Kids' Chance
Educating Children of Injured Workers

Reserve or Contingency Funds

For seven consecutive years Nonprofit Finance Fund's State of the Sector report revealed that less than 25% percent of those nonprofits responding had more than six months of cash in reserve. In fact, most of the nonprofits responding reported that they had less than three months of operating reserves on hand. And close to 10% had less than 30 days of cash on hand. This may be the reality for many nonprofits, but that does not mean that it is optimal.

Kids' Chance of America highly recommends that each of our member state organizations develop a program to build a reserve that will protect the organization, and specifically its scholarship awardees, from any unforeseen financial hardship.

Definition

A contingency fund is simply a reserve fund set aside to handle unexpected debts that are outside the range of the usual operating budget. Contingency funds protect the organization against possible loss in the event of an emergency. They can also be used to take advantage of an opportunity or new initiative that needs funding that may not have been included in the budget.

How Much Should We Have?

While there are general guidelines for setting operating reserve goals, they should always be accompanied by "it depends." Most standards are based on a formula that provides for enough unrestricted cash to cover operating expenses for several months. A commonly used reserve goal is three to six months' expenses. At the high end, reserves should not exceed the amount of two years' budget. At the low end, reserves should be enough to cover at least one full payroll including taxes, or in the case of Kids' Chance, one full scholarship round.

Keep in mind that these generic target amounts for reserves do not take into consideration the stability of your current financial position. The goal for operating reserves will change, too, when income or expenses become less reliable or predictable because of internal or external changes.

Developing a Cash Reserves Policy

As the governing body with fiduciary oversight to ensure the financial sustainability of the nonprofit, the board of directors may adopt a "reserve or contingency policy." When developing a policy, consider including 1) how much money KCXX will set aside at all times, 2) defining the types of circumstances that will result in assets in reserve being used, 3) the process you will use to make the determination whether or not to dip into reserves, 4) the process and timeframe for repayment into the reserve account, and 5) whether there should be any directions, restrictions, or limitations on what the money held in reserve may be used for. Remember, when the unexpected financial shortfall occurs, having cash reserves to tap can help a nonprofit sustain itself despite very tough times.