

Reserves Matrix

Reserves for Not-for-Profit organisations are critical to ensure unexpected financial events can be weathered without causing undue stress. One question often asked by Not-for-Profits is: how much or how many months should I hold in reserve? Below are some questions that can be used to determine what the reserve might need to cover and to provide guidance on the target reserve level for the organisation.

This matrix should be used as a guide only. We recommend you seek specific advice to determine an appropriate level of reserves for your organisation.

RANK FROM 1 TO 5

1. Is your revenue stream volatile or stable i.e., do you rely more on one-off donations or have longer term funding contracts? 1 Volatile 5 Stable	<input type="radio"/>
2. In the short to medium term, do you expect to run a deficit budget due to rising costs or diminishing revenue? 1 Deficit 5 Surplus	<input type="radio"/>
3. Do you have significant upcoming asset replacement/upgrade costs or expect significant maintenance costs in the short to medium term? 1 Significant assets will need to be replaced 5 No significant assets require replacement	<input type="radio"/>
4. Do you have significant operating expenses on contractual fixed terms that might attract early termination costs if a change of priorities occurs e.g., long term lease on building? 1 Significant fixed contractual expenses 5 Insignificant fixed contractual expenses	<input type="radio"/>
5. Do you have a significant number of permanent employees relating to contracts that could end with a short notice period? 1 High number of staff 5 Low number of staff	<input type="radio"/>
TOTAL	<input type="radio"/>

WHAT DOES MY SCORE MEAN?

Once you add up the scores then the higher the number (the closer the total is to 25) then potentially the lower number of months or amount required as cash or contingency reserves. This is not to diminish the importance of a reserve - even if you rank with a high score - as there is still a chance that reserves may also be needed to cover political, financial, or compliance risk within the sector and industry.

The lower the score (the closer the total is to five) suggests that there could be numerous significant costs that need to be covered. This means it might be prudent to try to hold higher cash or contingency reserves to cover unexpected costs or events including something as simple as receiving revenue later or less than expected.

Once you understand what you might need a reserve to cover, based on internal business plans and analysis, it should be included in your reserves policy so that from a strategic viewpoint, minimum values can be set. This in turn provides reassurance, both internally and externally, that the organisation is aware of what it needs to thrive through either unplanned future events or planned future events that will need a minimum level of investment to occur. We recommend updating this process annually as part of budget setting.

HOW CAN I REACH MY RESERVE TARGET?

We recognise that even with a minimum reserve target set, it can be a struggle to reach and maintain the target figure while trying to provide for the day-to-day operations. Often the only way to build the minimum reserve target amount up is to add to the balance intentionally and over time.

This means you need to consider how you can work towards setting amounts aside for the sole purpose of contributing towards the target reserve - apart from budgeting for an operating surplus through day-to-day operations, which is one of the best ways to increase reserve amounts.

Potential methods could include:

- Adding a line item in your budget designated as contributing to reserves so it becomes part of your budget process.
- Ensuring any interest received is used in addition to reserves i.e., contributes to the surplus, along with ensuring cash balances are monitored and invested to get the best return.
- Including windfall or one-off amounts outside of the budget as a contribution to the reserve balance.

The benefit of holding reserves at an appropriate target level plays a key role in ensuring the ability to weather a range of possible events.

To learn more about reserves, view our article [bdo.nz/en-nz/insights/not-for-profit/not-for-profit-reserves-survey](https://www.bdo.nz/en-nz/insights/not-for-profit/not-for-profit-reserves-survey).

For more assistance, contact your local BDO adviser or visit www.bdo.nz

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