

## Rebuilding Your Reserves

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## Learning Objectives

At the end of this session, you will:

- Be able to speak to the importance of financial reserves to the long-term viability of your organization with confidence.
- Learn how to strengthen your organization's existing financial reserves policies.
- Leave with ideas about how to rebuild your reserves.

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# Why Nonprofits Need Reserves

- To meet unanticipated financial contingencies
- To bridge cash flow needs
- To maintain financial solvency
- To weather economic cycles
- To fund expected opportunities
- To fund unexpected opportunities
- To drive capacity for new debt to fund major capital needs



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# June 2009 MCN Current Conditions Report

Organization Size	Have Available Reserves	Have a Line of Credit Available	Anticipate a Cash Shortfall
Small	73%	18%	27%
Medium	78%	35%	24%
Large	91%	51%	16%
Extra Large	94%	54%	14%

"To deal with recurring budget deficits, we cut expenses and pursued new revenue at this time last year. We managed to stabilize and pay off line of credit. But the organization **has no cash reserve** and does not yet know what government and foundation cuts are coming."

~ A housing organization for homeless youth



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Available at [www.mcn.org/outlook](http://www.mcn.org/outlook)

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## Same Report...Six Months Later

Organization Size	Have Available Reserves May 2009	Have Available Reserves December 2009	Change (±%)
Small	73%	62%	∓ 11%
Medium	78%	73%	∓ 5%
Large	91%	74%	∓ 17%
Extra Large	94%	69%	∓ 25%

### HOW MUCH DID THEY HAVE?

34% had less than one month / 18% had none / 6% had a reserve fund but depleted it in 2009

### WHAT ELSE?

24% anticipated using reserves in 2010...and those with minimal or no reserves were more likely to have cut budgets, eliminated staff positions, and reduced wages and benefits...and were also less likely to have been able to increase services to respond to growing demand.

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Available at [www.mncn.org/outlook](http://www.mncn.org/outlook) and <http://www.nonprofitsassistancefund.org/blog/>

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## July 2009 Urban Institute Study

### AGE DOESN'T MATTER

"Sixty-five percent of young organizations—defined as no more than five years old—had operating reserves that would cover less than three months of operating expenses, and nearly one-third of these young organizations have no operating reserves. Older organizations tend to be somewhat stronger, but even among those that are more than 30 years old, nearly 50 percent had low operating reserves."

### SIZE DOESN'T MATTER

"More than half of organizations in every range of expenses reported operating reserves of less than three months."

### MISSION DOESN'T MATTER

"More than half of all organizations across all missions, except for environment and animals, had operating reserves of less than three months."

### REVENUE BASE MAY MATTER

"Two categories had significantly more organizations with less than the suggested minimum reserves—those with revenue primarily from government grants or program services."

### HOW DID THESE ORGANIZATIONS FARE THE LAST RECESSION?

Those that filed an IRS Form 990 in 2000 but did not file in 2006 because of organizational closure or contraction reported reserves **ONE-THIRD THE LEVEL** of those organizations that survived.

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Available at [http://www.urban.org/uploadedpdf/411913\\_dc\\_nonprofit\\_reserves.pdf](http://www.urban.org/uploadedpdf/411913_dc_nonprofit_reserves.pdf)

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## Nonprofit Operating Reserves Initiative

- Ad hoc group of nonprofit finance professionals
- Center on Nonprofits and Philanthropy at the Urban Institute serves as secretariat
- December 2008 white paper recommendations:
  - Set a minimum operating reserves ratio.
  - Tailor your policy to your organization's needs and funding structures.
  - Recommendation = **no less than three months** of operating expenses.
  - Define how the operating reserves will be invested as part of your organization's overall investment policy.
  - Decide how often to measure and report.
  - Discuss how your operating reserves will be replenished if you need to dip into your reserves or they fall below the minimum threshold.

7 Available at <http://www.nccs2.org/wiki/images/3/3c/OperatingReservesWhitePaper2009.pdf>

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## Why You Need Them Today More Than Ever

In conclusion, both intuition **AND** evidence suggest that...

**Many nonprofit organizations have inadequate reserves and have suffered over the past 18 months because of it...**

**...and while many organizations are understandably focused on a relatively short time horizon...**

**...there is an emerging interest in addressing the question of financial reserves more prudently...**

**...to help you emerge from this current economic crisis well positioned to withstand the next challenge that arises.**

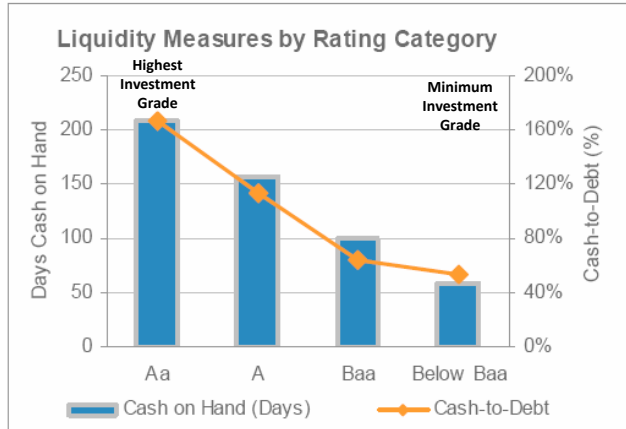
Adapted from "Maintaining Nonprofit Operating Reserves," The Nonprofit Operating Reserves Initiative Working Group, December 2008

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# Health Care Reserve Targets: Rated Credits



**Definitions**

Cash on Hand (Days)

$(\text{Unrestricted cash and investments} \times 365) / (\text{total operating expenses} - \text{depreciation and amortization expenses})$

Cash-to-Debt (%)

$\text{Unrestricted cash and investments} / (\text{long term debt} + \text{short term debt})$

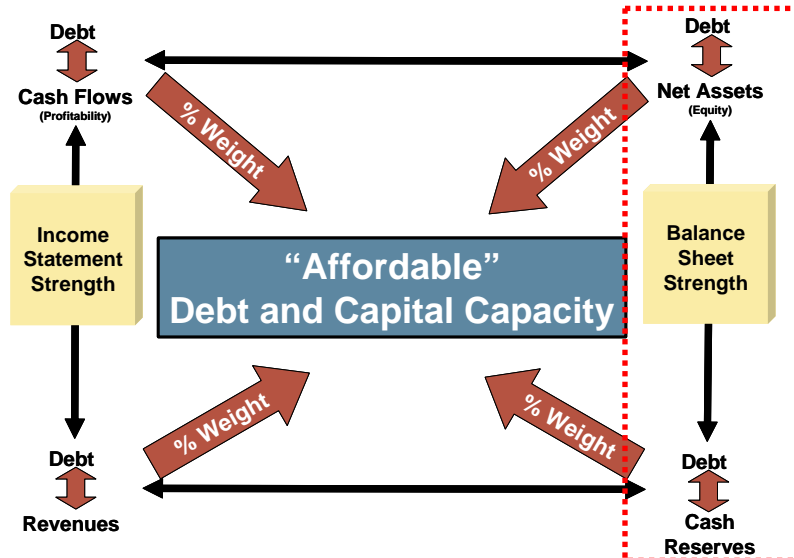
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Source: August 2009 Not-for-Profit Healthcare Medians for FY 2008. Moody's US Public Finance

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# Health Care: Emphasis on Strength...and Balance Sheet Recapitalization



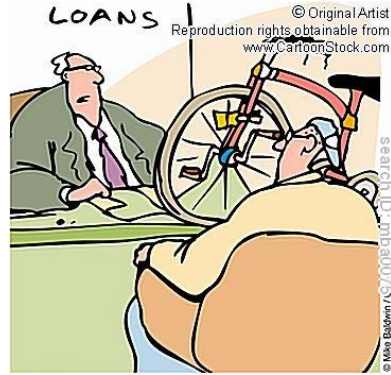
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# Who Cares About Our Reserves?

- Organizational leaders
- Board members
- Creditors
- Lenders
- Rating Agencies
- Customers
- Contributors
- A lot more people than you'd think when things go wrong...



"Yes, I suppose it does clatter when it rolls. Do you have any other collateral?"

# What We Are Seeing and Hearing



April 2009

**Moody's Developing New Liquidity Ratios for U.S. Universities, Hospitals & Other Not-for-Profits**

Current Public Disclosure is Inadequate



**Review says financial reserves are too low to assure long-term future**



**Campus Use of Financial Reserves Questioned**

**The Washington Post**

**Nonprofits Imperiled By Low Reserves**

In Tight Times, Lack of Cushion Can Mean Failure

## FINANCIAL NEWS

**Stress tests measure reserves needed to cover 2011 losses**

Dow Jones Newswires



**Pawlenty proposes \$2.7B unallotment**

## HOW ARE RESERVES IMPACTING YOU?

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## Common Questions

- What definition should we use?
- How much is enough?
- How much is too much?
- What sources can fund reserves?
- What should our policy include?



**WHAT QUESTIONS DO YOU HAVE?**

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# Risk is...Risky...What to Watch Out For

- Segregate current risks from hypothetical ones...**conversely, changes in strategic direction warrant reassessment.**
- Know which risks should be mitigated through insurance and / or litigation rather than reserves.
- Separate reasonable, ongoing risks to your from singular catastrophic events that could jeopardize entity-wide solvency.
- Beware of double-counting.
- Address the nuances of precedent relationships between risks when analyzing for aggregate financial reserve impact.



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## Referenced Resources

[http://www.nccs2.org/wiki/index.php?title=Nonprofit\\_Reserves\\_Workgroup](http://www.nccs2.org/wiki/index.php?title=Nonprofit_Reserves_Workgroup)

<http://www.mncn.org/outlook>

<http://smartgivers.org/AccountabilityStandards09.html>

<http://www.nonprofitsassistancefund.org/blog/>

[http://www.urban.org/uploadedpdf/411913\\_dc\\_nonprofit\\_reserves.pdf](http://www.urban.org/uploadedpdf/411913_dc_nonprofit_reserves.pdf)

