



## Developing Risk-Based Reserves

Many nonprofit leaders struggle with an age-old question: “How much should a nonprofit organization maintain in reserves?” A number of factors work against developing reserves: the pressures to enhance spending on program services in each operating cycle, using donor funds for current projects, and budgeting for break-even operating periods. Yet, developing prudent reserves can lead to more effective programs and an increased ability to successfully carry out your organization’s mission.

This recorded webinar will provide you with knowledge and insight to help you understand the purpose of reserves, common misconceptions, and how to develop reserves and explain them to stakeholders.

**Find additional resources on our event page:** <https://www.claconnect.com/events/2022/developing-risk-based-reserves>

### **Here is a transcription is this session:**

Jennifer Olivier:

Good morning. Good afternoon. Thank you for joining CLA today for this webinar on developing risk based reserves. My name is Jennifer Olivier. I'm assigning director at our firm's nonprofit practice. I'm passionate about nonprofits, and my role here at CLA is to help them with their accounting needs, assurance needs, working with organizations of all sizes. I am based in our Massachusetts office, but I do have clients both inside and outside of Massachusetts.

Melissa Murphy:

Hi everyone. I'm Melissa Murphy. I'm a manager in our nonprofit assurance practice based in our Massachusetts office as well, and happy to talk through risk-based reserves with you here today.

Jennifer Olivier:

Just want to call your attention here to this disclaimer. Just a reminder, that this presentation and the information that we're presenting is intended to be for general informational purposes only. Every situation and every organization is unique, therefore it's always important to consult with your advisors to get the necessary advice for your specific situation. Over the next hour, we will... After we go through our learning objectives, we will walk through defining reserves. We'll discuss the current environment and reserves for nonprofit organizations.

Jennifer Olivier:

We'll talk about best practices and trends and communicating the need for reserves as well as we'll walk through developing those risk-based reserve policies both in the format of the reserves and also in written policy that your organization may implement. The learning objectives for this session are outlined on this slide. After the session, you should be able to define reserves and identify common misconceptions, recognize the importance of reserves, identify how to develop a reserve policy and be able to articulate the importance of reserves to stakeholders.



Melissa Murphy:

Thanks Jen. In this next section, we'll go through defining reserves. A critical piece to the reserves conversation is understanding why reserves are important, and what reserves are. Over the next couple of slides, we'll talk through the importance. So, here we have why organizations need reserves. There are many reasons why an organization may need reserves and here we've just listed a couple such as bridging cash flows, weathering economic cycles, maintain and purchase productive assets. Each organization is different and may have a unique situation. So before starting a conversation with stakeholders and board members, it's important to determine why your organization needs to establish reserves.

Melissa Murphy:

So what is a reserve? Here, we're going to talk through a couple things that are not considered reserves. I think this is really important in understanding the need for reserves, and there are common misconceptions as to what a reserve is. So, is a reserve excess cash? No, it's not generally excess cash. Excess cash generally can be previously encumbered. Is it restricted cash? Oftentimes restricted cash is restricted by donors or other purposes. So it might not necessarily be restricted cash. What about endowment funds? I think this is a very important distinguishing factor between reserves and endowment funds. I know a lot of my clients have conversations with board members and stakeholders. Do we need an endowment fund or do we need a reserve fund?

Melissa Murphy:

Endowment funds generally are restricted by donors. You could also have board-designated endowment funds, which we'll get to in a little bit more detail on the next slide. But generally, these do not qualify as reserve funds. Are reserve funds unrestricted net assets or without donor restricted net assets? Not necessarily. Net assets without donor restrictions might include PP&E, which is not liquid. So here we break down net assets without donor restrictions into two categories. Those that are available and those that are not available such as equity in fixed assets.

Melissa Murphy:

So within our available category, we can have various designations. So, the first designation we show here in this slide is board designated operating reserves. So, operating reserves that we're going to talk about today. Then you have undesignated operating reserves. So these could be liquid, but they're not designated for any purpose. And then we move into board designated, which could be special purpose funds, or as I mentioned, quasi endowments. And the important thing to distinguish here is that generally quasi endowments are left to board interpretation of governing laws applicable, which may vary based on your location. So what the original contribution or the corpus is often restricted indefinitely, and that the earnings are used for operations. And that's one of the key takeaways here in distinguishing between quasi endowments and reserves.

Melissa Murphy:

So what are reserves? We talked a lot about what is not a reserve. So the two important factors here is they're liquid and available, meaning they can be converted into cash quickly with minimal impact to the price received. And then also they're net assets without donor restrictions. So there's no restriction for use by donors or further designation by the board such as a quasi endowment. So quickly here, we just



did a high level reserve calculation. So you'll start with your total net assets without donor restrictions, which is 2.5 million. Then we back out fixed assets net of debt, which we have 1.25 million in this example. We less any board designated funds such as special projects like a capital projects, or if there was a quasi endowment, which we have 750,000 here. And what's left is the available portion for undesignated operating reserves, which could be further board designated for your reserve policy or left undesignated.

Jennifer Olivier:

Great. Thank you, Melissa. Next, we're going to walk through the current environment and how it relates to reserve. So we really just, our intention here is to get you thinking about the environment around us, maybe some trends that you hear at your organization. And so really thinking about nonprofits, there is a big vast difference in comparing nonprofits to each other. There are some nonprofits that continually operate with operating surpluses. Others, at the same time, they may break even every year. They may be budgeting for break even. There are still other nonprofits that may operate with deficits, or a situation that is difficult to be in would be, you don't know how your [year 00:07:51] is going to end until you get there. I think over the past few years, specifically, I would say the past two years, it's really been a good time to sit back and think if you did not have in place a reserve or a response to the current economic situation, this is really a great time to reflect and take what you've learned and apply that into this consideration of a reserve.

Jennifer Olivier:

It may be a little difficult, looking at your metrics over the past couple of years to see what is your norm, what is your trends for expenses and growth? There might be some anomalies in the past couple of years, that it might take a little bit of digging to get into what is normal for the organization, and also understanding what impact different situations can have on the organization's finances. For organizations that already had an existing reserve policy, many are taking this opportunity to really dive in deeper. And this is a great place to take a step back and make sure that your reserve policy is covering what you intended it to, if you receive questions from governance or grantors on your policies, really taking a step back and just making sure that you're revisiting that in the current time.

Jennifer Olivier:

And so I think this is just my reminder to everyone as we continue through this discussion. I think take a step back and remember why we're all here; the end game for any nonprofit is your sustainability as an organization. You're striving to carry out your activities, achieve your mission. Perhaps you're working towards maintaining the organization as it is, or maybe you're aiming to build capacity, whatever it is that you're on the path to. Really the core is to make sure that your mission continues to be relevant in the future. So keep that in mind. And as you have these discussions regarding reserves, remind your leadership, your governance, your stakeholders of this, and really keep us at the basis of your thinking and thought process as you develop your reserves. Now, I think we have a good-size audience today, so we would like to really, I think, throw out a polling question at this point.

Jennifer Olivier:

We're just curious in your experience that you've had at your organization with reserves. So we'll launch a polling question with three options. Yes, we currently have a formal policy. Two, would be no, we're working on a policy. And three, you're at really just haven't started the discussion, you're looking to



learn more. Just take a few minutes to get the responses here from the surveys. Looks like we have a good response here. So we'll share these results of this survey with the audience. As you can see here, we know we have a pretty good spread of results here. So the survey has now ended and we've got about 40% of the organizations here do have a formal policy. About 31% does not, but are working through a policy. And about 30% are haven't had the discussion and here to learn more.

Jennifer Olivier:

So, we like that because a lot of times, working with nonprofits, a great place to start is often talking with your peers. And so for those that don't have a policy currently, there's certainly others that are working through that process now, or maybe they're in the same boat as yourself. So, thank you for your feedback there. As we continue the discussion through the current environment, just wanted to talk through misconceptions that perhaps you hear or you've heard and just put these out there and think about what these mean when discussing reserves. One thing I think a nonprofit hears or could hear from the public or funders or others perhaps on a board or within the organization is that we're a nonprofit. By definition, the IRS definition, we can't have a profit or a surplus.

Jennifer Olivier:

And again, I think it would be pretty difficult for anyone here on this webinar today to think that you could sustain an organization with zero net assets breaking even every year. Obviously organizations grow and profit isn't necessarily something that's being cashed out, but it's really something that's there to reinvest in the mission of the organization. Another misconception that is heard sometimes is that nonprofits that may have larger reserves, are they hoarding the funds? And again, that is something that is probably a misconception out there. But I would say that a lot of that can be cleared up by having a good story told for your organization.

Jennifer Olivier:

If you have an endowment, ensuring that the discussion is made on what the limitations are to your access to that funding. Another thing to think about is if you do have an operating reserve or you're thinking of building that reserve and you're anticipating some resistance, based on point number two, that's also a good place to make sure that you are telling your story, you're updating your disclosures in your financial statements and really telling your picture about what those reserves are for and what the intentions of the organization are.

Jennifer Olivier:

And lastly, here we've listed nonprofits with large reserves don't need more funds. Again, if not receiving more funds, definitely would hamper efforts to grow the organization and continue that mission. So that really does tie back into telling that story and explaining what those reserves are for. For instance, if there's a large capital fund, there could be a sizeable investment in capital in the future, and just making sure that we're aligning our reserves and how we're describing them.

Jennifer Olivier:

The last point here in this section here is the caught in the middle, and I think where some organizations feel often is they may feel discouraged from maintaining large reserves based on those couple of misconceptions that we discussed. But at the same time, as you go to granters and funders, oftentimes



they may see organizations with small or no reserves as risky for receiving funds. They may turn away from those organizations because they're not seen as having sound fiscal management. So you can see where having these policies, these reserves, these policies in place can really help you tell the picture and be able to tell the story to others of the strength and the fiscal strength of the organization. Melissa, you might be muted. I'm going to switch back over to Melissa for this next segment here.

Jennifer Olivier:

So the next session here is about communicating the need for the reserves. Melissa's just having a little technical difficulty, so we'll see if she can get herself unmuted. But really we wanted to walk through the discussion here on communicating why reserves are needed by the organization. And really communicating this is how you're telling the story, as we discussed on the last section. So we're talking about reserves that are needed to carry out the mission of the organization, planning for program expansion, planning for capital expansion. Whatever it might be is really communicating with your stakeholders on why those reserves are needed. And then next, thinking about how we tell that story to the board, to our stakeholders, to the funders.

Jennifer Olivier:

And along with that, I know for a lot of nonprofits, that discussion always starts with communicating the need of reserves to your board, getting the buy-in from your stakeholders. And really it's important to have these candid discussions and brainstorm with them. Be transparent about what reserves you're thinking about and which reserves you're planning to calculate and what the future use would be. Being sure to delineate between the different uses for reserves. We will walk through this in some more detail; is important to follow through that conversation with them.

Melissa Murphy:

Hi, Jen. Can you hear me?

Jennifer Olivier:

I can hear you, Melissa. Do you want to jump right in here?

Melissa Murphy:

Yeah. Sorry about that. I'm not going to mute myself now because I've been unmuting and muting and no issue, and then all of a sudden it just wouldn't unclick. So I will stay unmuted [crosstalk 00:16:50].

Jennifer Olivier:

If I missed any of your key points, feel free to back up in the slides, but I'll let you resume from here.

Melissa Murphy:

Okay. Thank you. So here; communicating the need to board members. It's just critical to be transparent about how reserves are calculated and the future use. Sorry, if I repeat Jen, because I was frantically trying to unmute, but I think we talked a lot about defining reserves, understanding the need. And it's just so critical that you understand this. You understand... or you just, you know your business in order



to have these conversations, and that's really the key piece here. So being transparent about how those reserves are calculated clearly delineate between uses for reserves. Going back to the why, what you're going to use those reserves for, if there are different needs, separating those out.

Melissa Murphy:

Generally, these can be difficult conversations to have with board members and also stakeholders. So really having a solid foundation as to the need and uses really helps move that conversation forward and making that link between strategic planning and reserves very clear. And that helps people understand why this is so important when having those conversations. So talking about the need with external stakeholders. Again, going back to that transparency; the more that you talk about it, I think the easier it is for individuals to understand. We go back to what Jen mentioned with the IRS definition of a nonprofit and the notion that nonprofits shouldn't be making a profit.

Melissa Murphy:

Or if you do make a profit, those need to go back directly into programmatic activities. There's just as a need to create this reserve in order to further the mission of the organization. And advertising the need and purpose of reserves through the discussion with stakeholders, website. Using financial documents like your audited financial statements and the 990 to help tell that story. Pulling in those strategic plans that you have down the line and how critical developing these reserves are for the future of the organization.

Melissa Murphy:

Another key piece is benchmarking yourself against peers. The 990 is a public document. So you can use that information and say, hey, this organization is a little bit like ours with the same mission and revenue stream or assets. Let's take a look at what their financial statements look like to see if we're on track. That helps develop what the expectations are, and really helps with telling the stories, especially to the external stakeholders, pulling examples from other organizations to say, hey, this is what we're doing. This is the environment, and this is why it's important.

Melissa Murphy:

Here, we've just identified some common challenges that nonprofits see within the industry, such as meeting demands of the community for program activities, I mean cuts and delays in funding. I think if we've learned anything these past couple of years, who knows what will happen and making sure that we're looking at historical data, how the organization responded to those certain periods of time where times were tougher, there were delays in funding, or there was something that came about that you didn't prepare for and taking a step back, looking at history and planning for the future. So that you're prepared next time something like that happens. There are a number of challenges that nonprofits can face and the ones we've outlined here, and there's many more, this really helps in the conversation about developing the risk based reserves that we'll talk about in more detail in the next section. But understanding these challenges and the organization's response again, is just so critical to having the conversation and creating a policy.

Melissa Murphy:



On this slide, we just further expanded on the conversations the common challenges, and having the conversations with funders, which really can be the most difficult part. Planning for reserves and incorporating that into your budget is a key piece of this conversation. And we'll, again, talk about that in more detail, but organizations are always having conversations with funders related to program expansion, operating support, program outcomes. These are easy conversations to have. On having funders understand the importance of developing these reserves or having a rainy day fund can be more difficult conversation, but again, just the transparency and consistently having the conversation, we have to create a normalcy that this is okay.

Melissa Murphy:

So we have another polling question here that we'll push out. How often do you speak with your board, funders and other stakeholders about the need for reserve funds? So we have, frequently, rarely or never. We'll give it a couple seconds to have responses come through, and I'm not going to switch to the survey tab, Jen, because I don't know if I can get back. So you let me know when we have enough responses and maybe if you could share the results would be good.

Jennifer Olivier:

Yeah. And it might not be coming through yet. So maybe we'll just wait a minute and see, I'm not seeing the results on mine either. All right. So it looks like we have enough responses now we can share on the screen. So Melissa, I'm guessing you probably can't even see the graph, but...

Melissa Murphy:

I can't.

Jennifer Olivier:

The answer to that question would be, we've got about 45% frequently have these conversations, which is great. We've got about 42% rarely have these conversations and just under 5% do not have these conversations. So that's great to see the results there.

Melissa Murphy:

I think it's back to you, Jen.

Jennifer Olivier:

Thank you. Thank you, Melissa. So what we're going to move into next is really just the fundamentals of actually figuring out the reserve and how do you quantify and what do you consider in building your risk based reserve? And so really, your initial considerations, when you start through this process would be thinking about the past for the organization, thinking about your future. It's important to really have a good understanding of your historical expenditures, how your cash flows change during the year. There may be for instance, some seasonal or cyclical nature of trends that your organization has experienced in the past. These are all information gathering that you want to do as you start thinking about reserves and thinking about which direction you want ahead.

Jennifer Olivier:



I think this past couple of years is a great place to think about what impact there has been on the organization, if there have been significant compensation the organization has had to make to pay for certain expenses, if there was loss of any revenue streams. All these things really come into play in thinking about the considerations for you developing your reserve. In addition, it is important as Melissa had alluded to as well, is these are all really looking at your budgeted expenditures, your budgeted cash flows and revenue, and making sure that you're taking that budget into consideration, thinking also about how you budget for your cash flows as well, and really distribute the influx of revenue, the outflow of expenses, and in order to really identify whether you have any peaks or values in those trends.

Jennifer Olivier:

It's also important and we'll get through this in a bit more detail, but thinking about risk tolerance, what risks are out there, what should the organization be considering as they develop the methodology behind their reserves? And another point to think about is if you do have a planned expansion or contraction, certainly something that you want to think about in developing your reserves. Obviously a planned expansion could take some outflows of cash, but on the other side of that, you have a possible contraction if you have a reduction in a specific revenue stream, you need to be able to prepare for that loss of revenue and how the organization would react. And so in this presentation, we've really broken down the development of your reserve into two phases.

Jennifer Olivier:

The first one would be identifying those risks that are out there to your organization, your divisions, your departments, and in phase two, taking that information and really quantifying those results and building your policy. So we'll walk through phase one on the next few slides, but really reviewing current policies, collecting data, facilitating discussions, before you move into phase two, where it's setting up the models, drafting, getting feedback and obtaining governance approval of those policies.

Jennifer Olivier:

So in phase one, this is where I think we had about 45, if I remember correctly, percent of the organizations here have a current policy. So really, taking that current policy and practice and reviewing it. For those that have started to draft it, or haven't got there yet, really it never hurts to ask peers in the industry for examples of what they have done, or maybe you've seen something along the way that you would like to take into context. But really looking at that current policy or what you have outlined for a policy and thinking about the business and reporting structure of the organization and thinking about how those can be addressed for this policy.

Jennifer Olivier:

It's also important to look, if you do have a current policy, did you identify perhaps operating reserve target? And how has that played out for the organization? Have you been able to meet those targets? Were they too low, too high? And really reflecting upon what the past was for the organization? In addition, if you do have a policy, think about, does your policy really address risks? Are you taking into consideration each program, department entity wide? And it really is important and we'll get through on the next slide in more detail, making sure you're asking the right people, what risks are out there that for those an accounting finance perspective may not be aware of. There may be things that they're not

thinking about. Also thinking, are there current strategic or capital improvement plans that should be considered as you draft a new or updated policy?

Jennifer Olivier:

And then thinking as well about how your policy discusses investment allocations and really defining oversight of the breakdown of what assets are reserved to back your policy. And so the first step here with data collection, for a small organization, you may not have the need to go out and do a formal survey, but you would want to certainly have these discussions. If you have a weekly or monthly staff meeting, have these discussions and make sure you're talking to each program and department. You're talking to development, you're talking to your maintenance department, you're talking to board members that may be serving on certain committees for programs. These are really the people that you want to get perspective of and having those questions around what have they identified as risks? How likely, and what is the timing of those occurrences to happen?

Jennifer Olivier:

What is the potential financial impact of those risks? And has the organization already implemented some type of mitigation to address those risks? So an example here, if you think about having your weekly meeting with your team and you've got your facilities manager there, he brings up the fact that in three years, you need to purchase a new roof. And so that could be a significant cost to the organization. And at that point, you've identified a specific risk. You know the timing of that occurrence, you know that it's probably 100% likely to happen. These are things that you want to take notes on as you walk through this risk process. It will come into the quantitative phase of this model development. Other things that could be out there that may not be as likely or timing could be uncertain, perhaps you're looking to make an investment in technology. You know what the ballpark range of that could be not quite sure the likelihood of that happening in the next year or two, but you do want to have some consideration to that cost in the future.

Jennifer Olivier:

Here in the next slide, we just have highlighted here some sample survey questions. Again, these may be a little bit too much for some organizations on the smaller side, but we just wanted to have an example out there, what are the concerns that your organization and your board has for the organization? Do you want to be prepared to adjust for down years? Do you want to be able to support new initiatives' opportunities? Are there large scale changes in place for the organization? Do you want to be able to respond to an emergency with a source of a line of credit that the organization has funded themselves? So all things that you can bring up in conversation, you could launch a formal survey, but things that are very relevant in developing your policy.

Jennifer Olivier:

Another optional phase, and again, this really varies based on the size of the organization and the number of people that you're interviewing to get their feedback is to have a stakeholder session. Once you've gathered some information is have a session to talk through the information gathered, talk as a group and figure out if there are any gaps in what has been collected for information, talk through the likelihood and the risks and really come to a consensus because when you develop these policies and you identify these risks, you want to make sure that everyone is on the same page and has bought into the same consensus for developing these reserves. You want to see what the materiality is of these



smaller risks. And I think an important reminder here is if you think back in a time of recession, if you think back to previous experiences with recessions, what were those risks and how material did they end up being to the organization?

Jennifer Olivier:

These are things to think about, take that historical context into place here, but really quantify, it may seem like a small risk, but could it be material? Are there things that you're missing in that analysis? Talk through with each other, your rationale for how you determine something was likely, the timing and the impact. One person in the organization may think that you don't need to upgrade your, I'm just going to say accounting system because accountant here. But then if you speak to your IT group, they might know that your license expires next year. So really getting a full understanding of the situation and the potential behind the timing and impact and likelihood for the risks.

Jennifer Olivier:

So once we've gone through that basic discovery process, identifying those risks, that's, when you want to start your modeling and really building the policy around those risks. And so in this phase, your objective is to develop a financial reserve model that's quantifying the risks that you've identified through the survey and your stakeholder sessions and compare it against current reserves if you have them, and really be able to create a tool for the organization to carry forward and to use in developing the policies. So the result after you do this modeling would be that you've compiled the total financial risk to the organization and that that information can be analyzed by reserve type, the time that that may occur as well as the likelihood. And just a reminder here for what I think we put here on these slides, some common reserve categories that we do see, because you really want to... once you've identified these risks, you're at a pretty specific level for the organization.

Jennifer Olivier:

One common one that we often hear about is the operating reserve. And so really that's your internal source of funds that you have available to respond to a sudden increase in expenses. You have something unbudgeted, you were supposed to collect on a pledge and now you found out it's not going to commit until the next month. So these are the type of things that your operating reserve would be there to cover much like a line of credit that you are drawing down and repaying as you use it. Another frequent item that we see would be if you have a capital budget or capital asset reserve, perhaps you have a plan to repair your facilities or perhaps you have a bigger, long term capital campaign to acquire building, new equipment, whatever it might be. That is something that we often see defined as a risk to the organization that a separate fund is established for.

Jennifer Olivier:

Continuing on here, just common themes that we do see. Another item would be a fundraising reserve, perhaps in a strategic plan that's been identified that you need to invest in your development group. And so therefore you want to really invest in developing that department to generate long term progress in your fundraising initiatives. It could also be that perhaps your fundraising was down for the year, unexpectedly, and you want to have something to really supplement that source of revenue for a year. An opportunity reserve, this with the intentions of building capacity, perhaps you want to build your staff capacity, invest in research and development, other infrastructure that has long term capacity impact for the organization. This list could probably go on and on and it's probably unique for every



nonprofit, but just things to think about as you're really looking to bucket those risks that you'd identified into a reserve fund. The last one here would be major initiatives. So this would be perhaps starting a whole new segment or program, something that is so major that it's going to take that reserve building to get to a point where the organization can take that leap.

Jennifer Olivier:

All right. We are going to walk through an example, and the sample organization that we identified has a need for a lot of reserves. So just bear with us, because we wanted to play out how this impact has been quantified and how those risks came into play. So in this example, this sample organization has developed this model where they have several different reserves needed. They've identified their operating reserve at 3.3 million. They have a need for some capital asset improvements of 1.1 million. They really want to step up their fundraising and supplement that with 800,000. There's some opportunities they look to take advantage of at 600,000 and they also have a major initiative that they've budgeted for, sorry, 900,000. So in total, the full risk valuation for this organization would be defined as 6.7 million. That would be the 100% valuation of what the risks identified for this organization were.

Jennifer Olivier:

So once we have that, this is the full coverage, we have all the risks covered through this model. If you had 6.7 million at this point, and you can set that up, I think we're good to go. But oftentimes this is a journey and we're taking baby steps to get where we need to go. And so we really need to hone in and see what are other priorities, what is most likely to be in need first? And how can I work towards building towards this model in more baby steps? So knowing that everything will not happen at once. What you really want to do is think about the likelihood, think about the time horizon and think about the probability of each of these events occurring. And so in doing that, this exercise could actually get a little bit more complicated than I think to walk through on the screen here with you today, but really going through that exercise for this organization, it was identified that \$4.7 million, once we consider the probability, the time horizon would be the need over the next five years.

Jennifer Olivier:

And so for this organization, that really is described to be 70% of the risks at the full evaluation. And that reserve of 4.7 million would represent 47% of a fiscal year's operating expenses. And so really there's some subjectivity into this as you're building, what you see as the probability, what you see as having a need to be reserved. And so going back to the table here, we have really created a ceiling and a baseline. Our reserve in this example is supported by a ceiling of 6.7 million. If we have the ability to fund that, we've covered 100% of our future risks identified, and we're also covering 67% of the operating expenses for a fiscal year. The bottom baseline that we identified here is 4.7 million. So you can see, that would allow this organization to cover 70% of their full risks. And we've also covered through that 47% of the forecast of fiscal year expenditures.

Jennifer Olivier:

So again, I think this is a lot of really drilling into the numbers, getting that feedback on probability, thinking about how you're going to really consider the likelihood and which are the most important reserves to keep in mind. It's also a good place to make sure that you are defining these amounts correctly, taking that step back and really making sure that for instance, you've identified the right



quantitative amount for your risk. If you think about, for example, your operating reserve and your target is for two months of operating cash on hand in a reserve, make sure in those situations that you've gone back and thought that, my organization is going to grow 50% next year, I really should be budgeting my operating reserve to cover that next year and really taking that dive into the numbers and making sure that you have the right amounts identified.

Jennifer Olivier:

And so finally here, we just want to throw out really some other considerations. Again, this is a lot of information it's hard to get through in an hour in deep detail. But really just remember that if you do set up an operating reserve or you have one, always consider that to be like a line of credit. If you take it out, you repay it. Best practice would be that in your policy, you are reporting to a committee or the board, whomever has oversight, on the use of the funds just to make sure that you're following the policies of the organization. Another reminder would be that the nature of these risks is continually changing.

Jennifer Olivier:

You will need to reassess these frequently, make sure that this becomes part of your model, whether it's going through this process annually and updating more frequently, less frequently, whichever is right for your organization. And with that, just remembering to adjust your data model for growth, reductions, changes in risk based on the activities that the organization is doing. The policy isn't something that you write and walk away from. It's something that you want to revisit each year, update and make it the most meaningful for the organization.

Melissa Murphy:

Thanks Jen. So on the next couple of slides, we summarize developing a reserve policy. Now a lot of this we've talked about, but thought it would be helpful to conclude on this in the next following slide. So policy development, what to include. Number one, purpose of building and maintaining a reserve. From the very beginning of the presentation, we talked about all of those examples on why an organization will need to build a reserves. And it's important to include that purpose in the policy. And again, as Jen mentioned, it's something that you revisit every year. So as needs change and things come up, you can reevaluate that purpose, but I think it's always good to try and be specific within the policy so that governance and management has something to go back on.

Melissa Murphy:

Also including definitions of types of reserves, intended use and calculation, and the timeline of targeted amounts, where your goals are and how long it takes to get there as far as calculating that number, that makes the most sense for your organization. The policy for contributing and building reserve funds. There are some questions that came through that we'll talk about shortly. And I think this is an important topic that we didn't really get to dive deep into. But depending on the various revenue streams organizations have, there could be a number of ways organizations can contribute and build reserve funds. Whether that's through soliciting certain types of contributions or incorporating it into grant budgets, there are a number of ways here.

Melissa Murphy:



Number four, we have authorization procedures for using funds from each type of reserve funds. So I think it's critical here, as Jen mentioned, to have that oversight, that governance to guide and make sure everybody's following the policy and using funds for their intended purpose. Number five, responsibilities for reporting reserve fund amounts and use of reserve funds. So always having that conversation, keeping the transparency there. If you're having monthly committee meetings or quarterly board meetings, this is always something that's talked about and revisited in each of those meetings to make sure things are on track and the policy is being followed. And then policies if needed about investment of reserve funds. That was another question that came through that I'm seeing, somebody asked, they include their reserve funds in an investment account.

Melissa Murphy:

And that might make sense for your organization. I think it goes back to the risk tolerance. If you're keeping those reserve funds in an investment account, the market is so volatile right now, so you need to make sure, and everybody needs to feel comfortable that having that cash in an investment account is tolerable for the organization. Especially when it's hard to predict what the market might look like at the end of the year or something like that. Also, depending on the makeup of your portfolio and what the risk tolerance is there. All things to consider, this does not encompass everything, but at least gives you a starting point. I think we go back to that original... at the beginning of the conversation, just especially in the nonprofit industry, every organization is different.

Melissa Murphy:

There are various ways organizations fund for their mission, which makes it difficult to give you a blanket approach to what this might look like. But we hope through this presentation here today, we at least give you a starting point to begin those conversations. We have about 10 minutes left and quite a few questions came through in the chat. Oh, I missed the conclusion slide. So let me go through that real quick and then I will circle back to the questions. So to wrap everything up, I think we touched on this already, but considering which reserve methodology best fits your organization, using the risk tolerance conversation to incorporate that into your methodology, encourage discussions amongst decision makers about developing risk based reserves.

Melissa Murphy:

Being transparent, we talked about that a lot, and just continuously having that conversation really helps make a difficult one, a little bit easier. And implement or adjust your reserve policy to improve financial health. It's something that you should be looking at at least annually and talking about multiple times during the year to make sure your policy is being followed, if anything comes up that you might need to adjust your policy. Having a clear guideline is very important here. So I think...

Jennifer Olivier:

Yeah, and so we do have probably a dozen questions. So for some reason we don't get to your specific question, we will make sure that someone follows up with you directly. But we can walk through, I think, the questions that we have here and Melissa, maybe we can alternate. I'll start first. But the one that I see here, which is probably a common presentation item would be how are reserve funds recorded within the financial statements? And so because reserves are taken from your net assets without donor restrictions, in your statement of financial position, that component would be included in net assets without donor restriction. You do have the ability on that statement to break down the composition.



Oftentimes, we see that broken down into perhaps undesignated operating reserve, whatever the specific reserve may be, if it's not on the face of your statement of financial position, you would make sure that your disclosures are providing that information. And letting the reader know that those are restricted funds, they're not liquid and available for use by the organization.

Melissa Murphy:

Another question we had, and I touched upon this briefly, but perhaps I wasn't super clear, concisely describing the difference between an endowment and risk based reserves. I think the most important takeaway is, generally an endowment is a little bit more restrictive than a reserve. An endowment generally could be governed by certain laws and the original contribution is generally restricted in perpetuity. Oftentimes, you could have an operating endowment, but a lot of times it might be for a specific program and a little bit more restrictive in the nature it could be used. And circling back, the earnings on the endowment are generally the only portion that could be used for operations, and then that's subject to your spending policy, which would be established by the organization. So, generally is a percentage anywhere from three to 5% a rolling average that's calculated.

Melissa Murphy:

So again, it can tend to be a little bit more restricted than a risk based reserve. Endowments generally are always kept in an investment portfolio to generate those earnings. We talked about a little bit already, risk based reserves might not necessarily be in an investment account depending on how quickly you need access or what you are reserving for. So generally you can have a little bit more flexibility as far as accessing those funds looking at a risk based reserve. I think historically, the notion of endowments in nonprofits were looked at as maybe not necessarily a rainy day fund, but we have this to fall back on if we ever need it. But there's just not that flexibility there that generally the risk based reserves, depending on what you're reserving for has. Hopefully that was a little bit more clear. Let me know if you want to add anything, Jen.

Jennifer Olivier:

Awesome. Thank you. We've just got a few minutes left here. Just looking at a couple of these other questions. So, one of them that I see, a lot of times these are really best practices, what's right for your organization may not be right for another organization. So, one of the questions here would be, do we see that finance committees or board approval is needed to tap into reserves? Generally, you want your organization's management to run the organization. You want them to be able to respond to a situation if they had a need for an emergency use of funds and they needed to tap into that operating reserve. So when you establish these reserves, generally you would be giving that permission to management to do what the policy intended for that reserve to do. Generally a best practice would be a communication on the activity within that reserve, if something was drawn upon getting that update from management would be necessary.

Jennifer Olivier:

But generally, you want to make sure that it's defined the process. So if you do want the board or the committee to know when it's being used, definitely write that into the procedures of the organization. And we all... sorry, Melissa. I was going to... was talking about policies. I see another one about is that a standalone policy or within an investment policy statement, there is some linkage between what the investment policy is, but really when you're developing these reserve policies, you want this to be its



own statement, its own policy, its own procedure followed. It's such a critical part of overseeing the organization of planning that you do want to make sure that you have a separate policy to specifically address reserves.

Melissa Murphy:

Well we had one question come in about sources of funding for creating a reserve, and another person that responded with an example. So I thought that would be helpful in answering that question, where they were able to, during the annual operating budget cycle, they don't necessarily budget for planned giving such as bequests. So any bequest that came in, they basically set aside and use that towards funding their reserve. So that's one example. I think I mentioned a few others earlier, such as incorporating it into grant applications, which can tend to be a little bit more difficult, but definitely an option. I think the notion of reserves is becoming more of a conversation in the nonprofit industry and more acceptable where people are understanding the need that's there. Especially after the past couple of years, how important it is for nonprofits to have that reserve, also through additional types of fundraising.

Melissa Murphy:

Again, I think it goes back to understanding your different revenue streams, and then also diversifying your revenue streams, especially those organizations that might solely be funded based on state or federal funds. It could be a little bit more difficult for them to fund a reserve just based on the nature of how they operate. So thinking about things differently, and different strategies on how to fund, whether that's maybe a separate campaign to tell your story, to help donors understand the need and what you'll use it for, and your strategic goals and what you're planning for in the future. Do you have any more, Jen?

Jennifer Olivier:

I think there's a few of these that may require more specific response. So there's a few of these, I think we'll certainly follow up directly afterwards. Just trying to... we've got just a couple minutes left to try to see if there's one that we can cover quickly. Some of these examples, if you're looking for examples of policies, I think one of my favorite things to do is to read different nonprofits' financial statements. If there's an organization that you compare yourself to or one that is in the same realm as you and looking at if you have connections, asking for their policies. A lot of times, we see in our local nonprofit finance managers groups and executive groups that this is something that the best resource often is either your advising professional, or it's your peers in the industry. And so there certainly are some example policies out there, we can follow up with those requests as needed. Do you see any others there, Melissa, that we can cover? I think we might be right at the top of the hour here, so.

Melissa Murphy:

Yeah, I think any ones we didn't answer, we'll follow up individually. But I think we got the big overarching questions out verbally.

Jennifer Olivier:

Great. Well, thank you everyone for joining us.



Melissa Murphy:

Thank you everyone. Have a great afternoon.

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