

LAW MEMO

Managing Your Cash Flow

Sound financial management largely depends on making reasonable cash flow projections. Simply put, a well conceived budget is not enough; your organization also must have enough money in the bank to pay its bills or it won't stay solvent.

Projecting cash flow is the process of accurately anticipating monthly (or another designated period) requirements for cash and relating them to the actual availability of cash needed to meet those needs.

“Unlike the budgeting or fund raising process—which often encourages an optimistic approach to income—cash flow projections take a hard, realistic look at when your income and expenses will come in and go out.”

—*All the Way to the Bank*

For arts organizations that do not present or produce their programs year-round, this is an especially important task because most of their earned income is generated during a few months or even a single weekend, while expenses are incurred throughout the year.

A cash flow projection or budget should not be confused with a “Statement of Cash Flows,” which is a statement that sometimes complements the more familiar components of a CPA’s year-end report—the statement of financial position (balance sheet) and the statement of activity (formerly known as the statement of revenues and expenses).

Likewise, negative cash flow should not be confused with running an organizational deficit. Negative cash flow occurs when the demand for cash is higher

than the amount of cash on hand. A deficit occurs when an organization overspends its operating income. Of course, negative cash flow can be a sign of a looming deficit.

This issue of *Arts Law Memo* explains how to prepare short-term cash flow projections and offers techniques for improving cash flow. It also discusses borrowing money and putting “idle” cash to work earning interest. Finally, it lists characteristics of financially healthy nonprofits and signs of financial trouble.

ANTICIPATE EXPENSES

Using your budget categories, begin by listing fixed monthly expenses, such as office rent and payroll. Simply divide annual budget figures by twelve and place them into each monthly column. Next, identify periodic expenses, such as insurance, and note the proper monthly time frame required for payment. Finally, estimate other up-front costs and forthcoming expenses.

ANTICIPATE INCOME

Develop a monthly budget reflecting cash receipts. List confirmed income sources, such as grants receivable, first. Then estimate other revenue. Be conservative! Consider the normal lag time between invoicing for services or pledges and depositing the money in the bank. Also, consult last year’s financial records, because past experience can help predict the future.

EXCESS OR SHORTFALL

Make note of the beginning cash balance. In the sample cash flow projection on the next page, it’s zero. But in most cases, you’ll start with your checking account balance. Next, determine the monthly cash excess or shortfall by subtracting disbursements from receipts.

Add this amount to the beginning balance to find the ending cash balance. If this amount is positive, your organization will have enough cash to meet its expenses. If not, steps should be taken to either increase that month’s revenue, decrease expenses, or both.

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VLAA helps artists and arts organizations solve and avoid legal and accounting problems by:

- Making referrals to lawyers and accountants;
- Mediating arts-related disputes;
- Publishing *Arts Law Memo* and concise how-to guides;
- Sponsoring seminars and public forums;
- Arranging for guest speakers;
- Maintaining a reference library;
- Operating an arts space clearinghouse;
- Supplying model contracts and other arts law and business materials;
- Facilitating meetings;
- Conducting and disseminating research on issues affecting the arts;
- Contributing articles to publications;
- Collaborating on arts advocacy initiatives;
- Matching volunteers with arts organizations seeking board members; and
- Providing access to the national VLA network.

This issue was written by Sue Greenberg, VLAA’s executive director.

This publication is distributed with the understanding that VLAA is not engaged in rendering legal or accounting counsel. We urge you to seek professional services to address your specific needs.

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SAMPLE FOUR MONTH CASH FLOW PROJECTION Labor Day Arts & Crafts Festival

Note: Some expenses (like rent) are monthly. They are divided by 12.

	FY01 Budget	July	August	September	October
RECEIPTS					
Advance Ticket Sales	2,000	500	1,000	500	
Gate Ticket Sales	10,000			10,000	
Booth Rentals	15,000	3,000	12,000		
Concessions	18,000			18,000	
Advertising	10,000	5,000	5,000		
Grants	12,000	2,000			10,000
Sponsors	24,000	8,000	12,000	4,000	
Special Events	12,000	6,000		6,000	
Annual Giving	15,000	2,000	2,000	2,000	2,000
Total	118,000	26,500	32,000	40,500	12,000
DISBURSEMENTS					
Salaries	48,000	12,000	12,000	12,000	12,000
Rent	12,000	1,000	1,000	1,000	1,000
Insurance	4,000		4,000		
Artist Awards	10,000	2,000		8,000	
Entertainment	14,000		1,000	12,000	1,000
Equipment Rental	10,000			8,000	2,000
Program Printing	3,000				3,000
Supplies	2,000	500	1,500		
Hospitality	1,000			1,000	
Marketing	9,000	5,000	3,000		
Special Events	4,000	3,000		1,000	
Total	117,000	23,500	22,500	43,000	19,000
Excess (Shortfall) of Cash		3,000	9,500	(2,500)	(7,000)
Cash at beginning of month		0	3,000	12,500	10,000
Cash at end of month		3,000	12,500	10,000	3,000

ADDRESSING SHORTFALLS

In *All the Way to the Bank*, Susan Kenny Stevens and Lisa M. Anderson note that “many nonprofit managers leave all the decisions about receivables, payables, credit and collection policies to their business managers. In cash poor organizations, these also should be executive management decisions.”

To address shortfalls, consider the following strategies: encourage payment by credit card; find a more advantageous date for your fund raising event or membership campaign; postpone major purchases; lease equipment instead of buying it; pursue delinquent accounts and add late charges when possible; arrange for certain bills to be paid over time; and consider obtaining a line of credit or loan from a bank.

TO BORROW OR NOT

Among the most difficult decisions will be whether or not to borrow money. According to Stevens and Anderson, nonprofits often shy away from loans because there are stigmas attached to being in debt and paying interest.

But under certain circumstances, they say, “*financing* a nonprofit’s activities can be as viable as *funding* them.” Examples might include a bridge loan to cover expenses when grant funds are not made available until the project is completed or borrowing to cover the unforeseen costs incurred when the roof is leaking or energy bills skyrocket.

Of course, banks are not willing to put themselves or your organization at risk by making a loan that will put either of you in jeopardy. “In my experience,” writes Jody Blazek in *Financial Planning for Nonprofit Organizations*, “the nonprofit in crisis mode only gets loans, if at all, from *angels*—patrons or funders who love the organization.”

SHORT-TERM INVESTING

Cash flow budgets also provide an opportunity to earn money by investing temporary surpluses. Options include certificates of deposit, U.S. savings bonds, risk-free Treasury bills, and money market accounts. The choice of a prudent investment vehicle should be made by the board of directors.

Characteristics of Financially Healthy Nonprofits

1. Financially healthy nonprofits have sufficient financial resources to ensure stable programming.
2. Financially healthy organizations have a ready source of internal cash—or access to cash—in times of shortfalls.
3. Financially healthy organizations are committed to income-based, rather than budget-based, spending.
4. Financially healthy organizations retain a positive cash fund balance at the end of the year.
5. Financially healthy nonprofits accumulate annual surpluses to use as a safety net in years when an unforeseen deficit does occur.
6. Financially healthy organizations have established—or plan to establish—an operating reserve to finance cash shortfalls and program growth.
7. Financially healthy nonprofits have a board of directors and management that hold themselves responsible for the financial stability of the organization.

Early Warning Signs of Financial Trouble

1. Your organization consistently spends more money than it receives in revenue.
2. You’re not paying payroll taxes in a timely fashion.
3. Payables—the amount you owe others—are mounting up and going unpaid.
4. You regularly dip into restricted or deferred funds for today’s expenses, coming up short later when the special project is ready to go.
5. More than 50 percent of your accounts receivable—the money others owe you—are 120 days or older.
6. You consistently need to get an advance from a funding agency to meet today’s expenses.
7. You have no idea how your organization got into such a financial mess, and you don’t know how to begin to pull it out.
8. You don’t know how much the organization owes, and you don’t know how to find out.
9. Lack of money has become the focus and dominant point of conversation at staff and board meetings.
10. You feel hopeless or are losing sleep at night because of the financial condition of your organization.

Source: *All the Way to the Bank*

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RESOURCES

Books

All the Way to the Bank: Smart Money Management for Tomorrow's Nonprofits (1997) by Susan Kenny Stevens and Lisa M. Anderson underscores the importance of solid financial management. It provides suggestions for improving cash flow and tips for selecting a bank and securing financing. It also explains how to develop an operating reserve and how and when to borrow money.

Jody Blazek, CPA, a founder of the Texas Accountants and Lawyers for the Arts, has written several books that focus on financial planning, tax compliance and auditing for nonprofits. Among them are: *Financial Planning for Nonprofit Organizations* (1996) and *Tax Planning and Compliance for Tax-Exempt Organizations: Forms, Checklists and Procedures* (2001).

These books and many others on arts law and business practices are available at the **St. Louis Volunteer Lawyers and Accountants for the Arts library** located within the Regional Arts Commission office, 3540 Washington, in Grand Center. The expansion of VLAA's library (which now includes the **Foundation Center's database on CD ROM**) and promotion of its use is made possible by a generous grant from the Gateway Foundation.