

It Depends - Factors to be Considered in Deciding What Amount of Reserves An Organization Will Plan to Maintain

by Richard F. Larkin, C.P.A., BDO Seidman, LLP, with Nonprofit Reserves Workgroup¹
 [Supplement to: *What are Adequate Nonprofit Reserves for Financial Stability? – “It Depends.”*
 A White Paper located at: http://www.nccs2.org/wiki/index.php?title=Nonprofit_Reserves_Workgroup]

- Every organization should plan for its reserves. Consider how the factors below might affect you. Your board, with advice of management, should adopt a formal policy for the reserve level it wishes to maintain, and review that policy regularly. Of course you cannot just make reserves appear on command; it may take an extended period to accumulate the desired level.
- Following is a list of factors to be considered by nonprofit organizations in making that decision. In many cases, no one of these factors will be determinative by itself; all applicable factors should be considered together.

Factors whose presence would indicate that the organization probably should try to maintain a higher* level of reserves	Factors whose presence would indicate that the organization can likely get along with a lower* level of reserves
<p><u>Operating funds</u> <u>[for financial sustainability]</u></p> <p>The main sources of expendable revenue may be subject to large unexpected negative fluctuations.¹</p>	<p>Our main sources of revenue are generally not subject to large unexpected negative fluctuations.</p>
<p>The nature of our activities is such that there is a high risk of there being significant unpredictable demands on our resources.²</p>	<p>It is less likely that significant unexpected demands on our resources will occur.</p>
<p>Our regular day-to-day fluctuations in income and expenses are significant.³</p>	<p>Our regular day-to-day fluctuations are relatively minor.</p>
<p>Our governing board takes a longer-term view of provision of services and its attitude is to be very sure there are always resources available.</p>	<p>The governing board believes it is of overriding importance that every possible resource is used in the provision of current program services.</p>
<p>Our governing board’s approach to planning and budgeting is a conservative and prudent one. While the organization may never have faced an event requiring the extended use of our reserves, the board considers this a fundamentally sound financial management practice</p>	<p>The governing board is generally willing to live ‘day-to-day’ and trust that resources will be available when needed. The board believes it is of overriding importance that every possible resource is used in the provision of current program services.</p>
<p>Our planning and budgeting processes have historically proved to be less accurate in forecasting financial results.⁴</p>	<p>Our planning and budgeting processes have historically proved to be fairly accurate in forecasting financial results.</p>
<p>Adequate backup sources of resources are not in sight.</p>	<p>We are confident that adequate backup sources of resources are likely to be available in a pinch.⁵</p>

¹ The views, recommendations and suggestions expressed in this paper are those of the Nonprofit Reserve Workgroup and have been established by the Workgroup on a consensus basis. Some members may disagree on some points. Workgroup members represent themselves and not their affiliations. This paper is not the product of the Center on Nonprofits and Philanthropy at The Urban Institute, which serves as secretariat for the Workgroup.

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<table border="1" style="width: 100%;"> <tr> <td style="text-align: center;"> Board-designated funds [for optimal mission accomplishment] </td> </tr> <tr> <td> <p>The nature of our activities is such that there is a high likelihood that unexpected opportunities will come our way, requiring additional (available) resources to take advantage of these opportunities.⁶</p> </td> </tr> </table>	Board-designated funds [for optimal mission accomplishment]	<p>The nature of our activities is such that there is a high likelihood that unexpected opportunities will come our way, requiring additional (available) resources to take advantage of these opportunities.⁶</p>	<p>The nature of our activities is such it is not very likely that such opportunities will come our way requiring additional (available) resources.</p>
Board-designated funds [for optimal mission accomplishment]			
<p>The nature of our activities is such that there is a high likelihood that unexpected opportunities will come our way, requiring additional (available) resources to take advantage of these opportunities.⁶</p>			
<p>There is a sense that a change in organizational direction may be considered desirable in the not-so-distant future.⁷</p>	<p>There is no change in organizational direction anticipated any time soon.</p>		

* - No attempt is made here to quantify ‘higher’ and ‘lower.’ That has to be done individually by each organization, considering all its circumstances. A reserve level that would be considered high for one organization may be completely inadequate for another.

Notes:

1. Examples might include: ‘September 11th’-type events that affect your charitable giving and fee income; natural disasters such as earthquakes, floods and hurricanes; a blizzard the day of your big annual gala fundraiser; general poor economic conditions or rising costs; organizational problems such as volunteer and staff misdeeds or lawsuits generating unfavorable publicity which turns away customers and donors; overly-optimistic budgeting of anticipated revenue (very common); dependency on one donor for 10% or more of the annual budget; short-term or non-renewable agreements such as some cause-related marketing contracts and corporate sponsorships; many other reasons.
2. Examples might again include: September 11th – if you are the Red Cross of New York; every day – if you are the Red Cross of Los Angeles; the same blizzard - which causes your roof to collapse; the organization’s labor union gains a major wage increase.
3. Payrolls have to be paid every payday. The electric company is likely to want cash, not a promise, to keep the power flowing. But income often comes in spurts, especially contributions. Also there may be seasonal factors. For example, many contributions probably arrive in December as donors do personal tax planning. Colleges collect tuition at the beginning of each semester, and then have to live off it until next semester. Orchestras sell season tickets in the spring to pay for concerts to be put on over the following winter. On the other side, utility costs are probably higher in the winter and summer (heating and air conditioning), but lower in between. Expenses of our annual conference will be bunched around the time of the conference.
4. For example, you have had numerous instances of situations such as cost overruns, or, ‘The project that everyone thought would succeed, didn’t.’ ‘The foundation grant that you thought was in the bag, wasn’t.’ ‘The big fundraising event failed to meet expectations.’

5. This is your Plan B. For nonprofits this can be some combination of: cash on hand, investments and surplus assets that can be sold, a bank line-of-credit, a foundation or other institutional funder that you know would help if asked, some individual donors who could be counted on if the going gets really rough, a plan to cut expenses to a bare bones level for a while. If an organization uses this to justify not establishing a reserve, the organization should define in writing this “Plan B” which names sources (to include: held assets, organizations and individuals) from which funds would come.

6. For example, recently an extremely rare major dinosaur fossil became available at public auction. Museums knew that it would sell for a high price, and it did. If your museum wanted this for its collection, it had to have resources available to cover the cost. (In the real case, the winning bidder managed to quickly tap some large corporations to help, but still had to put up quite a bit of its own money.)

7. A long-standing program just isn't what's best any more. Community needs have shifted. Resources will be required to phase out the old and bring in the new. The parallel here is to seed capital in a business.