Learning from the Community: Effective Financial Management Practices in the Arts

Summary Findings and a Framework for Self-Assessment

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Russell Willis Taylor, Editor

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Research

National Arts Strategies
Leadership Education for Arts and Culture

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Executive Summary

"After ten years with a tailwind, it's hard to adjust to being in a headwind… We're trying to figure out how you make smart decisions for the future in an environment where everything has changed." This is the challenge facing arts leaders today, in the words of one executive director we interviewed. National Arts Strategies, with funding from The James Irvine Foundation, interviewed arts leaders to understand how effective financial management practices at leading organizations might be used across the sector to respond to this new environment. This paper introduces the financial management practices we identified. While additional tools are needed to fully transfer practices across organizations, this paper provides a framework that arts organizations can use to start evaluating their own approaches to financial management.

The organizations investigated in this project are all very thoughtfully managed enterprises. Although they face similar challenges, their unique missions, strategies, and environments give them different priorities for financial management. And, as is true for managers everywhere, arts leaders have limited time to explore emerging concepts. There are therefore opportunities for arts organizations to enhance their financial management through:

- A structured framework for assessing overall financial management practice
- The introduction of solutions worked out at other arts organizations
- The introduction of leading ideas from outside the arts for common challenges

Benchmarking is a common approach for learning from other organizations in the arts sector. Our research suggests that while this numerical information is helpful – and easier access to more accurate data is needed – many effective practices cannot be captured through data alone. More direct methods for introducing ideas are needed. Potential solutions include senior-level educational programs, peer learning opportunities, and the development of tools for self-assessment and implementation. This report outlines important areas to address in these leadership tools.

Research Process

NAS investigated the financial management approaches of a small but representative group of arts organizations. We conducted individual interviews with the executive directors, finance directors, and a sample of board members at thirteen institutions. Ten organizations were part of the Cornerstone Arts Organizations, a cohort of leading California arts institutions identified by The James Irvine Foundation. Three additional organizations with small annual budgets, a group that was underrepresented in the Cornerstone cohort, were selected from the NAS client base to create a more complete sample of the sector. NAS also conducted desk research, reviewing publications on nonprofit and for-profit financial management to provide a framework for the financial management practices identified during the interviews.

Research Participants

The participating organizations represented a broad range of arts disciplines, including fine art museums, cultural museums, multimedia arts organizations, orchestral music, opera, ballet, theater, arts presenters, and art colleges. Three organizations had annual budgets of less than $1M, three organizations had budgets between $1M and $10M, and seven organizations had budgets greater than $10M per year. The study focused on California organizations, but also included one East Coast and two Midwest organizations to create a sample that represented all budget sizes. Organizations came from three mid-size and two of the largest arts markets in the United States.

Effective Practices in the Arts

NAS pulled together the most effective financial management practices from across organizations to create a composite picture for an "ideal" arts organization. When these practices are looked at together, a simple framework emerges for describing – or designing – a comprehensive financial management system. We can only touch on each practice briefly in this paper, and additional tools should be considered to help arts leaders use these concepts across the sector. Here we use the framework, structured as a series of questions, to step through these financial practices:

A Framework for Assessing Financial Management Practice

Financial Strategy	1. What is the financial management culture of the organization? 2. What are the "natural bounds" on income for this organization? 3. What are the fundamental drivers of financial risk and performance?
Financial Planning	4. How does the organization finance its operations? 5. How does the organization choose projects and investments? 6. How are income forecasts created, and from them, annual budgets?
Performance Evaluation	7. How is financial performance tracked to support decision making? 8. How is long-term performance tracked and compared to peers? 9. How do board structure and processes impact financial governance?

Organizational Culture and Financial Management

The norms and values of an organization's culture shape its processes and decisions. A culture that values "creating a lasting organization" as much as it values the artistic mission enables collaboration across disciplines and sound financial decisions, to the benefit of both objectives. The traditional conflict between "artistic mission" and "financial objectives" creates a culture that misses opportunities to improve both financial and artistic performance.

In practice, building a culture that respects the financial challenge as much as the artistic starts with the executive director. Consistent statements and actions by the executive director drive the norm through the organization. This can be a significant challenge in organizations with a separate artistic director and general manager; in this situation the value must be held as deeply and communicated as clearly by both leaders. In two organizations with long histories of balanced budgets, this leadership was easy to see. One executive director consistently talked about the financial and artistic together, describing their culture as "artistically liberal and fiscally conservative." The other spoke less directly about culture, but set a clear tone by describing an organization that "belongs to the community," and the place in the community he wants the institution to have years after he has retired and become "just" a patron.

Financial management culture starts with the actions of the executive director, but it is fully realized in the design of business processes. Leading organizations understand their financial norms, and design processes that embody and sustain those values. In these organizations artistic excellence and organizational sustainability are aligned and mutually supported, not in conflict with one another. One such organization in this study with a preference for riskier financial strategies invested in a very sophisticated financial reporting system, following a norm that rigorous management enables more risk taking. The "artistically liberal and fiscally conservative" organization mentioned earlier tightly limits their total budget and holds managers strictly to their expense forecasts; together these processes realize their norm that artistic creativity is enhanced when financial constraints and financial promises are both taken as givens (energy is spent on the creative process rather than "trying to push out the walls").

Strategic or long term planning is also a critical building block for an effective financial management culture. While the financial modeling done in this planning process is valuable, it is the focus and shared understanding of mission that this work brings to the organization that most impacts day-to-day financial decisions. Discussions quickly focus on projects and opportunities that are in line with mission, allowing more time to be spent on the financial analysis of this much smaller set of options. In this way, the effort to create and communicate a strategic plan helps create a financial management culture that is quick to focus and can be more rigorous in its investment decisions.

Financial Capacity

Market size and potential market share for earned and contributed income set an upper limit on the financial capacity of an organization. While these numbers can't be known perfectly, a thoughtful estimate is a check for evaluating strategies and budget expansion. This capacity analysis is independent of annual forecasting, and asks "How much income could we ever collect in a year?" rather than "How much income can we expect next year?"

Arts leaders have an intuitive understanding of the total market size for earned income, individual donations, and other contributed income in their local market and discipline. These executives have been part of their communities for many years, and know their markets well. More detailed analyses are undertaken only for significant new investments, such as the introduction of programs for a new audience or the development of facilities in a new location. In general, a more explicit estimate of market size and potential market share for earned and contributed income allows an organization to test bottom-up income forecasts. If the budget is expanding, is this in line with growth estimates for the total market, or is it an increase in market share? If it is an increase in share, from whom is this share coming? Are these reasonable changes?

New executive directors also benefit from explicit efforts to understand these upper limits on financial capacity, shortcutting the time it takes to gain an intuitive understanding. For example, a new executive director at one of the smallest organizations we interviewed collected financial statements from all the arts organizations that individual donors viewed as "substitutes." The executive director analyzed total giving in their market and market shares for organizations, and used the data to define upper limits on their own potential for donations and market share.

Financial Drivers

Explicit analysis of income and expense dynamics can help arts executives explore and discuss drivers of financial risk and performance. The critical drivers for the organization can then be used to help design financial reports and focus board discussions on the most important financial information. The more staff understand these underlying drivers, the more they can "think globally and act locally" to find solutions in their projects that support financial goals.

Arts organizations manage a portfolio of income streams (admissions, subscriptions, donations, etc.) and programs (e.g. exhibits, classes, bookstores) that each contribute to total income and also to financial risk and variability. The better an arts organization can characterize the sources of its financial risk and performance – such as income concentration, variability in income sources, level of fixed expenses, and trends in the cost of critical "inputs" such as orchestral musicians – the earlier it can identify critical performance and environmental changes. Arts executives at leading organizations readily discuss the critical financial drivers for their organizations, though not always with formal financial terms. For example, when arts managers talk about "structural deficits," they are referring to the interplay of these fundamental financial drivers.

More explicit consideration of these drivers can help arts leaders design financial reporting systems to track them, and focus discussions with the board and staff by clearly defining the critical topics. A comprehensive approach considers the sensitivity of a balanced budget to the interactions between:

- Income mix
- Income concentration
- Variability of income sources
- Sensitivity of income to longer-term business cycles
- Demand trends (e.g. total audience, average price, demographics)
- Fixed expenses
- "Quasi-fixed" expenses (e.g. payroll, long-lead and multi-year commitments)
- Cost trends for critical inputs (e.g. orchestral expense or exhibit insurance)
- Timing of income and expense during the year
- Availability of internal financing (i.e. accumulated net assets)

Capitalization

The most common capitalization (or financing) approach in the arts sector relies on annual operations, complemented by endowment and temporary "savings" for specific capital projects. Arts organizations can improve financial stability by using net assets and debt to create working capital reserves and to level income across long-term business cycles. Using named reserves to track net assets by purpose helps communicate strategy and objectives to staff and donors.

Most arts organizations finance their operations year to year, and if possible create an endowment to insure a stable floor of income. Organizations retain additional net assets only when saving for specific capital projects. Many arts leaders have expanded this model to address short-term and long-term financing needs. These practices help create a more complete capitalization model, or plan for financing using net assets and debt, that supports working capital needs and stable operations across business cycles.

A line of credit or net assets held in a working capital reserve cover short-term cash needs arising from the timing of income and expenses. Cash flow analysis is used to determine the timing and level of shortfalls, and therefore the level of working capital needed. Monthly cash flow projections or income milestones based on historical performance ensure that shortfalls are truly timing issues (that is, cash flow balances out for the full year) and not the result of deficit spending, which would erode financial capacity over time. The choice of a net assets reserve or a line of credit is a financial decision; arts leaders must consider the return they can achieve on investments, the interest rate on their line of credit, and the amount and duration of borrowing needed during the year to determine the best option. A rigorous financial analysis can identify the optimal mix of net assets and debt to use for working capital.

Some arts organizations use an additional net assets reserve to maintain their financial capacity across business cycles. Some of the operating surpluses generated when the economy is strong are retained specifically to supplement income in the next economic slow down. One organization describes this long range planning as having "a cookie jar" where they stash funds whenever possible (an image and understanding that carries over to their board). A more formal approach is to create a "quasi-endowment:" the board designates funds for long-term investment, but without the legal constraints on its use that exist for true endowment. The organization can then use the funds as needed to smooth out economic cycles, but use of the funds requires board approval.

With either approach, this net assets strategy "time shifts" income to create a stable capacity level that, while lower then the maximum possible in a boom, is higher than the limit during a downturn. The strategy also protects the endowment: these net assets are meant to be spent down and built back up across business cycles, relieving pressure to dip into endowment principal during downturns. Debt can be used to achieve the same goal; in effect this is a choice between reducing operating expenses before a downturn, or reducing them after the downturn to pay back debt. However, a net assets approach also contributes to a culture of financial discipline and long term planning, is reinforced through day-to-day financial decisions to manage the reserve, and works for smaller organizations that may not be able to access debt but can attract individual donors to fund these reserves.

In general, arts organizations track their net assets by restriction class as required for accounting. The different purposes of the unrestricted or temporarily restricted net assets pool are understood by the executive director and finance director, but are not immediately clear to board members, staff, or outside stakeholders from the financial reports. Tracking separate reserves for each financial objective helps communicate financial strategy, makes it easier to track performance against these net asset objectives, and is an effective tool for discussing needs with donors.

Capital Budgeting

"Capital budgeting," or deciding which projects to invest in, is both a mission and a financial decision in the arts. While mission must come first, stable organizations consider the financial implications as an integral part of selecting and designing projects. When a project is selected primarily for its financial contribution, then the financial analysis must be especially rigorous.

Arts executives consistently look at both the mission and financial impacts of potential projects and investments. Stable organizations test their alternatives for the financial impact of different expenses, income, timing of expenses, and other factors. If a program will continue beyond its initial funding, these organizations routinely and rigorously plan how any budget expansion will continue to be funded. These financial analyses allow arts leaders to discuss whether the differences in mission achievement justify the differences in financial impact, and to select the mix of projects that strike the best balance. A "back of the envelope" analysis can be a good first step: the executive director at a smaller organization uses a simplified income and expense model to quickly discuss with the artistic director the financial impact of different programs. A rigorous analysis can then follow to fully evaluate the most promising options.

A project that is in line with mission but is undertaken primarily for its financial contribution, such as a "blockbuster" exhibition selected to increase revenue, must pass a rigorous financial analysis. Arts leaders need to analyze projected cash flows from the project and compare them to other investment options to see which provides the best return for the risk. For example, is a blockbuster more profitable, for the risk involved, than increased investment in fundraising or marketing for events that are more central to mission? Net present value analysis is the most appropriate approach for comparing these options, though the ideal discount rate may not be clear. One organization we interviewed suggested a good strategy: use the cost of debt, return on endowment (a proxy for "cost of equity"), and judgment about the additional project risk to define a range for the discount rate, and then test how sensitive the analysis is to changes across that range. All cash flows from the financially driven project must be considered, including increased attendance at other programs or increased income from a café or bookstore generated by the attention to the popular program.

Annual Budget Process

Income-driven budgets are at the heart of financial management in stable arts organizations. Zero-based budgets created through an inclusive, collaborative process, and rigorous challenging of assumptions lead to the most accurate budgets. More advanced methods for forecasting can be beneficial, and an "80 / 20" approach to these techniques can work for arts organizations.

Income-driven budgeting, where expected income is determined first and expense levels are then set within this constraint, is standard practice in all the organizations we interviewed. While some organizations make their forecasts by "indexing" the previous year's income up or down by some percentage, the more effective practice is to start from a "zero basis" and build the income forecast from the bottom up. This process allows managers to evaluate specific assumptions and environmental changes that affect each source of income. The biggest challenge in forecasting is clearly the forecasting of individual donations. There may be an opportunity for arts organizations to use additional forecasting techniques, such as statistical methods to evaluate income variability or the effect of specific environmental factors. These techniques can be complex, but an "80 / 20" approach ("80% of the benefit comes from the first 20% of the effort") focused on the basics can often realize much of their benefit.

Detailed historical data is a key resource for accurate forecasting, but process design and common sense practices are equally important. One organization uses a practice of forecasting "people in the seats," not percentage of capacity, because "it is easy to say '80% of capacity' and feel that is achievable, but if you look at the number of people you have to get to walk through the door to achieve that, you don't believe it anymore." Another organization has created a budget process and culture in which budgets and assumptions are challenged aggressively; the result is that staff put more thought into their estimates. These cultural approaches are effective but they take commitment: an organization that is redesigning their budget process to improve collaboration between financial and artistic staff expects it to take three years to make the process a lasting part of the culture.

Financial Reporting and Tracking

The budget report is the primary tool for tracking financial performance in arts organizations, and the natural foundation for any extensions to reporting. Arts leaders can get a more complete view of financial issues by integrating longer-term financial views, incorporating balance sheet objectives, and designing reports to highlight financial contribution from each program.

The budget report, showing the current year's income and expense performance against plan, is the heart of performance tracking in arts organizations. While every budget report looks different from the next, some common enhancements help arts leaders identify risks sooner and keep an eye on critical financial drivers. First, organizations that must make financial commitments two or three years into the future integrate future forecasts into their budget report (Appendix, Example I). These forecasts are only approximate, but firm commitments and "place holder" amounts for other income and expenses are reviewed and updated regularly. Creating a single report that shows both current year and future commitments helps keep a critical financial driver – the amount and risk of future commitments – in the financial discussion of executives and the board.

The balance sheet is a less natural tool for financial discussions, but there are critical asset and debt positions that do need to be tracked. Arts organizations can effectively manage their balance sheet position by incorporating critical balance sheet items into the budget report itself. One organization we interviewed, with significant debt from a new building, tracked relevant net assets accounts along with debt expense in the budget (Appendix, Example II). This approach turned their plan for balance sheet position, determined by their finance specialists, into a set of budget goals that were natural for staff and board members to discuss. This practice can be extended to include additional balance sheet objectives (Example III). However, it can't replace the balance sheet itself: a periodic snapshot of financial position is still needed to verify progress.

A different budget report design helps arts organizations understand how programs contribute to or consume annual income. These reports track net financial contribution by core programs, such as exhibitions, and incremental activities, such as bookstore operations, to highlight the sources and uses of funds. The challenge here is allocating shared income or expenses. One organization we interviewed provides an effective answer: rather than allocating expenses, look at direct income and expenses first, then "layer on" shared expenses for the program, and then finally expenses shared across all programs (Appendix, Example IV). Avoiding allocations makes budget numbers much easier to understand and helps bring performance issues into sharp focus. Overall, this report design promotes discussion of the relationship between financial performance and mission choices by showing how specific programs and finances tie together.

Benchmarking

Benchmarking is an imperfect craft, but it is valued by board members and can be motivating for the organization as a whole. Focused efforts to collect data for specific initiatives should be combined with annual tracking of more broad-brush comparative data. Evaluating your performance using the metrics and rules of thumb of outside stakeholders is another way to approach benchmarking that helps arts organizations put their performance in context.

It is difficult to get accurate data on comparable organizations to benchmark operations in an arts organization. However, benchmark data does provide context for evaluating performance, and board members especially appreciate it. For critical decisions, such as a price increase, arts leaders invest more time and use their professional networks to get detailed information on the specific topic. For a more general "backdrop" for their organization's performance, arts leaders use service organization data. An annual, one page report comparing performance to peers complements an analysis against plan and historical trends. One organization found that comparison of the basics is best: income by source as percentage of expenses, expenses by category as a percentage of expenses, net assets and debt as a percentage of expenses, and change in net assets.

Another way arts organizations can put their performance in context is to track the same metrics that outside stakeholders use to evaluate them. Even if the metrics are flawed, this analysis helps the organization understand how it is perceived, and prepares it to explain to a donor or funder how the measure should be considered for this organization. Identifying potential stakeholders and exploring their metrics can turn up new opportunities as well. One organization discovered that banks highly value a non-financial operating measurement in their discipline because it shows stability; their performance on this metric made it easier for them to borrow money than they expected. Arts leaders must use their experience to determine when a metric is a useful new idea, and when it is a threat to be managed. In either case, a regularly updated report that tracks these metrics can be a powerful tool for evaluating performance against expectations.

Financial Governance

Board structure, communication, and interpersonal relationships are all critical to financial governance. Arts organizations use two-tiered boards to improve collaboration between the executive director and the board. When there are separate artistic and general managers, board members and executives must work together to avoid the risks in this management structure.

Executive directors and the board members we interviewed expressed similar concerns about board interactions. The biggest challenges for financial governance were engaging the board members with the most financial experience; helping board members understand the financial drivers for the organization; and managing with separate artistic and general managers. When there is a large board, board members are most effectively engaged in a two-tier structure, in which a small group of board members with significant interest and experience in financial management help guide operations, and the larger group focuses on fundraising and social responsibilities. It is up to the executive director to then educate board members about the organization. One executive director never misses the chance to teach: "He takes board members behind the scenes, shows them the difference between one option for scenery and another, helps people understand the impact of different budget decisions … He consistently goes through little bits of education." The education often goes in both directions: executive directors greatly help their organizations and their own development by seeking out financial experts on the board and engaging them as mentors.

When the organization has separate artistic and general managers, it is easy for board allegiances to become split between the two executives. In the most stable organizations, the risks for conflict in this management structure are as openly recognized as the benefits. The artistic and general managers are committed to each other, and form solutions together before engaging the board. In turn, the executive committee understands that conflicts between the two executives need to be handed back to the management team, not solved by the board. In the end, the responsibility sits with the board to speak with one voice when there are two executives reporting to them.

Self Assessment Tool

We have found again and again in our work that the key to innovation is investment in leaders. National Arts Strategies is exploring several methods to help arts executives take advantage of the financial management practices described here. As a start, we have developed the financial management self-assessment tool included at the end of this paper. Arts executives can use this scorecard to quickly assess gaps in their financial management practices. By capturing the results in a single report, the scorecard makes a natural starting point for strategic discussions within the organization. An executive director can complete the assessment, or senior staff and board members can each complete the tool so different views can be compared. Please feel free to make copies of the self-assessment tool as needed for your organization.

This self-assessment tool does not touch on every important practice in financial management. Rather, it tests against a sample of practices that are indicative of organizations using leading financial management approaches. This is not a scientifically developed instrument, but is derived from National Arts Strategies' experience with similar tools used in our leadership programs. The primary goal of this tool is to promote discussion and learning about financial management practices in arts organizations, and it is designed to help arts leaders relate the topics and practices described in this publication to their own organizations.

Appendix: Financial Reporting Examples

Example I: Multiple Year Budget Report

Budget Report	Actual FY 2000	Actual FY 2001	Actual FY 2002	Approved FY 2003	Draft Budget FY 2004	Draft Budget FY 2005
Operating Revenues						
International Season Sales						
Recital & Concert Sales						
Education Program Income						
Shop Revenues						
Other Revenues						
Total						
Operating Expenses						
International Season						
Recitals & Concerts						
Education Programs						
Production & Shop Overhead						
Marketing Overhead						
Development Overhead						
Administrative Overhead						
Total						
Deficit to Fund						
Development Revenues						
Operating Surplus (Deficit)						

Historical, current year, and future draft budgets all presented on a single page to show trends and to track future commitments. Significant variances are the basis for discussion among senior staff and the board, and can be explored through more detailed financial analysis.

Example II: Balance Sheet Objectives Integrated in the Budget Report

Budget Report

	Current FY2003	Proposed FY2004	FY2005	FY2006
Contributed Income				
Unresticted Giving				
Memberships				
Grants				
Subgrant				
Other Program Related				
Special Events, Gross				
Total				
Earned Income				
Admissions				
Program Fees and Other				
Rental				
Store, net of COS				
Endowment Distribution				
Total				
Total Contributed and Earned Income				
Total Operating Expenses				
Excess				
Debt Service				
Funds available for debt service:				
Campaign Pledge Receipts				
Excess from Operating Budget (Above)				
Total Sources for Debt Service				
Debt Service:				
Bank Lease				
Interest Free Loan				
Bond Principal Payments				
Bond Interest and Fees				
Total Debt Service				
Surplus After Required Debt Service (Deficit & Line of Credit Payment)				

An operating surplus, before debt payments and other uses of the surplus, is planned and tracked in the budget.

Net assets available in the "Campaign" account are highlighted, and planned and actual amounts can be tested against debt expenses

The final net assets surplus or deficit, after uses for debt, are planned and tracked.

Example III: Expanded Set of Balance Sheet Objectives Integrated in the Budget Report

Budget Report	Current FY2003	Variance Versus Budget	Variance Versus Prior Year	Proposed FY2004	Proposed FY2005
Contributed Income					
Individual Donations					
Private Donations					
Government Grants					
Total					
Earned Income					
Admissions					
Subscriptions					
Endowment Distribution					
Other Earned Income					
Total					
Total Contributed and Earned Income					
Total Operating Expenses					
Operating Surplus					
Surplus Allocation					
Debt Service					
PPE Investment					
Change in Working Capital Reserve					
Change in "Business Cycle" Reserve					
Change in Endowment					
Surplus After Capacity Buidling (Deficit)					

An operating surplus, before debt payments and other allocations of the surplus, is planned and tracked in the budget.

Changes in critical balance sheet items are planned and tracked in this section. The targets are set from, and results are reflected in, the balance sheet. This internal management report can be designed to best support decision making, and is not confined by the rules for external financial reports.

Any additional surplus represents undesignated funds that may be held as cash or allocated to any of the net asset objectives.

Example IV: Budget Report Showing Contribution By Program

Budget Report	**Year To Date**				**Variance Versus**		
	Actual	**Forecast #1**	**Budget**	**Prior Year**	**Forecast #1**	**Budget**	**Prior Year**
Performance Revenues							
Ticket Revenue							
Other Performance Fees							
Total Performance Revenues							
Direct Performance Expense							
Orchestras							
Conductor & Guest Artist							
Production & Operations							
Total Direct Expense							
Performance Contribution							
Indirect Performance Expenses							
Orchestra (Unallocated)							
Programming & Music Direction							
Production & Operations							
Marketing & Ticketing Selling							
Total Indirect Performance Expenses							
Performance Margin							
Development Activities							
Department Revenue							
Department Expense							
Development Income							
Other Activities, Income (Expense)							
Education, net							
Lease Events, net							
Site B Parking, net							
All Other, net							
Total Other Activities							
Administration Expenses							
Net Surplus (Deficit)							

Revenue and expenses that can be assigned to specific activities (in this case, specific performances) are tracked. In more detailed reports, these revenue, expenses, and contribution amounts are presented for each specific performance.

Direct revenues and expenses for the core program (i.e. performances) combine to show direct contribution to surplus or deficit.

Expenses that can be attributed to this program, but not to specific shows, are collected here, and included in the calculation of the overall contribution for the program.

The overall contribution to surplus or deficit for the program. If there were more than one "core" program a contribution section like the one above would be included for each. In that case, this top level report would likely show less detail on income and expenses for each core program.

A core set of income and expenses that are difficult to allocate. They are presented here in their own section, highlighting this area of operations rather than allocating them and making other numbers harder to interpret.

For incremental programs, the detail is left out and the net contribution is highlighted in this top-level budget report.

Adoption of Leading Financial Management Practices: A Self-Assessment Tool for Arts Leaders

National Arts Strategies has developed this self-assessment tool to help arts leaders begin assessing their financial management practices in comparison to other leading organizations in the arts sector. By capturing the results in a single report, the scorecard makes a natural starting point for strategic discussions within the organization. An executive director can complete the assessment, or senior staff and board members can each complete the tool so different views can be compared among the leadership.

This self-assessment tool does not touch on every important practice in financial management. Rather, it tests against a sample of practices that are indicative of organizations using leading financial management approaches. This is not a scientifically developed instrument, but is derived from National Arts Strategies' experience with similar tools used in our leadership programs. The primary goal of this tool is to promote discussion and learning about financial management practices in arts organizations.

This tool is distributed as part of the NAS publication "Learning from the Community: Effective Financial Management Practices in the Arts," and focuses on the topics and practices highlighted in that publication. You can find more information about the practices surveyed in this instrument in this NAS publication.

Completed By: ______________________________

Date: ______________________________

A. For each statement, please indicate whether the financial management practice is used in your organization:	**No**	**Partly**	**Yes**
Financial Management Culture			
1. We see the development of a lasting organization as essential to our artistic aims.	O	O	O
2. We have clear values and principles to help reconcile artistic and financial objectives.	O	O	O
3. Our discussions of artistic options always include consideration of financial implications.	O	O	O
4. The executive director models financial management values and principles for others.	O	O	O
5. Our financial management processes effectively put into practice our financial values.	O	O	O
Financial Capacity			
6. We track the total market size for earned income in our community.	O	O	O
7. We track the total market size for contributed income in our community.	O	O	O
8. We track our market share for earned income.	O	O	O
9. We track our market share for contributed income.	O	O	O
10. We evaluate budget expansions using data on market size and market share.	O	O	O
Financial Drivers			
11. Income sources are considered as part of a portfolio rather than individually.	O	O	O
12. We create stable streams of income to match our level of fixed and quasi-fixed expenses.	O	O	O
13. We analyze trends in demand and critical expenses to forecast the risk of future deficits.	O	O	O
14. We regularly discuss a set of critical financial drivers with our board.	O	O	O
15. Our staff uses their understanding of our financial drivers in making project-level decisions.	O	O	O
Capitalization			
16. We evaluate our financing needs over economic cycles, not one year at a time.	O	O	O
17. We have working capital reserves or a line of credit for cash flow purposes.	O	O	O
18. We have a net assets reserve to help level income across economic cycles.	O	O	O
19. We use separate net asset accounts to track funds intended for different purposes.	O	O	O
Capital Budgeting			
20. New projects are evaluated as part of an overall portfolio, rather than individually.	O	O	O
21. Alternative projects are evaluated on their financial and mission impact simultaneously.	O	O	O
22. We require a plan for continued funding or a sensible exit before we take on new projects.	O	O	O
23. Projects with primarily financial goals are identified, and must pass stringent financial tests.	O	O	O
Annual Budgeting Process			
24. We forecast income first, and then create expense budgets within these constraints.	O	O	O
25. We forecast budget items from a “zero basis” rather than “indexing” last year’s level.	O	O	O
26. The assumptions underlying budgets are made explicit, and are challenged and tested.	O	O	O
27. Managers, including artistic, are evaluated in part on the accuracy of their budgets.	O	O	O

	No	Partly	Yes
Financial Reporting and Tracking			
28. Our budget report makes it easy to see future financial commitments and forecasts.	O	O	O
29. We incorporate critical balance sheet items into our budget report.	O	O	O
30. Our budget report makes it easy to see the financial contribution of each program.	O	O	O
Benchmarking			
31. We collect information from peers to inform key decisions such as those about pricing.	O	O	O
32. We have a standard report for comparing annual financial performance to peers.	O	O	O
33. We compare our annual financial performance to the metrics used by outside stakeholders.	O	O	O
Financial Governance			
34. We have a finance or executive committee with responsibility for financial oversight.	O	O	O
35. We actively educate board members about the financial drivers for our organization.	O	O	O
36. Trusting relationships allow us to leverage the knowledge of financial experts on the board.	O	O	O
37. The artistic director and managing director speak to the board with one voice.	O	O	O

B. Add up the number of answers for each cell, and enter the sums in the table to the right. The table may be easier to read if cells are left blank when the count is zero.

We employ these leading financial management practices in:	**Total Number of Questions**	**No**	**Partly**	**Yes**
Financial Management Culture	**5**			
Financial Capacity Analysis	**5**			
Financial Drivers	**5**			
Capitalization	**4**			
Capital Budgeting	**4**			
Annual Budgeting Process	**4**			
Financial Reporting and Tracking	**3**			
Benchmarking	**3**			
Financial Governance	**4**			
Totals	**37**			

About This Publication

In 2002, The James Irvine Foundation and National Arts Strategies undertook a multi-year initiative with a group of leading arts organizations in California. The purpose of this work was to determine how best to support and strengthen non-profit arts leaders in two strategic areas: HR management and financial management. This report outlines the findings from the financial leadership work.

About the Authors

Jim Rosenberg, principal author, received his MBA from the Stanford University Graduate School of Business, and his BA in psychology from the University of Pennsylvania. Jim has fifteen years of experience in organizational management, with a focus on need finding and new product development. His work with National Arts Strategies applies his experience with both social science research and business management to investigate management questions that are important to the arts and culture sector, and to further develop the NAS leadership programs.

Russell Willis Taylor, President and CEO of National Arts Strategies, provided strategic guidance for this research and served as the principal editor. Russell has extensive senior–level experience in strategic business planning, financial analysis and planning, and all areas of operational management. She has held a wide range of managerial and Board posts in the commercial and non profit sectors, including executive director of the English National Opera, London, director of development for the Chicago Museum of Contemporary Art, and head of corporate relations at Stoll Moss Theatre Corporation in England. She has held the post of President and CEO at NAS since 2001.

About The James Irvine Foundation

The James Irvine Foundation is a private, nonprofit grantmaking foundation dedicated to expanding opportunity for the people of California to participate in a vibrant, successful, and inclusive society. The Foundation was established in 1937 by James Irvine, the California pioneer whose 110,000-acre ranch in Southern California was among the largest privately owned land holdings in the State. With assets of $1.2 billion, the Foundation expects to make grants of $56 million in 2004 for the people of California. For more information on the Foundation, please visit www.irvine.org.

About National Arts Strategies

National Arts Strategies was founded by the Ford, Rockefeller, and Mellon Foundations over 20 years ago to strengthen communities of arts organizations throughout the United States. We have worked on long-term technical assistance and educational programs in ten cities, and conducted educational seminars for over 2000 participants in the United States and Australia. NAS is now a leading provider of executive education leadership training for the arts in the United States, working with faculty members from the graduate schools of business of Stanford, Harvard, Columbia, and Northwestern. NAS provides high-level and immediately relevant training for arts leaders who are committed to both artistic excellence and organizational sustainability.