



# How Much Cash Should a Nonprofit Have in Reserves?



In early 2019, [Portland entrepreneur Junki and Linda Yoshida donated their landmark Troutdale home](#) as a retreat for kids who are battling cancer to the Randall Children's Hospital Foundation, valued at approximately \$2 million.

Another story this year about remarkable generosity: [Naitos' real estate proceeds lead to at least \\$5.5M in philanthropic gifts](#). In addition to Lines for Life, members of the Naito family will also be contributing gifts to eight other organizations for a total of \$5.5 million. Among the other organizations are Raphael House of Portland, the Oregon Historical Society, the Oregon Nikkei Endowment, the Portland Audubon Society and Central City Concern.

Relying on these types of unexpected donations is one way to build up your organization's reserves, but you can't count on these generous gifts.

Case in point is the Portland-based nonprofit [Elders In Action](#) which announced in April that it's closing after 22 years due to a lack of funding.

Whether flush with funds or struggling to keep the lights on, there's never enough funding for a nonprofit to accomplish every initiative it would like.

Every organization needs to determine how much it requires for Operations, in Operating Reserves, and what can be dedicated to mission-focused initiatives. The answers to these questions are, of course, "It depends."

The variables that must be considered include seasonality, worst case scenarios, and more. The key to developing a specific answer is knowledge - knowledge of the organization's current financial state and donation history, as well as the data that is produced from a solid budget and cash forecast.

For those organizations that struggle, a plan must be developed to raise donations and reduce expenses. If you are fortunate enough to have a surplus of reserves additional questions arise. Where do you put those reserves? How should you safely manage them? While the answers vary from nonprofit to nonprofit, there are a solid set of financial best practices to follow and ensure that these questions are answered.

## DEFINING YOUR NONPROFIT'S FINANCIAL NEEDS

Nonprofits impact their chosen communities by providing advocacy and services. A healthy nonprofit organization employs a set of financial management practices that will build flexibility and stability, both today and in the future.

The Wallace Foundation, a philanthropic organization, released a [study](#) on strengthening financial management in nonprofits. Based on its interviews with CEOs, lead financial officers, and reviews of annual reports and other documents, it determined that there are three practices essential for a nonprofit to be financially effective and strong.

- Understanding the true costs of all programs to create realistic and accurate budgets;
- Monitoring the financial status of the organization as a whole and individual programs on an ongoing basis; and
- Meeting the nonprofit's expenses in a timely manner.

When your organization creates realistic and accurate budgets, it should be able to meet its financial needs. The budget is the backbone of any nonprofit. At least annually, your team needs to assemble to project revenue (funding sources) as well as cash flow needs.

Your financial needs are going to be divided into several categories:

- **Operating Expenses.** This includes personnel expenses as well as payment for rent, utilities, technology, and other professional expenses related to the nonprofit's operation.

- **Capital and Financing.** Costs related to the repayment of capital purchases and any loan principal.
- **Operating Reserves.** What you've set aside for unexpected outlays.

## NONPROFIT UNDERLYING FINANCIAL REPORTING REQUIREMENTS

Nonprofits have detailed reporting requirements that are specified by the FASB. While a full list of the rules would be outside the scope of this article, there are several basic required reports that relate to your nonprofit's reserves and cash position.

- **Statement of Financial Position.** Similar to a balance sheet, this report lists the organization's assets and debts, as well as its net assets.
- **Statement of Activities.** Instead of an income statement, this report details any changes in permanently restricted, temporarily restricted, and unrestricted net assets.
- **Statement of Cash Flows.** Similar to for-profit companies, this statement shows the inflow and outflow of cash within the nonprofit.
- **Statement of Functional Expenses.** This statement reports expenses incurred during a period, allocated by program and support services.

Nonprofits should also be producing detailed budgets that they translate into a cash forecast. That forecast will be adjusted for:

- non-cash expenses;
- seasonality;
- cash inflows from grants; and
- planned capital expenditures.

## NONPROFIT STRATEGY AND POLICY REQUIREMENTS

Operating reserves must be discussed in relation to the overall organizational strategy of your nonprofit. When a nonprofit applies thoughtful planning, they have a better chance of balancing the competing priorities or revenue reliability, organizational capacity, infrastructure, and reserves. Some of the applicable strategies and policy requirements that can facilitate this process include:

- **Cash forecast strategy.** The notion that nonprofits should live hand to mouth is dangerous to survival and longevity. A winning cash forecast strategy includes allowances for annual contributions to operating reserves. This is the essence of strategic financial management and better positions the organization to continue delivering services long-term.
- **Cash shortfall strategy.** Before you can create a reserve, your organization should resolve cash shortfalls. Once established, however, an operating reserve can help resolve or offset the occasional shortfall cash flow imbalance.
- **Investment strategy.** How will you safely and securely invest surplus funds to be held as your nonprofit's operating reserve?

## HOW MUCH IS ENOUGH FOR YOUR NONPROFIT RESERVES?

Not having reserves on hand for a rainy day or an unexpected expense can spell disaster for a nonprofit. It's a common misconception that a nonprofit shouldn't earn a "profit." Rather, these organizations need to have cash on hand to handle an unanticipated event (including an opportunity), or their efforts for good could be wasted.

First, what is a nonprofit operating reserve? These are liquid assets that can be easily tapped when revenue falls short of expenses. Reserves are not equity in real estate, because this isn't readily converted to cash. They are also not endowments, because these funds have restrictions on their use. "Cash on hand" is also not considered a reserve because most nonprofits have restrictions for its use since it's not designated as "reserves."

Despite the importance of reserves, studies show that many nonprofits either don't have reserves or even have negative reserves. An [M.J. Murdock Pacific Northwest Nonprofit Survey](#) concluded that less than half of respondents had three months or less of operating reserves and Washington had the highest rate (24%) of nonprofits with no reserves.

So, what is the right level of nonprofit reserves? A more prudent amount is about six months of your nonprofit's annual operating expense budget. This requires that your organization take several vital steps.

- Fund your operating account on a rolling 12-month basis. This is particularly important in light of any seasonality issues.
- Determine your nonprofit's operating reserve needs using the 6-month guideline. Also, consider

contingency plans for possible worst-case scenarios for your geographic area and sector.

- Consider money set aside as funding for special projects. These funds are separate, not part of a reserve fund. They may include projects specified by more sophisticated donors.

## STORING AND SAFEGUARDING NONPROFIT RESERVES

Once you know how much your nonprofit needs in reserves, where should you keep that cash? Just storing it in a random bank account may not be the best or most profitable choice.

Many nonprofits choose to invest their reserve funds, but this is done with some strict parameters. If your nonprofit has a board of directors, you will need to set a policy and receive approval for the investment of these funds. The criteria for any reserve account is that it should be low-risk and accessible.

An operating reserve can be as simple as a business money market account that earns interest at a rate slightly higher than a savings account. Depending on the size of your nonprofit, you can also form an investment committee to identify a diverse portfolio of acceptable investment vehicles for your reserves.

In the alternative, your organization can choose to work with a financial planner or investment advisor for these purposes. Your CFO or other financial leaders can also access helpful information through the [National Council of Nonprofits](#).

## KEYS TO PROVIDING EFFICIENT RESERVES FOR YOUR NONPROFIT

You may be in the minority if you begin consciously including reserve planning in your nonprofit fundraising efforts. However, board members and even funders, if properly educated, would rather see a well-managed organization that includes a prudent operating reserve.

So, how does your nonprofit go about successfully setting aside enough cash for its reserves? In short, by focusing on three things:

- **Discipline.** Periodic budgeting is key so that the right amount of reserves are set aside to reflect changing conditions.
- **Structure.** Most donors and foundations want to support organizations that are well-structured. Having a strong financial team in place is the first step. Next, is having sound policies established that govern where reserves are stored, who can access them, and under what conditions.
- **Knowledge.** Inaccurate conceptions about reserves can negatively impact your organization. For example, not only should your leadership understand how much to set aside they should also understand which sources of revenue are available to be set aside as reserves, since some can't be banked at year-end.

In today's economy, nonprofit reserves are more important than ever. Every organization should have the goal of building a solid base for its operations as well as setting aside reserves for unanticipated events and opportunities. Knowledge of the amount of funds your organization requires in reserves will also help answer

the more commonly asked question – “How much can we spend?” Achieving the mission through various initiatives and programs is also vital to the continuity of every nonprofit.

Once your team has established a process for creating accurate budgets and has a working operating reserve, they should be evaluated annually. This will ensure that your nonprofit remains safeguarded from the unexpected.

A key component that contributes to the financial success of a nonprofit is having the right financial team in place. If your organization needs interim, part-time, or permanent staff, find out how [CFO Selections](#) can help your organization meet its goals.

## ABOUT THE AUTHOR:



Nancy Smith is a high capacity financial manager with success in a wide variety of settings in both the nonprofit and for-profit sectors. She is passionate about engineering process improvement and navigating transitions, resulting in sustainable efficiencies and cost savings. In addition to core accounting competencies, she is experienced at managing other

support functions such as IT, Human Resources, and Operations.

Nancy has directed the accounting and finance functions of multiple organizations as a full-time employee and as a consultant. As Chief Financial Officer of World Relief, a \$45M international relief and development organization, she led the integration of two finance departments and provided increased visibility and accountability of program operations through improving financial models and analysis. Most recently, she was Director of Accounting at the Evangelical Free Church of America where she acted as controller for a combined \$40M budget of the denomination, its US and international programs, and its charitable foundation. Nancy began her career as the Accounting Manager for C&C Paints and has also worked in public accounting at Ernst and Young, where she directed and participated in consulting projects for telecommunications companies and trade associations.

Nancy is a licensed CPA in Washington state. She holds an MBA in Finance/MIS from the University of Washington and a BA in Business from Seattle Pacific University.

## ABOUT CFO SELECTIONS:

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