**Outline for development of written reserve policies with example language**

For the full Nonprofit Operating Reserves Initiative Toolkit see:

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

**NAME OF ORGANIZATION**

**BOARD-DESIGNATED OPERATING RESERVE FUND**

**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 FUND by resolution at its DATE board meeting. The general purpose of the fund 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 Fund 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 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:*

1. *Manage cash flow interruptions*
2. *Minimize the need for working capital borrowing*
3. *Meet commitments, obligations or other contingencies*
4. *Generate investment income*

**II. Board-Designated Operating Reserve Fund Balance**

🡪 Describe the establishment of the fund. Include such details as:

* The ultimate goal amount for the fund and method / rationale for determining the amount (to provide history and background for future board members and staff leaders)
* Current operating reserve fund 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 fund
* The timeline and incremental plan for reaching the desired ultimate fund balance, if applicable
* Relationship to annual budgeting process and fundraising plan

[example:]

*The target amount to be attained and maintained for the Board-Designated Operating Reserve Fund 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 Fund, the ORG Board of Directors has designated $20,000 of existing accumulated liquid net assets as the beginning balance of the fund. 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 is to be funded over the next XX fiscal years in increments of $XX,000 through funding strategies incorporated into the ORG’s annual fundraising plan and capital budget.*

**III. Use of the Board-Designated Operating Reserve Fund**

🡪 Describe terms and use of the fund. Include such details as:

* Who may access the fund
* 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 funds 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:]

*The Executive Director may access up to $XX,000 for purposes as outlined above, so long as sufficient accounts or grants receivable are available to repay such usage within three months time. The Executive Director shall notify the Treasurer in writing; 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 Fund for greater than $XX,000 and/or for longer than 90 days will be paid back through a prescribed repayment schedule/method. Approval of any such usage and the proposed repayment schedule shall be requested by the Executive Director from either the Board or the Executive Committee. If approved by the Executive Committee, such disbursement shall be reported at the next full Board meeting.*

*At any time that a borrowing from the Operating Reserve is outstanding, the status of the borrowing and payments made against the proposed repayment schedule shall be reviewed at the regularly scheduled Board meetings.*

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

Can be used for:

1. *Internal line of credit for use to financially operate the organization*
2. *Funds to meet unfunded and unexpected organization needs*
3. *Funds to bridge between pledges and pledge receipts*

Should not be used for:

1. *Capital purchases (funded by Equipment Maintenance & Replacement Reserve)*
2. *Funds to make up a deficiency in the Capital Campaign*

[example re: relationship to commercial line of credit:]

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

*OR*

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

*OR*

*C. When cash flow funds are needed, the decision whether to use the operating reserve or the commercial line of credit first will be made on a case-by-case basis.*

[Note: management procedures, authorizations, etc. must be consistent with the choice of hierarchy.]

**IV. Management of the Board-Designated Operating Reserve Fund**

🡪 Describe the management of the fund. May include such details as:

* Who is responsible for managing the fund
* 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 the “numerator” in the reserve calculation listing which assets will be included or excluded in the formula for monitoring the reserve balance. For instance, excluding non-liquid or non-current line items such as prepaid expenses, inventories, fixed assets, long-term receivables, and deposits held by others produces a more conservative reading. The example below refers to a fully funded reserve that is cash only.

[example:]

*Under the direction of the Treasurer [or the Finance Committee] [or by Board Resolution], the Executive Director shall establish a separate bank account for the Board-Designated Operating Reserve Fund. 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 reserve investment policy.*

*The Operating Reserve Fund 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 as a liability – “Due to Operating Reserve” – in internal financial reports.*

**V. Operating Reserves Investment Policy**

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

[example:]

*As capital preservation and liquidity are the two main objectives for the 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. Authorization of Drawdown\* from the Board-Designated Operating Reserve Fund**

🡪 Define the terms and conditions for drawing down the fund for operating purposes in the case of a financial emergency, including procedures for eventual replenishment. (See also: “**Operating Reserve Shortfalls**”, below.)

[example:]

*A drawdown from the fund that will not or cannot be replaced with operating funds in the timeframe established in “****Use of the Board-Designated Operating Reserve Fund****” 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 fund from the established target level and is not recommended except under extraordinary circumstances.

**VII. Operating Reserve Shortfalls**

🡪 Describe the Board’s policy for restoring its Board-Designated Operating Reserve to target level (once achieved) if the fund has been depleted to below the target level. Include time and amount thresholds for which the replenishment policy will become applicable.

[example 1:]

*After the reserve target has been reached, if the Operating Reserve is and has been less than 75% of the targeted reserve level for two consecutive years, the Board of Directors, in the absence of any extraordinary circumstances, will adopt an operational budget that includes a projected surplus sufficient to rebuild the Operating Reserve Fund to its targeted reserve level over the following two years.*

[example 2:]

*After the reserve target has been reached, if the operating reserve is less than 50% of the targeted reserve level for two consecutive years, the Board of Directors, will adopt an operational budget with a projected surplus to rebuild operating reserves over the following two-four years back to its targeted reserve level.*

[example 3:]

*After the reserve target has been reached, in the event operating reserves are less than the targeted reserve levels, this deficit must be eliminated in a minimum of three years, with one third of the deficit balance being required to be funded in the current operating budget, until the reserve is restored to the target balance.*

**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 funds
* How often and in what manner they will report to the Board about funds activity
* 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 Board-Designated Operating Reserve Fund 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 Organization receives a reasonable rate of return considering the size of the reserve fund, the instruments in which it is invested and other relevant factors.*

*The Treasurer will report the status of the Board-Designated Operating Reserve Fund to the board as part of the regular Treasurer’s report.*

*The Operating Reserve ratio and target amount will be reviewed and updated annually as part of the annual budgeting process.*

*The Finance Committee will review 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.