How Much Surplus is Appropriate for a Non-Profit or Charity Organization

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The question arises within charity and non-profit organizations as to what level of surplus is appropriate to carry over from year to year. This is somewhat similar to the question you should ask yourself personally, "What level of cash and deposits should I have on hand personally to provide for my needs?" On a personal basis, you generally should have three to six months of living expenses set aside in savings accounts. This money can be used immediately in case of an emergency. It will give you money to provide for your living needs until your emergency is resolved, or until you can make other arrangements. This money, of course, is in addition to any other longer term investments you should have, such as for child education needs or retirement savings.

There was a report produced in the spring of 2010 by a U.S. member firm of Grant Thornton titled, "Maintaining Sufficient Reserves to Protect Your Not-For-Profit Organization." In summary, the report suggested that the appropriate amount depends on your specific circumstances. Appropriate reserves may range from six months to two years of operating expenses. In 2013, they published a report, "Reserves Planning: A Step-by-Step Approach for Nonprofit Organizations" setting out guidelines on how an organization can use risk adjusted forecasts to determine their own reserve requirements, rather than relying on rules of thumb.

Who makes this decision on reserve levels? The Board of Directors is responsible to ensure that there are sufficient funds available to support current program activities and, second, to plan appropriately for the future. To do so, they need to look carefully at current and future needs and the possible liabilities that could arise.

The Canada Revenue Agency (CRA) also has guidelines. They have Interpretation Bulletin – IT-496R issued in 2001 available on the CRA web site at http://www.cra-arc.gc.ca/E/pub/tp/it496r/ . Their guidelines are similar to that discussed above, indicating that each situation depends on particular facts. However, they do make a statement that in some cases surplus of one year is considered excessive, and sometimes even less could be considered excessive. However, the overriding issue is reasonableness based on your specific circumstances. Within that Bulletin, they state:

8. *An association may earn income in excess of its expenditures provided the requirements of the Act are met. The excess may result from the activity for which it was organized or from some other activity. However, if a material part of the excess is accumulated each year and the balance of accumulated excess at any time is greater than the association's reasonable needs to carry on its non-profit activities (see paragraph 9), profit will be considered to be one of the purposes for which the association was operated. This will be particularly so where assets representing the accumulated excess are used for purposes unrelated to its objects such as the following:*

(a) long-term investments to produce property income;

(b) enlarging or expanding facilities used for normal commercial operations;

or

(c) loans to members, shareholders or non-exempt persons.

This may also be the case where the accumulated excess is invested in a term deposit or guaranteed investment certificate that is regularly renewed within a year and from year to year, whether or not tbhe principal is adjusted from time to time.

9. *The amount of accumulated excess income considered reasonable in relation to the needs of an association to carry on its non-profit activities and goals is a question of fact to be determined with regard to the association's particular circumstances, including such things as future anticipated expenditures and the amount and pattern of receipts from various sources (e.g., fund raising, membership fees, training course fees). For example, it is conceivable that there would be situations where an accumulation equal to one year's reasonably anticipated expenditures on its non-profit activities may not be considered excessive, while in another situation, an accumulation equal to the reasonably anticipated expenditures for a much shorter period would be considered more than adequate. Where the present balance of accumulated excess is considered excessive or an annual excess is regularly accumulated that is greater than an association's needs to carry on its non-profit activities (see paragraph 8), it may indicate that the association's aims are two-fold: to earn profits and to carry out its non-profit purposes. In such a case, the operated exclusively requirement in paragraph 149(1)(l) would not be met.*

As discussed above, accumulating surplus funds in excess of its current needs may affect the association's status as a tax-exempt NPO. However, in certain cases, when an association requires a time period in excess of the current and prior year to accumulate the funds needed to acquire a capital property that will be used to achieve its declared exempt activities, the association's tax-exempt status may not be affected. For example, this could be the case if an association annually sets aside funds to provide for a special project such as the construction of a new building to replace an existing building when it deteriorates or no longer meets the association's needs. In such cases, any funds accumulated for this purpose should be clearly identified and all transactions concerning a special project should be clearly set out in the association's accounting records. Provided the funds accumulated for a special project are used for that project, an association's tax-exempt status should not be affected.

If you are looking for guidance on developing a policy or to assess your operating reserves, a toolkit has been developed in the U.S., sponsored by the National Center for Charitable Statistics, Center on Nonprofits and Philanthropy at the Urban Institute, and United Way Worldwide. It is available through Imagine Canada (http://sectorsource.ca/resource/file/operating-reserve-policy-toolkit-nonprofit-organizations) or at http://www.nccs2.org/wiki/images/d/df/Operating_Reserves_Policy_Toolkit_1st_ED_2011-07-28.pdf.

If you lost one of your significant sources of revenue, such as a major sponsor or a government grant, how long could you operate? You need to be able to do so until you find new revenues to offset the loss. If you incurred an unexpected expense, such as from a fire, a breakdown in equipment, an employee severance payment, etc., would you have enough funds to meet that cost and/or to carry you over until insurance proceeds were received?

In conclusion, management and the Board of Directors need to look at your particular situation and make the final decision on the appropriate level of surplus. To reach this decision, you should look at your day to day operating risks with respect to revenue and expenditures, your capital asset needs (such as new equipment) in the next few years, as well as other natural disaster or activity risks that may not be covered promptly by insurance. The answer will likely be in the range of six to twenty-four months on continuing operating expenses.

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Source: https://www.corkumfinancial.ca/how-much-surplus-is-appropriate-for-a-not-for-profit-or-charity-organization/