

## **Proposal for Revising the Calculation of Recommended Working Capital and Liquidity - GCWP<sup>1</sup> S 24 10 and 15**

### **Rationale**

The current policy provision regarding working capital is impacted by the following:

- (1) **Receiving Restricted Funds** - An organization improves its apparent compliance to the recommended minimum working capital if it receives (and holds) restricted income such as a Global Mission Grant, Thirteenth Sabbath Project Funding, or a Restricted Donation. This is true even though it is not in a better position to deal with a financial emergency. The opposite is also true. If an organization spends restricted net assets it appears to be in a worse working capital position in terms of the policy when in fact it is not in a worse position to handle an emergency.
- (2) **Spending Allocated and Restricted Funds** - The recommended minimum working capital increases when the organization spends allocated or restricted funds. Allocated or restricted funds are for special purposes. Spending from them does not increase the amount of working capital that the organization needs. However, the current policy calculation of a recommended minimum working capital includes these expenditures to determine what that amount should be. Therefore, the current policy calculation penalizes an organization if it spends to fulfill the intentions of allocated funds or terms of the restricted funds and could create an incentive to improperly retain these funds
- (3) **Allocating for Financial Contingencies** - An organization appears less compliant or more compliant with the recommended working capital when it increases or decreases, respectively, allocations for some financial contingency (e.g., exchange rate fluctuation). Neither the increase nor decrease in such allocations changes the ability of an organization to address financial emergencies.

### **Guiding Principles**

The following six principles guide the proposed revision to the Working Capital and Liquidity policies:

1. *Simplicity* - The calculation for Recommended Working Capital and Liquidity should be simple to understand and apply. This proposal does so by not providing for every conceivable consideration. Instead, the focus is on the most significant concerns.
2. *Responsiveness* - Organizations can and should make adjustments in response to a financial crisis. For example, they can lay off workers or reduce appropriations. However, adjustments require time and this policy looks at the Working Capital and liquidity reserves primarily as giving the organization breathing room to make such

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<sup>1</sup> General Conference Working Policy

adjustments in an orderly and worker sensitive approach. The Recommended Working Capital and Liquidity is not intended to be the complete response to financial threats.

This proposal removes the distinction between whether an organization pays a worker from allocated resources or regular operating resources. In both cases, and at least in the initial period of a financial emergency, an organization needs to continue paying all its workers - no matter the source of its funding.

3. *Availability of Board Allocated Net Assets* - Board allocated net assets should be available in times of economic emergencies. As such, no distinction is made between board allocated net assets and unallocated net assets, except allocations made by the board to meet constitutional or constituent requirements. The proposed policy does not exclude board allocated net assets, except allocations made by the board to meet constitutional or constituent requirements, from assessing the readiness of an organization to handle financial emergencies.
4. *Maintaining Donor Confidence* - Since maintaining donor confidence is of crucial importance, donor-restricted net assets are not considered part of the resources available to weather a financial emergency. Similarly, appropriations for special projects from other organizations (e.g., Global Mission Grants) require the same care.
5. *Minimal Provision* - An organization should make at least the minimal provision to ensure it can continue paying employment and contractual obligations during an economic downturn or financial emergency. These obligations include payroll, rents, mortgage payments, taxes, etc.
6. *Provision for Allocated Net Assets* - An organization should only make allocations of net assets that are matched with available resources. Allocations without matching to available resources misrepresents the financial condition of an organization. This proposal does not include allocated net assets, except allocations made by the board to meet constitutional or constituent requirements, in calculating the *Recommended Minimum Available Working Capital and Liquid Assets* for an organization.

## **Proposed Working Capital and Liquidity Policy** (To replace existing S 24 10 and S 24 15)

### **GCWP S 24 10 Recommended Minimum Available Working Capital and Liquid Assets**

Economic downturns and financial emergencies are part of the routine cycle of organizational life. Church organizations would do well in being prepared for such downturns and emergencies by ensuring resources are in place to prevent or minimize any disruption to its mission. Being prepared would include having sufficient resources to cover operational expenses and appropriations to subsidiary or related organizations for a predetermined period of time. Each organization should be mindful to build up reasonable reserves of working capital in preparation for unfavorable financial times. It would be prudent for an organization to hold a significant portion of its available working capital in liquid assets.

#### **Definitions**

1. *Working Capital* - The amount of current assets in excess of current liabilities. (Current Assets minus Current Liabilities)
2. *Current Assets Held for Donor Restrictions* - The current assets necessary to comply with the restrictions stipulated by donors or other organizations (Restricted net assets minus those specifically related to identifiable noncurrent assets).

Examples:

- Donor restricted donations still in hand (e.g., assets restricted to an evangelism project.
  - Restrictions placed on funds by grants from other organizations (e.g., Global Mission Grants)
3. *Current Assets Held for Mandated Purposes* - The current assets associated with resources set aside in response to mandates imposed upon an organization. These requirements include legal, denominational, constitutional, and constituent requirements. Specifically, these are Current Net Asset allocations made by the board for the purpose of complying with these mandated requirements. (Allocated net assets that meet these criteria minus those specifically related to identifiable noncurrent assets.)

Note: This is a small subset of all allocated net assets. Specifically excluded from this category are any allocated net assets that an executive committee can un-allocate without being in violation of these mandated requirements.

Examples:

- Funds set aside to comply with constitutional requirements (e.g., Constituency Session funding)
- Resources set aside by action of a constituency (e.g., Student Scholarship funding in hand).
- Resources set aside to comply with Denominational wide policy. (e.g., GCWP T 25 25 Currency Exchange Gains or Losses)

4. *Available Working Capital* - The Working Capital remaining after removing Donor Restricted Current Assets and Current Assets Held for Mandated Purposes (Working Capital minus Current Assets Held for Donor Restrictions and Current Assets Held for Mandated Purposes).
5. *Recommended Minimum Available Working Capital* - The minimum Available Working Capital that an organization should maintain in normal economic and financial conditions.
6. *Operating Expenses* - Expenses for basic operations. This includes salaries, allowances, administrative expenses, departmental expenses, and depreciation expense. It does not include appropriations and capital expenses.
7. *Net Outgoing Appropriations* - The excess of outgoing operating appropriations over incoming operating appropriations (Outgoing appropriations minus incoming appropriations. If incoming exceed outgoing, net outgoing operating appropriations is zero).
8. *Core Expenses* - Operating Expenses plus Net Outgoing Appropriations
9. *Available Working Capital Percentage* - Actual Available Working Capital shown as a percentage of the Recommended Minimum Available Working Capital (Available Working Capital divided by Recommended Minimum Available Working Capital). Percentages above 100% indicates that Available Working Capital is above the recommended minimum. A percentage below 100% indicates the degree to which Available Working Capital is less than the recommendation.
10. *Available Working Capital in Months* - This is the number of months that the Available Working Capital could support a predetermined period of Core Expenses. This policy is recommending a minimum of six months.
11. *Available Liquid Assets* - The Liquid Assets remaining after removing Current Liabilities, Current Assets Held for Donor Restrictions and Current Assets Held for Mandated Purposes (Liquid Assets minus Current Liabilities, Current Assets Held for Donor Restrictions and Current Assets Held for Mandated Purposes).
12. *Recommended Minimum Available Liquid Assets* - The minimum Available Liquid Assets that an organization should maintain in normal economic and financial conditions.
13. *Available Liquid Assets Percentage* - Actual Available Liquid Assets shown as a percentage of the Recommended Minimum Available Liquid Assets (Available Liquid Assets divided by Recommended Minimum Available Liquid Assets). Percentages above 100% indicates that Available Liquid Assets are above the recommended minimum. A percentage below 100% indicates the degree to which Available Liquid Assets are less than the recommendation.

14. *Available Liquid Assets in Months* - This is the number of months that the Available Liquid Assets could support a predetermined period of Core Expenses. This policy is recommending a minimum of three months.

## **Calculation**

### ***Recommended Minimum Available Working Capital and Liquid Assets***

The sum of six months and three months of Core Expenses for Available Working Capital and Liquid Assets, respectively:

Technical Provisions:

- (a) The six months and three months calculations equal 50% and 25% of the total of Core Expenses from the twelve months prior to the report for determining the recommended minimums of Available Working Capital and Available Liquid Assets, respectively.
- (b) The organization can reduce the actual operating expenses used in the calculation by the portion paid by *Current Assets Held for Donor Restrictions and Current Assets Held for Mandated Purposes*.
- (c) If incoming appropriations exceed outgoing, net outgoing appropriations is zero. The excess of incoming over outgoing appropriations does not reduce operating expenses.

## **Reporting**

Each organization must include in its financial reporting (see GCWP S 19) a schedule calculating the Available Working Capital and Liquid Assets as an amount, a percentage and in months. The organization may add notes to clarify changes in circumstances that might assist in clearer analysis.

## **Analysis**

During economic downturns or financial emergencies, Available Working Capital and Liquid Assets may fall below the recommended minimum amount. During periods of normal economic conditions, available working capital and liquid assets should be growing in preparation for the next downturn. The controlling board or executive committee for each organization should evaluate and determine what amounts in excess of the required minimums are appropriate for its organization. Included in this evaluation should be a consideration of inflationary influences that would make use of past information an unreliable source for making the calculations. Organizations should also be careful to avoid holding excessive working capital and liquid assets for financial emergencies.

## Sample Reporting - Working Capital and Liquid Assets Report for 31 December 20XX

### Available Working Capital:

|                                                   |                      |
|---------------------------------------------------|----------------------|
| Current Assets                                    | 140,000              |
| Minus: Current Liabilities                        | (60,000)             |
| <i>Working Capital</i>                            | <u>80,000</u>        |
| Minus: Current Assets Held for Donor Restrictions | (6,000)              |
| Minus: Current Assets Held for Mandated Purposes  | (4,000)              |
| <i>Available Working Capital</i>                  | <u><u>70,000</u></u> |

### Calculation of Core Expenses:

|                                  |                       |
|----------------------------------|-----------------------|
| Operating Fund Operating Expense | 80,000                |
| Net Outgoing Appropriations      | 50,000                |
| Total Core Expenses              | <u><u>130,000</u></u> |

### Recommended Minimum Available Working Capital

|                                                                                                                    |                   |
|--------------------------------------------------------------------------------------------------------------------|-------------------|
| Six months of Core Expenses (50% of 130,000)                                                                       | 65,000            |
| Surplus/(Shortfall) in <i>Recommended Minimum Available Working Capital</i>                                        | <b>5,000</b>      |
| <i>Available Working Capital Percentage</i> (70,000 divided by 65,000)                                             | <b>108%</b>       |
| <i>Available Working Capital in Months</i> (a minimum of 6 months recommended)<br>(70,000 divided by 130,000 x 12) | <b>6.5 Months</b> |

### Available Liquid Current Assets

|                                                   |                      |
|---------------------------------------------------|----------------------|
| Cash and Cash Equivalents                         | 40,000               |
| Cash Held for Agency                              | 15,000               |
| Investments                                       | 40,000               |
| Receivable from Higher Organization               | 15,000               |
| Total Liquid Current Assets                       | <u>110,000</u>       |
| Minus: Current Liabilities                        | (60,000)             |
| Minus: Current Assets Held for Donor Restrictions | (6,000)              |
| Minus: Current Assets Held for Mandated Purposes  | (4,000)              |
| <i>Available Liquid Assets</i>                    | <u><u>40,000</u></u> |

### Recommended Liquid Assets

|                                                                                                                      |                   |
|----------------------------------------------------------------------------------------------------------------------|-------------------|
| Three months of Core Expenses (25% of 130,000)                                                                       | 32,500            |
| Surplus/(Shortfall) in <i>Recommended Minimum Available Liquid Assets</i>                                            | <b>7,500</b>      |
| <i>Available Liquid Assets Percentage</i> (40,000 divided by 32,500)                                                 | <b>123%</b>       |
| <i>Available Liquid Assets in Months</i> (a minimum of three months recommended)<br>(40,000 divided by 130,000 x 12) | <b>3.7 Months</b> |