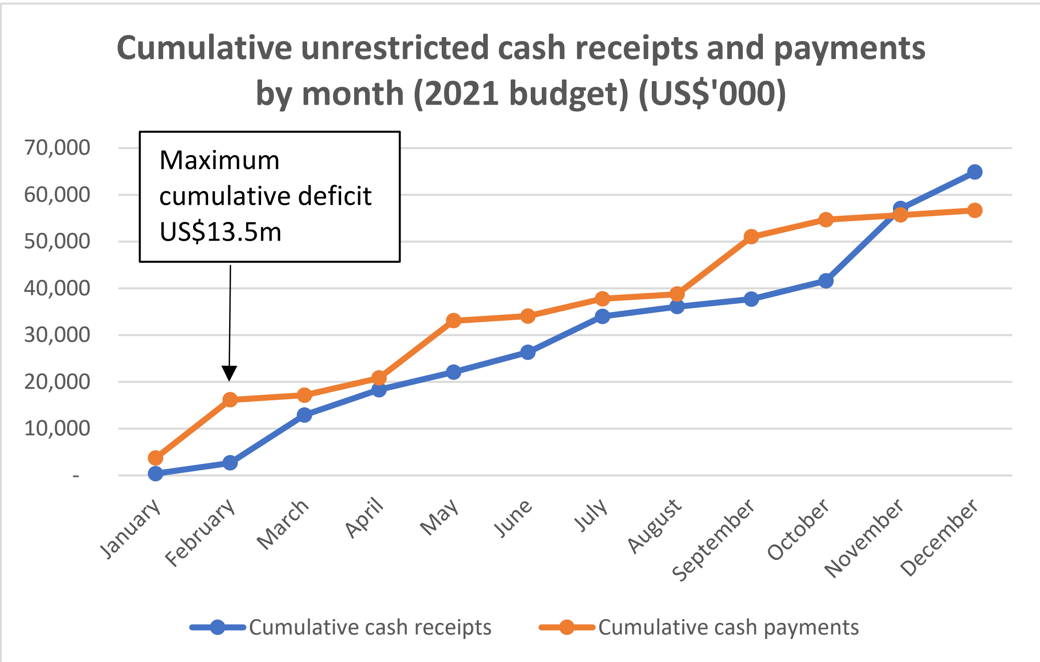
IPPF continues to invest in funder relationships. Many of IPPF's unrestricted donor contracts are running until 2022 in alignment with the current Strategy Framework and as 65% by value of the funding agreements have been signed, there is a reasonably high level of certainty for 2022. There is more uncertainty for 2023 as this will be a major contract renewal year and the reserves policy should be reconsidered at that time in case there is a major shift.

(v) Impact of future plans and commitments

- **Troughs in unrestricted cashflow**

IPPF's cashflow forecast for unrestricted funds shows that there are months when reserves will be called upon to cover shortfalls. This arises due to IPPF's standard practice of paying core grants to Member Associations in three equal instalments in January, May and September whereas nearly 50% of its core income is received from donors from October to December.

The graph below shows the budgeted cumulative receipts and payments for unrestricted cashflows in 2021 and highlights that (with no opening cash balance assumed) there is a maximum cash shortfall of US$13.5m.



IPPF's unrestricted core grant agreements are for one year, but there is an understanding that grants will continue to be paid over a number of years. The core funding agreements include a clause that IPPF is "under no obligation" to pay the core grant so it can notionally be reduced, albeit with potential reputational consequences.

- **Strategic plans**

Funds have been designated to ensure that IPPF can implement its strategy and there are no other material projects or capital spending plans that cannot be met from anticipated future income.

- **Defined benefit pension scheme**

Funds have also been designated to meet all of IPPF's defined benefit liability. The pension scheme deficit is estimated at US$12.4m in the scheme triannual actuarial valuation prepared by the scheme actuaries in July 2018. Current contributions are US$ 1.9m per annum with an annual increase of 3.5%. There is an agreement to maintain this level of contribution until such time the actuarial deficit in the scheme is mitigated.

- **Headcount reduction in the event of financial difficulties**

IPPF's employee base is approximately 286 people at a salary cost per annum of US$23.1m. A headcount reduction of 20% would cost around US$413k to deliver (assuming an average of five years' service) but lead to a reduced cost base of around US$3.4m per annum. Any reduction in headcount would need to be managed alongside a reduction in associated activities and would affect the ability to deliver organisational and operational objectives.

(vi) Agreeing a reserves policy

- **Option 1**

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.

In a worst case scenario, the financial impact on reserves of all potential risk events identified in this paper is as follows:

Risk	**US$'m Low**	**US$'m High**
Loss of unrestricted donor income	6.0	12.0
Impact of losing restricted projects – overhead loss	3.8	3.8
Impact of losing restricted projects – salary contribution	0.8	0.8
Employment relations	0.5	1.0
Working capital for projects	1.3	2.6
Fraud or misallocation of funds	0.5	1.0
Member Associations' needs	2.0	4.0
Unrestricted cashflow deficit	13.5	13.5
Redundancy costs in the event of financial difficulties	0.4	0.8
Total potential impact (worst case)	**28.8**	**39.5**
Prudent assessment of impact (two-thirds)	**19.2**	**26.3**

It is unlikely that all of these risks would occur simultaneously and so it is cautious to assume that two thirds would be a prudent assessment of the total potential impact on reserves.

A target reserve level of US$19m - US$26m is assessed as striking an appropriate balance between the need to spend income when it is received and maintaining operational integrity.

- **Option 2**

An alternative non risk-based approach would be to reserve a % of total cash income or a % of unrestricted expenditure. Based on 2020's results, the target level of reserves proposed here is

11-16% of total income and 32-44% of unrestricted expenditure. A comparison with other charities is shown in **Appendix A**. Although it is hard to make direct comparisons due to the different nature and risk profile of other charities, IPPF’s proposed reserve level appears to be in line with them.

5. Reserves monitoring

Reserves are reported monthly in the management accounts.

Business plans should be set with the intention of maintaining reserves around the target range. It is recommended that IPPF’s reserves policy be reviewed as part of the next strategy review which will develop IPPF’s new strategy for the six year period 2023- 2028 and annually thereafter.

Appendix A

Comparison of different charities' reserves policies as a percentage of both total income and unrestricted expenditure:

	Target reserves as % of total income		Target reserves as % of unrestricted expenditure	
	Low	**High**	**Low**	**High**
Sightsavers	6%	9%	18%	27%
MSI	10%	11%	19%	23%
IPPF	11%	16%	32%	44%
Save The Children	10%	14%	41%	55%
Cancer Research UK	29%	48%	31%	51%