FIRST CHILDREN'S FINANCE

Making Your Financials Work for You

Understanding and effectively utilizing your child care center's financial information

Learning Outcomes

Develop a working knowledge of basic financial terms, accounting systems, and financial reports

Develop a practical understanding of how financial information can help you make wise management decisions

Identify resources for further training and development

Gather Your Financial Documents

- Will your child care center end the year with a profit?
- Are you able to use the money your center earns to accomplish the things you feel are most important for the children in your care?
- If you are a nonprofit, does your Board of Directors have the information they need to make wise financial decisions?
- Do you know if the various programs your center offers are profitable?

Throughout this course, we will address financial topics that will help to answer these questions. But, before we start, take a moment to gather the most current financial documents and reports that currently exist for your child care center. Refer to them as you go through this course.

Accounting

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Many people think of accounting as something that only professional accountants need to deal with, but "accounting" from a practical standpoint, is the language we use to understand business.

If we want to understand one another, we need to use a common language, and if we want to understand businesses, we need to understand the common language that makes up "accounting".

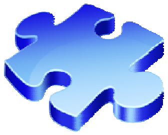
Accounting

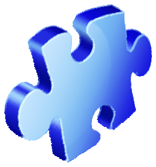
Accounting isn’t magical.

Accounting doesn’t have to be confusing.

Developing and understanding financial statements doesn’t have to be difficult or puzzling.

Financial accounting is simply a system of collecting the items that have to do with money in your business, then sorting them into an organized format that allows you to understand your financial situation and more successfully run your business.





Accounting

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An accounting system is comprised of the different activities a business undertakes to

- Keep track of (record) its financial activities
- Sort (classify) its financial activities into related categories
- Summarize and report its financial activities

Accounting – Keeping Track

The simplest way of keeping track of daily financial activities (or individual transactions) is done by recording those transactions into a checkbook. If you keep a checkbook properly, you will have a good idea of how much money you have available in your account at a given time. However, a checkbook doesn't easily allow you to *summarize* or *report on* activities, so most businesses use a computerized system to keep track of individual transactions. Some examples of these programs include *QuickBooks, Peachtree, or ProCare.*

Accounting – Classifying

Software programs allow you to enter individual transactions the same way you would in your checkbook, ***and*** to classify them into related categories (such as types of revenue or types of expenses).

An example of this is to classify all expenses that are related to the teaching supplies category in the same way.

Accounting – Summarizing

Software programs also allow you to summarize all those hundreds or thousands of individual transactions you make over the course of a month, quarter, or year so you can easily see, for example, how many dollars you spent on a category like “teaching supplies” or “rent” over the course of a year.

Who uses accounting?

The financial information prepared through the process of accounting is used by:

- Owners or managers of a business, in order to make management decisions about the business
- Boards of Directors of nonprofit organizations, in order to assure they are acting as responsible stewards in managing their organization's financial resources
- Governmental agencies, such as the IRS or other taxing authorities, to determine how many taxes an organization owes from the operations of its business
- Auditors, to assure that an organization is producing reliable financial information
- Foundations and other nonprofit funders, to assure that an organization is using its financial resources to accomplish its mission in an effective and efficient manner
- Lending institutions, to determine if an organization is credit-worthy
- *And others…*

How is accounting used?

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Because financial information is used both inside an organization and outside an organization, it is important that accounting records are kept consistently in all organizations.

The Financial Accounting Standards Board (FASB) (http://www.fasb.org/) includes representatives from public accounting, industry, and accounting education. In addition to conducting extensive research about accounting practices, they have developed ***generally accepted accounting principles,*** which guide the work of accountants and others who use financial statements, helping to ensure that users of financial statements find them useful.

How can accounting help you?

Keeping good financial records helps you or your accountant file your tax returns in a more efficient manner.

Keeping good financial records helps you plan for the future – and are an excellent management tool to help guide you in making decisions that affect the future of your business.

Keeping good financial records help you sleep at night because you don't have to wonder if you are making money or will have enough money to pay your bills from month to month (adequate cash flow).

A tool to help you reach your goals

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In order to be in existence for the long-term, your business should be able to do two things:

1. Generate adequate financial resources to meet your financial obligations when they are due *(generate adequate cash flow).*
2. Be profitable in the long term *(to develop enough reserves to meet future financial obligations such as replacing equipment, expanding, or carrying your business through hard economic times).*

Accounting helps you know if you are achieving these two goals.

How is accounting used?

Some of the most important types of information produced by accounting systems are **financial statements**.

Financial statements show the financial position of the business at the time of the report, and the operating results by which the business arrived at this financial position.

The most commonly-used financial statements are the income statement and balance sheet.

Having this information helps the user determine if the business is financially strong, if it is profitable, and if the future looks good for the business.

Income Statement

An *income statement* is the financial statement that keeps track of the money coming into your business (revenue) and the money going out of your business (expenses).

The difference between the money coming into your business and the money going out of your business to support the business's activities is called *net income. The ultimate goal of any business is to produce a positive net income (or profit) over the long-term.*

Your financial software will allow you to produce an income statement for a day, week, month, quarter, year, or any particular period of time. People typically produce income statement reports at least once a month to see if they made money or lost money during that month.

Quarterly statements can also be very helpful, because they break down a full year, and can help you to see if there are certain times of the year that you make money and certain times of the year that you lose money.

Income Statement

How can an income statement help you to manage your business? Here are some examples:

- If you keep track of the revenue and expenses of different programs (such as an infant program and a preschool program), you can see where you make money and where you don't.
- If you find that infant care brings more revenue (income) into your business but also costs you more to run (in expenses) due to higher staffing expense because of higher teacher to child ratios as well as other licensing requirements, you now have the information to help you decide whether using your space for an infant program makes good business sense.
- *Keep in mind that financial statements don't tell the whole story* – for example, you may find that if you don't have an infant program, families may move their older children out of your care because they don't want their children in two or three different centers. But at least you will have good financial information you need to help you make a wise business decision.

Income Statement

Income statements also allow you to see which expenses are out of line (either too high or too low) by comparing specific categories over the course of time.

For example, when you make individual decisions to purchase supplies, they all seem to make sense. However, when you see the total amount of money that you've spent for supplies over the course of a month, it can add up very quickly and you might find that you need to make the management decision to determine if supplies are being used wisely, wasted, or even stolen, and adjust your operations accordingly.

By regularly producing income statements, you can also compare how much you spent on specific categories last year versus this year – for example last April versus this April. If a specific category seems out of line, you may decide you need to do some further checking or make management decisions to keep costs in line by adjusting your operations.

Income Statement

Income statements also allow you to see if your income is going up or down over time.

If you see that your net income is down this May, but your expenses are higher this May than they were last May, you may decide to do some further checking to see if you can reduce your costs (i.e. staffing or other expenses) to make sure that your net income remains positive.

And, if you see that your net income is negative (you experienced a net loss of money over the time period), you realize right away that you can't continue to operate the same way over time or you will run out of money, so you can make adjustments to correct the problem sooner instead of later.

Income Statement

These are just a few examples of what your income statement can tell you.

Another use for your income statement is to check the results of your operations against those of other child care centers. By checking your expenses against percentage averages of other child care centers in the industry (industry averages), you can determine if you are operating in a manner typical of other centers in terms of how much you spend on operating expenses, what typical operating profit is, etc.

*Your local library or the James J. Hill Library can offer you assistance in finding industry averages for child care centers: (**www.jjhill.org**). To find industry averages, your librarian may need the NAICS (North American Industry Classification System) code for child care, which is 624410.*

Income Statement

For more information on income statements and other financial tools, check out the First Children's Finance website for resources, tips, and tools for centers at: **http://www.firstchildrensfinance.org/Tools_for_Child_Care_Centers_Financial.html**

Financial Statements

An income statement won't tell you the whole story about your financial status

- For example, an income statement will tell you how much income you received during the month for providing child care services, but if customers don't pay you in cash or you will be receiving money from the Child Care Assistance Program, it doesn't tell you how much cash you actually have in the bank and how much customers still owe you.
- The **balance sheet** will tell you how much money you have in the bank (listed in cash) and how much your customers owe (listed in accounts receivable).

Balance Sheet

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A *balance sheet* is the financial statement that keeps an ongoing record of what your business:

- Owns (things that have value, like money in checking and savings accounts, playground equipment, computers, desks, etc.) These items are called *assets.*
- Owes (things that other people have rights to in your business, like bills you owe your vendors, payroll taxes collected from employees but not yet paid, loans on your building or equipment, etc.) These items are called *liabilities.*

The difference between the amount of things you *own* and what you *owe* is called *equity, or net assets.*

If you are a for-profit business, this category is typically called "owner's equity", "capital", or "net worth". If you are a nonprofit organization, the amount is typically called "net assets", or perhaps "fund balance". This is because for-profit business owner(s) actually "own" that equity. In a nonprofit organization, this leftover amount are the net assets of the organization, and don't belong to individuals.

Balance Sheet

A ***balance sheet*** can help you make managerial decisions in a variety of ways. When categorized correctly, it can tell you, among other things:

- How much money you have in various accounts at any particular point in time
- How much money people owe you at any particular time
- How much debt you owe at any particular time
- How much of your debt is current (payable within one year), and how much debt is long-term

Balance Sheet

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A balance sheet is also what many lenders use to determine if you are credit-worthy by performing financial analysis of the statement. This analysis can help show lenders or others:

- How long it takes you to collect money owed to you
- If you have enough cash on hand to pay your bills
- If you have the ability to pay your short-term liabilities
- How many days it takes you to pay your suppliers
- *And many other things…such as whether you have made money or lost money over the history of your company's existence by showing the accumulation of net income in the* owner's equity *or* net assets *portion of your balance sheet.*

Balance Sheet

These are just a few examples of what your balance sheet can tell you, but the primary thing a balance sheet tells you is your current financial position, and if you're in a better financial position over time because your business is profitable in the long-term or if you're in a worse financial position over time because your business is losing money over the long-term.

For more information on balance sheets and other financial tools, check out the First Children's Finance website for resources, tips, and tools for centers at: **http://www.firstchildrensfinance.org/Tools_for_Child_Care_Centers_Financial.html**

Review

Financial statements show the financial position of the business at the time of the report, and the operating results by which the business arrived at this financial position.

An income statement keeps track of the money going into and out of your business during the course of a day, month, quarter, or year.

A balance sheet keeps an ongoing record of what your business owns, owes, and what is left over for the owner or organization.

Activity

Take a few moments to consider:

Are my accounting records set up so that all users are able to obtain the financial information they need from my accounting system?

How do I know if my child care center is making money or losing money?

Have I set long-term financial goals for my child care center?

What can I do to make sure our child care center achieves the goals we have set?

Managerial Accounting

Many people use financial information to make decisions about an organization, and there are many types of financial reports geared toward specific users. An example of a very specific use is income tax returns or IRS Form 990 for yearly nonprofit reporting.

For purposes of this course, the remainder of the information will be specifically geared toward the financial information and reports that will help the owner or manager of an organization to plan and control the daily operations and assist in long-range planning for the organization. This area of accounting is most-often referred to as *managerial accounting*.

Setting up an Accounting System

Financial Accounting serves as the basis for the preparation of financial statements and income tax returns. Because people <u>outside</u> the organization such as bankers, stockholders, the IRS, etc., use these financial statements, your accountant should prepare them so they conform with generally accepted accounting principles.

Managerial Accounting is meant to help people <u>inside</u> the organization, and while financial statements prepared with generally accepted accounting principles assist management in making decisions, it is also important to keep track of information in ways that are more specific to your business.

Setting up an Accounting System

For example, an accountant for a manufacturing plant and a child care center will both use generally accepted accounting principles to prepare financial statements, but the information they need to keep track of to make management decisions will be very different.

- A manufacturing plant will want to keep track of the cost of the parts that go into manufacturing their product, for instance, or will likely travel more outside of their community and have national marketing expenses to track.

- A child care center will want to keep track of how much they pay for educational supplies and equipment that wouldn't be pertinent to a manufacturing plant. They will want to keep track of how much they have to pay for the cost of food to feed the children in their care, which a manufacturing plant would not need to track.

Setting up an Accounting System

A child care center may also want to keep track of different programs – such as preschool programs and school age programs or summer programs to see if they are making money in one program and losing money in another program.

Or they may want to keep track of how much revenue they receive from private pay child care fees and how much of their revenue comes from the Child Care Assistance Program. This may be very important to future planning in the event the government changes the regulations and parameters that govern child care assistance payments.

Setting up an Accounting System

So how do we set up our accounting systems so we don’t feel like this at the end of the month or year?

Planning for the Future

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Two of the most useful financial management activities you can undertake are developing an annual budget and a monthly cash flow report.

- Preparing an annual budget helps you to think about your business on a higher level. Managers are required to act on and react to running the business on, a day-to-day basis. Taking time to prepare a budget helps you to think about long-term issues, like economic outlooks, competition, and the overall costs of running the business with your management team.

- The budgeting process also allows you to think about whether the costs that you are incurring really help you to accomplish your organization's mission and vision. Are you using your money to help you accomplish your most important tasks?

Planning for the Future

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- The budgeting process also helps you to realize you have expenses that don't seem apparent at first glance – such as costs related to personnel, like matching taxes, unemployment taxes, and other benefits. The process helps you to better understand your organization's total financial picture.

- If you are a nonprofit organization, developing a budget may be one of the most important tasks a board of directors can participate in. Developing a budget helps assure that you are planning to spend your money in the best possible way to accomplish your mission – and it sets up a system of measurement that the board can refer to every time they meet. They can compare the actual results of operating the organization with what they had planned the operating results would be. When they have this information, they can be wise financial stewards for their organization and better carry out their fiduciary responsibilities.

Budget

How do you prepare a budget?

- Typically, you and your management team (and board members, if nonprofit) will want to review the results of your last year's operations to really understand what happened during the last fiscal year.
  - Were you able to accomplish what you wanted to accomplish? Did your center meet your mission, vision, and organizational goals, or were you working day-to-day just to pay bills?
  - Were you able to operate at a profit, or did you experience a loss as a result of your operations?

Budget

- Then, you will want to estimate how much revenue you anticipate you will bring in during the upcoming year
  - If your center is not a start-up, this can be accomplished fairly easily by looking at last year's financial reports and determining how much you think the upcoming year will differ in each category from the previous year and make adjustments accordingly.
  - If you don't have last year's information to look at, you can still estimate your revenue fairly easily by thinking about it in a common-sense manner. How many children do you realistically expect to be enrolled in your center each month over the course of the next year? Multiply those numbers by the cost of tuition for one child according to your existing fee schedule.

Budget

Tip: *When estimating revenue, research shows that enrollment rates for start-up child care centers are typically 50-65 percent of licensed capacity. Even when fully-enrolled, a center will rarely reach 100% enrollment of its licensed capacity – 85-95% of licensed capacity is a much more realistic enrollment figure.*

Tip: *Use your budget during the year. When you prepare an income statement, compare it to the budget for that month. Look for variances. If the actual income statement has different account balances than what you expected, search to find out why that occurred. Then make operating adjustments as necessary so you can end the year in a positive position.*

Budget

- Next, estimate the expenses you realistically expect to incur as a result of serving those children and families in your care
  - Again, this can be accomplished fairly easily by looking at the actual cost of doing business from the prior year and making adjustments as necessary.
  - However, it is always good to look at each item on your budget to determine if you really need to spend money on each category. Start at zero, and build your budget on things you really need to do to accomplish your mission. This method is called zero-based budgeting, and has the advantage of eliminating some items in the budget that truly aren't needed.
  - Develop a realistic budget based on your plans. A form you may wish to use is the Annual Projection Template on the website of First Children's Finance: **http://www.firstchildrensfinance.org/Tools_for_Child_Care_Centers_Financial.html**

Cash Flow Report

A monthly cash flow report helps you with day-to-day budgeting for the actual cash in your account. It tracks when *cash* actually comes into your checking account, and when *cash* actually leaves your checking account.

Unlike a budget, which looks at the bigger picture of whether you make money or lose money over the long term, preparing a monthly cash flow report helps you to project if you will be short of money in a specific month or months, so you can plan for those shortages. If you know, for example, that you are typically short of money every September, you can plan for that by setting aside some of your profit from May to cover those future expenses.

Cash Flow Report

- A monthly cash flow report also helps you to plan when you will actually receive cash in your account – for example, if the family of a child in your care receives child care assistance, you may care for that child in June, but not receive the payment until July or even later. Cash flow planning helps you to determine if you will actually be able to write a check to pay bills when they are due, instead of reacting from crisis to crisis.

- When you know ahead of time what your expenses are going to be for each month, you can plan for expenses when they are due, such as insurance or quarterly taxes.

- You can also plan to use your dollars in ways that are most effective, for example, by targeting your advertising dollars for the times of the year you are likely to gain the most benefit from – like the beginning of the school year or the new calendar year.

Cash Flow Report

And, if the unfortunate occurs, and you don't have a reserve to carry you through a shortfall that lasts a few months, then you can plan ahead of time to arrange for a line of credit from a lender, or move up the fundraising events that you are planning.

Life can become manageable instead a negative chain reaction of not paying one bill in order to pay another – and you can get some much-needed sleep at night!

For Further Information…

Check out the First Children's Finance website at:

http://www.firstchildrensfinance.org/Tools_for_Child_Care_Centers_Financial.html

to download a sample Cash Flow Projection Worksheet

…and finally…

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The last item to cover in this course is how to set up our <u>chart of accounts</u> so that all of your financial statements really work for <u>you</u>.

One of the first things you do when you set up a computerized accounting system is to set up your chart of accounts.

A chart of accounts is not a report or a financial statement. It is a list of each account that your accounting system tracks, like a Table of Contents in a book, or a "drawer" where you keep similar items in a dresser.

A chart of accounts allows you to classify (sort) financial activities into related categories.

When you enter each individual financial transaction, you designate an individual account or accounts whereby to track that transaction (for example, when you pay your heating bill, you will likely designate that transaction to be put in the "utilities" account).

These accounts cover all of the accounts on your income statement <u>and</u> your balance sheet, and when you produce those reports, each individual transaction you made will show up in the appropriate categories, allowing you to see the big picture.

Chart of Accounts

The chart of accounts includes accounts (categories) from the Balance Sheet – such as assets, liabilities, and equity,

And it includes accounts (categories) from the Income Statement, such as revenues and expenses.

The important part to know is that you don't have to use the chart of accounts that came with your accounting system.

You can tailor it to fit your organization's specific needs.

The software program you are using will likely have an existing chart of accounts, but it will also allow you to delete or add new accounts or sub-accounts.

Chart of Accounts

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Think about it in terms of your own life. You may have created a budget for your personal life

Perhaps you created a category called "food"

…but you still spend more than you make, so you have to see where the problem is

Instead of having one category called food, perhaps you now create subcategories called "food – groceries" and "food-eating out"

It is now easier for you to better understand your spending habits, so you can get your own spending under control and balance your own budget

The same thought process applies to your organization

Reflection

When setting up your chart of accounts, think about what kind of information you will need from your financial statements

- What reports will you want to prepare?
- What kinds of decisions do you need to make about the finances in your business?
- Do you need a great amount of detail, or can you get by with a lower level of detail?

Chart of Accounts

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If you are a nonprofit, will you need to distinguish between corporate and foundation grants so you can monitor your fundraising efforts?

Will you need to keep track of the income and expenses for each separate program so you can make managerial decisions on which program(s) to continue providing to customers, and which ones you may need to discontinue in the future?

Chart of Accounts

Will you need to keep track of your insurance costs separately (business, liability, and worker's compensation, etc., or can they all be combined into one account?

If a nonprofit, will you need to provide specific information at a specific level of detail to your Board of Directors so they have the information they need to act as responsible stewards in managing the organization?

Does the level of detail allow you to determine if you are accomplishing your mission and your vision?

Chart of Accounts

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In a child care center's chart of accounts, your assets may include such items as

- Cash (in checking accounts and savings accounts)
- Other investments
- Accounts Receivable
- Grants Receivable
- Inventory
- Property
- Equipment

Chart of Accounts

In a child care center's chart of accounts, your liabilities may include such items as

- Accounts Payable
- Payroll Taxes Payable
- Insurance Payable
- Notes Payable

And your owner's equity, or net assets, may (depending on for- or non-profit status) may include such items as

- If for-profit, Owner's Capital
- If nonprofit, perhaps accounts like "Unrestricted Net Assets"
- Retained Earnings

Chart of Accounts

In a child care center's chart of accounts, your revenue may include such items as

- Parent Fees
- Child Care Assistance Program Revenues
- Registration/Holding Fees
- Fundraising Revenue
- USDA Food Subsidy Program
- Support – such as contributions and/or events

Chart of Accounts

In a child care center's chart of accounts, your expenses may include such items as:

- Personnel
  - Salaries
  - Payroll Taxes
  - Fringe Benefits
  - Payroll Services
- Transportation
- Occupancy Costs
  - Rent/Mortgage
  - Utilities
  - Building Repairs/Expenses
- Equipment
- Supplies
  - Program Supplies
  - Office Supplies
- Food
- Insurance
- Professional Fees
  - Accounting
  - Legal
- Marketing
- Postage
- Training/Education
- Other

Chart of Accounts

Spending time early on determining what you will need to track and developing your chart of accounts from that viewpoint will make all of your financial pieces more helpful to you.

Creating the appropriate level of detail in your chart of accounts will allow you to make better management decisions because the financial implications of your decisions will be easier to see.

Your accountant or financial consultant may be able to help you set up your chart of accounts so you can get the best information from your financial statements.

Review

The important thing to think about when setting up your chart of accounts is to determine how you plan on using the information you gather from your financial reports.

Some organizations will require a high level of detail, which means that they will need more accounts in their chart of accounts.

Some organizations require less detail, and can group together categories of revenues and expenses.

Most nonprofits will need to file an IRS Form 990, so will need to make sure they keep track of their financial information in a level of detail that allows them to properly fill out and file that form.

Reflection

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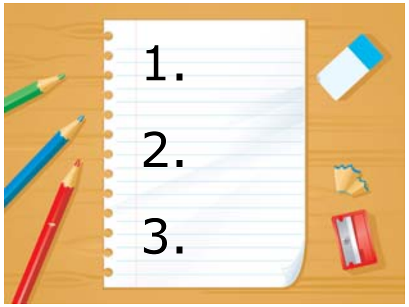
Take a few minutes right now to look at your financial statements. Write down at least three things you might adjust to make your accounting system become a better management tool for you.



Resources

Articles and publications on nonprofit financial resources can be found in the free management library at MAP for Nonprofits : **http://www.mapfornonprofits.org/**

Articles and publications on for-profit financial resources can be found on the Inc.com website at **http://www.inc.com/**, or at the Kauffman Foundation website at **http://www.entrepreneurship.org/**

A comprehensive overview of principles and practices of nonprofit organizations in Minnesota, including financial management, can be obtained through the Minnesota Council of Nonprofits: **http://www.mncn.org/info_principles8.htm**