

What Is The Right Amount To Keep In Reserve?

All nonprofit organizations need to have a “rainy day” fund they can tap into in an emergency. But how much rain do you need to be ready for? Determining the appropriate amount of your organization’s reserves can be tricky.

A reserve fund is what keeps your work moving forward after a sudden financial hit, such as the loss of a long-time supporter or a global disaster that attracts donor dollars at the expense of your cause. It should be of sufficient size and easily accessible. The bonus of building a healthy reserve is that, if you don’t need to tap it in an emergency, you might be able to use it to invest in your organization.

Determining the Magic Number

Every nonprofit will have a different answer to the question “How much money should be in our reserve?” You’ll need to base the amount on how much it costs to run your organization and the types of scenarios you must be prepared for.

Many nonprofit organizations determine what it costs each month to keep their organization afloat, and then multiply that amount by a specific time period to come up with their reserve amount. In this scenario, an adequate reserve might be equal to six months, one year or even three years of operating expenses. Generally, the steadier your cash flow (meaning you have regular and predictable expenses and a smooth influx of cash), the lower your reserves need to be. As volatility increases, so should your financial cushion.

In addition to covering day-to-day cash needs, a reserve can provide a way to finance unexpected problems or opportunities. For instance, the reserve can cushion a budget deficit created by a fundraising event or conference that falls short of financial expectations.

If your offices no longer meet your needs, consider setting aside a greater reserve amount so you’re prepared to move or build a new facility. If you plan to offer new services in the future, you can use a reserve to help offset startup costs.

In these cases, your board should brainstorm the possible scenarios your group might find itself

According to the *Journal of Accountancy* (June 2007), an IRS compliance check of tax-exempt organizations found excessive compensation to executives and officers resulting in tens of millions of dollars in penalties. More than 30% of the 1,223 organizations that received letters by the Exempt Organizations Office of the IRS amended their Form 990 as a result. The IRS then selected 782 organizations to be examined. Forty people in 25 organizations were assessed penalties totaling more than \$21 million. Besides lavish salaries and bonuses, the examinations uncovered payments for meals, gifts, automobiles and even vacation homes not reported as compensation.

IRS Section 4958 imposes an excise tax of 25% on an “excess benefit” provided by an exempt organization to a person who exercises, or is in a position to exercise, substantial influence over the organization’s affairs. If the excess benefit is not corrected within the tax period in which it is initially assessed, the penalty increases to 200%.

An excess benefit is one that exceeds the value of a person’s service to the organization. Section 4958 also imposes a 10% tax on excess benefits to officers, directors or trustees of organizations.

The organizations were chosen to be examined based in part on the compliance checks, which in turn were selected because of missing information on Form 990 or other red flags, so the findings don’t reflect a representative sample of organizations, the IRS noted. Even so, they suggest that significant reporting issues exist, the IRS said, and it recommended educating public charities about Section 4958 .

in over several years' time, estimate the costs and determine ways to set aside cash into a reserve for coverage.

Stashing the Cash

After calculating a reserve figure and determining a way to allocate part of your budget to it, make smart decisions about what to do with the reserve so your funds are secure, earn interest if possible and are accessible.

There are many types of investment vehicles to consider, so do your homework. You can use interest-bearing checking or savings accounts, certificates of deposit, Treasury bills, bond funds, money market accounts and numerous other vehicles that might be a good match for your situation.

There are pros and cons to all these accounts, and if you don't pay attention to the details, fees and penalties can chip away your hard-earned reserve. Be aware of minimum balance requirements and penalties if you drop below the balance threshold as well as fees for drawing on the funds. Another area to watch for is availability. Will you have access to your reserve when you need it?

Is "Too Much" Possible?

When you're diligently allocating part of your monthly budget to your reserve, earning a bit of interest and not taking any money out, eventually you'll find yourself with more than the amount you were shooting for. Congratulations! You now have the ability to invest some of that money into your

organization. The goal is not to grow the biggest reserve you can; it's to grow the biggest reserve you need.

In fact, amassing more than several years' worth of operating expenses may raise a red flag with organizations like the American Institute of Philanthropy, Charity Navigator, and the Better Business Bureau's Wise Giving Alliance, which provide guidance to consumers on charities and charitable giving, as well as the IRS.

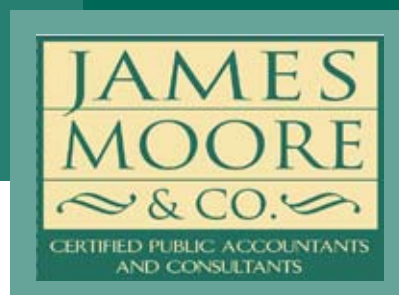
Donors and members may agree that having a safety net is prudent, but at a certain point they want to see their dues and other monies invested in the purpose of the organization.

Nonprofit organizations with significant endowments are potentially vulnerable on the issue of excessive surplus accumulation. However, as a practical matter, this issue appears to be pursued by the IRS only where the organization is controlled by one person or a few related persons whose actions may be motivated by personal rather than

charitable objectives. The bottom line is that a nonprofit organization must be able to show that the retention of funds for investment purposes is reasonable in light of all the facts and circumstances.

Shelter From the Storm

Having a rainy day fund is just good business. If your organization doesn't have a policy for and the means of funding a reserve account, start making plans today. Those storm clouds could roll in when you least expect them.



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