

# DEVELOPING FINANCIAL MANAGEMENT SKILLS IN A COMMUNITY ORGANISATION USING SCAFFOLDING: A PILOT STUDY

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## Abstract

The third sector literature argues that organizational capacity is important for community organizations to achieve their missions. Financial Management Skills (FMS) are important for the enhancement of capacity that supports the effective operations, accountability viability and governance of community organizations. However, many community organisations lack the necessary understanding of financial management. This paper examines the use of scaffolding to develop financial management skills in a community organisation. Participants completed a pre-test to determine the level of FMS and a post-test after the scaffolding sessions. The results indicate that scaffolding was effective in developing the participant's FMS. However, the time spent on each phase of the scaffolding learning cycle may influence the effectiveness of the method\*\*.

**Keywords:** Financial Management Skills, Community Organisation, Scaffolding

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## 1 Introduction

Community organisations (CO) are established to address a need or problem in the community in which they are established, (Holland and Ritvo, (2008). The organisation is considered to be effective if it achieves its stated objectives and reduces the need or introduces the desired change. However, to be effective the organisation must have the ability to undertake programs, manage funds assess performance and develop strategy and acquire resources. These skills can be grouped under the heading of 'capacity' and the enhancement of those skills referred to as 'capacity building'. The building of capacity supports the development of good governance by enabling the monitoring of resource use and organisational performance. However, the development of capacity cannot happen in isolation but requires antecedent conditions; in particular, the presence of financial management skills.

The model being suggested in this paper is that the acquisition of financial management skills will enable a CO to develop capacity. The development of capacity encourages an organization to operate effectively and supports the viability of the CO. Both are critical aspects of governance. Effectiveness in third sector organizations is, however, a contested concept and according to Herman and Renz (2008) it is also a socially constructed concept, however, they argue that it is not an arbitrary concept. According to Herman and Renz (2008) there are meaningful

dimensions of effectiveness such as financial condition, fundraising performance or program outcomes that can be supported by hard data. They go on to point out that the use of generally accepted accounting principles can provide evidence about revenues, costs, and surplus. Not all stakeholders however, will be able to use, or interpret the evidence in the same way as they lack financial management skills to do so. The acquisition of financial management skills such as understanding an organization's accounting system and financial statements, managing cash and budgeting are seen as important skills that can enhance an organization's capacity and governance.

## 2 Capacity Building, Effectiveness and Financial management Skills

Capacity is defined by Eisinger (2002) as: *a set of attributes that help or enable an organization to fulfil its mission*. He goes on to point out that effective organizations have a broad range of capacity attributes and the ability to use that capacity to meet organizational objectives. Eisinger goes on to argue that, based on the findings of others, that the critical components of capacity include acquiring appropriate resources, effective leadership, skilled and sufficient staff, a certain level of organizational structure and links to the broader community from which the organization can receive assistance.

According to Wagner (2003) there is no one single initiative that increases the effectiveness of a community organization but rather a systematic approach to improve the organization's capabilities at all levels. However, Wagner (2003) goes on to point out that building capacity utilizes many resources that CO management would prefer to use on programs. While the continued viability and effectiveness of a CO is underscored by building capacity there is a reluctance to invest scarce resources in the building of organizational capacity. In addition Wagner (2003) argues that CO's have been impeded in their efforts to develop capacity by a lack of knowledge about how to do so.

In keeping with Wagner (2003), Fredericksen and London (2000) have argued that internal organisational capacity enables organizations to implement programs and achieve goals and is derived from various elements within the organization. They propose that there are four elements of organizational capacity: 1) Leadership and Vision, 2) Management and Planning, 3) Fiscal Planning and Practice and 4) Operational Support. Financial management is a significant component of elements 2 and 3. Management and Planning and the ability to adapt to changing circumstances are essential to the survival of a CO. While Fiscal Planning and Practice enables an organization to support operations with adequate and predictable financial resources.

This element of capacity is emphasized by Fredericksen and London (2000) and is centred upon the existence and use of a formal fiscal systems incorporating fundraising, financial tracking systems and financial reporting systems. A formal fiscal system provides important information for planning as well as evidence of accountability. The elements of capacity operate interdependently with other organisational components such as the existence of a budget and the process of developing the budget both indicate the ability of an organization to plan the use of resources and adapt to its environment (Fredericksen and London (2000).

Dart (2010) argues that the concept of effectiveness centres on the extent to which a CO fulfils the purpose for which it exists. However, Dart concludes that there is no evidence that effectiveness is understood beyond the initial steps which commence but do not fulfil the causal chain required to produce the change to which the organisation aspires.

Herman and Renz (2008) argue that effectiveness continues to be a contested concept but they suggest that comparison is a key element; the more effective organisations are more likely to use accepted management practices; CO effectiveness is a social construct and it is important to differentiate effectiveness at program, organisation or at network levels.

They note that some CO leaders are uncomfortable with the idea that effectiveness is a social construct. However, they go on to say

*" although effectiveness is socially constructed, there are useful dimensions of effectiveness (for example, financial condition, fundraising performance, or program outcomes)n that can be grounded in hard data. For example, use of generally accepted accounting principles provides solid evidence about revenues, costs, and surplus."*(p. 410)

Thus, the effective operation of a CO is linked to capacity. The link between capacity and effectiveness is reinforced by Eisinger who quotes Forbes (1998) as defining effectiveness in two ways: 1) the extent to which an organization achieves its goals; and 2) the extent to which an organization has the ability to acquire and use resources to function and sustain its own survival. The ability of an organization to achieve its goals and marshal resources is enabled by the organization's capacity. An organisation's capacity is linked to the ability to undertake the following activities: strategic planning, budgeting, costing, recording and reporting financial transactions, monitoring cash-flow, measuring financial and non-financial performance (Anthony and Young 2003, and Zietlow Hankin and Seidner, 2007). These activities are fundamental to an organisation's governance. The authors referenced above argue cogently for a link between an organisation's ability to use FMS and organisational capacity.

Similarly, Ritchie and Kolodinsky (2003) point out that a significant component of organizational capacity and effectiveness is supported by management skills, particularly financial management skills. They argue that the ability to use financial analysis by the management of a CO is important for ensuring sound financial management of an organisation and enabling the organisation to fulfil its objectives. The ability to understand financial statements and analyse the information reported in the financial statements or the ability to budget and manage cash are examples of financial management skills.

In addition, Wagner (2003) states that donors have sought to increase the leverage from their donations by encouraging CO capacity building. Donors are justified in their demand that organisations undertake systematic capacity building to improve their effectiveness and governance, reinforcing the importance of FMS to CO's. However, as stated above, Wagner also argues that managers of CO appear reluctant to divert resources to build organisational capacity from programs creating a dilemma.

### 3 Bridging the Gap

While it would seem important that a CO develop FMS a number barriers limit their ability to do so. In the State of Victoria, Australia, most COs are staffed

mostly by volunteers who have little understanding of financial management (FM). Volunteers tend to join COs to participate in the organisation's activities and are content to leave FM to the treasurer who may in fact have very limited FMS. Undertaking courses in FM can be costly and time consuming in addition most courses have a commercial orientation and do not include material dealing with FM of non-profit organisations. In addition, access to FM courses can be difficult for volunteers located in rural and regional areas of the state.

To overcome these impediments a pilot program was devised to introduce FMS to CO volunteers. The program was designed to introduce participants to the financial management of COs and to be delivered over four hours. The program was designed to be taken to the participants therefore overcoming issues of access. It was assumed that participants had no knowledge of accounting and the pilot program was structured to move participants from a lack of understanding to greater understanding. Using a scaffolding method of instruction the program introduced participants to:

1. the accrual accounting system,
2. the financial statements; income statement, balance sheet, and cash flow statement, and
3. financial statement analysis.

The aim of the pilot program was to assist participants to acquire basic FMS through modelling various FMS. This instruction approach is called scaffolding and has been successfully used by David Rose to teach literacy to marginal groups in Australia.

#### 4 Scaffolding

Rose (2005) has developed a scaffolding approach to reading that includes:

1. Selecting an appropriate text,
2. Preparation before reading the whole text,
3. Paragraph –paragraph reading,
4. Text marking finding key information
5. Detailed reading involving more detailed text marking
6. writing

This approach can be used to develop financial literacy, specifically the ability to read, understand and analyse financial statements. The appropriate texts are financial statements; the preparation includes becoming familiar with accounting terminology and structure of financial statements. Steps 3, 4 and 5 involve reading the financial statements and increasingly more detailed analysis. While undertaking tasks of categorising financial information, constructing and analysing financial reports is the equivalent of the writing stage

Rose (2006) has described this approach in general terms as the scaffolding learning cycle that includes Prepare, Task and Elaborate. The learning cycle involves the instructor preparing the students for learning by introducing and explaining the new material. Students are then set tasks initially involving

substantial guidance from the instructor but that is reduced with each subsequent task. The final phase of the cycle allows for students to seek elaboration so that they are confident in using the knowledge they have gained during the previous phases of the cycle.

When the learning cycle is applied to financial literacy preparation means the introduction of the accrual accounting system, an introduction to the content and structure of financial statements and methods of financial statement analysis. At each step tasks are set involving categorising financial information, constructing financial statements and analysing financial statements.

The experiment reported in this paper consisted of two seminars each of two hours duration. In the first seminar's preparation stage participants were introduced to the functioning of the accrual accounting system and important accounting vocabulary. Participants were also introduced to structure and vocabulary of financial statements. In the task phase participants were required to classify financial data and complete financial statements. Participants were asked to complete the construction of a number of statements of financial performance (income statement) and statements of financial position (balance sheet). A significant amount of information was provided enabling participants to easily complete the statements. Less information was provided with each subsequent task. Thus participants were supported in the first task but the support was decreased with next task.

In the second seminar preparation consisted of an introduction and explanation of vertical and horizontal analysis (casting financial data into percentages) and ratio analysis including an introduction to ratios used exclusively in the third sector. Tasks were constructed, as they were in the first seminar, moving from most of the solution to tasks being provided to participants completing the task and providing the solution.

#### 5 Framework

The third sector literature suggests that financial management is a significant support for capacity building. While it would not be accurate to say that the acquisition of financial management skills will automatically lead to more effective COs it could provide organisations with capacity that would enable them to enhance their effectiveness and viability. The acquisition of and use of financial management skills is an antecedent to capacity building creating the conditions in which managing resources, planning and assessing performance are encouraged. However, many COs are staffed by volunteers who have little or no understanding of FM. In addition, access to appropriate FMS for non-profit organisations, such as COs, is problematic in Australia. The aim of the pilot study was to deliver a short course in a location and time suitable for the participants and determine whether a scaffolding instructional method can

facilitate the acquisition of FMS by volunteer members of a CO with very little understanding of FM.

## 6 Research Method

The pilot study used scaffolding with a volunteer organisation located in the south east of Melbourne's metropolitan area. There were 11 participants in the first session and 9 participants in the second. Instruction was given over two sessions, each of two hours duration. In each session material was presented to the participants using the scaffolding method. A pre-test was given to the participants at the beginning of each session and a post test was given to the participants at end of both sessions. At the end of the second session participants were also asked to complete an evaluation of the two sessions.

Yin (2003) argues that conducting an experiment in one organisation can be regarded as a case study.

He further argues that the number of participants in the experiment has no bearing on the results because the case study is not attempting gauge attitude or behaviour in a population. Rather, the purpose of an experiment is to observe the results when a specific method or approach is applied.

## 7 Results

The results reported in this paper suggest that the scaffolding method of instruction assisted the participants to improve their knowledge of FM. When the pre-test results are compared to the post-test results for the first session (See Tables 1 and 2) there is an increase in the number of correct responses, and a reduction in incorrect and "Don't know" responses. Statement 4 is the only statement to show a reduction in correct responses in the post-test. Statements 5, 6, and 7 had the smallest increase in correct answers

**Table 1.** Pre-Instructional Results Seminar 1

| Statements  | Correct response | Incorrect response | Didn't know |
|---|------------------|--------------------|-------------|
| There are 3 Financial Statements  | 3                | 2                  | 6           |
| A cash accounting system will record depreciation                         | 6                | 1                  | 4           |
| There are 5 categories of accounts  | 1                | 0                  | 10          |
| Assets appear on the Income Statement                                     | 7                | 3                  | 1           |
| Equity is the difference between assets and liabilities                   | 9                | 1                  | 1           |
| Non-cash items are reported in the Income Statement                       | 4                | 4                  | 3           |
| A liability is something owed by the organisation                         | 9                | 1                  | 1           |
| Equity appears on the Balance Sheet                                       | 6                | 1                  | 4           |
| Accrual accounting is considered to be more accurate than cash accounting | 2                | 2                  | 7           |
| All transactions are first recorded in journals                           | 7                | 2                  | 2           |

**Table 2.** Post-Instructional Results Seminar 1

| Statements  | Correct | Incorrect | Didn't know |
|---|---------|-----------|-------------|
| 1 There are 3 financial statements.   | 11      | 0         | 0           |
| 2 A cash accounting system will record depreciation                         | 9       | 1         | 1           |
| 3 There are 5 categories of accounts  | 7       | 1         | 3           |
| 4 Assets appear on the Income Statement                                     | 4       | 6         | 1           |
| 5 Equity is the difference between assets and liabilities                   | 10      | 0         | 1           |
| 6 Non-cash items are reported in the Income Statement                       | 5       | 5         | 1           |
| 7 A liability is something owed by the organisation                         | 11      | 0         | 0           |
| 8 Equity appears on the Balance Sheet                                       | 10      | 0         | 1           |
| 9 Accrual accounting is considered to be more accurate than cash accounting | 9       | 1         | 1           |
| 10 All transactions are first recorded in journals                          | 11      | 0         | 0           |

The results for the second session also show an increase in the number of correct responses (See Tables 3 and 4). However, statements 1 and 3 showed no improvement or decline, while the number of

correct responses for statement 6 was reduced from 3 to 1. Seven of the ten statements showed an increase in correct responses

**Table 3.** Pre-Instructional Results Seminar 2

| Statements   | Correct | Incorrect | Didn't know |
|--|---------|-----------|-------------|
|  | 1       | 2         | 6           |
| 1 The current ratio is calculated by dividing the current surplus by the current assets                  |         |           |             |
| 2 The operating margin does not apply to community groups.   | 1       | 3         | 5           |
| 3 Horizontal Analysis can only be applied to the Statement of Financial Position                         | 1       | 1         | 7           |
| Interest Earned indicates how many time over the interest expense could be paid                          | 0       | 2         | 7           |
| 5 Return on Assets shows how much would be earned by selling all the assets                              | 2       | 4         | 3           |
| 6 The Equity ratio shows the amount of equity to surplus   | 3       | 2         | 4           |
| 7 The equity ratio is one of the ratios used to determine financial vulnerability                        | 5       | 0         | 4           |
| 8 The operating margin cannot be used to determine financial vulnerability                               | 4       | 1         | 4           |
| 9 Vertical Analysis involves the converting of dollar amounts for one accounting period into percentages | 2       | 0         | 7           |
| 10 There are two development expenses ratios.  | 1       | 1         | 7           |

**Table 4.** Post-Instructional Results Seminar 2

| Statements   | Correct | Incorrect | Didn't know |
|--|---------|-----------|-------------|
|  | 1       | 7         | 1           |
| The current ratio is calculated by dividing the current surplus by the current assets                  |         |           |             |
| The operating margin does not apply to community groups.   | 7       | 2         | 0           |
| Horizontal Analysis can only be applied to the Statement of Financial Position                         | 1       | 8         | 0           |
| Times Interest Earned indicates how many times over the interest expense could be paid.                | 9       | 0         | 0           |
| Return on Assets shows how much would be earned by selling all the assets                              | 3       | 6         | 0           |
| The Equity ratio shows the amount of equity to surplus   | 1       | 8         | 0           |
| The equity ratio is one of the ratios used to determine financial vulnerability                        | 9       | 0         | 0           |
| The operating margin cannot be used to determine financial vulnerability                               | 7       | 2         | 0           |
| Vertical Analysis involves the converting of dollar amounts for one accounting period into percentages | 7       | 2         | 0           |
| There are two development expenses ratios.   | 3       | 3         | 3           |

The results recorded in Table 5 show that the participants generally agreed that the scaffolding method used over the two sessions improved their understanding of financial statements. A greater number of participants responded that they agreed with the statements in Table 5 than were unsure or disagreed. Of note are the responses to statements 1 and 2 indicating that a clear majority of participants believed they could better read financial statements

and felt that they could now contribute to a discussion about the financial management of their organisation. Statement 4 had the lowest number participants who agreed and the most who disagreed. This result can be explained by the limited time participants had to work through the practical examples. On two of the evaluations was written that the participants had felt that the sessions had been rushed.

**Table 5.** Evaluation

| Statement  | Agree | Not sure | Disagree |
|--|-------|----------|----------|
| 1 I am better able to read financial statements after participating in the seminar series.   | 8     | 1        | 0        |
| 2 I believe that I will now be able to contribute to the discussion about the financial management of our organization.  | 7     | 2        | 0        |
| 3 The method of instruction enabled me to understand the analysis of the Statement of Financial performance and the Statement of Financial Position                            | 7     | 2        |          |
| 4 The method of instruction has given me confidence to undertake an analysis of our organization's Statement of Financial performance and the Statement of Financial Position. | 5     | 2        | 2        |
| 5 I found that the method of instruction provided logical steps so that I moved from not understanding financial statements to a position of better understanding.             | 7     | 2        | 0        |
| 6 I thought the materials were appropriate for my understanding of the topic.  | 7     | 2        | 0        |
| 7.I could easily understand the presenter  | 7     | 1        | 1        |

## 8 Discussion

Generally the results indicate that using a scaffolding method of instruction to teach volunteer members of a CO to understand the accrual accounting system, to be able to read a CO's financial statements and analyse those statements was successful. The success of the instruction method was substantiated by the increase in correct responses between the pre-test and post-test for both sessions. The conclusion that scaffolding is an appropriate method to teach FMS to CO volunteers was reinforced by their evaluation of the sessions. The result for statement 4 (*The method of instruction has given me confidence to undertake an analysis of our organization's Statement of Financial performance and the Statement of Financial Position.*) on the evaluation does not contradict this assessment. First, a majority of respondents agreed with the statement; second, independently undertaking an analysis of a CO's financial statements is a significant step after only four hours of instruction. In comparison the responses to statement 2, (*I believe that I will now be able to contribute to the discussion about the financial management of our organization.*) are more positive. Statement 2 envisages the volunteer working with others while statement 4 implies undertaking the analysis by oneself.

Statements 3 (*The method of instruction enabled me to understand the analysis of the Statement of Financial performance and the Statement of Financial Position*) and 5 (*I found that the method of instruction provided logical steps so that I moved from not understanding financial statements to a position of better understanding.*) point to the volunteer's perceptions that the scaffolding method contributed to their understanding of the financial statements and their analysis. The growth in understanding of FMS is the basis of capacity building and the development of good governance.

The test results for statement 4 in session 1 and the test results for statements 1, 3 and 6 in session 2 are a reflection of the conditions under which the material was presented. There was a great deal of material to be covered in two sessions of two hours. Two of the participants had noted on their evaluations that the sessions had been rushed. The scaffolding learning cycle particularly undertaking the tasks and the opportunity for elaboration may not have been sufficient. It must also be noted that the instructional material presented in the second session was technically more difficult than the material presented in the first session.

## 9 Conclusion

The results of the pilot project reported in this paper suggest that a scaffolding method of instruction was successful in developing the FMS of a CO's volunteers. The pilot study has demonstrated that the provision of a short course aimed at improving the FMS of volunteers in a CO can overcome the barriers of cost, time and appropriateness. The course was of four hours duration, not a semester, and it was delivered at a time and location that was convenient for the volunteers. The material covered in the pilot study was specific to the non-profit sector and therefore considered to be relevant by the participants. The pilot study also demonstrated the potential of a targeted FMS course to be the basis of capacity building and the development of governance.

However, it was evident from the test results and the evaluations that the amount of time used for instruction is an important consideration. Sufficient time must be allowed for the task and elaboration phases of the FMS course to be given adequate time if scaffolding is to be completely successful. Future research could examine the impact on results of providing more time. Research also needs to be

undertaken to determine whether the FMS acquired by the participants are used in decision making.

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