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Improving Financial Management

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Budgeting is the tip of the financial management iceberg; it is the right place to start. Technical Leaflet #268 outlined the steps for developing a solid budget. Once your organization has a budget in place, the ongoing challenge is monitoring financial performance on a regular basis and developing mechanisms for making sound financial decisions.

Financial management is not the responsibility of any one person. Rather, it should be a shared responsibility among the board and staff. The board has fiduciary responsibility for the health and perpetuation of the organization—that is, they are expected to prudently take care of the nonprofit's assets on behalf of the general public. They cannot do that job without accurate, and timely, information.

There are two categories of financial reports: 1) internally produced budget and other financial reports that are generated monthly or at some other regular interval, and 2) the summaries that are part of an annual audit. Financial management goes far beyond providing and approving reports. The board and staff should also be assessing and considering how to improve financial performance, monitoring cash flow projections, and ensuring that proper checks and balances are in place.

Internal Financial Reports

In general, smaller organizations need to focus on preparing accurate, timely, and informative *internal financial reports* on a regular basis for the director and board. The format should remain consistent from board meeting to board meeting so that members can quickly find information they need. However, if reports are confusing or present the wrong level of detail, they should be revised. The treasurer or whoever prepares these reports should regularly ask for feedback on whether they meet the board's needs. Reports should also provide the director with the information required to monitor the financial health of the organization. One simple test: if the same questions get asked repeatedly, the reports are in some way confusing or inadequate.

As people who work with the public, we know that folks (including our board members) learn and absorb information in different ways. Financial reports tell a story; to get that story across to everyone, you need to use numbers, words, and pictures.

Figure 1 shows an example of a budget report, listing revenue and expense. It should include the following columns, using the same revenue and expense categories, in the same order, in each column:

- Prior year actual revenue and expenses
- Current year annual budget
- Current year budget to date (matching how far you are into the year; so six months in, this would be half the budget)
- Actual revenue and expense, year to date (YTD)
- Difference between budget to date and actual to date

At the bottom of each column, note the difference between revenue and expenses for that column.

Those are the numbers in the budget story. What about the words? For any item that is significantly off budget (either higher or lower), add a note that explains the difference. This not only helps those who are not facile with numbers, but it also draws the board's attention to the most significant and important issues.

Adding pictures means mastering the graphing functions in your spreadsheet or other software. Graphs are best for comparing data. You may want to create a bar chart that compares data (e.g., paid admissions, membership renewals, attendance at the annual house tour) from last year to this year, for example, or—if you run multiple sites—comparing statistics from each (library patrons versus historic house visitors, for example). Or if the mix of revenue or expenses is changing, you might want to create comparative pie charts. And sometimes reports or charts on subsets of your financial information may be appropriate. It can be easier to judge the success of a fundraising event, membership campaign, educational program, or other activity when the relevant information is pulled out from the main report.

Does a board need to review the budget report line by line? Absolutely not. It is the job of the treasurer and director to draw board members' attention to significant variations from budgets and projections. Time should be spent discussing responses to welcome and unwelcome surprises, not examining each and every number.

External Financial Reports

The *audit*, or a less exhaustive and extensive *compilation*, is prepared by someone from outside the organization who reviews all of the bookkeeping, financial transactions, and internally-generated reports. Audits have mainly external audiences—funders, public agencies, etc.—that require an objective review of operations. They also typically include a "management letter," which notes any deficiencies or questions about the financial management of the organization. In larger organizations, an audit committee receives the audit and management letter, reviews the findings, meets with the auditor, and reports back to the rest of the board about any significant issues or concerns.

The main report in the audit is the "statement of financial position," also known as the balance sheet. (The Financial Accounting Standards Board—FASB—changed all the report names several years ago, but many people still use the old names out of habit.) Some accounting software packages can readily produce these snapshot reports of organizational health anytime, throughout the year. Before the easy availability of such reports, they were only generated annually, as part of the audit. Balance sheets provide an overall picture of the organization: how much does it have and where (e.g., cash, investments, property), how much does it owe (e.g., accounts payable, loans payable), and how much is it owed (e.g., accounts receivable). As with all good financial reports, they compare the current and prior years. They are most useful when used to identify issues that need to be addressed, such as "we owe more

January–June 2014 Financial Report

Revenue

	Prior Year Actual	Current Budget	Budget YTD	Actual YTD	Difference	Notes
Memberships	$9,000	$10,000	$10,000	$9,500	-$500	*Campaign less successful, need targeted mailing*
Annual fund	$15,645	$15,000	$0	$0	$0	*Mail October 30*
Admissions	$7,965	$8,000	$3,000	$2,800	-$200	*Major storms in May; free advertising for new exhibit?*
Group tours	$4,568	$4,000	$2,000	$1,860	-$140	*Additional tours scheduled for July*
Student tours	$1,890	$2,000	$2,000	$2,154	$154	
Shop sales (net)	$4,367	$6,200	$2,325	$1,987	-$338	*New merchandise arriving August for auction support*
Town grant	$5,000	$5,000	$5,000	$5,000	$	
Wine tasting (net)	$1,980	$2,300	$2,300	$2,411	$111	*Three leftover cases purchased by committee members*
Auction (net)	$4,756	$4,200	$0	$0	$0	
Investment income	$3,678	$3,600	$1,800	$1,800	$0	
Revenue Total	**$58,849**	**$60,300**	**$28,425**	**$27,512**	**-$913**	

Expense

	Prior Year Actual	Current Budget	Budget YTD	Actual YTD	Difference	Notes
Director salary + benefits	$36,000	$36,000	$18,000	$18,000	$0	
Guides' hourly wages	$6,120	$6,000	$2,250	$2,250	$0	
Insurance	$3,600	$4,000	$2,000	$2,000	$0	
Maintenance	$2,655	$3,000	$1,500	$800	$700	*Roof tile replacement put off for one year*
Utilities	$3,689	$3,300	$1,800	$1,689	$111	*Heating savings better than anticipated, despite cold snap*
Temporary exhibit	$0	$4,500	$4,500	$4,612	-$112	*Replaced interactive panel*
School program supplies	$824	$800	$400	$552	-$152	*Purchased materials in bulk; will reduce overall cost*
Printing, postage, office	$856	$1,500	$700	$800	-$100	*Printed more letterhead than planned; second membership mailing*
Website contract	$2,850	$1,200	$600	$600	$0	
Expense Total	**$56,594**	**$60,300**	**$31,750**	**$31,303**	**$447**	
Net	**$2,255**	**$0**	**-$3,325**	**-$3,791**	**-$466**	

Figure 1

than we have in the bank." Because they are snapshots, capturing the financial picture on the day they were generated, balance sheets must be used in conjunction with other, more dynamic, reports.

The second audit report is the "statement of cash flows," which is not to be confused with the cash flow projection described below. The statement of cash flows is essentially a reconciliation of what came in

Reading Budget Reports for the Novice

While five columns of numbers for a myriad of revenue and expense categories may seem overwhelming for those unfamiliar with financial reports, for those with nonprofit or other business experience, these reports provide most of the necessary information and are relatively standard.

The columns are organized with the oldest information in the first or left column (column 1, prior year actuals) and the most immediately relevant information in the last or right column (column 5, difference between current year budget and actuals to date, otherwise known as over/under budget).

Here are some strategies for reviewing the report for items that may need to be questioned or explained:

1. Review the last column for large negative or positive numbers that represent *immediate* issues. These large differences between where you predicted you would be (column 3, current year budget to date) and where you are (column 4, current year actuals to date) need to be addressed. In some cases, the difference is due to timing and will correct itself shortly (as in the case of a membership renewal letter going out a few weeks later than planned), and so there is little to worry about. In other cases, the difference is a real issue (as in the case of fewer renewals) and so needs to be addressed by the board and staff.

2. To understand if your *long-term* strategies are working, consider where you are in the current year in comparison to the past (prior year actuals) and with your goals (annual budget). Prior year's actual revenue and expense (column 1) reminds you of how you did last year. Are you doing better or worse? Why? The annual budget (column 2) reminds you of what you planned to do this year. Are you on target with your plans, or do you need to make a change?

during the year and what went out, again compared with the prior year. It demonstrates exactly how and why the cash position of the organization changed.

Audits also account for the FASB-defined categories of funds: permanently restricted, temporarily restricted, and unrestricted. These categories are strictly defined and mandatory. Permanently restricted funds are those whose use (and occasionally, investment) are dictated by the donor in perpetuity. Temporarily restricted funds are also designated by the donor, but once the restrictions are satisfied, they are transferred to the unrestricted category. These may include grants designated for a particular program or funds raised for a specific project, like a new exhibition or capital repairs. Everything else is categorized as "unrestricted." This is confusing and annoying to nonprofit managers. What about the proceeds of de-accessioning, which we've restricted to direct care of the collection and new acquisitions? Or the recent bequest that the board voted to put in the endowment? Or the revolving fund we use to seed funding for the next publication? Or the small surplus from last year we voted to put into a maintenance reserve? FASB says that unless the donor put restrictions on those funds, they are, in truth, unrestricted and actually available for any and all purposes. So there may, in fact, be an additional report appended to the audit, explaining all of the policies and organizationally adopted restrictions on the "unrestricted" funds.

Improving Financial Performance

Organizations are searching for the holy grail of "sustainability"—finding a diverse and stable mix of revenue sources that can be counted on year after year. Most historical organizations understand that overreliance on any one source of funding is inherently unstable. There is no simple formula for sustainability beyond this: look at every revenue source and do the hard work to protect and grow those sources.

Of course, this is easier said than done. Organizations with sizable endowments saw their investment income drop after 2008. Those that enjoyed strong public support from their communities, counties, or states are finding those appropriations increasingly vulnerable. Foundation funding has not only become more competitive, but the funders themselves are demanding more accountability for demonstrable impact of the programs they have funded. We recognize the importance of identifying and cultivating donors with the capacity to be generous, but who in our organization has the skills and contacts to do that work?

Probably the area where historical organizations can make the most significant change is in the area of earned income. Many already have shops or publications programs. Some have profitable programs like symposiums or summer camps. But with some

Assessing Performance

The mnemonic "CASH" captures the four ways to benchmark an organization's performance. A well-managed organization keeps track of all of the four in parallel because together they provide a full picture of how the organization is functioning. It is worth noting that board members tend to relate well to this idea of benchmark data, particularly if they come from data-driven professions. They are often frustrated that historical organizations cannot provide good industry data against which they can assess performance.

C – Comparables. Every nonprofit should be able to identify a handful of organizations that are comparable to its operation: organizations with similar budgets, program offerings, and facilities along with similar communities and audiences. For example, the larger outdoor living history museums collect and share comparable data (not just financial data). Consider creating a small information-sharing network among peer institutions to collect and compare performance data.

A – Averages. Even though the wider community of museums and historical organizations includes organizations that are not directly comparable, there is value in understanding how an individual organization compares to the entire universe of similar nonprofits. State or national surveys are useful for finding good industry averages.

S – Strategic goals. As part of planning, an organization should set goals for performance. These goals should be challenging yet achievable. If your budget is built around your goals, failing to achieve goals will have a negative impact on the budget.

H – History. Snapshot data is almost useless; an organization needs historical data to assess patterns and trends. If an organization does not have good data about past performance, the most critical step in developing a good management performance program is setting up systems that will efficiently and accurately collect key data.

Look at one number—your paid admissions. Last year, you brought in $12,500. Is that a good or bad number?

Your group of friendly comparable organizations report $5,000 to $18,750, so you are doing better than average. But the AAM data report for the most recent year says that average admission revenue for institutions of your size is $22,300, so you're not doing well in those terms. But you also know that history museums generally have lower fees than children's and science museums of the same size. Your strategic plan called for increasing admissions to $20,000 over five years, and you are in year four of the plan, so you are not meeting those goals.

Then you look at the historical numbers:

Year 1: $950

Year 2: $12,000 (special traveling exhibit from the Smithsonian)

Year 3: $10,400

Year 4: $12,500 (special exhibit from your own collections)

You figured out that special exhibits boosted numbers significantly and consequently developed the capacity to do exhibits in house. So the trend lines are all positive. If you can continue to devote resources to developing an annual exhibition that gets people to visit, you probably can increase admission revenue over time. You won't meet the goals in your plan (and there may be financial implications from that), but you are now in a much better position to plan and budget for next year. And if you cancel the annual special exhibition, you can be pretty sure that admission revenue will drop again.

entrepreneurial focus, an organization can increase its earned income. The first step is to identify those programs for which there is a strong market and to figure out if they can be expanded. If you moved the symposium to a local church, could you accommodate more people? Would a fourth session of the summer camp fill? The second step is to look carefully at the price of revenue-generating programs. Are your fees competitive? When was the last time they were increased? The third step is to identify unmet needs and see if you can enter the market at low cost and/or charging a good price. Can you contract out senior staff to complete corporate histories or set up an oral history program? Can your staff advise on selecting appropriate wallpaper for historic house owners? But be cautious: sometimes "no one is doing…" because the market for that service is weak.

Most fundraising events (and programs) that don't change get stale and lose their attendees after just a few years. Perhaps the most painful change is pruning away those programs that were designed to be money-makers (versus those that are mission-critical) but which, in fact, are not. However, cutting programs that are not very profitable frees up time and energy for new or expanded programs that have greater potential to generate funds. Acknowledging that the historic home tour or lunchtime lecture series doesn't generate funds is the first step in making room, not only for new donors and funds, but also for new audiences. One popular idea is the non-gala: basically, you tell your supporters that there is no event—no need to get your best clothes dry-cleaned and hire a babysitter. Still give us the ticket price, but then take all the money you saved and either add it to your donation or take the family out for dinner.

Cash Flow Projections

No matter how you generate income or track your money, you must consider timing. You can stick to your budget and still find there's not enough cash to get through the month. Even worse, if the majority of your income comes in toward the end of your fiscal year and you fall short of projections, you haven't had time to change your spending. One tool that helps prevent you from going too far off the rails is an accurate *cash flow projection*. Monitoring the budget monthly or quarterly requires that you have a sense of when money comes in and goes out of the organization. Most software programs allow you to enter your budget by month in order to accommodate seasonal influxes (e.g., fundraising events or membership renewals) and irregular outflows (e.g., an exhibit build-out or insurance premiums). From that, your accounting software may allow you to create a cash flow projection, which lets you see how much cash you'll have at the end of each month.

You can also do this with a simple spreadsheet (or even by hand with a calculator), with the budget in the first column and then twelve more columns, one for each month. Take each line of your budget and project which month the revenue and expenses will hit.

Look at the example in figure 2. Start with revenue. Membership renewals go out right after the first of the year, so revenue arrives in January, February, and March. Because the museum is closed for four months, admission revenue and shop sales are projected evenly over eight months. But student tours only come in the spring, and group visits in the spring and fall. Funding from the town arrives in March. Now look at expenses. The director's salary is spread evenly over the year, but guides only work in the eight months the museum is open. Insurance is billed every six months, in April and October. Utilities are higher in the winter and drop in the spring and summer. The temporary exhibit has to be done by re-opening day, April 1, so those expenses all fall in March.

Then you do the math: how much did you start with that month, plus how much will come in, minus how much will go out. The total of that calculation becomes the starting point for the next month. In this example, when do things start to unravel? In April, when membership revenue has ended and the insurance bill comes due. So even though you have a balanced budget, by the end of the month, you are running in the red. Although you make it up in May, you then go through six months of negative cash flow, where you don't have enough cash to pay your bills, before recovering in December, when expenses are lower and revenue from the annual fund comes in.

What can you do? You need to think about shifting the timing of revenue and expenses. Your fall fundraiser (an auction) makes more money than the spring wine tasting. Can you retool the spring event to make more? Or add a summer fundraiser? Perhaps the board can make their annual fund gifts earlier in the year. Have you tried to get underwriting for the temporary exhibit? Try negotiating with the insurance company to change their billing schedule. If you can't move enough revenue and expenses to fix your cash flow, you might need to apply for a line of credit at a local bank. The point is that with a strong, accurate cash flow projection, you will know when you will fall short and find ways to make ends meet.

Cash flow projections also help you make better decisions. For example, suppose a board member observes that it seems counter-productive to have membership renewals go out right after the annual appeal. That may be true, but if you were to shift renewals later in the year, your cash flow would be even worse. You'd need more of a reserve to get you through the first few months of the year. Or perhaps someone observes that the town should send you

Cash Flow Projection

Budget	Month	January	February	March	April	May	June	July	August	September	October	November	December
		Museum closed December 1 to April 1				*Wine tasting*				*Auction*			
	Opening balance	**$1,200**	**$2,550**	**$2,000**	**$950**	**-$1,775**	**$0**	**-$2,125**	**-$4,450**	**-$6,775**	**-$4,100**	**-$7,625**	**-$5,150**
Revenue													
Memberships	$10,000	$5,000	$3,000	$2,000									
Annual fund	$15,000											$5,000	$10,000
Admissions	$8,000				$1,000	$1,000	$1,000	$1,000	$1,000	$1,000	$1,000	$1,000	
Group tours	$4,000				$1,000	$1,000				$1,000	$1,000		
Student tours	$2,000				$800	$1,000	$200						
Shop sales (net)	$6,200				$775	$775	$775	$775	$775	$775	$775	$775	
Town grant	$5,000			$5,000									
Wine tasting (net)	$2,300					$2,300							
Auction (net)	$4,200									$4,200			
Investment income	$3,600	$300	$300	$300	$300	$300	$300	$300	$300	$300	$300	$300	$300
Total Revenue	**$60,300**	**$6,500**	**$5,850**	**$9,300**	**$4,825**	**$4,600**	**$2,275**	**-$50**	**-$2,375**	**$500**	**-$1,025**	**-$550**	**$5,150**

Expense	Month	January	February	March	April	May	June	July	August	September	October	November	December
Director salary + benefits	$36,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000
Guides' hourly wages	$6,000				$750	$750	$750	$750	$750	$750	$750	$750	
Insurance	$4,000				$2,000						$2,000		
Maintenance	$3,000	$250	$250	$250	$250	$250	$250	$250	$250	$250	$250	$250	$250
Utilities	$3,300	$400	$400	$400	$200	$200	$200	$200	$200	$200	$200	$300	$400
Temporary exhibit	$4,500			$4,500									
School program supplies	$800				$200	$200				$200	$200		
Printing, postage, office	$1,500	$200	$100	$100	$100	$100	$100	$100	$100	$100	$100	$200	$200
Website contract	$1,200	$100	$100	$100	$100	$100	$100	$100	$100	$100	$100	$100	$100
Total Expense	**$60,300**	**$3,950**	**$3,850**	**$8,350**	**$6,600**	**$4,600**	**$4,400**	**$4,400**	**$4,400**	**$4,600**	**$6,600**	**$4,600**	**$3,950**
	Ending balance	**$2,550**	**$2,000**	**$950**	**-$1,775**	**$0**	**-$2,125**	**-$4,450**	**-$6,775**	**-$4,100**	**-$7,625**	**-$5,150**	**$1,200**

Figure 2

their check right after the first of the year. While it's always nice to have a larger balance in the checkbook, moving that earlier in the year won't, in fact, improve your cash flow. So perhaps it would not be worth expending political capital on that request. Can you manage with fewer guides in the fall, when there are no school tours? It would definitely be worth looking at attendance statistics. Although admissions and shop revenue are projected out evenly over eight months, in fact those may be slower months.

Checks and Balances

A basic principle of financial management is to ensure that no one person has sole control of the finances. There are several reasons for this. The first is to reduce the risk of fraud. If one person closes the cash register, counts the cash, and makes the deposit, there is little to prevent him or her from skimming cash. If the director approves all the invoices and signs all the checks, he or she could readily authorize fraudulent payments to friends or imaginary vendors. The second reason is to improve accuracy. Simply having two or more people double-checking math and data entry is an easy step. The person who keeps the checkbook might have someone else check the balance when the monthly statements come in. Finally, checks and balances protect everyone responsible for handing finances. Many people will reasonably refuse to be responsible for a nonprofit's finances if there's no one else making sure things are done properly and accurately.

There are some simple steps you can take. On the revenue side, make sure that cash and credit card transactions are not compromised. Two people should separately count cash receipts and reconcile the totals with documentation of sales (e.g., admissions, shop, etc.). If the organization deals with significant cash, deposit slips should be checked against revenue records by someone other than the person who made the deposit. Ensure that credit card information is properly encrypted on your website and that no hard copy records of credit card numbers are kept after the transaction has been processed. For example, don't keep a credit card number on file for memberships or annual fund donations. On the expense side, limit the authority any one person has over spending the organization's money. Checks over a certain amount should require a second signature (generally the president or treasurer). Any unbudgeted expenditure should be approved by someone other than the director: the treasurer, president, or executive committee, for example. Checks should be kept securely locked away, and no one should ever sign blank checks (even before taking a four-week vacation!).

If your organization has an audit or a compilation, the accountant will review your written or unwritten financial management policies and procedures and make recommendations for improvements. If you do not have an auditor, an accountant in the community may be willing to develop a policies-and-procedures document for your organization. Just be certain that procedures are appropriate to the size and scale of your organization.

Use Your Board Wisely

You may have avoided a career path that required a command of math and numbers, but there are many in your community who have just the skills you may lack. You don't have to do this work alone! Recruit a qualified, committed treasurer for the board and help him or her create a working finance committee that monitors financial performance carefully and helps you and the treasurer think ahead. Prepare clear financial reports and present them simply and clearly. If there are no questions, figure out if the board is confused or complacent! Focus the board's attention on the questions where they can add perspective and insights, not on minutiae. You may never be as comfortable with finances as you are with education, collections, or public relations, but providing good financial management is vital to generating trust within your donor community and ensuring your organization has the resources to accomplish your mission in the near and long term.

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