

# Nonprofit Operating Reserves - An Introduction

*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 internal benchmarks for financial stability that are specific to their organizations. A whitepaper: [Maintaining Nonprofit Operating Reserves: An Organizational Imperative for Nonprofit Financial Stability](#) was published in January 2009, and the [Operating Reserve Policy Toolkit for Nonprofit Organizations](#), 1<sup>st</sup> Edition, was released in September 2010. Both were endorsed by many prominent nonprofit organizations, funders, capacity builders, and businesses concerned with the well-being of the sector.

A new edition of the toolkit, [Board-designated Operating Reserves Policy Toolkit for Small and Midsize Nonprofit Organizations](#), was released in October 2022, to incorporate certain GAAP and FASB changes and to make the toolkit more accessible for small and midsize organizations.

## 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 that can lead to 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. For many years, nonprofits have consistently identified achieving long-term financial stability as a top financial challenge ([State of the Sector Survey](#) by Nonprofit Finance Fund).

## What Are Operating Reserves?

*Operating reserves* are the portion of “net assets without donor restrictions” that nonprofit boards have designated to strengthen financial stability. 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). Figure 1 shows suggested net asset terms that all nonprofit leaders and boards need to understand in preparation for designating operating reserves.

## Undesignated Funds

Undesignated funds fluctuate up or down according to day-to-day changes in normal cash flow activity and therefore need to include *working capital* (operating cash-on-hand) 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 to be maintained as working capital will depend on the organization’s risk tolerance, cash flow cycle and other factors. Undesignated funds can also include non-current, non-liquid assets excluded from a “funded” operating reserve.

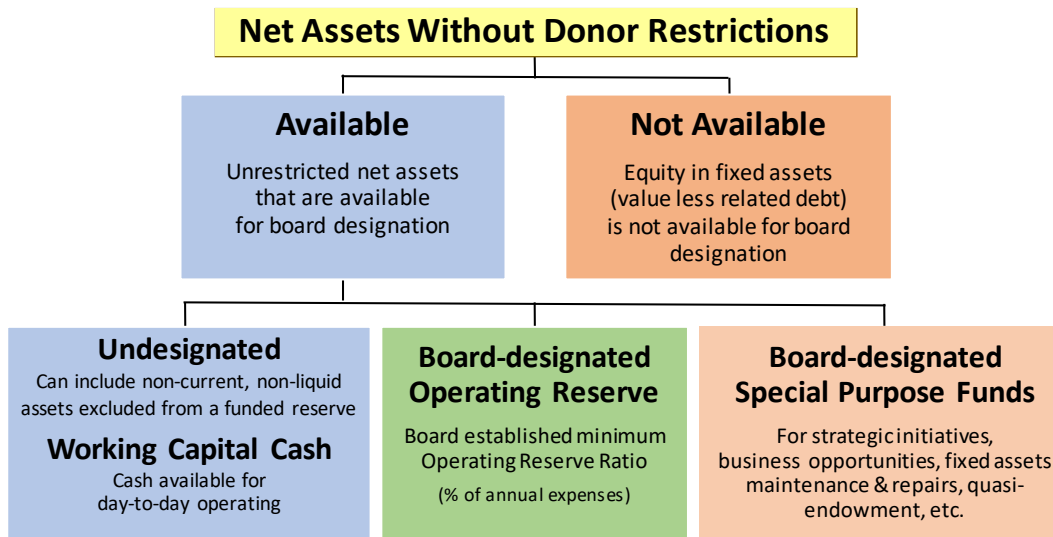
## Funded Operating Reserves

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. A funded operating reserve would 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 working capital cash and operating reserves, they can go on to build additional board designated *special purpose* reserves or funds to be maintained or expended for certain purposes such as 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 encouraging nonprofits to build adequate operating reserves and cash-on-hand, it recognizes that organizations need to include long-term plans for building special-purpose reserves as well.

Figure 1



## 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 may affect the decision. Generally, after combining the revenue volatility and spending control factors, your organization may determine that 25% is enough for your operating reserve, or that a higher target should be set. 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. See the updated **Board-designated Operating Reserves Policy Toolkit for Small and Midsize Nonprofit Organizations**.

## Communicating About Operating Reserves

The NORI workgroup recommends a disaggregated presentation of the Statement of Financial Position that separates restricted and designated funds from those available for operations. This presentation helps the reader to understand the composition of the organization’s net assets and its liquidity status.

ORG NAME Statement of Financial Position as of [DATE]	TOTAL	Unrestricted			Fixed Assets	Restricted	Notes
		Available for Operations	Board Designated Ops Reserve	Equip Reserve			
<b>ASSETS</b>							
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
<b>Total Assets</b>	<b>526,538</b>	<b>81,754</b>	<b>140,000</b>	<b>25,000</b>	<b>226,784</b>	<b>53,000</b>	
<b>LIABILITIES</b>							
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
<b>Total Liabilities</b>	<b>40,543</b>	<b>34,999</b>	<b>(10,000)</b>	<b>-</b>	<b>15,544</b>	<b>-</b>	
<b>NET ASSETS</b>							
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
<b>Total Net Assets</b>	<b>485,995</b>	<b>46,755</b>	<b>150,000</b>	<b>25,000</b>	<b>211,240</b>	<b>53,000</b>	
<b>Total Liabilities &amp; Net Assets</b>	<b>526,538</b>	<b>81,754</b>	<b>140,000</b>	<b>25,000</b>	<b>226,784</b>	<b>53,000</b>	

## Nonprofit Operating Reserves Policy Toolkit and Related Resources

The Nonprofit Operating Reserve Initiative is hosted by the Greater Washington Society of CPA’s free online resource website, [NonprofitAccountingBasics.org](https://www.nonprofitaccountingbasics.org). Historical and current NORI publications, policy templates, documents, toolkits, worksheets, etc. are available at [Nonprofit Operating Reserves](#) and the [NORI Document Library](#). *Please use these resources* to help your organization to determine an operating reserve target and to draft your reserve policy.

### 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 share our link to help spread the message about the importance of operating reserves in sustaining the nonprofit organizations that save and enrich our lives.

Contact [BessfromNORI@gmail.com](mailto:BessfromNORI@gmail.com).

<https://www.nonprofitaccountingbasics.org/nonprofit-reserves>

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