



Image by Nattanan Kanchanapra | Pixabay

BOARD-DESIGNATED OPERATING RESERVE POLICY TOOLKIT

FOR SMALL & MIDSIZE NONPROFIT ORGANIZATIONS

UPDATED EDITION
(APRIL 2023)

Sponsored by the Greater Washington Society of CPAs

[Nonprofit Operating Reserves](#)

TABLE OF CONTENTS

Preface & Acknowledgements	-	-	-	-	-	-	-	3
---------------------------------------	---	---	---	---	---	---	---	---

Toolkit Sections

Section 1: Operating Reserves: What Are They and Why Do We Have Them?	-							5
Section 2: Where Do Reserve Funds Come From?	-	-	-	-	-	-	-	7
Section 3: How Do We Determine a Target amount?	-	-	-	-	-	-	-	11
Section 4: How Do We Calculate the Operating Reserves Ratio?	-	-	-	-	-	-	-	14
Section 5: How Do We Develop a Written Operating Reserve Policy?	-	-	-	-	-	-	-	16
Section 6: What Are the Basic Policy Components?	-	-	-	-	-	-	-	17
Section 7: How do We Communicate About Our Reserves?	-	-	-	-	-	-	-	19
Section 8: How Do We Fund Our Reserves?	-	-	-	-	-	-	-	23
Section 9: Next Steps	-	-	-	-	-	-	-	24

Appendices

Appendix A: Written Operating Reserve Policy Example	-	-	-	-	-	-	-	25
Appendix B: Detailed Discussion of Some Reserve Policy Components	-	-	-	-	-	-	-	31
<i>What are appropriate uses for operating reserve funds?</i>								
<i>Setting and Reaching the Reserve Target</i>								
<i>Overall Capital Structure and Excess Accumulation</i>								
<i>Is a grant received for reserves considered unrestricted?</i>								
<i>Replenishment of Funds Borrowed from the Operating Reserve</i>								
<i>What should be included in the definitions section of our policy?</i>								
<i>Do we really need a separate bank account for the Operating Reserve?</i>								
<i>How do we best monitor the Operating Reserve?</i>								
<i>How often should the operating reserve policy itself be reviewed?</i>								
Appendix C: Legal, Tax, and Accounting Implications	-	-	-	-	-	-	-	36
Appendix D: Illustrative Statements of Financial Position	-	-	-	-	-	-	-	37
Appendix E: Sample Text for Audit Footnotes and IRS Form 990 Disclosure	-	-	-	-	-	-	-	39
Appendix F: Cash Flow, Working Capital Cash, and Operating Reserves	-	-	-	-	-	-	-	41
Appendix G: Glossary of Terms	-	-	-	-	-	-	-	45
Appendix H: Other Reference Materials	-	-	-	-	-	-	-	56
Appendix I: NORI Background and History	-	-	-	-	-	-	-	57

PREFACE & ACKNOWLEDGMENTS

Welcome to the **Board-designated Operating Reserves Policy Toolkit for Small & Midsize Nonprofit Organizations!**

This is a new edition of the Operating Reserves Policy Toolkit for Nonprofit Organizations first published in 2010 by the **Nonprofit Operating Reserves Initiative** (NORI). The new edition incorporates subsequent changes to accounting practices, has updated links to resources, and is designed to be more accessible to small and midsize organizations.

Our **mission** was then and is now to define, promote, and facilitate the practice of building and maintaining operating reserves throughout the nonprofit sector as a **key strategy toward ensuring the long-term sustainability** of the organizations and programs that save and enhance our lives.

Our **vision** is that all nonprofits will have a well-managed operating reserve in place in an amount appropriate to each organization's specific needs, and that **building and maintaining operating reserves will become universally understood as sound policy** and endorsed by nonprofit organizations' staff and board leaders, the donors and funders who support them, and the accounting professionals who serve them.

This Toolkit was created to provide a resource that will:

- help make a compelling case within the organization for the need to establish an operating reserve,
- provide factors to take into consideration in determining the size of the operating reserve for their organizations,
- suggest practices for raising funds for the reserve, managing it, reporting its balance, and communicating to internal and external stakeholders the intent and importance for its existence,
- offer some tools and references with which to go about drafting a policy and recording decisions, and
- put forward common terminology for referring to operating reserves that we hope will take hold among nonprofit organizations and their funders, donors, and financial professionals.

Happily, today there is far greater acceptance and understanding in the nonprofit field in support of this concept, and the Toolkit is referenced and linked to by many foundations, consultants, and capacity builders.

What's Inside:

The main body of this document defines what an operating reserve is, presents the rationale for creating one, and discusses a variety of issues that may affect the policy an organization ultimately creates, to establish, build, manage, and maintain its operating reserve.

Toolkit appendices provide additional details for the use of the person(s) leading the policy development project within the organization. The appendices include a policy outline with sample language, as well as more detailed and technical discussion of policy components, illustrations, an informative Glossary, and links to worksheets, a slide deck, and other resources that may be useful in your policy development process.

Use these tools. Please. Copy, paste, customize.

The process does not have to start from scratch. Explore the [NORI Document Library](#). Give us your feedback and please share tools with us that you have developed so we can continue to improve the web-based Operating Reserves Policy Toolkit and other training and implementation materials. [Register](#) with us (via email request at BessFromNORI@gmail.com) so we can inform you of future updates. Our mission is still to spread the word and share the tools that will facilitate better long-term financial sustainability among the vital nonprofit organizations that save and enhance our lives.

We've come a long way from when we began in 2008, but more recent challenges such as a global pandemic, climate change, inflation, and a possible recession are continued evidence that Operating Reserves are more relevant than ever.

We would like to thank the members of the original Workgroup and Toolkit Taskforce who conceived of and created the first edition of the Toolkit (still available in the [NORI Document Library](#)) and the Sponsors who endorsed and supported our efforts. We build on their work as we offer this Toolkit update.

Gratitude and Peace!

Nonprofit Operating Reserves Initiative (NORI) Toolkit Update Taskforce*

October 2022

* *Stanley M. Berman, CPA, CGMA*
Bess Hamilton Foley, chair NORI
Bill Levis, Affiliated Scholar, NCCS, The Urban Institute (Retired)
Rick Moyers, The Morris & Gwendolyn Cafritz Foundation
Patty O'Malley, CPA

(See [Appendix I: NORI Background and History](#) for more details.)

1. **OPERATING RESERVES: WHAT ARE THEY AND WHY HAVE THEM?**

The “what and why” of having operating reserves are intertwined and fundamental. In its very simplest concept, an operating reserve is a rainy-day fund, and people have such funds because they provide shelter from the storm. One group called it their “I can sleep at night” fund!

What: For purposes of this Toolkit revision, the term “operating reserves” refers to resources that a nonprofit board has formally designated, or “reserved,” for use in an emergency or to sustain financial operations during fluctuations in cash flow. More technical information will follow, but this is the basic idea. (The original Toolkit included two “not recommended” definitions of operating reserves: available and undesignated. This update focuses only on designated, fully funded, reserves.)

Why: There are many compelling reasons why you would have an operating reserve. Here are some fundamental reasons:

It supports fulfillment of mission and fosters strategic decisions. Without an operating reserve, cash flow stress can force expensive short-term crisis-based decisions, or worse, lead to curtailment or termination of programs. Operating reserves can help organizations to:

- preserve their capacity to continue mission programs uninterrupted by ups and downs in cash flow,
- accept and manage reimbursable grants,
- take advantage of unexpected opportunities,
- make bulk purchases at lower prices, and
- help promote good long-term planning and thoughtful decision-making.

It reduces stress and promotes better cash management. Living hand-to-mouth makes for a fragile organization with few cash management options. Having operating reserves can:

- reduce stress on the organization and its leaders caused by sweating payrolls and managing angry vendors,
- promote staff retention and reduce costly turn-over of key staff who burn-out under the sustained condition of chronic cash flow issues,
- better position the organization to negotiate a bank line of credit, which is part of a good, comprehensive cash management strategy, but not a replacement for adequate operating reserves.
- allow for better cash flow forecasting so the organization to be intentional about plotting in the use of an operating reserve to help smooth out cash flow in low balance months.
- enable stakeholders to anticipate recurring low cash flow months and support conversations with donors about possible changes to the timing of their gifts.

It **demonstrates proactive, prudent management** and planning and **promotes donor confidence**.

- The presence of an operating reserve is a strong indicator that an organization is managed by prudent, forward thinkers, who are committed to reliable program delivery and have positioned their organizations to continue to operate for the long haul.
- Such organizations are a better risk for investment of contributions and grant funding, for individual donors and institutional funders alike.

It **promotes compliance** to GAAP, regulatory and grant requirements, and good cash management protocols.

- Creating a separate operating reserve can provide a buffer to prevent accidental use of assets with donor restrictions or board-designated endowments.

See [Appendix F: Cash Flow Projections, Working Capital Cash, and Reserves](#)

See also [Instituting a Cash Investment Policy Statement](#) (JP Morgan 2022)

Depending on your organization's specific circumstances, you may find other compelling reasons to add to this list.

2. WHERE DO RESERVE FUNDS COME FROM?

Easy answer: Net Assets.

Specifically, “net assets **without donor restrictions**,” formerly called “**unrestricted** net assets.” Per a FASB ruling that took effect in 2018, “net assets without donor restrictions” is a required line item in the statement of financial position of audited financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP), and this term is also used in the IRS Form 990.¹

Operating reserves derive from the accumulation of unrestricted operating surpluses that are available for use at the discretion of an organization’s Board. **The amount of accumulated net assets without donor restrictions is increased or decreased as the result of annual operating surpluses or deficits.** Nonprofits pursue financial stability by budgeting for and achieving operating surpluses year after year to meet and maintain their operating reserves objectives.

To explain more precisely where reserves come from, it will be helpful to understand several terms and concepts we will use in the Toolkit.

Liquid Assets

Cash and other assets that can be converted to cash easily and quickly and that are not subject to significant market risk or early withdrawal penalties

Working Capital Cash / Operating Cash-on-hand

Cash assets that are available at management’s discretion to conduct day-to-day operations, not internally designated or restricted by a donor or other outside funder

Funded Reserves

A fund that has been set aside by the board of directors consisting of cash and/or investments that can be easily liquidated, without penalty

The operating reserve is a component of your statement of financial position. Following is a concept illustration of a statement of financial position. The balancing equation can be expressed as shown, or as “Assets = liabilities + net assets.”

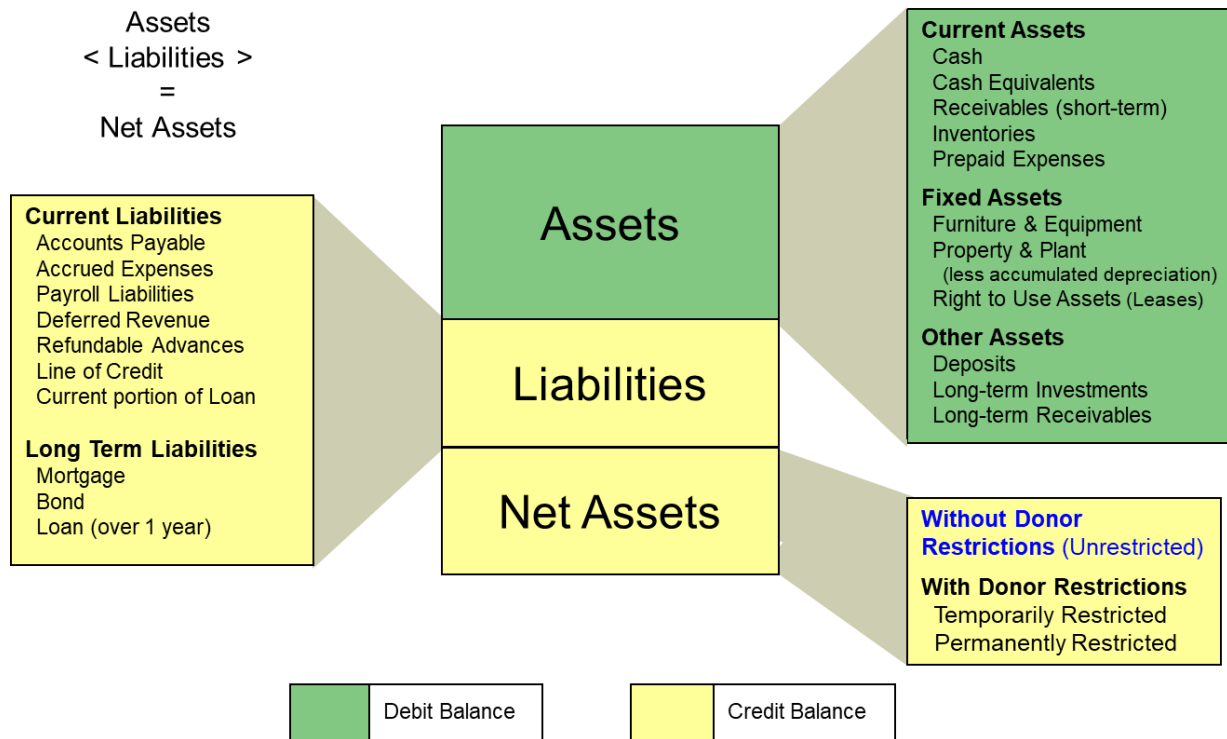
Simply put:

- **Assets** are what you have, or what other folks owe you or what they hold on your behalf.
- **Liabilities** are what you owe to other folks or what you hold on their behalf.
- And **Net Assets** are what’s left over, after liabilities are subtracted from assets.

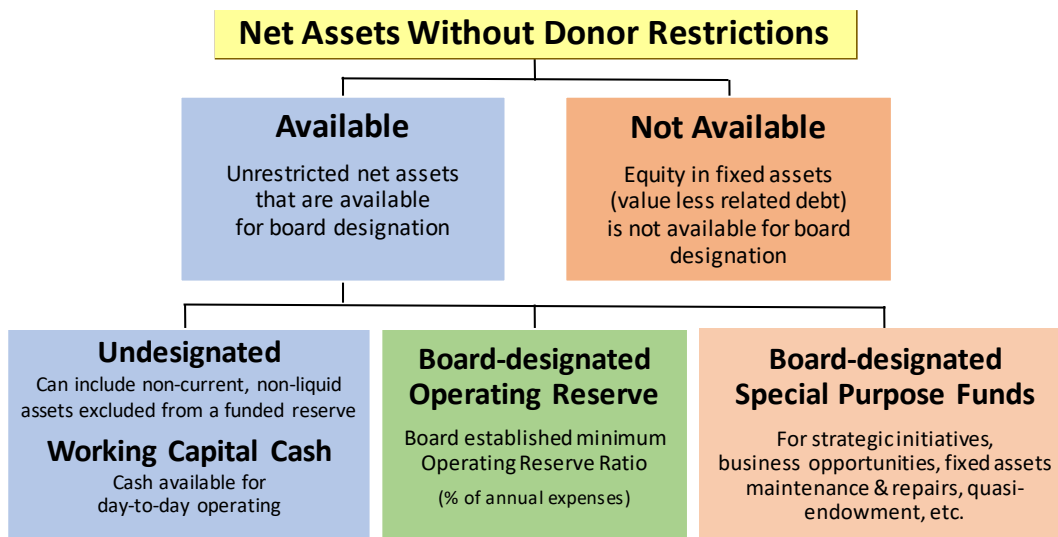
¹ Some funders and other nonprofit stakeholders who may continue to use outdated terms such as “balance sheet,” “profit & loss,” and “unrestricted net assets” are encouraged to adopt proper terminology for these items. See the [Glossary](#) for more details.

It is from the net assets without donor restrictions that boards can designate operating reserves.

Statement of Financial Position



To determine what is available to set aside for reserves, we need to examine what comprises Net Assets Without Donor Restrictions. The breakdown of unrestricted net assets, as depicted in the figure below, is critical to developing a clear and accurate sense of what may be **available** for an operating reserve.



Steps to Determining What Is Available for Designation

1. To serve its purpose, an operating reserve needs to be **liquid, or readily available**, so it is logical to consider **fixed assets as not available**, unless there is an immediate plan to sell (or liquidate) them. That is the initial breakdown. Note: the value of fixed assets shown in **net assets** is **net** of depreciation and net of any related long-term debt or loans.
2. From what is left as **available**, you will first want to ensure that there is sufficient day-to-day **working capital cash** (operating cash-on-hand) for the organization to run smoothly. That means understanding what the average operating cash balance should be and trying to keep the operating checking account at around that level for much of the year. (See **About Working Capital Cash** below.)
3. Consider what else might not be readily available. How long it will take certain **receivables** to come in? Are there significant non-cash **inventories** or **prepaids** that should be **excluded** from the balance available for designation? Is your operating reserve to be fully funded in cash (recommended)? (These details will be determined as you draft your operating reserve policy, covered in a later section.)
4. After allowing for working capital, excluding longer-term receivables and non-liquid inventories and other non-current assets, the remaining balance can be considered available for the board to designate for **operating or other purpose reserves**. (See **About Special Purpose Funds** below.)
5. Typically, a board will **prioritize establishing operating reserves** over special purpose funds, although funding both may need to happen in tandem in some cases.

About Working Capital Cash / Operating Cash-on-hand

As noted earlier, for this Toolkit edition, we define working capital cash as cash assets that are available at management's discretion to conduct day-to-day operations. (The broader term, working capital, could include some other current assets, but for small and midsize organizations we are focusing on cash balances for both operating cash-on-hand and fully funded operating reserves as a simpler concept.) Working capital cash/operating cash-on-hand is distinct from a board-designated operating reserve in that the reserve will have an explicit policy governing its use and replenishment, while working capital / operating cash is routinely accessible to staff management.

It can be daunting to accumulate both adequate working capital cash/operating cash-on-hand in the checking account and to set aside operating reserve funds. But it is good to **set these financial stability goals** for your organization and work toward achieving them. It may take some time but keep at it.

See also the Glossary entry for **Working Capital Cash** and **Appendix F: Cash Flow Projections, Working Capital Cash, and Reserves** for additional details and an illustration of the interaction between operating cash-on-hand and use of the operating reserve.

About Special Purpose Funds:

There are many reasons a special purpose fund might be established. Resources may be set aside to support pilot programs, or for an initiative arising from strategic planning, or to provide discretionary funds for a particularly entrepreneurial leader.

Less sexy are special purpose funds that allow for critical but boring things like building maintenance, major equipment replacement, or other operational concerns such as costs to move to a new facility. For groups that own their building, space, or expensive equipment critical for their programming, having maintenance and replacement fund(s) may need to be a serious consideration.

All such funds would be established to serve purposes that might destabilize the day-to-day running of the organization should they have to be covered by current operating funds.

Again, we advocate for creating the operating reserve before, or at least while, establishing special purpose funds, and before pursuing the establishment of an endowment.

See Glossary item [Board-designated special purpose funds](#) for more details.

Toolkit Actions:

- ➔ Follow the steps to determine what resources your organization currently has that would be **available for designation** as operating reserves.

3. **HOW DO WE DETERMINE A TARGET AMOUNT?**

The Nonprofit Operating Reserves Initiative (NORI) was formed in 2008 in response to the devastation caused by the recession that year. Many wonderful small and mid-sized nonprofits were lost because they tended to spend every penny they brought in and had no financial resiliency to get them through an extended downturn. Having an operating reserve may have helped some of them to survive then, and surely would have helped groups to continue operating through the pandemic shutdown, and to be better prepared to weather future periods of inflation and recession.

Exactly what amount should be in the operating reserve for an organization to consider itself to be **financially stable**? What amount would be **adequate**?

Not surprisingly, **it depends**.

After much discussion our Workgroup proposed that the *minimum* operating reserve ratio at the lowest point during the year be 25%, or about 3 months of the annual operating expense budget. But, is that the **right goal for your organization**? It depends on a variety of factors unique to you and your circumstances.



There is no single correct solution or benchmark – one size simply does not fit all when it comes to setting the amount for Operating Reserves.

An excerpt from “Nonprofits and Squirrels or, How big a reserve do you need?” by Richard F. Larkin, C.P.A.:

“...Of course, you cannot just make reserves appear on command; it may take an extended period to accumulate the desired level.

Related to this is continuing tension between wanting to spend currently everything we possibly can – because the need for our services is great, vs. putting something aside for the future. (Squirrels must be well programmed to handle this, as there are always lots of squirrels still around at winter’s end.) That tension is part of every organization’s (and person’s) existence.

There should also be Plan B. For nonprofits this can be some combination of: cash on hand, surplus assets that can be sold, a bank line-of-credit, a local foundation that you know would help in a pinch, 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.

Ask yourself, which organization needs larger operating reserves: (1) the Los Angeles Red Cross – think major, immediate, unpredictable events, or (2) a local day care center which owns its building debt-free, has a full roster of clients and a waiting list, adequate insurance, and a reliable funder which covers most of its operating budget? Now, where do you fall on that continuum?”

So, to answer the question of “how much,” an organization must begin by examining the factors at play in their operation. Two main areas that affect an organization’s financial risk levels are revenue streams and spending levels.

Revenue Volatility Factors: Common factors that affect revenue streams include, but are not limited to:

- Stability of donated revenue from primary sources
- Predictability of pledge collections
- Reliability of grants and contracts for services
- Level of dependence on one or two major donors
- Level of dependence on a single fundraising event
- Funder policies on support of overhead, indirect expenses (operating vs. restricted/project-only support)
- Economic health of the community
- Publicity that could adversely affect current or future revenues
- Likelihood of severe weather, natural disasters, or pandemics that would affect implementation of programs.

The extent to which any of these risks apply to your organization can help determine whether you might need a larger or smaller reserve. The more dependable and regular your funding is, the less risk, the lower the reserve might safely be.

Spending Flexibility Factors: Common factors that influence the ability to adjust spending levels include, but are not limited to:

- Ability to downsize operations quickly and still sustain core programs (e.g., cross-training of staff)
- Balance of full-time permanent staff vs. part-time temporary staff and/or contractors
- Extent to which economic or environmental events may affect demand for services, either up or down
- Long term leases with substantial penalties for cancelation
- Obligations to labor unions, union contracts
- Organization’s importance in community crisis situations (e.g., the organization’s mission involves disaster relief)
- Dependence on key person
- Obligations resulting from funding commitments made for longer than one year
- Amount of unsecured debt carried by the organization

In general, the less control over spending you have, the higher the risk, and the higher the reserve might need to be. The greater the number or magnitude of combined risk factors an organization has (whether they are revenue risks or risks related to spending requirements), the greater the need for a higher operating reserve.

Toolkit Actions:

- ➔ To determine the appropriate target amount for your organization's operating reserve, **convene a discussion among board and staff**, including staff who have reliable knowledge of the demands of day-to-day program implementation and resource development.
- ➔ **Use and adapt the Ratio Development Worksheet** to prompt discussion (available in the [NORI Document Library](#)).

How much is too much?

Our Workgroup refers to Standard #10 for Charity Accountability provided by the BBB Wise Giving Alliance, which says:

“Avoid accumulating funds that could be used for current program activities. To meet this standard, the charity's unrestricted net assets available for use should not be more than three times the size of the past year's expenses or three times the size of the current year's budget, whichever is higher.”²

We encourage organizations to be intentional about how their net assets are managed and presented. An organization may have a large amount in net assets without restrictions. However, it will look far better if the organization does not show its net assets without restrictions in one big undesignated lump. For instance, if an organization can break down that total into net investment in property and plant, a building maintenance fund, and an operating reserve, then the remaining balance that is available for operations will seem more reasonable. Having and showing these breakdowns indicates that the organization is aware of and proactively managing its resources. It also helps the reader of the statement of financial position to see a more accurate financial story of the organization.

See also Appendix B, item [Overall Capital Structure and Excess Accumulation](#).

² <https://give.org/donor-landing-page/bbb-standards-for-charity-accountability>

4. *HOW DO WE CALCULATE THE RESERVE RATIO?*

An organization can apply an operating reserve ratio to calculate its operating reserve level in terms of a percentage – operating reserves divided by the annual expense budget, or number of months – operating reserves divided by the average monthly expense budget.

Combining the revenue volatility and spending control factors may lead you to determine that 25% is enough, or that a higher or lower, target should be set. Once you have your target, you will want to translate that percentage ratio into dollars and/or calculate the ratio for an existing reserve balance, and to determine how much is needed to reach your target. For an annual budget of \$600,000, 3 months (or 25%) would be \$150,000; 4 months (or 33%) would be \$200,000, and so on. Following are some example formulas you may find useful.

Assumptions:

- The organization determined that **25%** is an adequate operating reserve target.
- The organization has decided to create a **fully funded** operating reserve, to be represented by cash assets only.
- The organization has determined it has **\$75,000** in cash available to fund to an operating reserve at present. (It excluded the value of property and facility-related net assets as well as working capital, receivables, prepaids, and the value of inventory.)
- The organization has determined the annual expenses to be **\$600,000.***

Here is the Math for 25% or a 3 Months' Reserve example:

Setting the Target

$\$600,000 \text{ (annual expense)} \times 25\% (.25) = \$150,000$

$\$600,000 \text{ (annual expense)} \div 12 = \$50,000 \text{ per month} \times 3 \text{ months} = \$150,000$

If your annual budget is \$600,000, and you only have \$75,000 available for a reserve at present, your current reserve ratio is 12.5%. You must accumulate another \$75,000 to reach your target.

Calculating the Ratio for Current Reserve Balance:

- **Percentage basis formula:**
 $\text{Operating reserves} \div \text{annual operating expense}^*$
 $\$75,000 \text{ (available)} \div \$600,000 \text{ (annual expense)} = 0.125 \text{ or } \underline{12.5\%}$
- **Number-of-months basis formula:**
 $\text{Operating reserves} \div 1/12\text{th of the annual operating expense}$
Step 1: $\$600,000 \text{ (annual expense)} \div 12 = \$50,000 \text{ per month}$
Step 2: $\$75,000 \text{ (available for reserve at present)} \div \$50,000 \text{ (1/12th annual expense)} = 1.5 \text{ or } 1\frac{1}{2} \text{ months}$

To determine the number of months of expenses your reserve could cover, you divide the \$75,000 available by the monthly operating cost of \$50,000 to learn you can cover 1½ months at present, vs. the target of 3 months.

To determine the amount for “annual operating expense” to use in the formula, an organization can use either prior year actual expenses or current year budgeted expenses. For organizations where a **significant portion of their expenses are **non-cash**, for example, **depreciation** expense or ongoing/reliable **in-kind** contributions, the organization may decide to exclude those non-cash expenses from the annual expense total.*

Toolkit Actions:

- ➔ Decide whether the operating reserve will be **fully funded** in cash.
- ➔ Determine the amount to be used as the **total expenses** factor (see asterisk note above).

5. *DEVELOPING A WRITTEN OPERATING RESERVE POLICY*

A board-designated operating reserve **policy** sets the goals for the reserve as well as the terms and conditions for its use. It provides definitions, history, and guidelines to build, maintain, and carefully manage the operating reserve.

We suggest the following sequential steps for developing a reserve policy.

1. Inception	Make the case for the need for an operating reserve to the Board. (NORI's whitepaper or reserve introduction document may be helpful.)
2. Recognition of Need	Board concurs with the case and asks finance (or related) committee to create draft.
3. Development	Utilize the NORI Toolkit and Templates (e.g., reserve ratio, outlines and sample language) to draft policy.
4. Draft Policy	Present draft policy to Board members.
5. Board Feedback	Board may approve or request revisions.
6. Final Draft	Policy is finalized and approved.
7. Implementation	Put into practice the guidelines established in the Operating Reserve Policy.

Toolkit Actions:

- Access introductory resources in the [NORI Document Library](#) to help to make the case for having an operating reserve:
 - Brief Intro to Operating Reserves
 - The Nonprofit Operating Reserves Initiative**, updated November 2022
 - Basic NORI Slide Deck
 - Nonprofit Operating Reserves ~ Creating a Policy**, updated November 2022
- See [Appendix H](#): Other Reference Materials.
- Utilize policy content resources at the [NORI Document Library](#).

6. WHAT ARE THE BASIC POLICY COMPONENTS?

Because “**it depends**,” your organization’s policy will be unique to your own circumstances. Following are the basic components that we suggest a good policy would include. Essentially, if you address these questions, you’ve got 99% of your policy. The purpose sets the **parameters and intentions** for the fund e.g., emergencies, long-term financial stability goals, other? Baking in some **history** as to why, when, and how the fund was established will provide useful information to future board members and staff leaders who may not have been present at the time, preventing second guessing and reinventing the wheel. Defining **terms** will put everyone on the same page. Setting **clear expectations** for the use and replenishment of funds, and being clear, before the need arises, about the process for securing authorizations and the conditions under which they are required, will make things go more smoothly when the time comes.

Section	Topics Addressed
Statement of Purpose / Philosophy	<ul style="list-style-type: none"> • Why is this board designating the reserve fund? • What are the objectives of the fund? Will it be fully funded?
Establishment of the Reserve Fund	<ul style="list-style-type: none"> • When was it established? • Target amount? Ratio calculation method/formula used? • Opening balance? Funding plan to reach target?
Definitions	<ul style="list-style-type: none"> • Define technical terms used throughout the reserve policy to establish clarity.
Use and Replenishment of Fund Assets	<ul style="list-style-type: none"> • Who may access the funds? • What authorization is given or required? • How much (\$/%) can be withdrawn? • What communication methods are acceptable? • What is the standard expectation for repayment of accessed funds?
Management and Monitoring	<ul style="list-style-type: none"> • Who is responsible for managing the fund? • Is a separate bank account required? • When is the reserve used vs. a Line of Credit? • What are the accounting procedures and reporting requirements? • What happens to any interest income? • What are the liquidity requirements for funds comprising the operating reserve? Can they be invested?
Role of the Finance Committee	<ul style="list-style-type: none"> • How will the committee monitor fund activity? • Will the committee be charged with developing the criteria to be used in deciding whether/how much to designate each year? • How often will the Operating Reserve Policy be reviewed and updated?

Some groups may also have a **line of credit** (LOC) with their bank, which is great to have as part of overall cash management strategy. The policy might address whether the LOC or the reserve is to be used first. Being clear about what happens to **income** from the account is a good idea. Some groups have a separate **investments policy** that provides guidelines for liquidity and risk thresholds for various categories of the organization's funds. If no separate investment policy exists, it is a good idea to include some investment parameters within the reserve policy itself, either in a separate section or within the Management and Monitoring section. (For small and midsize organizations, we do not recommend investing operating reserve funds in investments that are subject to market fluctuations.) Name the board level **committee responsible** for the fund and define their role.

It's OK if you want your policy sections to have different titles and to be in a different order. **Make it your own.** You may also want to include other conditions that may apply uniquely to your organization. For instance, your policy may also want to include provisions for:

- When/how to recalculate the formula for the operating reserve balance or target
- Timing and process by which the finance committee decides how much to designate to the fund annually,
- How to handle chronic operating reserve deficiencies (once target has been reached), or
- Terms and conditions for a permanent drawdown from the fund, and whether there will be a requirement or procedures for eventual replenishment.

Toolkit Actions:

- ➔ Utilize policy content resources at the [NORI Document Library](#).
- ➔ See [Appendix A](#) for sample policy outlines and language.
- ➔ See [Appendix B](#) for Detailed Discussion on Some Reserve Policy Components
 - What are appropriate uses for operating reserve funds?
 - Setting and Reaching the Reserve Target
 - Overall Capital Structure and Excess Accumulation
 - Is a grant received for reserves considered unrestricted?
 - What should be included in the Definitions section of our Policy?
 - Replenishment of Funds Borrowed from the Operating Reserve
 - Do we really need a separate bank account for the operating reserve?
 - How do we best monitor the Operating Reserve?
 - How often should the operating reserve policy itself be reviewed?
- ➔ See [Appendix C](#) for Legal, Tax, and Accounting Implications.

7. *HOW DO WE COMMUNICATE ABOUT OUR RESERVES?*

Now that we are implementing our policy, we will need to communicate with board members, funders, donors, and the public about our operating reserve. The most common way is via the financial reports that our organization produces for internal and external audiences. In either case, it's important to communicate using both numbers and narrative.

Internal Reports

- Show each reserve as a **separate line item** on the statement of financial position (SOFP) in the **net assets section**
- Show any borrowing from the reserve as **due to/due from** reserve in the **liabilities section**. (See the disaggregated SOFP format below.)
- Provide **narrative** in the **notes section** of reports explaining the establishment and purpose of the reserve and/or in the treasurer's report.

Audit / External Reports

- Show the reserve(s) separately in SOFP **net assets section**, and/or
- Provide narrative in the **notes section** of the audit to explain the intention of the board in creating reserves.
- Use **Section O** in the Form 990 to talk about the board's designation of your operating reserve and its sustainability objectives.

Internal reports should clearly show the status of the reserve funds and the extent to which they have been accessed at any given time. Both internal and external reporting provides you an opportunity to educate donors and funders and other stakeholders, to "brag" about how forward thinking and prudent your board is for creating funds that will position the organization to carry on with programming consistently and how critical is it for a well-functioning nonprofit to have a strong SOFP to support its strong programming.

External reports can shine a light on your reserves and support the audit requirement to address your organization's liquidity status more transparently. (FASB ASU No. 2016-14 **Liquidity and Availability Disclosure** requires the organization to disclose in both numbers and narrative the "nature and extent of available resources and the extent of external and internal limits placed on their availability.") Below is an example of language that a small arts organization put in the notes section of its audit along with a breakdown of the net assets balances. Similar language could also be used in the Form 990, Section O.

Example Audit Language: "Note"

In order to preserve the ability to execute programs without interruption and to invest in the long-term financial sustainability of the organization, the board of directors has designated a portion of unrestricted net assets for the following purposes: 1) Operating Reserve to be used to meet cash flow needs that are the result of the timing of receipt of grant funds; 2) Other reserves that have been

established to support strategic initiatives determined by the board including a Building Maintenance Fund and an Artistic Risk Reserve.

(Amounts for each fund would be shown for audit year and prior year.)

Presentation Format

Reading and understanding a nonprofit statement of financial position (SOF) is often not a strong suit for many board members or even some funders. This is why the NORI Workgroup recommends a **disaggregated SOFP** format (see model below) that includes multiple columns, and separate line items for net asset balances and designations. Indicating these designations on the SOFP is important for telling your financial story and demonstrating that your organization is intentional about how its net assets are managed and presented.

Presenting your net assets without restrictions in one big undesignated lump may lead a reader to conclude that you have an excess of assets available for operations. Without any breakdown or additional explanation, this can create the false impression that the organization is hoarding resources or sitting on more money than it needs. (A funder has informed us that this does come up in funder reviews of grantees financials, and that these designations can help address the issue.) If an organization can break down that large lump total, for instance, into net investment in property and plant, an operating reserve, and a building maintenance fund, then the remaining balance that is available for operations will be more reasonable. Showing these breakdowns not only indicates that the organization is aware of and proactively managing its resources, but it also helps the reader of the SOFP to properly understand the financial story of the organization.

In addition to separate designations in net assets line items, additional columns can further enhance understanding of the SOFP. Line item totals in the first column can be split apart into mini-SOFs in the columns to the right. A reader of a single-column SOFP might think that \$225,000 is a good amount of cash, but only by teasing it apart does one see that portions of that cash are restricted or designated, leaving a lower working capital cash balance than might have been assumed. Teasing it apart provides a clearer picture of operating liquidity.

Mini-SOFs can show that donor restricted net assets are represented by cash or receivables and that the board has designated both an Operating Reserve and a Building Maintenance Fund. The following format may not be relevant to a strict GAAP presentation for audit purposes, but it can prove highly valuable for internal management and even in communicating with funders, who may also appreciate the additional clarity.

~ continued ~

Disaggregated SOFP Presentation Example

The following disaggregated presentation model highlights how line item totals are apportioned among operating, restricted, and board approved investment in property and plant (fixed assets), as well as each of the board-designated reserve funds.

ORG NAME Statement of Financial Position as of [DATE]	TOTAL	Without Donor Restrictions				Restricted	Notes
		Available for Operations	Board Designated Ops Reserve	Equip Reserve	Fixed Assets		
ASSETS							
Cash	225,461	22,961	140,000	25,000		37,500	Cash comprises 4 categories
Receivables	74,293	58,793				15,500	AR includes a portion of restricted
Fixed Assets (net)	226,784				226,784		FA Net of Depreciation
Total Assets	526,538	81,754	140,000	25,000	226,784	53,000	
LIABILITIES							
Payables	24,999	24,999					Operations-related payables
Due to/from Reserve		10,000	(10,000)				\$10K borrowed from reserve
Loans	15,544				15,544		Loan related to fixed asset
Total Liabilities	40,543	34,999	(10,000)	-	15,544	-	
NET ASSETS							
Without Donor Restrictions							
Available for Operations	46,755	46,755					Available for day-to-day operations
Operating Reserve	150,000		150,000				Funded Operating Reserve
Other Reserves	25,000			25,000			Building Maintenance Fund
Property/Equip (net)	211,240				211,240		Fixed Assets net of related loan
With Donor Restrictions	53,000					53,000	Restricted for summer project
Total Net Assets	485,995	46,755	150,000	25,000	211,240	53,000	
Total Liabilities & Net Assets	526,538	81,754	140,000	25,000	226,784	53,000	

The presentation clearly shows how much has been borrowed from the operating reserve in the Due to/from Reserves line, just under Payables. In this example \$10,000 has been borrowed from the reserve. There are two net assets lines, (\$150,000 for operating + \$25,000 for other reserve funds) totaling \$175,000. Up in the cash line, there is \$10,000 less than the \$175,000 in the board-designated column, as \$10,000 in cash was moved into the operations column when it was borrowed.

That doesn't mean it became undesignated, just borrowed, per the established policy. To account for that, the "due to/from" line shows the borrowed amount as a positive in the operations column and as a negative in the board designated column, to keep the mini-SOFPs in balance. Additional narrative in a treasurer's report might explain the specific reason funds were borrowed and when they are expected to be repaid.

Toolkit Actions:

- ➔ Using language from the Purpose section of your Operating Reserve Policy, draft a brief statement to serve as **narrative description** and rationale in internal and external reports.
- ➔ Discuss with the finance committee and the accounting staff the possibility of adopting a **disaggregated statement of financial position** format and including separate net assets line items for each reserve fund.
- ➔ See [Appendix D](#) for more details on statement of financial position **presentation options**.
- ➔ See [Appendix E](#) for additional examples of Audit Footnotes and Form 990 **Disclosures**.

8. *HOW DO WE FUND OUR RESERVES?*

Now that we know how to report our reserve status, what strategies can we use to budget for and raise funds for the reserve? This is the big, practical question everyone has. Below are some suggestions that may echo your current strategies or give you some new ideas:

- Budget for operating **surpluses** annually.
The best way to build reserves is to have what Nonprofit Finance Fund calls “consistent surpluses.” Remember: not-for-profit does not mean no surpluses allowed – as the old saying goes – not-for-profit is a tax status, not a business model.
- Include a “contribution to reserve” **budget line item**.
You can explicitly budget for reserves by including a named line item: such as “Board Mandated Contribution to Reserve,” or similar.
- Fund non-cash **depreciation** expense.
Budget for depreciation. Bringing in cash revenue to cover non-cash depreciation expense is a great way to build liquidity for reserves and other capital purposes.
- Include reserve targets in multi-year **capital** budgets.
You will want to create a capital budget alongside your operating budget to cover additional non-operating cash needs such as loan principal payments, cyclical equipment and/or vehicle replacement costs, in addition to meeting financial capitalization targets.
- Include operating reserves as component of capital **campaigns**.
An operating reserve is a natural and logical component of a capital campaign, especially one involving a facility, as costs may initially go up faster than revenue. And there are always surprises.
- Include operating reserves as an option in **planned giving** campaigns.
Make the reserve a component of planned giving solicitations – the sustainability of the organization connects nicely to a donor’s desired legacy.
- Designate **board member** contributions (or % of them) to the reserve and/or assign a **% of each unrestricted gift** from individuals to the reserve.
- Designate staff **vacancy savings** to the reserve.
If a budgeted staff position is vacant, pay that money into the reserve instead of spending it elsewhere.
- Designate **windfalls** to the reserve.
Rather than spend out a large one-time, non-repeating gift on regular operations – put **all or part** of it into the reserve instead. As more major donors are giving substantial gifts without restrictions, e.g., MacKenzie Scott, it’s a perfect opportunity to strengthen core infrastructure and build capitalization.

What else? Add ideas that have worked for you. **Don’t get discouraged.** It may take years to get to your reserve target, but even a small reserve can prove useful as it is growing. See [Appendix F](#) for an illustration of how even a partially funded reserve might be used.

9. *NEXT STEPS*

As noted in the preface, this “Operating Reserves Policy Toolkit for Small and Midsize Nonprofit Organizations” was created to help nonprofit leaders and the financial consultants who serve their organizations to:

- Make a compelling case within their own organizations for the need to establish an operating reserve, and to communicate this purpose effectively to external constituencies,
- Provide factors to take into consideration in determining the operating reserve size/ratio that is appropriate for their particular organization,
- Suggest practices for building and managing the reserve and reporting its balance, and
- Offer some tools with which to go about drafting a policy to record their decisions and to guide implementation.

The main body of this document has defined an operating reserve, presented the rationale for creating one, discussed the many factors that would determine the size and management of one, and provided models for communicating about one and strategies for funding one.

The appendices that follow are for the use of the person or taskforce leading the policy development project within the organization, and for those charged with implementation and reporting. (An “Appendix A ~ Editable” version is also available in native Word format in the [NORI Document Library](#).) The appendices contain an annotated policy outline and technical details on policy components, accounting, reporting, tax, investment, and legal considerations.

A [Glossary](#) is also provided to encourage everyone to use consistent terminology in referring to operating reserves and reserve components that, frankly, we hope will take hold among nonprofit organizations and their funders, donors, and financial professionals. Again, we hope that it will become commonly understood and accepted that nonprofits of all sizes need to have operating reserves at a level appropriate to their own circumstances.

Use these tools. Please. Copy, paste, customize. Give us your feedback and share tools with us that you have developed so we can continue to improve the web-based Operating Reserves Policy Toolkit and other training and implementation materials. [Register](#) with us via e-mail request at BessFromNORI@gmail.com so we can inform you of updates. Our mission is to spread the word and share the tools that will facilitate better long-term financial sustainability among the vital nonprofit organizations that save and enrich our lives.

Gratitude and Peace!

APPENDIX A:

SAMPLE OPERATING RESERVE POLICY OUTLINE

Outline for development of written reserve policies with example language For Small and Midsize Nonprofits

For the full Nonprofit Operating Reserves Initiative Toolkit see:
<http://www.nonprofitaccountingbasics.org/nonprofit-reserves>

NAME OF ORGANIZATION

BOARD-DESIGNATED OPERATING RESERVE POLICY

I. Statement of Purpose / Philosophy

→ Define the purpose(s) and objective(s) of this Organization's operating reserve.

[example 1:]

The ORG Board of Directors designated an OPERATING RESERVE by resolution at its DATE board meeting. The general purpose of the reserve is to help to ensure the long-term financial stability of the organization and position it to respond to varying economic conditions and changes affecting the organization's financial position and the ability of the organization to continuously carry out its mission.

ORG will maintain a Board-designated Operating Reserve to achieve the following objective(s):

- 1. To enable the organization to sustain operations through delays in payments of committed funding and to accept reimbursable contracts and grants without jeopardizing ongoing operations.*
- 2. To promote public and funder confidence in the long-term sustainability of the organization by preventing chronic cash flow crises that can diminish its reputation and force its leaders to make expensive short-term crisis-based decisions.*
- 3. To create an internal line of credit to manage cash flow fluctuations and maintain financial flexibility.*

[example 2:]

The establishment and maintenance of a funded Board-designated Operating Reserve is a high priority. This will enable ORG to support strategic business practices and to:

- A. Manage cash flow interruptions*
- B. Minimize the need for borrowing from the Line of Credit*
- C. Meet commitments, obligations or other contingencies*
- D. Generate investment income*

II. Board-Designated Operating Reserve Balance

→ Describe the establishment of the reserve. Include such details as:

- The ultimate goal amount for the reserve and method / rationale for determining the amount (to provide history and background for future board members and staff leaders)
- Current operating reserve balance, if any, or amount of existing funds to be designated
- Any planned additions to the reserve using identified grant money and, if applicable, whether any required matching money is to be designated as part of the reserve
- The estimated timeline and incremental plan for reaching the target balance, if applicable
- Relationship to annual budgeting process and fundraising plan

[example 1:]

The target ratio to be attained and maintained for the Board-designated Operating Reserve is 25% or approximately 3 months of annual operating expenses. This ratio was deemed adequate after evaluating the organization's revenue and spending volatility and risks. In this case, the amount to be used as annual operating expenses in the ratio calculation will exclude the non-cash depreciation expense.

To establish the Operating Reserve, the ORG Board of Directors has designated \$40,000 of existing accumulated liquid net assets as the beginning balance of the reserve, representing 6% of current total operating expenses (excluding depreciation expense), of \$675,000.

The remaining \$127,750 to reach 25% of \$675,000, plus increases relative to increased annual operating expenses, is to be funded incrementally as determined by the finance committee during the annual budgeting process, through funding strategies incorporated into the ORG's annual fundraising plan and capital budget.

[example 2:]

The target amount to be attained and maintained for the Board-designated Operating Reserve is \$200,000 representing approximately 25% of annual operating expenses of \$800,000, or about 3 months of expenses on average. To establish the Operating Reserve, the ORG Board of Directors has designated \$20,000 of existing accumulated liquid net assets as the beginning balance of the reserve. The next \$60,000 is to be funded by a special one-time grant from AGENCY NAME of \$30,000 along with the required 1-1 match of new or increased donations committed during the 20XX fiscal year. The remaining \$120,000, plus increases relative to increased annual operating expenses, is to be funded incrementally as determined by the finance committee.

As part of the annual budgeting process, the finance committee will evaluate available resources and decide how much can be added/designated to the reserve to incrementally reach the intended target, based on the prior year's operating margin. Further, in conjunction with the board fundraising committee, a target amount for the contribution to the operating reserve will be determined for inclusion in the budget for the upcoming year.

III. Use of the Board-designated Operating Reserve

→ Describe terms and use of the reserve. Include such details as:

- Who may access the reserve
- What authorization is given or required
- What communication methods are acceptable

- Conditions (if any) under which funds can be accessed without explicit authorization
- The threshold (time and/or amount) requiring a higher level of authorization
- The standard expectation for repayment of accessed funds
- The method for reporting on the status of repayments including frequency and recipient(s) of the reports
- List specifically what the reserve can be used for (or not used for)
- Describe the relationship between the reserve and a commercial line of credit (if applicable) i.e., which should be used first, etc., if not addressed earlier (See example 3, Section I).

[example re: use and replenishment:]

The Executive Director may access up to \$10,000 for purposes as outlined above, so long as sufficient accounts or grants receivable are or will be available to repay such usage within three months' time. The Executive Director shall notify the Treasurer of such use in writing; the Treasurer shall acknowledge receipt of notification in writing. E-mail or fax shall be acceptable forms of notification and acknowledgement.

Any funds borrowed from the Operating Reserve for \$10,000 or greater and/or for longer than 90 days will be paid back through a prescribed repayment schedule/method. The Executive Director shall submit a request for any such usage along with the proposed repayment schedule to the Executive Committee for approval.

The status of any borrowing from and repayments to the Operating Reserve is outstanding shall be reflected in the monthly internal financial reports and reviewed at the regularly scheduled Board meetings.

[example re: what the reserve can be used for (or not be used for:)]

Can be used:

- A. *As an internal line of credit for use to financially operate the organization*
- B. *To meet unfunded and unexpected organization needs*
- C. *To bridge between pledges and pledge receipts*

Should not be used:

- A. *For capital purchases (funded by Equipment Maintenance & Replacement Reserve)*
- B. *To make up a deficiency in the Capital Campaign*

[examples re: use of reserve vs. commercial line of credit:]

In addition to its Operating Reserve, ORG maintains a line of credit (LOC) with ABC Bank. Relationship to Commercial Line of Credit.

The determination as to whether to use the Operating Reserve or to borrow from the LOC is to be considered case-by-case before granting permission for its use.

OR

Use of the operating reserve shall be subsequent to fully depleting any existing commercial lines of credit.

OR

The operating reserve shall be fully depleted before use of the commercial line of credit.

[Note: management procedures, authorizations, etc. must be consistent with the chosen of hierarchy of use for both the Reserve Policy and the LOC Policy.]

IV. Management of the Board-Designated Operating Reserve

→ Describe the management of the reserve. May include such details as:

- Who is responsible for managing the reserve
- Whether a separate bank account is required
- Who may open and/or monitor bank accounts
- Accounting procedures
- Reporting requirements
- Disposition of any interest income
- Liquidity requirements for funds comprising the reserve and whether and how they can be invested
- Define what assets are to be considered available for designation to the Operating Reserve. For purposes of a fully funded reserve, this would comprise cash or near cash without donor restriction or other board-designation. A fully funded reserve is recommended as best practice for small and midsize nonprofits. The example below refers to a fully funded reserve that is cash only.

[example:]

Under the direction of the Treasurer and by Board Resolution, the Executive Director shall establish a separate bank account for the Board-designated Operating Reserve. Policies and procedures for handling deposits, reconciling statements, safeguarding access, etc. shall be the same as established from time to time for any of the organization's other bank accounts. If feasible, the funds shall be invested according to the guidelines set in the Operating Reserves Investment Policy section below. Any interest income from the Operating Reserve shall be considered unrestricted operating income and may be added to the reserve at year-end at the discretion of the Finance Committee.

The Operating Reserve will be listed separately in the unrestricted net assets section of the organization's statement of financial position as "Board-designated Operating Reserve" and longer-term borrowings from the reserve will be shown/noted as a liability – "Due to Operating Reserve" – in internal financial reports.

The following modifications determine the factors used for purposes of monitoring the operating reserve balances:

- *Total Expenses excludes regular, ongoing in-kind professional legal services, and excludes depreciation expense.*
- *Available for designation excludes minimum working capital, long-term receivables, non-cash inventories, prepaids, and fixed assets.*

V. Operating Reserves Investment Policy

→ Define the risk tolerance and investment guidelines for the reserve (in the absence of a separate, comprehensive investments policy).

[example:]

As capital preservation and liquidity are the two main objectives for any investment of the operating reserve funds, the portfolio will focus on safe, short-term instruments that can be readily converted into cash.

Income from the investment of the operating reserve funds is not a priority, but the Treasurer and Finance Committee shall take reasonable steps to maximize income from the investment of the funds to the extent that such steps do not undermine the main objectives of safety and liquidity.

Examples of permissible investments are, without limitation, money market funds, certificates of deposit and the like. No such investment shall exceed the applicable insured limit for the institution in which it is invested. As deemed appropriate by the Treasurer and Finance Committee, the ORG may engage the services of a professional investment advisor to assist in making investment decisions consistent with this Investment Policy.

VI. Shortfalls or Drawdowns* from the Board-Designated Operating Reserve

- Describe the Board's policy for restoring its Operating Reserve to target level (once achieved) if the reserve has been depleted to below the target level. May include time and amount thresholds for which the replenishment policy will become applicable.
- Define the terms and conditions for drawing down from the reserve for operating purposes in the case of a financial emergency. May include procedures for eventual replenishment.

[example:]

It is the intention of ORG to continue to designate funds to the Operating Reserve to meet and maintain the determined target ratio. Once the target has been reached, should a borrowing reduce the reserve to below target, ORG will continue to work to replenish the reserve as soon as feasible based on annual evaluation of financial circumstances.

*A drawdown from the reserve that will not or cannot be replaced with operating funds in the timeframe established in "**Use of the Board-designated Operating Reserve**" above, must be approved by a majority of the Board, either by a majority of the votes of a quorum present at a regular Board meeting or by a 2/3 majority of the Board if such vote is conducted by other means. A record of any such action shall be maintained and be made a part of the Board meeting minutes. Any such action would remove the Board designation of "reserves" from these funds.*

**Note: this essentially decreases the reserve from the established target level and is not recommended except under extraordinary circumstances.*

VIII. Responsibilities of the Finance Committee

- Describe the responsibilities of the Finance Committee with regard to operating reserve and other board-designated funds oversight. Include:
 - How the committee will monitor the activity in the reserve(s)
 - The criteria the committee will use to decide whether/how much to designate to the reserve(s) each year
 - How often the Operating Reserve target amount and ratio will be reviewed and updated

- How often the Operating Reserve Policy will be reviewed and updated

[example:]

The Finance Committee shall receive reports on the Operating Reserve at its regular meetings and shall be charged with assuring that the funds are invested prudently in accordance with the guidelines stated above and that the ORG receives a reasonable rate of return considering the size of the reserve account, the instruments in which it is invested, and other relevant factors.

The Treasurer will report the status of the Operating Reserve to the board as part of the regular Treasurer's report.

The Finance Committee will review and update the operating reserve ratio and target amount and will determine whether and/or how much may be additionally designated to the reserve as part of the annual budgeting process. The decision will require evaluation of available cash assets and preservation of adequate working capital.

The Finance Committee will review all components of the Operating Reserve Policy every three years, or sooner if conditions warrant, and put forward any necessary changes for Board approval.

OPTIONAL:

Funds Designated for Other Special Purposes

→ Per the above outline, describe the policy and process the board will follow to create/designate other special purpose funds relevant to identified objectives of a strategic plan, etc., for example, Equipment Maintenance & Replacement, Human Resource Capacity Building, New Program Initiative, pursuit of unforeseen opportunities, etc.

.

(An “Appendix A ~ Editable” version is also available in native Word format in the [NORI Document Library](#).)

APPENDIX B:

DETAILED DISCUSSION ON SOME RESERVE POLICY COMPONENTS

What are appropriate uses for operating reserve funds?

In the Purpose section of the policy, you may want to clarify what your organization intends the operating reserves funds should and should not be used for. The Workgroup feels generally that operating reserves can be used for meeting commitments, obligations, or other contingencies for day-to-day operations. They would not, however, be used for non-operating expenses such as funding the purchase of a new building (barring the loss of an existing facility with insufficient insurance proceeds) or for establishing an endowment.

Here are some examples of how organizations have used their operating reserves:

- As an internal working capital line of credit to smooth over anticipated low cash flow months.
- For temporary use if there is a sudden shutdown of a major funder or decrease in expected revenue.
- To maintain current program operations when government payments are delayed.
- To respond to special community needs resulting from an unanticipated disaster, such as a hurricane.
- To cover capital cost emergencies that are not fully covered by insurance, that is, for instance, for a suddenly damaged roof vs. a routine roof replacement, which should, ideally, have been anticipated and covered by a separate Maintenance/Replacement Fund.

Obviously, operating reserves can only be maintained and increased when there are operating surpluses. And conversely, the operating reserve balance can become eroded or consumed by chronic deficits.

Setting and Reaching the Reserve Target

The formula for calculating a reserve target and a current reserve balance were provided earlier. One factor used in those calculations is annual operating expenses. For a variety of reasons, an organization may want to **exclude certain items from the annual operating expenses total**. For instance, if the organization has a significant amount of regular in-kind contributed professional services or donated facility use, or if its non-cash depreciation expense is especially high, it may decide to exclude these expenses from the target/balance calculations to get a more accurate sense of the cash needed to cover monthly cash spending.

Conversely, using the annual operating expense budget as the denominator for the operating reserve ratio might be inadequate for a growing organization with the need to finance other statement of financial position growth, such as capital expenditures, special purpose reserve funds, gift shop or other inventories, and prepaid expenses, etc.

Since the recommendation in this iteration of the Toolkit is to create a **fully funded reserve**, the current/ongoing reserve balance will be evident based on the amount of cash in the reserve account and the balance shown in the board-designated operating reserve account in the net assets section of the statement of financial position.

An operating reserve policy can be adopted, a target can be set, and an opening balance deposited while an organization continues to work toward reaching the target amount it set to fully fund the reserve. In the Establishment section of the policy, it may be useful for the organization to sketch in a **high-level funding plan** for reaching the target. This might be very general at the policy level vs. spelling out procedures that may change from year-to-year. For example:

“As part of the annual budgeting process, the finance committee will evaluate available resources and decide how much can be added/designated to the reserve to incrementally reach the intended target, based on the prior year’s operating margin. Further, in conjunction with the board fundraising committee, a target amount for the contribution to the operating reserve will be determined for inclusion in the budget for the upcoming year.”

Overall Capital Structure and Excess Accumulation

In her article “[Hidden In Plain Sight, Understanding Nonprofit Capital Structure](#),” Clara Miller notes that all organizations have a capital structure, whether they know it or not. It is best to be aware of and intentional about your capital structure. Setting a goal and plans to reduce or eliminate debt and establishing an operating reserve fund are good steps in this direction. Awareness is built by distinguishing liquid vs. fixed, showing how much is under donor restriction, and how much and what kind of debt may be present.

In the happy event that an organization is highly successful in having consistent and significant operating surpluses, it may want to discuss what happens if there appears to be an **excess of available (undesignated) assets without donor restrictions**. It will look far better for the organization to clearly communicate that it proactively manages and designates its available resources rather than show its net assets without restrictions in one big undesignated lump. Consider the following as possible net asset categories to strategically break down a large lump sum:

- How much is desirable/available for baseline **working capital cash/operating cash-on-hand**?
- Is there an operating reserve and is the original target **ratio still adequate** under current circumstances? Should it be increased?
- Do other **special purpose reserves** (e.g., building maintenance, strategic initiatives, etc.) need to be established? Is the balance of any current funds still adequate?
- Have all short-term **loans been paid off**? (It may make more sense not to use all available cash to pay off long-term mortgages and vehicle loans that have predictable monthly payments built into the operating budget and cash flow projections.)

If there are excess resources available after all of these items are fully/adequately funded, and short-term debt has been retired, the organization may decide it can **devote more resources to programs and core capacity** infrastructure. This should be done carefully, considering how long continued surpluses are likely. For instance, adding permanent new staff creates an ongoing fixed cost vs. periodically upgrading software or investing in staff development activities that are more controlled spending items.

The organization could also consider establishing a board-designated (quasi) **endowment**. (See [Appendix C: Legal, Tax, and Accounting Implications](#).)

In any event, an organization may want to establish its own net assets floor and ceiling – the floor ensures that the organization maintains adequate working capital cash and reserves; the ceiling serves as a trigger for avoiding excessive unassigned net asset accumulations. Our Workgroup refers to Standard #10 for Charity Accountability provided by the BBB Wise Giving Alliance, which says:

“Avoid accumulating funds that could be used for current program activities. To meet this standard, the charity's unrestricted net assets available for use should not be more than three times the size of the past year's expenses or three times the size of the current year's budget, whichever is higher.”

<https://give.org/donor-landing-page/bbb-standards-for-charity-accountability>

Is a grant received for reserves considered unrestricted?

It depends. The particular guidelines for such grants may or may not be clear regarding whether the grant is to be considered restricted. Since a board designation can only be applied to net assets without donor restrictions, it could be assumed that the grant will be released to unrestricted at the point that the board officially designates it to the reserve, which was the restricted purpose of the grant. It is best to work with your accountant and grant program officer to craft clear wording for the grant agreement relative to the granting organization's intent for the funds to become unrestricted at that point. The presence of an actual restriction in the grant documentation may have an impact on whether it will fall within the terms of your reserve policy.

Some major donors, foundations, and even government agencies have awarded grants for the specific purpose of creating or increasing an unrestricted board-designated reserve fund (typically referred to as cash reserve, working capital reserve, operating reserve, etc.) Please note: grants given for reserves are very different from grants for permanently restricted endowments. See Glossary items [Permanently Restricted Net Assets](#) or [Board-designated quasi-endowments](#).

Replenishment of Funds Borrowed from the Operating Reserve

The first set of questions about who can access the funds, what authorizations are required at what borrowing thresholds, and what communication methods are to be used, are simple to determine. Setting repayment/replenishment expectations may be more complex. Some considerations may include whether to require collateral, that is, explicitly identified receivables or

other expected revenue. And you may want to give some thought to what happens if these receivables or other revenue don't come in?

There is sample language in the **policy outline examples** that speaks to reserve deficits, longer-term replenishment, and even permanent withdrawal from the operating reserve.

In terms of policy for a small or midsize organization, simple statements may be better than trying to specify amounts per year for replenishment. For instance, your organization may want to craft a statement indicating that permanent withdrawals from the reserve are to be “avoided except in extreme cases,” and that any borrowing is to be “replenished as soon as feasible, preferably within the same fiscal year.” This codifies the intent without too much procedural detail that may be impossible to follow in reality.

What should be included in the definitions section of our policy?

Again, this depends. How knowledgeable are your board members about nonprofit financial terms? A good way to judge might be to ask board members not on the finance committee or policy drafting taskforce to read through the draft policy. Ask them to flag anything in the language used that they don't readily understand. The policy should be as simple and clear as possible without compromising on necessary content.

Some possible terms to include, if they are mentioned in the policy, are listed below. These terms are defined in the Glossary in [Appendix G: Glossary](#).

Annual operating expense budget	Net assets
Annual operating surpluses or deficits	Net assets with donor restrictions
Available net assets for operating reserves	Net assets without donor restrictions
Available net assets without donor restrictions	Not available
Board-designated funds	Operating funds
Board-designated operating reserves	Operating reserve policy
Board-designated quasi-endowment funds	Operating reserve ratio
Board-designated special purpose funds	Operating reserves
Budgeting for capital cash needs	Permanently restricted net assets
Depreciation	Temporarily restricted net assets
Equity in fixed assets	Undesignated operating funds
Financial stability	Undesignated operating reserves
Funded operating reserve	Unrestricted net assets
Liquid assets	Working capital cash / operating cash-on-hand

Do we really need a separate bank account for the Operating Reserve?

The short answer is “no,” *if* it is accounted for accurately. However, small and midsize organizations may find accounting for the reserve simpler and safer if there is a separate savings account to house the reserve funds and, perhaps, any donor restricted cash. Transfers from and to the savings account would provide a record of the borrowing and replenishment from the operating reserve and releases of funds from restriction. Having the cash separate also helps to avoid any accidental unauthorized use of designated or restricted funds.

How do we best monitor the Operating Reserve?

During the fiscal year, it is recommended that management, on an ongoing basis, report any borrowing and replenishment from the designated reserve balance as part of its **regular financial reporting** to the board (or designated committee). This is best done using the disaggregated statement of financial position format shown in the [Toolkit Section 7: How do we communicate about our Reserves?](#)

At the end of each fiscal year, or during the annual budgeting process, the finance committee, with input from staff management, will want to determine whether there are surplus funds available (remembering to also retain sufficient day-to-day working capital cash) that can be used to **increase the designated reserve** balance, until such time as the reserve target has been reached.

Additionally, the operating reserve target amount may need to be increased annually to stay in alignment with any increases to the total expense budget projected for the coming year.

How often should the operating reserve policy itself be reviewed?

The Workgroup suggests that the policy be reviewed every three years by the board (or designated committee), or sooner if conditions warrant. Variables to consider when re-evaluating the policy include significant changes in operations, anticipated changes in community or other needs, significant changes in funding base, changes in the regulatory environment affecting charitable giving, and the stability of the local economy. Any changes to the policy must be approved by the board.

APPENDIX C:

LEGAL, TAX, AND ACCOUNTING IMPLICATIONS

Does the operating reserve fall under Financial Accounting Standards Board Accounting Standards Codification 958-205-45 Other Presentation Matters?

An operating reserve does not automatically fall under ASC 958-205-45-15 that deals with “endowments,” as defined in the document. Pursuant to ASC 958-205-45-15 endowment is defined as follows:

Net Assets of an Endowment Fund

45-15 Pursuant to paragraph 958-210-45-1, an NFP shall report the net assets of an endowment fund in a statement of financial position within the three classes of net assets based on the existence or absence of donor-imposed restrictions:

- a. Permanently restricted net assets. For example, the portion of a permanent endowment that must be maintained permanently-not used up, expended, or otherwise exhausted-is classified as permanently restricted net assets.*
- b. Temporarily restricted net assets. For example, the portion of a term endowment that must be maintained for a specified term is classified as temporarily restricted net assets.*
- c. Unrestricted net assets. For example, a board-designated endowment, which results from an internal designation on unrestricted net assets, is not donor restricted and is classified as unrestricted net assets.*

Thus, whether some portions of an organization’s net assets are covered by the ASC depends on the organization’s intention regarding the assets.

Since operating reserves are normally not donor-restricted, the question becomes one of the intentions regarding any board-designated amounts. If the board has formally designated such reserves as endowment (or specifically for the long-term production of investment income, regardless of whether the word “endowment” is used), then they are covered by ASC 958-205. If the purpose is expressly or implicitly for some other purpose, such as an operating reserve or building maintenance reserve, for example – even though some income may incidentally be earned from temporary investment of the funds – then they would not be covered by ASC 958-205.

APPENDIX D: ILLUSTRATIVE STATEMENT OF FINANCIAL POSITION

As discussed in the Toolkit [Section 7: How do we communicate about our Reserves?](#) the Workgroup highly recommends the disaggregated statement of financial position (SOFP) format for interim (between audits) reporting.

The following illustration of the disaggregated presentation highlights the how line item totals are apportioned among operating, restricted, and board approved investment in property and plant (fixed assets), as well as each of the board-designated reserve funds. The version below shows the line item totals broken into 5 mini-SOFPs. A board member looking at this can clearly see:

- the total for each line item as exported from the accounting software,
- that operating cash and near-term receivables, less the payables and the money borrowed from the reserve, reveal what is truly available for operations in net assets,
- that the operating reserve cash is \$10,000 less than the designated amount due to the temporary borrowing of it from the reserve,
- that the designated equipment replacement reserve cash is present,
- the net value of fixed assets, less the related loan, and the net value of property and equipment, and
- that restricted net assets are represented by cash and receivables.

ORG NAME Statement of Financial Position as of [DATE]	TOTAL	Without Donor Restrictions				Restricted	Notes
		Available for Operations	Board Designated		Fixed Assets		
			Ops Reserve	Equip Reserve			
ASSETS							
Cash	225,461	22,961	140,000	25,000		37,500	Cash comprises 4 categories AR includes a portion of restricted FA Net of Depreciation
Receivables	74,293	58,793				15,500	
Fixed Assets (net)	226,784				226,784		
Total Assets	526,538	81,754	140,000	25,000	226,784	53,000	
LIABILITIES							
Payables	24,999	24,999					Operations-related payables \$10K borrowed from reserve Loan related to fixed asset
Due to/from Reserve		10,000	(10,000)				
Loans	15,544				15,544		
Total Liabilities	40,543	34,999	(10,000)	-	15,544	-	
NET ASSETS							
Without Donor Restrictions							Available for day-to-day operations Funded Operating Reserve Building Maintenance Fund Fixed Assets net of related loan Restricted for summer project
Available for Operations	46,755	46,755					
Operating Reserve	150,000		150,000				
Other Reserves	25,000			25,000			
Property/Equip (net)	211,240				211,240		
With Donor Restrictions	53,000					53,000	
Total Net Assets	485,995	46,755	150,000	25,000	211,240	53,000	
Total Liabilities & Net Assets	526,538	81,754	140,000	25,000	226,784	53,000	

Looking at just a single total column, a reader of this report might not understand that so much of the cash was restricted or designated or that \$10,000 had been borrowed from the reserve. This may be mentioned in narrative notes, but then board members would be required to do the math on their own to figure out the resulting balances.

Your reports are truly your means of communicating the financial expression of mission fulfillment and sustainability. It's best to be as transparent as possible and to make the data as clear accessible as possible to your report readers. And your grant may depend on it. **Presenting your net assets without restrictions in one big undesignated lump may lead a reader to conclude that you have an excess of assets available for operations.** Without any additional explanation or breakdown, this can create the false impression that the organization is hoarding resources or sitting on more money than it needs. (A funder has informed us that this does come up in funder reviews of grantees financials, and that these designations can help address the issue.)

If an organization can break down that large lump total, for example, into net investment in property and plant, an operating reserve, and a building maintenance fund, then the remaining balance that is available for operations will be more reasonable. (Your organization's breakdown may be different from the example and you may decide to combine all the designated funds in one column.) Showing your breakdowns not only indicates that the organization is aware of and proactively managing its resources, but it also helps the reader of the SOFP to properly understand the financial story of the organization.

For more information, search for Reclassing Net Assets in QuickBooks on the website <https://www.nonprofitaccountingbasics.org/>.

APPENDIX E:

SAMPLE TEXT FOR AUDIT FOOTNOTES AND IRS FORM 990 DISCLOSURE

FASB ASU No. 2016-14 Liquidity and Availability Disclosure requires the organization to disclose in both numbers and narrative the “nature and extent of available resources and the extent of external and internal limits placed on their availability.”

Organizations should have a discussion with their auditors about including a note in the audit regarding the operating reserve and/or other special purpose reserves or quasi-endowments, as a part of meeting this requirement. Your auditor will want the note to tie to the statement of financial position presentation and may need to test the balances as part of the audit procedures.

Below are a couple samples of audit notes re: operating and other reserve funds.

Sample 1:

The organization defines Board-designated Operating Reserves as the portion of “net assets without donor restrictions” that the Board has designated for use in emergencies to sustain financial operations in the event of significant unbudgeted increases in operating expenses and/or losses in operating revenues. The amount of accumulated “net assets without donor restrictions” is increased or decreased as the result of annual operating surpluses or deficits. The organization pursues financial stability by budgeting for and then achieving reasonable, modest surpluses year after year in order to meet their *operating reserves* objectives.

The Board has established a goal of maintaining a minimum operating reserve of two months of operating costs (\$350,000) and a maximum of five months operating costs (\$875,000) as of this audit date.

The balance of Board-Designated Operating Reserve held by the organization at 12/31/## is calculated as follows:

Total Assets without Donor Restrictions	\$1,732,950
Less Equity in Fixed Assets	<u><\$ 476,300></u>
Net Assets Available for Designation	\$1,256,650
Less Board Designated Amounts for:	
Operating Reserves	<\$350,000>
Replacement of Fixed Assets	<\$175,000>
New Program Seeding	<\$100,000>
Quasi-Endowment	<u><\$500,000></u>
	<u><\$ 1,125,000></u>
Undesignated, Available for Operations	\$ 131,650

Sample 2:

Board-designated Operating Reserves are a portion of the accumulation of operating surpluses that are available for use at the discretion of an organization's board. The presence of a board-designated operating reserve increases an organization's ability to absorb or respond to temporary changes in its environment or circumstances, for example the unanticipated event of significant unbudgeted increases in operating expenses and/or losses in operating revenues.

The organization maintains an Operating Reserve Policy that requires the Board set aside a portion of Available Net Assets at the end of each fiscal year to fund a Board-designated Operating Reserve. The policy also establishes a goal for the Board-designated Operating Reserve of a minimum target balance equal to two months of operating expenses (\$300,000) and a maximum balance of five months operating expenses (\$750,000).

Available Net Assets are defined as the portion of total net assets without donor restrictions that are available for designation by the Board for operating reserves and non-operational special purposes or board-designated quasi-endowment that further the mission of the organization.

Available Net Assets (without donor restrictions) at 12/31/09 are:

Total Unrestricted Net Assets	\$ 967,450
Less Equity in Fixed Assets	<\$ 75,300>
Less Board-designated Operating Reserve	<\$330,000>
Less Board-designated for Special Initiatives	<\$ 50,000>
Less Board-designated Quasi-endowment	<\$375,000>
Undesignated, Available for Operations	\$ 137,150

The Board of the organization has established an operating reserve target of \$350,000 (2.3 months of operating costs) in accordance with the policy.

APPENDIX F:

CASH FLOW PROJECTIONS, WORKING CAPITAL CASH, AND RESERVES

Managing an organization's cash flow can be a complicated process of balancing and showing the interactions among different types of cash resources including inflows and outflows from operations, existing working capital / operating cash-on-hand, use and repayment of an operating reserve and/or a bank line of credit, and adjustments for accruals, all while being mindful of not using cash that is donor-restricted or board-designated for purposes other than operating.

Operating Inflows and Outflows

As an organization prepares its annual operating budget, the total for each line item should be broken down on a month-by-month basis to estimate when cash is expected to come in from various income sources and when cash will likely go out to cover spending. These estimates will be used for the cash flow projections and will help the organization's leadership to anticipate and plan for when additional resources may need to be accessed.

Working Capital Cash / Operating Cash-on-hand

Working capital cash is distinct from a *board-designated operating reserve* in that the latter will have an explicit policy governing its use and replenishment, while working capital is routinely accessible to staff management.

The broader term, Available for Operations, is often used to identify the portion of net assets that is neither restricted by donors nor is otherwise designated by the board.

Working capital cash would be a part of Available for Operations in net assets. This Toolkit is focused on cash-on-hand as an *asset* rather than the broader *net asset* term of Available for Operations. This is because net assets include the impact of operating liabilities and may at times have a negative value, even when cash is present in assets.

Working capital cash would obviously not include any part of net assets *with donor restrictions* or with board designations. Further, net investments (equity) in fixed assets would also be excluded from working capital cash due to being illiquid, as would long-term receivables and long-term investments. (See Toolkit [Section 2.](#))

The Workgroup feels that it is important for an organization to determine an amount of working capital cash to be maintained to help ensure that operations can run smoothly with only occasional need for borrowing from an operating reserve or a line of credit. Given that it's highly likely that operating inflows and outflows will not evenly match in any given month, the amount available in working capital cash will naturally fluctuate. In thinking about a minimum amount of cash to have on hand for operations, an organization will have to look at its cash flow in trend and identify the minimum it would need to retain to cover certain critical costs during any given month.

Whatever the rationale for the amount, it's a good idea to have in mind a minimum adequate operating cash balance so the organization can anticipate when action may need to be taken to maintain the balance, e.g., borrowing from the operating reserve, or a line of credit if available. If day-to-day cash is so low that the reserve or the LOC must be accessed frequently, the working capital cash minimum may be set at higher amount.

Operating Reserve and Line of Credit

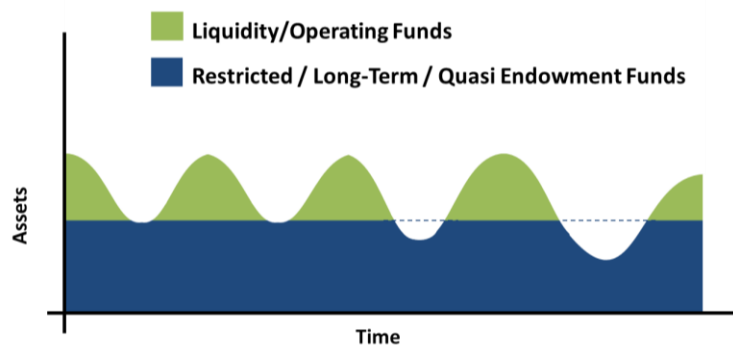
Two great cash management tools are a bank line of credit (LOC) and the board-designated operating reserve that can function as an *internal* line of credit. An organization should have a policy for the use and repayment of both.

Non-Operating Cash

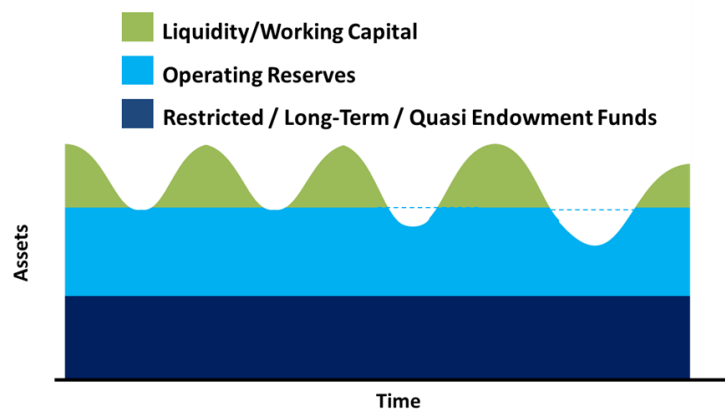
Non-operating cash is cash that is either donor-restricted, or designated by the board as a quasi-endowment, or designated for other purposes such as building maintenance. These cash resources should not be included in the operating cash flow projections, until donor restrictions have been satisfied or unless the board has removed the designation.

Managing Organizational Cash Flow

Good forecasting can help prevent accidental use of assets with donor restrictions or board-designated endowments.



Creating a separate operating reserve can provide a buffer to preserve restricted or other designated funds and maintain adequate working capital cash to smooth out cash flow in low liquidity months.



Illustrations based on material from "The Cash Investment Policy Statement: Developing, Documenting and Maintaining a Cash Management Plan," a paper published by BlackRock®

See also [Instituting a Cash Investment Policy Statement](#) (JP Morgan 2022)

Managing Cash Flow for Operations

Doing cash flow projections for operations allows an organization to anticipate when operating cash might run low, leaving enough time to plan for how the operating cash deficiencies will be addressed.

Following is an illustration of the use of operating reserves to maintain a minimum working capital cash balance of \$35,000 with an Operating Reserve balance at \$140,000. In his case, both restricted cash and the operating reserve cash live in a savings account separate from the operating checking account. The illustration also shows the impact of monthly vehicle loan principal payments and a capital purchase in April.

Working Capital Cash and Operating Reserve In Action ~ Illustration							
ORG Cash Flow Projections	Minimum desired Working Capital / Operating Cash Balance set at \$35,000						
Month >>	JAN	FEB	MAR	APR	MAY	JUN	JUL ...
Operating Cash Opening Balance >>	126,000	37,000	35,200	36,600	125,250	38,050	52,050
Operating Activity							
Inflows from Operations	65,000	173,000	143,000	294,000	51,000	185,000	
Released from Restriction			25,000	5,000	40,000		
Outflows from Operations	(150,000)	(195,000)	(175,000)	(166,000)	(175,000)	(168,000)	
Net Cash from Operations	(85,000)	(22,000)	(7,000)	133,000	(84,000)	17,000	
Other Cash Transactions							
Capital Purchases				(4,950)			
Loan Principal Payments	(4,000)	(3,800)	(3,600)	(3,400)	(3,200)	(3,000)	
Access <Repay> Operating Reserve		24,000	12,000	(36,000)			
Net from Other Cash Transactions	(4,000)	20,200	8,400	(44,350)	(3,200)	(3,000)	
Net Cash Increase <Decrease>	(89,000)	(1,800)	1,400	88,650	(87,200)	14,000	
Ending Operating Cash Balance	37,000	35,200	36,600	125,250	38,050	52,050	
Operating Reserve Balance in Savings	140,000	116,000	104,000	140,000	140,000	140,000	
Restricted Balance in Savings	70,000	70,000	45,000	40,000	-	-	
Savings Account Total >>	210,000	186,000	149,000	180,000	140,000	140,000	
Total All Cash	247,000	221,200	185,600	305,250	178,050	192,050	
Loan Principal Balance	28,000	24,200	20,600	17,200	14,000	11,000	

Without temporary use of cash from the operating reserve, the ending operating cash balance in the month of February would have been \$11,200, which is below the minimum desired working capital cash balance of \$35,000 determined by the organization; without borrowing \$24,000 in February and \$12,000 the next month, operating cash would have run out by the end of March. Sufficient income arrived in April to transfer the \$36,000 temporarily borrowed from the operating reserve back to the savings account. If the organization had an LOC, that could be used in combination with, or in lieu of, the operating reserve, according to the relevant policy parameters.

This illustration also shows the monthly restricted cash balances, with reductions as releases from restriction occur. Cash is transferred from the separate savings account to the operating bank account in the Operating Activity section as it is released. This allows for straightforward tracking and transparent accounting.

The sample organization has an expense budget of \$1.8 million, so its \$140,000 reserve fund represents less than 10% of annual operating expenses (vs. their 25% eventual target). **It may take years to fully accumulate the reserve target amount.** Meanwhile, having worked toward their financial goals, **even having just 10% in operating reserve has helped them** to better manage cash flow.

APPENDIX G: GLOSSARY OF TERMS

By Consensus of the Nonprofit Operating Reserves Initiative Toolkit Revision Taskforce, 2022

A top priority for nonprofit leaders needs to be maintaining operating reserves at levels adequate for achieving **financial stability**³. Financial stability of nonprofit organizations includes maintaining operating reserve ratios at levels adequate for preserving the capacity of nonprofit organizations to deliver on their missions for a reasonable period of time in the event of unforeseen financial shortages.

The terms below have been used in the Toolkit and Appendices and definitions in this glossary are intended to be consistent with IRS Form 990 instructions, and new standards issued on August 18, 2016, by the Financial Accounting Standards Board (FASB) “intended to simplify and improve how a not-for-profit organization classifies its net assets, as well as the information it presents in financial statements and notes about its liquidity, financial performance, and cash flows.” FASB provides standards for external financial statements certified by an independent accountant for certain types of nonprofit organizations.⁴

One-size-fits-all standards for what it means to be financially stable are not feasible. However, there can be common terminology and definitions so that we can have a consistent way of talking about nonprofit financial stability, operating reserves, board-designated funds and reserve policies. The following terms are defined alphabetically in this glossary.

Annual operating expense budget	Net assets
Annual operating surpluses or deficits	Net assets with donor restrictions
Available net assets for operating reserves	Net assets without donor restrictions
Available net assets without donor restrictions	Not available
Board-designated funds	Operating funds
Board-designated operating reserves	Operating reserve policy
Board-designated quasi-endowment funds	Operating reserve ratio
Board-designated special purpose funds	Operating reserves
Budgeting for capital cash needs	Permanently restricted net assets
Depreciation	Temporarily restricted net assets
Equity in fixed assets	Undesignated operating funds
Financial stability	Undesignated operating reserves
Funded operating reserve	Unrestricted net assets
Liquid assets	Working capital cash / operating cash-on-hand

³ *Maintaining Nonprofit Operating Reserves*, 2008. A White Paper by the Nonprofit Reserves Initiative Workgroup that can be found at: <http://www.nonprofitaccountingbasics.org/sites/default/files/01-OperatingReservesWhitePaper2009.pdf>

⁴ Users of this glossary are expected to be familiar with FASB Accounting Standards Update 2016-14—Not-For-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities’ net asset concepts, which are not described in detail in this document.

Definitions

Annual operating expense budgets

Annual operating expense budgets are the denominators used in calculating operating reserve ratios.

Annual operating expense budgets do not include purchase of fixed assets and other non-operating expenses.

Annual operating expense budgets for use in operating reserve ratios will include expenses that may be covered by releases of restricted funds. For example, operating reserve ratio denominators include the organization's total payroll and other personnel related budgets.

Annual operating expense budgets used in operating reserve ratios can *exclude* budgets for depreciation, contributed services and donated use of facilities. However, contributed services and use of facilities would be *included* if they are only temporarily in-kind and would soon need to be replaced with cash expenditures. Annual operating expense budgets can also *exclude* use of tangible in-kind, non-cash donations if loss of such donations would not need to be replaced with cash expenditures.

Actual annual operating expenses for the prior year can be used as an alternative denominator to the annual operating expense budgets. Decisions regarding exclusion of in-kind facility use and professional services would still apply.

Annual operating surpluses or deficits

Net assets without donor restrictions (formerly unrestricted net assets), including board-designated operating reserves, are generated through annual *surpluses* of unrestricted revenues over expenses. On the other hand, net assets without donor restrictions and operating reserves are depleted through annual *deficits* of expenses exceeding unrestricted revenues.

Available net assets for operating reserves

The First Edition of the Toolkit offered three versions of "available," two of which were "not recommended." Given the increased transparency about liquidity currently required by FASB, and the Workgroup's recommendation for small and midsize groups that an operating reserve comprise cash assets, the definition below reflects only the recommended version.

To determine what is available for operating reserves, begin with Total Net Assets and, step by step, subtract items considered not available for designation, starting with net assets with donor restrictions and proceeding with other net assets that may be non-liquid or non-current, or that have been set aside for other purposes:

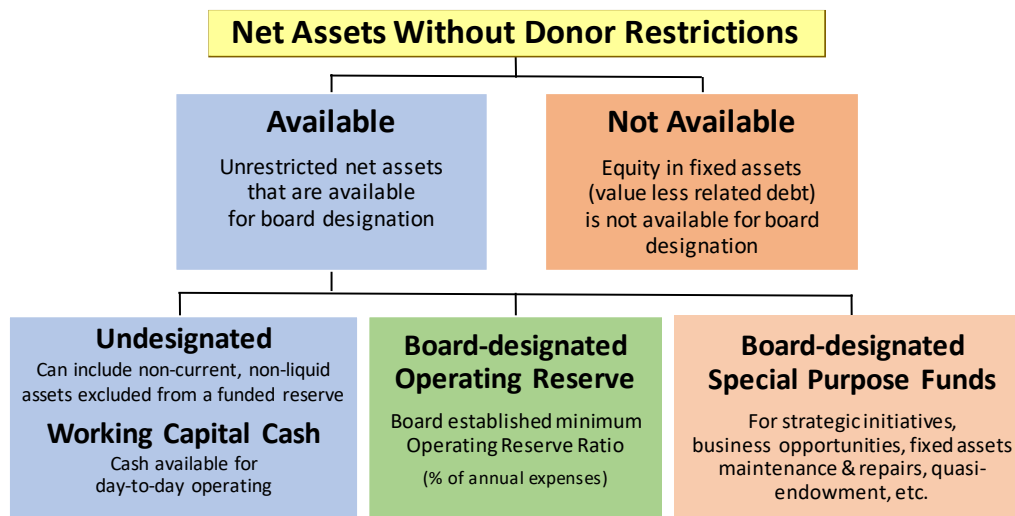
Total Net Assets

1. < Net Assets with Donor Restrictions (restricted permanently or temporarily) >
2. < Net Equity in Fixed Assets (fixed assets net of depreciation and less any related long-term debt) >
3. < Any Net Assets already designated (e.g., special purpose funds or quasi-endowment) >
4. < Non-current, non-liquid assets (longer term receivables, pledges, prepaid expenses, inventory or deposits or assets held by others) >
5. < Amount of cash determined as adequate for day-to-day operating cash-on-hand >
= Available for operating reserve

For simplicity, an organization *could* informally consider as reserves any net assets not restricted by donor or comprising net equity in fixed assets, without deducting the other less liquid statement of financial position items. However, it could *appear* that an organization has adequate reserves when, in fact, cash reserves might actually be very low, putting the organization at risk of experiencing serious financial viability issues in the event of an emergency.

Available net assets without donor restrictions

A simple definition is to subtract equity in fixed assets (fixed assets net of depreciation and less any related long-term debt) from total net assets without donor restriction. Net assets *with* donor restrictions are, by definition, not available.



From what is **available**, boards are free to designate net assets for various purposes including operating reserves and for non-operational special purpose funds and board-designated quasi-endowment funds that further the mission of the organization. (See also [Equity in fixed assets](#) definition.)

Board-designated funds

Board-designated funds are “subject to self-imposed limits by action of the governing board”⁵ of an organization. Funds may comprise board-designated operating reserves, board-designated special purpose funds, and board-designated quasi endowment funds. Such funds are derived from available net assets without donor restrictions. (See illustration above.)

As a general rule, building adequate board-designated operating reserves is viewed as the first priority over starting or building *other, non-operating* board designated funds. Non-operating board-designated funds are for *optimal mission accomplishment* while board-designated operating reserves are for financial stability.

Once an adequate board-designated operating reserve, as determined by each organization’s board according to its particular circumstances and financial position, has been acquired, boards and CEOs can focus on designating additional funds for strategic purposes and optimal mission accomplishment. These *non-operating* funds are designated for purchase of fixed assets, development of new programs, taking

⁵ from [changes to The Master Glossary related to FASB’s Accounting Standards Update \(ASU\) 2016-14](#).

advantage of unexpected opportunities, investment in quasi endowment, and other specific purposes. These board-designated funds are for *non-operating* purposes and are not available for operations without board approval. However, because the funds are without donor restrictions, boards are free to remove or change any designations they have made if/when financial conditions change.

Board-designated operating reserves

Board-designated operating reserves are a portion of net assets without donor restrictions that have been set aside by an organization's governing board for uses defined in its established operating reserve policy.

The board-designated operating reserve can serve as an internal line of credit with board specified terms of use and replenishment, to draw from when needed to cover the normal cash flow fluctuations of day-to-day operations or in cases of emergencies. Funds *borrowed* from board-designated operating reserves can be *repaid* when, for example, anticipated revenues are received.

This policy Toolkit recommends that for small and midsize organizations the board-designated operating reserve be fully funded, that is, represented by cash assets. The fully funded reserve would not include receivables, inventory, prepaid expenses, long-term assets, and deposits held by others

The balance of the board-designated operating reserve is shown as a net asset line item. It is strongly recommended that organizations also have net asset line items showing balances for equity in fixed assets (see definition), other board-designated funds, and of course for net assets with donor restriction. In addition, it is recommended that organizations go further and employ reporting formats that distinguish asset, liability, and net assets balances minimally into classifications of restricted funds and board-designated funds separately from funds available for operations.

(See [Appendix D](#) for recommend model for disaggregated statement of financial position.)

Board-designated quasi-endowment funds

Board-designated quasi-endowment funds are a portion of *net assets without donor restrictions* that have been set aside by an organization's governing board to function much as permanent endowments do. The principal of a quasi-endowment is maintained intact and only the income is spent either for operations or for purposes specified by the board.

Because there are no donor-imposed restrictions on the funds when they are designated, these funds remain under the control of the governing board and management. They can be undesignated and made available for general use at the discretion of the board.

Organizations should consult with their accountants when establishing a board-designated endowment, as doing so will affect liquidity disclosures in the annual audit. Quasi-endowment funds are often invested in less liquid, longer-term investment instruments.

As with any board-designated fund, the board should develop a written policy detailing the objectives for the quasi-endowment and providing guidelines about how it is to be used and invested, disposition of income, etc.

It is recommended that adequate working capital cash and operating reserves be accumulated, and any necessary infrastructure reserves be funded, before initiating a quasi-endowment.

Board-designated special purpose funds

Board-designated special-purpose funds are a portion of *net assets without donor restrictions* that have been set aside by an organization's governing board to further programmatic and organizational goals,

objectives, and special needs. These funds are under the control of the governing board and management. They are available for use at the discretion of the board. The following are some examples.

Programmatic:

- Disaster relief funds and other programmatic emergencies
- Special projects (often one-offs, rather than related to ongoing programming).
- Unanticipated programmatic opportunities. For example, a "Carpe Diem" or "Artistic Venture Capital" or "Opportunity" Fund set aside by the board to position its entrepreneurial artistic or executive director to launch a new project or seize a timely opportunity that would otherwise destabilize the organization financially.
- A Program Development Fund set aside by the board to be available for major program, strategic initiatives, or pilot programs requiring significant development or start-up costs before becoming sustainable.

Organizational and infrastructure:

- Building & Equipment Maintenance & Replacement Fund(s), which might be funded in part by including a capital acquisition funding line item in the annual cash organizational budget or by allocation of funded non-cash depreciation expense.
- Sustainability of operations [major fluctuations] fund for organizational emergencies, unusual or emergency situations such as moving to new facilities, CEO turn over or similar unexpected disruptions in operations and services

Board designations for *purchase of fixed assets* and for *fixed asset maintenance and replacement* are intended to be spent on land, buildings, furniture, equipment, works of art, software, or other fixed assets. Once the fixed assets are purchased, maintained or replaced, the amounts are transferred from board-designated net assets to equity (net investment) in fixed assets. The target balance for these funds would then need to be re-evaluated, and the funds replenished over a set timeline, if and as appropriate.

Board-designated special-purpose funds are intended for uses other than general operations and are expected to be expended solely for special projects and purposes. Board-designated special-purpose funds are not intended for use to cover payroll for permanent employees, occupancy and other unavoidable operating expenses.

Board-designated special purpose funds may or may not require replenishment once the purpose is met. For instance, a certain level of funding may need to be maintained in an equipment or building maintenance fund vs. the spend down of funds accumulated for a specific one-off project. As with any board-designated fund, the board should develop a written policy detailing the objectives for each designated fund and providing guidelines about how it is to be used, whether and how it is to be replenished, if it can be invested, and the disposition of any income, etc.

It is recommended that adequate working capital cash and operating reserves be accumulated before initiating special purpose funds. An exception could be an equipment or building maintenance fund that is deemed simultaneously necessary for continued successful operations.

Budgeting for capital cash needs

Organizations need to consider their potential need for cash that may not be covered by standard operating expense line items that appear in operating budgets. Such cash needs will require funding

sources and should be represented by one or more line items to be included somewhere in the annual cash operating budget, usually below the net from operations. Examples of potential capital or acquisition cash needs for small and midsize organizations might include:

- Purchase of fixed assets (e.g., land, buildings, equipment, furniture, other facilities, software, technology with a useful life of over one year and costing above a certain threshold established by the board. *)
- Renovation or some major repairs that improve or extend the useful life of an asset (routine maintenance and small repairs would be considered an operating expense – consult your auditor to confirm which is which)
- Debt service (principal portion of loan payments; (interest would be considered an operating expense).

Any unused portion of capital funding that is not restricted by a donor can be used to fund board-designated operating reserves.

* An organization's board is encouraged to adopt a policy that specifies what approvals may be needed to make a capital purchase, whether multiple bids are required, how to budget for capital purchases, and what the cost threshold will be to trigger amortization of the cost vs. taking it all in one year. (Search for "Capital Purchases & Capitalization Threshold Policy – Sample" on the **Nonprofit Accounting Basics** website <https://www.nonprofitaccountingbasics.org/>.)

Depreciation

Depreciation is a natural expense category in an operating budget and in a statement of functional expenses following GAAP. Depreciation is the amortization of the cost of fixed assets, such as buildings, vehicles, furniture, and equipment, that spreads the cost or the purchase over its useful life, rather than taking a single large expense in the year of the purchase. It is a process of cost allocation and not valuation. Depreciation increases expenses but does not reduce cash. Depreciation is recorded by debiting depreciation expense and crediting accumulated depreciation.

An organization's board is encouraged to adopt a policy that specifies what approvals may be needed to make a capital purchase, whether multiple bids are required, how to budget for capital purchases, and what the cost threshold will be to trigger amortization of the cost vs. taking it all in one year. (Search for "Capital Purchases & Capitalization Threshold Policy – Sample" on the **Nonprofit Accounting Basics** website <https://www.nonprofitaccountingbasics.org/>.)

Bringing in cash income to cover non-cash depreciation expense is a way to build liquidity and accumulate funds that can then be used for debt service cash requirements or designated into maintenance and replacement funds, operating reserves, or other purposes.

Equity in fixed assets⁶ (see also Depreciation definition)

Equity in fixed assets, or net equity in property, plant, and equipment (PP&E), or net investment in PP&E, comprises the value of net fixed assets (cost net of accumulated depreciation) less any related long-term debt. PP&E net assets are usually not restricted and are therefore reported in the *net assets without donor restriction* section of a statement of financial position. However, portions of *equity in fixed assets* could be

⁶ Users of this glossary are expected to be familiar with the term 'fixed assets,' which are not described in detail in this document.

temporarily restricted and/or permanently restricted if there was a requirement specified by a donor of the asset. In that case, these portions would appear in the *net assets with donor restrictions* section of a statement of financial position.

Equity in fixed assets may include land, buildings, equipment, furniture, leasehold improvements, works of art and other assets with a useful life of more than 1 year and that exceed an organizations capitalization threshold. *Fixed assets* are reported net of depreciation in the asset section of a statement of financial position.

Financial stability

Financial stability of nonprofit organizations includes maintaining operating reserve ratios at levels adequate for preserving the capacity of nonprofit organizations to deliver on their missions for a reasonable period of time in the event of unforeseen financial shortages. It is also recommended that an adequate amount of working capital cash (see definition below) also be maintained to support routine day-to-day operations.

Funded operating reserve

A fully funded Operating Reserve, which is strongly recommended, is established consisting of cash assets and accounted for in the net asset section of the statement of financial position *separately* from other net assets.

Liquid assets

Liquid assets are defined as cash, and other current assets that can be converted to cash quickly and easily, and that are not subject to significant market risk or early withdrawal penalties. In other words, cash or near-cash, which could include very near-term receivables and/or very short-term investments.

(See Toolkit [Section 2.](#))

Net assets⁷

Net assets = assets *net* of liabilities, or excess of assets over liabilities, similar to equity (in a business).⁸ Net assets appear on a statement of financial position and are minimally required to be classified as *with donor restrictions* or *without donor restrictions*. Additional classifications within either of these sections is permitted and encouraged to provide clarity and transparency.

Net assets with donor restrictions

Formerly called *restricted net assets* and categorized as *temporarily* or *permanently* restricted. FASB has updated its net assets classification requirement to only two categories:

- Net Assets with Donor Restrictions (can include both permanent and temporary restrictions)
- Net Assets without Donor Restrictions

⁷ Users of this glossary are expected to be familiar with the term ‘net assets,’ which is not described in detail in this document.

⁸ The generally understood terms ‘assets,’ ‘liabilities’ and ‘equity’ are not defined in this glossary.

For functional ease in tracking restricted funds internally, organizations that have endowments that are restricted by the donor in perpetuity will likely want to continue to account for them separately from other restricted funds that have more temporary restrictions such as for time or purpose.

Net assets without donor restrictions

Formerly called *unrestricted net assets*, are net assets that have no restrictions placed on them by donors. *Net assets without donor restrictions* are eligible to be designated by the organization's governing board for program, infrastructure, and financial stability purposes. See *Available net assets without donor restrictions* above.

Not available [see also Toolkit [Section 2](#) and Available net assets definition]

Operating funds [see also Undesignated operating funds definition]

Operating funds are assets and liabilities related to day-to-day operations, also known as *undesignated net assets* or *available for operations*. They can best be shown on a statement of financial position using the recommended disaggregated format provided in this Toolkit. (See Toolkit [Section 7](#) and [Appendix D](#).) A net asset account (line item) is recommended to show the balance of operating funds as distinct from board-designated net assets, net equity in fixed assets, or net assets with donor restrictions.

Operating reserve policy

An operating reserve policy describes the establishment of a board-designated operating reserve, setting a target goal or ratio for adequate for financial stability. The policy would include guidelines for building the reserve, managing its use and replenishment, and reporting and monitoring requirements. (See Toolkit [Section 5](#) and [Section 6](#) and [Appendix A](#).)

Operating reserve ratio

The operating reserve ratio = operating reserves divided by annual operating expense budget.

An organization's operating reserve ratio can be calculated in terms of a **percentage**:

→ *operating reserves divided by annual operating expense budget*

Or **number of months**:

→ *operating reserves divided by 1/12th of the annual operating expense budget*

(See Toolkit [Section 3](#) and [Section 4](#) regarding determining and calculating the ratio.)

The operating reserve ratio is an indicator of whether the organization has enough operating reserves available to meet operating costs including payroll and other personnel related expenses for a reasonable period (*) if it were to receive no revenue during that period.

(*) The *minimum* operating reserve ratio at the lowest point during the year suggested by the Nonprofit Operating Reserves Initiative Workgroup is 25% or 3 months of the annual operating expense budget. However, **this is a suggested starting point**. The Workgroup concluded that the level of nonprofit operating

reserves adequate for any individual organization is “it depends” – **there is no one size fits all operating reserves ratio or benchmark.**⁹

Operating reserves¹⁰

Operating reserves are elements of net assets in statements of financial position as well as numerators used in calculating operating reserve ratios.

Operating reserves are that portion of *net assets without donor restrictions* that nonprofit organizations maintain, or their boards have designated or *reserved* for use in emergencies to sustain financial operations for a reasonable period in the event of significant and unanticipated, unbudgeted increases in operating expenses and/or losses in operating revenues, or to smooth over temporary cash flow fluctuations.

Operating reserves are generated through annual surpluses of unrestricted revenue over expenses. Likewise, operating reserves are depleted through annual deficits, expenses exceeding unrestricted revenue.

(See all Toolkit sections and appendices.)

Permanently restricted net assets (see also Net assets with donor restrictions)

Permanently restricted net assets used to be a required line item – if present – in the statement of financial position prepared in accordance with generally accepted accounting principles (GAAP) and IRS Forms 990 of not-for-profit organizations.

FASB has since updated its net assets classification requirement to only two categories:

- Net Assets with Donor Restrictions (can include both permanent and temporary restrictions)
- Net Assets without Donor Restrictions

For functional ease in tracking restricted funds internally, organizations that have endowments that are restricted by the donor in perpetuity will likely want to continue to account for them separately from other restricted funds that have more temporary restrictions such as for time or purpose.

Temporarily restricted net assets (see also Net assets with donor restrictions)

Temporarily restricted net assets used to be a required line item – when present – in the statement of financial position prepared in accordance with generally accepted accounting principles (GAAP) and IRS Forms 990 of not-for-profit organizations.

⁹ See “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 USA, LLP; Appendix A - in the Whitepaper: *MAINTAINING NONPROFIT OPERATING RESERVE, An Organizational Imperative for Nonprofit Financial Stability*, December 2008 by the Nonprofit Reserves Initiative Workgroup that can be found at:

<http://www.nonprofitaccountingbasics.org/sites/default/files/01-OperatingReservesWhitePaper2009.pdf>.

¹⁰ This glossary uses the term “operating reserves” because, while “reserves” is a popular term for referencing financial strength, it is not used with consistent meaning and is not described or found extensively in not-for-profit authoritative accounting literature. When it is used in various articles and documents on nonprofit reserves, it can refer to all available unrestricted net assets, which would include all board-designated funds, or be limited to the portion of available unrestricted net assets designated for operating reserves. Further, the term “reserve” can also be used in an entirely different accounting context – in the insurance industry for example.

FASB has since updated its net assets classification requirement to only two categories:

- Net Assets with Donor Restrictions (can include both permanent and temporary restrictions)
- Net Assets without Donor Restrictions

Organizations that have endowments that are restricted by the donor in perpetuity will likely want to continue to account for them separately from other restricted funds that have more temporary restrictions such as for time or purpose.

Undesignated operating funds (see also Operating funds definition)

Undesignated operating funds is a line item reported in the *net assets without donor restrictions* section of a statement of financial position. The balance of undesignated operating funds fluctuates up or down according to day-to-day changes in normal operating activity. Undesignated net assets are always net of liabilities.

The balance can best be shown on a statement of financial position using the recommended disaggregated format provided in this Toolkit. (See Toolkit [Section 7](#) and [Appendix D](#).) A net asset account (line item) is recommended to show the balance of undesignated operating funds as distinct from board-designated net assets, net equity in fixed assets, or *net assets with donor restrictions*.

Undesignated operating funds can include non-current assets such as long-term receivables, inventory, prepaid expenses and deposits held by others. These non-current assets are excluded from the calculation of operating reserve ratios. (See Toolkit [Section 4](#) and [Section 7](#) and [Appendix D](#).)

This breakdown of board-designated operating reserves and undesignated operating funds can be for internal accounting and reporting purposes and could also be included in general purpose external financial reports. Undesignated net assets for operating might also be referred to as *available for operations*.

Undesignated operating reserves

The original Toolkit included two “not recommended” definitions of operating reserves: “available” and “undesignated.” This Toolkit update focuses only on designated – preferably fully funded – operating reserves.

While not recommended, the undesignated operating reserves option may be used by organizations that do not have the capacity, or chose not, to account separately for multiple categories of *net assets without restriction*. When not separated, this balance can include non-current, non-liquid assets such as pledge and other receivables, inventory, prepaid expenses, deposits held by others, and non-available fixed assets. Use of the undesignated operating reserves option is not recommended because it can appear that an organization has adequate operating reserves when, in fact, liquid cash reserves can be very low or nonexistent, putting the organization at risk of experiencing serious financial viability issues in the event of an emergency.

(See Toolkit [Section 1](#) and [Section 2](#).)

Unrestricted net assets (see also Net assets without donor restrictions definition)

Occasionally funders and others may use this term, but it is no longer GAAP.

Working capital cash / operating cash-on-hand (see also Operating funds definition)

Working capital cash is distinct from a *board-designated operating reserve* in that the latter will have an explicit policy governing its use and replenishment, while working capital is routinely accessible to staff management.

The term Working Capital may also be used to refer to resources “available for operations,” but for purposes of this edition of the Toolkit, we define working capital cash/operating cash-on-hand as “*liquid* assets that are available at management’s discretion to conduct day-to-day operations,” with liquid defined as “cash and other assets that can be converted to cash quickly and easily and that are not subject to significant market risk or early withdrawal penalties.”

Near-liquid, e.g., near-term receivables, could be included, but that would complicate tracking, which may be burdensome for a small organization. While some undesignated investments such as stocks, ETFs, etc. could be quickly liquidated without penalty, we do not recommend including them as operating cash-on-hand nor as a component of an operating reserve. This is because the value of these investments fluctuates with the market, making them less reliable as a ready resource as their value is a moving target.

(See Toolkit [Section 2](#) and [Appendix F](#).)

APPENDIX H: OTHER REFERENCE MATERIALS

Although dates on some of the following references are several years old and some old terminology may be used, the references are well-written, and the basic concepts relative to operating reserves remain solid.

- **Operating Reserves** – *NonprofitAccountingBasics.org* website sponsored by the Greater Washington Society of CPAs Educational Foundation
<https://www.nonprofitaccountingbasics.org/nonprofit-reserves>
- **NORI Document Library** – *Resources for operating reserves policy development, advocacy, Policy outlines, ratio development worksheets, slide deck, archive, etc.*
<https://www.nonprofitaccountingbasics.org/nonprofit-reserves/>
- **Nonprofit Reserves: The Real Deal**
NPQ Nonprofit Financial Commons webinar, October 2022, Hilda H. Polanco, presenter
<https://nonprofitfinancials.org/>
- **Strategic Reserves and Endowments: Guidance for Forward-Thinking Funders and Grantees**
Nonprofit Quarterly webinar, May 2019, Hilda H. Polanco, presenter
<https://nonprofitquarterly.org/strategic-reserves-and-endowments-guidance-for-forward-thinking-funders-and-grantees/>
- **Six Steps for Sustainability Planning** *by Rebecca Thomas*
Rebecca Thomas & Associates
<https://www.rebeccathomas.com/blog/2017/09/14/six-steps-for-sustainability.html>
- **Hidden in Plain Sight: Understanding Nonprofit Capital Structure** *by Clara Miller, 2003*
<http://www.nonprofitfinancefund.org/commentary/hidden-plain-sight-understanding-nonprofit-capital-structure>
- **The Grasshopper or the Ant: A Review of Endowment Giving Policy Options**
By Russell Willis Taylor for the Doris Duke Charitable Foundation Arts Program, 2006
<https://www.artstrategies.org/a-review-of-endowment-giving-policy-options/>
- **Organizational Slack (or Goldilocks and the Three Budgets)** *by Woods Bowman*
<https://nonprofitquarterly.org/organizational-slack-or-goldilocks-and-the-three-budgets/>

See also references in the Toolkit sections and footnotes.

APPENDIX I: NORI BACKGROUND

The **Nonprofit Operating Reserves Initiative** (NORI) and related Workgroup were formed in 2008 in response to the devastation caused by the recession that year in which so many small and mid-sized nonprofits that were doing great work in our communities were lost. Our Workgroup determined that these groups were financially fragile because they tended to spend every penny they brought in on programs and had no financial resiliency to get them through the extended downturn.

To address this issue of under-capitalized small nonprofits, our workgroup set itself two objectives: to define “Operating Reserves” and establish guidelines to help nonprofit leaders determine benchmarks for financial stability that are specific to their organizations.

Our **mission** was and is to define, promote, and facilitate the practice of building and maintaining operating reserves throughout the nonprofit sector as a **key strategy toward ensuring the long-term sustainability** of the organizations and programs that save and enhance our lives.

Our **vision** is that all nonprofits will have a well-managed operating reserve in place in an amount appropriate to each organization’s specific needs, and that **building and maintaining operating reserves will become universally understood as sound policy** and endorsed by nonprofit organizations’ staff and board leaders, the donors and funders who support them, and the accounting professionals who serve them.

We published a white paper titled “**Maintaining Nonprofit Operating Reserves**” in January, 2009, to convince funders and board members alike that under-resourced organizations cannot do their best work when they are at constant risk of insolvency. Some members of the NORI Workgroup then formed the Operating Reserves Policy Toolkit Taskforce as a logical follow up. The taskforce compiled the original “**Operating Reserves Policy Toolkit, 1st Edition**” that was released in September 2010 to serve as a technical reference for nonprofit board and staff policy committees, as well as their financial consultants and professionals, as they respond to the message of the whitepaper.

This Toolkit was created to provide a resource that will:

- help make a compelling case within the organization for the need to establish an operating reserve,
- provide factors to take into consideration in determining the size of the operating reserve for their organizations,
- suggest practices for raising funding and managing the reserve and reporting its balance,
- offer some tools and references with which to go about drafting a policy and recording decisions, and

- put forward common terminology for referring to operating reserves that we hope will take hold among nonprofit organizations and their funders, donors, and financial professionals.

The NORI documents now have a permanent home as a section of the Nonprofit Accounting Basics website <https://www.nonprofitaccountingbasics.org/>, a free online resource for small and midsize organizations provided by the Greater Washington Society of CPAs Educational Foundation as a service to the nonprofit community. We are grateful for their generosity in hosting us!

Information about NORI and access to its Document Library can be found at:
<https://www.nonprofitaccountingbasics.org/nonprofit-reserves>