Business Resilience Toolkit

Cash reserves

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Transcript:

What are cash reserves, and – as a not for profit - how do you know when you have enough?

Hello, I'm Jane Arnott and I'm the General Manager for Consulting at Community Business Bureau.

In this video we're going to cover three key aspects of cash reserves.

First – what are cash reserves and why they're important?
Second – how can you work out how much you need?
And finally, how to build cash reserves?

So – what are cash reserves? Essentially, these are the unrestricted funds you have. It's the amount of your cash balance that is not allocated to a specific purpose – so you have discretion or control over how you spend it. For example, if you are paid a grant in advance, you might have cash in the bank – but you can only use this to deliver your grant activities – so it's actually also a liability on your balance sheet. Or you might own your own property, so that's an asset, but you can't access the value of the property without selling or borrowing against it, so it's not a cash reserve.

Cash reserves may include funds that you need available for future outgoings or commitments – such as employee entitlements – and that's why they are so important. Cash reserves are readily accessible funds that you can access to commit to growing new services, to fund planned capital expenditure, and to cover unexpected expenses or lower than forecast revenues. So cash reserves play an important role in your organisation's financial sustainability and resilience.

Let's have a look at how you work out how much you need in reserves.

There's no easy formula for this. For not for profits, you have an obligation to spend your funds on delivering your mission, so you need to find a balance between having enough cash reserves available to manage your organisation well, but not so much that you're neglecting your purpose. The ACNC says that you should be able explain to the public, regulators and potential funders what you consider to be an appropriate level of reserves and why.

They also provide some tips on the things you should consider when working out how much you need in reserves. These include:

- Your current and future liabilities – including things like staff entitlements for long service leave or redundancy

- Political or funding changes that may impact on future income – for example if you're moving from receiving grant payments in advance to payments in arrears, you'll need some cash on hand to manage cash flow
- Any external trends that may affect your future income or service delivery. For example, will an economic recession reduce your income from donations? Or will it increase the demand for your service?
- Your compliance obligations – and how might they change in future? A good example here are Royal Commissions – which are likely to result in increased compliance obligations in the relevant sector.
- What future business costs are you expecting – for example do you need to replace or upgrade your property, vehicles, technology etc, or are you looking to grow your services. This is likely to require expenditure up front, before you receive income for the new service.
- Are you expecting any legal claims? Even if these are covered by insurance, it's possible that you may need funds to pay out first, and then claim back.

You might have some additional items to add to this list. We have a video on Pestel and context canvas – these are tools that you can use to analyse external factors that might impact on your organisation, and may require you to have some cash in reserve. You should also look at your risk register, which may identify some other areas you need to cover off.

Estimating a value against each of these items will give you an idea of the total level of reserves you might need if everything happened at once. In reality – it's highly unlikely that it will all happen at the same time, so once you have your big figure, you can start working back to a more realistic target based on the events you expect are more likely to happen, or that you know to be future commitments.

And finally, it's worth reviewing your reserves target every now and then, and particularly if you have any significant business changes, or you have spent money from your reserves. Things change, and your target may need to change too.

Working through your required level of cash reserves will give you a target, but it doesn't necessarily mean that you have this money available to you now. So, let's have a quick look at how you build cash reserves.

You may be able to build cash reserves from your operating surplus. If you're budgeting to make a profit, you can look to allocate a portion of the profit to your reserves.

Be mindful of your funding agreements. Some funding arrangements don't allow organisations to keep any surplus under the agreement, and either require it to be returned, or spent on additional activities, so you can't use these funds to accumulate reserves.

You can also look at fundraising options: Donations or other fundraising revenue that comes with no strings attached can be very beneficial in helping to build reserves. Or you could fundraise for an endowment, to provide some long term financial security. These are common in universities, arts institutions and some larger service organisations.

Finally, if you're in the fortunate position of having sufficient reserves available, what next? As I said at the beginning of the video, it's important for not for profits to use their resources to deliver against your purpose. This is an opportunity for you to think ways of you can deploy your funds to increase your social impact, or strengthen your organisational resilience, for example through investments in areas such as IT, which may increase your efficiency, and mitigate some risks.

Related video to watch next: Budgeting.