



ANNUAL MEETING HANDOUT

Balance Sheets: What Do They Really Tell You?

This working session showed attendees what to look for on the balance sheet, how to do calculations to gauge a museum's health and ways to format statements for more clarity.

Presenters

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Annual Meeting & MuseumExpo

As the museum field's premier professional development opportunity, the Alliance's Annual Meeting & MuseumExpo showcases the best thinking from practitioners and visionaries on major issues confronting museums and the communities they serve.

This session handout is from the 2013 Annual Meeting in Baltimore.

Interpreting the Balance Sheet

AAM Conference May 22, 2013, 8:45 am

Patricia Egan & Nancy Sasser

Unrestricted Statement of Activity or Income Statement

Revenue

Operating:

- ▶ Admissions, memberships, other earned
- ▶ Investment income
- ▶ Contributions
- ▶ Net assets released from restriction

Non-operating:

- ▶ Gifts for facilities
- ▶ Gains/losses on investments
- ▶ Net assets released from restriction

Expenses

- ▶ Program
- ▶ Education
- ▶ Marketing
- ▶ Development
- ▶ Facility
- ▶ Administration
- ▶ Depreciation

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Change in Unrestricted Net Assets = Surplus or Deficit = Net Income or Loss

- ▶ Operating net income
- ▶ Net gifts for capital campaigns, facilities
- ▶ Net market gains and losses on investments

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Unrestricted Net Assets beginning of year

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Unrestricted Net Assets end of year

Statement of Position or Balance Sheet

Net Assets (the accumulation of all the years of a museum's surpluses and deficits)

- ▶ Unrestricted
- ▶ Temporarily restricted
- ▶ Permanently restricted

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Assets (what you own)

- ▶ Bank & investment accounts
- ▶ Money owed to you
- ▶ Building & Equipment

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Liabilities (what you owe)

- ▶ Payables to vendors
- ▶ Deferred revenue
- ▶ Loans

Net Asset Classes

- ▶ **Unrestricted (UR)** - available to be spent now on operations. Includes accumulated operating surpluses and deficits, property and equipment, and any board-designated funds, such as a cash reserve or endowment.
- ▶ **Temporarily Restricted (TR)** - available either at a future date or for a specific project – not available now to be spent on operations. Includes funds that are restricted by the donor and will be used for an operating activity in the future – for example, a grant for a future exhibition – or a grant for capital purposes, such as purchasing property and equipment. When the restriction is fulfilled, then the net assets are moved (released) to the unrestricted operating statement.
- ▶ **Permanently Restricted (PR)** - funds are never spent, but income generated by investment of the funds may be spent. Most often these are permanent endowment funds.

Four Measures of Financial Health

- ▶ **Working Capital** - consists of unrestricted resources available for operations. Adequate working capital provides financial strength and flexibility to an organization and the ability to meet obligations as they come due. Each organization should determine its own working capital needs. Working capital is the fundamental building block without which organizations cannot grow, take risks, and fulfill their programmatic mission.
- ▶ **Invested Capital** - includes assets usually invested long-term, approximates reserves and endowment, and may be unrestricted, temporarily restricted, or permanently restricted. Income from invested capital is generally available for operations or specific purposes. Each organization should target an appropriate level of invested capital after developing sufficient working capital
- ▶ **Fixed Assets** - includes all land, buildings, equipment, and other fixed assets owned by an organization. The amount that an organization invests in fixed assets will vary, and should be tailored to the needs of the organization and the larger community.
- ▶ **Debt** - includes all short and long-term contractual obligations of an organization such as notes, bonds, and leases payable. Ability to repay debt is key to financial health.

Working Capital

Liquidity + Reserves

**Working Capital = UR current assets – UR current liabilities
+ TR or PR working capital reserves**

or

**Working Capital = UR net assets – Fixed assets (net of
depreciation) - UR investments* + TR or PR working
capital reserves**

Questions to Ask:

- ▶ Is working capital positive or negative?
- ▶ Has working capital grown or declined during the past several years?
- ▶ Is working capital growing in proportion to the growth in operating size (see calculation below)?

Working Capital Ratio = Working capital/Total expenses

Working Capital Ratio

The working capital ratio relates working capital to the size of the organization's operation. An increase in the ratio over time, which indicates growth in financial strength at least in proportion to growth in operating size, is a healthy trend. Each museum should determine the amount of working capital it needs, considering normal operating needs and future financial needs. An organization with a negative ratio has been forced to borrow from temporarily restricted funds or deferred revenue, from the bank, or by stretching what it owes vendors. Organizations with negative ratios are likely to suffer periods of severe cash flow stress or financial crisis.

* A board-designated endowment fund technically could be made available to the company for working capital purposes if the board votes to change the designation on the funds. We're assuming that if a museum has created a board-designated endowment fund, the board and staff would prefer to maintain that fund so it can generate revenue to support operations.

Invested Capital

**Invested Capital (approximates endowment and reserves)
= Total long-term investments**

Questions to Ask:

- ▶ Is invested capital growing or declining?
- ▶ Is invested capital growing in proportion to the growth in operating size (see calculation below)?

Investment Ratio = Total investments/Total expenses

Investment Ratio

Invested capital that provides a significant revenue stream for operations increases the strength and sustainability of an organization. The investment ratio measures the approximate level of invested capital (endowment and reserves). An increase in the ratio over time, which indicates investment growth at least in proportion to growth in operating size, is a healthy trend.

Fixed Assets

$$\text{Fixed Assets} = \text{Total property \& equipment} - \text{Accumulated depreciation}$$

Questions to Ask:

- ▶ Are fixed assets growing or declining?
- ▶ Has the museum projected the increased operating costs of proposed facility additions prior to adding facilities?
- ▶ Is the museum investing in its building and equipment on an ongoing basis to avoid deferred maintenance (see calculation below)?

$$\text{Deferred Maintenance Indicator} = \frac{\text{Accumulated depreciation}}{\text{Depreciation expense}}$$

Deferred Maintenance Indicator

The deferred maintenance indicator is used to assess the relative likelihood of deferred maintenance and need for investment in fixed assets. A declining trend in the ratio is a healthy trend. For those organizations that own facilities or have major leasehold improvements, a deferred maintenance indicator greater than fifteen years may indicate the need to invest in plant. For organizations that own furniture and equipment, but no facility, a deferred maintenance indicator in excess of six years may indicate a need to invest in equipment.

Total Debt

**Debt = Notes/loans payable + Bonds payable +
Lines of credit drawn down + Capital leases payable**

Questions to Ask:

- ▶ Is debt increasing or decreasing?
- ▶ Does the museum have a dedicated source of funds for repayment, for example, pledges to be collected?
- ▶ Has the museum had difficulty making payments on a timely basis?
- ▶ What portion of annual revenue is dedicated to servicing debt, both principal and interest? Is the debt service increasing faster than annual revenues?

Statement of Financial Position - Balance Sheet
June 30, 2009

	Museum A	Museum Z
Assets		
Cash and cash equivalents	1,221,000	585,000
Accounts receivable and contributions receivable	950,000	450,000
Inventory	185,000	170,000
Prepaid expenses	150,000	200,000
Total current assets	<u>2,506,000</u>	<u>1,405,000</u>
Investments	1,050,000	1,800,000
Property and equipment, net	4,900,000	1,200,000
Total assets	<u><u>8,456,000</u></u>	<u><u>4,405,000</u></u>
Liabilities and Net Assets		
Liabilities		
Accounts payable and accrued expenses	425,000	250,000
Deferred revenue	141,000	105,000
Notes payable	450,000	100,000
Total current liabilities	<u>1,016,000</u>	<u>455,000</u>
Net Assets		
Unrestricted	2,440,000	1,750,000
Temporarily restricted	2,850,000	400,000
Permanently restricted	2,150,000	1,800,000
Total net assets	<u>7,440,000</u>	<u>3,950,000</u>
Total liabilities & net assets	<u><u>8,456,000</u></u>	<u><u>4,405,000</u></u>

Unrestricted Revenue & Expenses
FY 2009

	Museum A	Museum Z
Earned Revenue	1,620,000	1,475,000
Investment Revenue	10,000	(75,000)
Contributed Revenue	4,880,000	4,550,000
Total Revenue	<u>6,510,000</u>	<u>5,950,000</u>
Total Expenses	<u>6,450,000</u>	<u>6,000,000</u>
Net Income (Change in Unrestricted Net Assets)	<u><u>60,000</u></u>	<u><u>(50,000)</u></u>

Calculation of Ratios

	Museum A	Museum Z
Working Capital		
Unrestricted net assets	2,440,000	1,750,000
Less property and equipment (net)	4,900,000	1,200,000
Less unrestricted investments	0	0
Plus TR or PR working capital reserves	0	0
Working capital	(2,460,000)	550,000
Working Capital Ratio		
Working capital	(2,460,000)	550,000
Divided by total expenses	6,450,000	6,000,000
Working capital ratio	-38%	9%
WCR in months	(5)	1
Investments		
	1,050,000	1,800,000
Investment Ratio		
Total investments	1,050,000	1,800,000
Divided by total expenses	6,450,000	6,000,000
Investment ratio	16%	30%
Fixed Assets		
	4,900,000	1,200,000
Deferred Maintenance Indicator		
Accumulated depreciation	3,300,000	450,000
Divided by depreciation expense	275,000	115,000
Deferred maintenance indicator (yrs)	12.0	3.9
Debt		
Notes, mortgages payable	450,000	100,000
Bonds payable	0	0
Lines of credit	0	0
Capital leases payable	0	0
Total Debt	450,000	100,000

Museum A

Disaggregated Statement of Position

June 30, 2009

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Assets				
Cash and cash equivalents	(1,779,000)	2,800,000	200,000	1,221,000
Accounts receivable & contributions receivable	-	50,000	900,000	950,000
Inventory	185,000			185,000
Prepaid expenses	150,000	-	-	150,000
Total current assets	(1,444,000)	2,850,000	1,100,000	2,506,000
Investments	-	-	1,050,000	1,050,000
Property and equipment, net	4,900,000	-	-	4,900,000
Total assets	3,456,000	2,850,000	2,150,000	8,456,000
Liabilities and Net Assets				
Liabilities				
Accounts payable and accrued expenses	425,000	-	-	425,000
Deferred revenue	141,000	-	-	141,000
Notes payable	450,000	-	-	450,000
Total current liabilities	1,016,000	-	-	1,016,000
Net Assets				
Unrestricted	2,440,000	-	-	2,440,000
Temporarily restricted	-	2,850,000	-	2,850,000
Permanently restricted	-	-	2,150,000	2,150,000
Total net assets	2,440,000	2,850,000	2,150,000	7,440,000
Total liabilities & net assets	3,456,000	2,850,000	2,150,000	8,456,000
Working capital (other formula)				
UR current assets	(1,444,000)			
minus current liabilities	1,016,000			
Working capital	(2,460,000)			