A Guide to Spotting Financial Risks in Orchestras

2026 National Conference

JUSTINE TOWNSEND: We are going to dive in, and Molly is going to get us started on this first section, and then I'll jump back up for the second one.

MOLLY YOON: Thank you, Justine. Alright, I'm sure everyone is so excited to dive in, so without further ado, let's get started. As we start with our presentation today, I want to emphasize that when we talk about financial risks, we're talking about the red flags that can impact your orchestra. So what are those red flags we're talking about?

Red flags are critical warning signs and an indicator of potential risks. The definition should seem practical enough. As you continue through the slides, you will see that the presence of red flags can indicate potential issues, such as your financial statement, material misstatements, fraud, compliance issues, sustainability issues, cash flow and government issues, among others. The bottom line here is red flags often lead to financial trouble when they are not addressed. A key step in identifying red flags is regularly reviewing your monthly financials, including both internal and external statements and the related information. You're going to hear us reiterate this throughout this presentation. If you're not getting it right now, this is the first thing you can put on your list of today's takeaways.

So as I mentioned earlier, identifying a red flag is important for everyone in the room today. Each of us has a responsibility to identify those red flags. We highly recommend a process for every leader with budget responsibilities to identify and remedy those red flags before the auditors come in and address them. So for those of you who are board members, if you attended our tech session yesterday or attended one of our training webinars before, you know that the board members have a fiduciary responsibility to every organization that they represent.

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And part of that duty includes ensuring your orchestra's financial health. One of the ways to do that is by reviewing the monthly financials to evaluate the organization's overall financial health. So for those of you who sit on the management team, which are the three of those bubbles are in the center of this slide, you should be aware of potential financial red flags or warning signs to avoid your financial distress. Again, regularly monitoring those financial statuses to help to identify the trends, red flags, and opportunities to mitigate those. And finally, we have auditor and a consultant. Their role is to plan and to prepare an audit, exercising a healthy degree of skepticism. Although it's the auditor's responsibility to call out an organization, but only if red flags are identified, it's on the management and the board to prevent those red flags from interfering with effective and ethical operations of your orchestras.

So here I have discussed who is responsible and explained a little bit about how to spot those red flags. Next, let's talk about some details on why spotting red flags are so important. It's critical to address financial red flags to avoid inaccurate financial reporting, compliance issues, and financial instability. It should be obvious, but relying on inaccurate financial information, whether it's internal by the executive director or board or externally for the audit or by our founders, it can lead to poor decision-making, loss of trust, audit challenges, and potential reputational damage.

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So with respect to compliance, organizations must meet a range of regulatory requirements. So this includes IRS Form 990 reporting, as well as some state-level requirements such as mandatory audits or reviews when certain fundraising thresholds are met. And in some cases, there are also local requirements, like tourism funds reporting and the compliance audit. And for orchestras specifically, there is also included industry reporting, such as the orchestra statistical report, which is the annual data reporting and SMU DataArts report.

And finally, grant and founder reporting is critical to ensure continued funding and compliance. So addressing red flags timely can help an organization avoid penalties, fines, loss of funding, and even loss of its nonprofit tax exempt status. Finally, with respect to operational sustainability, ignoring those red flags can disrupt the program and threaten long-term sustainability and meeting those artistic goals. So it's essential to proactively address risks before they escalate.

So let's talk about what to do when you spot those red flags. The simple answer is act immediately. Red flags are cues to take action. So that means most importantly, what we have listed first is to ask questions. You want to dig deeper, you want to investigate, and then figure it out. We also encourage you to use what we call professional or healthy skepticism, which means that you need to critically question and evaluate the information that you're looking at.

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That helps you to identify those red flags. And once those red flags are identified, you need to implement corrective strategies to mitigate the risk. So I think that's enough for the open session. For the next session, Justine is going to show this process in action.

TOWNSEND: Thank you, Molly. Molly is a good ease-in into me. I'm going to overwhelm you and potentially over stimulate you. So that was like your slow ease-in, because I am intense and energetic and insanely passionate. And also we are going—this is a working session, y'all. So we're going to be working together. So if you are at a table alone, I do encourage you to consolidate with somebody else, just so that you can kind of have conversations at your table.

Okay. We are going to go through and find all the red flags, y'all, and talk about how to fix them. This is a "how to find your problems and how to fix them" session. That's what I should have named it. Okay. Here is how we are going to do this. We are going to go through each of your financials and other documents and show you—and we are going to do it as a group—so scary. Y'all are going to do it first, and then I will tell you if you are right or wrong. And maybe you will find some we don't have on here. But we are going to go through, and we are going to talk about cash management first and where to spot those red flags, then what questions to ask, right? And then how to fix it—for each of these.

So we are going to do that for liabilities and net assets and show you on the statement of financial position, which some people might call a "balance sheet," concentration of revenue and expense allocations. We are going to look at that statement of activities which some folks might call an "income statement" and "the statement of functional expenses."

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We are also going to look at what you need to pay attention to in the audit and the Form 990. Don't worry, I am not going to make y'all look at a bunch of audits and Form 990s. We won't do that. That is torture. I am not cruel. It is 8:30.

And then governance and oversight, we are just going to talk. There is really a conversation about what we need to be paying attention to and what we should be doing. So really giving you this framework and walking through, "Hey, these are all the potential problems we could find." Not all of them, but here is a bunch of financial problems we could find and how to fix them. Okay. So here is the framework we just talked about. What is the red flag? What are those questions we need to be asking to find those red flags? What are the risks? So sometimes it looks like a red flag, and then we say, "What are the risks?" and we get context, and it turns out to be like beige or yellow, right? And sometimes it can even be a green flag because it is like, "Oh, yay, we raised a ton of money last year for this project that we actually executed on this year." So it might look bad, but it is actually a good thing. So we will go through that, too. And then how do we mitigate those risks once we have identified them? So that is the how to fix it.

So let's start with cash management because—and also we are going to spend the most time on cash management because let's be honest, this is our biggest problem, right? Who here feels like cash management is the easiest part of your job? Yeah, that is what I thought. Okay. So we have very lumpy cash that is going to make it very difficult sometimes for us to spot some red flags. So let's get started, guys. Here is a cash section of a statement of financial position or balance sheet, depending on what world you come from. And you are going to see here that we broke—we made some choices.

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This is not the way it is always presented, right? We did some choices here to make this an exercise. We don't normally see three years. Usually we see two years, right? We usually see a comparison of two periods or a comparison of actual to budget. But we are getting three years here so we can do some trend analysis for funsies. And then we are also breaking out our unrestricted and restricted cash. This is not required, but I do encourage it because doesn't it make it so much easier to see the problems? Like, isn't it kind of obvious? So I would love to hear from y'all before I reveal the answers. I would love to hear from the crowd. What are my red flags, guys? Let's start calling them out. I'll run over and Vanna White it. And y'all shout them out to me. Come on.

Okay, so for the recording, we've pointed out we have a negative $165,000 unrestricted cash problem. We've pointed out that we have total negative cash. That's a problem. We've pointed out that we have declining cash balances. That's a problem. And we've pointed out that we have declining unrestricted cash balances. I'm not hearing the scariest red flag yet. Yes! The only what? Oh, that was so valuable.

FEMALE VOICE: The only cash you have is already restricted.

TOWNSEND: The only cash we have is restricted. So if we are spending any cash, what are we doing?

FEMALE VOICE: Going in the hole further.

TOWNSEND: What are we doing?

2nd FEMALE VOICE: I'm with her.

TOWNSEND: Okay. What are we doing? Oh, what are we doing? I heard it over here. What are we doing? What are we doing?

[00:12:01]

3rd FEMALE VOICE: We are breaking donor trust.

TOWNSEND: Yes, and that is also illegal. It is illegal what we are doing. We are misappropriating restricted assets. That's a serious red flag. And y'all, that should have been the very first thing you all said. Oh my God, we've misappropriated restricted net assets! We've misappropriated restricted cash! Okay, good job, guys. Let's go see. How'd we do? Negative total cash balance. Good job, guys. Declining total cash trend. Good job. Negative unrestricted cash, and declining restricted cash. We also are getting declining restricted cash, and we've overspent. So good job, guys. All right. What do we do about it?

First question I'm going to ask: Are these bank accounts reconciled? Sorry. My animations are a real situation, y'all. I hate them. Okay. So are the bank accounts reconciled? That's going to be my very first question. Because how did I end up with negative cash? Oh, and this is where I tell a fun story, which has been anonymized to protect the innocent and also not-so-innocent people involved in this situation.

I once went to a symphony and reconciled cash, which had not been done in months, months, my friends. And what I discovered was that cash was about a million dollars less than they thought it was. And there was no money for payroll for the entire orchestra in less than a week. And the audit had misstated cash by a million dollars. So it was also in the audit.

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So why is it important to reconcile cash every single month? Because we can accidentally think that we're doing everything right and recording everything, but potentially we are not. And all of a sudden we're having emergency board meetings to say, "Hey, I need all y'all to pay your pledges today because payroll is due in four days." So I'm here to collect pledges and also say, "Oh, no, we've got a problem."

Okay? I shouldn't have been the one to tell them. They should have known already. It was my first day. Okay. Could fraud be occurring? If cash is negative and cash is constantly declining, and I don't know why, what's going on? Is this a nefarious situation? Could fraud be occurring? I've definitely illegally misappropriated donor-restricted cash. That has definitely happened. And then I want to look at are my processes and internal controls strong and effective?

So not only am I doing the bank recs, but am I doing them accurately and timely? So here's my favorite bank rec I've ever seen. It was all reconciled and at the bottom, it just said, "Reconciling adjustment" every month, and that number just went up and up and up. And it was like, "Okay, well, what's this?" And they're, "Oh, that's the difference." Well, what makes up the difference? I don't know, but it keeps growing. Yeah, well, we need to find out, right? So we need to find out what makes up that difference and why is it growing? And then are those financial reports being reviewed regularly? Am I as a board member getting financials every month?

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Am I as an executive director getting financials every single month? And not just am I getting financials, but are they accurate? Are they complete? Do they give me all the information I need to know to be able to make decisions? And also, do they make sense? Or am I getting a printout of the general ledger, and I'm supposed to figure out what all these transactions are? Or am I getting real numbers? Am I getting real numbers compared to some kind of benchmark? The budget? Last year? Our hopes and dreams? A strategic plan? Literally anything. Are we comparing to anything?

Because if we just show up with results, then we always look successful. Results, right? But what are those results compared to? That's how we can get into our financial trends analysis, right? What is changing over time? And not just what is changing over time, but how are we doing on those goals?

Okay. So we want to review the statement of activity and consider the corresponding impact on unrestricted and restricted. Thank you. I'm going to give that back to you for a second. Okay. So these are the questions I'm going to start asking. When I have that cash, when I look at that cash situation, these are my questions. Y'all do not have to take pictures of this. Come see me at my booth right down there. I've got an orange shag rug. I will happily email you these slides afterwards. No reason to do all that. So I need to know what is happening with my unrestricted support? Am I losing it? Or am I not asking for it? What's going on there? What are we doing?

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Insufficient earned revenue. What's happening with my ticket revenue? Did I delay a sale date, and that is why I ended up with negative cash? And then maybe I didn't think about what the impact of that was going to be. Right? What about a significant increase in expenses? Was there an unbudgeted expense? Was there a major capital maintenance expense we were not expecting, and that's what ended us up in the red? What about a loss of a grant or a program? Did we lose something? What happened? Sometimes we didn't lose it. We just never submitted the invoice to the school district for them to go ahead and pay us for like all of the education programming we did for the semester. I cannot tell you how many times this has happened. Try to get money from a school district after their fiscal year ends. Try. You cannot. Right?

So sometimes it's just, "Did we forget to invoice?" That is a very actionable, fixable problem. And then, you know, we already talked about that. Okay. Are there any questions that you would ask, after looking at that report, that we didn't have on this list? Y'all, you only help each other if you share. If you have ideas I missed this is the brain trust.

FEMALE VOICE: Just what led to those various problems?

TOWNSEND: Yes! The question, follow up question. Once I get the answer to all of that is why. Right? Why? Oh my gosh, the thing I hate the most is when there's an explanation for variances, and that explanation is this is higher than that, or this is lower than that.

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Like I can't do math in my head and see. Like tell me why. I don't care. I know that it's higher or lower. Why? If we're not communicating why, and if we're not getting to the why, we're never going to get to an answer. So that was good. Anything else? Any other questions y'all would ask? Did I miss anything else? This is a very smart room.

MALE VOICE: I'd ask what the next six months might look like.

TOWNSEND: Yeah. How do we get through this? What a great segue to my next slide. Thank you. Any others while I'm running back to the front? All right. Okay. What do the next six months look like? Let's build a plan for sustainability. How do we survive when we find ourselves in a situation with negative cash? And we're going, "Oh, crap." Well, we're going to look for ways to increase cash. So, I'm going to look at, am I mining my audience data for a donor pipeline? If somebody has been to three shows in a season, they are a fan. And they want to give you money. Take them to coffee and get it. Even if it's $25 a month for the rest of their life, I will take that. That is a lot. Y'all, I have been giving $10 a month to a public radio station. I do not live there anymore for the last 15 years. They have gotten $1500. Well, more than that. What have they gotten? Like a lot more. I don't know. Okay. Monthly giving automatic renewals, right? Forever and ever and ever we want that money. You can get a lot more than $25 if we ask for $25 a month.

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How about rental revenues? Are we monetizing every single asset we have that is not in use? Do I have an empty parking lot that I could sell parking to during the day? What can I do to monetize literally everything? Collaborations. Where can I save money, and where can I get access to new audiences so I can drive up revenue by collaborating and introducing myself to different parts of the community and different kinds of arts-interested folks?

And then if you're not doing dynamic pricing, what is wrong with you? Do you know that if you do dynamic pricing, you can increase revenue 20% the first year you put it in place? And I'm not talking about manual dynamic pricing, where you think you're doing dynamic pricing, but it requires a human to adjust it. I'm talking about automatic dynamic pricing that automatically adjusts. Lots of friends out here in the hallway, please implement that if you haven't already. That is an automatic boon to your revenue.

What about monetizing special experience for your biggest fans? What we have that nobody else has in the arts is fans. Oh my gosh, and do you know what? People come to the orchestra. You know what? They all used to play. And they would love to do like rehearsal with the orchestra. Yes, I know it's going to cost you an orchestra service, but y'all, if you can monetize that, we can make it worth that orchestra service to do—or a conductor for a day, whatever. You got free shows in the community. You can do conductor for a day in the community. What can you do to monetize those amazing experiences when you have guest artists in town? Or when you have a rock star first chair cello player who's just everybody is amazingly in love with your principal cello player, and everybody's got a crush on him.

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Or maybe everybody's got a crush on your harpist. I don't know. But maybe she wants to hang out with everybody in the green room when she's not playing. Right? What can we do to monetize those experiences? And then, let's develop a cost-cutting plan. So first thing we got to do when we're developing a cost-cutting plan is make sure we don't cut the wrong things. So what's the sine qua non? What can we not live without? What is our mission? What are those expenses that are the life blood of our organization? And if we cut that, that's not a mission anymore. That's sacrosanct. We're never cutting that again. Cool. What can we cut? What pivots should we be making? What are we doing that we just do it because we've been doing it forever, but the impact is not, like, awesome? And it doesn't really bring in any money. And nobody's funding it anymore. So what can we sunset? Right? What could we pivot to? What are short-term pivots that we can make? And what are the long-term pivots?

When you are doing your budget each year, you should have identified already—in a situation, these are the things that are going to go. You should already know. First quarter, I got a problem. This is the stuff we don't do. Second quarter, I got a problem. This is the stuff we don't do. Identify that during the budget process so that when we find out we're negative $10,000 cash, we're not scrambling to find out what we're going to do. We're just like, duh, we cut these things. And now we've got to go find some money. Okay. How about accessibility? So do we have any savings investments or reserves? If you don't have a reserve policy where basically any year you operate at a surplus, which I know is a laughable thing to say in this room.

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But God, if it should ever happen, let's sock that away in a reserve. What I really prefer to do is what everybody in this room really loves doing is taking your budget and then taking depreciation off at the bottom and being like, "But that's not a cash expense." But if we left depreciation in and then took that depreciation and put it in an operating reserve, then when it was time to do maintenance, guess what? We would have a fund for it. [WHISPERING] That's why accountants invented depreciation, y'all. We want you to set that money aside. We do things for a reason.

Okay. Are there any pledges we're not collecting? Right? Like I called everybody in the room, and I said, "Hey, everybody, get ready to pay your pledges today. Today's the day. How about the endowment? Can I get a line of credit with the endowment? Can I get a line of credit with the bank? I'm going to need board approval. How long is that going to take me? I need to rally the troops immediately. I want to get the board in the room and start having conversations right away. And I'm not going to pull the board in the room without a plan, though. I'm not going to say, "Hey, solve this problem with a line of credit, and then I have no plan to go on after that. Because if I were a board member, I'd be like, "No, we're not going to take out debt without a plan." So have a plan. And then can we go to some of our favorite donors and say, "Hey, can we pay a little early this year? How about we do our annual gift a little early, and then can spending be delayed?

Spending being delayed—really be careful about that. Don't cut things you actually need to do. And don't delay paying your payroll taxes. Okay. A tale of three orchestras, y'all. We have three orchestras here. I've got—

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Oh, these are all like Group 3 orchestras, I think, is what I did in my examples. Yeah, they're all Group 3. This is, you know, kind of an average for y'all. Okay, I've got a distressed orchestra, I've got a stable orchestra, and I've got a growing orchestra. But all of them have red flags. Some just maybe more than others. So what are my red flags? And you can tell me any orchestra, but I'm going to walk around. Y'all tell me these red flags. What do I have? What's my problem?

FEMALE VOICE: All of them have major accounts receivable that they haven't collected.

TOWNSEND: Very good. Large accounts receivable balances. What else?

MALE VOICE: No operating reserves.

TOWNSEND: No operating reserve! That's the big one. What else? What's the other red flag?

FEMALE VOICE: [INAUDIBLE]

TOWNSEND: A lot of restricted cash. They all have a lot of restricted cash. Anything else?

FEMALE VOICE: No endowment?

TOWNSEND: No endowment? No endowment! Very good. Okay, what about Orchestra A? That was my obvious one. Red flag in Orchestra A. Negative cash. Right? What about Orchestra B?

FEMALE VOICE: Most of the cash is restricted.

TOWNSEND: Most of the cash is restricted. Right? I'm highly leveraged that way. I'm in danger. But Orchestra A is in real problems because again we've misappropriated restricted assets.

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Okay. So what we need to do to keep an eye on this ahead of time is pay attention to the days cash on hand. Right? We want this to be in our monthly financials, this number, days or months cash on hand. If you have the luxury of months of cash on hand. So let's take a look at that. Here's an analysis, and I've got my days cash on hand on the bottom, right? Same orchestras. A, B, C. Negative 3, 31, 100. So even my orchestra that's in the best position is just barely over my bare minimum of 90 days. And that 90-day kind of rule of thumb, if you're a festival, or if you're very seasonal, you need six months, guys. Really. And what did we learn during the pandemic? We really need six months. We really do. So 131 days, negative 3 days. So I would be watching on my financials every month for that number. And when I see it approaching that 100, less than 90 days, we're really going to start having conversations, right? And then as a board, we want to set a policy. How many days do we want to have in that operating reserve? How many days do we need to have in order to feel comfortable?

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Okay. So raise your hand. How many days of cash on hand do you currently have? A, 0 to 60 days. Really? Okay. I see two. I see two very tentative hands. Sixty to 90 days. Over 90 days. All right. And now we're going to add this metric to our financials going forward so I know what it is. That's not everybody. That's not all hands, y'all. So for everybody who didn't answer to A, B, or C, my goal was you raise your hand on D, if y'all didn't get it. This was one of those, like, you have to say yes things.

Okay. So what did we go through in cash? We went through. We're going to ask questions and investigate. We want to know why. I don't care that it is higher or lower. Tell me why it is higher or lower. I want to complete timely bank reconciliations. That is a non-negotiable. I'm going to manage remittance fund collection and monthly reporting. Right? I am going to make sure that my AR is not growing, that my pledges are being collected, that conversations are being had. To my two potentially development/marketing folks in the room. Pledges are rad. I love getting pledges. Oh my God, I'm such a fan of pledges. But I don't actually care about that pledge until it turns into cash, y'all. Because a pledge is cool, but if it's not collectible, it's not cool at all. It's actually like a problem because it's going to mislead me. And I'm going to think, I mean, it's going to lull me into a false sense of security. That's what an unfulfilled pledge does, right?

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So I want to make sure that I am collecting, right? It's not enough to just get the pledge. We need to collect. And then we want to prepare budgets and make sure we're looking at our cash forecasts, right? So that I can see the cliff coming. We have the lumpiest cash of like any non-profit. We are lumpy, y'all. So if we are not doing cash forecasting, we are going to struggle. Y'all, there's so much space up front. Come up front. Nobody should be standing up. There's so much space. You're not going to offend me. I'm all over this room. Please come forward.

And then regularly reviewing the Actuals versus Budget. That is explaining why. If there is no benchmark on comparing the numbers to, what do they mean, right? Nothing. They don't mean anything unless I have something to compare them to. And then I always want to have a plan for short-term cash needs. So if you don't have a line of credit right now, even if you're one of those folks who raised your hand and said, "Oh, yeah, I got it. I've got over 100 days of cash on hand." You still need a line of credit for emergencies. They take about 90 days at a minimum to secure. So it's not something you wait until you have negative cash to get. And also, y'all, I don't know if you know this, but it's real hard to get a loan when you don't have any money. It's a lot easier when there's money in the bank. So it's a good idea to get that line of credit when you need it the least, so that it is available to you.

All right. Now let's get into liabilities and net assets. Here's what I'm going to be worried about. That payroll tax liability. If I am a board member, I am watching the payroll tax liability every single month like a hawk. Because if that number goes up but staff didn't increase, we are not submitting our payroll taxes, and I can be held legally liable as a board member, and I am going to say something.

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Because I don't want to go to jail or get fined. By the increasing pension or 403b or 401k liabilities, I am also most likely not submitting like I should be. And that is going to cause a problem and fines and a legal issue. I don't have a line of credit. Like I said, they take time to get. Get it. And then my other red flag, maxed out line of credit. Especially if I have a low cash balance, and all my other liabilities are high. So I've also got an AP balance that is like four months' worth of expenses because I have not been paying bills because I don't have any cash to pay them. So I have like, oh, my AP balance is four months' worth of bills. Oh, my line of credit is maxed out. Oh, I've got $5,000 cash in the bank. We are in a serious situation. So I am really going to not wait until I get to that day, but instead, as a person who reads financials, which everybody in this room, at some point in time you read financials or you're responsible for a budget, right? I am always going to be looking for that. Those growing liabilities and when I am getting to the point where I have no more wiggle room.

All right. Let's get back to spotting red flags. So here we go, guys. I got three orchestras again, the same three orchestras. I got Orchestra A, Orchestra B, and Orchestra C. And I got some red flags. And they are kind of obvious. So let's hear them. Red flags. Come on, guys. I will just stick the microphone in your face. Remember, I teach college. I will voluntell. First red flag.

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MALE VOICE: Oh, I just looked at it. Let's see. The refundable—the conditional grants, I think, is a big challenge for me, specifically with Orchestra A, only because we don't know exactly when that's going to come in. And that's always a challenge for me.

TOWNSEND: Well, a refundable advance means we've received the grant, but we haven't met the conditions. Very good, though. That is a red flag because we need to be checking to make sure that we are meeting those conditions. Right? So that revenue becomes available to us. Good.

Thank you. All right. Next red flag.

MALE VOICE: Well, you've got negative cash on the hand for Orchestra A and deferred revenue at $680,000.

TOWNSEND: What does that mean?

MALE VOICE: It means you've spent all your deferred revenue.

TOWNSEND: It means we've spent all our deferred revenue. What happens if I have to cancel a show because there's a hurricane?

FEMALE VOICE: That's a problem. So then you've still got to pay people.

TOWNSEND: We have to refund tickets. Am I able to refund tickets?

FEMALE VOICE: No.

TOWNSEND: No. I can't refund tickets. Do you know how many people in this room have this problem right now? How many people in the room have more deferred revenue than cash on hand? Yeah. Yeah. Yeah. I imagine that will get a lot higher in July, August. Right? July, August, we're going to be sitting at that cusp. So when we're looking at our operating reserve, we're looking at what do we need to cover cancellations? What do we need if there's a hurricane or a tornado or wherever I live? Right?

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I'm from Texas, so we have hurricanes. So I'm going to choose the hurricane example there. What else? Even if I just look at performances, the only orchestra who's actually able to refund tickets would be Orchestra C. And then look how much money they would have left. Not enough to cover expenses. Right? This is our big red flag that we often miss, and maybe we know about, but we stop thinking about. But I always want to watch those conditional grants. Right? I'm tracking those. What else? We've got the refundable advances, no coverage. Okay, guys, here's how you can compare yourselves to others to find out whether or not your net assets are good or not. And I just want to give a shout out to Andrew, who gave me this data. Thank you very last minute. I super appreciate it.

Y'all, I love data. I'm a nerd if you didn't notice. But here's our benchmark data from the OSR. It just came out. This is our FY25 data, by orchestra. Some interesting insights in this data. Right? So group one and group two, the most restricted. But also, they typically have the largest endowments. So I would anticipate that, right? That's actually a sign of health for the larger orchestras to have those large endowments and to have those large restricted percentages.

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Group seven, what's going on there? I think it's very specific, and so you get specific grants for your specific projects, right? But then if we look at group eight, so the smaller you are, the more flexible you need to be. That's really what this tells us, right? The smaller you are, the more flexible you're trying to be. But this gives you a benchmark, so that when you look at your net assets, you can go, "Well, how are we doing?" And you can look and see, compared to your group.

All right. Now let's look at some net asset red flags. I like to make it easy. We got XYZ Orchestra here. Three years. Again, I would not usually present three years in a statement of financial position. We're just looking at the net asset section. And what do I have? At least I got an operating reserve. So I did that. I did that.

MALE VOICE: I look at the first line there, net assets without donor restrictions. And the trend over time.

TOWNSEND: So net assets without donor restrictions are negative. And there's a trend of that increasing over time. But what does that mean? If my net assets without donor restrictions are negative, and my net assets with donor restrictions are positive, what have I done?

MALE VOICE: Heavy reliance on the donors?

TOWNSEND: Hmm, you spent your cash. You spent donor-restricted cash. So you've misappropriated donor-restricted assets again. Relax. Okay. So what's our plan?

[00:44:00]

Because if I give this to an auditor, I'm getting a going concern. Right? The auditor is going to look at this and say, "Y'all are going to be in business next year?" So in order to avoid that going concern, I'm going to have to give the auditor a plan. So I need to come up with a plan to respond to this very specific situation. And I need to understand exactly what is happening here. So I need to be asking all of those questions. Right? So I am going to be looking at what's going on with my sustainability and what's going on with those donor-restricted net assets. The first thing I'm going to do, though, when I've already done this is a mea culpa, and I'm going to go to the donors, I'm going to say, "Hey, y'all, can we release that from restriction and maybe unrestrict that? Because nine times out of ten, it is our fault this is restricted because we've raised it restricted. The donor does not care what it supports nine times out of ten. You sent them a letter saying, "Hey, we're raising money for this, and then you took them out to lunch, and you said, "Hey we're raising money for this." And they were like, "Yeah, I want to give to that. And you could have just said, "We're raising money for stuff like this." And they would have said, "Yeah I want to give money to that." And then what about unrestricted? So just call them up and say, "Hey, it's stuff like that. Can we unrestrict it? And then we solve a problem, right? We solve that problem immediately, and your donors love you. That's why they give you money. They don't want you to get a going concern. That is not what they want, especially because you're the one who restricted it when you asked them for it. So just ask them to unrestrict it. I've never had a donor say no. I've had a lot of development folks be very scared to ask. But I've never had a donor actually say no after the ask was made.

[00:46:04]

So what are these risks? Right? We got the risk of financial unsustainability, right? Insolvency and going concern. When we're looking at those net assets, that is the result of our operations over time. The cumulative results of our operations. So if our unrestricted net assets are negative, the cumulative results of our operations are negative, so we need to figure out how to shift.

And then inappropriate use of donor-restricted net assets. We've talked about that a lot. I feel like I've hit that home. Yeah? Okay. I'm getting nods. Okay. And then inability to use the restricted funds to cover those deficits. And this is the big one. The loss of the donor or grantor confidence, right? When your foundations see negative net assets, they know that you spent their grant inappropriately. They're sophisticated. They're going to look at your 990. They're going to see that. So we need to solve that problem before we get to the audit. We need to solve that problem before we get to the 990.

And then difficulty paying expenses, and then our board and leadership liability, right? If we've misappropriated donor-restricted assets, we've put our board in danger. And then that going concern audit opinion. Okay, how do we fix it? Figure out what the differences are and why do they exist, right? What's the problem? Why didn't this go according to plan? How do we fix it? We're going to pay attention to any of these big, scary things, like increasing payroll liabilities, that line of credit status, and the net assets. Because those are the big ones that if I keep my eye on that, that gives me kind of the long-term health of the organization. I can see.

[00:48:07]

Okay. Separately in track and regularly review those net assets. I like a net asset roll forward in your monthly board packet that shows—I'm just going to wander around. I can't stand just stay still—that shows all your grants. These are all the grants we have outstanding. This is the status of what we've spent on them. This is how much restricted we have, and this is the deadline on all of them. I want that in my board report, or at least in my management report every month. If I were the ED, I would want to know that at a minimum, especially on those conditional, refundable grants. Where are we on meeting those conditions, especially as compared to the deadlines? Because what I really don't want to have to do is give back $185,000 cash. That's

worse than canceling a show, because at least when you cancel a show, half your audience members are going to donate their tickets back to you, right? Okay. We're going to diversify those revenue sources. Y'all, I have a whole webinar on diversifying your revenue sources for Artistic. It's got 38 ideas for new revenue streams. It's free. It's on my website. It's linked at the end of this. Enjoy.

And then renegotiate all those vendor terms. If you are spending a ton of money annually with a vendor, renegotiate, right? Especially if it's been three or four years and you know that you are a large portion of their business, you're in a good position to renegotiate. More favorable terms. And then where can you get to those donors and ask them to release? And always, always communicate transparently.

[00:50:01]

I know it's really scary. Remember at the beginning when I told you all that I walked into a board meeting of a bunch of board members I'd never met before, and I'm like, "Hi, I'm your consultant. And also I need you all to give us money right now. And also we don't have—we are a million dollars shorter than you thought we were for like the last year. Hi, my name is Justine." Right? Sometimes we have to deliver really terrible information. But you know what? Showing up and being transparent and saying, "Hey, let's all solve this problem together, and here are the steps to get out of this," is always going to be better than delaying those financials because they're uncomfortable to discuss. Or only doing quarterly financials because they're uncomfortable to discuss. Right? And then it's too late to do anything. Don't avoid it because it's uncomfortable. Do that with your feelings instead. Just kidding.

And then a board vote to release the designated operating reserves and making sure that you have that policy, you know what that policy is. Don't let your board set aside operating reserves without creating a policy for how to get access to them. Because you'll never get them again. Because a new board will come on and be like, "I don't know what they wanted to do for that. And I don't want to hurt their feelings or do something different than what they said." Right? So make sure you have in writing, how do I get access to that? And then always participate in the OSR and utilize that data as a benchmark. If you have no other benchmarks, if you have not budgeted yet, if you don't have a prior year, if you are brand spanking new, you at least have the OSR.

Okay. And now concentration of revenue and expense allocation. What are my red flags, guys? I'm going to get real aggressive with voluntelling because we're running out of time for patience. So I'm just letting everybody know I have not picked on this back corner. So I'm going to come over here and pick on this back corner. All right. What do we see? It's XYZ Symphony. I got revenues and support. What are my red flags?

MALE VOICE: The loss of the NEA.

TOWNSEND: Loss of the NEA. Ooh, who felt that? Too soon. Okay, what else?

FEMALE VOICE: The ticket sales didn't go up every year. They went down in—

TOWNSEND: Right. So we went up in '25, and then we went back down in '26. So what's going on with our ticket sales? What else?

FEMALE VOICE: Individual contributions are dropping here.

FEMALE VOICE: That's what I was going to say.

TOWNSEND: Kind of a little bit rapidly, right? What else?

MALE VOICE: I've got to get a look here. Keep looking.

TOWNSEND: All right. We'll come back to Jim.

FEMALE VOICE: Your net from your special events is going down.

TOWNSEND: Special events are declining. It's the net, right? So it might be that we're saying we're raising more money gross, but the cost of doing special events has increased, but it's difficult to increase the ticket price. Right? So we're having a lowering net on our special events. What else?

MALE VOICE: Individual contributions are down.

TOWNSEND: Individual contributions are down and trending. What else?

FEMALE VOICE: Total revenue going down.

TOWNSEND: Total revenue is declining. Right? What about concentration of revenue? Where's my revenue concentrated? What am I dependent on? Ticket sales. I'm dependent on ticket sales. That's my highest concentration of revenue, right? That's why there's so much pressure on us to sell tickets.

[00:54:02]

Okay, so we got that loss of federal funding, declining community support. It is not just that individual contributions went down. All of my contributions are going down. My special events are declining. My individual contributions are going down, right? Foundation grants staying about level. Production sponsorships, very slight increase, right? So I have a declining community support. So I want to look at what's going on in my donor base as a whole. And then I want to segment out and see, is there a specific group where this is concentrated? Are these major donors? Are these my annual fund donors? What is happening? I'm going to go analyze my special events cost. Is it the cost? Or is it that we have declining attendance at our special event? Is it worth it anymore to do that special event? Right? We all know they are a lot of effort.

Okay, real quick. Every time I mention special events, I just have to get on this soapbox. Sorry, Molly. Put me on a one-minute timer. Don't let me go over. Y'all, special events are donor cultivation events. Okay? That is not a fundraiser because of the amount of time it takes your staff. You know you could write a grant. You could write 50 grants in the time you spend putting together that special event and raise way more money. Right? The point of that event is donor cultivation. So if you are not doing the follow-up, and if you are not treating it as a true donor cultivation event, and you are not tracking your results over time.

[00:56:00]

How many donors did we cultivate from that event to determine whether or not to continue to do it, then you are not fully assessing the quality of your special events, and you are not maximizing the value of that special event. If you're going to drive your staff crazy and make everybody stop doing their job for three weeks to put on a gala, right? Which is what happens. Every person in this room, I don't know, y'all can't see each other's faces, but every person in this room is nodding, annoyed at me. Right? So if we are not making money on them, then they need to be donor cultivation events. And if we are not using them as donor cultivation events, please stop doing them. Okay? PSA over.

Okay, so do you regularly review the risk of your revenue concentration? A, yes. Raise your hand. Dang, y'all, I'm proud of this room. Folks who aren't doing it, go ahead and raise your hand. I'm proud of you, too, because you're going to start doing it tomorrow. Okay, so expense allocations. What can go wrong with expense allocations? My friends, so very much. We get weird on the 990s sometimes, and we don't really know what we're doing sometimes, and so our expense allocations can look a little crazy, and then that's a red flag for the IRS to audit us. And also if we ever get an audit, that's a problem. Because we need to allocate our expenses the same way every year. So what do we notice about Artistic, guys?

FEMALE VOICE: A large dip in fiscal year '25.

[00:58:00]

TOWNSEND: Right. So we allocated only 8% of our expenses to the orchestra in 2025?

FEMALE VOICE: And moved to production.

TOWNSEND: Yeah. That's weird. Why would we all of a sudden decide the orchestra is a production expense? Weird choice. What's going on in education and community?

FEMALE VOICE: Down in FY25.

TOWNSEND: That's weird. How about G&A?

MALE VOICE: How about G&A? Well, it's going down a little too much probably. Did we—

TOWNSEND: Yeah, looks like we over-allocated in '24, and then we way under-allocated in '26. Nobody's G&A is 5%. That's not happening. Jim and I are overhead. All right. Fundraising and development. What is going on in fundraising?

FEMALE VOICE: It looks like it's—I can't see without my glasses.

TOWNSEND: Oh, I'm sorry here.

MALE VOICE: Not enough.

TOWNSEND: Not enough. We failed to allocate anything to fundraising in '24. That's weird. So even the ED didn't do any fundraising at all? Probably not true. And then the next year we were like, "Ah, we'll throw 8% at it." And the next year we're like, "Um, 15% feels right." What's going on in marketing?

MALE VOICE: Unlikely that those numbers are right. If it's static, there's something in the numbers.

TOWNSEND: Looks like I'm forcing that number, huh? Like in my bank rec, where it's like, "Oh, that's the difference." That's the plug, right? But if I'm only, only looking at my total program services ratio, nothing has changed, and that looks very reasonable.

[01:00:03]

So it kind of seems like we want to look at more detail. But guess what, y'all? The OSR is here to help. Ta-da! Again, let's thank Andrew. He gave us this. He gave me a lot of numbers, and then I turned it into this. Okay. What do we see? We see none—no single group is over 75% in program services, which is what charity watchdogs tend to want. But don't worry. On the 990, we throw marketing into programs. So on the 990, which is what all the charity watchdogs look like, we're at 75%. It's cool, don't worry. Right? But for our purposes, I want to compare it to the OSR, not to other 990s. I want to know, okay, how am I doing compared to other orchestras in my group? I don't want to compare myself to a Group 1 if I'm a Group 8, because it will look like I'm under-allocating expenses to artistic. But if we look, the smaller the orchestra, the higher our total supporting services are going to be—which makes sense, right? Because the amount of overhead we have to do doesn't really change based on how many programs you're running, right? Like we still got to do the basics. Any other insights from this you'll notice? I thought this was fascinating. We'll keep it moving. I know we're short.

[01:02:01]

So here are those risks we talked about. We got dependence on limited funding sources, declining community support, revenue shortfalls, increased vulnerability to economic shifts. The less operating reserves we have, the more vulnerable we are to crazy things like the NEA being just like dismantled and all your grants getting cancelled. And then, oh wait, you're getting them back. But oh, wait, they're cancelled again. But oh, wait, sign this form and you get them back. But oh, wait, you can't sign that form because it's legally binding. Right?

And then improper cost allocations. That's a big one. Staffing turnover, and then managing to the desired ratio. So you really have to watch that staffing turnover because that can skew your ratios if you left a major position open all year. Your education is going to decline if your head of education and community is—it takes you a whole year to replace that person right? We're just going to have a lower percentage that year, and that's going to make sense. As long as we know why, it's okay. It's not a red flag, it's a beige flag, right? Then how do we fix it?

We want to make sure that we are always strengthening those donor relationships with regular engagement, especially those donors that we are the most reliant on. If we have a revenue concentration—quick story. I know we're running out of time. Very quick.

I once had a client that had a very generous donor, what I would call a "sugar daddy donor" because they were completely and totally reliant on him. And he had given them a building, a very nice building, and he gave them that building on the condition that they name the building after him. Not his last name, his whole name. And then, when they were remodeling the building 30 or 40 years later, they changed it to just his last name.

[01:04:06]

And he took the building back. And he was still their major, number one donor, and he took all his funds and his building. They ceased to exist. Okay, so spread it out. Get into alternative funding sources. Go watch the revenue diversification thing. 38 ideas. Don't do all of them, though, y'all. Like, choose the good ones.

Okay. Invest in donor retention strategies and recognition. Implement that cash forecasting and scenario planning. Cash forecasting is key to know what your runway is, right? And then reducing any unnecessary administrative costs, getting into that cost-cutting plan, the sustainability, and then making sure that you're reviewing those financials over time. And then, always compare to the OSR.

Okay. Real quick. What am I doing? Two minutes? I got this. Y'all, we got this. All right, everybody, raise your hand. How long after your year end do you do your audit? Less than three months? Raise your hand fast. Congratulations. Three to six months? Y'all are killing it. Six to nine months? Great job. And how about we don't receive test [?] services? Who doesn't get an audit? Nobody? Everybody here gets an audit? All right. Okay. So my big, my big red flag on my audit is going to be my audit opinion date. I am going to make sure that my audit opinion date is before my 990 date. The audit opinion should never be after the 990. That is a problem. That's a big red flag. If my audit is dragging on for 400 million years, I want to know why. Now listen, y'all. There's a lot of auditors who are overworked right now, and there is an accountant shortage.

[01:06:03]

So sometimes that's the reason. But find out if that's the reason, or if it is that your staff is not getting it done or cannot get it done, because that requires intervention. Okay. Other things to look for. You got a new audit firm every year, your opinion shopping. You have no audit if you're required to have one. If you're not required to have one, that's not a red flag. You got significant audit findings. My thing is if those audit findings don't change. It's okay to have a bad year. It's okay for things to fall apart. Turnover happens. My goodness, the wheels can fall off the bus, but we fixed it. Right? If I'm getting the same audit findings year after year, I have a problem I need to fix immediately. Okay.

And then here's a going concern opinion. Don't get it. And then the 990 red flag date. If you go three years without filing a 990, you will lose your tax exempt status, and it is a pain in the butt to get it back, and then you cannot raise any tax exempt funds while you are doing that. So that is a problem. Don't do that. All right. Here's all the spots on the 990. I suggest you review if you're a board member or the ED. These are your red flags. Again, come see me and I'll send you these slides. We don't have time for this.

Okay. Governance and oversight. This is all the stuff you need to be doing. This is all the stuff that are problems, right? Management can't produce financial reports on a monthly basis. That's a problem. Infrequent board meetings, conflict of interest, lack of segregation of duties. Those bank recs aren't getting done, and nobody's reviewing them. I'm going to pay attention to that. All right. I'm just going to keep going. Okay.

Identify the common red flags. There they are. There's the framework. That's what we did today, y'all. Here are a bunch of links to a bunch of different stuff that y'all can have for free. Bunch of different webinars. Send them to your board members. Send them to your friends.

And then here's who we are. We're in booth 21, orange shag rug. Come see me if you have questions. I'm happy to email these slides to you. Thank you so much. And I told you we'd make it.

[01:08:02]

[APPLAUSE]