Analyzing Financial Statements

Whether you are the owner of a for profit child care business or the executive director or board member of a nonprofit child care center, you are responsible for the organization. You are responsible for making sure that there are reliable procedures in place to manage the business or organization. You are also responsible for planning for the future of the enterprise.

To carry out your duties, you must have financial information that is **correct** and **timely**. You have to have confidence that the business or organizational financial statements are properly prepared and are providing accurate information. If you have any doubts about the accuracy of your financial information, you should clear those up with your bookkeeping staff or accountant first. If at all possible, management should review financial information monthly. If you are just starting to review your organization's statements regularly, it may take a few months to start noticing patterns or inconsistencies in the information.

Financial Information	What You Should Look For
Balance Sheet The balance sheet is a snapshot of an organization's financial worth. It has three main sections: Assets (what the company owns), Liabilities (what the company owes) and Net Worth (what the company is worth.) Assets = Liabilities + Net Worth	Are assets greater than liabilities? If not, the company has been running at a loss or deficit. Are there enough cash and collectible receivables to cover bills due now? Is the company behind on payroll or other taxes? For nonprofit organizations, are there large deferred revenues without corresponding cash assets? If yes, the nonprofit may be robbing Peter to pay Paul.
Income and Expense Statement The income and expense statement shows the company's income and expenses over a specific period of time (usually a month, quarter, or a year.) The actual income and expenses are typically compared to the budget or projections. Income – Expenses = Profit or Loss	Is income greater than expenses? Was the company able to pay all operating expenses? Are expenses in line with industry averages? Have there been any unusual changes in income or expenses from month to month? Is there anything to watch for in the upcoming month(s)? How do the actual income and expense figures compare to the budget/annual projections?
Budget/Annual Projection The budget or annual projection is prepared annually before the start of the organization's fiscal year. It is based on the organization's goals and objectives for the coming year.	Is the budget or annual projection reasonable and based on previous years' financial performance? How do actual income and expenses relate to the budget for the same period?

www.firstchildrensfinance.org
1-866-562-6801

Management should ultimately do more than review the financial statements. You should compare current financial statements to a benchmark such as the budget or annual projection. You can also compare the current financial statements to those from the past to look for trends, both good and bad, that can affect future performance. Is income growing from year to year or has it been declining? Are profits stable, growing or decreasing over the last few years?

Sometimes, analysis of a few key ratios can be used to expand your understanding of your organization's financial situation. Tracking these ratios from year to year can also help you evaluate your organization's financial situation.

A Few Key Ratios	What They Can Reveal
Current Ratio Current Assets / Current Liabilities = Current Ratio	The Current Ratio gives a clue about an organization's capacity to pay its bills and other obligations in a timely manner. A ratio of 1:1 or higher is considered good.
Quick Ratio Cash + Accounts Receivable / Current Liabilities = Quick Ratio	The Quick Ratio is a more conservative version of the Current Ratio. A ratio of 1:1 or higher is considered very good.
Debt to Net Worth Ratio Total Liabilities / Net Worth = Debt to Net Worth Ratio	The Debt to Net Worth Ratio measures how well an organization can borrow money and repay its creditors. A ratio of 3:1 or lower is generally considered satisfactory. If a child care business or organization owns real estate and is carrying a mortgage, a Debt to Net Worth Ratio as high as 6:1 may be acceptable. A negative ratio is not good and shows that the company has been operating at a loss.
Percentage of Budget for Personnel Total Wages + Taxes + Benefits Expense / Total Expenses = Personnel Costs Rate	This percentage rate is typically between 55% to 70% for child care businesses. However, many nonprofit or specialized early care and education programs may have a higher personnel cost percentage. Any change in the Personnel Costs Rate is significant, because staff costs are the largest expense item.
Days Cash on Hand Unrestricted Cash / Total Operating Expenses (minus depreciation and unusual non-operating expenses)/365 = Days Cash on Hand	This gives a quick test of how adequate the organization's operating reserve is. Thirty days is a minimum reserve with 90 days as a goal. Days Cash on Hand is especially important for nonprofit organizations dependent on operating grants or enterprises that receive most of their income from the child care assistance program.