Operating Reserve Policy

***About this Tool***

This tool contains sample elements that can be used in the creation of an operating reserve policy. As with any policy of this nature, the NFP may wish to consult their legal counsel or independent auditor for assistance in developing an operating reserve policy that is appropriate for the organization that has been customized based on the risks, operations and structure of your organization.

An operating reserve can be a valuable tool to help a not-for-profit entity (NFP) respond to temporary changes in circumstances or in its environment. By building and maintaining an operating reserve, an organization has the ability to better manage its cash flows on a day-to-day basis.

An operating reserve is an accumulation of resources without donor restrictions, often resulting from surpluses, which are available for use at the discretion of the governing board (board of directors or board of trustees). In order for the operating reserve to function effectively, the organization’s board should adopt a formal policy that addresses each of the following items:

* the purpose of building and maintaining the reserves,
* a calculation of the target amount,
* the intended use of the reserves,
* who will have the authority over use of the reserves,
* how the reserve account will be monitored, and
* a plan for replenishing the reserve balance.

The various components included here may or may not apply to every NFP and require discussion and decision-making with management, the governing board and the finance committee as deemed appropriate under the circumstances.

*NAME OF ORGANIZATION*

*OPERATING RESERVE POLICY*

1. PURPOSE

The purpose of this Operating Reserve Policy for [insert name of Organization] is to build and maintain an adequate level of net assets without donor restrictions to support the organization’s day-to-day operations in the event of unforeseen shortfalls. The reserve may also be used for one-time, nonrecurring expenses that will build long-term capacity, such as staff development, research and development, or investment in infrastructure. Operating reserves are not intended to replace a permanent loss of funds or eliminate an ongoing budget gap. The organization intends for the operating reserves to be used and replenished within a reasonable period of time. This Operating Reserve Policy will be implemented in conjunction with the other financial policies of the organization and is intended to support the goals and strategies contained in those related policies and in strategic and operational plans.

1. DEFINITIONS AND GOALS

The Operating Reserve Fund is defined as the designated fund set aside by action of the governing board. The minimum amount to be designated as operating reserves will be established in an amount sufficient to maintain ongoing operations and programs for a set period of time, measured in months. The operating reserve serves a dynamic role and will be reviewed and adjusted in response to internal and external changes. [Describe short term goals if reserves are currently less than six months. Describe capacity building goals, if any.]

The target minimum Operating Reserve Fund is equal to [insert adequate number of months] months of average recurring operating costs. [The actual calculation of average recurring operating costs can vary between organizations, so describe the organization’s specific calculation for measuring.]

In addition to calculating the actual operating reserve at the fiscal year-end, the operating reserve fund target minimum will be calculated each year after approval of the annual budget. These reserves will be reported to [identify who will receive the reports, i.e. the Finance Committee and governing board] and included in the regular financial reports and/or dashboards.

1. ACCOUNTING FOR RESERVES

The Operating Reserve Fund will be recorded in the accounting system [determine if the organization’s accounting system has this capability] and financial statements as Board Designated Operating Reserve. The Operating Reserve Fund will be funded and available in cash or cash equivalents. Operating reserves [customize as appropriate: will be maintained in a segregated bank account or investment fund, in accordance with investment policies or will be commingled with the general cash and investment accounts of the organization].

1. FUNDING OF RESERVES

[This section must be customized to reflect the authority and process selected by the organization]

The Operating Reserve Fund will be funded with surplus operating funds without donor restrictions. The governing board may, from time to time, direct that a specific source of revenue be set aside for operating reserves. Examples may include one-time gifts or bequests, property sales, special grants, or special appeals.

The [Chief Executive Officer and/or Chief Financial Officer] will identify the need for access to reserve funds and confirm that the use is consistent with the purpose of the reserves as described in this Operating Reserve Policy. Determination of need requires analysis of the sufficiency of the current level of reserve funds, the availability of any other sources of funds before using reserves, and evaluation of the time period for which the funds will be required and replenished.

1. AUTHORITY TO USE OPERATING RESERVES

[This section should be customized when creating the policy to reflect the authority and process selected by the organization. Three possible approaches are included as examples]

* 1. Approach A: The Chief Executive Officer will submit a request to use operating reserves to the Finance Committee of the governing board. The request will include the analysis and determination of the use of funds and plans for replenishment. The organization’s goal is to replenish the funds used within [add number of months] months to restore the Operating Reserve Fund to the target minimum amount. If the use of operating reserves will take longer than [indicate number of months] months to replenish, the request will be scrutinized more carefully. The Finance Committee will [either (1) approve or modify the request and authorize transfer from the Operating Reserve Fund or (2) the Finance Committee will recommend the request to the governing board].
  2. Approach B: Authority for the use of operating reserves is delegated to the Chief Executive Officer and/or Chief Financial Officer in consultation with the Treasurer and/or Chair of the Finance Committee. The use of operating reserves will be reported to the governing board at their next scheduled meeting, accompanied by a description of the analysis and determination of the use of funds, and plans for replenishment to restore the Operating Reserve Fund to the target minimum amount. The Chief Executive Officer must receive prior approval from the governing board if the operating reserves will take longer than [indicate number of months] months to replenish.
  3. Approach C: Authority for use of up to [$xx,xxx] of operating reserves is delegated to the Chief Executive Officer and/or Chief Financial Officer in consultation with the Treasurer and/or Chair of the Finance Committee. The use of operating reserves will be reported to the governing board at their next scheduled meeting, accompanied by a description of the analysis and determination of the use of funds, and plans for replenishment to restore the Operating Reserve Fund to the target minimum amount. The Chief Executive Officer and/or Chief Financial Officer must receive prior approval from the governing board for use of operating reserves in excess of [$xx,xxx].

1. REPORTING AND MONITORING

[This section should be customized to reflect the authority and process selected by the organization]

The Chief Executive Officer and/or Chief Financial Officer is responsible for ensuring that the Operating Reserve Fund is maintained and used only as described in this Policy. [Discuss the impact of market declines on maintaining operating reserves and determine if additional policy language is needed] Upon approval of the use of operating reserve funds, the Chief Executive Officer and/or Chief Financial Officer will maintain records of the use of funds and plan for replenishment. She/he will provide regular reports [define frequency] to the Finance Committee and/or governing board of progress to restore the fund to the target minimum amount.

The Chief Executive Officer and/or Chief Financial Officer will annually discuss what additional risk factors might be considered for the organization, the impact of budgeting on operating reserve levels, and any requirements with funders or chartering organizations.

1. RELATIONSHIP TO OTHER POLICIES

The Chief Executive Officer and/or Chief Financial Officer shall maintain the following board-approved policies, which may contain provisions that affect the creation, sufficiency, and management of the Operating Reserve Fund [identify policies required by the organization such as the following]:

* + Investment Policy, including risk tolerance
  + Risk Management related policies and tools to diminish risk, including Contingency or Disaster Preparedness Plan
  + Policies related to Operating and Capital Budgeting
  + Fund Development Policies

1. REVIEW OF POLICY

This Policy will be reviewed by the Finance Committee every [time period] at minimum, or sooner if warranted by internal or external events or changes. Changes to the Policy will be recommended by the Finance Committee to the governing board for approval. This policy, upon every revision hereof, must be distributed by the [insert body of designated supervision] to the following individuals/entities: [list all officers, staff, and advisors that might need a copy].The Finance Committee (the Committee) is established by [insert organization’s name] governing board to recommend financial policies, strategies, and budgets that support the mission, values and strategic plan of the organization. Its purpose is to ensure the financial health and integrity of the organization in pursuit of its mission to [insert organization’s mission statement].