



Operating Reserves

A Step in the Right Direction

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NEEDS SCAN REPORT

Operating
Reserves:
A Step in the
Right Direction

A key indicator of the health and well being of an effective nonprofit is how many months of cash reserve it has on hand to sustain itself through the ups-and-downs of funding and the ever-changing economic landscape. Many nonprofits do not have an adequate “rainy day” fund and need to improve this financial condition.

Why is it important to have an operating or cash reserve? This cushion can help your organization sustain its operations in the event of significant, unplanned or unbudgeted increases in operating expenses and/or losses in operating revenues.

For example, cash reserves can help you bridge the gap for meeting payroll and other program expenses while waiting for a grant check to arrive. These reserves can also help you weather an unexpected economic downturn, which may affect fundraising efforts. “Nonprofit” does not mean “no surplus allowed” and this reserve cash can help serve as working capital in other unplanned circumstances.

According to the Nonprofit Reserves Workshop of The Urban Institute, operating reserves are the portion of unrestricted net assets available for use in emergency situations.¹ Many experts in nonprofit financial management, including the Nonprofit Finance Fund, suggest that nonprofits maintain a minimum reserve of 25% or three months of its total operating budget.²

While a three-month reserve is a useful benchmark goal for many nonprofits, reserve needs can vary from organization to organization. That’s why it’s important for each group to determine its own needs based on its own circumstances. This process can start with the advice of The Nonprofits Assistance Funds, which suggests that you review your revenue sources, project month-by-month cash flow, make an effort to anticipate shortfalls, and create a workable and realistic set of financial policies and practices.³

Creating this set of key financial policies, including a cash reserve policy, requires the work of the board of directors, the finance committee and key staff members (for instance, executive director, chief financial officer or accountant) to help determine the organization’s appropriate financial measures.

¹ Washington-Area Nonprofit Operating Reserves, Blackwood, Amy S and Pollack, Thomas H. The Urban Institute, Charting Civil Society, No 20, July 2009

² Getting to Twenty-Five Percent: On Margins and Reserves <http://www.nonprofitfinancefund.org/blog/getting-twenty-five-percent-margins-and-reserves>

³ <http://www.nonprofitassistancefund.org>



**No organization moves from zero reserves
to a three-month reserve overnight, so this effort
takes time and careful planning.**

So what steps can you and your board take to begin this important conversation? We suggest dedicating a portion of an upcoming board meeting to the following questions:

- Do we have a cash reserve currently? If so, do we have a written board policy guiding the development of a cash reserve? For what purposes can we tap the cash reserve?
- On what timeline can we realistically build a reserve? If we can't build a three-month reserve, what is a realistic goal for our organization?
- How can our regularly reviewed financial management tools—annual budget, monthly income and revenue statements, cash flow projections, fundraising plan, etc.—help us with these planning efforts?
- Which unrestricted funding sources could we allocate towards our reserve fund?
- Do we have a finance committee? What is the scope of its work? If don't have one, should we create one?

No organization moves from zero reserves to a three-month reserve overnight, so this effort takes time and careful planning. Assessing your current financial condition can help you set realistic cash reserve goals and determine what steps you can take to meet your target. A review of your funding history can benefit this planning effort too. Dedicate a board work session to consider the following issues:

- Where does our current revenue come from?
- How realistic is our current budget picture given what we know about our funders?
- Do we anticipate any shortfalls in funding this year? How about a surplus?
- If we anticipate a shortfall, what steps can we take to plan for and address this?

Building and planning an operating reserve is an important financial practice, and one way to start is to budget for a baseline reserve equal to one month's operating expenses. Whether yours is a well-established group or a new start-up, the discipline of building a reserve is a step towards organizational sustainability and future success.