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# Operating Reserve

*Too Much, Too Little?*

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Presenter-Mark Palmer

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To calculate the operating reserve of an organization you should divide the annual operating budget by 12 and multiply by x number of months of cash that the board has determined are necessary to hold in reserve.

*Example-*

\$300,000.00 divided by 12 = \$25,000.00 x 6 months = \$150,000.00

Is this statement true or false? Why?

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## Objectives-

Answer common questions about the operating reserve.

Identify the determinants in identifying the amount needed for an operating reserve.

Offer assistance in development of an operating reserve policy.

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Frank Kurre, CPA, a principal with Grant Thornton has conducted a national survey involving 50 nonprofit executives nationwide, their CEO's, CFO's and COO's. Twenty-six Grant Thornton not-for-profit partners and over 50 Grant Thornton managers contributed their experience.

*The white paper detailing their findings will be published later this month. It will be posted on the NMC website.*

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## Attendee Survey-

How many of your organizations have...

0-3 months operating reserve?

3-6 months operating reserve?

6-9 months operating reserve?

9-12 months operating reserve?

12 months or more operating reserve?

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Nonprofits are criticized for having too much or too little in reserves.

Trying to apply a common standard for reserves is a mistake.

Commonly applied standards range from 3 months to 2 years.

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Nonprofits will identify the reserve amount differently based on which sub-sector a nonprofit falls within.

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# Unique considerations impacting reserve amount-

## *Education-*

Higher Education- Scholarship funding

## *Museums/ Theatres-*

Arts organizations are typically harder hit in an economic downturn than are other institutions

Exhibit income

## *Social Services-*

Medicare/ Medicaid reimbursement

Federal/State reimbursement

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## Unique considerations impacting reserve amount-

### *Medical-*

Medicare/ Medicaid reimbursement

Insurance payment

Client payment

### *Private Schools-*

-Honoring annual teacher contracts

-Scholarship programs

### *Other Sectors-*

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## Defining operating reserves-

- Net asset balances

  - Unrestricted (both board designated and non-designated)

  - Board designated may include- Quasi endowment funds and/or debt reserve/ sinking funds as well as plant funds

  - Temporarily restricted

  - Permanently restricted

- Operating reserves

  - Funds that are available to support the day-to-day operations of an organization

*Board designated net assets should not be used to “hide” excess reserves.*

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To sustain mission and program activity an organization must:

- ensure adequate financial resources are raised and sustained in order to fund programs.
  - closely monitor operating and capital budgets and take steps to ensure the organization operates within their budget.
  - ensure adequate liquidity to avoid a cash crunch and disruption in operations.
  - maintain strong internal controls.
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## Myths-

- Nonprofit organizations should not generate a surplus.
  
  - Nonprofits organizations should not accumulate significant assets or net assets.
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## Considerations for maintaining adequate cash

- Mission and long term plans
  - Type of organization
  - Corporate structure
  - Investment in physical plant
  - Debt structure
  - Current and future commitments
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## Considerations for maintaining adequate cash

- Contingencies
  - Funding sources, including fundraising activities
  - Types of programs provided
  - Self insurance
  - Workforce compensation and benefits
  - Collaborative activities
  - Staff transition
  - Life Cycle
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## Case study 1-

Using the cash flow budget provided, review the statement and accompanying notes and craft an operating reserve policy.

### Sample-

It is the policy of XYZ organization to approve an annual budget such that its minimum reserves, based on cash flow projections, would not be less than X months of operating revenue. Under normal circumstances the Board will strive to maintain x amount, however the purpose of the reserve is to provide a ready resource in an unexpected circumstance. To that end, the Board will approve those times at which it is appropriate to dip below the established reserve amount.

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Case study 1-

This is the cash flow budget for the NMC.

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## Case Study 2-

This is the cash flow budget for a domestic violence shelter. Consider the special needs of this organization and craft an operating reserve policy.

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# Q & A

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