State of the American Orchid Society
April 25, 2009
Houston, Texas

No one has to be reminded how the world wide economy has affected all of our lives. Everywhere you look you see signs of the tremendous challenges we are faced with to make ends meet. Your Society is no different. The past year and a half have challenged the Society to look for ways to pursue change along two parallel tracks: a financial turnaround to help ensure that our financial viability is intact and a strategic realignment to create a plan that will guide us as we move forward. Over the course of the past two decades, we have been operating on a budget to budget basis relying on our reserves to make up for any operating losses. For too long, we operated like a benevolent flower club rather than the nonprofit business that we are. For example, we operated with an outdated database and information technology infrastructure that saw very little improvement in customer relationship management over the years. We had inadequate policies and procedures that hampered our ability to deliver maximum value to our Members and skewed resource allocation. We had a staff that was very dedicated but did not match association needs. The cumulative result of these approaches, as well as a larger than expected operating loss for the year ending 2008, has seen our reserves continue to shrink. This coupled with declining donations, fewer Members, and our investment results has put the Society into a perilous position.

In order to address many of the concerns that we have been asked about over the course of the past year, we thought it would be helpful to explain where we currently are, how we got there, and what our plans are for righting the ship. As you can see by our balance sheet, our net assets have eroded to the point where we currently have no unrestricted assets to draw upon, and in fact, we have already had to access restricted assets to meet our short term liquidity needs. The question that needs to be asked is how did this happen. Essentially, we can point to four major reasons that we would like to explain in a little more detail:

1. Loss of Membership
2. Delayed implementation of our new management information system
3. Economic downturn
4. Lack of a successful development campaign

Loss of Membership

As you can see from the graph and the schedule in addendum II, our membership numbers continue to decline. Six years ago, we had membership numbers exceeding 26,000 members. Since then, we have seen a steady decline in Members to the point where today we have approximately 16,282 members. Now many will point to the dues increase back in 2005 as the reason for the decline, but we feel that this is only part of the answer. For example, the demographics of our membership are getting older and the internet is providing a lot of orchid information in lieu of hobbyists joining. In addition, we have been relatively successful in attracting new Members only to see them drop out after the first year or two. To achieve growth and maintain a membership program, we need to look at all we are doing to add value to what we offer. We need a plan that will give us a step by step roadmap with measurable objectives to achieve success. We can't simply go about offering a free book or $10 off and expect to be successful. We need to fully understand what hobbyists are looking for and plan accordingly.

Management Information System

Perhaps the biggest single contributor to our 2007/2008 operating loss was the challenge we had in getting our new management information software up and running in a timely fashion. By way of background, management identified that one of the biggest challenges to our organization was the lack of a single integrated management information system. We had as many as 17 separate and distinct databases that did not feed into our financial system. Management suggested that we put together a request for proposal (RFP) and identified five companies that were able to meet the RFP. We eventually approved Advanced Solutions International as our provider of choice with an initial bid estimated at $250,000. The package included the base membership package with a fund raising and events module, financials, marketing, and our new website. It also included an estimate of 502 hours to complete the data conversion and implement the system. One of the reasons that Advanced Solutions International was chosen was their reputation in the nonprofit industry. ASI has over 3000 customers worldwide and is recognized as the largest privately held provider of association management software. Their customers include the National Association of Broadcasters, the National Kidney Foundation, the Texas Medical Association, and the Country Music Association.

However, the time required for the conversion of the existing databases was totally underestimated once the project began. Instead of an implementation of 500 hours which was to begin in September 2007 and be completed by the beginning of January 2008, it took an additional 1000 hours of consulting time to complete the task. We did not begin getting timely financial statements until November 2008. This equated to an increase in cost of approximately $200,000 for the system. In addition, the delay in getting financial statements on a timely basis seriously hampered the Board and management. The additional costs were not restricted to the implementation of the new system. Our outside accounting firm and our auditing firm had to commit more time to get us caught up which added an additional $150,000 to our cost.

Despite these challenges, there is some good news as a result of our investment in iMIS. Our website continues to improve. Content is better. Functionality has improved. A sense of community through the Forum has been building. We are looking into allowing banner ads and a section dedicated to commercial members. One of the other developments as a result of our improve database capabilities is our e-newsletter which debuted in January. It contains a wealth of culture information and tips for all levels of hobbyist. It also reaches out to younger members who are more comfortable with email.

Economic Downturn

The current state of the economy has certainly helped contribute to the 2008 year end deficit as well as the deficit we are experiencing year to date with this year's budget. Looking at our current year, we are finding a sharp decline in revenues through the first six months. Revenues are down by almost 19% from budget.

- Membership revenues are down by 13%
- Advertising revenues are down by 30%
- Gift shop revenues are down by 31%
- Admissions revenues are down by 38%
- Contribution revenues, factoring out one large gift, are down by 75%
- Special event revenues are down by 71%

Some of this can be blamed on overly optimistic forecasting. However, there is also a very good indication that the economy is having an adverse affect on some of the key metrics that drive the success of the Society. This is particularly true when you examine areas like advertising, gift shop revenues, special events, admissions and contributions.

Lack of a successful development campaign

Effective fund raising depends on effectual planning and rigorous execution. Most of the recent success in the development area for the organization can be attributed to Board gifts and the aforementioned donation. For example, last year we had four campaigns and only one campaign actually raised more money than it cost to prepare and mail the solicitation. Also, none of the four campaigns attracted more than 200 contributions. In addition to these facts, we have only been able to attract one grant which was from the Palm Beach County Cultural Commission and that amounted to two gifts of less than $95,000 over the course of two years. We have gone through the expense of hiring an outside grant writing firm which has identified some attractive targets for us to concentrate on but to date very little has been done with this information. We should also have had an estate plan established but this too has not been acted upon.

In order for fundraising to be effective, we need to formalize a plan and have our financial house in order before we attempt to solicit donations from outside sources. Without this, we are simply spinning our wheels.

The Steps Taken

Obviously, we had to make some drastic changes in order to keep the investment you have in the Society viable. This meant that we had to do a number of things immediately to help in our decision making and ensure that we continue to support activities that are consistent with our mission as an organization. On the surface this may seem to be a pretty straightforward task. However, we had to look at each activity and see if it contributes to our bottom line or the value of the organization to the Membership.

The Plan Moving Forward

As we look to the future, we need to concentrate on a number of key areas that will help us right the ship and prepare us to take advantage of the opportunities that we identify.

Reduce Expenses- The challenge we have in the short term is very real. No one has a crystal ball and can predict where the economy is going or what consumer confidence will be. At the Board of Trustees Meeting at Longwood Gardens in October, we asked management to reduce expenses by $300,000 for the current fiscal year. Management eliminated staff positions, implemented salary and pension reductions, and cut programs and services in order to achieve this goal. In addition, in January we approved a plan that called for the closing of the gift shop in February with the gardens being closed to the public at the end of May, even though we continue to look for prudent financial options to keep the gardens open. From November through February, we have seen an expense reduction of $197,000 and it is our hope that the steps taken in expense reduction will keep any loss for the remaining few months of the fiscal year at a minimum. Naturally we'd like to say that we will either break even or possibly realize a small profit but the world financial situation is far too volatile to make such a promise We will, of course, monitor every line item, revenue and expense on an ongoing basis and do whatever we can to achieve our goal. The investment results are still troubling. Unrealized losses through February amounted to over $369,000 which affects our balance sheet in the various fund balances. Although this is not a cash flow item, the losses have to be reflected in our financial statements and adversely affect our reported monthly and year to date figures**.** If we continue to fall short of revenues, we will need to make additional cuts almost on a real time basis.

Borrow from Restricted Funds-Because of the losses we experienced in 2007/2008 and the challenge we had starting off this fiscal year, we had to look for options that would allow us to continue to operate and meet the liquidity needs of the organization. Management identified two possible alternatives for consideration. The first was to secure a line of credit from a bank. As many of you know we own the building and property free and clear. Our bankers said that we most likely have to put up the building as collateral. In other words, it would be a secured loan which would have necessitated periodic payments of interest and principal. Since it's impossible to forecast when the Society will return to a positive cash flow basis, this alternative was not chosen. . The second option was to access restricted funds. On the advice of legal counsel, we asked management to contact the executors of the Mary McQuerry estate and explain the predicament we were in. They very graciously offered to help by allowing us to borrow up to $250,000 of Mary's restricted funds on an interest free basis as long as the principle is paid back within 3 years. We have accessed this line and the net affect after accounting for interest, dividends and realized and unrealized losses is approximately $235,000.
As a side note, in order for the Board to monitor the situation and insure we do not dip into other funds that are either temporarily restricted or permanently restricted, we have separated them into unrestricted, temporarily restricted and permanently restricted accounts.

Finish the Strategic Plan-We spent a great deal of time establishing a framework for the plan. Each Committee is providing input into the plan which will guide our activities in the coming years. One of the first things we need to do is to compile the various Committee outputs and incorporate them into the strategic plan including a realistic financial forecast for the next three to five years. It should comprehensively cover all of our current activities, our projected future programs and services, and should create measurements on when and how the benefits will be completed. In addition, it should talk about the governance of the organization complete with a thorough review of our bylaws, our committee structure, our nomination and election procedures and management's role in the success of the organization. It is natural for many Boards to view financial problems as isolated when in fact the financial state of any business relies on understanding the inter-relationship between all the various components.

Build Reserves- Reserves serve a number of vital purposes. They enable the Society to take advantage of unique opportunities that arise. They also provide ongoing non-dues, investment income that reduces dependence on dues income and the size of dues increases. What we have done over the years is to use reserves for ongoing programs or current operations, to eliminate (temporarily) the pain of a dues increase. But this is eating the seed corn. Because it reduces income in future years, it means greater dues increases, or reduced programming down the road, which can further hurt membership recruitment and retention. And reducing reserves unnecessarily puts the Society at risk, should one of those negative events happen. It also reduces the Society's ability to take advantage of special opportunities.

Develop a Comprehensive Membership Plan- To achieve growth and maintain a membership program, we need to look at all we are doing to add value to what we offer to all the segments of the organization. We need a plan that will give us a step by step roadmap to achieve success.

We continue to focus on the value we add to your membership. For example, we just recently tested our first webinar that we hope will bring more education on demand to the membership and our local affiliated societies. We entered into an agreement with the Evolution Art Group which is exposing thousands of consumers to the beauty of the flower that captivates our passion. Our AQ Plus product is getting better with each release and provides judges and nonjudges alike with the most comprehensive awards database in the world today. Finally, we simply cannot forget our flagship publication, Orchids, which continues to provide the most comprehensive education and information and provides our Members with one of our most visible benefits.
The purpose of this document is to give you a more complete understanding of where we are as a Society. One of the key initiatives that this Board supports is the need for open and honest communication with the Membership. This is your organization and as a Member you have the right and obligation to get your questions answered. We hope that this is a good start.

<u>Addenda</u>

I. **2003-2008 Balance Sheet**

II. **Membership Report**

III. **Contributions**

IV. **Investment Returns**

Financial Terms

1. **Deferred revenue**. Cash that has come in the door but is not yet earned because we have not delivered the service paid for. For example, membership dues, AQ Plus subscriptions, advertising, and special events revenues are all deferred revenues. Deferred revenue is booked as a liability on the statement of financial position (because we would owe it back if we did not provide the service) and then moved over to the statement of activities once earned.
2. **Prepaid expenses**. Cash that has been paid for a service prior to us receiving the service. Prepaid expenses are recorded as an asset on the statement of financial position until we receive the service and then are moved over to the statement of activities once incurred.
3. **Designated net assets**. Net assets that are "restricted" by the board. Because boards cannot truly restrict net assets—only a donor can do that—if a board wants reserve money restricted they need to "designate" it.
4. **Unrealized gains and losses**. These are changes in value of investments that would result if the investments were sold, even though we have not actually sold anything. We account for these changes as revenue or expenses. Note that if we did sell the investments, we would have a realized gain or loss.
5. **Budget**. This is the financial representation of what the organization plans to do in a given year. It is a guideline, not a law. Although we try to stick closely to it, things happen that are outside of management's control.