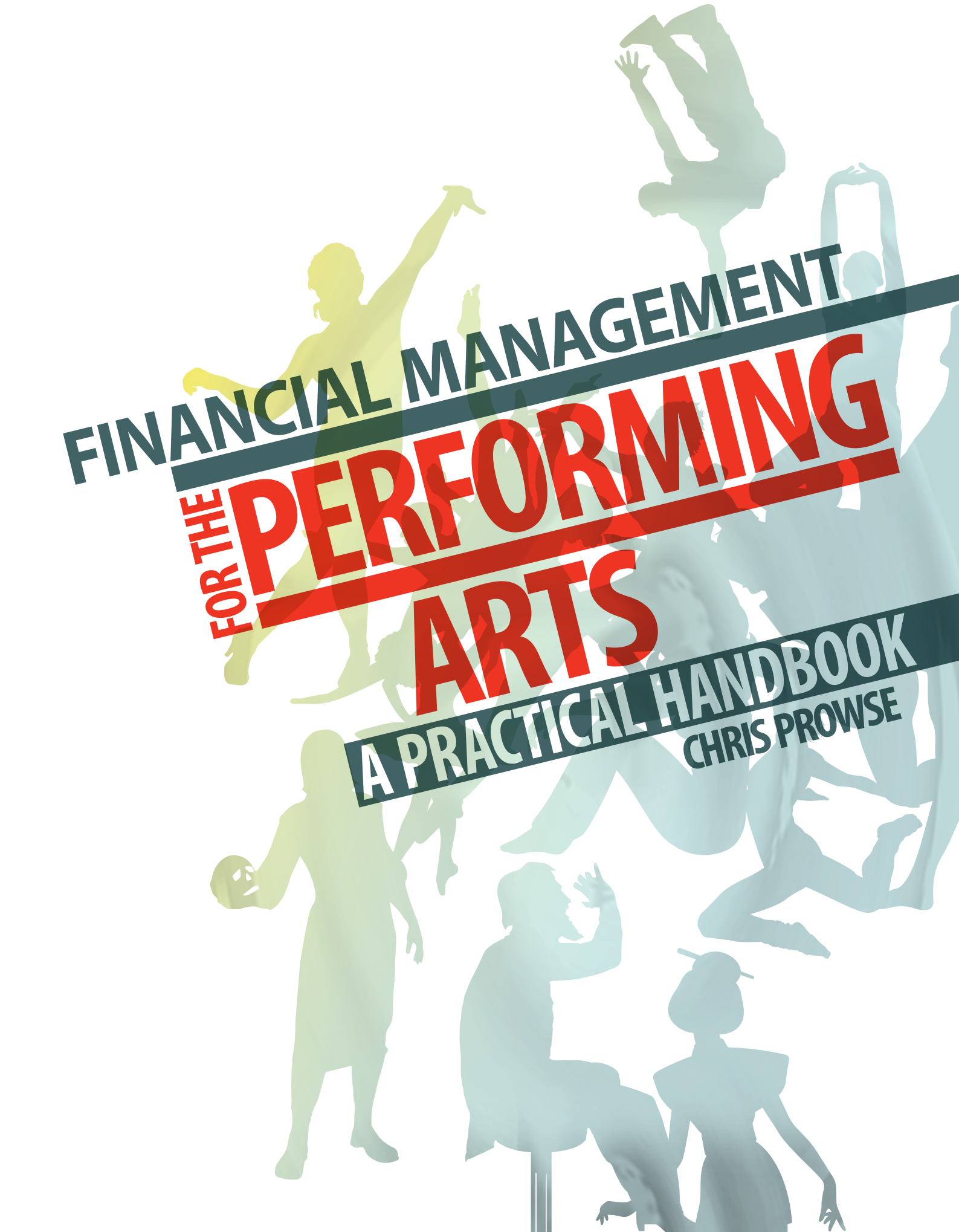
FINANCIAL MANAGEMENT FOR THE PERFORMING ARTS

A PRACTICAL HANDBOOK

CHRIS PROWSE



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The subjects covered in this book are based on his teaching experiences at Toi Whakaari/The New Zealand Drama School and from work with various performing arts organisations.

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Introduction

This book is written for those who are about to assume responsibility for the financial management of a performing arts production or a performing arts organisation. Maybe you have just taken on a job as a theatre administrator, or maybe you are about to put on your own show. In either case some knowledge of financial management on your part will be crucial to the success of the productions you are responsible for.

The performing arts are not just about creativity, they are also about business. Like any other business, the production must earn enough money to pay the bills and provide the artists with a living. This means that attention must be given to the financial as well as to the creative aspects of the production.

But do not fear; this book will not try to turn you into an accountant! The intention is to give you the ground-floor skills that will enable you to feel confident about handling the financial matters you may come across in your endeavours. This book will help you understand what the financial structure of your business is (or should be), how to read financial statements, the difference between accrual and cash accounting, and how to construct and manage budgets and work out your cash requirements. Finally, it will give you an introduction to running the financial aspects of your own business.

This book is written for New Zealand conditions, although the principles are universal. While it may get you under way, you should also be prepared to familiarise yourself with other information that you may need to know about when running your business in New Zealand. Much of this is readily available on websites such as those provided by the Inland Revenue Department (IRD) (about income tax, GST and PAYE), the Companies Office (about companies), the Charities Service (about charitable entities) and the Ministry of Business, Innovation and Employment (about New Zealand business and employment matters). As this information already exists I have not covered these areas in any great detail. Also, these are areas that change from time to time, and businesses need to keep up to date and be aware of changes as they occur. Other countries will have similar sources of information about their own commercial practices and taxation regimes.

It is to be hoped that you will be able to tackle most of the situations that you come across. However, some business matters can be complex, and where complexities occur you should consider engaging an expert to assist you. This assistance is likely to be provided by an accountant or lawyer. It is best to be proactive and get professional assistance to find a solution to an anticipated problem, rather than wait and then seek help to help sort out a mess after it has occurred. The more you know about financial management, the more you will also know about what you don't know and when help may be needed. This knowledge will make you better equipped to make important judgement calls about what you can confidently do yourself and what you may need help with.

The best approach to financial management is to be methodical. It is a three-step process of planning, action, and then evaluation. In fact, if you think about it, these three steps will not only apply to financial management but also apply to all the other aspects of putting on a successful production.

Chapter 1 – Business structures

The types of arts businesses you are involved with may vary. It may be that you are working as an individual or with others producing your own play, or maybe you are contracted by an established theatre, dance or opera organisation, or you may have joined the local theatre society. Whatever the situation, it is important to understand what type of business structure you are involved with, especially if you have financial management responsibility for that business.

Purpose – for profit or not for profit

The first distinction to make is between those arts businesses that operate for profit and those that operate as not-for-profit businesses. This is not about one wanting to make a profit and the other wanting to make a loss, but rather about what happens to the profits. Generally, the owners of the for-profit business keep the profits for themselves, while the profits of a not-for-profit business are used for a charitable purpose such as promoting the arts in the community.

Both these types of business structures are valid and meet certain business needs. If you run your own business, you will probably need to keep the profits to live on. If you are responsible for running a not-for-profit performing arts organisation, such as the Royal New Zealand Ballet, the profits will be reinvested back into the organisation for the good of the artistic activity supported by that particular business.

A useful characteristic of not-for-profit organisations is that they can apply for registration as a charitable entity with the Charities Service. If the application for registration is approved by the Charities Service, the entity is not required to pay income tax on its profits. The criteria that the Charities Service uses to determine whether an entity can register as a charitable entity are twofold:

- the purpose of the entity must fall within the four charitable purposes set out in section 5(1) of the Charities Act 2005
- the entity must provide a public benefit.

Section 5(1) of the *Charities Act 2005* says that charitable purpose "*. . . includes every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community.*" To determine whether the purpose of the organisation meets the requirements of this section, the Charities Service refers to the law surrounding charitable purposes, which has been developed over many centuries of court cases. Many performing arts organisations are successful in meeting the Charities Service's criteria, usually where they have educational or community-based purposes. A few examples of arts organisations operating as charitable trusts are the New Zealand Opera, the Auckland Philharmonia Orchestra, the Court Theatre and the Royal New Zealand Ballet.

Obviously, for-profit organisations cannot claim to have charitable purposes, as the owners of the business rely on the profits for their livelihood; in other words, the profits are not used to benefit charitable purposes. Consequently, the business must pay income tax on the profits, just like an employee who pays taxes on his or her wages. After the business has paid its taxes, it can then decide if it wants to reinvest the after-tax profits back into the business in order to make more profits or pay out the profits to the owners of the business. Examples of a for-profit business are a theatre production that shares its profits with the participants or a performing arts business venture that puts on productions to make profits for its shareholders or investors. We all know that productions in the West End of London or on Broadway, New York, often work on a for-profit basis.

Common business structures used by performing and related arts organisations

Both for-profit and not-for-profit performing arts organisations can use a variety of different business structures. The most common structures are a sole trader business, a partnership, a trust, and a company. There are other structures that can apply as well. Many amateur theatre groups with a membership use society structures. Government owned organisations are different from the others. For example the New Zealand Symphony Orchestra is a government-owned Crown entity established by an Act of Parliament.

If you are involved with the management of an arts organisation, it is important to know what sort of business structure the organisation is using. Some structures can be used by both for-profit and not-for-profit organisations. The most common structures are listed in the table below.

For profit	Not for profit
• Sole trader • Company • Partnership • Trust • Society or club • Government-owned Crown entity	• Trust • Society or club • Government-owned Crown entity • Company

Sole trader

A sole trader set-up is perhaps the simplest business structure. It is simply an individual person carrying on a business under his or her own name. If you decide to write a play for a particular theatre and the theatre agrees to pay you a royalty or a fee, unless you have formed a company or another legal entity, you will be doing business under your own name as a sole trader.

The main advantage of operating as a sole trader is that there is no need to set up a separate legal entity such as a company or trust. This means that when you stop your business there is no need to go through the complications of winding up the business entity. In addition, there are no annual reporting or filing requirements as exist with a company or registered charitable trust. However, you will have to file an annual tax return with the IRD.

The main disadvantage is that the sole trader is personally liable for any debts incurred from the business activity. If you cannot pay your business debts, you may be required to sell your personal assets, such as your home, to get the extra money to do so. There is no limited liability protection as exists with a company, which will be discussed later on in this chapter.

Operating as a sole trader can be a good way to start your business. If you decide to operate as a sole trader, it is important that business and personal transactions are kept separate for both accounting and tax purposes. This is necessary because the business receipts and payments have to be accounted for separately in order to work out whether the business made any profits and how much tax is payable on those profits. The best way to do this is to open up a separate bank account for the business's deposits and payments. If all business transactions are either deposited into or paid from this bank account, it will provide a good record of your business income and expenditure. It is also important to keep a record of all your bank statements, invoices and receipts, and deposit and cheque butts. This is not only useful for accounting for your business transactions but also required by the IRD.

The income tax situation for a sole trader is quite simple. You add up all the income that you earn from your business and deduct any related expenses, then add what's left to other income you may have earned from wages, interest or other sources, and pay tax on the total income using the IRD's tax rates for individuals. These tax rates are the same tax rates that are used for calculating PAYE deductions on wages and salaries.

Partnerships

A partnership is a group of people carrying on a business together and sharing the risks and profits, for example, a group of actors who agree to join forces to put on a play. Often the term "co-operative" is used in the theatre world to describe a group of actors who are working together on a profit-sharing basis. A co-operative is a generic term, and the group might be a partnership or another type of business structure, depending primarily upon who accepts the risk. This will be discussed later in this chapter.

When talking about partnerships, it is important to make a distinction between general and limited partnerships. This book will concentrate on general partnerships as they are more relevant for those working in the performing arts. Limited partnerships are more common for investment purposes.

A general partnership is not a separate legal entity, as is the case with a company. It is a group of individuals or organisations working together as partners in the same business, and each partner is individually and severally liable for the total debts of the partnership. The profits (or losses) of the partnership are divided up between the partners on some agreed basis, and the partners individually pay income tax on their share of the profits at the rates of tax applying to their own total taxable income.

As is the case with a sole trader, there are no formal requirements when setting up or winding up a general partnership. However, it is advisable to have a partnership agreement that states what the business of the partnership is, who is responsible for what, and how the profits are to be shared. The disadvantage of using a partnership as a business structure is that the individual partners might find themselves responsible for partnership debts incurred by one of the other partners. This is why, when a group of people are in business together, a company is often a preferred business structure to that of a partnership. A company structure provides some protection to the individual against being liable for such business debts.

Limited liability company

Here we are talking about a company, as defined by the Companies Act 1993, that is set up for business purposes. People in theatre will refer to a "theatre company" or a "company of actors". This does not necessarily mean the theatre or group of actors is a registered company complying with the provisions of the Companies Act.

A company constituted under the Companies Act is a legal entity in its own right and separate from its owners, who are called the shareholders. So if you set up a company to run your business, it will be the company that invoices the customers, employs the employees, owns the assets and pays the bills – not you as the owner of the company.

The Companies Act 1993 sets out the statutory requirements for running a company. The company has to have a name that is approved by the Companies Office, and will have to be registered by the Companies Office. The Companies Office charges a small fee for the name approval and registration. In addition, all companies must file annual returns with the Companies Office and pay an annual filing fee.

All companies must have at least one director appointed by the shareholders to run the company. For a small company owned by an individual shareholder (the owner), that shareholder may also be the company's sole director. Otherwise, a company can have one or many shareholders, depending on how many people are issued shares in the company.

A company is a popular business structure because the liabilities to its creditors are limited to the assets of the company. A company with limited liability has the word "Limited" (or "Ltd") as part of its name to indicate this status. Generally, the individual shareholders cannot be held liable for the debts of such a company. However, this is not necessarily so for the directors of the company, who must be careful to ensure that the company trades in a responsible way and does not incur debts that the directors know the company cannot repay. If this occurs, the directors can be held personally liable for such debts. You should also be aware that a bank

or the company's creditors may require personal guarantees from the directors and shareholders before they lend money to the company. This means that if the company cannot repay its debts, those who have given the personal guarantees must do so.

Companies are also useful structures to use where there is more than one owner of the business. The owners of the company are called shareholders, and a company can have one or more shareholders. The Companies Act 1993 and the constitution of the company set out the rights and powers of the shareholders, including who shares in the profits of the company. The usual way for a company to share the profits amongst the shareholders is to pay a proportion of the profits to each shareholder. This payment is called a dividend. For example, if there are four shareholders with equal rights, the profits that the company has left after deducting income tax might be paid as a dividend with each shareholder receiving 25% of the profits.

A company pays income tax at a flat tax rate, while individuals are required to pay different rates of tax for different levels of income. In some instances a company can operate on a not-for-profit basis and will not have to pay income tax if it has a charitable purpose and is registered by the Charities Service. Some performing arts organisations use a charitable company structure, and often the company's shareholder is a charitable trust.

Be prepared to spend more time on administration if the business is to be run as a company. The company must be registered with the Companies Office, with whom it must file an annual return. More frequent returns may be required where the company's shareholding, directors or other details are changed. The company must comply with the Companies Act and its own constitution (if it has one).

Another complication that arises from a company structure is that the Companies Office and IRD require certain procedures to be followed to wind up the company when the business comes to an end, unlike a sole trader situation for which there are no such formal procedures.

You may wonder at what point you should form a company to run your business. In many cases this will be the second step in the life of your business. The business may start as a sole trader and then grow to the extent where it is taking on more liabilities, perhaps employing a number of people, or even looking for others to invest in the business. If so, a company structure may be worth considering. However, it is advisable to obtain advice from an accountant, lawyer or business advisor before you decide to take this step.

Trusts

Trusts can be both for-profit and not-for-profit. Most performing arts organisations that operate as trusts are reliant on government funding, donations and private sponsorship, so find it best to operate on a not-for-profit basis. Examples of such performing arts trusts are the New Zealand Opera Trust and the New Zealand International Arts Festival Trust. These organisations are incorporated under the Charitable Trusts Act 1957 and registered as charitable entities under the Charities Act 2005, which means they don't pay income tax. The profits of such not-for-profit trusts must be used for charitable purposes that benefit the community, such as providing artistic productions. Performing arts trusts provide these benefits by reinvesting profits back into their businesses to support their ongoing operations.

The objectives and obligations of the trust will be set out in the trust's deed. The trust deed will also set out a procedure for appointing the trustees, who (like the directors of a company) are responsible for running the trust and providing the benefits. In the case of a performing arts trust, the benefits will relate to that particular art form and to those in the community who may benefit from it.

A trust can be incorporated under the Charitable Trusts Act 1957 so as to operate as a separate entity, owning its own assets and being responsible for its own liabilities. However, the trustees (like company directors) have to act responsibly and must not recklessly incur debts that cannot be repaid, as otherwise the trustees can be personally liable for such debts.

Societies and clubs

Societies and clubs are owned by and serve the interests of their respective memberships. These structures are more likely to be used by amateur arts organisations. Some of these amateur organisations employ people to assist with their productions and some produce large-scale productions. Consequently, these societies can run substantial businesses.

A society can be either for profit or not for profit, and may be incorporated or unincorporated. An incorporated society must register under the Incorporated Societies Act 1908. Once incorporated, the society becomes a distinct entity separate from its members. This entity will own the assets of the society, and members are not liable for the society's debts or other obligations.

Societies can have charitable purposes and can register with the Charities Service. If a society is registered as a charity then, like other structures (such as a trust), it will be exempt from paying income tax on its charitable activities.

Societies and clubs do not generally pay income tax on those activities that only involve their members and that do not relate to business activities with non-members. This is referred to as the mutuality principle. This makes sense because if a group of people join together to form a club and pay subscriptions to the club to cover the costs of the club's activities, then they are carrying on an activity for their mutual benefit rather than trading with others to make business profits.

Government-owned arts organisations

All the major government cultural funding agencies - Creative New Zealand, NZ On Air, Te Mangai Paho, and the New Zealand Film Commission - are Crown-owned entities and have Acts of Parliament, which set out their responsibilities. There is also the Crown Entities Act 2004, which sets out generic requirements for Crown entities.

The government also owns the New Zealand Symphony Orchestra, which is New Zealand's largest performing arts organisation. Like the government funding agencies, the New Zealand Symphony Orchestra has its own Act of Parliament (the New Zealand Symphony Orchestra Act 2004) and is a Crown entity governed by the Crown Entities Act 2004.

The Crown entities mentioned above, report to the minister responsible for the Crown entity and to Parliament. Their boards are appointed by their respective minister. These organisations receive their funding from the government, and their legislation exempts them from paying income tax.

Co-operatives

The term "co-operative" or "co-op" is used frequently in the performing arts to describe a group of artists getting together to create and present a show. The actual structure that the co-op uses can vary depending on how the group members interact to operate the business. It may be a partnership arrangement, or it may be made up of one person, a principal, who contracts others to perform tasks. The principal may operate as a sole trader, a company or a trust. Likewise, those that contract with the principal may be individuals or a business structure, such as a company.

Regardless of how the business is structured, "co-operative" or "co-op" is often used in the performing arts where there is an arrangement for the artists to share in the income from the production rather than being paid a fixed fee or wage.

Chapter 2 – Reading financial statements

What financial statements tell us

To manage the finances of a business, it is important to have a basic understanding of how to read financial statements. The financial statements of a business tell the reader whether the business has made a profit or a loss for a specific period of time, and what assets and liabilities it has. Two main statements make up the financial statements: the statement of financial performance, and the statement of financial position. The statement of financial performance (also referred to as the profit and loss statement, or the income and expenditure statement) shows the income and expenditure for the period being accounted for. The difference between these will be the profit or the loss for the period. The statement of financial position (also often referred to as the balance sheet) shows the assets of the business less the liabilities (monies owing to others) as at the end of the period. The difference between the assets and the liabilities is the equity that the owners of the business have in the business, in other words, what they own.

The financial statements report on the financial performance and financial position of the business for a specific period of time (referred to as the reporting period). Businesses normally produce annual financial statements in which the reporting period is for one year or 12 months. However, for management purposes, financial statements are often produced more frequently. A large business may produce monthly statements showing the financial performance and financial position on a monthly basis as the year progresses. This information is usefully compared to the business's budget (budgets are discussed in later chapters).

The financial statements will also show comparative figures for the previous reporting period, which is useful for reviewing the financial trends. Annual financial statements complying with accounting standards and with relevant legislation will have other supporting statements, including a statement of accounting policies, a statement of cash flows, and notes to the accounts. Reading this additional information will provide background and detailed information to support the information given in the statement of financial performance and the statement of financial position. Don't scold yourself if some of this supporting information seems to be written in a foreign language and you feel as if you need an experienced accountant to provide a translation. It is to be hoped that in the future the regulators who set the reporting requirements will require financial statements to be presented in such a way that they are understood by a wide range of readers, and not just by accountants.

Below is a very simple example of a set of financial statements for an imaginary business called *As You Like It Productions*. The financial statements show the financial performance and position for the year ended 31 March 2000.

Statement of financial performance
For the year ending 31 March 2000

Income	
Ticket sales	15,000
Grants	5,000
Total income	**$20,000**
Less expenses	
Production costs	12,000
Marketing costs	5,000
Administration costs	1,000
Total expenses	**$18,000**
Profit (also referred to as a surplus)	**$2,000**

Statement of financial position
As at 31 March 2000

Current assets	
Bank account	1,000
Trade receivables (also referred to as debtors)	2,000
Plus non-current assets	
Computer	1,000
Total assets	**$4,000**
Less current liabilities	
Trade creditors	1,000
Total liabilities	**$1,000**
Net assets (total assets less total liabilities)	**$3,000**
Represented by equity (ownership)	
Opening or original equity provided by the owners	1,000
Plus the profit for the period	2,000
Total equity	**$3,000**

The purpose of the statement of financial performance is fairly obvious. Most of us are familiar with the concept of calculating the profit or loss of a business by subtracting the expenses from the income.

The statement of financial position is a little less straight forward. This statement shows the assets, liabilities and equity of the business as at the end of the reporting period. (It is often also referred to as a balance sheet. Why a balance sheet? Well, simply because it balances; the equity must equal net assets.)

There are a few concepts that you need to be aware of when looking at a statement of financial position. The first is that a distinction is made between current and non-current assets and liabilities. Current assets and liabilities are usually expected to be settled (turned into cash) within 12 months of the end of the reporting period. The "current" classification is also used for assets used primarily for trading purposes, such as inventories (or trading stock). In the case of an arts organisation, an example of inventories would be the wine, beer and other goods sold by the theatre's bar. Non-current assets usually relate to assets that will be held for some years, such as equipment (for example, a computer), properties or investments. Non-current liabilities are usually debts that do not have to be repaid within the next 12 months. An example of the distinction between current and non-current liabilities is in the case of a 10-year mortgage. The amount of the mortgage that has to be paid in the next year is classified as current, while the remaining years are classified as non-current.

Another thing to note is that money owing to the business by debtors (in the example, this could be money owing by the ticketing agency) and money owing by the business to creditors (in the example, this could be money owing to the local hardware store for set construction materials) are treated as assets and liabilities in the statement of financial position. One way to look at the statement of financial position is as a snapshot of what the

business owns and owes at a particular date. Using the example of the statement of financial position, if as at 31 March 2000 the business was able to turn all its assets and liabilities into cash at the values given in this statement, the effect would be that the business would finish up with $3,000 in cash (provided that all the debtors paid what was due and the computer was still worth $1,000). The $3,000 cash is, in effect, the net worth (assets less liabilities) that belongs to the owners of the business. This is referred to as the owner's equity in the business.

Examples of income and expenditure, assets and liabilities, and equity

The following are examples of income and expenditure, assets and liabilities, and equity that we might come across in a performing arts business:

Income	Expenses
• Ticket sales • Programme sales • Grants from government funding agencies • Donations • Sponsorship income • Interest from investments	• Royalties • Set construction • Lighting hire • Costume materials • Stage props • Touring costs • Fees and wages for directors, designers, actors and production team • Marketing and advertising costs • Venue hire costs • Administration costs such as telephones, bank fees, office supplies, postage, legal costs, etc • Interest paid on loans • Depreciation of assets

Assets	Liabilities	Equity
• Bank accounts • Term deposits • Investments • Trade receivables (debtors) • Loans by the business to others • Equipment • Motor vehicles • Property • Expenses paid in advance that relate to a future period	• Bank overdraft • Loans to the business • Trade creditors • Income tax owing • GST owing • Schedular tax and PAYE owing • Income received in advance that relates to a future period (GST and PAYE are defined in the glossary at the back of the book)	*The following are some of the different ways that are used in financial statements to describe the make-up of the business owner's equity:* • Accumulated funds • Reserves • Share capital • Retained earnings (These terms are defined in the glossary at the back of the book)

Difference between accrual and cash accounting

Understanding the difference between accrual and cash accounting is essential if you are going to be able to read and understand financial statements.

Let's start with the concept of cash accounting. If you have a bank account, you will be familiar with this concept. Cash accounting is simply accounting for cash that is received and cash that is paid out. If all the cash receipts and cash payments are put through your bank account, the balance shown in your bank statement will tell you how much money you have in your account. But if you are in business, the bank balance does not equate to how much profit you have earned from your business, and if you are in overdraft, it does not necessarily mean the business has made a loss. The cash received will tell you how much you have received from those who have paid for their tickets, but it doesn't tell you how much people owe you for tickets they have received but not yet paid for. Likewise, the payments in your bank statement will tell you who you have paid but not about the bills you have not yet had a chance to pay.

Accrual accounting essentially records both the cash transactions and the accruals (what is owing to and by the business). If you look back to the financial statements for As You Like It Productions you will see that the statement of financial performance showed ticket sales of $15,000 and the statement of financial position showed trade receivables of $2,000. Let's assume the trade receivables consisted of $2,000 of ticket sales collected by the ticket-selling agency but not yet paid to As You Like It Productions. This means that the ticket sales income of $15,000 shown in the statement of financial performance is made up of cash received of $13,000 and ticket sales for which the cash has not yet been received of $2,000.

A similar situation exists for the expenses. The statement of financial performance shows expenses of $18,000, and in the statement of financial position there are trade creditors of $1,000. This means that $17,000 of the expenses has been paid and $1,000 is yet to be paid. These will be unpaid invoices from suppliers as at 31 Match 2000.

Matching income with expenditure

Accrual accounting not only takes into account income and expenditure that has not yet been received or paid, but also matches the expenditure incurred in producing the income with the income that is earned for the specific financial year or reporting period. Furthermore, the income that may have already been received is only recognised as income when it has been earned. This means that adjustments have to be made within each financial year to the receipts and payments where the income has not been earned and the expenditure and income do not match. A common example of this in performing arts businesses is ticket sales received in advance in one financial year that are for a production planned for the next financial year. In this case, this income is not earned until the following year. The need to match expenditure with income arises where production expenditure is paid for in the financial year prior to the financial year in which the production occurs and income is earned from that production. In this situation the expenditure is assigned to the financial year that the income is earned from the production.

Accrual accounting treats the income received in advance as a liability until the production occurs. This is logical because if the production did not happen then the money would have to be refunded to the ticket buyers. Prepaid expenditure is treated as an asset until the production occurs, at which point it is treated as an expense. The logic here is perhaps less clear, but this treatment recognises the fact that the business has made an investment in a production that will produce income in future years. The expenditure is then matched against that income when the production is staged and the income earned.

Depreciation

Another characteristic of accrual accounting is that certain costs are accounted for over a number of future financial periods. This is again to do with matching the expenditure to the income where the income will occur over a number of years, and happens with those assets that are commonly known as fixed assets. (Fixed assets are also referred to as property, plant and equipment.)

Fixed assets are assets that are bought to produce or supply goods or services. Examples are sewing machines purchased to make costumes, theatre lights owned by a hire company to be rented out, or a computer used for office administration purposes.

When a fixed asset is bought, it is expected that it will be used for more than one financial period. A decision is then made as to the expected productive or economic life of the asset over the time it will continue to be of use to the business in earning income. The original cost is then spread over those productive years by what accountants refer to as depreciation. There are different methods of calculating depreciation that can be used to spread the original cost. The easiest to use is the straight-line method, which spreads the cost evenly over the productive years. For example, if a computer that costs $1,000 is expected to last four years before it is replaced, the costs will be spread by depreciating the assets by $250 each year. This means that for each of the four years there will be an expense for depreciation in the statement of financial performance of $250.

Again, there is a significant difference between accounting for a fixed asset using an accrual basis compared to that using a cash basis of accounting. Using the example of the computer above, from a cash perspective there is a payment of $1,000 in the year when the fixed asset is purchased, and from an accrual perspective there is an annual expense of $250 for each of the four years. So when the fixed asset is bought, it is shown in the statement of financial position as an asset worth $1,000. In the statement for each subsequent year, the value is reduced by a depreciation expense of $250, until at the end of year four the value in the statement of financial position is reduced to zero.

The value of the fixed asset given in the statement of financial position, which is arrived at by deducting the accumulated depreciation from the original cost, is referred to as the book value. This value is not necessarily the same as the value that the asset can be sold for (the market value). The market value will depend upon what someone is prepared to pay to purchase the asset from the business, and therefore may be more or less than the book value.

Double entry accounting

As soon as you get involved with financial management, you will meet accountants who will introduce you to the concept of double entry accounting. Some unkind folk will tell you that double entry accounting was invented by accountants in order to double their fees. But history credits the invention, or at least the refinement of the invention, to Luca Pacioli, who was a fifteenth-century Italian monk, and being a monk he must have had honourable intentions! It is important to understand double entry accounting because it is the basis on which present-day financial statements are compiled.

Double entry accounting is based on two interrelated mathematical equations. The first equation is the basis of the statement of financial position.

Assets less liabilities = equity (the owner's stake in the assets)

This equation is easy to prove. Let's assume that the first thing you had to do when setting up a business was to buy a computer. If you bought a computer for $1,000 and had to pay for the computer with $500 of your own money and you borrowed $500, your equity (or your portion of entitlement) in the computer is $500. If you look back at the statement of financial position of As You Like Ptoductions you will see that the statement of financial position is set out to reflect this formula – that is, assets less liabilities gives the equity in the business.

As any mathematician will tell you, whatever changes are made to the equation, it must remain in equilibrium – that is, one side equals the other. To demonstrate this, let's assume there are a number of subsequent business transactions following the purchase of the computer. First, you invest another $500 into the business by putting the money into the business's bank account. The equation now looks like this:

Asset (bank) $500 + asset (computer) $1,000 – liability (loan) $500 = equity $1,000

Notice how the asset and equity parts of the equation have both increased by $500 and the equation still balances. Now, you decide to repay the loan of $500 with the money you have in the business bank account. The equation changes to:

Asset (computer) $1,000 less liabilities (nil) = equity $1,000.

Note that with these formulas there is always a double entry required if the equation is to remain in equilibrium.

Not all transactions affect the statement of financial position. Income and expenditure transactions also affect the statement of financial performance. The formula for the statement of financial performance is:

Income less expenditure = profit or loss

The profit or the loss will either increase or decrease the equity. This is because the profit is invested back into the business by increasing the assets or decreasing the liabilities, while a loss would have the reverse affect. As the two equations above are interrelated, they can be combined as follows:

Assets less liabilities = equity plus income less expenditure

Here is an example to demonstrate the interrelationship between the two equations. The business buys goods with cash for $500, then sells the goods for $1,000 to a customer who agrees to pay $500 now and $500 in the future.

The statement of financial performance will show income of $1,000 less expenses of $500, giving a profit of $500. The statement of financial position shows equity of $500 and an asset (being the debtor) of $500. To explain this, it is easiest to consider each step relating to each transaction:

- **Step one** – When the business buys the goods with cash, an expense of $500 is recorded in the statement of financial performance and $500 is taken from the amount shown for the bank account in the statement of financial position, resulting in a bank overdraft.
- **Step two** – When the goods are sold, sales of $1,000 are recorded in the statement of financial performance and $500 is added to the amount shown for the bank account for the portion of the sales paid by cash, and a debtor of $500 is established in the statement of financial position for that portion of the sales for which cash has not yet been received.
- **Step three** – The difference between the sales income of $1,000 and the expense of $500 for buying the goods results in a profit of $500. This profit of $500 is then taken from the statement of financial performance and added to the equity in the statement of financial position.

Applying the above steps to the formula would look like this.

	Financial position					Financial performance	
	Asset Bank	**Asset Debtor**	**Less liabilities**	**=**	**Equity**	**Plus income**	**Less expenses**
Opening position	500	0	0	=	500	0	0
Step 1	-500			=			500
Step 2	500	500		=		1,000	
Step 3				=	500	-1,000	-500
Result	**$500**	**$500**	**$0**	**=**	**$1,000**	**$0**	**$0**

You may find that accountants use what they call "journal entries" to describe and record these transactions. You may come across all sorts of accounting systems – some may be handwritten, others may use computer spreadsheets, but these days most will use computer accounting systems. Whatever systems are used, the principles of double entry accounting remain the same. The figures in the equation will change with each transaction, but the equation must always balance so that equity equals assets less liabilities.

Reading financial statements

Let's read a set of financial statements and see what information we can obtain from them. Below are the financial statements for First Time Productions for its first two years in business. The financial information given in the financial statements is for the current year ending 31 March 2001 and includes comparative results for the previous year ending 31 March 2000.

FIRST TIME PRODUCTIONS
Statement of financial performance
For the year ending 31 March 2001

	2001	*2000*
Income		
Ticket sales	15,000	10,000
Grants	5,000	2,500
Total income	**$20,000**	**$12,500**
Less expenses		
Production costs	12,000	10,000
Marketing costs	4,500	2,500
Administration costs	1,500	1,000
Depreciation	500	-
Total expenses	**$18,500**	**$13,500**
Profit/(Loss)	**$1,500**	**($1,000)**

FIRST TIME PRODUCTIONS
Statement of financial position
As at 31 March 2001

	2001	*2000*
Current assets		
Bank account	1,000	500
Trade receivables (grants yet to be received)	1,500	1,000
Total current assets	**2,500**	**1,500**
Less current liabilitites		
Trade creditors (production costs yet to be paid)	1,000	500
Working capital (current assets less current liabilities)	**$1,500**	**$1,000**
Plus non-current assets		
Computer (depreciated value) Note 1	1,000	-
Net assets (total assets less total liabilities)	**$2,500**	**$1,000**
Represented by equity (ownership)		
Opening or original equity provided by the owners	1,000	2,000
Plus the profit/(loss)	1,500	(1,000)
Total equity	**$2,500**	**$1,000**
Note 1:		
Cost of the computer	1,500	
Less annual depreciation (to be spread over 3 years)	500	
Depreciated value	$1,000	
(Note: The depreciated value is also referred to as the book value of the asset.)		

These financial statements tell the story of what has happened over the last two years to First Time Productions. When the business started on 1 April 1999, the owners provided equity by putting cash of $2,000 into the bank account of the business. In the first year, the business did not sell enough tickets to cover the costs, which resulted in a loss of $1,000. By the end of the first year, the cash in the bank had decreased by $1,500, from $2,000 to $500. This was because the business had paid $13,000 of its expenses ($500 was still owing) and had received in cash income of $11,500 (grants totalling $1,000 were still due to be received). This accounted for the decrease in the bank account of $1,500.

The next year is more of a success story. The ticket sales and grants came to $20,000, which was more than the expenses of $18,500, resulting in a profit of $1,500. The bank account increased by $500 to $1,000. The reason the bank account did not increase by $1,500 (the same amount as the profit) is a little bit more complicated, and needs to be examined further.

The opening bank balance as at 1 April 2000	**$500**
Add to this cash that has been received	
Trade receivables received during the year	$1,000
Income received during the year ($20,000 less grants of $1,500 yet to be received)	$18,500
Deduct any payments	
Trade creditors paid during the year	–$500
Expenses paid during the year ($18,500, less unpaid production costs of $1,000 and depreciation of $500)	–$17,000
Purchase of a computer	–$1,500
Closing bank balance as at 31 March 2001	**$1,000**

The reason the depreciation does not affect the bank account is that it is a non-cash expense. Depreciation is a way of spreading the computer cost of $1,500 over the three-year life of that asset.

There may be a few subplots of the overall story that are not disclosed in these financial statements. So, as well as telling a story about what has happened to the finances of the business, the financial statements may also challenge the reader to ask for explanations as to why certain results have occurred – for example, why have both the income and the expenditure increased in the second year when compared to the first year? This will be a question for management to answer.

Other useful information that can be obtained from the financial statements concerns the financial health of the business. It is important to know whether the business is solvent and able to pay its debts as they full due for payment. The statement of financial position can tell us this. In the example above, as at 31 March 2001 First Time Productions has $1,000 in the bank and trade receivables (debtors) of $1,500 due for collection. This is more than ample to pay the creditors, who are owed $1,000. When looking at the financial health of the business, it is important to assess whether all the trade receivables are likely to be received on time and will not default. If some are doubtful or bad debts, this should be taken into account when assessing whether the business can pay its debts on time.

Finally, it should be kept in mind that the financial statements provide historical information as at the end of the accounting period. In the case of First Time Productions, this is 31 March 2001. If the reader is assessing the financial heath of the business using historical information, it is important to ask what has occurred since 31 March 2001 that may have changed the financial position of the business. The questions that need to be asked include whether the business has subsequently made any losses and whether the business still has enough cash to pay its debts. A good financial manager will require regular reports about the financial progress of the business.

Chapter 3 – Production budgets

Why you need a budget

This chapter looks at constructing a budget for a performing arts production. The budget is an essential tool for planning and managing the finances of a production. Without a budget you are unlikely to know how much the production is going to cost and how much income you are likely to earn. If you have prepared a budget, it is so much easier to know what expenditure you can afford, what the ticket price should be, and how many tickets have to be sold in order to cover the costs of the production. The preparation of the budget should be part of the planning process for the production and be completed before financial commitments are made to produce the show.

Budget covers life cycle of production

A production budget should cover all the steps necessary to develop and stage a production. There are five specific steps in the life of a performing arts production. The first step is the creation or acquisition of the work. This step requires a commitment of expenditure for either the writing of the work or the acquisition of the rights to perform the work, or for both. The expenditure may include an advance payment to the creators of the work, costs related to testing and workshopping the script, and legal costs associated with obtaining rights.

Once the work is available, the next step is planning for the production. This involves developing the designs and production plans, engaging artistic and production contractors and employees, and setting up administrative support systems. During this time the budget should be finalised. The next steps will involve rehearsals and then the performances of the production. Most of the income and expenditure will occur during the rehearsal and performance periods. Following the completion of performances, there will be a wrap-up period to pay the outstanding bills for the production, provide reports to the funding agencies and other interests, and wind up the production or to put it into storage until future performances can be organised.

Research for budget

A good budget will be well-researched and not based on guesswork or blind hope. A good way to start the research is to find out what the production is about and what the essential requirements to produce the work are. Take the time to read the script, listen to the music and familiarise yourself with other background information about the production. Once you have a general idea of the requirements, it is time to talk to the producer, the director and the production manager about production plans, venues and designs.

The next step is to obtain quotes and find out about the rates of pay and fees that are likely to apply to employees or contractors engaged for the production. You should request costings from those who are responsible for particular parts of the production, such as the set builder, the costume maker, the publicist and the venue manager. Other useful sources of information are the budgets for similar types of productions. While each production has its own unique characteristics, there will be common factors that you can learn about from other productions.

As well as researching the costs, it is also necessary to research how the income can be derived. The preparation of the budget for ticket sales income will include finding out what the seating capacity is for the venue, what ticket prices are normally charged for this type of production and for this venue, and what was the attendance for similar productions, which may indicate what can be expected for this one. You should also think about other possible sources of income, as many performing arts productions will find that the budgeted income from ticket sales is insufficient to pay for all the costs of the production. Additional income is often needed from grants from government funding agencies such as Creative New Zealand, sponsorship by commercial firms or donations from philanthropic organisations. The levels of funding from these types of

organisations need to be researched, as some will only fund certain types of productions and some will have limits on how much funding they will provide. It is wise to tie down these sources of income before the business starts spending money on the production. Most funders will require you to provide an application for funding, which usually has to include financial information about your production, including your production budget.

Break-even point

The budget should tell you about the financial viability of the production. One way of judging this is to assess how many tickets would need to be sold to cover the expenditure in order to break even. The break-even point is important because it is the dividing point between making a profit or a loss. If the number of ticket sales required to break even is realistic, this will boost your confidence about the likely financial success of the production. If it appears too high, then this may challenge the financial viability of the production. If the production looks like making a loss, you may have to rework the budget by cutting back expenditure and/or looking for ways to increase the income.

Variable and fixed income and expenditure

Understanding the difference between variable and fixed income and expenditure will help you calculate the break-even point for your production. Variable income is determined by the level of activity or volume. In other words, it is the quantity sold multiplied by the price. For example, ticket sales income is calculated by multiplying the number of ticket sales by the ticket price. Fixed income is different; it is not affected by the quantity or the level of activity. This income is normally a fixed amount for a period of time. For example, a Creative New Zealand grant will be fixed by Creative New Zealand for a predetermined period or for a particular production. Provided you meet the conditions of the grant, the income from this source will not normally be affected by variables such as the number of ticket sales.

Variable expenditure also fluctuates in proportion to the activity or volume. For example, royalties may be calculated as a percentage of ticket sales. Another example is theatre hire costs, which may be affected by the number of performances in the venue. Fixed costs are not affected by volume, such as the number of ticket sales, or by activity, such as the number of performances. Like fixed income, fixed costs are fixed for a period of time or for particular productions. They can be predetermined and, provided the original estimates are sound, should not change because of activity or volume. Examples of fixed costs are the estimate for the construction of the set, the office rental, or the fixed fees for the director and designer.

To sort out what is variable income and expenditure, it helps to identify the variable factors that may affect your production. The major variable is likely to be the number of people who attend the performances and buy a ticket. The number of attendances will also affect the number of programmes that are sold and the royalties that are paid. Another variable may be the number of performances. If the number of performances increases, then attendances and ticket sales may increase, more programmes may be sold, more royalties and ticket agency commissions may be paid, venue hire costs may increase and front-of-house costs may also increase.

Another variable to consider is the time allowed for rehearsals and performances. It may be that the production crew and actors are paid on a weekly basis and the budgets have been prepared on an assumption as to the required number of weeks needed for the rehearsals and performances. If the number of weeks changes, so will these related variable costs.

Calculating break-even point

Now that you know the difference between variable and fixed income and expenditure, it is possible to calculate the break-even point. The break-even point is where the income equals the expenditure. Once it is calculated, you should check that it is realistic and set at an achievable level. The major determinant for breaking even is usually the number of ticket sales.

It is also important to remember that an average ticket price may need to be calculated if there is a range of ticket prices available for sale.

To work out a simple break-even point where the only variance is the number of ticket sales, the following equation can be used:

(A x P) + I – E = 0

A = those attending who buy tickets (in other words, the number of tickets sold)

P = average ticket price

A x P = ticket sales income

I = other income

E = expenditure

The formula can be presented in different ways:

(A x P) + I = E

or

(A x P) = E – I

or

$$A = \frac{(E - I)}{P}$$

Let's start with a very simple example of how to use this formula. Let's assume the ticket price is $10, the other income is a grant of $1,000, and total production costs are budgeted at $2,000. We can then use the formula to calculate how many tickets have to be sold for the production to break even.

(A x $10) + $1,000 = $2,000

(A x $10) = $2,000 – $1,000

$$A = \frac{\$2{,}000 - \$1{,}000}{\$10} = \frac{\$1{,}000}{\$10} = 100$$

In other words, 100 tickets need to be sold at a ticket price of $10 for the production to break even.

This break-even position can be presented as a budget:

Seating capacity of theatre	200
Ticket price	$10.00
Number of ticket sales needed to break even	**100**
Break-even attendance as % of the theatre's seating capacity	**50%**
Income	
Gross box office income	1,000
Grant	1,000
Total income	**$2,000**
Less costs	
Production costs	2,000
Total costs	**$2,000**
Profit/Loss	**$ –**

This formula can get complicated if there are many variables that need to be included in the equation. If you understand how mathematical formulas work, you can expand the above formula to take account of the other variables to calculate the break-even point.

The break-evven point can be calculated by setting up the formula within a spreadsheet cell if you are using a program like Microsoft Excel. Spreadsheets can also be set up to calculate the break-even point using trial and error if working out mathematical formulas is not your strong point. To use the trial and error method, the spreadsheet needs to be set up using the addition, subtraction and multiplication functions of the software. The number of ticket sales used to calculate the sales income is then adjusted upwards or downwards until the incv less the expenditure equals zero.

Now that you understand how to calculate the break-even point of a budget, we can move on to look at the degree of detail that needs to be covered in a production budget.

Expenditure categories

First decide how you want to categorise the expenditure in the budget. These categories can be based on different production activities or on areas of responsibility. Categorising by activities is the most common. However, first make sure that the accounting system being used for the production can report against those categories of activities. Accounting systems have chart of accounts that list the account codes for each of the required accounts. The accounting system should be able to provide an account code for every category in the production budget.

Here is an example of some of the main expenditure categories for a large performing arts production, which cover the main production inputs needed to put on the production (not all of them may be applicable, and in some cases there may be even more categories required to cover other facets of the production):

- Producer
- Directors – stage and music
- Designers – set, costumes and lighting
- Rights and royalties
- Artists/cast – lead and support
- Musicians
- Production staff – production manager, stage manager, lighting and sound operator, set maker, costume maker, etc
- Production costs – set construction materials, props, lighting, music and sound, costume materials, direct insurance, etc
- Touring costs – travel and accommodation
- Venue hire and front-of-house staff
- Publicity and advertising – publicity staff, programmes, posters, newspaper advertisements, flyers, photographs, artwork, etc.
- Administration – production accountant, insurance, legal costs, communications, office space, power, bank fees, etc
- Contingency allowance.

Contingency allowance

One of the expense categories above that needs further explanation is the contingency allowance. Budgets at best can only be an estimate of what is likely to occur. Nothing about the future is certain, and even with budgets that are based on the best available information you may find that unexpected changes occur. These may arise from unexpected price increases, currency fluctuations or unexpected disruptions or delays. An allowance is often made for such unforeseen changes by way of a contingency allowance, which can be seen as a safety net to provide for the unexpected. The contingency allowance is often a percentage of the total budgeted costs and an allowance of up to 10% of total production costs is common. Anything above 15% may suggest that the budget is not based on sound assumptions or is based on too many uncertainties.

Categorising budget income

The categories for income will be fewer than the categories for expenditure. The main ones will be ticket sales, grants, sponsorships, donations and programme sales. The calculations for ticket sales may be reasonably complex, depending on the range of ticket prices on offer, allowances for ticket agent's commission, and other deductions related to ticket sales such as credit card charges. The budgeting for programme sales will also need to include an assessment of the proportion of the audience that is likely to buy a programme.

Another consideration is the effect on the budget of complimentary tickets and programmes that are given away at no charge. Complimentary tickets are often issued to publicise a production, and budgets often provide for a percentage of the tickets to be complimentaries. If, for example, it is assumed that 10% of the audience

will have been issued with complimentary tickets, do not include those attendances as part of the ticket-buying attendances. Another approach is to discount the average ticket price by a factor of 10% if the budgeted ticket sales income is based on total attendance including an allowance for the 10% of the audience who will receive complimentary tickets.

Effect of goods and services tax (GST) on budget

GST is a tax on the sale of goods and services and affects both income and expenditure. When preparing the budget it is necessary to decide whether the budget is prepared exclusive or inclusive of GST. This will depend upon whether the business is registered for GST. If the business is registered with the IRD for GST, the budget figures should exclude GST. If the business is not registered for GST, the budget figures should include GST where the expenditure is likely to include GST. This is because if the business is not registered it must bear the cost of the GST on expenditure. GST can be a complex area, so business managers need to be up to date with the IRD's requirements for applying GST and understand the advantages and disadvantages of being registered for GST. It is also necessary to know what the current GST rates are and what transactions are affected by GST.

Construction of a detailed budget

Below is a format for a detailed production budget for a production called *The Tuppenny Opera*.

This budget format has two parts. The first part is a summary income and expenditure budget, which provides information about the number of performances, the venue seating capacity, the number of complimentary tickets, the estimated attendance, the ticket prices and the break-even point. The total of all of the expenditure categories is the total production expenditure. These expenditure categories are then broken down into detailed expenditure for each category in the second part of the budget (referred to as the production expenditure budget). At the end of this second part is an allowance for a contingency of 10% of the total production costs of $44,080. As mentioned before, this contingency is to provide for any unexpected expenditure.

This format is designed for internal management purposes. If you are required to prepare budgets for external organisations, such as Creative New Zealand, then they may require the use of a different format to meet their own purposes. It may be that their format does not meet your internal management purposes, in which case two formats may have to be used.

Part 1

SUMMARY INCOME AND EXPENDITURE BUDGET

Production: The Tuppenny Opera – Performance dates from 1 June 2000 to 14 June 2000

Note: This budget excludes GST as the business is GST-registered.

	Performance venue – Upstage Theatre	
	Number of performances	10
	Total seating capacity of venue	200
	% of complimentary tickets	10%
	Average estimated attendance per performance	140
	Total estimated attendance for all performances	1,400
	Less the estimated complimentary tickets (10%)	140
	= Total estimated ticket sales	**1,260**
	Average budgeted ticket price excluding GST	$40.00
	Ticket sales as a % of total seating capacity	63%
	Break-even (number of ticket sales required)	1,074
	Break-even number of ticket sales as % of total seating capacity	54%
	Income	
	Ticket sales (1,260 ticket sales @ $40)	50,400
	Programme sales (net of programme cost)	700
	Donations	1,000
	Sponsorship	4,000
	Grants	5,000
A	**GROSS INCOME**	**$61,100**
	Less variable expenditure – % of income	
	Royalties - 10% of gross ticket sales	5,040
	Booking fee - 2% of gross ticket sales	1,008
B	**TOTAL VARIABLE EXPENSES**	**$6,048**
	Less production expenditure (see detailed budget)	
	Producer and director fees	5,600
	Rights and royalties (fixed expenditure)	600
	Cast	12,800
	Musicians	6,400
	Production management	7,400
	Production costs	3,150
	Venue costs	3,400
	Publicity	1,800
	Administration	2,930
	Contingency	4,408
C	**TOTAL PRODUCTION EXPENDITURE**	**$48,488**
	PROFIT/(LOSS) A–B-C	**$6,564**

Approved ..... Date .....

Part 2

PRODUCTION EXPENDITURE BUDGET FOR THE TUPPENNY OPERA

	Commence	*End*	*No.*	
Rehearsals	17 May 2000	31 May 2000	10	
Performances	1 June 2000	14 June 2000	10	
Performance venue – Upstage Theatre				
Producer and director fees				
Producer				2,000
Director				1,500
Set and costume designer				750
Music director				750
Lighting designer				600
Subtotal				**$5,600**
Rights and royalties (fixed costs only)				
Music rights				600
Subtotal				**$600**
Cast	***weeks***	***weekly rate***		
Rehearsal				
Actor 1	2	$800		1,600
Actor 2	2	$800		1,600
Actor 3	2	$800		1,600
Actor 4	2	$800		1,600
Performance				
Actor 1	2	$800		1,600
Actor 2	2	$800		1,600
Actor 3	2	$800		1,600
Actor 4	2	$800		1,600
Subtotal				**$12,800**
Musicians	***weeks***	***weekly rate***		
Rehearsal				
Musician 1	2	$800		1,600
Musician 2	2	$800		1,600
Performance				
Musician 1	2	$800		1,600
Musician 2	2	$800		1,600
Subtotal				**$6,400**

Production management	***weeks***	***weekly rate***	
Rehearsal			
Production manager	2	$800	1,600
Stage manager	2	$700	1,400
Set construction fee			1,500
Performance			
Production manager fee			500
Stage manager	2	$700	1,400
Technical operator	2	$500	1,000
Subtotal			**$7,400**
Production costs			
Set construction materials			500
Tools			200
Sound equipment hire			500
Lighting hire			500
Costume hire			1,000
Hair and make-up			200
Direct insurance costs			250
Subtotal			**$3,150**
Venue costs	***weeks***	***rate***	
Rehearsal venue hire	2	$500	1,000
Performance venue hire	2	$1,000	2,000
Cleaning	2	$200	400
Subtotal			**$3,400**
Publicity			
Publicity manager			500
Graphic designer			500
Printing costs			500
Media advertising			300
Subtotal			**$1,800**
Administration			
Accountant			800
Bank fees			30
General expenses			1,000
Insurance			500
Legal fees			600
Subtotal			**$2,930**
TOTAL PRODUCTION COSTS BEFORE CONTINGENCY			**$44,080**
PLUS CONTINGENCY	**10%**		**$4,408**
TOTAL PRODUCTION COSTS INCLUDING CONTINGENCY			**$48,488**

Supporting information

Additional worksheets may be needed to calculate some of the detailed expenditure for the production's budget. For instance, in the budget for *The Tuppenny Opera* a supporting work paper could be used to calculate the set construction costs of $500. Below is an example of a supporting worksheet:

Set construction materials	*Quantity*	*Unit cost*	*Total*
Sheets of hardboard	10	$25.00	**$250.00**
Metres of untreated framing timber	20	$10.00	**$200.00**
Packets of nails	4	$5.00	**$20.00**
Number of hinges	4	$7.50	**$30.00**
TOTAL			**$500.00**

This supporting information should be kept as a record of how income and expenditure was calculated for the budget. Keeping the information allows you to investigate why differences have occurred between the budgeted and actual income and expenditure, and the worksheet can also be a useful starting point if a similar budget has to be prepared in future.

Budgeting for tours

If the production is to be performed at different places then a separate budget should be prepared for each performance venue. The income and expenditure will not necessarily be the same for each town or theatre. This may be because each venue has different seating capacities, the expected number of ticket sales is different for each location, the range of ticket prices differ for each venue, and the production, touring and other costs are affected by the nature of the venue and the location.

Here is an example of the differences that may occur for a production that is going to be performed in Auckland and in Wellington. In this case the producer has identified the differences and prepared a separate budget for both the Auckland and Wellington theatres. A budget based on achieving a break-even result has also been prepared for each theatre.

SUMMARY INCOME AND EXPENDITURE BUDGET

Production: Having A Laugh *Note: excludes GST* Performance dates 7 April and 10 April	**Auckland** The Jupiter Theatre		**Wellington** The Ambience Theatre	
	Budget	Break-even	Budget	Break-even
Number of performances	1	1	1	1
Seating capacity of each venue	600	600	800	800
Budgeted ticket sales for each performance	500	425	600	519
Total paying attendances as a % of seating capacity	83%	71%	75%	65%
Average ticket price (net of GST and booking fees)	$74.00	$74.00	$69.00	$ 69.00
Programme sales - 50% of paying attendance	250	213	300	259
Programme sales price net of GST	$4.35	$4.35	$4.35	$4.35
Income				
Ticket sales	37,000	31,483	41,400	35,789
Programme sales	1,088	925	1,305	1,128
Advertising revenue from programmes	600	600	700	700
Sponsorship	10,000	10,000	8,000	8,000
Grants	7,000	7,000	7,000	7,000
GROSS INCOME	**$55,688**	**$50,008**	**$58,405**	**$52,617**
Less variable expenditure				
Royalties payable to the playwright - 10% of ticket sales	3,700	3,148	4,140	3,579
Venue hire - 15% of ticket sales	–	–	6,210	5,368
LESS TOTAL VARIABLE EXPENDITURE	**$3,700**	**$3,148**	**$10,350**	**$8,947**
Less production expenditure				
Director and other creative fees	4,500	4,500	4,500	4,500
Rights and Royalties (fixed expenditure)	500	500	500	500
Cast	5,000	5,000	5,000	5,000
Production management	8,000	8,000	6,000	6,000
Production costs	3,000	3,000	4,000	4,000
Touring - travel and accommodation	8,000	8,000	9,000	9,000
Venue costs	5,000	5,000	1,000	1,000
Publicity	2,000	2,000	3,000	3,000
Programme costs	600	600	700	700
Administration	6,000	6,000	6,000	6,000
Contingency - 10% of above production expenditure	4,260	4,260	3,970	3,970
LESS TOTAL PRODUCTION EXPENDITURE	**$46,860**	**$46,860**	**$43,670**	**$43,670**
PROFIT/(LOSS)	**$5,128**	**$ –**	**$4,385**	**$ –**

Use of Excel spreadsheets for compiling budgets

If an Excel spreadsheet is used to prepare the budget, the software's ability to add, subtract, calculate and link cells can be used so that the spreadsheet will automatically recalculate the profit or loss if any of the figures are changed. This feature is most useful when amendments to the budget are required. It is also useful for calculating the attendance and ticket price sensitivities, to achieve break-even. It is worth learning how to use Excel spreadsheets, as it makes the task of preparing budgets so much easier than using a pencil and rubber.

Chapter 4 – Assessing the financial risk

Appraising the budget result

Once the budget is prepared make sure you look at the overall result and ask yourself if it is achievable. You will need to ask yourself if the key assumptions are realistic.

Let's look at the *Tuppenny Opera* summary income and expenditure budget again:

SUMMARY INCOME AND EXPENDITURE BUDGET

Production: The Tuppenny Opera – Performance dates from 1 June 2000 to 14 June 2000

Note: This budget excludes GST as the business is GST-registered.

	Performance venue – Upstage Theatre	
	Number of performances	10
	Total seating capacity of venue	200
	% of complimentary tickets	10%
	Average estimated attendance per performance	140
	Total estimated attendance for all performances	1,400
	Less the estimated complimentary tickets (10%)	140
	= Total estimated ticket sales	**1,260**
	Average budgeted ticket price excluding GST	$40.00
	Ticket sales as a % of total seating capacity	63%
	Break-even (number of ticket sales required)	1,074
	Break-even number of ticket sales as % of total seating capacity	54%
	Income	
	Ticket sales (1,260 ticket sales @ $40)	50,400
	Programme sales (net of programme cost)	700
	Donations	1,000
	Sponsorship	4,000
	Grants	5,000
A	**GROSS INCOME**	**$61,100**
	Less variable expenditure – % of income	
	Royalties - 10% of gross ticket sales	5,040
	Booking fee - 2% of gross ticket sales	1,008
B	**TOTAL VARIABLE EXPENSES**	**$6,048**
	Less production expenditure (see detailed budget)	
	Producer and director fees	5,600
	Rights and royalties (fixed expenditure)	600
	Cast	12,800
	Musicians	6,400
	Production management	7,400
	Production costs	3,150
	Venue costs	3,400
	Publicity	1,800
	Administration	2,930
	Contingency	4,408
C	**TOTAL PRODUCTION EXPENDITURE**	**$48,488**
	PROFIT/(LOSS) A–B-C	**$6,564**

The budgeted result is a small profit of $6,564, based on a ticket price of $40 (net of GST) and an estimated number of ticket sales of 1,260. To achieve this, 10 performances are planned in a 200-seat theatre with the number of ticket sales averaging 63% of the total seating capacity for the 10 performances. The budget tells us that if the production is to break even, the total number of ticket sales for all the performances will have to be 1,074 which is 54% of the seating capacity.

The reader of the budget will form a view on the reasonableness of these assumptions. He or she will have to assess whether the budgeted number of ticket sales and the break-even point are reasonable for this particular production. This will require an assessment of the risks of putting on this production, considering such factors as the likely popularity of the production, whether the ticket price will be acceptable to the intended audience, whether the venue is suitable for the production, the recent success or otherwise of comparable productions, and the effect of any other competing events that may be happening around the same time.

Sensitivity analysis

A sensitivity analysis is a helpful tool for assessing the financial risk of a production. This assesses the levels of profit or loss for a range of projected numbers of ticket sales or ticket prices. Often three scenarios are looked at for both the number of ticket sales and ticket prices. Here is an example of such a sensitivity analysis for the budget for *The Tuppenny Opera*:

Ticket sales sensitivity

Sensitivity rating	Total ticket sales	Ticket sales as % of seating capacity	Average ticket price excluding GST	Profit (Loss)
Optimistic	1,620	81%	$40.00	$19,236
Most likely	1,260	63%	$40.00	$6,564
Pessimistic	900	45%	$40.00	($6,108)

Ticket price sensitivity

Sensitivity rating	Total ticket sales	Ticket sales as % of seating capacity	Average ticket price excluding GST	Profit (Loss)
High	1,260	63%	$50.00	$17,652
Medium	1,260	63%	$40.00	$6,564
Low	1,260	63%	$30.00	($4,524)

Calculating break-even attendance for the example

The break-even number of ticket sales of 1,074 is calculated by expanding the break-even point equation discussed earlier in Chapter 3 to take into account all the different types of variable and fixed income and expenditure relating to this particular budget. The equation can be constructed as follows:

A = total estimated ticket sales for all performances
P = ticket price of $40
A x P = ticket sales income
FI = fixed income (programme sales, donations, sponsorship, and grant income)
VE = variable expenditure (royalties and booking fees) = 10%x(AxP) + 2%(AxP)
FE = fixed expenditure

Note: Programme sales may be variable income, but to avoid over-complicating the example programme sales have been assumed to be fixed income.

The break-even formula can therefore be written as:

Income = Expenditure
or
(AxP) + FI = 10%x(AxP) + 2%(AxP) + FE

or after putting in the figures
(Ax40) + 10,700 = 10%x(Ax40) + 2%(Ax40) + 48,488

Steps to isolate the attendance as at the break-even point:

Step 1
Therefore: 40A + 10,700 = 4A + 0.8A + 48,488

Step 2
Therefore: 40A - 4A – 0.8A = 48,488 – 10,700

Step 3
Therefore; 35.2A = 37,788

Step 4
Therefore: $A = \frac{37,788}{35.2}$

And finally, this calculation tells us that at the break-even point, A = 1073.52, rounded to 1,074.

Given that the number of performances is 10 and the seating capacity per performance is 200, this means that the break-even number of ticket sales of 1,074 as a percentage of the total seating capacity is 54%.

Sharing the risk with others

While the reasonableness of the average ticket price, the number of tickets sold, and the ability to control the expenditure will have a major bearing on the financial success of the production, there are other considerations to take into account when assessing how to manage the financial risks.

One consideration is the extent to which other income can be derived from sponsorship, grants and donations. The first attempt to compile the budget may indicate that the number of ticket sales or the ticket price required to achieve a break-even is unrealistic. If this is the case, additional income from sponsorships or grants may be required to lower the break-even point to an acceptable level. Sponsors will be attracted by the ability of the production to promote the sponsor's goods, services or corporate image. However, there may be additional costs associated with the sponsorship, such as free tickets and promotion costs. Grants are usually obtained from government agencies and donations from private philanthropists who support artistic and cultural activities. In New Zealand the government provides this support through Creative New Zealand. Government grants are in effect a subsidy that allows the production to have a ticket price that will be realistic for attracting audiences.

Another consideration is the extent to which the financial risk of the production can be shared with others. This issue usually arises when making the arrangements with the venue or theatre that the production intends to use for the show. These arrangements can vary quite considerably from venue to venue, and some venues will offer a range of different deals. The arrangement with the highest risk for the producer is a fixed hireage arrangement, in which the producer pays the hireage charge regardless of whether or not the production makes a profit. In some cases the venue will treat the fixed hireage charge as a minimum charge and require a percentage of the ticket sales where they exceed the minimum charge.

Some venues will offer arrangements where the risks are shared between the venue and the producer. This usually works on the basis that the venue takes a share (percentage) of the ticket sales income as its charge for the use of the venue. The advantage here is that the producer is only liable to pay the venue its share if income is actually earned from the sale of tickets. If there are no sales, there are no venue costs to pay.

Another variation is where the venue is willing to pay the production to perform in that venue. This arrangement may occur if the venue has the role of being a promoter as well as a venue. It may be that the venue pays the production a fixed fee. The arrangement may also include the production sharing the ticket sales income on the basis that the fixed fee is a minimum fee.

In all the types of arrangements described above, it will be necessary to consider which costs are to be the responsibility of the producer and which will be those of the venue. Usually the more risk the venue has, the fewer costs it will want responsibility for. For a fixed hireage arrangement, it is likely that the venue will be more willing to cover front-of-house and some technical and marketing costs. If the venue works on a share-of-income basis, it is likely to require the producer to cover some of these costs. Some venues have standard arrangements, while others may be open to negotiation on the terms of the arrangement with the producer.

Another common arrangement is for the actors and production crew to share the risks. This is often referred to as a theatre co-operative arrangement. In such cases the parties agree that they will not charge predetermined fees for their services but will be paid by sharing in the profits of the production. This means there are no obligations on the producer to pay those agreeing to this arrangement unless the show makes a profit.

Ultimately, the way financial risk is managed will depend upon the degree to which the producer wants either certainty about the financial result or the ability to maximise the financial returns if the production is a financial success. How the producer approaches these alternatives will depend upon the producer's willingness to either take on all the financial risks or share those risks with others. The financial resources of the producer will have a bearing on this decision.

Chapter 5 – Managing cash flows

Importance of cash flow forecast

The budget for *The Tuppenny Opera* in chapter 4 tells us that by the end of the four weeks of rehearsals and performance it is expected that income of $61,100 will be earned, and that there will be expenditure on royalties, commissions and production costs of $54,536. Consequently, there will be a profit at the end of the production period of $6,564. This is important information for assessing what the total income and expenditure are likely to be, and whether the production is financially viable and likely to make a profit.

However, it is also important to know when the income is likely to be received and expenses will need to be paid during the production period. Put another way, when will the deposits and payments go through *The Tuppenny Opera's* bank account and what will the ongoing bank account balances be? Will there be enough money in the bank account during the production period to pay the bills as they fall due for payment, or will the account fall into overdraft and require an overdraft facility from the bank? To answer these questions, a cash flow forecast needs to be prepared, which will give management an indication of the timing of cash receipts and payments (the flow of which is referred to as the cash flow).

Using cash accounting to prepare cash flow forecast

To prepare a cash flow forecast, it is important to understand the difference between accrual accounting and cash accounting (refer back to chapter 2 to refresh your memory about the difference between the two). The cash flow forecast is based on cash accounting rather than accrual accounting. It is also important to understand that receipts and payments may include the receipt and payment of GST, the payment of taxes such as PAYE and schedular withholding taxes, and payments for fixed assets (such as the purchase of equipment) that may have been treated in the budget as depreciation. The cash flow forecast should show what the bank statement is likely to look like at various times during the period of production.

Below is an example of what the cash flow may look like for *The Tuppenny Opera* if one week is set aside for planning, the next four weeks for rehearsals and performance periods, and the final week to wrap up the production. Look at each line of the receipts and payments information to see if it differs from the information in the income and expenditure budget. There are, in fact, some noticeable differences, and these will be discussed later.

Here is the weekly cash flow forecast for the production:

WEEKLY CASH FLOW FORECAST FOR THE TUPPENNY OPERA

	Planning	Rehearsal period		Performance period		Wrap-up	Total
	week1	week2	week 3	week 4	week 5	week 6	
Receipts including GST							
Ticket sales				25,200	25,200		50,400
Programme sales				350	350		700
Sponsorship			4,000				4,000
Grants	5,000						5,000
Sub total	**$5,000**		**$4,000**	**$25,550**	**$25,550**		**$60,100**
Plus GST on receipts - 15%	750		600	3,833	3,832		9,015
Receipts with no GST							
Donations		1,000					1,000
Receipts	**$5,750**	**$1,000**	**$4,600**	**$29,383**	**$29,382**		**$70,115**
Payments including GST							
Royalties						5,040	5,040
Commissions					1,008		1,008
Producer and director fees	2,800				2,800		5,600
Rights and royalties (fixed expenditure)	600						600
Cast - see below							-
Musicians - see below							-
Production management		1,500	3,000	1,700	1,200		7,400
Production costs	500	100		1,500	1,050		3,150
Venue costs				1,700	1,700		3,400
Publicity				900	900		1,800
Administration	500	300	300	300		1,500	2,900
Sub total	**$4,400**	**$1,900**	**$3,300**	**$6,100**	**$8,658**	**$6,540**	**$30,898**
Plus GST on payments - 15%	660	285	495	915	1,299	981	4,635
Payments with no GST							
Bank fees						30	30
Actors and musicians net of withholding tax		3,840	3,840	3,840	3,840		15,360
Schedular withholding tax at 20%						3,840	3,840
Payments	**$5,060**	**$6,025**	**$7,635**	**$10,855**	**$13,797**	**$11,391**	**$54,763**
Net - receipts less payments	**690**	**(5,025)**	**(3,035)**	**18,528**	**15,585**	**(11,391)**	**15,352**
Less payment of GST						4,380	4,380
Net cash flow after GST payment	**690**	**(5,025)**	**(3,035)**	**18,528**	**15,585**	**(15,771)**	**10,972**
Opening bank balance	**-**	**690**	**(4,335)**	**(7,370)**	**11,158**	**26,743**	**-**
Closing bank balance	**$690**	**$(4,335)**	**$(7,370)**	**$11,158**	**$26,743**	**$10,972**	**$10,972**
Reconciliation of bank balance with budget profit							
Closing bank balance as above							10,972
Profit from summary sheet							6,564
The difference is the contingency that has not been spent in the cash flow forecast							4,408

Assumptions when preparing cash flow forecast

When preparing a cash flow forecast, deciding when the income is likely to be received is the most important assumption you will make. This should not be based on wishful thinking but on whatever factual information is available, or on informed assessments. For example, unless the tickets to the show are being pre-sold, the income from ticket sales will not be received until the performances occur. In the case of the Tuppenny Opera example, this will be in weeks four and five. This will also be the case with programme sales. When sponsorship and grant income is received will depend upon what terms of payment are applied by sponsors and those making the donations and grants. Some will be happy to pay at the beginning, some will spread the payments and some will want to wait until after the performances have been completed. Negotiating the timing of these payments may be critical in keeping the bank account from going into overdraft or avoiding the need to borrow money.

Assumptions also have to be made about when payments of expenditure are likely to occur. Some payments, such as for royalties on ticket sales, are likely to be made following the completion of the performances once the total income from ticket sales is known and the royalties can be calculated. Other royalties, such as for music rights, may have to be paid upfront before the production is able to use the music. There may also be other timing considerations, such as when the production people, actors and musicians are entitled to be paid. The timing of payments can be researched by checking contracts and other payment terms.

As receipts and payments will include GST, and as in this example the business is GST registered, the cash flow forecast should be prepared on a GST- inclusive basis. The forecast for The Tuppenny Opera has been prepared by adding GST for those receipts and payments for which GST applies. GST does not apply to all income and expenditure – for example, interest, donations and wages are exempt. If you are preparing a cash flow for a GST-registered business you need to read the information provided by the IRD about how GST works.

Finally, you need to make sure the cash flow forecast provides for the payment of all taxes, including GST, schedular withholding tax, PAYE and income tax. Read the IRD"s information about PAYE and schedular withholding tax deductions from payments to employees and contractors and how and when these taxes are to be paid.

Once you have forecasted when the receipts and payment are likely to occur, the cash flow information can be used to tell what the balance in the bank account is likely to be at the end of each week:

End of week 1: $690
End of week 2: overdrawn by $4,335
End of week 3: overdrawn by $7,370
End of week 4: $11,158
End of week 5: $26,743
End of week 6: $10,972

This information makes it obvious that the production will have a cash flow problem in weeks two and three because it will be paying out more money than it has received. This will swing the other way in weeks four to six when the income from ticket sales is received, but until then the production will have a cash flow shortfall. It can either arrange an overdraft with the bank, defer the payment of some expenses until after week three or try to pre-sell tickets in weeks two and three. The cash flow forecast has shown its value here by highlighting the need to manage a cash flow shortfall in the early weeks of the production period.

Although the cash flow forecast is prepared on a cash basis of accounting, the final bank balance should still be reconciled with the profit or loss in the production budget to check that the cash flow forecast reconciles with the budget. To do this, any differences have to be identified and checked to ensure that they are valid differences. Sometimes budgets will include depreciation, in which case the treatment of the purchase of a fixed asset in the budget will be different from the treatment in the cash flow forecast. The budget will include the depreciation for the cash flow period and the cash flow forecast will include payment for the purchase of any of the fixed assets that occurred during the cash flow period. In this case, the reconciling difference will be the difference between what was paid for the fixed asset in the cash flow forecast and the amount of depreciation for future periods, which has not been assigned to the budget.

For The Tuppenny Opera, the difference is the contingency of $4,408 that has been provided for in the budget, but in this example it is anticipated that the contingency will not have to be used. If the contingency is not used, this will mean that the profit from the production will be increased by the amount of the unspent contingency.

Chapter 6 – Controlling expenditure

Control systems for expenditure

To avoid blowing the budget, you need to have systems in place to control the budgeted expenditure. The first step is to determine who has authority to approve both the incurring and the payment of expenditure. Before the budget is adopted for use, and before any decisions are made to incur the expenditure in line with the budget, it should be approved by the producer. The producer in this case is the person with the ultimate responsibility for the production and the control of the finances, and could be an individual who owns the production and is providing the finances, or a general manager or the board of an organisation. This will depend on the business structure of the production and on who has ultimate responsibility for the finances.

You also need to have procedures in place to approve changes to the budget, which may vary depending on its complexity. In some cases the artistic or production managers may be given authority by the producer to approve changes to the individual items within that part of the budget for which they are responsible. This is usually on the basis that any increases are offset by decreases in other expenditure areas. However, in some cases the producer may choose not to delegate this authority and may require that all changes be approved by the producer. The degree of delegation is a decision for the producer to make.

Below is an example of how the delegation of authority and approvals may work for a large production:

Level 1

The producer assumes responsibility for the overall budget.

Level 2

The production manager is delegated responsibility for the set, costumes and technical budgets. In this example, the production manager reports to the producer.

Level 3

The production manager delegates responsibility for the props budget to the stage manager, for the set construction budget to the set builder, and for the costume budget to the costume maker. In this example, the stage manager, set builder and costume maker will all report to the production manager.

Each person who is delegated control over a particular part of the budget needs to understand the risk elements associated with that part. For example, the set builder needs to be aware of the level of difficulty involved in building the set and of what changes are likely to affect the cost of the materials and labour required.

Use of order books

For a big production it may be necessary to have order books, in which case no purchase should be made without a purchase order form being completed, and then being authorised by the person responsible for controlling the expenditure for that part of the budget. The order book should have at least two copies of every order form, of which the first copy is given to the supplier and the second kept as a record of the order. When the relevant invoice is received from the supplier it is matched to the second copy of the order and, if these agree, and the goods have been received then the invoice is authorised for payment.

The second copy in the purchase order book provides useful information about the expenditure commitments that have been made. This information can be compared with the budget to check whether the committed expenditure is in line with the budgeted expenditure.

Cheques or electronic payments should always be signed or actioned by authorised people, and the bank will need to be notified of who these people are. As an added control, businesses will often require that two authorised people sign each cheque or action each payment (if payments are made by electronic banking).

There should be regular financial reports prepared that compare the actual expenditure with the budgeted expenditure. The responsible managers should review these reports, identify any variances and decide what action is needed to rectify the variances.

Here is an example of the type of information that can be recorded by the purchase order.

PURCHASE ORDER FORM

Order no. 201

25 October 2011

Purchaser:

Tuppenny Opera Company

Supplier:

Southern Timber Supplies
8 Forest Road
Wellington

Description of order:

20 metres of 100mm x 50mm undressed timber
@ $6.70 per metre $134.00

Cost includes GST **Yes** / **No**

Purchase authorised by: .....

Purchase order agreed to supplier's invoice or receipt by: .....

Petty cash systems

Some expenditure may be too small to justify using purchase orders and making cheque payments, such as buying coffee and milk purchased from the local dairy for morning tea. A petty cash system is a good way of handling this type of expenditure. Petty cash systems usually work along the following lines:

- A petty cash float is established for an approved sum – for example, $100. With a big production, there may be separate petty cash floats for the different departments.
- Someone is then designated to be the person responsible for the petty cash expenditure. A petty cash tin or container is often used for storing cash and receipts.
- When a purchase is made using cash from the petty cash float, a receipt must be obtained and kept.
- When all or most of the cash has been spent, the receipts are given to the person authorised to make the payments and the cash float is topped up to the approved sum.

A petty cash form is used to record the use of the float and calculate the amount required for its reimbursement. Here is an example of a petty cash form:

PETTY CASH FORM

Production .....

Department .....

Date		Accounts code	Payment	Balance
	Approved petty cash float			**$100.00**
	Less payments including GST			
3-Mar-10	2 bottles of milk	21	$9.50	
4-Mar-10	Coffee for morning tea	21	$7.50	
5-Mar-10	Sugar for morning tea	21	$1.50	
5-Mar-10	Safety pins for wardrobe	16	$5.50	
6-Mar-10	Notepads for stage manager	22	$15.00	
7-Mar-10	Parking for production van	14	$10.00	**$49.00**
	Total petty cash still not spent			**$51.00**
	Float (as above)			**$100.00**
	Amount of float to be reimbursed			**$49.00**

Expenditure approved and all receipts attached

Signed ..... Date .....

Approving changes to budget

Once the budgeted expenditure is approved, the budget should not be changed unless there are significant changes to the overall production. This can occur if, for example, a decision is made to change the play or the venue, or there is some other major change that makes the existing budget no longer useful for managing the finances of the business. Such occurrences will require a rebudgeting exercise, in which case the new budget needs to be approved by the producer.

Sometimes expenditure in the budget may have been either under or over-provided for, and a decision must then be made on what to do about the savings or extra expense. The savings may be used to increase the profit or cover another part of the budget that is experiencing extra expenditure. Extra expenditure in one area of the budget may mean that less can be spent in another part of the budget. These decisions should be made by the producer or whoever has the delegated authority.

Actual expenditure compared to budget

Every production should have an effective accounting system to record the actual transactions. What type of accounting system is used will depend upon the scale of the production. For a small production it may be handwritten records or the use of a spreadsheet, while for a larger production accounting software may be needed. Unless you know about accounting systems, it is best to seek professional advice about what accounting system best suits your production.

The accounting system should be one that operates using the accrual method of accounting, so that income and expenditure take account of what is owed and owing as well as what is received and paid. It must be able to provide reliable and accurate information, which needs to be up to date to be of real use.

In the case of a production like The Tuppenny Opera, the accounting system can provide weekly reports so that the income and expenditure may be compared to the budget at regular intervals during the production period. It would be like driving a car blindfolded during the six weeks of the production if the reports only became available at the end of that time. This would be a high-risk approach, and the chances are that the car would have crashed long before the end of week six!

During the production period, the reasons for the variances between actual results and the budget should be looked into and decisions made as to what to do about them. It may be that expenditure has to be reduced if the variances indicate that the production may incur a loss. It is also a good idea to use this information to forecast what the actual results may be at the end of the production period.

Another important aspect to keep an eye on is the actual cash flows, and you should regularly compare these to the cash flow forecast. This can be done by comparing the weekly cash flow forecast estimates to the receipts and payments on the bank statement at the end of each week. Again, action may be needed if the actual cash flows are worse than what was planned for in the cash flow forecast.

Below is an example of a comparison of the actual results for The Tuppenny Opera production at the end of the six-week production period with the figures in the budget. This information is usually presented in three columns – the actual, the budget and the variance between the actual and the budget.

SUMMARY INCOME AND EXPENDITURE – ACTUAL v BUDGET

Production: The Tuppenny Opera – For the six weeks ending 14 June 2000

	Performance venue – Upstage Theatre	Actual	Budget	Variance ( ) = negative variance
	Number of performances	10	10	-
	Total seating capacity of venue	200	200	-
	% of complimentary tickets	12%	10%	2%
	Average attendance per performance	150	140	10
	Total attendances including complimentaries	1,500	1,400	100
	Ticket price	$38.00	$40.00	($2.00)
	Average ticket price discounted by 10% for complimentaries	$33.44	$36.00	($2.56)
	Total attendance as % of capacity	75%	70%	5%
	Break-even based on the total attendance	-	1,192	
	Break-even attendance as % of capacity	-	60%	
	Income			
	Ticket sales	50,160	50,400	(240)
	Programme sales	750	700	50
	Donations	500	1,000	(500)
	Sponsorship	500	4,000	(3,500)
	Grants	5,000	5,000	-
A	**GROSS INCOME**	**$56,910**	**$61,100**	**$(4,190)**
	Less variable expenditure – % of income			
	Royalties - 10% of gross ticket sales	5,016	5,040	24
	Booking fee - 2% of gross ticket sales	1,003	1,008	5
B	**TOTAL VARIABLE EXPENSES**	**$6,019**	**$6,048**	**$29**
	Less production expenditure (see detailed budget)			
	Producer and director fees	5,600	5,600	-
	Rights and royalties (fixed expenditure)	600	600	-
	Cast	12,800	12,800	-
	Musicians	6,400	6,400	-
	Production management	7,800	7,400	(400)
	Production costs	3,600	3,150	(450)
	Venue costs	3,400	3,400	-
	Publicity	2,500	1,800	(700)
	Administration	3,100	2,930	(170)
	Contingency	-	4,408	4,408
C	**TOTAL PRODUCTION EXPENDITURE**	**$45,800**	**$48,488**	**$2,688**
	PROFIT/(LOSS) A–B-C	**$5,091**	**$6,564**	**$(1,473)**

***Note**: This budget has been prepared using the total attendances which includes both tickets sold and complimentary tickets provided for free. Consequently the average ticket price has been discounted by the number of expected complimentary tickets.*

The variance between the actual results and the budget figures tells an interesting story. The actual profit is $1,473 less than what was expected in the budget. There are a number of reasons for this. Some variances are favourable, but in this case those with the bigger monetary effect are the unfavourable ones. Below is a summary of the favourable and unfavourable results:

Favourable results

- 100 more people attended the production than were expected in the budget.
- $50 more was earned from programme sales.
- There was a saving of $29 on royalties and commissions due to the decrease in ticket sales income.
- While production expenditure exceeded the budget by $1,720, this was covered by the contingency of $4,408 resulting in expenditure being down by $2,688.

Unfavourable results

- The average ticket price was down by $2.00. This was further reduced by 56 cents per ticket because of the increased number of complimentary tickets issued. Consequently, income from ticket sales was down by $240.
- Donations income was down by $500.
- Sponsorship income was down by $3,500.

This information is useful for analysing the financial performance of a production and may point to ways to improve the financial management of future productions, either by producing more accurate budgets or by providing better financial controls over income and expenditure. In this case the major shortfall was for the sponsorship income.

Using other means to track actual expenditure

Ideally, an accounting system for the production will be able to provide timely reports about actual expenditure so that the managers know how actual expenditure is tracking compared to the budget. However, accounting systems often run to monthly cycles, which are not much use to the production manager who wants to know day by day, or at least week by week, how expenditure is tracking. In this situation the production manager has to develop other systems to track expenditure. One useful system is to use the information provided by the purchase order, as the manager can then use the duplicate copies to keep track of what expenditure has been committed. Some accounting systems will generate purchase orders, but in many cases a purchase order book is more accessible and portable.

Another useful way of controlling expenditure is to look at what actual expenditure has been committed to date and then estimate what the expenditure is likely to be at the completion of the production. The actual expenditure to date will be obtained from the expenditure recorded by the accounting system. The estimate at completion will be an assessment made with reference to the actual expenditure to date, purchases orders which are not yet recorded in the accounting system, and an assessment of what expenditure is still likely to be incurred. This will require judgment, taking into account potential areas of either cost increases or savings. Adding additional columns to the budget is a useful way for managers to make these assessments.

Here is an example:

Production costs	Budget	Actual to date	Estimate to complete	Variance comparing estimate to complete with budget (+) = over (-) = under
Set construction materials	500	200	500	-
Tools	200	100	210	+10
Workshop hire	-	100	100	+100
Sound equipment hire	500	300	350	-150
Lighting hire	500	250	250	-250
Cabling	-	-	30	+30
Costume hire	1,000	750	800	-200
Costume materials	-	20	20	+20
Costume tools	-	-	15	+15
Scenery artist materials and paint	-	30	30	+30
Hair and make-up	200	-	200	-
Direct insurance costs	250	-	300	+50
Subtotal for production costs	**$3,150**	**$1,750**	**$2,805**	**-$345**

The above example indicates that some expenditure had not been budgeted for, but even so the estimated expenditure to completion indicates that final expenditure will be less than the budget.

Chapter 7 – Annual budgets for arts organisations

An arts organisation, in the context of this chapter, is an organisation set up to operate continuously producing a number of productions each year (for example, the Royal New Zealand Ballet or Circa Theatre).

Difference between production and overhead income and expenditure

The budgets of arts organisations can be broken down into two essential parts. The first part is an accumulation of the individual production budgets for each of the productions that are planned for the year. The planning process will usually start with determining the programme for the year (the annual programme), which will relate to the overall artistic and operating objectives of the organisation. For a theatre company, the annual programme may be continuous with only a short break between each play for the changeover to the next production. In the case of a ballet or opera company that is producing large touring productions, the company may plan for only two or three productions each year.

Production budgets will then be prepared for each individual production, similar to the budgets discussed in the previous chapters. These individual budgets will normally concentrate on the income and expenditure directly related to the production. A separate annual budget for overheads will be prepared to cover income and expenditure not directly related to the cost of producing the individual productions. Examples of overhead costs are the fees paid to the board, management costs, office expenses, office rentals, communication costs and depreciation of assets. These costs are sometimes referred to as indirect costs.

There may also be income that is not directly related to the individual productions, such as annual grants and sponsorships provided to the organisation for general operating purposes rather than for specific productions. Again, these might be referred to as income related to overheads or as indirect income.

The overhead income and expenditure can either be proportioned between the various production budgets (as discussed below) or shown separately. Below is an example of an annual income and expenditure budget for the Two Left Feet Dance Company. In this particular example, the overhead income and costs have not been allocated to each individual production but are shown separately.

THE TWO LEFT FEET DANCE COMPANY
Income and expenditure budget – For the year ending 31 December 2000

Programmed productions for the year	A	B	C	D	Total	
Production budget						
Number of ticket sales	2,000	3,000	1,000	4,000	10,000	
Average ticket price	$10.00	$11.00	$8.00	$12.90	$10.90	
Direct income						
Ticket sales	20,000	33,000	8,000	48,000	109,000	
Sub total	**$20,000**	**$33,000**	**$8,000**	**$48,000**	**$109,000**	
Less direct costs						
Direct production costs	22,000	31,000	26,000	43,000	122,000	
Direct marketing	5,000	5,000	5,000	5,000	20,000	
Sub total	**$27,000**	**$36,000**	**$31,000**	**$48,000**	**$142,000**	
Direct loss	**$(7,000)**	**$(3,000)**	**$(23,000)**	**$0**	**$(33,000)**	**A**
Unallocated overhead budget						
Indirect income						
Indirect grants	-	-	-	-	40,000	
Indirect sponsorship	-	-	-	-	20,000	
Sub total					**$60,000**	
Less indirect costs						
Indirect administration	-	-	-	-	8,000	
Indirect depreciation	-	-	-	-	4,000	
Sub total					**$12,000**	
Indirect surplus					**$48,000**	**B**
Overall annual surplus					**$15,000**	**A + B**

Looking at the annual budget above, we can see that three of the productions (A, B and C) are budgeted to make an accumulated loss of $33,000, while production D is budgeted to break even. In this example, the dance company is expecting to receive general grants and sponsorship of $60,000 and incur overhead costs of $12,000. This will leave $48,000 to offset against an accumulated loss of $33,000 from productions A, B and C, giving an overall annual surplus (or profit) of $15,000.

Allocating overhead income and expenditure

However, performing arts organisations often want to examine the financial viability of each production as a stand-alone production, and this means that the overheads then have to be allocated to each production on some rational basis. The method of allocation is always arbitrary to some extent, but the aim should be to find some relationship between the production activity and the overhead activity. Looking at the example of the Two Left Feet Dance Company, it may be that each production period will be three months long and a decision can be made to allocate 25% of both overhead income and expenditure to each production. This is illustrated below:

THE TWO LEFT FEET DANCE COMPANY
Income and expenditure budget
For the year ending 31 December 2000

Programmed productions for the year					
	A	**B**	**C**	**D**	**Total**
Performance months	3	3	3	3	12
Number of ticket sales	2,000	3,000	1,000	4,000	10,000
Average ticket price	$10.00	$11.00	$8.00	$12.00	$10.90
Income					
Ticket sales	20,000	33,000	8,000	48,000	109,000
Indirect grants	10,000	10,000	10,000	10,000	40,000
Indirect sponsorship	5,000	5,000	5,000	5,000	20,000
Sub total	**$35,000**	**$48,000**	**$23,000**	**$63,000**	**$169,000**
Less costs					
Direct production costs	22,000	31,000	26,000	43,000	122,000
Direct marketing	5,000	5,000	5,000	5,000	20,000
Indirect administration	2,000	2,000	2,000	2,000	8,000
Indirect depreciation	1,000	1,000	1,000	1,000	4,000
Sub total	**$30,000**	**$39,000**	**$34,000**	**$51,000**	**$154,000**
Surplus/(Loss)	**$5,000**	**$9,000**	**$(11,000)**	**$12,000**	**$15,000**

In some situations the allocation of indirect income and expenditure (the overhead component) may be more complicated than the proportional approach used above. There may be a different rationale used for different types of indirect income and expenditure. Here are four examples showing different ways of allocating indirect income and expenditure to the various productions:

- An annual grant has been provided on the basis that the organisation will produce four productions. The funder has not specified what amount of the annual grant has to be spent on each production. In this situation, the grant could be allocated equally to each production or some other method could be used, based on the scale of the production or the degree to which grant income is necessary for the production to be financially viable. In the budget example below, the organisation has decided to allocate the grant equally to each production.

- Different sponsors have agreed to sponsor each production. Production A will receive $6,000, production B will receive $4,000, production C will receive $7,000 and production D will receive $3,000. In this situation, the income received from each sponsor is directly related to each particular production and should be allocated as such.
- The indirect marketing costs are assumed to be the same for each production.
- The annual costs for administration and depreciation are $8,000 and $4,000 respectively. In the example below, the organisation has decided to allocate these costs based on the number of performance months for each production as a proportion of the total performance months.

THE TWO LEFT FEET DANCE COMPANY
Income and expenditure budget
For the year ending 31 December 2000

Programmed productions for the year					
	A	**B**	**C**	**D**	**Total**
Performance months	2	3	1	4	10
Number of ticket sales	2,000	3,000	1,000	4,000	10,000
Average ticket price	$10.00	$11.00	$8.00	$12.00	$10.90
Income					
Ticket sales	20,000	33,000	8,000	48,000	109,000
Indirect grants	10,000	10,000	10,000	10,000	40,000
Direct sponsorship	6,000	4,000	7,000	3,000	20,000
Sub total	**$36,000**	**$47,000**	**$25,000**	**$61,000**	**$169,000**
Less costs					
Direct production costs	22,000	31,000	26,000	43,000	122,000
Direct marketing	5,000	5,000	5,000	5,000	20,000
Indirect administration	1,600	2,400	800	3,200	8,000
Indirect depreciation	800	1,200	400	1,600	4,000
Sub total	**$29,400**	**$39,600**	**$32,200**	**$52,800**	**$154,000**
Profit/(Loss)	**$6,600**	**$7,400**	**$(7,200)**	**$8,200**	**$15,000**

Note that the basis used to allocate the overhead or indirect income and expenditure will affect the profit or loss for each individual productiovn. If this information is going to be used to assess the financial viability of each production, the allocation needs to be based on a rationale that will assist that assessment. The assessment of each production will depend upon the objectives of the organisation, which may include a mixture of artistic and financial considerations. For example, production C is budgeted to make a loss. The management of the Two Left Feet Dance Company may accept this loss because the profits from the other three productions are sufficient to cover the loss for production C.

Break-even point

For an arts organisation, the break-even point is significant both for individual productions and from the perspective of the overall annual budget. The break-even point may be assessed in terms of total ticket sales. The number of ticket sales required to break even provides an indication of the overall financial viability of the planned productions and a means of assessing the financial risks.

In the example below, the Community Musical Society has prepared its budget based on achieving annual ticket sales of 16,000. This will provide a small profit of $3,600. The breakeven attendance is slightly less at 15,848 ticket sales. To break even, the company will have to sell on average 66% of the seats available in its theatre. Whether this level of attendance is realistic or not will depend upon whether the productions are capable of attracting the required audience and whether the ticket price is affordable. Assessment of these factors needs to be based on market research and information about historical trends for similar productions.

Below is the budget and break-even calculations for the Community Musical Society:

THE COMMUNITY MUSICAL SOCIETY
Income and expenditure budget
For the year ending 31 December 2000

Productions for the year					
	A	**B**	**C**	**D**	**Total**
Number of performances	30	30	30	30	120
Capacity of the venue	200	200	200	200	
Maximum seating capacity	6,000	6,000	6,000	6,000	24,000
Number of ticket sales	4,000	3,900	3,600	4,500	16,000
% of capacilty	67%	65%	60%	75%	67%
Average ticket price	$25.00	$20.00	$26.00	$24.00	$23.73
Income					
Ticket sales	100,000	78,000	93,600	108,000	379,600
Indirect grants	10,000	10,000	10,000	10,000	40,000
Indirect sponsorship	5,000	5,000	5,000	5,000	20,000
Sub total	**$115,000**	**$93,000**	**$108,600**	**$123,000**	**$439,600**
Less costs					
Direct production costs	50,000	40,000	36,000	60,000	186,000
Direct marketing	8,000	7,000	6,000	9,000	30,000
Indirect administration	50,000	50,000	50,000	50,000	200,000
Indirect depreciation	5,000	5,000	5,000	5,000	20,000
Sub total	**$113,000**	**$102,000**	**$97,000**	**$124,000**	**$436,000**
Profit/(Loss)	**$2,000**	**$(9,000)**	**$11,600**	**$(1,000)**	**$3,600**
Break-even (number of ticket sales)	**3,920**	**4,350**	**3,154**	**4,542**	**15,848**
Break-even % of capacity	**65%**	**73%**	**53%**	**76%**	**66%**

The number of ticket sales required to break even is calculated as follows:

$$\text{Number of ticket sales} = \frac{\textbf{Production costs + Marketing costs + Administration costs + Depreciation - Grant income – Sponsorship income}}{\textbf{Average ticket price}}$$

Cash flows

Arts organisations, like all other businesses, must manage their cash flow during the year and have enough cash in the bank to pay the bills as they fall due. This is particularly so for performing arts organisations because money often has to be spent on production costs before the show opens and ticket sales are made.

The cash flow forecast for an arts organisation follows the same principles as discussed in chapter 5 for an individual production. An arts organisation takes the individual cash flows for each of its productions and combines this information to prepare a cash flow that covers the full year. This may be done on a weekly or monthly basis, depending on how much of a breakdown is needed to manage the cash flows. The cash flow forecast will highlight what the bank balance is likely to be at the end of each week or month. If it is in overdraft, the options are to borrow money, ask that grants and sponsorship income be paid in time for the organisation to pay its bills, try to presell tickets or, if possible, delay making payments until the cash is available.

Working capital

Cash is required for a wider purpose than just paying the bills as they fall due. You will hear financial managers talk about the need for arts organisations to have adequate levels of working capital (in fact, this applies to any business). Working capital in this context is the amount of net cash that the organisation has at its disposal. To find out the working capital of an organisation, look at the balance in the bank account plus those debtors that can be relied upon to make prompt payments, less creditors and taxes that have to be paid. Working capital is important because it not only helps cover the times when payments have to be made before cash is received from ticket sales, but also provides a safety net for when ticket sales are less than expected. In the budget for the Community Musical Society above, if the society's ticket sales for the year fall short of budget by 10%, the company will incur a loss of $34,360. After adding back the non-cash depreciation of $20,000, the cash shortfall is likely to be $14,360. Unless the Society has working capital to cover the shortfall it will be under financial pressure to borrow the money, or it could be forced into liquidation by its creditors.

How much is an adequate level of working capital for an arts organisation is a judgement call based on the perceived risk of not achieving the budget and the extent to which cash is needed to address the timing differences in receipts and payments. A budget that indicates high risk in these areas may require a higher level of working capital than a budget that is based on lower risk assumptions. As a rough rule of thumb, an arts organisation that has prepared a careful budget based on good assumptions and research, and that is confident of controlling its costs, may feel comfortable carrying working capital equivalent to 10% to 20% of its annual budgeted ticket sales revenue.

Capital expenditure

Another reason for an arts organisation to carry an adequate level of working capital is to provide for capital expenditure on items like equipment, venue upgrades and technology. Expenditure on these items will not be included in the annual income and expenditure budget, but should be planned for by preparing a separate capital expenditure budget. This budget should cover a number of future years and should be updated annually. Here is an example of a five year capital expenditure budget for the Community Musical Society:

THE COMMUNITY THEATRE SOCIETY
Capital expenditure budget for the next 5 years
Prepared 1 January 2001

	Year ending 31 December				
	2001	**2002**	**2003**	**2004**	**2005**
Technology					
Create new website	20,000				
Upgrade website				10,000	
Computer and software upgrade		10,000			
New ticketing software			30,000		
Equipment					
Replace sound desk				5,000	
New lights		15,000			
Venue upgrades					
Replacement seats					25,000
Annual capital expenditure	**$20,000**	**$25,000**	**$30,000**	**$15,000**	**$25,000**
Less forecast annual depreciation	20,000	22,000	23,000	22,000	20,000
Cash surplus/(shortfall)	**$-**	**$(3,000)**	**$(7,000)**	**$7,000**	**$(5,000)**

To prepare this budget, the Society would have had to look ahead and consider what new assets it may need and what existing assets need replacing. The annual capital expenditure will be a cash outlay and should be included in the annual cash flow forecast for that year. Working capital will be needed to cover this expenditure, and if that is not available the Society will need to borrow or raise extra funds. A potential lender will probably want to look at budgets and cash flows to see if the Society will generate enough income to repay any loans that are provided.

One way of roughly checking if the organisation can afford its planned capital expenditure is to compare the annual budgeted capital expenditure with the estimated depreciation for the year. The depreciation is an annual amortisation of past capital expenditure and as such is not cash-related expenditure. As a rough rule of thumb, this deprecation can considered as producing free cash that can be used for the purchase of new assets.

Three-year budgets and cash flow forecasts

It is usually regarded as good management practice to prepare budgets and cash flows for a longer period than just one year. Arts organisations usually develop long-term strategic plans that require financial planning to span a number of future years. Also, government funding agencies often commit to funding on a three-year basis, and sometimes for longer periods, and if so these agencies will require future budgets to confirm the need for future funding.

Obviously, the further ahead an organisation plans, the more uncertainty there is likely to be. Because of this uncertainty, arts organisations that prepare three-to-five-year budgets will update them on an annual basis. There will often be significant changes from year to year to take account of the effect of current results and what is now known about the future.

Chapter 8 – Running your own business

Difference between being self-employed and being an employee

If you are an actor, production manager, producer, musician, director, designer or writer, or are involved in some other way in putting on a performing arts show, the chances are that most of the performing arts work that you do will be as a self-employed person running your own business. Sometimes a self-employed person will be referred to as a contractor. It is important to know the difference between being self-employed and being an employee (in fact, you can be both self-employed and employed at the same time – for example, you might be employed on a part-time basis and continue to do contract work for the rest of the time).

"Contract for services" and "contract of services" are terms that you will often hear used in this context. A contract for services is when you provide your services as an independent contractor, while a contract of services is when you are employed by an employer. The distinction is important because an employee has rights to holidays and sick leave that a contractor does not. In addition, an employee has PAYE tax deducted by the employer from their wages while a contractor has to take care of their own income tax.

You cannot change your employment status from that of an employee simply by calling yourself an independent contractor. There are legal tests to determine whether a person is a contractor or an employee. The differences are that as a contractor you have a lot more control over how the work is done, are likely to have some level of independence in deciding how you run your business, are not integrated into another person's business and often provide your own resources to do the work.

Life as an employee is a lot simpler than running your own business as a contractor. When you start your employment you sign an employment agreement and complete a tax code declaration. Your employer will then deduct income tax (PAYE) from your wages and pay it to the IRD. At the end of the tax year you may want to check whether you have paid the right amount of PAYE, but apart from that there is not much more for you to worry about. Enjoy your paid holidays and sick leave!

If you are self employed and running your own business, life will be more complicated. You have to think about:

- having agreements with your customers that explain what services you will provide and how much you expect to be paid
- issuing invoices to your customers for the goods and services that you provide to them
- keeping records of all supporting receipts, invoices and other documents to enable you to account for all your income and expenditure. You will also need to maintain accounting records
- filing an annual tax return. The type of tax return will depend upon how you operate your business as there are different types of tax returns for different types of businesses
- paying provisional income tax and year-end residual income tax
- registering for GST, if your turnover or gross income is over the prescribed threshold.

Contracting out your services

When you arrange to provide goods or services to a customer, both parties need to agree in advance what goods or services need to be provided, when they will be provided and for how much. This agreement should be in writing as a signed contract, or a signed letter of agreement, or even an email that is acknowledged by both parties. The form of the contract or agreement may be simple or complicated, depending on what is required. In many cases an arrangement will be simple and documented by a letter (or email) from you to the customer. For example, you may present the customer with a letter along the following lines:

1 January 2000

Sir John Falstaff
Upstage Theatre
Main Street
Timaru

Dear Sir John

Thank you for asking me to design the set for your production of *Henry IV* at Upstage Theatre. My understanding is that the design must be completed by 22 June 2000. My fee will be $1,000, which is payable in full on 22 June 2000.

If you are in agreement with the terms of this letter can you please sign the enclosed copy and return it to me.

Yours sincerely

Neil Coward

1 West Road
Timaru

If Neil Coward is GST-registered, he should state that the fee of $1,000 is exclusive of GST. If he does not mention this, it will be assumed that the $1,000 is inclusive of GST.

The arrangement may in fact be a lot more complicated than this simple example. It may be that Upstage Theatre Company requires the designer to co-ordinate the work with others, use certain elements in the design, oversee the construction of the set and be responsible for the set construction budget. The designer may want to retain the copyright in the design and be paid a royalty, which may be in addition to the fee. If the arrangement has any degree of complexity, a lawyer should be engaged to draw up a contract that covers all the terms and conditions of the engagement.

Invoices

Using the above example, when Neil Coward wants to be paid on 22 June 2000, he should send Upstage Theatre an invoice. The invoice can be handwritten, typed, produced by a computer accounting system, or from a pre-printed invoice book obtained from a stationery shop. How the invoice is produced does not matter, but it needs to contain some essential information – the date of the invoice, who is being billed, what services or goods have been provided, how much is to be paid and when the payment is expected. How you set out this information is a matter of personal taste, but here is an example of an invoice that Neil Coward could send to Upstage Theatre.

22 June 2000

Invoice to:

Sir John Falstaff
Upstage Theatre
Main Street
Timaru

From:

Neil Coward
1 West Road
Timaru

Fee for designing the set for the play *Henry IV*	$1,000

Please pay within 5 days of receipt of this invoice.

If Neil Coward is registered for GST, he has to supply Upstage Theatre with a tax invoice in order to add GST to the fee that he is invoicing. The tax invoice will have additional information that is not shown on the non-GST invoice above. The invoice is called a tax invoice, the GST number of the supplier (Neil Coward) is provided, and the amount of GST is added to the fee. Here is an example of a GST tax invoice:

22 June 2000

Tax Invoice to:

Sir John Falstaff
Upstage Theatre
Main Street
Timaru

From:

Neil Coward
1 West Road
Timaru

GST No. 11 111 111

Fee for designing the set for the play *Henry IV*	$1,000
Plus GST @ 15%	$150
Total amount due including GST	**$1,150**

Please pay this invoice within 5 days of receipt of this invoice

Record keeping

Record keeping is an important part of running your business. You will need to keep your business records in order to account for the business's transactions, manage the finances of your business and calculate your taxes. It is essential to keep the receipts and invoices issued by you, receipts and invoices received by you for purchases and payments, bank statements, eftpos and credit card receipts, credit card statements, worksheets showing tax return calculations, and wages records (if you are an employer). It is also a good idea to keep any contracts or agreements you are a party to. All these records should be filed in some logical order, usually chronologically. The IRD requires that all business records, including those in electronic form, be kept by the business for at least seven years from the end of the tax year to which the records relate.

Your business should also keep accounting records of assets (assets owned by the business or monies that are owed to the business), liabilities (loans, creditors and other monies the business owes), and accounting records of all income and expenditure. This information is needed to calculate the business's profit or loss and keep track of its financial position. The easiest way to account for these business transactions is for all transactions to go through the business's bank account, which means no "under the table" payments. The bank statement then provides a record of all the receipts and payments of the business. At a minimum, it is advisable for the business to operate a cash book that records the receipts and payments as they occur. This can then be matched to the deposits and payments on the bank statement and the differences reconciled. The reconciliation of these differences is referred to as a bank reconciliation.

Cash books can take many forms, including those with pre-ruled columns that can be purchased from stationery shops, but these days spreadsheet software is often used. Below is an example of a basic cash book set-up:

In this example the column headed "Amount on bank statement" can be reconciled to the information in

BASIC CASH BOOK COLUMNS

For a GST registered business – Receipts

Date	*Received from*	*Amount on bank statement*	*If GST @ 15% is included*	*Ticket sales (net of GST)*	*Other income (net of GST if applicable)*
		A =	B+	C+	D+
10 Dec 00	Fees from Upstage Theatre	1,150.00	150.00	1,000.00	
11 Dec 00	Interest	100.00	-		100.00
	TOTALS	**$1,250.00**	**$150.00**	**$1,000.00**	**$100.00**

PAYMENTS

Date	*Payments to*	*Amount on bank statement*	*If GST @ 15% is included*	*Expenses net of GST if applicable* – *columns for each expense item in budget*	*Column for GST & PAYE payments*
		A =	B+	C+	D+
10 Dec 00	Hardware Co - production costs	115.00	15.00	100.00	
30 Dec 00	Bank fees	10.00	-	10.00	
30 Dec 00	IRD - GST payment	135.00	-		135.00
	TOTALS	**$260.00**	**$15.00**	**$110.00**	**$135.00**

the bank statement. If there are any receipts or payments on the bank statement that are not shown, these transactions can be written into the cash book.

The GST column records information about the amount of GST to be paid to the IRD. In this case, the amount of GST to be paid is $135.00, being the GST of $150.00 on the fee from Upstage Theatre less GST of $15.00 on the production costs.

The cash book can also be used to work out the bank balance. This is calculated as the total receipts of $1,250 less payments of $260, giving a bank balance of $990.00.

Paying business income taxes

As mentioned earlier, paying the taxes for your business is a lot more complicated than if you are an employee with PAYE deducted from your wages by your employer. In your first year of being self-employed, the worst trap to fall into is to think that all the income you receive is yours to spend. Other than where withholding tax has been deducted from schedular payments, the income you receive will not have had any income tax deducted from it. You will have to remember to set aside some of that income to pay your taxes at the end of the tax year. If you are-GST registered, you may also have to pay GST at regular intervals as well.

In your first year of business, the tax on your profits for the year ending 31 March does not have to be paid until the following year. If you made a profit, provisional tax payments will be payable in the second year of business. Be aware that in your first year of business you can make voluntary payments of income tax.

Below is an example of a tax calculation for a person who earns income both from employment and from being a contractor (the calculation assumes that the tax year ends on 31 March):

As at 31 March	***Taxable income***	***Tax paid***	***Type of tax***
Part-time wages	20,000	3,900	PAYE
Fee for acting role	10,000	2,000	20% schedular tax
Net income from a festival production ***Note 1***	10,000		
Gross income	**$40,000**	**$5,900**	
Less deductible expenses ***Note 2***	1,000		
Net taxable Income (a)	**$39,000**		
Tax on (a) ***Note 3***	7,740		
Less Tax already paid	5,900		
Tax to pay	**$1,840**		

Note 1	
Income from a fringe festival production	
Ticket sales income	20,000
Less production costs	5,000
Less venue cost	5,000
Net income	**$10,000**

Note 2	
Example of deductible expenses related to being an actor	
Make-up	500
Books for research	500
Total	**$1,000**

Note 3: The tax calculations should be done using the relevant tax code and tax rates provided by the IRD. The above tax calculation is only a generic example and the tax rate used is not necessarily an applicable rate.

Besides paying income tax, self-employed people may also need to make separate payments for student loans and ACC levies (which are based on the self-employed income).

Preparing a budget for the business

It is helpful to prepare an annual budget for your business at the beginning of each year to assess the business's likely income and expenses. Make sure the budget is realistic and not overly optimistic. Also prepare a cash flow statement based on your budget. Consider the assets you will need to buy, the loans you will need to repay and when you will have to pay income taxes and GST.

You may also have to pay fringe benefit tax (FBT) and PAYE if you are employing people as part of your business. If so, you should become familiar with your tax obligations as an employer. This book does not attempt to provide detailed information about income tax, GST and employment-related taxes, which is available from the IRD (check the IRD website). Tax rates and the way taxes are assessed and paid change from time to time, and businesses need to keep up to date with them.

Choosing a business structure

Before the business gets under way, you should think about what sort of business structure best suits it. The types of business structures used in the performing arts are covered in chapter 1. As some of those structures relate to larger arts organisations, this chapter will discuss what types of business structures may relate to a person running their own business for the first time.

While the business is small, it may be best for you to operate as a sole trader. When the business grows, a company structure may be more useful. In some cases a partnership may be another option if the business is a team effort. Here are some of the differences between a sole trader, a partnership and a company structure that are worth considering:

Sole trader

- A sole trader is a person operating a business as an individual, using the person's own IRD number.
- Operating as a sole trader is simple and inexpensive to set up and run.
- It is easy to dissolve.
- There is no need for company records of shareholdings, minutes or filing returns with the Companies Office.
- The owner of the business is personally liable for the debts of the business.
- The business pays income tax on a provisional tax basis.
- The income tax rates are the same individual tax rates that would be used if the person were an employee.

General partnership

- A general partnership is a simple structure that is useful when two or more people derive income from joint efforts and are prepared to share the business risks.
- The business does not need to be registered.
- The partnership is not a taxpayer. Partners share in the net profits and then pay income tax as individuals on their share of the income. However, a partnership does need a separate IRD number and is required to file a tax return advising the IRD of its income and expenditure and of the partners' share of the profits or losses.
- If it is a general partnership, limited liability does not exist and the partners are jointly and severally responsible for debts incurred by the partnership.
- It is generally advisable to have a partnership agreement that reflects the nature of the business and states the responsibilities of each partner and how the profits are to be shared amongst the partners.

Company

- A company is a separate legal entity from the owners or operators of the business. The limited liability status of the company protects the shareholders from being responsible for the company's debts.
- A company can be a good way to manage the interests of multiple owners.
- Shareholders can also be employees of the company, in which case the company deducts PAYE from the wages paid to the shareholders.
- The requirements of the Companies Act must be complied with and annual returns filed with the Companies Office.
- A company is required to have its own IRD number and file a tax return.

Importance of professional advice

The information given in this chapter is an introduction to some of the accounting, legal and tax issues you will need to consider, particularly if this is the first time you are running your own business and are self-employed. If you are planning to operate as a business, it is a good idea to obtain professional advice before you start, which may help to avoid costly mistakes later on.

Preparing a business budget and a personal budget

In the first year of running your own business you may be uncertain about how much money you have to live on. A good way to address this is to prepare budgets both for your business and for your personal affairs. When preparing the budgets, be realistic and don't overestimate your income, or you may find yourself spending money that you don't have. Start by preparing the budget for the business, which will give you an indication of how much net income (after allowing for business expenses and income tax) you are likely to earn in the coming year and have available for your personal use.

Here is an example of such a budget for your business activities:

Income	
Gross fees (what you expect to invoice)	**$20,000**
Less deductible business expenses	5,000
Net taxable Income	**$15,000**
Less income tax that will need to be paid on the net taxable income	3,000
Less an allowance for student loan repayments on the above net taxable income (estimated at 10%)	1,500
Less allowance for ACC payments	200
= Income you can use for personal purposes	**$10,300**

***Note**: The income tax, student loan, and ACC levy figures are for example purposes only. Specific calculations should be made for each particular situation and be based on the particular rates and levies applying to the taxpayer at the time of the calculation.*

Next, prepare a budget for your personal finances. This will assess what your personal disposable income will be, how much you have to spend on your living costs, entertainment and other personal costs, and how much you can save.

Below is an example of a budget for your personal finances:

Receipts	
Income from your business that you can use for personal purposes (from the business budget above)	10,300
Plus net wages (after PAYE and other deductions) from employment such as a part-time job	15,000
Other receipts such as interest	500
Total Receipts - A	**$25,800**
Less Payments	
Rent	7,000
Transport	1,500
Food	5,200
Clothes and accessories	2,500
Mobile phone	600
Entertainment	1,500
Repayment of loans and credit card	500
Other expenses	300
Total Payments - B	**$19,100**
A – B = savings	**$6,700**

Your budget will be nothing more than a best estimate based on the information you have at the time you prepare the budget. You should update the budget as the year progresses and you have a better idea of what your business and personal income is likely to be, and of how much you are spending on expenses.

Business checklist

To help with running your business, here is a checklist for you to consider when starting up. The checklist covers the areas discussed in this chapter.

Financial planning

Have you prepared a business or financial plan for your business?

- Prepare a budget.
- Consider whether you need extra money, such as a loan, to start up your business.
- Prepare a budget for purchasing equipment.
- Consider what insurances you need for your business.

Business structure

Have you considered the type of structure that best suits your business?

- If it is operating as a sole trader, there are no specific requirements, as you can trade as an individual.
- If it is a company, you need to register the company with the Companies Office.
- If you are forming a partnership with others, think about the need for a partnership agreement.

Tax matters

Do you need an IRD number?

- If your new business structure is either a partnership or company, a new tax number needs to be obtained from the IRD.
- If you are operating your business as a sole trader, use your personal IRD number.

Do you need to register for GST?

- If your business turnover is over the threshold then you must register for GST. Otherwise, registration is voluntary.

Are you going to employ people or engage contractors subject to schedular deductions?

- If so, you will need to register with the IRD as an employer.
- Employees and contractors will need to complete an IRD tax code declaration.
- If you are an employer, you need to become familiar with employee deductions such as student loan repayments and the KiwiSaver scheme.

When will you have to pay income tax and other taxes?

Things to consider include:

- income tax, provisional tax payments, and early tax payments in the first year of business
- putting aside money for GST, PAYE, withholding tax deductions and income tax payments
- student loan and ACC payments for the self-employed
- what income will be taxable, and what expenditure can be deducted to calculate the net taxable profit.

Accounting and business systems

What sort of accounting and financial systems do you need?

Things to consider include:

- opening a separate bank account for the business, rather than using your personal bank account
- using contracts or agreements when providing services to others
- how you will invoice customers for your services
- setting up a good filing system for invoices, receipts and payments
- what type of accounting system best suits your business.

Seeking advice

Do you need help?

- Consider whether you need any professional advice to help set up your business.

A final word

Being self-employed for the first time may seem a daunting prospect, as there is a lot to think about when setting up your business. While it may seem a lot harder than being an employee, self-employment does have its rewards. There is nothing like being your own boss of a successful business!

Case studies

The following case studies are provided to give further examples of how budgets can be prepared for productions of different sizes. These budgets have been prepared on the basis that they provide information about the financial viability of particular productions. They are examples only and not reproductions of the budgets of actual productions.

Case study 1

Budget for small self-produced musical production

Background

A group of three musicians decides to put on two performances of original music at a fringe festival. The show requires a sound technician and a lighting operator.

The venue requires no charge for hosting the performances, as it operates a bar and considers the bar sales will cover the venue costs. The venue holds an audience of 150.

The fringe festival requires a registration fee of $350.

The group of musicians teams up with a sound technician and a lighting operator, and all agree to work together as a "collective" or "co-op" to put on the show. They agree that they will all contribute towards the costs and will share the income equally between all five participants. The co-op is not registered for GST.

To see whether the production is financially viable, the collective prepares a budget. This budget is prepared on the basis of a ticket price of $20 and a total of 226 tickets being sold for the two performances, which requires an attendance of 75% of the total seating capacity. If this happens, each of the participants will receive $600 after the budgeted costs have been paid. The budget also shows that they need to sell a total of 76 tickets to cover the budget costs of $1,520.

For a small production like this one, a detailed cash flow forecast is probably not required, but it is still useful to be know when payments need to be made and when income is likely to be received. In this case study, the fringe registration fee, the artwork for posters and the printing of the posters will probably have to be paid for before the income from ticket sales is received. So those involved will have to use their own money to pay for these costs until such time as they can be reimbursed from ticket sales. Once the ticket sales income is received, those who paid the expenses can be reimbursed and whatever is left over can be split up between the participants. As they have agreed to equal shares, the five participants will each receive 20% of the net income left over after the expenses have been paid.

A contingency of $200 has been included in this budget to cover any unforeseen costs that may arise. If the contingency is not used, the net profit will increase from $3,000 to $3,200. Each participant will then get another $40 each (20% of $200).

SMALL MUSICAL PRODUCTION BUDGET
For the Fringe Festival
(Not GST-registered, so figures are inclusive of GST)

Venue, attendance and pricing			
Room audience capacity with table and chairs	150		
Performances	2		
Total audience capacity for the two performances	300		
Budgeted ticket sales	226		
Budgeted ticket sales as % of total audience capacity	75%		
Ticket price	$20		
Break-even: total ticket sales required to cover expenses	**76**		
Income from ticket sales			
	Paying attendances		
Performance 1 - Wed 17 February	113	$20.00	2,260
Performance 2 - Thurs 18 February	113	$20.00	2,260
Sub total	**226**		**$4,520**
Less expenses			
Registration with fringe			350
Posters	100	$2.00	200
Sound and lighting equipment hire			620
Artwork for posters			150
Contingency			200
Sub total			**$1,520**
NET PROFIT (income less expenses)			**3,000**
Split of net profit between the 5 participants			
Musician 1		20%	600
Musician 2		20%	600
Musician 3		20%	600
Lighting operator/projectionist		20%	600
Sound technician		20%	600
		100%	**$3,000**

Case study 2

Production budget for medium-sized play

Background

Elizabeth has formed a company called Morning Tea Productions Limited to produce the play Tea for Two by Roger Wall. Playmarket requires a royalty payment for the playwright of 10% of ticket sales net of GST and booking fees.

The company is registered for GST. The current GST rate is 15%.

The company has arranged to use Main Street Theatre, which has a seating capacity of 120 and will provide front of house staff and sell the tickets. The theatre will charge a booking fee of $1 (including GST) per ticket and receive 15% of the gross ticket sales net of GST. The company has decided that the public ticket price will be $30 (including GST). This means that the company will receive $25.22 after Main Street Theatre deducts its $1 booking fee and after GST is deducted.

The play requires two actors. All those providing services will be engaged on a contract-for-services basis so will be contractors rather than employees. All the contractors are registered for GST except the two actors. The company is required to deduct schedular tax (also known as withholding tax) of 20% from the actors' payments.

The plan is to have one week to set up, one week of rehearsals and two weeks of performances. There will be 5 performances per week. Once the performances are finished, it is expected to take a week to wrap up the production.

After researching the costs the company expects them to be as follows:

- *The director will be paid a fee of $1,500 plus GST.*
- *The set and costume designer will be paid a fee of $750 plus GST.*
- *The lighting designer will be paid a fee of $500 plus GST.*
- *The actors will be paid $800 per week for rehearsals and performance.*
- *The stage manager will be required for the two weeks before performances start and the two performance weeks. The weekly fee will be $700 plus GST.*
- *The technical operator is required for the week of rehearsal and the two performance weeks. The weekly fee will be $500 plus GST.*
- *The carpenter has given a quote for set construction of $900 including GST.*
- *The estimated production costs, including GST, are set construction materials –$230, lighting hire – $575, and costume hire – $230.*
- *Rehearsal rooms will cost $90 for the rehearsal week, and there will be a cost for power, which is estimated at $40. These costs all include GST.*
- *The graphic designer is expected to cost $500 plus GST. The quote for printing flyers is $575 (including GST). The quote for media advertising is $345 (including GST).*
- *Administration costs (excluding GST) are estimated as general expenses – $60, insurance – $250, postage – $50, and stationery – $60. Bank fees are estimated to be $30 (GST does not apply to bank fees).*

The company has decided to print 350 programmes. The cost is $1 per unit (excluding GST). The company plans to sell the programme for $2 (including GST) and expects 50% of the ticket-buying audience will buy a programme.

To provide for any unknowns or unexpected expenses, the company adds a contingency of 10% to the total production costs.

The company has been advised by Creative New Zealand that it will receive a grant (net of GST) of $7,000 to assist with the production, and a kind aunt has said she will donate $500.

The company prepares a budget (exclusive of GST) to assess how much money it will make from the production if an average of 70 ticket buyers (or 58% of seating capacity) attend each of the ten performances. If the budget is achieved, the company will make a profit before tax of $3,807. The company also prepares a break-even budget, which shows that average paying attendance of 42% of the total seating capacity is needed to break even.

A weekly cash flow forecast is prepared for each of the five weeks, based on an assessment of when income will be received and expenses paid. This forecast is prepared on the basis that the contingency allowance of 10% will not be used. It shows that the company's bank account will be in overdraft in the second week. To cover this cash shortfall, the company will ask the bank to provide an overdraft facility.

Below are the summary income and expenditure budget, the detailed production expenditure budget and the weekly cash flow forecast that the company has prepared for the production.

SUMMARY INCOME AND EXPENDITURE BUDGET

PRODUCTION: Tea For Two – Performance dates from 7 April to 16 April
Note: the budget excludes GST

		Budget	*Break-even*
	Number of performances	10	10
	Seating capacity of venue	120	120
	Average paying attendance per performance	70	51
	Total estimated paying attendance	700	508
	Total paying attendance as % of seating capacity	58%	42%
	Ticket price	**$30.00**	**$30.00**
	Average ticket price (net of GST and booking fees)	**$25.22**	**$25.22**
	Programme sales - 50% of paying attendance	350	254
	Programme sales price net of GST	**$1.74**	**$1.74**
	Income		
	Ticket sales	17,652	12,799
	Programme sales	609	442
	Donations	500	500
	Grants	7,000	7,000
A	**GROSS INCOME**	**$25,761**	**$20,741**
	Less variable expenditure		
	Royalties payable to playwright – 10% of ticket sales	1,765	1,280
	Venue hire - 15% of ticket sales	2,648	1,920
B	**TOTAL VARIABLE EXPENDITURE**	**$4,413**	**$3,200**
	Less production expenditure (see detailed budget)		
	Director and other creative fees	2,750	2,750
	Rights and royalties (fixed expenditure)	200	200
	Cast	4,800	4,800
	Production management	5,083	5,083
	Production costs	900	900
	Venue costs	113	113
	Publicity	1,650	1,650
	Administration	450	450
	Contingency	1,595	1,595
C	**TOTAL PRODUCTION EXPENDITURE**	**$17,541**	**$17,541**
	PROFIT/(LOSS) before income tax (A-B-C)	**$3,807**	**$0**

DETAILED PRODUCTION EXPENDITURE BUDGET

Tea For Two

Note: the budget excludes GST

	Commence	*End*	*Weeks*	
Rehearsals	1 April	5 April	1	
Performances	7 April	16 April	2	
Main Street Theatre				
Director fees and other creative fees				
Director fee				1,500
Set and costume designer fee				750
Lighting designer fee				500
Subtotal				**$2,750**
Rights and royalties (fixed costs only)				
Music rights paid to APRA				200
Subtotal				**$200**
Cast	***weeks***	***weekly rate***		
Rehearsal				
Actor 1	1	$800		800
Actor 2	1	$800		800
Performance				
Actor 1	2	$800		1,600
Actor 2	2	$800		1,600
Subtotal				**$4,800**
Production management	***weeks***	***weekly rate***		
Rehearsal				
Stage manager	2	$700		1,400
Technical operator	1	$500		500
Performance				
Stage manager	2	$700		1,400
Technical operator	2	$500		1,000
Set construction				783
Subtotal				**$5,083**
Production costs				
Set construction materials				200
Lighting hire				500
Costume hire				200
Subtotal				**$900**

Venue costs			
Rehearsal venue hire			78
Power - fixed cost			35
Subtotal			**$113**
Publicity			
Graphic designer			500
Printing costs			500
Media advertising			300
	unit cost	***quantity***	
Programme costs	$1.00	350	350
Subtotal			**$1,650**
Administration			
Bank fees			30
General expenses			60
Insurance			250
Postage			50
Stationery			60
Subtotal			**$450**
TOTAL PRODUCTION COSTS BEFORE CONTINGENCY			**$15,946**
PLUS CONTINGENCY 10%			**$1,595**
TOTAL PRODUCTION COSTS INCLUDING CONTINGENCY			**$17,541**

WEEKLY CASH FLOW FORECAST

Tea for Two

Note: GST rate of 15%	Preparation week $	Rehearsal week $	Performance week $	Performance week $	Tidy-up week $	Total $
Receipts including GST						
Ticket sales			8,826	8,826		17,652
Programme sales			304	304		609
Grants	3,500				3,500	7,000
Sub total	**$3,500**		**$9,130**	**$9,130**	**$3,500**	**$25,261**
plus GST on receipts - 15%	525		1,370	1,370	525	3,789
Receipts with no GST						
Donation		500				500
Total receipts - A	**$4,025**	**$500**	**$10,500**	**$10,500**	**$4,025**	**$29,550**
Payments including GST						
Royalties					1,765	1,765
Venue hire					2,648	2,648
Producer and director fees			2,750			2,750
Rights and royalties (fixed expenditure)	200					200
Production management	1,200	1,200	1,200	1,483		5,083
Production costs	200		700			900
Venue costs		113				113
Publicity	500		850		300	1,650
Administration	250			170		420
Sub total	**$2,350**	**$1,313**	**$5,500**	**$1,653**	**$4,713**	**$15,529**
plus GST on payments - 15%	352	197	825	248	707	2,329
Payments with no GST						
Bank fees					30	30
Cast		1,280	1,280	1,280		3,840
Schedular (withholding tax - 20%) - paid to IRD					960	960
Total payments - B	**$2,702**	**$2,790**	**$7,605**	**$3,181**	**$6,410**	**$22,688**
Net receipts and payments A - B	**1,323**	**(2,290)**	**2,895**	**7,319**	**(2,385)**	**6,862**
Less payment of net GST					1,460	1,460
Net cash flow after GST refund or payments	**1,323**	**(2,290)**	**2,895**	**7,319**	**(3,845)**	**5,402**
Opening bank balance	**-**	**1,323**	**(967)**	**1,928**	**9,247**	**0**
Closing bank balance	**$1,323**	**$(967)**	**$1,928**	**$9,247**	**$5,402**	**$5,402**
Reconciliation with summary budget						
Profit from summary sheet						3807
Difference is the contingency that was in this case not spent						1,595

Glossary of financial and accounting terms

Accounting period

- The reporting period that is covered by the accounting information.

Accumulated funds

- The retained earnings and reserves of the business. This term is usually used for trusts. These funds will be disclosed in the statement of financial position.

Accrual accounting

- A method of accounting that records transactions when they occur rather than when the equivalent cash is received or paid (for example, sales are recorded when the customer is invoiced for the goods or services).

Amortisation (depreciation)

- The amortisation (depreciation) of an asset is to systematically spread of the cost of the asset over its useful life.

Assets

- The resources controlled by the business that have a future economic value. Examples are bank accounts, monies owing to the business, buildings and equipment.

Break-even point

- When the income and the expenditure for a production or an activity are equal. There is neither a profit nor a loss.

Capital expenditure

- The purchase of an asset that will have an economic or productive life for more than a year.

Cash accounting

- A method of accounting that only accounts for cash receipts and cash payments.

Company

- A legal entity that is separate from its shareholders and is constituted under the Companies Act 1993.

Co-operative

- For the performing arts a term to describe a group that contributes to a production on the basis that they will be paid out of any profits earned from the production.

Contingency

- An allowance that is provided in the budget for unplanned or unexpected expenditure.

Creditors

- Money the business owes that has not yet been paid. Also known as accounts payable and trade payables.

Current assets

- Assets that a business expects to realise, sell or consume within 12 months after the end of the reporting or accounting period.

Current liabilities

- Liabilities that a business expects to settle within 12 months after the reporting or accounting period ends.

Debtors

- Money owing to the business which has not yet been paid. Also known as account receivables or trade receivables.

Depreciation (amortisation)

- The depreciation (amortisation) of an asset is to systematically spread the cost of the asset over its useful life.

Direct costs

- Costs that have a direct relationship with earning income from a specific production or activity. Examples include the costs of engaging actors and building the sets for the production.

Dividends

- Profits that a company distributes to its shareholders in proportion to their entitlement.

Equity

- This is the owner's residual interest in the business after deducting the liabilities from the assets of the business.

Financial statements

- Consist of (at a minimum) a statement of financial position (balance sheet) and a statement of financial performance (income and expenditure statement) for the reporting or accounting period.

Financial year

- The year for which the business accounts for its business activity and produces annual financial statements.

Fixed costs

- Costs that remain relatively constant for a specific period and are not directly affected by variables such as the number of tickets sold. Examples are administration costs, depreciation and marketing costs.

Fixed income

- Income that remains relatively constant for a specific period, such as grant income. Fixed income is not affected by the quantity of ticket sales or the level of activity.

Fixed assets

- A term used to describe tangible assets such as property, plant and equipment.

GST (goods and services tax)

- GST is a tax on the supply (sale) of most goods and services in New Zealand, most goods imported into New Zealand and some specified imported services.

Incorporation

- Incorporated entities include companies incorporated under the Companies Act 1993, charitable trusts incorporated under the Charitable Trusts Act 1957 and societies incorporated under the Incorporated Societies Act 1908. Incorporated entities are separate legal entities that can own assets and incur debts and other liabilities.

Indirect production costs

- Costs not directly associated with staging and selling the production, such as general administration costs.

Liabilities

- Monetary obligations owing by the business to others. Common liabilities are bank loans, money owing to creditors, and customers who have purchased tickets in advance.

Net assets

- Net assets are calculated by deducting total liabilities from total assets. Net assets are equivalent to the owner's equity in the business.

Net loss (net deficit)

- The amount by which total expenditure is more than total income. For non-profit organisations, net loss is often referred to as net deficit.

Net profit (net surplus)

- The amount by which total income is more than total expenditure. For non-profit organisations, net profit is often referred to as net surplus.

Operating expenditure

- Expenditure incurred in generating annual income.

Overhead cost

- Overhead cost is another term for indirect costs. See indirect production costs above.

PAYE

- The employer who pays salaries or wages is required by the IRD to deduct PAYE tax and pay that tax to the IRD.

Reserves

- Part of the owner's equity that has been designated for a specific use or that has arisen from a particular occurrence.

Retained earnings

- Net profits that have been retained by the business rather than distributed to the owners of that business.

Share capital

- Equity that relates to shares issued to the shareholders of a company.

Shareholder

- A person or entity that owns a share or share capital in the equity of a company.

Variable income

- Income that fluctuates in direct proportion to the activity of the business or the volumes or quantities sold. Ticket and programme sales are examples of variable income.

Variable expenses

- Expenditure that fluctuates in direct proportion to the activity of the business or the volumes or quantities produced or sold. An example is the royalties payable to the playwright that are calculated as a percentage of the ticket sales.

Working capital

- This is the amount of net assets that the business has available after covering the current monetary obligations of the entity. For an arts organisation, working capital is useful to purchase equipment and to enable the business to pay its liabilities on time without the need to borrow.