

## OPERATING RESERVES IN NONPROFITS

### What are operating reserves?

Operating reserves are similar to retained earnings or owners' equity in the for-profit business sector. They are funds, usually accumulated over a period of several years, which are available for use by the organization at the discretion of the board of directors (i.e., net unrestricted fund balance).

### What is the purpose of operating reserves?

Nonprofit organizations must maintain the balance between income and expenses in order to survive. Achieving this year after year is a considerable challenge due to the many economic uncertainties. Most organizations can expect to incur an operating deficit at some time. Operating reserves can provide the cushion necessary for an organization to survive the lean periods and the unexpected events which drain funds. Operating reserves can:

- **Enable an organization to survive shortfalls.** Without such reserves, the very survival of an organization during a steep economic decline or a protracted period of deficit may be threatened.
- **Enhance the flexibility of an organization.** When used like “venture capital”, they can fund new programs or expand the organization's geographic area or scope of services.
- **Expand credit opportunities.** More favorable bank terms for financing may make an organization's growth and expansion possible.

### How much should be in operating reserves?

In a survey cited by The Non-Profit Times, 25 national nonprofit organizations were asked what their guidelines were for operating reserves, more than half maintained unrestricted reserves between one and 49 percent of current unrestricted expenditures. Only 16 percent had no operating reserves. The amount of operating reserves needed depends upon the individual organizational circumstances, including:

- **Reliability of income sources.** If income is derived primarily from a predictable, broad based membership or body of contributors, the level of operating reserves may generally be lower than if income is derived primarily from a few large funders.
- **Seasonality of cash flow.** If cash flow is irregular or characterized by periods of dormancy or expenses spike at one or two times a year, operating reserves should be generally higher than if cash receipts are consistent throughout the year and expenses do not substantially fluctuate.
- **Timing of cash flow.** If there is usually a significant delay in the collecting accounts receivable, reserves should be higher than if revenue receipt is generally within 30 days or better.
- **Size of budget.** Small and large organizations experience different financial challenges.
- **Availability of other financing.** If other sources of credit are available to cover emergency situations, operating reserves may generally be lower.
- **Availability of other assets.** If other unrestricted investments or an endowments exist to lessen the risks of the organization in bad times, the operating reserves may be lower.
- **Future plans.** If an organization needs to replace significant major equipment or buy a building as soon as one is located, a operating reserves should be higher.