

The Nonprofit Operating Reserves Initiative

How long could an organization last or continue to fulfill its mission if there were an unexpected loss of income or surge in demand for services? That question compelled experienced individuals representing multiple facets of the nonprofit sector to form the Nonprofit Operating Reserves Initiative (NORI) Workgroup in spring 2008, with two objectives: to define “Operating Reserves” and establish guidelines to help nonprofit leaders determine benchmarks for financial stability that are specific to their organizations. Their efforts have resulted in a whitepaper: [Maintaining Nonprofit Operating Reserves, An Organizational Imperative for Nonprofit Financial Stability](#) published in January 2009, and the [Operating Reserve Policy Toolkit for Nonprofit Organizations](#) released in September 2010. The white paper and the toolkit have been endorsed by many prominent nonprofit organizations and businesses concerned with the well-being of the sector.

The Case for Nonprofit Operating Reserves

Supports Fulfillment of Mission and Fosters Strategic Decisions ~ Operating reserves help organizations preserve their capacity to deliver on their missions in the event of unforeseen financial shortages, position them to accept and manage reimbursable grants, and help promote good long-term decision-making. Without an operating reserve, cash flow stress can force expensive short-term crisis-based decisions, or worse, lead to curtailment or termination of programs.

Sound Investment ~ Individual donors and institutional funders can invest their contributions and grants with confidence in organizations that have built and maintain operating reserves. The presence of an operating reserve is a strong indicator that the organization is managed by prudent, forward thinkers, who are committed to reliable program delivery and have positioned their organizations to remain sustainable. Such organizations are a better risk for investment of contributions and grant funding.

“Nonprofit” does not mean “no surplus allowed” ~ Spending every penny each year on programs may seem laudable, but it leaves the organization with no financial flexibility to respond to emergencies. The organization is vulnerable to being destabilized, thereby jeopardizing its mission. Accumulated surpluses comprising an adequate level of operating reserves are a necessary component of nonprofit sustainability.

Improves Cash Management and Reduces Stress ~ Having operating reserves reduces stress on the organization and its leaders, and reduces turn-over of key staff who can burn-out under sustained, chronic cash flow issues. Having a line of credit in place is part of a good cash management strategy, but a line of credit is not a replacement for adequate operating reserves.

Evidence is clear ~ The need for nonprofits to establish and maintain operating reserves is well documented. Two recent sources of data include research conducted by the National Center for Charitable Statistics ([Washington-Area Nonprofit Operating Reserves](#), June 2009)* and results of the [Nonprofit Finance Fund Nonprofit Sector Surveys](#).

What Are Operating Reserves?

Operating reserves are the portion of “unrestricted net assets” (see following illustration) that nonprofit boards designate for use in financial emergencies. “Unrestricted net assets” is a required line item in the balance sheets of financial statements prepared in accordance with generally accepted accounting principles (GAAP). Figure 1 shows suggested net asset terms that all nonprofit CEOs and boards need to understand in preparation for designating operating reserves.

Undesignated Operating Funds

Undesignated operating funds fluctuate up or down according to day-to-day changes in normal cash flow activity and therefore need to include *working capital* in the form of liquid assets outside of board-designated reserve funds that are available at management’s discretion to manage day-to-day operations. The amount of cash assets held as working capital will depend on the organization’s risk tolerance, cash flow cycle and other factors. Undesignated operating funds can also include non-current, non-liquid assets excluded from a “funded” operating reserve.

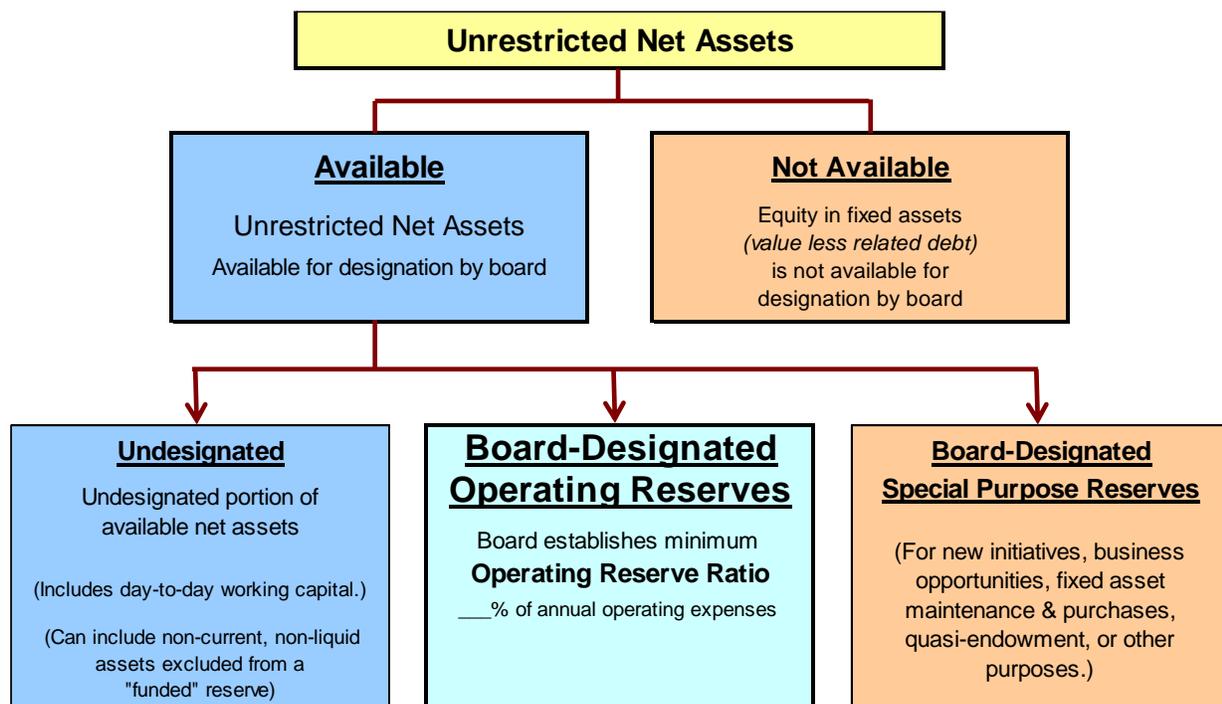
“Funded” Operating Reserves

Some organizations account for “funded” reserves by employing fund accounting methods where assets consisting solely of liquid assets – i.e., cash and cash equivalents – correspond to their board-designated reserves portion of net assets. In this way, operating reserves can exclude (in addition to equity in fixed assets) other non-current assets, net of related liabilities, such as long-term receivables, inventory, prepaid expenses and deposits held by others.

Special Purpose Reserves

Once organizations have accumulated adequate operating reserves and the working capital portion of undesignated operating funds, they can go on to build additional board designated *special purpose reserves*¹ where needed for fixed asset maintenance and acquisition, new strategic initiatives, unexpected business opportunities, quasi endowment and/or other non-operating purposes. While NORI is focused on helping the 50% of nonprofits with available net assets of less than 3 months of annual expenses, development of reserve policies need to include long-term plans for building both operating reserves and special-purpose reserves as well as maintaining undesignated operating funds with sufficient working capital.

Figure 1



¹ Some organizations do not classify their special purpose unrestricted net assets as “reserves” but as board-designated special purpose “funds.” One reason is because certain special purpose funds such as funds designated for fixed asset maintenance and purchases are not held in “reserve” but are expended when the purposes are met.

Developing a Reserve Policy

The NORI Workgroup stresses that there is **no single right answer to how much an organization should have in an operating reserve**, but recommends that 25 percent of an organization's annual operating expenses (3 months of expenses on average) is a good baseline for a board-designated operating reserve. Regarding what level of operating reserves might be adequate for financial stability, the Workgroup reached the conclusion that **"it depends"** – each organization must arrive at its own rationale for what it considers adequate. Factors such as revenue volatility, spending flexibility, governance and management culture, programmatic risk levels, the economy, environmental risks, and even the organization's life-cycle stage will affect the decision. Once the target amount for the operating reserve is decided, the board should adopt a clear policy for the use and replenishment of the designated funds, and a funding strategy for reaching the target amount, which could take a number of years. The NORI Toolkit can be useful for these purposes.

Nonprofit Operating Reserves Policy Toolkit

The NORI Toolkit Technical Workgroup was convened in 2009 to create the Operating Reserve Policy Toolkit for Nonprofit Organizations. **Lead Sponsors** are the National Center for Charitable Statistics, a program of the Center on Nonprofits and Philanthropy at The Urban Institute and United Way Worldwide, Membership & Financial Accountability Department. Lead sponsors provide staff support, IT, web services and other resources for the development and dissemination of the toolkit. **Supporting Sponsors** endorse the Nonprofit Operating Reserve Initiative and its mission *"to help nonprofit organizations establish board-approved policies for maintaining operating reserves at levels adequate for achieving financial stability."* There is no direct financial commitment involved with becoming a sponsor. There are currently 17 supporting sponsors, and others are welcome.

Call to Action

Organizations and their funders may ask: can an organization with high demand for its services afford to put aside reserve funds? But the real question is *"Can organizations afford not to have an operating reserve?"* You are asked to endorse the mission of the Nonprofit Operating Reserves Initiative and help to spread the message about the importance of operating reserves in sustaining the nonprofit organizations that save and enrich our lives. Share our link and/or become a supporting sponsor. Contact BessfromNORI@gmail.com.