



# RESERVES

DEFINING & DETERMINING  
APPROPRIATE LEVELS

# Definitions Of Different Types Of Reserves



# Types & Definitions Of Reserves



## Donor Restricted

### Permanently Restricted Net Assets

- Principal balance remains intact
- Income can be used for a purpose as specified by the donor

### Temporarily Restricted Net Assets

- Principal & Income to be used for specific purpose as directed by the donor

## Unrestricted

### Undesignated

- Funds can be used for any purpose deemed necessary

### Board Designated

- Funds are not restricted by the donor
- The Board designates the funds for a particular purpose
- The Board can move these funds back to undesignated at any time if circumstances change or warrant

# Types & Definitions Of Reserves



## Liquid net Assets

- Cash
- Investments & Securities
- Receivables
- Inventories

## Net Assets Not Readily Convertible to Cash

- Fixed assets
- Certain investments or holding that are not marketable
- Long-Term Notes receivable

# Types & Definitions Of Reserves



**Financial reserves = A subset of liquid net assets. They are a distinct pool of assets that an organization can access either to:**

- Mitigate the impact of unbudgeted or undesirable financial events
- Pursue opportunities of strategic importance that may arise in the future

# What Liquid Assets Could Be Excluded From “Financial Reserves”?

- Any Permanently or Temporarily Restricted Net Assets
- Liquid assets required to cover working capital fluctuations throughout the year
- Liquid assets required to cover known events over the course of the next year
- Board Designated Unrestricted Net Assets?



# Importance of Maintaining Appropriate Reserve



# Be Prepared For Economic & Market Risks

Disaffiliation & Church closures

COVID-19

- Lack of in-person worship
- Increased unemployment reached 15% for first time since Great Depression

Stock market crash (i.e. 2008-2009)

- S & P fell 50% & unemployment reached 10%

Declining U.S. attendance

Potential litigation costs



# Be Prepared For Economic & Market <sup>=</sup> Risks

**Avoid making unplanned cost reduction measures in a knee-jerk manner.**

If revenues fail to meet expectations, reserves can be used as a stop gap until:

- Revenues reach target levels or
- A more strategic approach can be planned to implement necessary cost reductions

# What Is An Appropriate Level Of Financial Reserves



# How Much Is Appropriate?



- Many standards are used to establish reserve levels including months of operating expenses or even a set dollar amount
- These standards are relatively arbitrary and not organization nor risk specific
- **Given today's economic realities, these approaches won't be satisfactory going forward**

# How Much Is Appropriate?



- While there may be similarities, each Annual Conference, General Agency or Local Church is unique
- What is appropriate for one organization, regardless of similarities may not be the same for another.

**There are no easy answers!**  
**One size does not fit all!**  
**We have a lot of thoughtful work to be done!**

# Reserve Planning: Establishing Target Levels



# 5 Key Steps To Reserve Planning



1. Determine a baseline long-term financial forecast
2. Create a detailed analysis of potential risks and the potential magnitude of their impact on the organization
3. Quantify your projected average annual risk
4. Establish target reserve levels
5. Identify the funding plan / approach



# Step

## 1



### **Develop Baseline Financial Forecast**

- If reserves are meant to mitigate adverse financial circumstances, it is critical that you understand the baseline you are insuring against.
- Identify and measure key drivers of financial performance.
- Develop a long-term forecast of at least 4-5 years for all aspects of the organization. This will also identify cyclical trends that may not be evident in an annual budget.

# Step 2:



## Detailed Analysis Of Potential Risks & Their Impact

### Identify your potential risks

- Churches / members leaving the denomination
- Major building repairs
- Pension health liabilities
- Lawsuits
- Others?

Quantify the range of impact of each risk

Assign a likelihood of occurrence for each risk / range.

# Step 2:



## **Detailed Analysis Of Potential Risks & Their Impact**

### **Other potential risks facing all organizations**

- Governance
- Personnel
- Economic / Financial
- Compliance
- Technology
- Fraud
- Natural Disasters / Terrorism
- Operational Process
- Brand Loyalty

# Step

2:



## Detailed Analysis Of Potential Risks & Their Impact

Critical to collaborate with all leaders of the organization. **Don't do this in a silo.**

- Provides a more comprehensive and detailed analysis. Different perspectives are important to arriving at best estimate of a potential risk.
- Builds buy-in throughout the organization and increases the integrity of the analysis.
- Creates a shared perspective on the long-term direction.

# Step 3:



## Quantify Your Annual Risk

**Calculate a probability adjusted outcome of potential risk and incorporate into the long-term forecast.**

- Impact should be done by year. The potential impact might be greater in one year vs. another, arriving at the best estimate of a potential risk.
- Scenario planning is also important. Have a range of long-term plans so that you are ready in case reality is worse than you predicted.

# Step

4:



## Establish Your Target Reserve Levels

### Factors to include in setting target reserve levels:

- The calculated projected impact by year of the identified risks
- The likelihood of these impacts being one-time vs. ongoing
- The organization's ability to reduce expenses or increase revenues in the face of the realized risk
- The organization's appetite for risk



# Benefits of Reserve Targets Using these Steps

1. Improved organizational understanding of the potential risk factors and their impact
2. A more defensible rationale for the reserve levels
3. Development of a long-term strategic plan that provides a road-map for actions and decisions while contemplating the potential impact of key risk factors

# Other Things To Consider



# Other Things to Consider

## Your budgeting practices will impact reserve levels

- Conservative approaches will likely lead to higher reserve levels or lower usage than planned
- Aspirational budgets will likely lead to lower reserve levels & increased usage vs. the plan.
- **It is important to use an honest assessment when establishing your reserve targets!**

## Develop and document a reserve policy

## Review the reserve targets and reserve policy regularly (preferably annually)

# QUESTIONS





# THANK YOU



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