



April 21, 2022

To: Columbia Association Board of Directors
Lakey Boyd, President/CEO

From: Susan Krabbe, Senior Vice President and CFO

Cc: Lynn Schwartz, Director of Finance/Treasurer
Jackie Tuma, Director of Audit and Advisory Services
James Young, Chair, Audit Committee

Re: UPDATED - Recommended FY 2022 Funding – Emergency Cash Reserves

NOTE: At its April 14, 2022 work session, the CA Board discussed staff's recommendation to add \$3 million to the Emergency Cash Reserves in fiscal year (FY) 2022. A Board member suggested increasing the proposed FY 2022 funding to meet or slightly exceed the targeted reserve balance of \$5,133,000. Staff agrees with that suggestion and has amended the recommendation in this document to reflect the proposed change. Please refer to the redlined changes in this document for your information and vote at the April 28, 2022 Board meeting.

In April 2021, the CA Board approved CA's Emergency Cash Reserves Policy (attached), the first time in CA's 56-year history that such a reserve was established. As part of the fiscal year (FY) 2022 budget process, the CA Board of Directors (Board) approved the establishment of a \$2 million cash reserve, the beginning of an Emergency Cash Reserves for CA that would be built upon going forward. A condition of the Board's decision was to charge staff with developing a reserve policy, including funding sources, timeline, withdrawal and replenishment directions, to be submitted for Board evaluation, analysis and approval by April 30, 2021.

Background, Approach and Methodology

In 2021, staff researched reserve fund guidance for nonprofit organizations and found that the general response is that it depends on the nature of the organization and its risk factors. The last formal nonprofit "best practice" is from 2008, with the formation of the Nonprofit Operating Reserve Initiative (NORI). NORI's guidance suggested that, while there is no general formula, three months' (25%) of operating expenses was a good baseline cash reserve. (See: <https://www.nonprofitaccountingbasics.org/nonprofit-reserves>)

However, since 2008, nonprofit organizations continue to expand their application of enterprise risk management (ERM) concepts. Risk is generally defined as the chance of something happening, measured in terms of probability, and any impact that may adversely or positively affect the achievement of an organization's long-term business objectives.

CA staff used this more data-driven, risk-based cash reserves approach to recommend the establishment of the Emergency Cash Reserves for CA and developed an Emergency Cash Reserves risk matrix in April 2021, which the Board used in its evaluation of the policy.

In March 2022, CA staff updated the April 2021 risk matrix based on the Third Quarter FY 2022 financial results and other operational and governance-related factors. The following chart provides the risk matrix updated as of March 31, 2022:

\$000's					Emergency Cash Reserves			
Description and Identified Risk	Maximum Potential Exposure	Impact %	Likelihood %	Time Horizon	Minimum at 4/30/22	Target at 4/30/24	Target at 4/30/26	Target at 4/30/28
Operations –								
60 days cash on hand	\$8,541			FY 2026	\$1,623	\$1,951	\$4,751	\$8,541
Annual charge revenue –								
Declining property values	\$5,000	50%	40%	FY 2025	\$0	\$500	\$1,000	\$1,000
Line of credit –								
Nonrenewal of the line of credit	\$20,000	40%	5%	FY 2024	\$0	\$400	\$400	\$400
Legal –								
Uninsurable legal expenses	\$19,500	90%	40%	FY 2025	\$3,510	\$5,265	\$7,020	\$7,020
Target reserve balance at fiscal year end					\$5,133	\$8,116	\$13,171	\$16,961

The assumptions for the updated March 2022 risk matrix are:

- The 60 days cash on hand is based on FY 2022 year-end estimate as of March 31, 2022 for total expenses less depreciation.
- The annual charge revenue risk is based on a maximum potential 10% decrease in valuations, the impact of which is estimated at 50% and the likelihood is 40%.
- The existing commercial line of credit expires in June 2023.
- The maximum potential exposure for uninsurable legal expenses is based on benchmarked insurance coverage for several risk exposures. The “likelihood” percentage was increased and the time horizon shortened based on a current assessment of related risks.
- Full funding of the targeted reserves is projected for April 30, 2028, an extension of two years over the previous timeline, due to the increase in the total and other cash needs during this period of time.

It should be noted again that these target Emergency Cash Reserves are separate, distinct and in addition to the \$3 million cash reserve required by our lender for the 2020 term loan financing.

Recommended FY 2022 Funding

As reported in the FY 2022 Third Quarter Financial Report, CA's anticipated cash position for April 30, 2022 is significantly better than what was budgeted, due primarily to the receipt of the Employee Retention Tax Credit (ERTC) funds in FY 2022. Strong expense controls and better than expected annual charge revenue have also contributed to this favorable cash position. The ERTC was developed to help organizations retain employees during the pandemic and resulting financial crisis. Using a portion of these funds to strengthen CA's financial position and emergency reserves sends a very powerful and positive message reassuring current employees regarding organizational stability and security. Additionally, it also serves to encourage prospective employees to join CA in a very challenging recruiting season.

Overall, the strategic objective of adequately funding Emergency Cash Reserves is to protect against disruption to CA's program and organizational continuity due to significant, immediate unforeseen changes in circumstances. The proposed addition would bring the total Emergency Cash Reserves to \$5,133,000 as of April 30, 2022, which is 30% of the full reserves amount targeted for funding by April 30, 2028 (a targeted total of \$16,961,000).

The initial required funding of \$2 million was done as of April 30, 2021. Thus, given the updated risk matrix and CA's anticipated cash position as of April 30, 2022, **staff recommends that the CA Board approve an addition to the Emergency Cash Reserves of \$3,133,000 in FY 2022, to bring the reserve balance as of April 30, 2022 to \$5,133,000, the minimum target for FY 2022, per the risk matrix.**

Columbia Association Inc.
Emergency Cash Reserves Policy

I. Purpose

The purpose of the Emergency Cash Reserves policy is to build and maintain an adequate level of cash reserves to help ensure the long-term financial stability of Columbia Association (CA) and to position CA to respond to varying economic conditions and changes affecting CA's financial position and its ability to continuously carry out its mission for the community.

CA will maintain the Emergency Cash Reserves to achieve the following objectives:

- > To maintain day-to-day operations to the extent feasible in the event of unforeseen, immediate and otherwise unsurmountable shortfalls. The Emergency Cash Reserves are not intended to replace a permanent loss of revenue or subsidize an ongoing budget gap.
- > To promote community confidence in the long-term sustainability of CA by preventing catastrophic cash flow crises that could diminish CA's reputation and force the leaders of the organization to make expensive, short-term crisis-based decisions.

This policy will be implemented in conjunction with CA's other financial policies and is intended to support the goals and strategies contained in those related policies and in strategic and operational plans and budgets.

II. Definition and Goals

The Emergency Cash Reserves are defined as the designated cash set aside by action of CA's Board of Directors (Board), at the recommendation of CA staff.

A lower and upper funding level range shall be proposed by CA senior management to the CA Board for consideration and approval in conjunction with the adoption of CA's budget. CA senior management will conduct a detailed review of the Emergency Cash Reserves at least once every three years.

III. Accounting for the Emergency Cash Reserves

The Emergency Cash Reserves will be recorded in CA's accounting system and financial statements as board-designated cash reserves. The Emergency Cash Reserves will be maintained and invested in accordance with CA's Board-approved investment policy. It is not required that the Emergency Cash Reserves be physically segregated in a separate bank account although CA senior management may decide to do so.

IV. Funding of the Emergency Cash Reserves

The Emergency Cash Reserves will be established initially by cash generated from operations and financing activities in FY 2021. The CA Board may, from time to time, direct that a specific source of revenue be set aside for the Emergency Cash Reserves. For example, sources may include one-time grants, proceeds from the sale of assets, or a portion of greater than anticipated revenue.

V. Authority to use the Emergency Cash Reserves

The President/CEO has authority to access and use the Emergency Cash Reserves so long as that use is consistent with the purpose outlined in this policy, and provided that any amount withdrawn and subsequently replenished results in a funding level at fiscal year-end representing a Board-approved funding level.

A draw-down from the Emergency Cash Reserves that will not or cannot be replaced with operating funds within the same fiscal year must be approved in advance by a majority of the CA Board.

VI. Reporting and Monitoring

The President/CEO is responsible for ensuring that the Emergency Cash Reserves are maintained and used only as described in this policy. CA's Audit Committee and Board will monitor the status of the Emergency Cash Reserves as a part of CA's fiscal year-end reporting practices and procedures.

The President/CEO will maintain records of the Emergency Cash Reserves and will provide regular reports to the Audit Committee and the CA Board, including progress to get the Emergency Cash Reserves to the target minimum amount, and then to restore to the target minimum amount following a draw-down.

Changes to the Emergency Cash Reserves funding level may be proposed by the President/CEO to the CA Board for their deliberation. If there is to be a reduction in the Board-approved funding level, such a decision must be approved by a majority of the Board.

VII. Review of Policy

Senior management will review this policy every three years at minimum, or sooner if warranted by internal or external events or changes. Changes to the policy will be recommended by CA senior management to the Board and approved by a majority of the Board.