Cumbria County Council

Financial Planning/ Management

We hope this brief guide will prove helpful. However if you require support or further clarification on any of these matters please contact our Business Adviser by contacting the Children and Families Information Service on **08457 125 737.**

The Business Adviser can offer advice with developing business plans and financial planning. The Business Adviser can also offer support on a range of other business and management related issues including marketing, fundraising, governance and sustainability.

Sound financial management is central to the effective running of any early years setting; therefore it is vital that finances are properly planned, monitored and controlled. This guide will help to explain (and possibly make easier) some of the aspects of financial management for you.

All elements of your finances need to be managed, planned and monitored on a regular basis - especially your bank balance and what cash you have coming in and going out. There are three key areas to financial management:

- **Forecasting -** setting a budget and planning cash flow.
- **Management information -** areas that need to be looked at regularly to ensure that the business is healthy, is on track and has enough cash.
- **Financial records -** records need to be kept in order to help settings plan for the future and to make sure they are compliant with any regulations from HMRC, Companies House or the Charity Commission.

Setting a budget

A budget is a detailed statement of what your business expects to spend and receive in every area of your business over a specific period, typically a year.

A budget should detail every item of income and expenditure that is due to occur (you may wish to lump smaller details under broader titles ie under the budget line 'Consumables' you could include the cost of food, milk, sundries etc).

Without a budget the business will not know whether it can continuously cover its costs. Equally if the budget is not updated regularly with actual figures compared against the original estimations managers will have no idea whether things are on track and will not be in control of the business. This regular monitoring allows managers to make changes and implement strategies as and when needed.

When setting the budget businesses who have been in operation should use the previous year's actual trading figures as the base for their estimations and then adapt these in line with inflation, as well as also taking into consideration any plans that may/will change the picture eg growth, addition/reduction of hours occupied, extra/less staff, lower birth rate etc. New businesses will have to use informed estimates based on their market research to produce their budget.

Expenditure

When considering expenditure; costs can fall into one of two categories 'fixed' and 'variable'.

Fixed costs - are costs that generally remain the same and have to be paid irrespective of the number of children in the setting eg rent, rates, and utility bills. As these costs generally remain the same year to year they can be budgeted for.

Variable costs - are costs that will increase/decrease depending on the number of children attending the setting, for example if you have more children your snack bill (if you provide them) will likely increase. These costs can be harder to budget for, especially if occupancy levels change significantly throughout the year.

The biggest expenditure for most childcare settings is staff salaries. It is important to remember when budgeting staff costs you include staff on-costs such as employer's contribution to PAYE, National Insurance and Pension contributions. It is also important to budget for any periods of sickness/holidays that will result in extra staff having cover in order to meet the required staffing ratios.

Reserves

All businesses should also allocate an amount for contingency, to allow for any unexpected problems that may occur. We recommend settings keep as a minimum three months' worth of running costs along with enough money to cover their redundancy commitment (this can be calculated here **gov.uk/calculate-your-redundancy-pay)** - we recommend this amount as it should be an adequate level of funds if the provision had to close.

Many businesses keep this money in a higher interest account away from their current account (although this is good practice, only do it if your cash flow allows you to). Having a current Business Plan in place will help to identify what contingency may be needed. There is advice and templates of Business Plans available on our webpage **cumbria.gov.uk/childrensservices/childrenandfamilies/cfis/childcarersupport.asp**

Capital Expenditure (such as a new building/extension) - should be recorded separately for both the income/expenditure. Please note many childcare settings are not registered for VAT on their normal trading activities, but have to pay it on major building works - VAT is a very complex matter, please refer to your accountant for more information.

Income

When predicting income it is helpful to display the different sources separately. Income sources may include; fees, free entitlement payments, any grants to be received and for the voluntary sector any fundraising/donations likely to be raised. Try to ensure all levels of income are both realistic and achievable.

If you are an existing business you can use various sources of information to aid these calculations i.e. last year's figures, numbers on role, previous trends, Free Early Education Single Funding Formula budget forecast, numbers of children in the area (taken from the Cumbria Observatory) etc.

If you are a new business your market research will be crucial for this exercise, it will enable you to know specific information about your area and the fees and services currently delivered there - ultimately other childcare businesses in your area may be your competitors. For new businesses it is also important that a number of forecasts are produced based on different levels of occupancy so that it displays the impact of each scenario on the business.

Please note all organisations - even charities, have to; even if it's minimal, make a surplus in order to survive. In order to do this it is important that you set your fees above your break even point. Break even point is the point in which a setting neither makes a profit or a loss.

Calculating your fees break-even point (based on 75% occupancy)

Use your budget to work out what your annual expenditure will be:

Total annual expenditure	÷	**Number of weeks open (per year)**	=	**Weekly expenditure**

The next step is to calculate your maximum hours available each week to sell.

Hours per week the setting can offer	x	**Number of registered places**	=	**Total hours available to be sold each week**

As it is unrealistic to expect 100% occupancy, especially when just starting out, this exercise is being based on a setting achieving 75% occupancy. Therefore to work out the total number of hours likely to be sold based on 75% occupancy do the following calculation, (N.B. change the figure in the second box to the occupancy percentage you think your setting is likely to achieve).

Total hours available to be sold each week	x	**0.75 (for 75%)**	=	**Total hours likely to be sold each week**

From this you can work out what price you need to charge per hour in order to break even when occupancy is at the realistic level.

Weekly expenditure	÷	**Total hours likely to be sold each week**	=	**Break even hourly rate**

As previously explained, all organisations, even charities, need to make a surplus in order to survive as this surplus helps:

- Provide a buffer against late payers or unexpected bills.
- Provide a buffer against seasonal ups and downs in income.
- Build up cash for refurbishments or updating toys and equipment.
- Reinvest in the business including training and development for staff and volunteers.

Therefore your fee should be your break even hourly rate plus a 'profit margin'. Your 'profit margin' is something you need to really consider. How much of a margin you apply is completely up to you, but ensure you don't price yourself out of the market unless of course you provide something that local competitors don't and that your parents are willing to pay for.

Your profit margin could be based on a certain amount extra per hour e.g. 60p per hour or a percentage of the fee per session. Either way your profit margin means that for every hour of childcare you are providing for each fee paying child you will be gaining that amount towards your profit. (i.e. if the break even fee was £3.00 and you decided on a 20% profit margin you would be charging £3.60 per hour per fee paying child, therefore gaining 60p towards your profit for every hour they attend).

Once you have decided on an hourly fee rate it may also help to calculate your occupancy breakeven - this is the amount of fee paying children you will need to attend each day in order to cover your costs.

Total hours likely to be sold each week	÷	**Total hours available each week**	=	**Number of full time* children needed to break even each week**

*by full time it is meant that the child attends for every hour the setting can offer each week. Please note this does not take into consideration any Free Entitlement funding.

Cash flow forecasting

A cash flow forecast is designed to show just that - the flow of money into and out of the business on a month by month basis (ie when cash will be spent or received). Cash is the lifeblood of every business and many businesses fail not because they are not profitable but because they don't have enough cash available. The time you spend working out your cash needs and monitoring your cash flow is time well spent. This is because a cash flow forecast allows a setting to:

- Find out when you might not have enough cash before you run out, enabling you to put plans in place to address these shortfalls. This is by far the most important reason for a cash flow forecast.
- Find out when you might make extra cash and plan efficient uses for it.
- Make sure you have enough cash for any essential purchases.
- Ascertain the impact of potential changes on the business for example a rise in minimum wage, the cost of taking on an extra member of staff etc.

Cash movements in your childcare business will happen daily; receiving payments from parents, paying bills, purchasing goods and use of petty cash. As the picture will change so quickly it is important to review these figures regularly. By doing this it will not only save time in the long run but will also enable you to make management decisions quickly and efficiently based on sound evidence.

The initial establishing of a cash flow may take some time, but once established updating any changes (such as increasing/decreasing child numbers) or cash movements will be a quick and easy task. A sample cash flow forecast is available on our webpage - you may wish to adopt this template or adapt/develop your own in line with your own specific income/expenditure lines.

Monitoring

Good financial management is just as essential before you begin the business as well as throughout its operation. Regular monitoring allows you to look at:

- **The past -** to learn lessons and develop for the future.
- **The present -** to make sure everything is going as it should be.
- **To the future -** to make plans, to test various scenarios (such as wage increases etc) and ensure business sustainability.

As we said above regular financial monitoring allows managers to make changes/implement strategies as and when required, giving managers much greater control over the business. Once a budget has been established it is advisable to check your financial position at least once a month. This should include comparing income and expenditure against those set out in your original budget. Regularly reviewing allows any inconsistencies to be identified and understood at an earlier position - allowing the setting to put plans in place to address these variances as required before things get out of hand.

Best Value

It's advisable to look at any contracts in place on at least an annual basis to see whether they are still best value. These may include banking services, utility bills, waste collection and any other product/service you pay for. This should not be a hugely time consuming task but may save you some money!

Keeping Records

Keeping accurate accounting records is an essential part of financial management, not only could it possibly save you money on your accountancy fees (if you use one) but it is also a legal requirement placed upon businesses. Businesses have to keep up-to-date and accurate records of income and expenditure. HMRC require such financial records and related paperwork be kept for a minimum of six years from the end of the last company financial year that they relate to.

Supporting paperwork should be kept along with accounts books (either paper or on computer). Please note this is not an exhaustive list but some of the paperwork required to be kept include:

- Invoices raised by the business for fees.
- Details of any grant funding.
- Paperwork supporting any other income sources.
- Receipts for anything purchased by the business.
- Invoices for costs such as rent, rates, gas, electricity, water.
- Invoices for repairs.
- Invoices or receipts for any travelling expenses.
- Details of wages paid to employees and PAYE, NI and any other deductions or payments made through the payroll ie pay slips.
- Bank/loan statements.
- Cheque books and paying in book stubs.
- Contracts relating to grant funding.

The law does not state how businesses must store this information; therefore a filing system that you introduce is your own preference.

Penalties can be incurred if you do not keep adequate records or you do not keep your records for the required period of time.

Petty Cash

'Petty Cash' is a system for managing the money kept in a business to meet small, everyday expenses that don't really justify the cost and complication of going through a formal process of placing orders, paying invoices, writing cheques etc - this may be used for items such as milk, stamps etc.

Although 'petty cash' is a less formal way of administrating money that does not mean you can be casual about the way you operate your system.

Petty cash should be kept in a locked box in a safe place, together with receipts for money spent. Managers may decide that only certain members of staff have access to this money. Managers should stress the importance of keeping receipts for goods the money is used to purchase.

One person should be responsible for petty cash. They should first decide on how much the float should be, this amount will vary from setting to setting but will be just a little over the amount that is usually spent in a month (for example £100). This amount will need to be withdrawn from the bank.

This money should then be placed in the 'petty cash' box and recorded in the petty cash book or on an Excel template developed for the same purpose.

Every time money is taken out, a petty cash receipt or voucher should be written and then signed when the money is handed over. The receipt for the goods this money is used for should then be attached to the petty cash voucher.

The receipts/vouchers should be recorded in chronological order.

At the point that the 'petty cash tin' is balanced the payments vouchers are totalled up - the vouchers total plus the money in the tin should add up to the original float amount i.e. if the float was £100, the vouchers add up to £75 therefore there should be £25 in cash remaining in the box.

A cheque would then be drawn up for cash to make the float back to its original amount and the vouchers filed away.

It's suggested the petty cash tin should be balanced on a weekly basis so that any errors can be detected and corrected (any circumstances that may have caused a discrepancy are more likely to be remembered if it is balanced regularly). The frequency of topping up the float will depend on how much and how often it is used, however it is advisable to keep petty cash use to a minimum.

Please note - This money should not be mixed with any other sums of money (for example money received for payment of fees) it should be kept separately at all times; otherwise it is almost impossible to keep track of properly. It is also advisable that when recording the expenditure on your cash flow you break it down by the budget title ie 'consumables' 'resources' etc. rather than lumping it as a sum under the title 'petty cash' as this will help to understand your spending better.