Sport Management

Principles and Applications

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CHAPTER 10

Financial management in sport

OVERVIEW

This chapter introduces readers to the financial management function in sport organizations. Through the use of critical incidents and illustrative cases, a number of core accounting principles will be discussed. Special attention will be given to the budgeting process and the analysis of balance sheets, profit and loss statements, and cash flow statements, together with the key principles of sound financial management. Throughout the chapter reference will made to a range of accounting terms and financial management concepts. The overall aim is to have readers build a broad accounting vocabulary that will give them a basic level of financial literacy, which can,

in turn, be used to better understand the administrative processes required to build a sport organization's financial viability.

After completing this chapter the reader should be able to:

- Explain how sport has changed over the last 50 years and what that means for the effective financial management of sport organizations;
- Understand the importance of professional financial management in sport;
- Identify the ways in which the financial operations of sport organization can be best reported;
- Explain how assets are organized and how they differ from liabilities;
- Explain how profits and/or surpluses are calculated for sport organizations and the difference between operating profit and net profit;
- Understand the importance of cash and the use of cash flow statements to ensure ongoing liquidity;
- Explain how budgets operate and explain why they are crucial to effective financial management of sport organizations; and
- Diagnose the financial health of a sport organization.

THE FINANCIAL EVOLUTION OF SPORT

As previous chapters have demonstrated, sport is now a sophisticated institution with an often complex legal and financial structure. It is, in many respects, a fusion of business and entertainment where the consumers are the fans and the players; the producers are the clubs, associations, and leagues; and the distribution channels are the sport arenas and sport stadia (Carter 2011; Foster, Greyser and Walsh 2006; Gomes, Kase and Urruria 2010; Quinn 2009; Shropshire and Davis 2008; Smit 2007. Like all forms of business, sport organizations require a strong system of financial management to ensure their long-term sustainability. However, this has not always been the case, and sport around the world has gone through four phases of commercial and financial development over the last 50 years.

This metamorphosis of sport into a form of business, with its associated financial systems, begins in Phase 1 with sport as a recreational and cultural practice where sport organizations are rudimentary, their revenue streams are small, sport is played mainly for fun, and activities are organized and managed by volunteer officials. This model is often described as a kitchen-table approach to sport management, because the game is administered by a few officials making key decisions from a member's home. It has some strengths because it not only ensures the involvement of grassroots players and members and provides a strong local community club focus, but it also nurtures a strong set of values that centre on playing the game for its own sake and the concomitant ideal of amateurism. At the same time, it perpetuates a simple system of management driven by an administrative committee made up of a few elected members and self-appointed officials.

There is the president who is the public face of the club or association and a secretary who keeps things ticking over by maintaining a member register and organizing others to manage teams, run events, and maintain the clubrooms and playing facilities. There is also a treasurer who looks after the financial affairs of the organization. The treasurer is more often than not unfamiliar with the theory and principles of accounting, but makes up for a lack of expertise with a mind for detail and a desire to ensure receipts run ahead of expenses.

The second phase is commercialization, where more revenue streams are utilized and both staff and players are paid for their services. Whereas the kitchen-table model depends on member subscriptions, player registration fees, and social activities for their financial viability, the commercialized sport model uses sport's commercial value to attract corporate and other sponsors. In this phase, sports that have the capacity to draw large crowds increasingly understand that these crowds can be used to attract businesses who want to increase product awareness, secure a special and exclusive sales channel, or obtain access to a market segment that will be receptive to their product. Sport is still a recreational and cultural practice, where the sport's overall development is the primary goal, but there is also an emerging or secondary strategy that focuses on elite development and the building of pathways by which players can move to the premier league or competition.

The third phase is bureaucratization, where the structures of sport organizations become more complex, administrative controls are established, and functional specialization increases. This phase is heavily dependent upon its antecedent phase, because an effective bureaucracy requires additional resources. In this phase, club, league, and association structures are transformed so as to include a board of directors whose prime responsibility is to set the strategic direction and ensure compliance with government regulation. This, then, establishes an organizational divide between the 'steerers' (the board) and the 'rowers' (the chief executive officer and operational staff) who are expected to implement the board's plans and policies. In addition, a business-like set of functions and processes are created, which are built around administrative support, marketing, finance, game development, coaching player development, and the like. In this phase less management space is given to the sport-as-recreation-and-cultural-practice model and more to the sport-as-business model.

The fourth and final phase is corporatization, where sport embraces the business model by valuing brand management as much as it does player and fan relations. Revenue streams are increasingly dominated by sponsorships and broadcast rights fees, merchandise sales are deepened, and managers adopt a more professional outlook where the need to secure a competitive edge overrules the desire to hold on to old traditions. This is the phase in which players become full-time employees, player associations are established to protect their interests, and the sport's governing bodies take on the role of employers. A formal industrial relations system is created that leads to detailed contractual arrangements, collective bargaining agreements, and codes of conduct. The marketing process also becomes increasingly sophisticated as the sport club, association, or league becomes a brand; members and fans become customers; sponsors become corporate partners; and the brand name and image are used to strengthen corporate partner arrangements and build up a merchandising arm.

This phase also features a move toward managerialism, whereby sport becomes more accountable to its stakeholders for its performance and use of resources. This is particularly evident in sport's relationship with government, where government funding becomes increasingly contingent upon sport meeting certain specific and agreed upon outcomes. This focus on managerialism also leads to greater transparency through an emphasis in performance measurement. Under this framework it is no longer appropriate to only measure player performance, but also things like internal processes and efficiency, financial performance, market performance, employer, and in particular player behaviour, and even social responsibility.

These forces make sport more complex to operate, and as a result sport organizations become generally more regulated. In some instances the regulations are initiated by government-framed legislation. Government controls include venue safety rules, anti-discrimination programs, and crowd-control policies. In other instances the regulations are internally imposed. Internal regulation is highly visible within professional sport leagues and competitions, where player recruitment is governed by drafting rules, player behaviour is constrained by a combination of collective agreements and codes of conduct, salaries are set within a total wage ceiling, revenues are redistributed from the most wealthy to the most needy clubs and associations, and games are scheduled to ensure the lowest cost and greatest revenue. Although this type of corporate regulation can be problematic because of its heavy emphasis on bureaucratic control and detailed performance measurement, it also ensures a disciplined system of management by creating a common purpose, setting a clear strategic direction, and securing strong leadership (Beech and Chadwick 2013; Stewart 2007a). A summary of each phase in the sport-as-business evolution is provided in Table 10.1.

TABLE 10.1 Sport as business: evolutionary phases and features

	Values	*Revenue focus*	*Structural focus*	*Management focus*
STAGE 1 Kitchen table	Amateurism Volunteerism	Member funds Social club income	Management Committee	Sustaining operations
STAGE 2 Commercial	Viability of sport Member service	Gate receipts Sponsorship	Management portfolios	Marketing the club
STAGE 3 Bureaucratic	Efficient use of sport resources Accountability	Corporate income Merchandising	Divisions and departments	Improving club efficiency
STAGE 4 Corporate	Delivering outputs Building the brand	Brand value Broadcast rights	Board policymaking Staff operations	Increasing club value Regulating constituents

FUNDING SOURCES FOR SPORT

It is clear that the new business-based, corporate model of sport involves a significant expansion of income. However, it is important to not throw the baby out with the bath water, and so traditional forms of revenue have been maintained, although in a slightly more sophisticated form. Member fees are still important, as are fundraising from social activities and gate receipts. However, as was touched upon previously, new and varied revenue streams have opened up over the last 30 years which have transformed sport and the way it operates (Foster Greyser and Walsh 2006; Szymanski and Kuypers 2000). The funding of sport organizations begs a number of questions, the main ones being listed here.

1 Where does the money come from?
2 Where is the money spent?
3 How are the movements of money monitored?

In answering these questions it is important to distinguish between funds that are used to create infrastructure and facilities, and funds for use in managing the day-to-day activities of a sport organization. So, there are two types of basic funding uses. The first is funds for investment in capital development, and the second is funds for recurrent and operating activities.

Capital funding

Capital funding, which is money to finance investment in assets, can come from a number of sources listed here.

1 Government grants which may be federal, state, or local. The point to note is that there are differences between sports which reflect not only their scale of operation but also their likelihood of generating international success. Funding may also be subject to certain conditions being met, such as adopting certain policy requirements or working within a legislative framework.
2 Loans and borrowing which could be short term (up to a year) or long term (up to 20 years). Loans and borrowings are known as debt finance. The points to note are that it provides ready cash for investment in facilities and income producing assets. On the other hand, it also incurs an interest burden and may not always generate an increase in income.
3 New share issue or a public float which is known as equity finance. The points to note are that, like borrowing, it provides ready access to cash, but, unlike borrowing, does not impose the burden of interest payment or repayment of the principle to lenders. However it does hand over control to shareholders, and there is expectation that a dividend will be delivered.
4 Retained earnings, which is money re-invested in the sport organization. The points to note are there is no interest payment and control is retained over funds used. For

nonprofit sport organizations, the retention of earnings is mandatory, because this is a legal requirement.

Recurrent funding

The recurrent funding of sport involves money to fund day-to-day operations, which comes from a variety of sources depending on the type of sport enterprise. The main revenue sources are briefly noted here, together with the strengths and weaknesses of each source:

1 Membership fees which may be full adult, associate, family, and similar categories. The points to note here are that they are usually upfront and relatively stable and therefore provide an immediate source of cash. Membership also serves a marketing function by establishing a core customer base.
2 Spectator admission charge which includes the categories of full adult, family, special groups, and premium. The points to note are that although there is a high degree of flexibility, it is subject to significant variation because of changing attendance patterns and differences in the scheduling of games.
3 Corporate facilities including boxes and hospitality. The points to note are that a large investment is required, but the strengths are that business connections are made and premium rental fees can be charged.
4 Player fees and charges include entry fees, facility charge, and equipment hire. The points to note here are that revenue is dependent on demand, and the user pays for the experience.
5 Special fundraising efforts are another source of recurrent funding and may include a dinner dance, rage-party, auction night, a trivia night, and so on. The points to note are that the burden is on staff and members to arrange and attend functions. However, these types of events can be profitable through large markups on food and drink.
6 Lotteries and gaming such as raffles, bingo, and gaming machines. The points to note are that permits are often required, margins are low, and there is solid competition from other venues.
7 Merchandising such as memorabilia, scarves, T-shirts, jackets, and autographed equipment. The point to note is that although it can produce is a significant short-run increase in revenue, it can also plateau out with a fall in on-field success.
8 Sponsorships and endorsement are another good source and may include naming rights, partnerships, signage, product endorsements, and contract deals. However, the points to note are that the organization can lose control and become dependent on sponsor income and defer to their partnership demands.
9 Catering may include take-away or sit-down food or drink. The point to note is that it is labor intensive, but because it is delivered in a non-competitive environment, higher profit margins can be sustained.
10 Broadcasting rights such as television and radio, and more recently Internet and mobile phone streaming rights. The points to note are that it focuses on elite sports with a large

audience base and may be irrelevant for most community-based sports associations and clubs. At the same time it provides the single largest revenue source for professional sport leagues.

11 Investment income such as interest earned and shared dividends. However the points to note are that share prices can vary at short notice, and losses can be made which increases the level of risk. In addition, interest rates may be low.

12 Government grants, which may be federal, state, or local. The points to note are that there are often marked differences between sports, they can vary from year to year, and like government capital funds, are subject to contain conditions being met.

The expenses incurred in running a sport enterprise are also varied. They include:

1 Wages and salaries such as permanent, contract, or casual administration staff and players. The points to note are that it is usually the largest expense item and is subject to inflation and competitive bidding as clubs aim to secure the best playing talent.

2 Staff on-costs, which include insurance, training, leave, and superannuation. The points to note here are that they are legally required, ongoing, and linked to the employment contract.

3 Marketing costs, which include advertising, sales promotion, site visits, trade displays, and give-aways. The point to note here is that it is easy to exceed budget estimates because there is always a tacit assumption that too much marketing and promotion is never enough.

4 Office maintenance includes power and light, phone and fax, postage and stationery, and printing. The points to note here are that it is ongoing and tight control is required.

5 Venue maintenance includes the playing area, the viewing area, and member facilities. The point to note here is that maintenance expenditure is ongoing and frequently absorbs a significant amount of revenue.

6 Player management includes equipment, clothing and footwear, medical services, fitness and conditioning, and travel. The points to note are that although they constitute an essential investment in improved performance, they also require tight budgeting.

7 Asset depreciation includes facilities, buildings, cars, and equipment. The point to note here is that assets lose value and must be replaced. Also, depreciation is a non-cash expense, and it is essential that assets be amortized as expenses over their lifetime.

KEY FINANCIAL MANAGEMENT QUESTIONS TO ASK

At the same time, it is important to note that although significant segments of sport are now big businesses, most sport organizations are relatively small and depend on the support of club members, volunteer officials, community businesses, and local government to sustain their operations. Whereas high-profile professional sport leagues turn over hundreds of millions of dollars a year, the majority of sport clubs and associations are lucky to secure any more than a million dollars to fund their operations

(Dolles and Soderman 2013; Quinn 2009). A majority of sport is really a form of small business. A suburban supermarket turns over more money than most sport clubs and associations.

However, no matter what the scale or size of sport organizations, they all need to be managed in a sound and responsible manner (Shibli and Wilson 2012). Many sport administrators do not feel comfortable handling money or planning the financial affairs of clubs and associations, which often arises out of poor background knowledge and a lack of experience in managing complex financial issues. In practice, there are many straightforward, but essential financial questions that sport managers need to answer. They include:

1. What do we own?
2. What do we owe?
3. What did we earn?
4. What did we spend?
5. Did we make a profit?
6. Do we have enough cash to pay debts when they fall due?
7. How big is our interest bill?
8. Are we borrowing too much?
9. Did we improve upon last year?
10. How do we compare with other similar sport organizations?

UNDERSTANDING FINANCIAL INFORMATION

There is also the problem of making sense of the vocabulary of accounting. The distinction between assets and liabilities is mostly clear, with assets amounting to all those things we own and liabilities being all those things we owe to others. However, the distinction between tangible and intangible assets and current and non-current liabilities may often be less clear. The concepts of owner's equity, shareholder's funds, and net worth can also cause confusion, and further difficulties can arise when contrasting operating profit with net profit.

Consequently the effective management of any sport organization requires not only a sound knowledge of the principles of financial management, but also the support of a financial recording and reporting system that allows a quick and easy reading of the club's or association's financial health (Hart 2006; McCarthy 2007). It is now taken for granted that a professionally managed sport organization will produce three integrated annual financial reports. The first document is a statement of performance, or profit and loss, which reports on the revenues earned for the period and the expenses incurred. The second document is a statement of position, or balance sheet, which reports on the current level of assets, liabilities, and equity. The third document is a statement of cash flows, which identifies the cash movements in and out of the organization. The cash flow statement is divided into activities related to day-to-day operations, activities that involve the

sale and purchase of assets, and activities that involve the securing and borrowing of funds and their repayment. The balance sheet, profit and loss statement, and cash flow statement are discussed in more detail next.

THE BALANCE SHEET

The balance sheet measures the wealth of a sport organization. Assets are placed on the left-hand side of the balance sheet, and liabilities are placed on the right-hand side. Proprietorship (also termed owner's equity, net worth, or accumulated funds) is located on the right-hand side and represents the difference between assets and liabilities. The balance sheet gives a clear picture of a sport organization's wealth at a point in time by contrasting its assets (things it owns) with its liabilities (things it owes). The balance sheet also indicates how the assets of the organization have been funded. It can be through equity (i.e. the capital of the owner/s) or from borrowed funds from some other organization or individual.

It is important to note that not all assets are the same. They can be broken down into a number of categories (Hoggett, Edwards and Medlin 2006) as can liabilities. As a result a balanced sheet will be set up to provide a clear picture of the level of both current and non-current assets and current and non-current liabilities. The level of owner's equity or shareholders' capital (or accumulated funds as it is usually called in nonprofit organization statements) will also be identified in the balance sheet because it is effectively the difference between the two. This is because assets can be accumulated through either the owner's capital, reinvested profits, or borrowed funds.

Assets

As noted earlier, assets are all those things owned by an organization. To put it more technically, they constitute resources owned and controlled by an entity from which future benefits are expected to flow. The assets of a balance sheet are not only broken down into their various categories, but they are also listed according to their degree of liquidity, with the most liquid coming first and the less liquid coming later in the statement. The measure of an asset's liquidity is the ease with which it can be converted to cash, and all those assets which can easily converted are listed under the current assets heading. The most frequently cited currents assets are cash in bank, accounts payable or debtors (which include those short-term invoices or bills for payment has not yet been received), investments in the share market (which can be converted to cash through quick sale), and stocks of material and merchandise (which at a pinch can be sold for cash). Items like prepaid expenses (that is, bills paid in advance) can also be included here. The level of current assets is an important indicator of the financial health of a sport organization because it is the means by which bills are paid and creditors' demands for payment are met.

Assets are also listed as fixed or non-current. These assets include everything that cannot be easily and quickly converted to cash. Some stock and materials will be listed here when they do not have high turnover. The main items will be all those tangible or material

TABLE 10.2 Balance sheet: asset categories

Asset category	*Degree of liquidity*	*Example*
Cash in bank	High (current)	Trading account balance
Accounts receivable	Medium (current)	Monies owed by club members
Prepaid expense	Medium (non-current)	Payment of next year's insurance
Company shares	Medium (current)	Ownership of shares
Inventory	Medium (current)	Stock of sports equipment
Office equipment	Low (non-current)	Computer system
Other equipment	Low (non-current)	Office furniture
Motor vehicle	Low (non-current)	Ownership of vehicle
Property	Low (non-current)	Ownership of office building
Building improvements	Low (non-current)	Stadium renewal

assets that are essential for generating revenue, but are difficult to sell at an appropriate price in the short term. These items include office furniture and equipment (including all sorts of sports equipment), motor vehicles, buildings, and land. Building improvements (e.g. a stadium upgrade) are also examples of fixed assets. The main categories of assets are listed in Table 10.2.

The balance sheet of a sporting organization can be complicated by a number of other factors. For example, assets can either increase in value over time (i.e. appreciate) or decrease in value over time (i.e. depreciate). Property, stocks and shares, and various scarce artefacts and memorabilia are particularly prone to increase in value. On the other hand, there are other assets that can lose value quickly, and includes those things that incur constant use and wear and tear, or become obsolete, or both. Moreover, there are assets that, although not tangible, clearly add value to the organization and should be accounted for. Accountants have recognized these financial facts of life for many years and have consequently devised strategies for managing these phenomena (Atrill, McLaney, Harvey and Jenner 2006).

Depreciation

Depreciation is based on the principle that all non-current assets represent a store of service potential that the organization intends to use over the life of the asset. Assets therefore have a limited life as a result of their ongoing wear and tear and probable obsolescence. Accounting for depreciation is the process whereby the decline in the service potential of an asset, such as a motor vehicle, is progressively brought to account as a

periodic charge against revenue. That is, the asset is devalued in response to its purchase price or market value and offset against income. In order to allocate the cost of the asset to the period in which it is used, an estimate must be made of the asset's useful life. This will usually be less than its physical life. For example, in the case of a motor vehicle, it may be decided that after three years it will not be operating as efficiently and therefore will be worth less after this period, even though it is still running. If an asset has a residual, or resale value, then this amount will be subtracted from the asset cost to establish the actual amount to be depreciated.

The simplest method for depreciating an asset is the straight line or prime cost method. This method allocates an equal amount of depreciation to each full accounting period in the asset's useful life. The amount of depreciation for each period is determined by dividing the cost of the asset minus its residual value by the number of periods in the asset's useful life. Take, for example, a computer system that was purchased for $11,000. It is anticipated that the system will have a resale value of $1,000 after five years. Using the straight line method of depreciation the annual depreciation will be $2,000. This figure is obtained by dividing the difference between the purchase price and the residual value ($10,000) by the five years of anticipated useful life. This annual depreciation will then be posted as an expense in the profit and loss statement for the following five years. This process of spreading the cost of an asset over a specific period of time is called amortization. The idea behind this process is that there needs to be a clear way of showing the relationship between spread of benefits from an asset's use and the costs involved in creating those benefits.

Asset valuation

Asset values can also change to reflect current conditions and prices. Unless otherwise stated, assets are valued at their purchase price, which is known as historical cost. However, many assets, particularly land and buildings, can increase in value over time. Unless this is periodically done, the true values of assets can be seriously understated. This problem can be overcome by a revaluation of the assets by a certified valuer, with a note to this effect accompanying the annual statement of financial operations and standing.

In practice 10.1 Sport stadia asset management: the case of the Melbourne Cricket Club

Around the world there are many sport stadia that have made a strategic decision to completely re-furbish and re-design their facilities. Of course, we all know that this type of 'grand plan' comes at a cost. We also understand that the stadia owners and managers will be most often required to secure funds from external sources to make it all happen.

Take, for example, the internationally famous and iconic Melbourne Cricket Ground (MCG) and its occupant, the Melbourne Cricket Club (MCC). In 2002 it

decided to demolish its ageing stand and start again by putting up 'state of the art' facilities. But to make all this happen it had to borrow a significant amount of money. In fact, its borrowings totalled well over $300 million. In 2006, and just in time for the Commonwealth Games, it had spent all its borrowed money, but what it got in return was a scintillating bundle of world-class facilities. But, as we all know, when you borrow money, you not only have to pay back the full amount you borrowed – which is commonly called the 'principal', but you also have to pay an annual interest charge. If we assume the annual interest charge is around 8%, then in the first few years the total interest bill will be something in the order of $20 to 24 million. This represents a serious drain on one's cash deposits.

This heavy repayment burden immediately raises the question as to just what benefits are going to accrue from this very big investment and when it might be clear that the decision to borrow all this money was, in fact, a good one. And there is a risk that the repayment burden may be so severe that the ability to repay may be impossible.

But the MCC/MCG has a strong cushion against any cash flow problems. It is its 'membership'. It has many thousands of members and is able to maintain a 20-year waiting list with virtually no promotional or marketing effort whatsoever. Moreover, it is Australia's premier sport stadium and has no difficulty securing tenants, the main ones being the Australian Football League and the Cricket Australia. And, to top it off, it regularly attracts 50,000 to 80,000 spectators to games. These strong attendance figures consequently enable it to (1) negotiate big catering and hospitality contracts, (2) hire out expensive corporate suits with no difficulty, and, finally, (3) secure big-brand advertisers to place signage around the ground.

The financial 'moral' to this story is short and sharp. It is that investing in expensive assets is a sound thing to do, but only if you are sure the assets can deliver the best-quality services. If this occurs, then you can be confident that that these services will generate sufficient additional revenue so that not only will all loans and interest bills be paid off, but that there will be a handsome surplus with which to undertake even further investments. If, on the other hand, the newly created assets are unable to deliver these benefits, the future will look very uncertain indeed. In the case of the MCC/MCG, it took a calculated risk and reaped the rewards. Although in 2017, it still owed AUD$177 million to banks and other financial institutions, its revenue of AUD$149 million was more than enough to cover its interest and loan repayments, while also covering all its operational spending. And, its net worth – the difference between total assets and total liabilities – continued to grow, and at last count was AUD$298 million. There is now talk that the MCC will undertake a further infrastructure upgrade that will future-proof the stadium for the 2020s and beyond.

Liabilities

Simply put, liabilities are those things that an organization owes others. To be more exact, they are the present obligations of an entity which, when settled, involve the outflow of economic resources (Hoggett, Edwards and Medlin 2006). Like

assets, liabilities can be categorized into current and non-current. Current liabilities included monies that are owed to people in the immediate future for services and goods they have supplied. For example, a club may have purchased some sporting equipment on credit for which payment is due in 30 to 60 days. This is called accounts payable or debtors. Other current liabilities include short-term borrowings, member income received in advance, and taxes payable in the short term. Income received in advance is an interesting case because it is often intuitively viewed as revenue or asset and not a liability. However, under the accrual accounting model it is clearly not relevant to the current flows of revenue and expenses. But as monies received it has to be accounted for. So, what happens is that it is debited to cash in bank and credited as something we owe to members in the future. That is, it is a liability which is listed as income received in advance. Non-current liabilities include long-term borrowings, mortgage loans, deferred tax liabilities, and long-term provisions for employees like superannuation entitlements.

The accumulation of liabilities is not of itself a problem, so long as the debt is used to build income earning assets. However, if increasing debt is associated with losses rather than profits, then the gap between assets and liabilities will increase. It is not uncommon in sport for clubs to have liabilities that exceed the value of their assets. Hundreds of football clubs in Europe make losses, and a sizeable proportion of these loss-making clubs have more liabilities than assets. This situation is replicated in Australia where the net worth of some clubs in rugby and Australian-rules football is negative (that is, they have more liabilities than assets). In the long run, these trends are unsustainable.

Balance sheets can say a lot about a sport organization's financial health. However, balance sheets do not tell us much about a sport club's earnings, profits, and losses over the course of a month, quarter, or year. For this information we must turn to the profit and loss statement, or as it is often called in the nonprofit sector of sport, the income statement.

PROFIT AND LOSS STATEMENTS

It is not just a matter of examining a sport organization's assets and liabilities at a point in time in order to diagnose its financial health, it is also crucial to shift one's attention to the financial operation of sport clubs and associations over time (Atrill, McLaney, Harvey and Jenner 2006). The first thing to be said about the profit and loss statement is that it can go under a number of names. It can also be called an income statement, which is the nonprofit sector terminology, and is also referred to as a financial statement of performance. The point to remember about most sport organizations is that they do not focus on profits and losses, but rather surpluses and deficits (Anthony and Young 2003). In any case, it does not alter the fact that these statements looks at the revenue earned during a period (say 3 or 12 months) and compare it with the expenses incurred in generating the revenue. Profit

and loss statements are straightforward to compile and moderately easy to understand, but there are some tricky areas that need to be discussed.

The first point to make is that although profit and loss statements contain many cash movements, they do accurately represent the total cash movements in and out of the organization, because they are essentially about earned income and incurred expenses. As a result they will include many transactions that do not include the movement of cash. In other words, revenue can be earned, whereas the cash may come much later. But it is still a revenue item that needs to be identified in the profit and loss statement. For example, a sport consulting business may have completed a strategic planning exercise for a large national sport association and invoiced it for $50,000. If, at the end of the accounting period, the invoice has not been paid, it will still be included in the profit and loss statement as income. The adjustment or offset in the accounts will be an equivalent (i.e. $50,000) increase (or debit) in the accounts receivable asset account. If the invoice had been immediately paid, the adjustment would have been made as an increase (or debit) of $50,000 to the cash in bank asset account.

Revenue, or income as it is frequently called, is typically divided into operating and non-operating items. Operating items include all those revenues like member income and merchandise sales that provide the funds to support the day-to-day running of the club or association. Non-operating items include funds that are irregular, or even out of the ordinary. An asset sale, a special government grant or a large donation are examples of non-operating income. As noted in the early part of this chapter, sport organization revenues have expanded dramatically over recent years, but for the non-professional clubs the main sources are member fees, gate receipts, government grants, fundraising activities, and sponsors.

Expenses should also be treated cautiously. The profit and loss statement should include all incurred expenses rather than just paid expenses. Buying something on credit or by cash is an expense. On the other hand, paying for something that will not be used until next year, for example, should not be listed as an expense or the period under consideration. It is an asset (i.e. a prepaid expense). For example, rental or insurance paid in advance involves a movement of cash out of the club or association, but does not constitute an expense incurred for the current period.

Depreciation

Depreciation is another expense issue that has to be dealt with. And, to repeat, depreciation is an estimate of the wear and tear of working assets. In an office setting, computers are quickly depreciated for two reasons. First, they are heavily used, and second, they quickly become out of date and obsolete. Depreciation is therefore recognized as an expense and should be included in a profit and loss statement. Depreciation can be calculated in a number of ways, the most simple being the straight-line method. If, for example, a motor vehicle is purchased for $30,000 has an estimated life of five years and no residual value, then the depreciation expense for the following five years will be $6,000 per annum. Some sporting club finance mangers make the mistake of listing the full cost of the motor vehicle in year 1 as an expense, but this is clearly misleading. The correct

way to treat this transaction is to list it as an asset and then depreciate (i.e. amortize) it over its estimated lifetime. Interest paid and interest earned also appear on profit and loss statements. Interest paid will be classified as an expense, whereas interest received will be classified as revenue.

Operating versus net profits

When analyzing profit and loss statements it is also important to distinguish between operating profit (or surplus) and net profit (or surplus). The differences between these two terms comprise abnormal revenue and expenses, and extraordinary revenue and expenses. A transaction will be classified as abnormal if it is a regular occurrence, but in a specific case is significantly higher than normal. In the case of a sporting club an abnormal item might be an accelerated depreciation of office equipment, or a supplementary government grant. A transaction will be classified as extraordinary if it is a significant transaction and

TABLE 10.3 Profit and loss statement template

Item	*Amount ($)*	*Total ($)*
Operating income		
Member fees	50,000	
Events	10,000	
Grants	30,000	
Total operating income		90,000
Operating expenses		
Administration	50,000	
Events	20,000	
Insurance	10,000	
Total operating expenses		80,000
Operating profit		10,000
Non-operating income		
Special government grant	10,000	
Non-operating expenses		
Depreciation	20,000	
Net profit		0

does not regularly occur. A sporting club example includes fines for breaching salary cap regulations (this happens frequently in the Australian Football League and the National Rugby League) or the sale of an asset (this occurs in the English Premier League where players can be traded under certain conditions).

Operating profit does not include the abnormal and extraordinary items, and is confined to those transactions that are directly related to day-to-day activities that regularly recur over the standard accounting cycle. So, operating profit is the difference between operating income and operating expenses. Net profit is something else again, and will take into account all abnormal and extraordinary items. If the sport club happens to be part of profit making entity, then it may be required to pay tax on its profits. This item will be subtracted from operating profit to get to a net profit figure.

Depreciation is also frequently listed as a non-operating item and can also make a significant difference to the level of profit. An operating profit can be transformed into a net loss by the inclusion of depreciation as a non-operating expense. Sometimes claims are made that depreciation can distort the real profit of a sport organization, but in fact the opposite is the case. Depreciation is a legitimate expense since it takes into account that amount of assets used up to generate revenue. In the context of this discussion, a typical profit and loss or income statement is illustrated in Table 10.3.

In practice 10.2 Australian National Football/Soccer League

A re-vamped Australian National Football/Soccer League, otherwise known as the A-league, was established in 2005 under the auspices of the national governing body, Football Federation Australia (FFA). It was built on the foundation of a national league fraught with financial mismanagement and deep ethnic rivalries. The aim of the A-league was to deliver a high-level professional competition that represented all the major urban areas of the nation, while discarding all ethnic influences on club identities. With this principle in mind, the following eight teams were founded: Adelaide United, Central Coast Mariners, Melbourne Victory, Newcastle Jets, New Zealand Knights, Perth Glory, Queensland Roar, and Sydney FC. Each club was given a five-year exclusivity deal in its own market as part of the league's 'one-city, one-team' policy. This was intended to allow clubs to develop an identity in their respective region without the impediment of local competition. However, despite this protection, some clubs floundered, and over the following 10-year period, Wellington Phoenix replaced New Zealand Knights, Gold Coast United and North Queensland Fury both joined the league and departed from it, Melbourne Hearts (which became Melbourne City) joined up, as did the Western Sydney Wanderers. All of these clubs were privately owned, which suggested that they were, in the long haul, keen to deliver a small profit at least, for the owners.

At one level, the A-League was very successful. Crowds increased, the league secured a lot of media attention – most of it positive – and the standard of play increased exponentially. Even Red Bull, the international energy drink business, was thinking of investing in a team. But the league was still unable to collectively balance its

books, so to speak. Some clubs folded, and others – and in particular, Central Coast Mariners (situated about 50 kilometres north of Sydney) – were regularly running operating losses. In one instance the Mariners did not have enough ready cash to pay their players. It was estimated that, overall, the clubs' private owners lost more than $200 million combined – an astronomical amount. And all of the club losses occurred despite the support of the giant media conglomerate, News Corp. News Corp, which owns the monopoly pay-TV business Fox Sports, recently signed a broadcast rights agreement with FFA that delivered the game $58 million a year for six years.

So, how can a sports league like the A-league perform poorly from a financial perspective when it appears to be so popular and so well organized? It can only be explained by the failure of clubs to properly manage their spending and not have it exceed their revenue earning capability. The problems of the A-league were the result of not adhering to a basic financial management principle: do not spend beyond your income.

CASH FLOW

We can now move on to the cash flow statement. It should be apparent that profit and loss statements do not give a clear picture of the movement of cash in and out of a sporting club or association. Cash flow statements aim to fill this gap by listing all movements of cash under three main headings. These headings are operating activities, investing activities, and financing activities. The aim here is to get a picture of the net inflow and outflow of cash and the extent to which a club or association is able to meet its cash payment obligations. This is an important issue, because without sufficient cash to pay bills when they fall due, there is the lingering possibility that creditors will take legal action to ensure payment. This may result in insolvency and bankruptcy.

The transactions that are included in the operating activity section include all those day-to day activities that are required to keep the organization running. They include wages and salaries (cash out) and payment for supplies (cash out), on the one hand, and membership income (cash in) and government grants (cash in), on the other. Good financial management will aim to ensure that the cash coming from operating activities will exceed the cash going out, although a short-term net cash outflow may not be all that serious.

Investing activity transactions include all those things that involve the purchase and sale of assets. The sale of assets will be associated with cash inflow, whereas the purchase of assets will produce an outflow of cash. The purchase and sale of office equipment and property of various sorts will fall under the investing heading, and so too will the purchase and sale of stocks, shares, and debentures. Although the sale of assets can generate a quick supply of cash, it will also deplete the organization of income earning resources, so a balance needs to be struck to ensure that crucial assets are not depleted. On the other hand, the purchase of assets immediately absorbs cash, and it is therefore important to monitor the amount of cash being used for this purpose.

Financing activities involve all those things that involve the procurement of equity and borrowing of funds, on one hand, and the withdrawal of funds and repayment of borrowings, on the other. An increase in cash holding can come from loans, bonds, mortgages, debentures, and other borrowings, whereas a fall in cash holding will come from the repayment of loans and the redemption of debentures.

A cash flow statement provides a clear and concise picture of how cash is used internally and where it goes externally. It also signals the level of liquidity and the ease with which cash payments are supported by cash reserves. A chronic net cash outflow on operating activities is cause for concern, because it is likely to lead to asset sales or borrowings being used to finance the cash deficit. And, as was noted previously, this can lead to a fall in club or association net worth, and threaten its long-term viability.

BUDGETING SYSTEMS

Budgeting is a crucial part of the financial management process (Hoggett, Edwards and Medlin, 2006; Wicker, Breuer and Pawlowski 2010). It is one thing to construct some simple accounts and diagnose the financial health of sport clubs, associations, and leagues. It is another thing to make sure resources are available for allocation to the various parts of their operations. No matter how wealthy a sport organization is, its resource base will always be limited, and decisions have to be made as not only where the resources are allocated (facility maintenance, player salaries, coaching staff, equipment upgrade), but also how much each operational activity will receive. Moreover budgets are finite, and the constraining factor will always be the amount of available funds.

Budgets are really financial plans that involve the allocation of funds to strategically important operations and activities. Budgets are essential for ensuring costs and expenses are contained and do not exceed the planned revenue. Good budgets act as a constraint on spending and also provide a clear picture of the anticipated sources of revenue. Budgets came in different shapes and forms, but they all share the desire to control spending patterns and make sure the spending is grounded in an appropriate level of funding and financial backing.

Benefits of budgeting

A good system of budgeting is crucially important for sport clubs and associations. As already noted, the sport world has become increasingly complex, and the need to manage money effectively is stronger than ever. In addition a well-planned budget is the basis for efficient management and ensuring viability over the long term. The benefits of budgeting are many. They can:

1 help anticipate the future and thereby assist the strategic planning process;
2 give a clear picture of resource needs and program priorities;
3 signal where there may be revenue shortfalls;
4 allow management to better manage and monitor spending;