

To: AGA Board
From: AGA President
Date: January 25, 2015
Re: Reserve Policy

Dear Board,

1. As we have noted in past meetings, we have a substantial cash reserve, currently on the order of \$411,000, and seemingly beyond the needs of the organization for an operating reserve. That money is to be used for the purposes of the organization, but in particular, we want (a) to make sure we have an adequate but not excessive operating reserve (b) to make sure we can meet our long term liabilities (c) to spend money productively on improving our members' enjoyment and promoting the game generally and, (d) if and to the extent decided by the board, to grow a capital base to support the growth and stability of the organization and promote the game long term.
2. To those ends, I propose we divide the reserve into three portions as follows.
 - a. An operating reserve, which we use to fund the current year's operations and cash flow and to cope in the event of unexpected demands or revenue shortfalls. The minimum would be calculated according to item 3 below.
 - b. A project fund (which would constitute a line on the balance sheet or reserve calculation, not a separate account) which the board would use at its discretion to fund new activities and developments, with the expectation in some cases that some or all of the funds might return as revenue if the project is successful. For example, the decision to start a chapter rewards program might constitute a draw on the project fund. The board could decide to top it up if it declines, reduce it if alternate uses or emergencies arise, but in the meantime, it is money that can be used for creative but considered risks.
 - c. An endowment. This money would be invested, albeit conservatively, in liquid financial assets under the supervision of a professional advisor, and an annual draw, either set as a percentage, perhaps 4% or 5%, to be taken out and added to the income side of the organization's budget, or else set as a fixed proportion or all of the cash income of the investments. The endowment could be drawn down in the event of an emergency, as the assets would all be liquid. I would note that the AGF invests its substantial reserves in liquid investments already.
3. Calculating the correct "operating reserve need" could be done as follows. The AGA has five main categories of use of funds, discretionary budget, Congress operations, membership escrow, Congress escrow and miscellaneous other liabilities. A percentage of each anticipated use should be kept as a reserve.
 - a. The smallest is the last, at the moment about \$10,000 in various flow-through or custodial funds, for example the club prizes of the Cotsen tournament. All these are liable to be called on in the coming year, so 100% should be in the operating reserve.

- b. Our annual discretionary budget, mostly funded by membership revenues, is under \$70,000 at the moment. Non-profit industry standard is that 25% of this amount should be the operating reserve of the organization. 100% would be very conservative. 50% is acceptable in general and I think is prudent in our case because we have several other categories of reserve in this list and so the risk of reserves being called on could effectively be cross-collateralized. I propose we take 50% as our reserve.
 - c. I have excluded the Congress from our discretionary budget because although a lot of money comes into and out of the AGA for Congress and the AGA is the responsible entity for Congress, most of the money is pass-through payments for board and lodging. A worst case scenario is a Congress where we pay all the fixed costs, including bring the pros in and paying their stipends, and nobody comes. That risk would be on the order of \$75,000 in my judgment. In reality, we would cancel long before such a disaster came to fruition. On the other hand, there are significant risks of a shortfall and significant deposits to be paid. In my judgment, \$50,000 cash on hand covers the need for cash investment in Congress and the risk of a shortfall. I think the operating reserve should include 100% of this amount.
 - d. Membership escrow. Our balance sheet includes \$103,000 or so owed to members for multi-memberships, the vast majority owed to life members. The reality of this is that about 10% or so of this amount is charged off in a given year and included in our income, so in theory we need only include 10% of this amount in an operating reserve, but I think 25% makes more sense. In essence, it represents our obligation to keep a happy, thriving AGA going for our 100 or so life members irrespective of whether anyone else in the US wants to play go anymore. More than 25% would be inappropriate since the obligation will continue for some decades and keeping those funds in cash is imprudent over that time scale. I recommend 25% of the member escrow be operating reserve.
 - e. Congress escrow. This is the obligation we owe to chapters to fund their go activities in consideration of their efforts in holding a Congress. In theory, we could be called upon to spend all of it (about \$58,000 mostly recently earned) in the same year, but the reality has been that we've been spending 10% of it a year. I think we can pick either 25% or 50%. I am willing to say 25%.
4. Process
- a. In the first year, 2015, I say we designate an amount for an endowment of \$200,000. This could produce a draw of \$8,000 to \$10,000 by next year, a substantial increase in our discretionary budget. We further designate \$50,000 as the project fund. This would leave cash for operations of \$161,000.
 - b. Our calculated operating reserve need is \$135,000, so the \$161,000 is sufficient operating cash for this year.
 - c. Each fiscal year in the future, the treasurer or I calculate (a) the operating cash on hand and the project fund cash on hand and (b) the operating reserve need, and report to the board. If the reserve need is greater than operating cash, or circumstances have changed (i.e. a year of bad results or a disastrous Congress), the board may opt to move funds, redesignate the project fund or alter the budget to accumulate reserves.

5. Cash and investment management

- a. I will figure out with Roy if there are cash management options that enable us to get more of a return on the cash on hand, since it would still be significant, but it is not going to be more than 1 percent at best in the current environment.
- b. I will seek bids from a few advisors, as we recently did for the INAF fund. One bidder, with the board’s permission, would be the Credit Suisse office in Los Angeles. They are managing the INAF fund. They won that work in part because they manage some funds for my family (very well, I may add) and were willing to price their services aggressively. The family connection was disclosed to the INAF board, which had no problem with it, and I think constitutes a minimal conflict of interest. However, if the board is uncomfortable with that connection, I will exclude them from the list. In any event, I would recommend a firm of similar caliber and conservatism.

6. Worksheet

		Annual Reserve Ratio	Operating Reserve Need	Project Fund	Available for Endowment
Assets:					
Current Cash	\$411,000				
Long-term liabilities					
Membership (90% life member)	\$103,000				
Congress Escrow	\$58,000				
Other Custodial	\$10,000				
Total	\$171,000				
Unrestricted assets	\$240,000				
Uses:					
Annual Discretionary Budget	\$70,000	50.00%	\$35,000	\$0	\$35,000
Annual Congress Risk/Cash Investment	\$50,000	100.00%	\$50,000	\$0	\$0
Membership to fund	\$103,000	25.00%	\$25,750	\$0	\$77,250
Congress escrow to fund	\$58,000	25.00%	\$14,500	\$0	\$43,500
Other Custodial	\$10,000	100.00%	\$10,000	\$0	\$0
Unallocated	\$120,000	0.00%	\$0	\$50,000	\$70,000
			\$135,250	\$50,000	\$225,750
Current Cash	\$411,000				
Endowment	\$200,000				
Project Fund	\$50,000				
Available as operational reserve	\$161,000				

