

Demystifying Reserve Funds

Presented to you by:



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Speaker Bios



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- Co-founder & CEO @ Enkel Backoffice Solutions
- Works closely with over 100 NPOs and Charities to manage their day-to-day bookkeeping and provide accurate financial reporting



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- Director of Service Delivery @ Enkel Backoffice Solutions
- Over 15 years of experience specializing in assurance, advisory and tax compliance for not-for-profit organizations



About Enkel

- Based in Vancouver, BC
- Worked with over 100 NPOs and Charities across Canada
- Provides outsourced bookkeeping and accounting services



Bookkeeping



Payroll



Accounts
Payable



Accounts
Receivable



Controllership

What we will be covering:

- Common Misconceptions about Reserve Funds
- Types of Reserve Funds and Challenges
- How to Establish a Reserve Fund
- How to Determine the Right Amount of Reserve
- Best Practices for Managing your Reserve Funds
- External Audit Considerations





What is a reserve fund?

A 'Reserve Fund' consists of assets (generally liquid assets) set aside by the organization to provide funding for a planned future need or a cushion for unplanned events or expenditures.



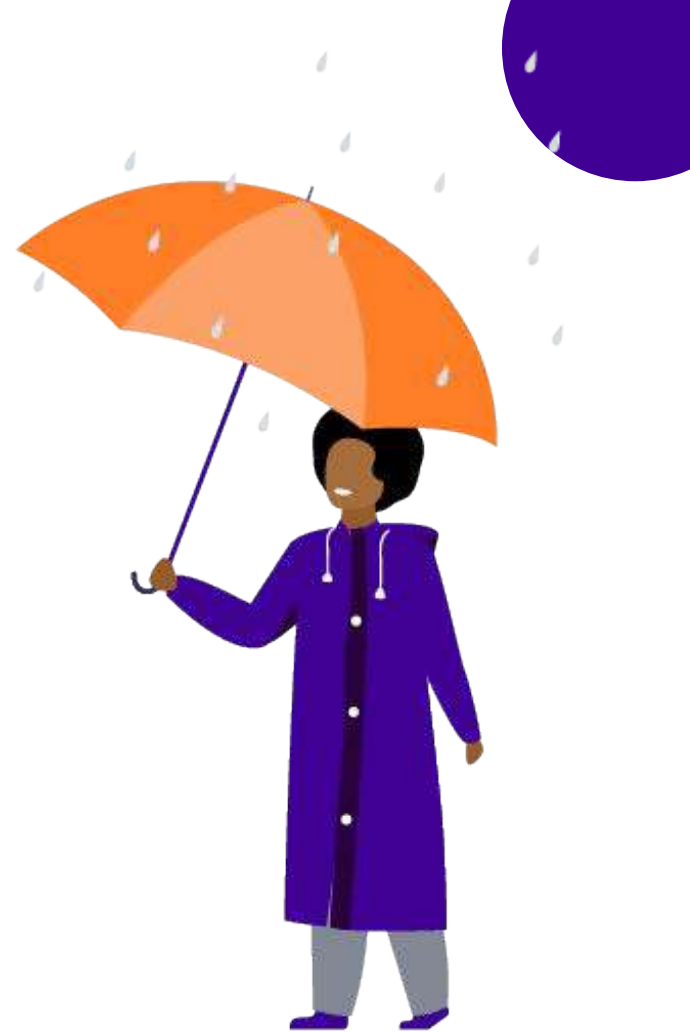


**Why should your
organization have
reserve funds?**

Reason 1.

To weather the rainy days

Does your organization have enough resources to continue operating in the event of a pandemic, natural disaster or economic downturn?

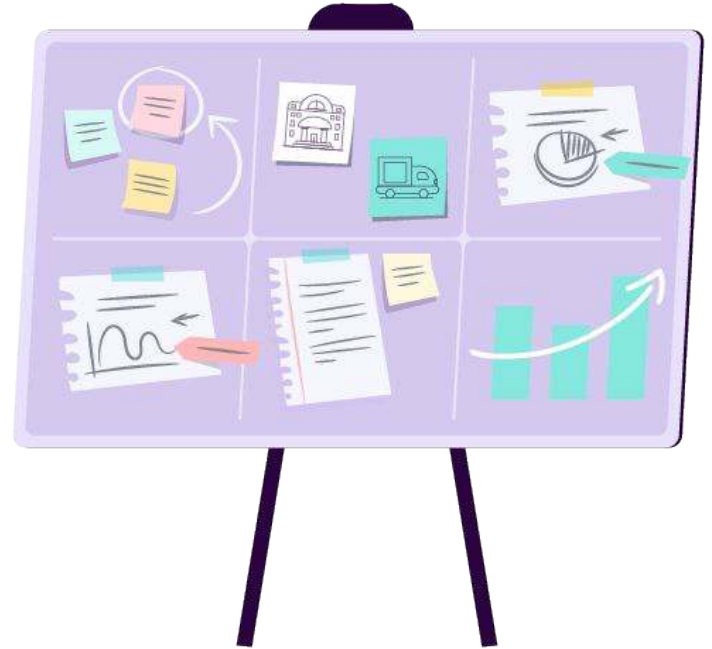


Reason 2.

To plan for the long-term

Are there assets that will need to be replaced?

Could there be significant cash outlays required to evolve or maintain operations?



Reason 3.

To plan for new programs

Could there be a significant cash outlay required to start these programs?

How do you remain relevant as socioeconomic and demographic factors are changing?

Do you need to adapt your programs to a digital format?





Common Misconceptions About Reserve Funds

Misconception 1.

Having reserves will hurt our fundraising

- Certain grantmakers might not provide funding if the organization has a reserve

In Reality.

Having reserves can boost your fundraising

- Reserve funds are an indicator of responsible financial management
- Funders should have more confidence in organization's ability to carry out mission

Misconception 2.

Endowment funds are the best route to financial sustainability

- Provide continuous financial support for a specific component of the organization's activities
- Activities could be as broad as supporting the operations of the organization, or as narrow as providing scholarships to a specific course

In Reality.

Endowment funds can pose problems in the long term

- Risk of endowment forcing organization to remain focused on an activity that they wish to de-prioritize in the future
- Market volatility can lead to unexpected changes in investment returns
- Additional long-term governance and stewardship required by management or leadership



Misconception 3.

**An unrestricted reserve is
a bad thing**



In Reality.

**Unrestricted reserves
allow for organization to
react quickly to changing
circumstances**

Types of Reserve Funds



Endowment
Funds



Internally Restricted
Funds



Externally Restricted
Funds



Endowment Funds



Endowment Fund Challenge #1.

Building Trust

Trust is a critical factor in donor decision making

Solutions:

1. Consider having your financial statements audited
2. Ensure that you have a reputable experienced treasurer
3. Communicate with stakeholders on a regular basis
4. Manage public perception & avoid controversies
5. Plan on building long-term relationships with potential donors



Endowment Fund Challenge #2.

How Funds are Invested

- Decisions are hard due to record low interest rates and market volatility
- Donors want the money to last over the long term
- Investments often need to be made within guidelines provided by donor

Solutions:

1. Consider the risk vs. reward when making investment decisions
2. Work with a reputable investment advisor

Fund Management

1.

Find an investment advisor or a number of investment advisors with credibility

2.

Work with larger, trusted institutions



Investment Allocation Considerations

Risk

- What can the organization handle in the short-term and long-term?
- What is the risk profile of your donors?
 - Future donors may be more or less risk averse and could make donation decisions based on the investment history and profile

Fees

- Are you getting the best value for your money?
- Is your portfolio manager able to report back at the level of detail required by your stakeholders?



Endowment Fund Challenge #3.

Fluctuating Investment Returns

- Impacts your organization's ability to plan for the long term
- Can your organization handle some near-term risk for greater long-term returns?
- Misconception that absolute risk mitigation is always required

Solutions:

1. Forecast your organization's cash flow needs to understand your investment time horizon
2. Short term cash needs should be easily accessible and be in lower risk liquid assets
3. You can also use unrestricted or in some cases, internally-restricted funds, to mitigate the impact of fluctuating investment returns



Internally Restricted Funds

*Funds with restrictions imposed by the board
through a board resolution*

Types of Internally Restricted Reserve Funds



Operating Reserves

- To cover the organization's operating expenditures in the event of unexpected funding shortfalls



Capital Reserves

- To save up for future capital purchases such as new buildings, new equipment or major renovations



Other Reserves

- Depending on the requirements of your organization



Internally Restricted Fund Common Challenges

1.

Building Trust With Board

- Management needs to **provide board with the right data** (historical or forecasted) **to set aside the right amount of money** to achieve the specified purpose

Solution: Make sure you are able to produce accurate financial results on a consistent basis

2.

Achieving Specified Purpose

- Board needs to believe that the specified purpose is achievable
- Need to ensure clarity and alignment in goals & objectives

Solution: Meet with your board regularly to review financials and discuss if the balance in each internally restricted fund is sufficient



Externally Restricted Funds

Funds with restrictions imposed by a funder or donor



Externally Restricted Fund Common Challenges

1.

Agreeing on specifics with funder

Solution: Define and set goals for the funds

2.

Administrative costs to deliver the program

Solution: Add a provision for administrative costs to administrative budget

3.

Funder/Donor Reporting

Solution: Know what your organization can commit to and plan in advance



Best Practices for External Reporting

Know what your organization can commit to

Before talking to your donor about the reporting requirements

- You need to have an idea of your organization's reporting capabilities
- Talk to your bookkeeper to find out...
 - What can you share?
 - Can you track funds spent for the initiative for a specific donor separately?
 - What is the reporting frequency?

Plan in advance

After finalizing the reporting requirements

- Plan for your reporting requirements in advance
- Provide the donor with a sample report at the outset
- Figure out if you need an audit or review engagement



How to Establish a Reserve Fund

How to Establish a Reserve Fund

For Endowment Funds

- Reach a binding agreement with the 3rd party
 - Discuss the short term and long term terms of the arrangement
 - i.e., What should happen to the funds when the organization winds down
OR Can the organization move a % of the principal over to unrestricted funds after 10 years?

How to Establish a Reserve Fund

For Internally Restricted Funds

- Through board resolution that clearly outlines the purpose of the funds
 - Example: We are going to put aside X amount of funds to purchase a new building in 10 years.

How to Establish a Reserve Fund

For Externally Restricted Funds

- Reach a binding agreement with the 3rd party
 - Ensure you have a thorough understanding of the terms of the agreement and your reporting requirements
 - Example: The funds are to be used solely for nutritious hot lunches for all the elementary school students in East Vancouver.

How to Establish a Reserve Fund

For Internally Restricted Operating Reserve Funds

- Through board resolution and a reserve fund policy that clearly outlines the:
 - Purpose of the funds
 - Definition of the reserve fund, intended use and calculation of target amounts
 - Assignment of authority for using the reserve fund
 - Responsibilities for reporting reserve fund amounts and use of reserve funds
 - Other specific policies regarding the investment of reserve funds

What is the “right” amount to reserve?

- Is it having sufficient operating cash flow for 1 month, 2 months, 2 years?
- Or enough to wind down the organization?
 - Board members are personally responsible for the costs if the organization does not have enough resources to wind down the organization.
- Perform Scenario Planning to forecast your organization’s future needs



How to “Top up” your Reserves

For Internally Restricted Funds

- Through a board resolution or policy

Example: We want our operating reserves levels to equal to 3 months of our budgeted operating expenditures. As the organization grows, you’d expect for expenditures to increase and as a result, additional unrestricted amounts will need to be restricted.

For Endowment Funds & Externally Restricted Funds

- Request for additional funding from funder



Best practices for managing your reserve funds





Tip 1.

Use class tracking functionality in your accounting software

A way of capturing revenues and expenses relating to your reserve funds

Tip 2.

Use separate bank accounts & investment accounts

Easier to track interest income and expenses in relation to the specific fund

Tip 3.

Have a central document that summarizes the restrictions and reporting requirements associated with all funds

To ensure management and staff clearly understand the restrictions associated with each fund at all times



Tip 4.

Review the fund transactions on a monthly basis

To ensure that the funds are used in accordance with the restrictions

Tip 5.

Making sure that everyone on your team is on the same page

Every staff member on your team should have a clear understanding of:

- How the various funds can be used
- How the funds are to be tracked

Repurposing Restricted Funds

Repurposing Internally Restricted Funds

- Requires a board resolution

Repurposing Externally Restricted Funds

- Requires consultation with the donor or funder
- **Ask before you do**



External Audit Considerations

1.

Ensure all documentation is available and maintained including original agreements and schedules supporting the changes in the balance

2.

Board resolutions should be documented and should be completed before year end

3.

Consult with your auditor on major strategic and structural changes to avoid adverse consequences such as a “Going Concern” note or unexpected contingent liability



Final Thoughts

- COVID-19 has forced NFPOs to take a hard look at capitalization and liquidity
- Reserve funds are a tool that organizations can use to manage and plan for the long-term, as well as unforeseen future challenges
- Engage in discussions with your stakeholders about your ideas
- Ensure your accountant understands what these funds are and how they need to be tracked and reported

Questions?



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Download the free list

Key Considerations For Your Organization's
Internally & Externally Restricted Funds



Download link: <https://bit.ly/3nMzsIP>

