A Cheat Sheet For A Down Economy

By Thomas A. McLaughlin

Stop worrying about the economic mess and start doing something concrete about it. If you're a CEO or member of a board committee, call in your top financial person and ask them the questions in this column.

If you're a streetsmart nonprofit executive or a manager, take the CFO out to lunch and put this cheat sheet on your lap. (Look off in the distance occasionally to make it look like you're thinking deeply.) Or, see if you can get someone else to ask the questions.

- How Liquid Are We, Really? Cash is king, or queen, depending on the realm. As long as you have sufficient cash you can outlast most blows the environment delivers. But you need to be sure that the things listed as cash really are cash.

Many colleges and universities use a Wachovia Bank offering known as Commonfund Short-Term Fund. They discovered this past fall that the phrase "almost like a checking account," which they tended to use to describe the fund, was not the same thing as "exactly like a checking account."

When Wachovia froze the fund, some of the participating institutions realized they had misunderstood how it worked right from the beginning. For participants with adequate cash reserves, this was merely an annoyance. For those with the cash needle close to zero it was a crisis.

- Do We Have Unrealized Losses? If the answer to this question is yes, congratulations. At least you have an investment portfolio large enough to lose enough money to influence your bottom line. These are the times when the value of a portfolio as an economic buffer is clear, because investments cushion what otherwise might be a very unpleasant financial jolt. These buffered organizations also give the nonprofit sector its recession-resistant character.

Timing is everything. When the tech bubble burst in March 2000, the downward slope was gentle enough that the red ink from unrealized losses didn't show up until calendar year 2001. More important, relatively few nonprofits' fiscal years end in March or April, so everyone had time to adjust. This time, the sharp downtown in September of this year probably caught organizations with investment portfolios and September 30 fiscal year ends in a short-term crunch with no time to recover. Nonprofits with December 2008 fiscal year ends and those whose fiscal years end in June of next year have more time to avoid red ink.

- Are We Profitable? One of the best things you can do is to make sure that operating costs are under control. While you can't do much about unrealized losses, you should be able to influence operating outcomes. This is the year to make a profit, preferably a big one to offset all the other potential sources of unhappiness. Those monthly reports you're getting showing how much profit or loss you made are the vehicle for staying on top of this metric.

Keeping operating revenue in balance with operating expenses is always important, doubly so today because external economic realities are eroding capital. Running a deficit just adds another source of erosion.

For some the internal and possibly external pressures to run a deficit in these times will be considerable. The arguments for keeping services and benefit levels where they are even if it means a deficit will be compelling. However, organizations that do this face a double whammy, losing revenue while spending at the same level. For the majority of organizations that don't have deep reserves, this practice is not sustainable for long.

- Freeze or Postpone? Paper or plastic? Take both, please. Spending freezes are a crude tool, but they can help in the short term as long as everyone accepts the need for them. With their heavy-handed but egalitarian downward pressure on spending, freezes offer the most intuitive alternative to painstaking attempts to be "fair."

All raises are frozen, no out-of-state travel is allowed, etc. Postponements are another obvious choice, although it should be noted that most operating expenses can not be postponed in large enough quantities for a long enough period to have a substantial impact. This is why postponements are often more effective with the purchase of large assets or construction projects, although contractual penalties can outweigh the virtues of postponement in some cases.

- What's the Status of Our Line of Credit? Lines of credit are a specific kind of short-term loan in which a bank agrees to make cash available on demand up to a pre-specified limit. When the cash is used, the outstanding balance is charged interest. In normal times, lines of credit are supposed to represent a quick and easy way to bring cash into the bank account without going through the contortions of acquiring a long term loan.

For a down economy, institutional lines of credit can be tricky. Since lines of credit are uniquely short term, different regulations apply. Normally a borrower should be "out" of its line of credit for 30 consecutive days during the year, or else the borrowing is considered to be longer term and different requirements apply.

The risk in today's economy parallels that of a previous credit crunch, in which federal regulators pressed banks to be sure of the creditworthiness of their lines of credit customers by enforcing the 30-days-out rule. If there is borrowing on the line of credit, and if the bank has the right to "call" the line, it can worsen the cash flow crunch for an organization. At a time when the federal government is flowing capital into banks to loosen credit this might not be likely, but the risk could still be there.

- What's Our Single Largest Asset? Nonprofits must own assets, or things of value, to operate. How your organization chooses to hold its assets can help determine how well you will weather this storm. Look for the single largest asset on your balance sheet, then stop for a moment to think about who controls that asset in your organization. That's your biggest risk area, and you need to understand it in the context of a bad economy. Here are some tips. If your largest asset is:
- Cash. Red flag. This is lazy money, cash sitting by the pool all day instead of working hard earning interest. Who controls those cash accounts? It's probably a staff person, possibly even a staff person buried somewhere in the back office without a lot of

supervision. Even a good system of checks and balances and internal controls is thin protection against an insider hungering for that cash. Fix the problem right away.

- Accounts Receivable. Whoever controls those receivables controls your organization. Can they deliver on their promises to pay? If they can, will they actually pay on time? In a down economy it is important to ask yourself if those who owe you money will be paying in full and on time. Even if everything looks okay now, watch those receivables very closely.
- Grants Receivable. This is a similar issue as above, except that payment might be more secure -- and slower. In down times, foundations' portfolios experience exactly what any set of investments experiences -- that sickening feeling of the roller coaster going down fast. They might pay slower or seek to stretch out that multi-segment award.
- Investments. This was covered, mostly, in this above. If your single largest asset is a portfolio of investments, your major problem is making sure they're managed properly.
- Real Estate. Here, too, is a possible double whammy. Real estate values are going down every month. That's manageable unless you plan to sell soon. But if your single largest asset is real estate, pay careful attention to your cash balances. Real estate can suck the cash right out of an organization. If you're overloaded on this end you might not have enough cash for normal operations and you could wind up house rich and cash poor.

You can see the insidious nature of all this. If you freeze spending, slow down investments, look for savings and forego purchases you're doing the right thing for your organization. If everyone does that, the economy slows down. That's the paradox, and it always takes a while to work out of it. But at least you'll be around to see the upturn.

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