Budgeting 101

by Donna K. Thornton, MBA

Budgeting is the single most critical element in providing quality childcare. Now that I have your attention and offended some, let me tell you why I can make such a bold and truthful statement. Budgeting is the process of allocating a set amount of money for a particular purpose. How those allocations are made determine if the center is solvent, financially healthy, and providing excellent care.

> Dictionary.com says budgeting is *an itemized summary of estimated or intended expenditures for a given period along with proposals for financing them.*[1]

The responsibility of management is to determine how money is going to be expensed and how the cash flow will be generated to accomplish the budgetary goals – and that is budgeting in its simplest form.

A budget has two categories -- Income and Expenses. Income is driven by setting the right price which generates enough cash to exceed expenses. Expenses are the center's legal obligation for payment.

Expenses fall into two categories – fixed which remain the same regardless until the obligation is fulfilled and variable fixes that fluctuate from month to month.

Fixed expenses are things like rent, mortgages, car payments, utilities, taxes, and loan payments. Variable expenses are payroll, credit cards, maintenance, and consumables. Consumables are anything children consume including food, toys, and materials.

Management decides how much money income will be needed or desires to be spent. Those decisions and process takes deliberate planning.

Budget Planning

Research says that for every minute we invest in planning, we get a four-minute return– that is a 400% Return on Investment. With that kind of margin—we can't afford not to spend time in planning next year's budget.

Sadly many Directors neglect planning especially when it has to do with the budget, but I am trusting this article will change your mind and priority about budget planning.

Planning makes it easier to evaluate the center's progress and makes necessary adjustments if the receipts or spending does not meet projections. Budget planning ends with a solid target and a set of financial goals that will guide you throughout the year.

The Planning Process

In the beginning anything new may feel a little scary and awkward. But budget planning can be fun if you don't dread it. View it as the most important task you have to ensure the success of your program.

You will need to collect some data, schedule time away from the center, and get to work. Now that you are ready to start, use these three simple steps to develop your plan:

1. Look at your historical financial data
2. Examine your present information and spending patterns
3. Look forward to set next year's financial goals.

It's really easy. So, no excuses be diligent until you get your budget on paper.

1st Step Looking Back

Historical data reveals how the center's money was expensed. Examine last year's financial statements and tax returns.

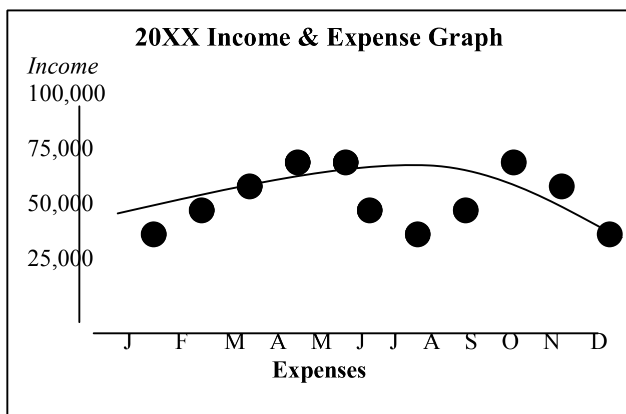
- How much money was spent on payroll?

- What amount was expensed for facility?
- How much money came in?
- Was there any profit?

After those questions are answered, you'll go one step further and take a quick visual snap shot of your income and expenses.

To get a quick picture of your center's cash flow draw a simple graph. Look at the example; the income on the left side, months on the bottom, and cash plotted in dots. When the line is drawn, the picture becomes clear.

After you have plotted the information, it will become clear what months you didn't have enough cash.



This center was in the red or short of meeting its expenses in January, February, June, July, August, and September. It broke even or had enough income in May and December.

It was in the black or had a profit or surplus in April, October and November. Six months out of the year—the center's income was not able to cover the expenses. That tells us something is terribly wrong. The problem could stem from several reasons:

1. The price for care is not set correctly.
2. The center's expenses are out of control or doesn't fall within industry ratios.
3. The tuition is not collected according to policy.

Please do this exercise. It will give you an instant picture of what needs to be corrected and valuable information for your next budget cycle.

Once you have finished the graph, you're ready for the next step -- examining your current situation by looking at your present cash flow and comparing them to some industry ratios.

2nd Step Examining Present Cash Flow

In examining your current cash flow, be honest with your condition. Is cash flowing adequately to meet your weekly obligations? Do you dash to the bank to make the deposit before payroll is due? Are your bills current? Have your payroll tax deposits been made on time?

When cash is flowing, it is so much easier to meet the budgets demands. The stress mounts and life is not good when there isn't enough cash to meet the monthly obligations—and that problem has to be corrected.

Although academicians may debate how much should be allocated on the budget categories, reality dictates that a center's budget must balance. It is fiscally irresponsible to operate in the red or spend more money than is coming in. That is inevitable if you do not know the range or ratios to operate within.

In 1998, Iowa State University published *Child Care: Financial Basics*, which outlined fiscal ratios[2]. The writers proposed:

- Personnel ratios from 55-70%
- Facility(cumulative) costs from17-23%
- Children's consumables from 8-13%
- Miscellaneous /other services from 3-4%
- Profit or surplus from l5-7%.

If we do the math with the higher percentages, we'll discover that's spending is 117% of gross (total) income which would mean that a center would operate at a loss or in the red.

If we calculate the lower end, the center would be at 88% of gross. If we averaged the two

together, we would have spent 102.5% of gross income. Operating over budget for any reason is risky.

For example, if tuition income equals a 100% of total gross revenue and spending is 120% - the center looses 20% annually. If 70% of gross revenue is devoted to payroll – other line items are out of balance and something is forfeited.

Unfortunately, deficits have to be paid. Often owners give up a paycheck or children's resources are sacrificed when ratios are out of balance. Neither is acceptable.

Balancing a child care center's budget and providing great care is achievable when there are fiscally sound ratios. Allocating 50-55% for payroll, 8-10% for Facility cost, 10-12% for Children's consumables, 3-5% for Misc. and 10-15% for profit or surplus results in a solvent center.

Category Explanations

Industry Ratios	
Payroll	50-55%
Facility Cost	8-10%
Consumables	10-12%
Misc.	3- 5%
Profit/Surplus	10- 15%
	81-97%

Payroll costs include direct care staff, administration, benefits, and payroll taxes.

Facility costs are the rent, mortgage, utilities, maintenance, property taxes, and van payments- any cost associated with operating the facility.

Consumable costs are anything that is used or consumed by the children including food, paper products, and toys, even equipment.

Miscellaneous costs include professional fees, emergencies, or anything that doesn't fit nicely into the other categories.

Profits are the excess cash or what is leftover after paying the obligations. It is very important to note here that regardless of your center's tax status, for profit or not for profit – there must be excess or surplus to be financially solvent.

Now its time to do the math on your current expenses in relation with the ratios to determine where you are and what category needs to be brought into line.

If your checkbook is bleeding – that is a good indication you are experiencing a negative cash flow and can remedy that situation by using the industry ratios.

Stay on top of your cash flow. If you align your ratios and the situation is not remedied then ask these questions:

1. Is the tuition policy consistently and fairly enforced?
2. Are late tuitions collected?
3. Are you charging the right price for care?

Cash flow problems can be corrected if costs are controlled, policies are followed, and the correct price is charged for care.

Setting the Right Price

Setting the right price is a process that calculates the breakeven point and adds a profit or surplus to the total. Sounds simple but often its more complicated than that. Our business is emotionally charged and highly competitive which makes pricing complicated.

Directors care about affordability and full enrollment. So many sacrifice the profit margin to meet those conditions. If a profit is not made – a center is not healthy and you can't provide

Parents are willing to pay for good care—so when you are calculating your price – don't call the competition to find out what price they are charging. Charging the right price will ensue making your current obligations.

3rd Step Looking Ahead

Now that you have looked back, looked at the current situation, you are ready to look ahead to next year's spending. Begin by asking:

- What do I want to spend?
- Do I want to give raises? And if so how much?
- Do I need to buy a van or playground equipment?
- Do I want to start a savings or reserve account?

After deciding the total of next year's budget, determine the enrollment that it will require to meet that budget. Divide the projected budget by your center's licensed capacity to get the annual tuition per child. The center's capacity affects the tuition and changes the breakeven point. Because enrollment is rarely maintained at 100% capacity, use a conservative percentage. Look at the difference it makes in the price per week calculating at 100% and 85%.

$$\frac{\text{Projected Budget}}{\text{Licensed Capacity}} = \text{Annual Tuition}$$

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For example:

$750,000 Annual Budget/ Full Capacity 100 Children = $7,500 annual tuition per child or $145 per week

$750,000 Annual Budget/ 85% Capacity 85 Children = $8,824 annual tuition per child or $170 per week

Setting the right price ensures the budget process to be successful.

Conclusion

Budgeting basics begins with understanding the importance of budgeting and its planning process. Budgeting leads to solvency in the financial health of the center and support in the position of providing great child care.

The investment you make in planning and processing your center's budget will yield multiple returns. By reviewing your budget regularly, you'll feel confident in knowing the numbers; assured in understanding the ratios, and have the information you need to make adjustments quickly before problems mushroom.

Franklin D. Roosevelt said *Happiness is not in the mere possession of money, it lies in the joy of achievement and in the thrill of creative effort.* Enjoy the budgeting process. You will be thrilled when you see your projections come into reality.

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