HUMANITARIAN ACADEMY · HUMANITAIRES JOBS

Mini MBA Finance and Grants: managing donor money and financial health

Course handout · Week 11 : Reserves, unrestricted funds and funding diversification

A programme of exactly 3 months (12 weeks, 144 hours) to manage the finances of a humanitarian organisation and donor funds: NGO accounting and restricted funds, budgets and shared costs, cash and foreign exchange, budget monitoring and forecasts, eligibility rules, the grant cycle, partner funding, audits and fraud, financial health, full cost, reserves and diversification, governance and turnaround. Corrected numerical exercises, three monthly exams with case studies, and a verifiable diploma from the Humanitarian Academy.

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Week 11 : Reserves, unrestricted funds and funding diversification

Objectives

- Write a reserves policy: target, composition, rules for use and replenishment.
- Assess a diversification strategy (private funds, foundations, pooled funds, private sector, earned income) according to its cost and return.
- Understand the sector's innovative financing (country-based pooled funds, anticipatory financing, insurance, blended finance) and their financial requirements.

The reserves policy

A **reserves policy**, adopted by the board, answers four questions:

- **Why**: to cover late payments by donors, fund end-of-contract indemnities, respond to an emergency before any funding arrives, absorb an exchange loss or a cost declared ineligible.
- **How much**: a target calculated from the risks, not an arbitrary figure.
- **Who decides on use**: authorisation thresholds (management, treasurer, board).
- **How to replenish**: a 2- to 3-year plan when the reserve is used.

Risk-based calculation. Example of an NGO with 12 million USD a year:

Risk	Calculation	Amount
Average pre-financing	2 months of expenditure of projects paid in arrears (4 M USD/year)	667,000
End-of-contract indemnities	calculated legal obligations	350,000
Potential ineligible costs	1% of expenditure	120,000
Initial emergency response	board decision	200,000
Total		1,337,000

That is about 1.3 months of total expenditure. A target reserve justified in this way is much easier to defend before the board, donors and private supporters than a "three months" taken from a manual.

Unrestricted funds, a strategic resource

Unrestricted funds (free private donations, membership fees, earned income, some flexible multi-year institutional funding) are scarce: often less than 10% of a humanitarian NGO's

income. Yet they are the only funds that make it possible:

- to respond in the first 72 hours of a crisis;
- to cover the costs donors do not pay for (fundraising, innovation, preparedness, shared cost shortfall);
- to enter a country or a sector before a donor commits to it;
- to build and rebuild reserves.

The golden rule: unrestricted funds must be **allocated by explicit decision**, in the organisation's annual budget, and not consumed by default to fill gaps. An organisation that "discovers" at year-end that its free funds have covered project overspends has lost its strategic freedom without deciding to.

Diversifying: costs and returns

Each funding source has an **acquisition cost** and a **return**. The useful ratio: cost of fundraising / amount raised (or its inverse, the return on investment).

- **Institutional donors**: large amounts, high cost of proposal writing and compliance, restricted funds.
- **Foundations**: medium amounts, often more flexible, long-term relationship.
- **Individual donations**: high start-up cost (the first gift often costs more than it brings in), but regular donors are profitable over several years.
- **Private sector**: sponsorship, technical or logistics partnerships, sometimes in kind.
- **Earned income**: services (training, studies, warehouse rental), to be checked against the organisation's tax status.

Example. A regular giving recruitment campaign costs 60,000 USD and recruits 1,000 donors at 15 USD a month. 30% stop in the first year; thereafter, assume 1,000 × 70% = 700 active donors on average over 3 years. Income over 3 years ≈ 700 × 15 × 36 = 378,000 USD. Return: 378,000 / 60,000 = 6.3 dollars per dollar invested, but with a first year that is probably loss-making. Funds are therefore needed to invest before reaping the returns.

Pooled funds and anticipatory financing

Several humanitarian funding mechanisms have particular financial requirements:

- **Country-based pooled funds** (CBPFs, managed by OCHA): open to national and international NGOs after a capacity assessment that sets a risk level. The level determines the maximum project size, the pace of instalments and the frequency of controls.
- **CERF** (Central Emergency Response Fund): funds United Nations agencies, which then sub-grant to partners.
- **NGO emergency start-up funds** (networks such as the Start Network): decisions within 72 hours, lighter reporting but very short spending deadlines.
- **Anticipatory financing**: funds released before a foreseeable shock (drought, flood) on the basis of trigger thresholds; procurement and payment procedures must be ready in

advance.

Risk level example. An NGO rated "high risk" by a country fund receives its funds in three instalments (for example 40%, 40%, 20%), with a financial check before each instalment. Rated "low risk", it can receive 80% on signature. The cash stakes are considerable: investing in its systems to improve its rating is often the best financial investment a national NGO can make.

Innovative financing

Beyond grants, the sector is experimenting with several instruments:

- **Parametric insurance**: a payout is triggered by an index (rainfall, wind speed) rather than by loss assessment. Example: African regional drought insurance mechanisms.
- **Impact bonds**: investors pre-finance a programme; the outcome payer repays with a return if the agreed results are achieved. Requirement: rigorous measurement of results and high structuring costs.
- **Blended finance**: combining grants with loans or guarantees to attract private funds, more common in recovery than in emergencies.
- **Islamic social finance**: zakat, waqf, sukuk with a humanitarian purpose, with their own eligibility rules on beneficiaries and investments.
- **Payment by results**: the donor pays per verified result (for example per child vaccinated), which transfers performance risk to the organisation.

> Before adopting an innovative instrument, ask: who bears the risk if the results are not achieved, and does the organisation have the reserves to absorb it?

Investments and managing surplus cash

An organisation holding significant reserves or advances must have a prudent **investment policy**, adopted by the board:

- **Priorities**: security of capital, then liquidity, then return, in that order.
- **Acceptable instruments**: interest-bearing accounts, term deposits in sound banks, short-term government securities. No speculative investments.
- **Diversification of banks**: do not concentrate everything in a single bank, especially in a fragile country.
- **Interest on donor funds**: many contracts require interest earned on advances to be declared and used for the project, or returned.
- **Ethical and religious considerations**: exclusion of certain sectors, preference for products compliant with Islamic finance depending on the context.

Example. 1,000,000 USD of reserves: 400,000 in a current account and an interest-bearing account (immediate liquidity), 400,000 in staggered 3-month deposits, 200,000 in 12-month deposits. At 4% a year on term deposits and 1% on the interest-bearing account (with 300,000

placed in it), income is about 600,000 × 4% + 300,000 × 1% = 24,000 + 3,000 = 27,000 USD a year, without compromising the ability to respond.

Exercise: a reserves policy for a national NGO

Situation. A national NGO, annual expenditure 4,800,000 USD. One third of expenditure comes from donors who pay in arrears, with average pre-financing of 3 months. Legal end-of-contract indemnities: 180,000 USD. Historical ineligible costs: 0.5% of expenditure. The board wants to be able to launch an emergency response of 100,000 USD without waiting. Current free reserves: 250,000 USD. Planned net unrestricted funds: 60,000 USD a year.

Tasks. 1) Calculate the target reserve. 2) In how many years would the target be reached at the current pace? 3) Propose two levers to speed things up.

Answer. 1) Pre-financing: 4,800,000 / 3 = 1,600,000 USD a year, i.e. 133,333 a month, × 3 = 400,000 USD. Indemnities 180,000. Ineligible costs: 0.5% × 4,800,000 = 24,000. Emergency 100,000. Target = 704,000 USD. 2) Gap = 704,000 − 250,000 = 454,000 USD; at 60,000 a year, about 7.6 years, i.e. 8 years: too long. 3) Levers: reduce the need (negotiate advances or quarterly payments with the donors who pay in arrears, which reduces the pre-financing component); increase unrestricted funds (better indirect cost coverage, sharing of indirect costs with the intermediary, earned income, a donation campaign); and have the board approve an interim 3-year target.

Key takeaways

- A reserves policy says why, how much, who decides and how to replenish.
- A target reserve calculated from risks is more defensible than a standard number of months.
- Unrestricted funds are allocated by explicit decision, not by default to fill gaps.
- Each funding source has an acquisition cost; diversification requires investing before reaping.
- Investments: security, liquidity, return, in that order; check the rules on interest earned on donor funds.

Quiz

1. Projects paid in arrears: 3,600,000 USD a year, average pre-financing 2 months. The reserve needed for this risk is:
   A. 300,000 USD
   B. 1,200,000 USD
   C. 720,000 USD
   D. 600,000 USD
2. In an NGO investment policy, the order of priorities is:
   A. Return, liquidity, security
   B. Liquidity, return, security
   C. Security, liquidity, return
   D. Return only
3. A campaign costs 40,000 USD and brings in 160,000 USD over 3 years. The return per dollar invested is:
   A. 2
   B. 4
   C. 0.25
   D. 120,000
4. In parametric insurance, the payout is triggered by:
   A. A measurable index (rainfall, wind)
   B. Assessment of actual losses
   C. The donor's decision
   D. The final report
5. An NGO rated high risk by a country-based pooled fund generally receives:
   A. The full amount on signature
   B. An interest rate
   C. No funding
   D. Smaller instalments with more frequent controls

Quiz answers : 1. D · 2. C · 3. B · 4. A · 5. D