How much should my nonprofit have in its operating reserve?

Keeping cash in reserve for a "rainy day" may seem like a luxury, but maintaining a nest egg can ensure your organization's long-term financial health. Yet recent reports suggest that many nonprofits do not have enough saved in their operating reserves.

The Propel Nonprofits, a Minneapolis-based nonprofit whose mission is to build financially healthy nonprofits that foster community vitality, explains how an operating reserve works:

An operating reserve is an unrestricted fund balance set aside to stabilize a nonprofit's finances by providing a "rainy day savings account" for unexpected cash flow shortages, expense or losses. These might be caused by delayed payments, unexpected building repairs, or economic conditions.

Reserves should not be used to make up for income shortfalls, unless the organization has a plan to replace the income or reduce expenses in the near-term future. In short, reserves should be used to solve timing problems, not deficit problems.

A commonly used reserve goal is 3-6 months' expenses. At the high end, reserves should not exceed the amount of two years' budget. At the low end, reserves should be enough to cover at least one full payroll.

However, each nonprofit should set its own reserve goal based on its cash flow and expenses. Organizations that have contracts or fees with regular and reliable payments don't need as much in cash reserves as organizations that rely on periodic grants, fundraising events or campaigns, or seasonal activities.

To be a viable operating reserve, there should be a board agreement and policy about how reserve funds can be used: When they can be used, who is authorized to use them, and how this is reported to the board.

See also our related Knowledge Base article:

- What's the difference between contingency and scenario planning? Where can I learn more about these topics?

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