



A TEMPLATE AND GUIDE FOR NONPROFITS

# Developing your Reserve Fund Policy



BDO FMA



## Acknowledgements

FMA is grateful to the work of the National Center for Charitable Statistics, Center on Nonprofits and Philanthropy at the Urban Institute, and United Way Worldwide for their work on “[The Operating Reserve Policy Toolkit for Nonprofit Organizations](#).” Much of the content in the policy template and guide has been adapted from the Toolkit and related research. For more detail, background information, and resources on reserves policy, please download the Toolkit from the link above.

**Congratulations** on drafting your organization’s Reserve Fund Policy! You’re taking an important step towards ensuring your organization’s financial resilience.

Because organizations differ widely—from budget size to business model—there’s no simple one-size-fits-all reserves policy. With a little work and help from this template and guide, you’ll be able to build a policy that fits your organization’s goals and needs.

## How to Use this Tool:

The first section of this tool is your **Reserve Fund Policy Template**, a blueprint for your organization’s policy. As you go through the template, you’ll want to customize the sections written in blue, at minimum, but there may be more sections that you want to adjust.

You’ll also see **Pro Tips** along the way that will refer you to the **Reserve Fund Policy Guide**. Each Pro Tip will provide you with a bit more background information and questions to consider to complete that section of your policy.

### GUIDE

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**Part One:  
Reserve Fund Policy  
TEMPLATE**

Customizable template for your reserve fund policy; follow the Pro Tips along the way for helpful tips and additional information in the Guide

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**Part Two:  
Reserve Fund Policy  
GUIDE**

Companion guide to the reserve policy template, organized by the Pro Tips you’ll find in the policy template

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# Part One: Reserve Fund Policy Template

## Purpose

The purpose of the Reserve Fund for **Name of Organization** is to help ensure the **long-term ability** of the organization to meet its mission. **Name of Organization** will maintain the reserve to achieve the following **objectives**:

- ▶ To create an internal line of credit to manage cash flow and maintain financial flexibility
- ▶ To enable the organization to sustain operations through delays in payments of committed funding
- ▶ To pay for one-time, nonrecurring expenses that will build capacity, such as staff development or research and development

**PRO TIP 1**  
Articulate a clear set of objectives

The Reserve Fund is **not intended to replace a permanent loss of funds or eliminate an ongoing budget gap**. It is the intention of **Name of Organization** for reserves to be used and replenished within a year.

## Definitions & Goals

**PRO TIP 2**  
Assess your risks to set your target

The Reserve Fund is defined as **funds set aside by action of the Board of Directors**. Its ongoing operation and oversight is delegated to the **Executive Committee/Finance Committee**.

### TARGET MINIMUM AMOUNT

The minimum amount to be designated for the Reserve will be established as an amount sufficient to **maintain ongoing operations and programs** for a set period of time, measured in months. The Reserve serves a dynamic role and will be reviewed and adjusted in response to internal and external changes.

The **target minimum** Reserve Fund is equal to \$\_\_\_\_\_, representing **three/six/twelve** months of operating expenses on average.

The **calculation of average monthly operating expenses** includes all recurring, predictable expenses such as salaries and benefits, occupancy, office, travel, program, and ongoing professional services. Depreciation, in-kind, and other non-cash expenses are not included in the calculation.

**PRO TIP 3**  
Define your operating expenses

**PRO TIP 4**  
Create a plan to build your fund

### FUNDING RESERVES

To establish the Reserve Fund, the **Name of Organization** Board of Directors has **designated \$\_\_\_\_\_**, of existing accumulated liquid unrestricted net assets as the beginning balance of the fund. **The remaining \$\_\_\_\_\_ is to be funded over the next \_\_\_\_ years through funding strategies incorporated into annual fundraising and budget planning.**

The amount of the Reserve Fund **target minimum will be calculated each year** as part of the annual budgeting process. This amount will be reported to the **Executive Committee/Finance Committee/Board of Directors** and included

in the regular financial reports. The Reserve Fund will be funded annually **1) with surplus unrestricted operating funds or 2) as an expense included in the organization's annual budget.** The Board of Directors may from time to time direct that a specific source of revenue be set aside for its reserves. Examples may include one-time gifts or bequests, special grants, or special appeals. Organization staff will ensure that any donations designated for the Reserve Fund will not carry restrictions that conflict with the Board's oversight of the fund as outlined in the policy.

## Investing Reserves

### PRO TIP 5 Consider investment options

The Reserve Fund will be funded and available in **cash or cash equivalent funds**, in accordance with the risk preferences, liquidity needs and investment objectives of the organization.

The reserves will be **comingled with the general cash accounts** of the organization but segregated in financial reporting.

OR

The Reserve Fund will be maintained in a **segregated bank account or investment fund**, in accordance with the organization's Investment Policy. Policies and procedures for handling deposits, reconciling statements, safeguarding access, etc. will be the same as for any of the organization's other bank accounts.

## Shortfalls

If the Reserve is and has been **less than \_\_\_% of the target reserve minimum** for two consecutive years, the Board of Directors will adopt an operational budget with a projected surplus sufficient to rebuild the Reserve Fund to its targeted reserve level over a prescribed number of years.

### PRO TIP 6 Create a plan for shortfalls

## Accounting for Reserves

The Reserve Fund will be **listed separately in the unrestricted net assets section** of the organization's statement of financial position as "Board-Designated Reserve" and the status of borrowings from the reserve will be reported in financial reports to the board.

## Using Reserves

### MANAGEMENT IDENTIFIES APPROPRIATE USE

The Executive Director and staff will identify reasons for accessing the reserve funds and confirm that the use is consistent with the purpose of the reserves as described in this Policy. As a part of this process, the Executive Director will do the following:

- ▶ Analyze the reason for the needed funds;

- ▶ Assess the availability of any other sources of funds before using reserves (e.g. line of credit); and
- ▶ Evaluate the time period that the funds will be required, and then replenished.

## BOARD AUTHORIZES USE AND MONITORS RESERVES

The Executive Director may access the reserves for purposes as outlined above, as long as sufficient funds are available to repay such usage within **three/six/twelve** months' time.

The Executive Director will submit a request to the **Treasurer/Finance Committee/Executive Committee** in writing, which will include the analysis and determination of the use funds and plans for replenishment (as outlined above). The **Treasurer/Finance Committee/Executive Committee** will approve in writing or modify the request and authorize transfer from the fund. Email is an acceptable form of notification and acknowledgment.

**PRO TIP 7**  
Establish  
strong  
controls

## BORROWING FROM RESERVES

Any funds borrowed from the Reserve Fund for **longer than three/six/twelve months will be paid back through a prescribed repayment schedule**. The Executive Director shall request approval of any such usage and the proposed repayment schedule from the **Board of Directors/Executive Committee**. If approved, such disbursement shall be reported at the next full board meeting. At any time that a borrowing from the Reserve is outstanding, the status of the borrowing and payments made will be reviewed at Board meetings.

A **draw-down** from the fund that cannot be replaced in the timeframe established above **must be approved by a majority of the Board**, either by a majority of the votes of quorum present at a regular Board meeting, or by a two-thirds majority of the Board if such vote is conducted by other means. A record of such action will be maintained and be made a part of the Board meeting minutes.

## REPORT AND MONITOR USE OF FUNDS

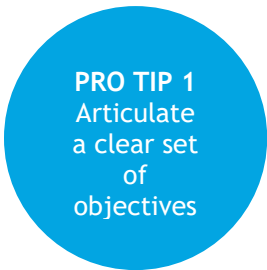
The Executive Director is responsible for ensuring that the Reserve Fund is maintained and used only as described in this Policy. Upon approval for the use of Reserve, the Executive Director and finance staff will maintain records of the use of funds and plan for replenishment. **Name of Organization** will **provide regular reports** to the **Board of Directors/Executive Committee** of progress to restore the fund to the target minimum amount.

## Review of Policy

**PRO TIP 8**  
Review and  
adapt your  
policy

This policy will be **reviewed every year/every other year at minimum**, by the **Executive Committee/Finance Committee**, or sooner if warranted by internal or external events or changes. Changes to the Policy will be recommended by the **Executive Committee/Finance Committee** to the Board of Directors.

# Part Two: Reserve Fund Policy Guide



In the first section of your Reserve Fund Policy, you'll outline the purpose and objectives of the fund. While the purpose language can be general, you'll want to take some time to **reflect on why your organization needs an operating reserve and identify a few specific objectives**. Here are some sample considerations and related objectives to help guide your thinking. The objectives you choose should reflect the particular considerations of your organization.

Consideration		Objective
Your organization is entrepreneurial and innovative, which from time to time requires it to incur unexpected costs	→	To pay for one-time, nonrecurring expenses that will build capacity or provide long-term benefits
Your organization faces seasonal shortfalls in revenues/increases in expenses	→	To provide an internal source of funds during seasonal deficits
Your organization is located in an area that experiences significant natural disasters	→	To provide an internal source of funds to respond during an unexpected natural disaster

A key first step to building a Reserve Fund is determining the appropriate amount of reserves to have on hand at your organization. Most organizations set the target minimum as a **fixed number of months of operating expense or percentage of annual operating expenses**. There's no standard formula to determine the right amount, but you can start by evaluating the revenue and spending risk factors that are specific to your organization.

All organizations bear some inherent risk in their business models. Typically those risks relate to revenue streams or spending patterns:



► **Revenue risk factors** include any factors that could make your revenue volatile or inconsistent.

► **Spending risk factors** include any factors that could make it difficult for your organization to adjust or scale back expenses.

Follow the **three-step instructions** on the next page to determine how your organization's business model and inherent risks will inform the target reserve minimum you set.

## STEP 1: LIST THE RISK FACTORS YOUR ORGANIZATION FACES<sup>1</sup>

Using the **examples below as a guide**, list out in separate columns the potential revenue and spending risk factors facing your organization.

### Example Revenue Risk Factors

Your organization relies on just a few funders for 70 - 90% of its revenue

Your community is facing an economic crisis and individual contributions are trending downwards

Your foundation and government grants do not provide general operating support

### Example Spending Risk Factors

Your organization is the only disaster relief provider in an area susceptible to hurricanes

Your organization could not easily downsize in a budget crisis without sacrificing services

Your organization has several multi-year spending/funding commitments

## STEP 2: ADD UP YOUR RISK POINTS

After you've written out the risk factors, add up the risks from each column, **giving each risk a value of one "point."** If you think that a risk is greater in magnitude—this could be because you believe it's more likely to occur or would be more impactful than the others—assign that risk a greater point value using your best judgment.

## STEP 3: USE THE DECISION MATRIX

Take the total number of points you get for spending and revenue risks and **use the decision matrix** below to determine how many months of operating expenses your organization should aim to have in its reserves. For example, an organization with 6 points in revenue risks and 3 points in spending risks would aim to have between 3 and 6 months of operating expenses in their reserves.

		Revenue Risks	
		1-5 points	5+ points
Spending Risks	1-5 points	3 months operating expenses	3 - 6 months operating expenses
	5 + points	3 - 6 months operating expenses	6 or more months operating expenses

<sup>1</sup> This step-by-step guide has been adapted from the Operating Reserve Balance Decision Matrix and related sections in the Operating Reserve Toolkit. FMA has created a 1-5 and 5+ point rubric for tallying risks in place of the Toolkit's narrative references to organizations with "low," 2 and 7, or "several" risk factors.



**PRO TIP 3**  
Define your  
operating  
expenses

Once you know how many months of operating expenses you need, you'll want to make sure you **know what is and isn't included in your average operating expenses**. For most organizations, this will include all recurring, predictable expenses like salaries and benefits, rent, travel, and program. It won't include depreciation and in-kind expenses.

You'll want to take a minute to consider whether there are any expenses specific to your organization that should be factored in here. For example, you might not include pass-through programs or capital purchases in expenses for your reserves calculation.

**PRO TIP 4**  
Create a  
plan to  
build your  
fund

Many organizations will establish their reserve fund before having the cash on hand to meet their target minimum amount. Those organizations will want to **plan out the incremental payments and schedule for reaching the target minimum** and include it in their policy.

There isn't one funding plan for every organization, but here are some considerations you might want to address:

- ▶ Is there **cash** your board can set aside to start?
- ▶ Do you have a funder who is or could be interested in making a **special, one-time grant** to support your reserves?
- ▶ **How big of a surplus can your organization budget** this year and in the next few years to fund your reserve?
- ▶ Are there **creative fundraising strategies** your development team can employ to fundraise for the reserve?

If your organization does receive a special, designated gift for its reserves, you'll want to pay close attention to any **restrictions associated with the gift**. It's not uncommon for nonprofits to accept a donation designated for reserves that winds up being restricted in ways that conflict with its reserve policy. This can create extra headaches for the accounting and management of reserve funds. To avoid these scenarios, suggest to your donor or funder that their gift be restricted for your organization's reserves but that your reserve policy solely restricts use and governance.

**PRO TIP 5**  
Consider  
investment  
options

Among the many management questions you'll want to address in your policy is **how and where to invest your reserves**. Some organizations choose to open separate investment accounts for their reserve funds to grow their reserves and create an additional measure of control. Keeping your reserves in a separate account can **prevent any misuse of or borrowing** against reserve funds that would otherwise be comingled with the organization's cash accounts. That being said, your organization is not obligated to open a separate account.

If your organization chooses to open a separate investment account for its reserves, you'll want to **make sure to set an investment policy** if you don't already have one. Investment policies help organizations take into account their risk preferences, growth targets, and short-term cash needs when making investing decisions. Most reserves are invested in cash and cash-equivalent funds but you'll want to discuss your needs with your board to make the right decision. For more information on investment policies and options, please refer to the "[The Operating Reserve Policy Toolkit for Nonprofit Organizations](#)" or a primer on Investment Policies from the [Council of Nonprofits](#).

**PRO TIP 6**  
Create a  
plan for  
shortfalls

Down the road your organization may face a shortfall, when your actual reserves drop below your target reserves. This could be because you tapped into your fund at some point or because your operating expenses increased and you weren't able to meet a surplus budget target. Whatever the reason may be, you'll want to **plan for how your organization will replenish its reserves during a shortfall.**

Typically an organization will create a plan to remedy a shortfall only **after two years** of not meeting its target minimum. For your policy, you'll need to decide how much of a shortfall merits a board response. Most organizations will execute a replenishment plan when **they reach 50 to 75% of target reserve levels.** Depending on your risk factors, your board may want to adjust that level.

Reserves can only guarantee the long-term financial stability of an organization if they are carefully managed by your board and staff. In the **Using Reserves** section of your policy, you'll **outline the requirements, controls and procedures for using your reserves.** In other words, what happens after your organization's executive director identifies the need to use their reserves?

**PRO TIP 7**  
Establish  
strong  
controls

To consider as you set your controls:

- ▶ Most organizations allow the executive director to access reserves with just committee or treasurer approval when the **amount is below a defined limit** and/or the anticipated **payback period is within a set number of months.**
- ▶ When requests are above those thresholds, your executive director would need to seek out full board or executive committee approval.
- ▶ The thresholds that you set here should **take into account your risk factors** while at the same time **ensuring ease of access** to the reserve. Reserve funds would not be useful to organizations if they were just off-limits bank accounts, so you don't want to make the requirements too onerous.

**PRO TIP 8**  
Review and  
adapt your  
policy

Your reserve fund policy is a living document that should continue to reflect the circumstances facing your organization over time. Operations, programs, risks, and budgets can all change, and so your policy should adapt as well. For this reason, we recommend that you **require regular review of your policy** by your board or overseeing committee, when changes can be recommended and approved.

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BDO FMA exists to build a community of individuals with the confidence and skills to lead organizations that change the world.

As of 2021, FMA has become a part of BDO USA. With this new relationship, we augment FMA's empathetic approach to meeting clients where they are with the significantly broader range of accounting, advisory and consultative services for which BDO USA is known.

BDO FMA provides expert fiscal management staff and capacity-building technical assistance, including organizational consultation and training, using an approach tailored to individual organizations and their specific needs. BDO FMA serves nonprofit organizations and funders, empowering them to effectively manage their resources, improve operations, and position themselves for stable, long-term growth.

The following is an outline of services that BDO FMA can provide:

Our Services	
<b>Fiscal Infrastructure Review</b>	Assistance with developing the internal fiscal staffing, systems and processes to support the financial complexity of your programs and operations.
<b>Financial Advisory Services</b>	Support to your organization's leaders in understanding and making decisions on critical financial issues, including business modeling, budgeting, cash management, creating dashboards, and strategic planning.
<b>Internal Controls Consulting</b>	Assistance with defining staff roles and responsibilities to ensure internal controls that protect your organization's resources and meet contemporary auditing standards. We can also work with you to document this control structure in a customized fiscal policies and procedures manual.
<b>Accounting System Implementation</b>	Designing, installing, and training on the most widely used accounting software programs available for nonprofit organizations.
<b>HR Consulting</b>	Help with minimizing risk by ensuring policies, documents and practices are compliant with government regulations, create efficiencies by implementing best practices through available technology and achieve excellence by hiring and retaining top quality fiscal staff.
<b>Outsourced Fiscal Management Services</b>	Management of the full range of your organization's accounting and financial management tasks on an outsourced basis, including providing support for the annual financial audit.



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