

03

FINANCIAL SUSTAINABILITY

3.1

FINANCIAL SUSTAINABILITY

This section on financial sustainability covers: diversification of organisation revenue, timing of revenue compared to costs, creation of financial reserves, working capital policy, and options in a financial crisis.

DIVERSIFICATION

The purpose of non-profit sporting organisations is to make positive change in the communities they serve. Your organisation should have a plan that sets out what it wants to achieve, by when, for whom and how. For more assistance please go to:

<https://sportnz.org.nz/managing-sport/search-for-a-resource/guides/planning-in-sport->

These activities will need resources – both financial and non-financial.

Subscriptions from the organisation's members can be enough to cover operating costs. Even if this is the case, it is a good idea to diversify revenue where possible.

This means creating other revenue sources apart from subscriptions, such as grants, donations, special events, sponsorship and fundraising.

Organisation revenue may not be reliable; therefore an organisation should continually assess (as part of a risk management programme) how likely its income sources are to continue, even if it has already diversified.

Some revenue sources are mostly predictable, such as subscriptions, but others may be affected by competition for grants and sponsorship; economic climate; reduced availability of grant money; or poor performance by the organisation.

HAMPDEN TENNIS CLUB

Operating revenue report for the 12 months ended 30 June 20X3

CURRENT MONTH

	\$ ACTUAL	\$ BUDGET	\$ VARIANCE		% VARIANCE	
REVENUE						
Grants	-	20,000	(20,000)	U	(100%)	●
Member subscriptions	600	2,000	(1,400)	U	(70%)	●
Tennis lessons	-	-	-			●
Court bookings (non-members)	1,980	1,000	980	F	98%	●
Wine sales fundraiser	-	-	-			●
Bar	267	1,000	(733)	U	(73%)	●
Total Revenue	2,847	24,000	(21,153)	U		

YEAR TO DATE

	\$ ACTUAL	\$ BUDGET	\$ VARIANCE		% VARIANCE	
REVENUE						
Grants	-	80,000	(80,000)	U	(100%)	●
Member subscriptions	66,435	72,500	(6,065)	U	(8%)	●
Tennis lessons	52,800	35,200	17,600	F	50%	●
Court bookings (non-members)	16,574	15,000	1,574	F	10%	●
Wine sales fundraiser	174	5,500	(5,326)	U	(97%)	●
Bar	4,657	20,000	(15,343)	U	(77%)	●
Total Revenue	140,640	228,200	(87,5690)			

A vertical analysis to find the percentage of net operating revenue items to total revenue compared with the budgeted percentage is presented.

The vertical analysis reveals members' subscriptions as 46% of the total actual revenue, which was budgeted to be 32% of the total revenue. As the other sources of revenue did not occur as budgeted, subscriptions ended up being a higher percentage of revenue.

Although the club has a plan of revenue diversification in place, the failure to secure non-conditional grant money, sufficient subscriptions, bar profit and fundraising income has meant the club has received \$87,560 (\$228,200-\$140,640) less income than budgeted.

Tennis lessons and court bookings were above budget, but not enough to cover the other revenue decreases.

HAMPDEN TENNIS CLUB

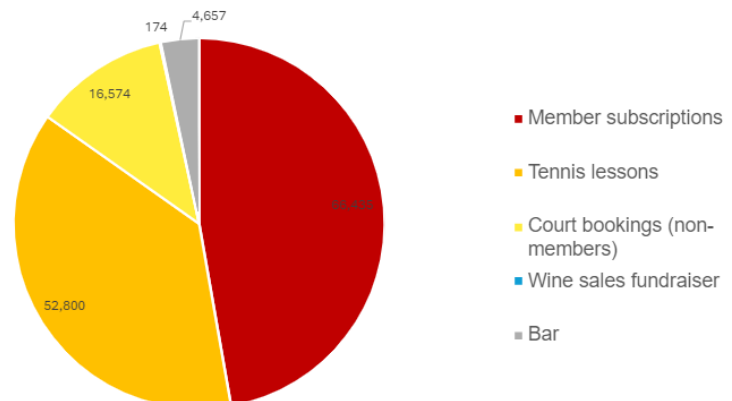
Vertical operating revenue analysis

YEAR TO DATE

	\$ ACTUAL	% TOTAL	\$ BUDGET	% TOTAL
REVENUE				
Grants - non-conditional	-	-	80,000	35%
Member subscriptions	66,435	46%	72,500	32%
Tennis lessons	52,800	36%	35,200	15%
Court bookings (non-members)	16,574	15%	15,000	7%
Wine sales fundraiser	174	-	5,500	2%
Bar	4,657	3%	20,000	9%
Total Revenue	140,640	100%	228,200	100%

The following pie chart graphically shows Hampden Tennis Club's actual operating revenue for the year.

Hampden Tennis Club actual revenue year ended 30 June 20X3



3.2 EXERCISE 4

REQUIRED:

The Hampden Tennis Club's subscriptions were budgeted at 32% of revenue.

A. Do you think this is too low?

* Suggested solutions are in chapter 5.0

3.3 EXAMPLE 2

Example of a secure, diversified revenue organisation.

MAYGENVALE BADMINTON CLUB

Operating revenue report for the 12 months ended 30 June 20X3

YEAR TO DATE

	\$ ACTUAL	\$ BUDGET	\$ VARIANCE		% VARIANCE	
REVENUE						
Member subscriptions	79,000	80,000	(1,000)	U	(1%)	
Investment income	12,600	12,000	600	F	5%	●
Sponsorship	7,000	6,000	1000	F	17%	●
Total Revenue	98,600	98,000	600			

MAYGENVALE BADMINTON CLUB

Vertical operating revenue analysis for the 12 months ended 30 June 20X3

YEAR TO DATE

	\$ ACTUAL	% OF TOTAL	\$ BUDGET	% OF TOTAL
REVENUE				
Member subscriptions	79,000	80%	80,000	82%
Investment income	12,600	13%	12,000	12%
Sponsorship	7,000	7%	6,000	6%
Total Revenue	98,600	100%	98,000	100%

- If the normal operating expenses to run the Maycenvale Badminton Club are \$86,500 per year, the actual surplus in 20X3 is \$98,600 – \$86,500 = \$12,100.
- The club has no debt apart from accounts payable due for payment next month.
- The investment account of the club has \$150,000 in it, and has built up over many years of financially prudent management. It is invested conservatively.
- Sponsorship is for the annual club tournament held each August.
- As can be seen, membership fees are 80% of total revenue received. The investment income is secure every year and is invested in conservative or lower interest-bearing accounts.

Emergency financial reserves

- Sometimes events can happen beyond the control of an organisation which adversely affect financial performance. This can also occur because of organisational financial mismanagement.
- In the event of a financial emergency, if an organisation has an emergency reserve fund this can be accessed to provide much-needed funds.

3.4

EXERCISE 5

HEI HOI INDOOR BOWLING CLUB

Statement of Financial Position (Excerpt) as at 30 June 20X3

	\$ ACTUAL
CURRENT ASSETS	
Bank	\$8,652
ACCUMULATED FUNDS	
Emergency Reserve Fund	\$30,000

REQUIRED:

What do you think is wrong with this scenario of the Hei Hoi Indoor Bowling Club?

* Suggested solutions are in chapter 5.0

3.5 EXAMPLE 3

The Fenchurch Ski Club accounts show the following:

FENCHURCH SKI & SNOWBOARDING CLUB

EMERGENCY RESERVE EXAMPLE

Statement of Financial Position (Excerpt) as at 30 June 20X2

	\$ ACTUAL
CURRENT ASSETS	
Bank cheque account	\$14,122
Emergency fund bank account	\$40,000
ACCUMULATED FUNDS	
Emergency Reserve Fund	\$40,000

As can be seen, there is a separate bank account containing \$40,000, which is the same as the emergency reserve fund in Accumulated Funds.

FENCHURCH SKI & SNOWBOARDING CLUB

Statement of Financial Position (Excerpt) as at 30 June 20X3

	\$ ACTUAL
CURRENT ASSETS	
Bank cheque account	\$2,102
Emergency fund bank account	\$28,000
ACCUMULATED FUNDS	
Emergency Reserve Fund	\$28,000

If during the next year the club needs to withdraw \$12,000 (due to their ski slope bus breaking down), the Statement of Financial Position will now look like this.

The emergency bank account has decreased by \$12,000 to \$28,000 and the emergency reserve fund has also decreased by the same amount. Reserves can also be held for special projects and treated in the same way as in the example above.

Working Capital Policy

Working capital, as we have seen in Section I, is the difference between our current assets and current liabilities.

In order to pay our current liabilities, we need to have sufficient cash to do so. If we have accounts receivable and inventory, we should convert these to cash as quickly as possible.

The ideal ratio for working capital is 2:1 or better, i.e., for every \$1 of current liabilities we have \$2 of current assets.

A non-profit sporting organisation struggling with its working capital will have difficulty paying the monthly accounts.

An organisational policy for working capital might require an organisation to have enough cash to cover three months of expenses. That means if average monthly cash expenses are \$6,000 there would be \$18,000 worth of cash in the bank account.

A constantly large bank account compared to our normal monthly cash expenses may indicate we are not using our cash resources effectively. A 12-month buffer of cash to meet monthly expenses, i.e., maintaining a \$72,000 bank account to pay \$6,000 worth of monthly expenses, illustrates this.

Financial Distress

Organisations for one reason or another, at times, can struggle financially, i.e., have insufficient cash to pay their expenses.

The consequences of this are obvious. Changing leisure patterns in the last few decades, for example, have meant some organisations' member numbers have dropped.

A sporting organisation with cash flow difficulties, regardless of the cause, will have to take action – sometimes urgently.

Some options are to:

- Convert accounts receivable to cash as soon as possible
- Make arrangements with creditors to have a longer payment time, or delay payment
- Arrange or extend a bank overdraft
- Sell surplus, non-strategic assets
- Reduce expenses
- Increase revenue

Activity Analysis

An obvious way to correct financial distress is to reduce costs, as this can be a quicker option than trying to increase revenue. However, we don't want to cut expenses which will financially worsen the organisation or make it difficult to achieve its mission. One way to find out the impact of cutting expenses is to perform an activity analysis.

An activity analysis identifies an activity and then links expenses and revenues associated with it to attempt to find a realistic cost or profit.

3.6

EXAMPLE 4

HAMPDEN TENNIS CLUB ACTIVITY ANALYSIS EXAMPLE

Serving of drinks in the Hampden Tennis Club bar is an activity and the direct costs are wages and inventory purchases. The direct revenue from this activity is drink sales.

Some costs, such as inventory purchases, are easy to identify, but others, like bar-related electricity on one metered account, are more difficult.

Reasonable estimates will have to be made in such cases.

If we were to perform an activity analysis to get a true cost to operate the bar, it might look like this.

ACTIVITY	\$ REVENUE	\$ EXPENSES	NOTES
Bar sales	36,522		
Cost of sales		31,865	
Wages		15,000	
Electricity		1,230	1
Insurance/Rates		460	2
Building Repairs and maintenance		248	3
Total	36,522	48,803	
Deficit	(12,281)		

Notes:

- 5% estimate on electricity costs of \$24,600
- 10% of rates \$2,300 = \$230 + bar insurance of \$200 + general building insurance \$30
- 10% estimate on building repairs and maintenance of \$2,485

If we eliminate the bar activity, it appears we would save \$12,281. However, some of the costs which are allocated to the activity may not be able to be eliminated.

The variable costs, revenue and fixed costs directly related to the activity (known as avoidable costs) can be eliminated. These are bar sales, cost of sales, wages, insurance on bar plant, and electricity (even though electricity is an estimate, non-use of ice machine, bowers and bar lights etc. will reduce this cost).

Rates, building repairs and building insurance relating to the club building are allocated to the bar because of the space used by the bar – BUT eliminating the bar activity will not make these costs disappear.

This is because these costs – known as unavoidable costs – occur regardless of whether an activity is carried on or not. For example, the Hampden City Council will not reduce the rates account just because the bar is no longer operating in that space. The club still occupies the property and that is the driver of that cost.

=If we deduct the unavoidable insurance/rates and building repairs costs, then eliminating the activity of bar sales would save \$11,773.

ACTIVITY	\$ REVENUE	\$ EXPENSES
Bar sales	36,522	
Cost of sales		31,865
Wages		15,000
Electricity		1,230
Insurance		200
Total	36,522	48,295
Deficit	(11,773)	

Stopping activities that are unprofitable may not be the only course of action. Other creative solutions may be able to be found – so an unprofitable activity does not necessarily mean it should be automatically stopped.

Other activities at Hampden Tennis Club

It would make no sense to cut the tennis lesson activity cost of \$15,000 as \$67,800 worth of revenue would be eliminated. An activity analysis can still be performed to see if there are any strictly variable costs that can be applied against this revenue.

Another activity is court booking fees for non-members. Allocation of maintenance costs and rates against this activity could be made, but if costs are unavoidable it makes no sense to take these into account to see

whether an activity should be eliminated or not. The electricity costs incurred for lighting the courts at night would be relevant if they could be accurately measured.

Fixed costs

Fixed costs that cannot be allocated to an activity support the infrastructure of the club, and these include cleaning, bank fees, building maintenance, printing, telephone, and audit fees. These costs can be examined to see if any savings can be made.

The single biggest cost for the club is the manager's salary of \$60,000. The main task the manager was asked to perform was to generate income. However, this was not successful, and the wine fundraiser, non-conditional grants, and conditional grants were nowhere near budgeted expectations.

The reason why the manager has not performed to budget expectations needs to be examined closely. This is to eliminate placing blame unfairly where the circumstances are beyond the control of the manager.

If the club needs to make drastic cuts in expenditure to survive, it may decide to eliminate the position of the manager and form a management committee to take over this function.

Sensitivity analysis – revenue

Sensitivity analysis, or “what if”, shows the impact, for instance, if the club raises its subscription fees to members, or increases non-member court fees or tennis pro lesson fees.

An easy solution might be just to raise the charges for revenue activities at the Hampden Tennis Club. However, if price sensitivities exist this may cause a “death spiral” if members decide to leave the club due to the increases or go elsewhere for court-hire and tennis lessons.

Therefore, any attempts to increase revenue should be carefully considered, as the last thing an organisation wants is to make the situation worse by losing revenue.

Value for money, nearby tennis clubs, economic conditions and socio-economic groups are just some of the factors a club needs to consider before increasing its fees.

3.7

EXERCISE 6

MOTEO CROQUET CLUB ACTIVITY EXAMPLE

The Moteo Croquet Club was established in 1921 and has 5 hectares of land with 1ha in the croquet grounds, and another in car parking and club buildings. The other 3ha are leased to an organic squash grower.

When the club first started it was 2km from the outskirts of the town, but urban sprawl has meant houses surround the club in a now very desirable and affluent neighbourhood. The population of the town is 12,000, and most residents in this dormitory suburb are wealthy retirees.

Each member pays the same subscription.

The club's greens were called the best in New Zealand last year by Croquet Player magazine.

Most of the members are retired, and the average age is 69.

The club's revenue budget for the current year presented to the 240 members showed subscription revenue of \$48,000, donations/grants of \$17,000 and lease revenue of 3ha to an organic squash grower of \$6,000.

The expense budget is rates of \$8,500 for the area the club uses and \$4,500 for the unimproved leased land to the organic squash grower; association levies of \$900; insurance \$2,200; audit \$2,000; croquet lawn care \$49,000; electricity \$4,900; club house expenses \$1,400; repairs and maintenance \$2,600; and telephone \$1,200.

REQUIRED:

- A. Draft up a budget for Moteo Croquet Club (ignore GST).
- B. Are there any items for which an activity analysis can be performed?
- C. Make any suggestions for improving the financial performance of the club, including making reasonable assumptions as to a sensitivity analysis.

* Suggested solutions are in Chapter 5.0

3.8 CASH

CASH FLOW MONITORING

As the saying goes, “cash is king”. That is, without cash we cannot pay expenses to operate our organisation. Therefore, it is obviously very important to monitor our cash position. The responsibility to monitor cash normally falls to the organisation’s treasurer, and it is their responsibility to keep a watchful eye, and alert the governance board if any problems with cash flow occur – sooner, rather than later.

In Section 2, the importance of budgeting was examined. The budgets for Hampden Tennis Club were prepared on an accrual basis – that is, recording transactions when they were expected to occur, not when they actually happened.

For instance, the club sent out all of its subscriptions on 1 September 20X2 for payment by 30 September 20X2. We record this in our accrual budget as this is when the subscriptions are due. Does this mean we will receive all of the subscriptions by 30 September 20X2? Unlikely! In practice, the subscriptions will be spread over several months, and some may remain unpaid.

The accrual budget is therefore not an appropriate tool for monitoring cash flow.

CASH FLOW BUDGET

A cash flow budget monitors our cash flow by estimating realistically when revenue is received and expenses paid.

It begins with the current bank balance and estimates the timing of revenue and expenses going in and out of the bank account resulting in an estimated closing balance.

This closing bank balance then becomes the opening bank balance for the next month.

In order to be an effective tool, cash flow budgets require careful monitoring of when revenue will be received and when costs are paid. Cash flow budgets should be updated frequently – usually monthly – to reflect any changing circumstances.

An accurate cash flow forecast can allow an organisation to predict, with reasonable confidence, its cash position and may give some time to react to an upcoming period of cash flow issues.

On the next page is an example of a cash flow budget for three months of the Hampden Tennis Club. These can be completed as simple Microsoft Excel or similar spreadsheets.

The cash flow budget shows a healthy closing bank balance and is covering expenses easily.

The governance body should review the cash flow statement monthly to ensure there are sufficient funds available – or to take corrective action, if need be. The organisation’s accountant/treasurer should review the cash flow more frequently.

However, this is the beginning of the tennis season and when the bulk of the club’s income from subscriptions, tennis lessons and court bookings from non-members is received.

If we look at the cash flow budget for the last three months of the financial year, we see a completely different picture.

Important:

The club’s \$30,000 cash grant for the building of the new pavilion is budgeted for October. As we have seen from previous example’s we know the club has used this to pay some of their operational expenses.

This has put them in a bad position for when they need to start building the pavilion, or in case they must return the grant. Ideally this would have been deposited in a separate bank account and therefore would not usually be included in an operational cash flow budget.

HAMPDEN TENNIS CLUB

Cash Flow Budget for the 3 months ended 30 November 20X2

	\$ SEPTEMBER	\$ OCTOBER	\$ NOVEMBER
Beginning Bank Balance	7,630	57,065	103,825
CASH INWARDS			
Grants – conditional	-	30,000	-
Grants – non-conditional	-	-	-
Member subscriptions	48,800	9,965	3,320
Tennis lessons	16,800	14,300	12,000
Court bookings (non-members)	6,500	7,800	5,700
Wine sales fundraiser	-	-	-
Bar profits	2,000	9,000	10,000
Total Cash Inwards	74,100	71,065	31,020
CASH OUTWARDS			
Audit fees	2,500	-	-
Bar purchase	600	4,000	4,500
Bank fees	25	25	25
Cleaning	530	520	520
General expenses	1,400	300	500
Insurance	-	-	2,200
Interest	-	-	-
Electricity	1,900	1,700	2,200
Printing	1,200	-	-
Rates	-	1,150	-
Repairs & maintenance (tennis courts)	5,500	-	-
Repairs & maintenance (building)	-	-	-
Telephone/Internet	110	110	110
Wages & salaries	7,500	7,500	7,500
GST payments	3,400	-	9,200
Equipment purchase – ride-on lawn mover	-	9,000	-
Total Cash Outwards	24,665	24,305	26,755
Closing Bank Balance	57,065	103,825	108,090

HAMPDEN TENNIS CLUB

Cash Flow Budget for the 3 months ended 30 June 20X3

	\$ APRIL	\$ MAY	\$ JUNE
Beginning Bank Balance	32,500	8,135	2,280
CASH INWARDS			
Grants – conditional	-	-	-
Grants – non-conditional	-	-	-
Member subscriptions	-	-	-
Tennis lessons	-	-	-
Court bookings (non-members)	1,200	1,700	1,500
Wine sales fundraiser	-	-	-
GST refund	-	-	200
Bar profits	600	500	300
Total Cash Inwards	1,800	2,200	2,000
CASH OUTWARDS			
Audit fees	-	-	-
Bar purchase	-	-	-
Bank fees	25	25	25
Cleaning	530	520	520
General expenses	1,400	300	500
Insurance	-	-	-
Interest	-	-	-
Electricity	600	600	600
Printing	-	-	-
Rates	-	-	1,150
Repairs & maintenance (tennis courts)	12,000	-	-
Repairs & maintenance (building)	2,500	-	-
Telephone/Internet	110	110	110
Wages & salaries	6,500	6,500	6,500
GST payments	2,500	-	-
Equipment purchase – ride-on lawn mover	-	-	-
Total Cash Outwards	26,165	8,055	9,405
Closing Bank Balance	8,135	2,280	(5,125)

Compared to the cash flow budget for the three months ended 30 November 20X2, the three months ending 30 June 20X3 show a different story, with a projected negative closing balance of (\$5,125).

If the cash flow statement is prepared in enough time, it can give a warning – as it has done in this case – that the bank balance will be in overdraft.

Arrangements can then be made in advance to have a temporary overdraft if reducing or delaying payment of expenses - or other appropriate action - is unsuccessful.

If further cash flow budget analysis shows the negative cash flow is ongoing, a more serious issue may be apparent.