



# **NONPROFIT MANAGEMENT CASE COLLECTION**

**NEW STAGE THEATRE**

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**CS-0033**

## **NEW STAGE THEATRE**

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### **Case Abstract**

The treasurer of New Stage Theatre is faced with a deficit budget for the upcoming year. The organization needs to be able to forecast revenues and budget expenses. Its existing accounting system does not meet all the needs of the organization. This case focuses on the special problems that nonprofit organizations have in developing budgets and devising management accounting systems.

PLEASE NOTE: The material contained in this case does not necessarily represent actual people or conditions.

## **NEW STAGE THEATRE**

Don't talk to me about expenses. I don't want to hear about your problems. I don't need to know that you need another person in the office. Show me where we are going to get the income, then tell me how you want to spend it.

Thomas Cashion was feeling frustrated again. The executive committee of New Stage Theatre had prepared a budget with a deficit of \$40,000. The season before had been budgeted to break even but had instead lost nearly that amount. Cashion, the treasurer, did not want New Stage to fall into the practice of budgeting deficits and then expecting an angel to come along and bail them out.

Philosophically, I just can't accept budgeting a deficit. I will resign before I present this budget to the board for adoption. I think that the board has got to accept the responsibility for finding other ways to raise money in addition to those that are already in the budget. The \$40,000 that is termed a deficit I am going to put in the income section and call "Board Responsibility for Funding."

Although it was his first term as treasurer (a voluntary, non-paying position) of New Stage, he had been active in other voluntary organizations for over thirty years. So, he was well aware that the board was responsible for funding and that the New Stage board had always worked very hard to raise money. Thus the budget item title he proposed was important to him. Cashion continued

This \$40,000 is over and above everything else they have already planned. Before I present this budget, I want to include ideas, concrete ideas, where people are assigned to various projects, where those people will see that they must not only accept the responsibility for that amount of money but that in fact the tools are in place for that to happen.

### **History and Organization**

New Stage, Inc. was a nonprofit corporation that operated the state's only professional theater. Its first home was an old church that seated 98. Jane Reid-Petty was the founding managing director. According to a profile published in the *The Clarion-Ledger*, she had performed about twenty-five lead roles as well as served as board president, acting coach, dramaturge, executive producer, and director. She and a small group of friends started the theater by forming a working board that sold tickets, designed advertising, painted sets, and answered telephones. Twenty-three seasons later, it was housed in a 364-seat theater, and Jane Reid-Petty was its producing artistic director. The original board members were still serving on its board and as patrons. New Stage had a staff of sixteen in addition to guest actors, directors, and designers. The budget had grown from about \$10,000 in the first year to \$475,000 in 1993. Season ticket holders had grown to about 3,000. The regular season consisted of five productions running almost three weeks each as well as special performances and road tours. It had joined the prestigious League of Resident Theatres (LORT).

### **Administration of a Not-for-Profit Organization**

New Stage could be described as a one-person organization, and that person was Jane Reid-Petty. The officers changed each year; she was always there. If she wanted to be sure that something was done, historically it had been up to her to get it done. One year there might be a strong president and treasurer to whom she could turn things over, but the next year the board might elect somebody who would do nothing. She reasoned that if she got too far away from operations, then she would not be able to jump back into it. The easiest thing, she believed, was just to stay on top of it, to keep in touch with it, year by year.

Cashion did not have an answer for this. It was one of the common dilemmas of most volunteer associations—they depend on a staff of volunteers. Few sanctions apply to a volunteer who falls down on the job. All you could do is say, "Gee, I wish you'd do it." Somehow the system had to accommodate itself to the varying degrees of dedication and expertise. Furthermore, people were forgetful. They had other priorities. It was necessary to keep telling them how important the work was or to find other means to motivate them.

### **Selection of Plays**

The season was well planned with shows being selected and commitments with actors being made far in advance. The planners generally had a pretty good sense of how well a play would be received. Musicals and Shakespeare always did well. But New Stage scheduled some shows each season that were known in advance not to be good producers. Cashion observed that these plays were usually the ones that the more sophisticated board members loved. It was not only that they liked those kinds of plays but that they wanted to teach the audience to like them too. They saw the presentation of challenging plays to the public as an important part of the mission of New Stage. As Jane Reid-Petty once remarked to *The Clarion-Ledger* about play selection and the need to attract a wide audience, ". . . but I'm not interested in running a theater that is out there to cater to the popular taste. I've got better things to do with my life." She added that as the years rolled on, New Stage's audience had developed more of a "New York taste."

### **Budget Process**

After the season's offerings had been determined, usually by January, the finance committee convened through March to draw up play budgets. Capital improvements were not included in the regular budget as special drives were conducted to finance these projects. Once the shows were selected, the expenses were difficult to modify. Cashion explained to the committee

They don't say, "We spent \$100,000 on scenery last year so let's spend that much this year." They say, "*Midsummer Night's Dream* is going to need a fairly elaborate set so where we ordinarily spend \$5,000 on a play, let's spend \$7,000 on it and, if we're careful we can get the cost of one of the other plays down to \$3,000."

It is either three or six or ten players. That is not a controllable item. One way you could control that item is to cast it with a non-equity person as opposed to an equity person and maybe get a little cheaper rate on the labor cost. But, there is a limit there, too. We operate under contract with the actors' equity union that specifies that we must use certain percentages of equity actors through the year, and that percentage goes up each year. They're constantly putting pressure to use more and more equity actors.

Preparing the other side of the budget, sources of funds, was largely a forecasting function based upon historical data. Revenues from subscriptions, single-ticket sales, and advertising were estimated. Subscription ticket sales for New Stage had been fairly stable for four or five years. Statistical information was available that was used to project ticket sales for shows in markets similar to that of the capital city. Unearned revenue (contributions by individuals and corporations) was estimated. General economic conditions had an impact on contributions and, to a lesser extent, on subscriptions. The predicted expenses were compared with the total of the estimated earned and unearned income (see Appendix A). Any excess of expected expenses over anticipated revenue was termed an income gap. Grants, benefits, and other fundraising activities were used to fill this gap. Otherwise, the board had to decide whether to carry a deficit for the year or to make cuts in expenditures. One rule stood fast: protect the product. Since the shows themselves were virtually untouchable, cuts in expenses could come only by such means as reducing the marketing budget or substituting volunteer efforts for paid staff. It was at this point that Cashion had insisted that the proposed deficit for the upcoming year be termed "Board Responsibility for Funding."

Forget the expense budget. That will take care of itself. Let's talk about the income side. Where are we going to get the money? Who's going to give the money? Don't come to me with a \$400,000 expense budget for me to approve and say, "Well, we will raise that much money." Forget that. I want to see how exactly we are going to raise \$400,000. Are your ticket sales reasonable? Are your subscriptions reasonable? Are your grants reasonable? In terms of history, have we been getting \$50,000 in grants? Can we in fact raise it to \$75,000? Have we been getting \$100,000 in single ticket sales? Is it realistic, based on the plays you are planning to do, that subscriptions will go to \$150,000?

### **Accounting System**

Record keeping was important. One reason was that grant-giving agencies require accountability for funds. A second reason was that the amount of royalties paid was a function of gross receipts. All record keeping was done by hand and relevant information was transferred into the accounting system which was maintained by a service bureau. The manual system and the system maintained by the service bureau often had discrepancies in amounts, and it was sometimes difficult to reconcile differences between these two data entry systems. Despite the fact that extensive records were kept, they were not integrated into the accounting system. The accounting system did not accumulate revenue and expense by show; thus it was difficult to tell how successful or unsuccessful a show was, whether too much was spent on costumes or set-building, or whether it met the expectations set for it.

The management of a not-for-profit organization may not place as high a priority on development of an information system as would any ordinary for-profit business. Cashion described this attitude:

These organizations just do not see, cannot be persuaded to see, the value of this information. Therefore they put all of their priorities into developing the artistic side. They will pay a lot of money to get in a conductor or a high-powered director. They will pay a lot of money to get in a better actor, but they will pay hardly anything to get in a bookkeeper. They have never been persuaded that good records and good information will in any way help them to do what they are trying to do. The only thing they think they need is somebody really gung ho to go out and make an appeal to the benevolence of some donors.

Season tickets alone did not cover all the play expenses. Therefore New Stage had to schedule plays that would attract the occasional playgoer. Their mission of presenting challenging plays and keeping ticket prices affordable meant that they were in trouble if they had gauged the projected attendance of any show incorrectly. After a year in which New Stage had unexpectedly had to borrow almost \$70,000, Cashion realized that they should maintain a cash buffer equal to about twenty-five percent of the annual budget.

A grant didn't come in. A fundraiser didn't take place. Three or four things happened that caused the deficit. The point is, if it happened once, it can happen again.

Appendix A

**NEW STAGE THEATRE  
OPERATING STATEMENTS  
FOR THE YEARS ENDED JUNE 30,**

	<b>Actual</b>			<b>Budgeted</b>
	1990	1991	1992	1993
<b>EARNED INCOME</b>				
Single Ticket Sales	93,190	133,520	109,219	100,000
Subscriptions	104,090	90,605	108,986	120,000
Program Advertising	12,687	11,260	11,710	12,000
Interest	11,855	6,325	5,016	7,000
Other Revenue	9,107	10,673	11,013	21,000
<b>TOTAL EARNED INCOME</b>	230,929	252,383	245,944	260,000
<b>UNEARNED INCOME</b>				
Contributions	71,684	78,420	94,194	96,000
<b>TOTAL EARNED &amp; UNEARNED INCOME</b>	302,613	330,803	340,138	356,000
<b>EXPENSES</b>				
Personnel	214,997	255,722	277,170	312,000
Production	24,825	29,081	40,523	40,000
Administration	39,783	32,742	43,720	38,000
Promotion	43,014	48,872	49,464	49,000
Building	36,872	30,318	32,728	34,000
Special	966	4,314	3,376	200
Depreciation	11,319	12,512	11,934	
<b>TOTAL EXPENSES</b>	371,776	413,561	458,915	473,200
<b>INCOME GAP</b>	(69,163)	(82,758)	(118,777)	(117,200)
<b>OTHER REVENUE</b>				
Grants	39,550	42,535	23,450	42,000
Benefits	16,291	49,188	7,084	35,000
Other				42,000
<b>TOTAL OTHER REVENUE</b>	55,841	91,723	30,534	119,000
<b>EXCESS(DEFICIENCY)</b>	(13,322)	8,965	(88,243)	1,800

### DISCUSSION QUESTIONS

1. Can the goals of New Stage be inferred from its budget and organization?
2. Contrast Thomas Cashion's goals for New Stage with those of Jane Reid-Petty. What impact would these different goals have on the management decision making of New Stage.
3. What factors, tangible and intangible, would motivate a businessman like Cashion to get involved in activities like New Stage?
4. How does the absence of a profit figure affect the management of an organization?
5. What steps can Cashion take to allow the New Stage management to predict incoming cash and forecast expenditures necessary during a season? What should be his approach to the board?
6. Should expenditures and revenues be accumulated on a show-by-show basis? Why might the management of New Stage not prefer to accumulate financial data on a show-by-show basis?

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An earlier version of this case was prepared by Kathryn Merrell, Gerry Printz, John Stribling, and Kitty Timko as part of a course requirement.

## TEACHING NOTES

### Case Summary

The treasurer of New Stage Theatre faces a deficit budget for the upcoming year. The organization needs to be able to forecast revenues and budget expenses. Its existing accounting system does not meet all the needs of the organization.

This case focuses on the special problems that nonprofit organizations have in developing budgets and devising management accounting systems. Differences in goals and performance measures between for-profit and nonprofit organizations are explored in an appendix.

The case is appropriate for a cost or managerial accounting class at the undergraduate or graduate level. It could be used in a behavioral management class to discuss differences in goals of different members of such an organization; that is, the artist vs. the businessperson/volunteer. It could also be used in a course dealing with accounting or management of nonprofit organizations as a means of extending the usual syllabus beyond governmental organizations, schools, and hospitals.

### DISCUSSION QUESTIONS

1. *Can the goals of New Stage be inferred from its budget and organization?*

Not entirely. Like those of most other not-for-profit organizations, New Stage Operating Statements break down expenses by functional areas (personnel, production, etc.) rather than by program (new drama, educational drama, etc). A conversation with the treasurer indicated that the organization kept additional records that at least maintained attendance figures by show. These figures could indicate success in terms of selling tickets but did not measure the costs of doing so.

But, administration costs were a small percentage of total expenses indicating that Cashion was correct that not much money had been spent on the office. It is unclear which people's salaries were included in Personnel, so office employees might have been in this category.

Appendix A contains Operating Statements for 1990, 1991, and 1992 and a budgeted Operating Statement for 1993. The 1993 statement does not include an amount for depreciation, either because they were trying to prepare an estimated cash flow statement or because they did not want the expected deficit to be even larger than the amount estimated. An amount should be inserted for depreciation in order to compare the years in common-sized statements. The following statement arbitrarily uses \$11,934, the amount for 1992.

	1990	1991	1992	1993
<b>EXPENSES</b>				
Personnel	57.83%	61.83%	60.40%	64.31%
Production	6.68%	7.03%	8.83%	8.25%
Administration	10.70%	7.92%	9.53%	7.83%
Promotion	11.57%	11.82%	10.78%	10.10%
Building	9.92%	7.33%	7.13%	7.01%
Special	0.26%	1.04%	0.74%	0.04%
Depreciation	3.04%	3.03%	2.60%	2.46%
<b>TOTAL EXPENSES</b>	100.00%	100.00%	100.00%	100.00%

The other revenue item, Responsibility for Board was in fact, as Cashion pointed out, a deficit item. Since no plan had been developed to raise this money, it was not actually an estimated revenue item; therefore the common-sized statement below omits it.

#### EARNED INCOME

Single Ticket Sales	25.07%	32.29%	23.80%	20.61%
Subscriptions	28.00%	21.91%	23.75%	24.74%
Program Advertising	3.41%	2.72%	2.77%	2.47%
Interest	3.19%	1.53%	1.09%	1.44%
Other Revenue	2.45%	2.58%	2.40%	4.33%
<b>TOTAL EARNED INCOME</b>	62.12%	61.03%	53.81%	53.59%

#### UNEARNED INCOME

Contributions	19.28%	18.96%	20.53%	19.79%
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#### TOTAL EARNED & UNEARNED INCOME AS A PERCENTAGE OF TOTAL EXPENSES

	81.40%	79.99%	74.34%	73.38%
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#### OTHER REVENUE

Grants	70.83%	46.37%	76.80%	54.55%
Benefits	29.17%	53.63%	23.20%	45.45%
<b>TOTAL OTHER REVENUE</b>	100.00%	100.00%	100.00%	100.00%

2. *Contrast Thomas Cashion's goals for New Stage with those of Jane Reid-Petty. What impact would these different goals have on the management decision making of new Stage?*

Both had a genuine love for the organization and for the theater in general. Cashion brought a businessperson's attitude and experience to his role as treasurer. He believed in preplanning financially as well as dramatically. Reid-Petty wanted to educate the public. She behaved as if the product would cause the necessary funding somehow to materialize.

Such a conflict in goals could well develop into a conflict between the two principals. Each could think that the other really did not understand what is important, and eventually could quit listening to the other's point of view entirely. Dismissal of consideration of monetary means could end in financial disaster for an arts organization; loss of respect for the artistic side could be equally destructive.

3. *What factors, tangible and intangible, would motivate a businessperson like Cashion to get involved in activities like New Stage?*

Businesspeople support the arts because they realize that the arts provide employment for many people helping the tax base and the retail base in a community. But most individuals in business, like others not in business, volunteer out of a genuine love for the arts. In addition, they receive satisfaction from using their organizational and managerial abilities to make achievements. Moreover, as citizens of their communities, they believe that a thriving arts program is an effective means of promoting a city and can serve as a civilizing force.

4. *How does the absence of a profit figure affect the management of an organization?*

Ordinarily, corporations use profit to determine if their products (or services) are meeting the needs of the market place and if the costs for those products (or services) can be kept below revenue.

In a not-for-profit organization, other output measures must be used. For example, General Motors can use the sales and profitability of different models of Chevrolet to decide what mix to produce next year, but New Stage will continue to offer difficult drama even if the ticket sales for comedies would be higher. A not-for-profit organization will practice cross-subsidization. The profit per show is not important; the ability to realize sufficient revenue to offer the desired mix of plays is.

It is important that a not-for-profit organization be able to return to its donors feelings of gratitude and accomplishment. In addition to these more nebulous measures, the more sophisticated and knowledgeable donors are requiring a more exacting stewardship—for example, the establishment of the National Information Bureau and similar watchdog agencies. Society is inexorably moving toward a more objective and more detailed evaluation of a not-for-profit organization's efficiency and effectiveness. The gratitude may be difficult to measure but the stewardship had better not be.

5. *What steps can Cashion take to allow the New Stage management to predict incoming cash and forecast expenditures necessary during a season? What should be his approach to the board?*

Both incoming cash and expenditures should be plotted to determine what seasonal or cyclical patterns exist. He should note hypotheses for high points and low points—for example, a particularly popular play and impact from other organizations. Once the pattern has been established, he can compare it with the current year's cash flow use to determine whether the current year's cash flow is behaving in the same pattern as that of previous seasons. Such a plan serves as an early warning system to indicate if some action needs to be taken.

6. *Should expenditures and revenues be accumulated on a show-by-show basis? Why might the management of New Stage not prefer to accumulate financial data on a show-by-show basis?*

Yes, if the purpose is to monitor actual inflow and outflow to compare with what had been expected as of that date. Thus, if cash receipts for a particular show are less than estimated, then the board knows immediately that some action will have to be taken. It must be remembered that for a for-profit enterprise, productive activity is intended to produce a net cash inflow. There is a direct relationship between the production and delivery of product or service and the receipt of cash. The product or service is produced for the purpose of, and is offered for, sale, if possible at a price designed to recover something more than the cost of production. Absence of a sufficient flow of cash from sales to cover costs of production and operation means the eventual failure of the enterprise. In contrast, the goals of New Stage are to provide education through the form of theater presented, not to earn a profit by offering entertainment. Any attempt to measure profit by show might encourage offering more popular shows and lessen the educational achievement.