Homecare Cooperative Initiative

A Project of CDF

IN PARTNERSHIP WITH ICA GROUP

Introduction to Financial Management:

A Manual for Home Care Cooperative Board Members

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About this Manual

This manual is part of the Cooperative Development Foundation's Rural Cooperative Development Grant. The ICA Group and Margaret Lund wrote this report to assist CDF and the Homecare Cooperative Initiative in its efforts to strengthen, grow and scale home care worker cooperatives across the country. For more information visit: www.cdf.coop or www.icagroup.org.

How to use this manual

You have just been elected to the board of directors of your homecare cooperative – congratulations! Election to the board is a sign that your fellow members have confidence in you and trust you to help oversee the important shared asset that is your cooperative.

The purpose of this manual is to help you to do just that: fulfill your duty as a board member to oversee the financial health of the cooperative and steward its assets on behalf of all the members. Having a better understanding of financial measures and metrics will also help you to identify possible issues or challenges faced by your co-op, and more effectively discuss solutions with your fellow board members and management. It will also help you identify key opportunities for the co-op to advance its mission.

It's a big job – where to start?

One clear way to think about the duty of a co-op board member from a financial perspective is that your job is to **MEASURE**, **MONITOR**, and **MANAGE** the financial health of our co-op. This guide will give you tools for doing all three. Focusing on the most important aspects of your cooperative's financial picture will help you to understand the **past** performance of the cooperative, grasp its **present** financial position, and plan for the **future** you want.

FINANCIAL DUTIES OF A CO-OP BOARD MEMBER

MEASURE

Tools: Financial Statement
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MONITOR

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MANAGE

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MEASURE

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Measuring Financial Performance: How to read financial statements

The fundamental tools for understanding and measuring financial performance in any business are the financial statements. The two most common financial statements are the income statement and the balance sheet. These two are often joined by a third report, a cash flow statement, which helps to link the two. All three of these reports are illustrations of past performance, that is, they tell us what has already happened. The income statement shows how money has flowed through an organization over a certain period of time, while the balance sheet is a measure of all of the financial activity in a business up to a particular date.

The Income Statement

Where is our money coming from? Where is it going?

Is our cooperative a profitable business?

Many people see the income statement as the most important of all the financial reports because it tells you where your money came from and where it went.

Income statements show the financial activity of a company over a period of time. The sample on page 6 is an annual statement, so it shows the total income and expenses for the co-op over the course of an entire year. Income statements are also commonly generated for shorter periods of time, such as monthly, quarterly or "year to date." These shorter time period statements allow you to see things like the seasonality of a business, if revenues or expenses tend to always go up or down at certain times of year. They also help to pinpoint the exact point in time where something important may have changed in the organization.

Common Financial Statements

- Income Statement: The financial activity of a company over a period of time.
- Balance Sheet: A "snapshot" at one particular point in time, showing how the co-op has used its money in the past, and where the money came from.
- Cash Flow Statement: A measure of how much cash entered (or left) the cooperative over a period of time.

What an income statement tells you:

Revenues

In our sample on page 6, we can see that our co-op has both public pay clients and private pay. It is good to track income by source so the board can see if one or two customers represent a large portion of income, or if revenue from certain clients is going up or down. (Other versions could contain even more detail, tracking each major public pay client by name for example.) For a home care agency, the equation for revenue is Billable Hours x Billing Rate. Revenue sources with higher billing rates will drive more revenue from fewer hours and revenue sources with lower rates will need to bill more hours to bring in more revenue.

Cost of Goods Sold

"Cost of Goods Sold", or COGS as it is known ($758,400 in our example), is the direct expense of creating the goods or services that a company sells. For a bakery, this would be the cost of flour, sugar, eggs etc. plus the bakers' wages to make the bread and cakes. For homecare, this figure is almost entirely made up of caregiver wages and other related personnel expenses.

Gross Margin

"Gross margin," also called "gross profit" ($256,600 in our example) is the amount that is left over after paying the core costs of delivering care. These are the funds available to pay all other expenses, including rent, equipment, marketing, staff recruitment and any administrative expenses. This is what people are referring to when they say "overhead"—it's literally the cost of keeping a roof overhead, and other related things that are necessary just to do business.

Net Income

"Net income" ($58,205) is what is left after all expenses have been paid. This figure is usually presented before taxes are figured in to make it easier to compare the core business performance of a company year to year, even if tax rates change. This number can also be known as net operating income, as opposed to accounting net income which includes taxes.

Each expense is listed separately, to make it easier to see where the money went (see income statement on page 7). Items on the income statement are often presented as a percentage of revenues, so you can see if your co-op's performance is in line with comparable companies, even if those companies are bigger or smaller than yours in terms of revenue. Income statements are also commonly presented with a comparable column, comparing each entry to this point last year, for example, or comparing each entry to the budgeted figure (we will see examples later in this manual). This helps board members to identify if something isn't going as expected

Sample Homecare Income Statement

	Current Year
Revenue	
Private Pay	800,000
Public Pay	200,000
Billable Mileage	15,000
Total Revenue	1,015,000
Total COGS	758,400
Gross Margin	256,600
Operating Expenses	
Administrative Payroll	109,500
Marketing	20,000
Professional Services	7,600
Board Expenses	2,350
Recruitment	10,200
Office Expense	18,715
General and Admin	26,530
Total Expense	194,895
Net Operating Income	61,705
Other Income/Expense	
Interest	3,500
Net Income Before Taxes	58,205

and may be an issue they want to ask management to explain further. These types of comparisons are described further in the Monitor section of this manual.

In this example, for every $1 the co-op makes in sales, it will need to pay about 75 cents of that dollar out to a caregiver to provide the direct care (a variable expense described more on page 8), leaving only about 25 cents of each dollar to cover all other "fixed" expenses. "Break-even" (a concept discussed more below on page 24) is when the co-op has enough revenue after paying all the variable expenses to pay all the fixed ones.

Sample Homecare Income Statement

	Current Year	
Revenue	1,015,000	
Total Cost of Good Sold (COGS)	758,400	74.7%
Gross Margin	256,600	25.3%
Operating Expenses	198,395	19.5%
Net Ordinary Income before Taxes	58,205	5.7%
Other Income/ Expense		
Net Income Before Taxes	58,205	5.7%

How to use an income statement

It is clear from the example that homecare is a challenging industry – at the end of the day, net income in our example is less than 6% of sales. This means that only six cents of every dollar of revenue will likely end up as profit. Or put another way, to make $100 more in profit, we need $1,667 more in sales. If you charge $25 an hour for example, that means providing 67 more hours of care. If you charge $20 per hour, it takes 83 more hours to make $100 more in profit.

This makes it tempting to look at every expense item and ask, "Why can't we cut out that expense?" in order to get more profit at the end of the day. This is always a fair question, but it is also important to remember that in a high touch service industry like homecare, many expenses are directly related to maintaining and increasing revenue. A co-op that depends on private pay clients, for example, will have to have a strong market presence (which

Fixed and Variable Expenses:

In reviewing expenses, a distinction is often made between "fixed" and "variable" expenses. Fixed are those expenses (like office rent) that are pretty much the same, no matter how much business the organization does. Variable expenses are those like caregiver wages or insurance that change directly based on the amount of work done.

In reality, of course, even "fixed" expenses can change. If a co-op doubles in size, for example, it may need a new office and then this "fixed" expense of office rent will likely go up. But it won't change with every new hour or client, only at intervals. Some expenses can also be both fixed and variable, depending o n how you look at them. Administration costs, for example, can be looked at both as a fixed expense (X number of staff members), or variable (number of hours in admin needed per billable hour of revenue).

usually means marketing expenses) if they want to continue to attract new clients to replace those that will naturally be lost. A homecare co-op might also have to spend regularly on staff recruitment and retention in order to have the caregivers necessary to work the hours needed to bring in the revenue. We also know that higher caregiver wages lead to lower turnover and happier customers. So, while it is certainly true that expenses can and should be managed (the sidebar tells the story of how one co-op successfully dealt with rising mileage costs), a better question for a board member to ask might be: **"What is the co-op getting in return for our spending on X or Y item?"**

The Balance Sheet

What do we own, and what do we owe?

What's this business worth?

The second very important financial statement for a board to review and understand is the balance sheet. A balance sheet is often referred to as a "snapshot" at one particular point in time, showing how the co-op has used its money in the past, and where the money came from.

Assets

The first half of a balance sheet is a list of **"Assets"**. Assets are all the valuable things that the co-op owns. This can include cash in the bank, money owed to the co-op from customers ("accounts receivable"), and any equipment, vehicles or other things of value that it has purchased in the past.

Liabilities and Equity

Where did the money come from to buy all this neat stuff? That is what the second part of the balance sheet tells you. This part is called the **"Liabilities and Equity."**

Liabilities

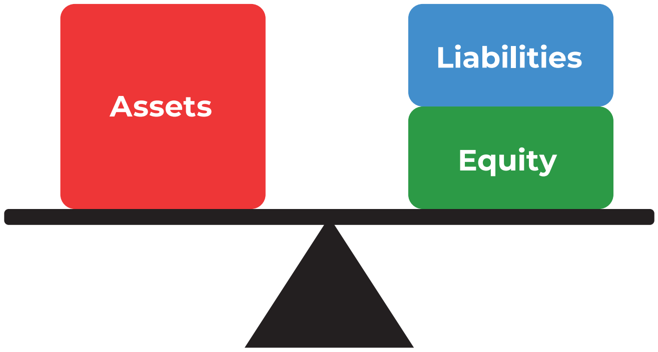
Liabilities are amounts of money that have been borrowed from, or otherwise provided by, other people. This could include a loan from a bank, or any money that is owed on a short-term basis such as a delivery from a supplier that has not yet been paid for, or wages that have been earned by employees but not yet paid out in payroll.

Equity

The other place that money for the co-op can come from is you – that is, from the member-owners of the co-op. All the money that that is invested in a business from the owners of that business is called "**equity**." The total equity or ownership stake in a cooperative is a combination of stock purchased by each member of the co-op, plus any patronage or profits that have been allocated to the member-owners in the past in the form of stock (this is called "patronage retained" because it is retained in the cooperative rather than paid out in cash).

Example: If a used car is priced at $5,000 you might put $1,000 down and get a car loan for the remaining $4,000. In this case, the car is the asset ($5,000), the loan to the bank or credit union is the liability ($4,000), and your equity in the car is the remaining $1,000 you put down.

Additional equity comes from the net income for the current period (you will notice, in our example to on page 10, that the net income figure of $58,205 is the same as the net income figure shown on the income statement) and any net income from the profits of previous years that has been kept in the co-op as “retained earnings” ($13,500 in our example). All these funds together come in some way or other from the member-owners of the co-op, so all of them together make up the total equity that owners hold in the business. Taken together, the liabilities and equity section shows what is **owed** to others and what is **owned** by the cooperative member-owners themselves.



Co-op Case Study: Mileage Expenses

Caring Co-op is a worker-owned cooperative serving a public pay market in a rural area. For a year and a half, the cooperative had struggled with financial losses—revenues had declined while expenses stayed almost the same, delivering the co-ops its first operating loss in four years. A line-by-line analysis of expenses found one major culprit -- the co-ops mileage reimbursements to members had gone through the roof! Slowly creeping up every year, total mileage reimbursement expense had more than doubled in four years, while the average miles driven per caregiver had almost tripled. A major cause was a policy change by their largest public payer client which reduced the allowed number of hours per client, meaning that co-op members had to do more jobs (and drive more miles) to earn the same amount of revenue. Mileage reimbursement was a popular member benefit in this rural market where caregivers are responsible for their own transportation, and the co-op didn’t want to give it up. Instead, co-op leaders took a three-pronged approach of:

1) taking a hard look at scheduling to manage shifts more efficiently;

2) presenting real-time data to their public client, demonstrating the true cost of care and negotiating a rate increase to cover the increased mileage expense generated by the client’s policies;

3) adding expected mileage reimbursement into the effective hourly wage they presented to new recruits, helping to show that caregivers actually had a higher take home pay than some comparable jobs in the marketplace.

In doing so, the co-op showed a savvy combination of cost cutting, revenue enhancement, and making the best of things to address a chronic problem.

As the name implies, a balance sheet must balance. The total value of the assets of the business must equal the combination of liabilities (funds from others) and equity (funds from owners).

Current VS. Long Term

An important further division in a balance sheet is between "current" assets and liabilities and long-term ones.

Current Assets

Current assets are defined as either cash, or anything that can reasonably be turned into cash in 12 months or less. In most home care co-ops, clients pay on a 15-, 30-, or 60-day cycle, so accounts receivables from those clients is a current asset, because we know those invoices will be paid in a relatively short period of time. "Fixed" assets are things like equipment or vehicles that we do not expect to turn into cash anytime soon.

Depreciation

"Depreciation" is an accounting term that basically refers to wear and tear. A new computer, for example, might reasonably last about 3-5 years before it must be replaced. Showing the value of that asset at its purchase price on the balance sheet year after year would not really be accurate, because an old computer is worth a lot less than a new one. Accounting accounts for this issue by removing a little bit of value from a fixed asset every month until the end of its expected useful life, at which point its value for the purposes of the balance sheet will be zero (it could still be useful in real life). In our example, the co-op owns $12,500 worth of equipment, but it

Sample Homecare Cooperative Balance Sheet

	12/31
Current Assets	
Checking Account	$45,000
Savings Account	$22,000
Petty Cash	$300
Total Cash	$67,300
Accounts Receivable	$77,480
Other Current Assets	$900
Total Current Assets	$145,680
Equipment	$25,000
Less Depreciation	($3000)
Total Fixed Assets	$22,000
Total Assets	$167,680
Current Liabilities	
Payroll Liabilities	$28,375
Other Liabilities	$350
Current Part LT Debt	$8,750
Total Current Liabilities	$37,475
Long Term Debt - Bank Loan	$27,000
Line of Credit	$4,500
Total Liabilities	$68,975
Equity	
Member Common Stock	$15,000
Patronage Retained	$12,000
Net Income	$58,205
Retained Earnings	$13,500
Total Equity	$98,705
Total Equity and Liabilities	$167,680

also carries $3,000 of depreciation or wear and tear, which indicates that some of that equipment is likely new, but some of it is not. Because home care doesn't use a lot of equipment, depreciation is not a big concern for our co-ops.

Current Liabilities

Current liabilities are similar to current assets, in that they are debts or other funds owed to other people that are expected to be repaid in less than 12 months. The payroll liability of $28,375 in our example will be paid out on the next payroll date, so that is clearly a current liability. Money owed to suppliers also falls into this category, as does any part of a bank loan that is required to be paid in the next year.

Long-Term

Long term liabilities are funds that are owed to others, but that do not need to be paid right away. An example would be a bank loan with a five-year term. Most of that debt would not need to be paid this year, but rather over the course of the next five years. So, the amount owed on that loan over the next 12 months is a current liability, and the amount owed for the following four years is a long-term liability.

The point of tracking current assets and liabilities is to know what financial obligations the co-op might have in the near term, and whether there is likely to be enough cash (or assets that can quickly be turned into cash) to pay them. Another important reason for board members to pay attention to accounts payable (owed to others) and accounts receivable (owed to us) is to recognize any potential problems early and take care of them. For example, if a big customer used to pay in 30 days and now is taking longer, that is something to pay attention to, and perhaps discuss with them. Similarly, if, for some reason, the co-op is not paying its bills as expected (accounts payable to others starts to creep up more than usual) that is something a board member needs to know and ask management about.

In accounting practice, the difference between current assets and current liabilities is known as "working capital." Managing and tracking working capital is of critical importance to home care cooperatives and will be discussed further in the Monitor section.

Key Takeaways on using a balance sheet

A balance sheet is essentially a story just waiting to be told. In our example, we can see that our co-op has borrowed money from a bank in the past but owns only a modest amount of equipment, so they must have used that bank debt for something else. As a new board member, you want to better understand what the bank loan was used for, and what its terms are. We can also see that the co-op's net income for the year is positive, as is their retained earnings, so they are a profitable company this year and have been profitable in the past (good news for a new board member, a solid company!). These are just some examples. Other elements of the balance sheet can be used to calculate ratios and other tools that will help you as a board member to monitor your co-op's financial performance. We will discuss that more in the Monitor chapter below.

The Cash Flow Statement

Are we going to have enough cash?

If we are supposedly making money, why do we never seem to have any?

A reality of being in business that every owner must face at one time or another (and as a co-op member, you are a business owner!) is the difference between being profitable and having money (that is, cash). **"If we are making money, why don't we ever seem to have any?"** is a common frustration of many small business owners. The cash flow statement is a tool to help you to understand what is going on.

While the income statement and the balance sheet are commonly generated as regular monthly statements for any business, many business owners look at their cash flow statements only once or twice a year. In the home care industry, however, cash flow is often tight, and it is good practice to use this important tool more often.

The example cash flow statement at the start of this section is for our sample co-op.. It starts with net income – how much money did the co-op earn? But that is not where it ends.

To get the final amount of cash we would expect to have, we typically add back two expenses to the net income figure: depreciation and interest. Depreciation is what is called a "non-cash" expense, that is, you don't put any cash towards the expense, but it still shows up on your financial statement. Remember, depreciation is accounting's way of showing the wear and tear on your equipment. To show how your equipment is becoming less valuable over time depreciation gets deducted from Fixed Assets on the balance sheet and is recorded as expense on the income statement. But you don't ever have to pay anyone any new money for that expense because you already paid all the money for the equipment when

Sample Cashflow Statement

	Current Year
Cashflow from Opperations	
Net Income	58,205
Additions to Cash	
Depreciation	3,000
Interest	3,500
Subractions from Cash	
Increases in A/R	(25,000)
Decreases in A/P	(10,500)
Increase in prepaid expenses	(2,655)
Total Change in Working Capital	(31,655)
Net Cash Flow from Operations	(26,500)
New Member Equity	
Cashflow From Investing Activities	5,000
Cashflow from Financing Activites	
Initial Loan	47,300
Loan Payment (debt service)	(11,500)
Net Cashflow from Financing Activites	35,750
Net Change in Cash	67,300
Ending Cash Balance	67,300

you first bought it. This amount is taken out of your income to show the amount of value "lost" in the equipment during the time period the income statement covers. But you can add it back into your cash flow because the cash for this expense was already paid at a previous time, so it doesn't require any cash now.

The table below shows how the purchase of $10,000 in equipment affects cashflow over five years assuming the equipment depreciates at $2,000 per year. We can see that after the initial purchase of the equipment no cash is spent in subsequent years, so we must add back the non-cash expense to our cashflow statement to accurately reflect the amount of cash in the business.

Interest is a different case. When anyone makes a loan payment, part of each payment is to pay interest to the lender, and part of the payment is to pay back the loan (called loan "principal"). Interest is an expense (goes into the income statement) while the principal payment portion reduces the amount owed to the lender on the balance sheet.

The entire loan payment however, needs to be paid in cash and is taken out further down in the cash flow statement. So, we add the interest portion back on top to avoid double-counting this expense.

Accounts Receivable & Accounts Payable

Other items that can affect the amount of cash in the bank at the end of the day are your accounts receivable (money owed TO you) and accounts payable (money YOU owe other people) balances. When you invoice a client for work that you have done, accounting counts that money as "earned" at the time you did the work, so it goes into income at that time. However, we all know that not all customers pay for work on the same schedule. Some pay within a few days, others take two months. These differences account for much of the "accounts receivable" line on the homecare co-ops financial statement.

In our sample case, the co-op has $25,000 more owed to them from clients at the end of the year than at the beginning. The money was recognized as income on the income statement, but the co-op is still waiting to get the actual cash. If the co-op had reduced accounts receivable over the

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Assets						
Cash	(10,000)	0	0	0	0	0
Equipment	10,000					
Depreciation		(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
Net Book Value	10,000	8,000	6,000	4,000	2,000	0
Expenses	0	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)

last year, the amount accounts receivable was reduced by would be added back to cash as the co-op collects the cash owed to the business.

Similarly, an increase or decrease in accounts payable affects cash flow. In this case, the co-op paid down $10,500 of short-term funds they owed to other people over the course of the year (good!), but this also resulted in a reduction in cash.

Prepaid `expenses like insurance also can have a big effect on cash flow. For example, If you have a big insurance bill due once a year, you have to come up with the cash at the time it is due — **It is important to be aware of large annual payments and their typical timing so the cooperative can anticipate this drain on cash and be sure to have saved enough money to pay for it**. But the actual insurance isn't all used up at the time of payment, of course. Rather, the insurance coverage will be valid for the whole year. The remaining amount is known as a "prepaid expense" because the co-op had to pay this expense in advance. Another drain on cash. All of these are grouped together as "cash flow from operational activities" because they have to do with the day-to-day operations of the co-op.

Member Equity

For a cooperative, an important potential source of new cash flow is member equity. When a new member joins the cooperative, they purchase a share of stock in the business. This is not "income" for the co-op, because it's not money in exchange for the sale of a product. Member equity is part of the value of the business. We saw on the balance sheet that member equity is an important element of that document. In our example, each member share costs $1,000 and the co-op gained five new members this year and didn't lose any, so member equity increased by $5,000.

Loans

Finally, we account for any loans that the co-op received in the cash flow statement. A loan is a money you must pay back, so it does not go into the income statement, which is for money earned. But it certainly increases cash. The total amount of a new loan appears on the balance sheet (as a liability, because it is owed to someone else) but it also goes into the cash flow as a positive ($47,300 in this case). Then you take out any amount that you had to make in loan payments over the course of the year ($11,500) to get a net amount of new cash from financing activities.

In our example, between all these transactions, the co-op gained $67,300 in new cash over the course of the year. But the business only earned $58,205, so this is a case where the business ended up with more cash than earnings. Why? The big reason in this case appears to be the loan they took out that year.

Key Takeaways on using a cash flow statement

The most important learning to take away from this discussion is: **Cash flow is different from income**. They are both very important, just different. The other important takeaway is how debt and member equity fit into the cash flow. Both items increase cash but are not income.

Cash versus accrual accounting

One complexity that you will come across if you have anything to do with accounting is Cash versus Accrual accounting. What is that? Cash is easy to understand – in a cash accounting system, everything is “booked” or entered into the accounting system only when payment is received. In a lot of ways that makes sense, and for small amounts of income and expenses, it is probably the way to go.

The trouble is, a cash accounting system makes it very difficult to analyze your business, compare it year to year, and figure out what is going right and what is going wrong.

Just to give an example, what if a big customer, Customer Big, suddenly started paying their bills from the co-op 80 or 90 days after the invoice instead of the usual 30 days. So, the June invoice instead of being paid in the next month, July, as expected, is now being paid in October. That would be a big problem. Under a purely cash accounting system, it would look like the co-op had hardly any earnings in July, because they were used to getting a big check from Customer Big. Yet everybody had worked the same hours in July--they just hadn’t gotten paid as expected. So, a purely cash accounting system makes it look like the problem in July is lack of work, when in fact the problem is late payment.

On the expense side, a purely cash system would also take a large annual payment like an insurance premium, and book it entirely in the month that it was paid, making that one month look unprofitable. But what if there were some normal expenses that were too high in that month as well? That important fact might get buried under the “losses” created by the large insurance bill, making it difficult to identify and focus on important operational issues.

In place of a purely cash accounting system then, we use one called “accrual” accounting. Accrual accounting enters items into the income statement when they occur and in appropriate amounts, rather than when the cash comes in or goes out. Income is booked when earned—making it easy to compare July of this year with July of last year for example. And large annual expenses such as insurance are allocated across the entire year, so 1/12th of the expense would show up each month rather than the whole expense all at one time.

Accrual accounting also makes it possible to accurately figure out some important metrics that will be discussed in the next section, which in turn will make it possible to more accurately track and monitor your co-op’s financial performance (one of your jobs as a board member!). We recommend that all co-ops use an accrual accounting system to ensure accurate reporting of financial activity.

They can help your business to be a better business in many ways: you can use loans to buy equipment or finance receivables to help you grow; and member equity demonstrates the commitment of worker-owners to their co-op. But they are not the same as revenue from selling homecare services.

Conclusion

To build a successful homecare cooperative, you need to sell your services and pay your expenses, with something left over at the end. All three of our key financial statements—the income statement, balance sheet, and cash flow statement—will help your co-op to track and **MEASURE** important information, which can then be used to better understand and **MONITOR** financial performance and **MANAGE** your future.

MONITOR

Homecare Cooperative Initiative

A Project of CDF

MONITORING FINANCIAL PERFORMANCE: HOW TO ANALYZE FINANCIAL PERFORMANCE

It's important to know how your co-op is doing. Now that you have a better handle on that, what to do with all the information?

For most co-op boards, the financial metrics show a combination of some factors that are going well, and some that can be improved. There are several tools that a board can use to help themselves better understand their cooperative's financial position, and how changes in the business will affect financial performance. There are three main methods of monitoring a cooperative's financial performance: comparisons, metrics, and dashboards.

Comparisons

Financial performance can be compared based on time, budgets, or industry benchmarks. Each method provides a different perspective and can help a board member answer key questions.

Time: How are we doing compared to last year, last quarter, or last month?

Comparisons across time are the simplest and most intuitive method of monitoring financial performance. Your cooperative likely already does some form of this during each board meeting. But, as a new board member, how should you use this information to better understand your cooperative?

In the example to the right, we see that the cooperative has increased revenue from year 1 to year 2 by $55,000 with an increase to gross margin of $26,200. Additionally, we can see that the cooperative only increased operating expenses by $6,395, leading to an increase in profits of almost $20,000. What we can conclude is that the co-op was able to increase revenue while adding only minimally to operating expenses. This was a successful year for the co-op – one you would like to repeat in year 3.

SAMPLE HOMECARE INCOME STATEMENT

	Year 2	Year 1	Variance
Revenue	1,015,000	960,000	55,000
(COGS)	758,400	729,600	28,800
Gross Margin	256,600	230,400	26,200
Operating Expenses	198,395	192,000	6,395
Net Ordinary Income before Taxes	58,205	38,400	19,805
Other Income/ Expenses			
Net Income Before Expenses	58,205	38,400	19,805

- Your job as a board member is to see this change and ask follow-up questions to better understand why revenue increased with minimal additional expenses. Did the cooperative find a more cost-efficient marketing strategy?
- Did billable hours per client increase?
- Or, on the other hand, maybe salaried office staff put in long hours in year 2 to grow revenue and are now in danger of burnout.

These are all explanations of why profits increased in year 2, but you won't find out unless you ask the right questions!

Budget: How are we doing compared to how we expected to perform?

Budgeting is a vitally important planning and monitoring tool that all businesses should use. Setting a budget forces the board to plan for the upcoming year, set goals, and think about the long-term success of the business (drafting a budget is discussed in chapter 3 below). Tracking your financial performance in comparison to the budget assures management, the board, and the membership are accountable to each other and to the goals set by the budget. Finally, the budget is a learning tool – it can help the board better understand why the cooperative did or did not meet its financial goals so we can all do better in the future.

In the previous example, compared to year 2 the board was quite happy with the increase in the cooperative's profit. However, when the board turned to a different analytical tool and compared financial performance to what the board budgeted for in year 2, our sample co-op fell short of expectations.

By looking at the variance between the year 2 income statement and the year 2 budget we can see that revenue growth fell short of expectations. Why did this happen? Again, we need to ask more questions.

- Maybe the cooperative did not invest enough in sales and marketing and consequently did not secure the expected number of new clients.

SAMPLE HOMECARE INCOME STATEMENT

	Year 2	Budget	Variance
Revenue	1,015,000	1,200,000	(185,000)
(COGS)	758,400	900,000	(141,600)
Gross Margin	256,600	300,000	(43,400)
Operating Expenses	198,395	200,000	(1,605)
Net Ordinary Income before Taxes	58,205	100,000	(41,795)
Other Income/ Expenses			
Net Income Before Expenses	58,205	100,000	(41,795)

- Or, if the cooperative relies on Medicaid reimbursements, maybe the public payer has been referring fewer clients or fewer hours per client.

By comparing financial performance to the expected budget at various intervals during the year (at the end of every quarter, for example) the board will be better able to identify problems and address them.

Industry Benchmarks: How are we doing compared to similar companies?

Every board member has thought at one time or another, "I wonder what our competition is doing?" While you will not be able to find out exactly what your competition is doing, industry surveys can give you a pretty good sense of how similar agencies are operating. In home care, the Annual Home Care Pulse Benchmarking report provides the most comprehensive collection of financial benchmarks for home care companies. It is very useful for all home care cooperatives to purchase and review the report annually, if possible.

Using data from the 2019 Home Care Pulse Benchmarking report we can see how our sample home care cooperative is performing compared to the industry.

	2018	Percent	Industry Benchmark*
Income	1,015,000		1,835,000
Total COGS	758,400	74.7%	61.9%
Gross Margin	256,600	25.3%	38.1%
Operating Expenses	198,395	19.5%	31.5%
Income before Taxes	58,205	5.7%	6.6%

*Percentages are for agencies between $800k and $1.6 M

We can see the cooperative is smaller than the industry average. For a younger cooperative or one in a more sparsely populated area this would not be surprising, but it also means it might be difficult to compete with larger competitors. We can also see that the cooperative has a much higher Cost of Goods Sold (COGS) than the industry average – why? As a caregiver centered organization, this is most likely due to the higher wages and benefits provided by the cooperative. On the other hand, the cooperative has much lower operating expenses when compared to the industry. It appears that the cooperative balances higher labor costs with lower operating expenses to maintain similar profit margins to the industry at large.

Operating differently than the industry standard is not necessarily a good or bad thing, but it is useful to know as a board member. In our example, it is a good thing that the co-op pays higher wages than the investor-owned companies that make up most of the survey – we want that number to be different. But in other cases, we might want to ask why our expense line for something is so much higher than everyone else's. Your competitors operate in the same market and under the same regulations as your cooperative and have made financial decisions based on those same circumstances. Tracking industry benchmarks gives you a good idea of what your competitors are doing, and how your cooperative is similar or different from them.

Metrics

Your cooperative's income statement, balance sheet, and cashflow statements are full of hidden information that will help you better understand the business. You just need to do some small calculations to reveal a world of useful data for your cooperative. In the table below we have listed out some standard financial management metrics. The remainder of this section will cover some of the most important metrics for home care cooperatives to track.

BASIC FINANCIAL METRICS BY TRACKING PERIOD

Weekly
- Client Hours
- Days' Cash
- Payrolls'

Monthly
- Client Hours
- Net Working Capital
- Average Hourly Rate
- Average Hourly Labor Cost
- Receivables
- Hourly Gross Margin
- Travel Metrics
- Revenue by Payer

Yearly
- Client Hours
- Fixed Costs
- Caregiver Turnover
- Revenue by Payer

Hourly Gross Margin

Hourly gross margin tells you how much the cooperative earns per billable client hour. For example, if the cooperative bills $25 per hour and caregiver wages, benefits, and travel expenses cost $19 per hour, then the hourly gross margin for the cooperative is $6 per hour. So, the metric can be determined by the following formulas:

Hourly—HourlyExpense=Hourlygrossmargin

or

$$\textbf{Hourly Gross Margin} = \frac{\textbf{(Total Gross Margin)}}{\textbf{(Total Client Hours)}}$$

Why is this metric so important? Well, it combines revenue, direct labor costs, overtime expenses, travel costs, and the number of billable client hours into one number that lets management and the board of directors know how much money the cooperative is earning on each hour of work.

How to use Hourly Gross Margin to manage your cooperative

In the above example we know that the cooperative has $6 per hour that will be used to cover operating expenses, pay down debt, and, hopefully, build equity for the membership. Gross margin can be increased in two ways – either increasing prices or decreasing cost of goods sold. For example, if the cooperative regularly bills 50,000 hours per year, an increase in hourly gross margin of $.60 will lead to a $30,000 increase in margin. A corresponding decrease in caregiver wages by $.60 would lead to the same $30,000 increase in gross margin.

For many home care cooperatives, it might be difficult to increase prices, and decreasing caregivers' wages is typically not an option. Despite these restrictions it is still useful to track hourly gross margin because there are other less obvious changes in the business that can also affect hourly gross margin, and that the co-op might be better able to manage. For example, gradual increases in overtime expense and travel costs will eat into the gross margin, slowly eroding the cooperative's profitability over time (remember the example of travel costs on page 9). Knowing this, a cooperative that sees a reduction in hourly gross margins may find that scheduling and hiring challenges resulted in increases to direct labor costs, which in turn, reduced margins, hurting profits. Knowing the cause can help the board find a potential solution.

A gross margin analysis can also be done for each major customer to see which ones are more profitable than others. It might be tempting, for example, to sign a big new contract even if the pay is lower than you would like. But there is a big difference between not making as much profit as you would like and losing money with every hour you work. It may be OK to add a lower paying customer as long as fixed

Co-op Case Study: Overtime Expenses

Nice Town Home Care Cooperative is a successful worker-owned home care cooperative whose clients are mainly private paying individuals and families. Like most homecare agencies, Nice Town Homecare often struggled with recruiting enough caregivers to meet demand. Getting the numbers right was particularly difficult with so many different clients because the number of hours needed could go up and down a lot in a short time period. The co-op found themselves often forced to pay caregivers overtime. This was a benefit to the individual caregiver, but because rates were set according to the base pay, this meant the co-op lost money each hour of overtime. While overtime on holidays was simple to identify and charge back to clients, many overtime hours were due to a short-term mismatch between available caregivers and available hours in general. It was therefore difficult in many cases to allocate the increased cost to a particular client and bill them for it. The co-op considered instituting a penalty for last minute assignments, but worried that would leave a negative impression on new clients, and last minutes assignments were only one of the causes of the problem anyway. Finally, co-op leaders just accepted the fact that overtime was a part of their lives and calculated a new overall rate that all clients would be charged that would cover both the direct expenses of providing each hour of care, plus any expected overtime. Workers were still paid overtime for the specific extra hours they worked, but now the source of that funding was not the particular client, but rather the overall revenue pool. Fortunately, the majority of the co-ops clients accepted the rate increase without question.

Nice Town Homecare Cooperative's thoughtful analysis led to a win-win situation for everyone: members kept their valuable overtime opportunities while the co-op was able to cover the true cost of care without damage to its reputation. At the same time, clients were given a more predictable overall cost structure, something many of them appreciated.

costs are adequately covered, but we should strive to price our services appropriately for each customer. Many large public payers for example, routinely take 60, 90 or even more days to pay their bills. This has a cost. Knowing and understanding your actual costs per customer, or per category of customer, will help you in negotiating viable contracts in the future.

Cash and Working Capital

Managing cash is critical for home care businesses. Cooperative board members can use three simple metrics to better understand their cash position.

- **Day's cash** is a measure of how many days a business can continue to operate without new revenues. In our sample co-op, operating expenses were $198,395 in year 2 – and divided by 365 the co-op spends about $543 per day on operating expenses. At the end of the last fiscal year the co-op had $67,300 in cash, which, when divided by $543 comes to 123.8 days, or more than four months, of cash. Typically, businesses strive to keep at least 60-90 days of cash on hand, but this can vary tremendously by industry.

SAMPLE CO-OP CASH METRICS

Day's Cash	123.8
Payroll's	2.31
Net Working Capital	108,205

or

Hourly Gross Margin = (Total Gross Margin)

(Total Client Hours)

A cooperative with low cash reserves is in danger of missing payroll, while a co-op with an excess of cash should consider either re-investing in growth or distributing the retained equity to its member-owners.

- **Payroll's cash** is a measure of cash that is more specific to the home care industry. By far the largest expense in a home care business is caregivers' wages and other direct labor costs. It is useful to know how many payrolls can be covered by the current amount of cash on hand. Assuming the co-op pays every two weeks, we can divide total COGS by 26 (# of payrolls in a year) to get an average payroll of $29,169. Thus, our sample co-op has a little over two payrolls of cash on hand.

- **Net Working Capital** If a co-op has significant accounts payable or accounts receivable the above two metrics may

METRIC	FORMULA
Day's Cash	Cash on hand / Total Operating Expenses/365
Payroll's Cash*	Cash on hand / Direct Wage Expenses/26
Net Working Capital	(Current Assets)– (Current Libailites)

*26 for co-ops that pay every two weeks, 24 for co-ops that pay twice a month.

or

Hourly Gross Margin = (Total Gross Margin)

(Total Client Hours)

not be the best measure of the co-op's ability to pay its expenses. Net working capital subtracts current liabilities (typically short-term debt plus accounts payable) from current assets (typically cash plus receivables). By factoring in incoming cash (accounts receivable) and outgoing cash (account payable and debt payments), net working capital is a simple calculation that gives a fuller picture of the co-op's ability to cover its expenses.

Break-even

One of the most important decision-making tools for any business is a break-even analysis. While it sounds complicated a break-even analysis is actually quite simple. For a home care business, the formula is:

$$\textbf{Billable Client Hours} = \frac{\textbf{(Total Operating Expenses)}}{\textbf{(Hourly Gross Margin)}}$$

For example, let's imagine your cooperative billed 40,600 hours at $25 per hour last year with an average hourly labor cost (wages + taxes+ benefits) of $18.68 per hour. Therefore, the hourly gross margin is $6.32 per hour ($25-$18.68) and your break-even is:

$$\textbf{Break-even (volume or units)} = \frac{198{,}395}{\$6.32/\text{hour}}$$

$$= \textbf{31,390}$$

This means that your cooperative needs to bill 31,390 hours' worth of work, at average rates and costs, to cover operating expenses. Hours beyond that amount contribute to paying down debt, distributing equity to members, or saving for future cash flow needs

For a start-up cooperative the break-even analysis helps to give a target for the number of billable hours needed for the business to achieve financial sustainability and independence. Given that your cooperative is already in operation, how can your cooperative use the break-even formula? One useful scenario is when the cooperative needs to increase or add an operating expense. In this case, you can use the break-even formula to better understand the impact of that new expense on the cooperative. For example, if you needed to hire a new administrative staff member at a total cost of $50,000 per year. What does this mean for the co-op?

$$\textbf{Break-even (volume or units)} = \frac{(198{,}395 + 50{,}000)}{\$6.32/\text{hour}}$$

$$= \textbf{39,301 hours}$$

Using the break-even formula, we can see the co-op now needs an additional 8,000 billable hours to cover the additional operating expenses associated with hiring the new administrative staff person and still achieve the same financial results. While the cooperative could add this new staff member and still be slightly profitable, it will be more difficult at the current level of business. On the other hand, if the new staff member is in a sales and marketing role, the board could expect them to bring in more than 8,000 hours of new business. In this case it may be well worth the expense.

It is important to note that break-even is only the beginning number we need. Achieving break-even means that the business is not losing money with every hour; but it is not necessarily making money either. This formula is a very useful quick calculation, but does not account for repayment of debt, for returning equity to member-owners, or to build a reserve. A co-op that has debt to service or that aims to return a small patronage refund to members will have to bill additional hours to yield the cash for those needs.

Advanced Financial Metrics

Tracking key financial metrics will give a cooperative's management and board of directors a solid understanding of the financial and operational health of the cooperative. As a cooperative grows, though, and complexity increases there are more advanced financial metrics that must be tracked. The metrics in this section are divided up into three sections: income statement metrics, balance sheets metrics, and home care specific metrics.

Income Statement
- Revenue by payer
- Travel Time and Mileage

Balance Sheet
- Average Days Receivable
- Payrolls Cash

Home Care Specific
- Per Client Acquisition Cost
- Client Lifetime Value
- Caregiver Lifetime Value

Income Statement Metrics

Revenue by payer: For any cooperative that receives revenue from both public pay and private pay clients it is critical to understand the overall percentage of the cooperative's revenue that is generated by each client type. This will help determine what the right client mix is for the cooperative and will allow management to set targets for either growth or reduction in different revenue categories, depending on the cooperative's needs and goals.

Travel Time and Mileage: Some cooperatives choose to reimburse caregivers for travel time and mileage. This expense will vary based on where a client lives and how urban or rural a cooperative's service area is. When taking on a new client it is important to consider travel time and mileage in relation to the new revenue that the client will generate. If not closely monitored,

METRIC	FORMULA
Average Days Receivable	$\frac{\text{Accounts Receivable x 365}}{\text{Annual Revenue}}$
	This formula allows a business to calculate the average numbers of days an account receivable is outstanding for the business.
Payrolls Cash	$\frac{\text{Cash on hand}}{\text{Payroll expenses per period}}$
	This metric allows an agency to understand its ability to cover upcoming payroll expenses with its cash on hand. If this metric equals 1 then the business has exactly enough cash on hand to cover one payroll period.

new clients that increase travel time significantly can increase direct expenses and reduce margins.

Balance Sheet Metrics and Ratios

Quite often the information contained in the balance sheet can best be understood through a few different formulas and ratios. For cashflow management, it is crucial for any home care cooperative to track the metrics outlined below.

Home Care Specific Metrics

In the home care industry, there are benchmarks that all agencies should track to measure their performance. While national benchmarks will not always be a perfect match for local markets, they should be used as a guideline to track the cooperative's performance in comparison to the industry.

Per Client Acquisition Cost: Client acquisition costs are important to track as they tell you how much money the agency is spending to bring in a new client. If it costs $500 to bring on a new client, an agency needs to bill a minimum of $500 of work with that client to make up for marketing expenses. High client acquisition costs might be worth it if that agency can bring on a 24/7 client but might lose money for the cooperative if the client only needs a few hours of home care a week. This metric is important to track by marketing channel. For example, if a newspaper ad costs $500/month and brings in three new clients, client acquisition costs for that marketing channel are $167 – much cheaper than the industry average of $590 per client.

METRIC	FORMULA
Client Acquisition Cost	$\dfrac{\text{(Total Sales and Marketing Expense)}}{\text{Number of new clients}}$
BENCHMARK= $590	
Client Lifetime Value	$\dfrac{\text{Annual Revenue}}{\text{Number of clients}} \times$ Average client length of service (in years)
BENCHMARK= $8,051	
Caregiver Lifetime Value	$\dfrac{\text{Annual Revenue}}{\text{Number of Caregivers}} \times$ Average length of employment (in years)
BENCHMARK= $12,243	

Client Lifetime Value is a measure how much revenue, on average, a home care agency earns per client. Agencies that have clients stay on for longer periods of time will have a higher client lifetime value.

Caregiver Lifetime Value is a measure of how much revenue, on average, a home care agency earns per caregiver. Agencies with better caregiver retention and longer caregiver tenure will have a higher caregiver lifetime value.

Non-Financial Metrics

Are we going to have enough staff to serve our clients?

Are we delivering good value to our member-owners?

Financial measures aren't the only ones that are critical to tracking overall performance in homecare. A key measure in our industry

Co-op Case Study: Performance Management through Metrics

Staff recruitment was a big issue for worker-owned Community Co-op. It seemed like just as soon as one new caregiver was hired, another got lured away by a different job offering better pay or easier working conditions. Co-op members were frustrated that their staff recruitment efforts didn't seem to be leading to any progress.

With the help of a financial consultant, they decided to use their financial metrics to try and solve the problem. First, they identified a goal – how many net new caregivers did they really need to reach their revenue goals? The answer was net five. That meant with expected turnover, the hiring goal had to be higher than that. Next, they started looking at the various places that they advertised for new caregivers. There were local newspaper ads, internet job sites, a local community college with a CNA program, and simply word-of-mouth. Each had different costs. Luckily, the co-op had good financial records and had been tracking these costs separately as "recruitment expenses" so they were able to look at the relationship between each spend and the resulting hires. For six months in a row, the co-op tracked:

- Monthly cost
- # of applications generated
- # of people called back and interviewed
- # of people hired

What they found, not surprisingly, was that the local community college was the best source of solid recruits, yielding by far the lowest cost-per-hire. Somewhat surprisingly, the local newspaper came in second, with the online job board a close third in terms of the actual number of successful new hires generated.

Then Community Co-op took their analysis further: they continued tracking these variables, but also added the additional data points of

- Was still employed at the end of 90 days
- Was still employed at the end of 6 months.

This led to some interesting results. While the online job board had generated almost the same number of hires per dollar as the local newspaper, those hires tended to not stick around. At the 6-month mark, only 1 of 6 was left. The community college recruits had a much better rate of retention, but the best six-month retention rate of all was for those who had come to the co-op through word-of-mouth from existing co-op members. This led Community Co-op to re-think their spending on staff recruitment. While they still use internet ads, they also started exploring new ways of local recruitment building on their success with local newspapers, and most importantly, started offering a referral bonus for any staff member who recruited another solid caregiver to the team. A new emphasis on recruitment in the monthly staff newsletter also led to more quality hires, at no additional cost. Using financial metrics helped Community Co-op to get the most out of their recruitment dollars and make progress on an important strategic goal that previously had seemed impossible.

Non-financial metrics:
Other non-financial metrics that home care agencies include:

- Caregiver turnover
- Client turnover
- Client satisfaction
- Caregiver satisfaction

is staff recruitment and turnover. A co-op that can't keep caregivers will have a much harder time delivering quality care. Other important non-financial metrics are client satisfaction and member satisfaction. All these metrics can be tracked on a regular basis.

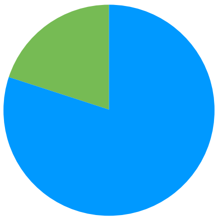
Dashboards

A dashboard can be used to tie all these metrics together into one cohesive snapshot of your co-op's performance. A dashboard typically tracks the 4-5 most important metrics that a co-op board has chosen as their own key datapoints. This will typically include both financial and non-financial metrics.

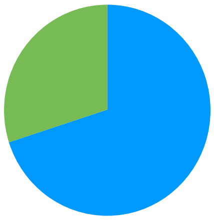
Dashboards are most helpful when the metrics being tracked are tied to goals set by the board at the beginning of the year (see dashboard on pg. 28 about strategic planning). And these goals, in turn, will

	Aug	Sept	Oct	Nov
RECRUITMENT/RETENTION				
Applications	13	44	11	5
Hires	0	2	3	0
Involuntary Turnover	3	2	0	0
Voluntary Turnover	0	0	1	0
Total Turnover	3	2	1	0
Net Change in Workforce	-3	0	2	0
BUSINESS METRICS				
Billable Hours	3,397	3,650	3,524	940
Avg. Billing Rate	$21.00	$20.00	$21.00	$22.00
Gross Marg	33%	32%	33%	34%

SATISFACTION



Caregivers
7/10



Caregivers
8/10

be tied to answering the key question of **“How do we deliver the best value to our member-owners and our community?”**

Some co-ops may choose to track activities in addition to performance metrics. For examples, a co-op that is aiming to improve recruitment and retention may track caregiver turnover as the **performance metric** and number of job applications received as the **activity metric**. This way the co-op can see if certain types of job postings lead to more applications, and if the increase in applications will eventually lead to reduced turnover (see story to the side).

Some dashboards also use **trend analysis** to capture how performance is shifting over time. An example dashboard of this kind is below. This cooperative is focused on increasing margins through targeting higher paying clients and improving caregiver recruitment and retention. Your cooperative will have different goals and will likely choose some other metrics to track.

MANAGE

Homecare Cooperative Initiative

A Project of CDF

MANAGING FINANCIAL PERFORMANCE—HOW TO BUDGET AND PLAN

While it can often be challenging to step back from the day to day challenges of working in a home care cooperative, it is your responsibility as a board member to take the time to plan for the future. In the short-term, it can often feel as if you have more immediate responsibilities, but financial planning is crucial to the long-term success of the cooperative. A cooperative that doesn't plan for the future is not nearly as likely to meet their goals.

Home care can be a frustrating industry, because many of the biggest factors that affect your company's business, such as federal Medicaid reimbursement rates, are simply beyond your control. However, a good board acts to control those things that they can control and build the future they want. The financial management tools you have learned to help understand and monitor your co-op's finances are also great tools to use in planning its future.

At its best, the annual budgeting process should prompt some good conversations between board and management, so start the process early to give yourselves plenty of time. For a co-op on a calendar fiscal year for example, management should generally start drafting the next year's budget in September. That gives the board time to respond to the draft with ideas and questions, and for management and the finance committee of the board to do a second draft for approval at the November or December board meeting. These tasks can be included on your annual board calendar as regularly recurring responsibilities.

Budget

A board's number one tool for managing financial performance is the annual budget. We saw in the previous section that the budget clarifies the previous year's performance, but it is also a planning tool. But you might ask, **"How do I know what is going to happen?"**. You don't. But that shouldn't stop you from thinking about what is likely to happen, and what the co-op's response should be if it does.

Budgets generally start with assumptions based on the previous years' experience. Some budget items you can be pretty sure about—if you have a lease on your office, you know what the rent next year should be (the "fixed" expenses we talked about earlier).

But other big items in the budget are not so obvious – **"Where do we expect our revenue to come from?"** is an important question, for example, and not a simple one. The answer given in the budget will usually be a combination of what happened before (Client A is a good client, and we know they are happy with our performance so we expect that to continue, or Agency B has consistently sent us about $XX in business every year and so likely will again) plus some educated guesses about new things.

A good budget is a combination of comfort and calculated aspiration—you want to feel confident about most of the figures. Yet if you are trying to make improvements to your operations (earn enough to make a distribution to worker members for example

The Board Calendar

Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
Review key metrics	Review key metrics	Review key metrics	Review key metrics	Review key metrics	Review key metrics	Review key metrics	Review key metrics	Review key metrics	Review key metrics	Review key metrics	Review key metrics
Review previous year financials			Review quarterly financials			Review quarterly financials			Review quarterly financials		
Board self-evaluation				Board training				Start drafting budget	Review & amend budget	Approve budget	
Board nominations	Plan annual meeting	Send out board election material	Annual Meeting and board election	Elect board officers				Planning retreat		Plan Manager annual Reviews	Manager annual review
		Member survey			Plan summer picnic		Customer survey		Co-op Month celebration	Plan end of year party	

or add a benefit for members) a budget will also entail some well-thought out ideas for things that you are planning to turn out differently (better) than previous years. Maybe you want to keep your overhead to a specific percentage of revenues or increase your sales by 10%. The budget will help you to monitor your performance, month-by-month, to see how you are doing in meeting these goals. It is important to have these conversations in the board meetings as the budget is being developed to make sure everyone is aligned in the goals. In this respect, a budget is where the strategic planning and financial planning processes meet.

A budget can also show you when things are not going well, and what is likely to happen if no changes or improvements are made. It is one thing to lose money one month, or one quarter, or even one year. But you can't do that month after month or year after year or your cooperative will go out of business. A cooperative is after all a business like any other. The budgeting process is a good place to start confronting some less-than-ideal trends, identifying the causes (what we thought was going to happen versus what actually happened) and discuss what can be done. Budgeting helps you to have this conversation **before** things get too bad, so you can manage the situation.

Managing your financial future entails identifying those measures that you would like to either change or remain the same and following up with yourself on a regular (often monthly) to monitor progress.

This sample we saw in Chapter 2 illustrates this process. In our example, the co-op expected revenue to be about $40,000 more than it was. From a budgeting perspective, a co-op board might ask themselves, **"Which of our revenue estimates turned out to be incorrect, and why?"** They might also examine the operating expense items to see if the board's projections for operating expenses matched growth expectations. Perhaps the board expected a low-cost marketing plan to yield better results. Or maybe a large referral partner began to refer fewer clients over the course of the year. There are often no big right or wrong answers to these questions. The point is to be aware of what happened, in order to better plan for the future.

When building the budget for next year, the board should consider why the cooperative fell short of the budget in year 2. If you have determined that the cooperative under-invested in sales and marketing, then your budget for next year should increase that expense if you plan on growing revenue. Or the cooperative's administrators need to reconnect with a referral partner whose referrals have dropped off in the last year. Effective boards of directors use budgets to understand the previous year's financial performance, learn from it, and incorporate those learning into the following year's budget.

Advanced Financial Management Tools

One of the great things about budgeting and financial projections in general is that you can make mistakes on paper before they happen in reality.

SAMPLE HOMECARE

	Year 2	Budget	Variance
Revenue	1,015,000	1,200,000	(185,000)
(COGS)	758,400	900,000	(141,600)
Gross Margin	256,600	300,000	(43,400)
Operating Expenses	198,395	200,000	(1,605)
Net Ordinary Income before Taxes	58,205	100,000	(41,795)
Other Income/ Expenses			
Net Income Before Expenses	58,205	100,000	(41,795)

Some of the more advanced tools for financial management include making various versions of a budget or financial projection (best case, worst case, most likely case) to see the differences between them – sometimes small variables have big impacts. Another tool is something called **"sensitivity analysis"** or a **"What-If" Analysis** where you look at what might happen if you keep all your assumptions the same but change just one key variable. For example, "What if our labor expense went from 65% to 70%?" or "What if our revenues went down by 10%?" Tools like these can help you, as board members, to better understand some of the risks that your co-op is facing and take some actions to improve the situation.

You will likely need to get some help from a financial professional to use some of these more advanced kinds of financial planning

Co-op Case Study: Budgeting

Best Homecare is a new homecare cooperative, a project of a helpful nonprofit organization whose leaders understood the importance of high-quality jobs and high-quality care for their vulnerable clients. The nonprofit didn't have much experience in homecare directly, but staff had worked in other social service sectors. Based on their previous experience, Best Homecare started out with a full-time officer manager, a full-time care coordinator and a full-time Executive Director, just to make sure everything ran smoothly. The office ran great, but there never seemed to be enough money to pay everybody, and the nonprofit was forced to cover the salaries of some of the cooperative's office staff.

An industry analysis found that Best Homecare had less than $50,000 in revenue with an overhead expense of an organization earning $500,000 in revenue. To bring the co-op more into line with other successful homecare companies and break even on their financial performance, they would either have to increase revenues to cover the cost of the three office employees or reduce the hours (cost) of these positions. With the help of a financial consultant, the co-op determined that they must earn more than five times projected revenue to keep their existing office staff in place without continuing support the co-op through grants. That task seemed just too daunting. Alternately, if they went with the office staff they could afford, they would have to cut the hours of these three jobs in half.

By talking to other homecare cooperatives, Best Homecare found they could combine the Care Coordinator and Office Manager positions into a single job, and make do with a part-time Executive Director, who could also share duties with the parent nonprofit. By making these changes, Best Homecare set themselves on a path to a more stable financial future, and, most importantly, a path towards financial independence from their parent nonprofit.

tools, but they can be a very useful way to see the results of some mistakes on paper instead of expensive reality.

Strategic Planning

A disciplined annual budgeting practice is probably the most important planning tool a co-op board can put in place. You really need an annual budget in order to oversee your co-op and carry out your duties as a board member.

Another vital tool which often gets lost in the hectic nature of daily life is the strategic plan. While a budget is a one-year look into the future, a strategic plan usually has a 3-5 year horizon. In putting together a strategic plan, a board focuses on larger goals and ambitions that may take longer than 12 months to make happen and identifies key steps or milestones that would mark progress in meeting these longer-term objectives.

A strategic plan is a good place to start tackling some more ambitious goals than simply staying afloat year-to-year (which is often hard enough as it is!). For example, a co-op might want to offer healthcare to members. Each year the board tries to fit it in the budget, but each year the idea is dropped because there isn't enough money.

So instead of saying, "We can never afford healthcare," the board could use its financial planning tools (along with a good technical assistance provider to lead the way) and explore a different question which is **"What would have to happen for us to be able to afford to offer healthcare?"**

Using multi-year financial projections and trying out different assumptions, the board could identify the right mix of variables (more revenue, better prices, and/or lower expenses) that would allow enough room

WHEN DO WE DO WHAT?

Required/highly recommend

Monthly	Quarterly	Annually	Every 3-5 Year
Review key metrics	Quarterly financial perfromance review	Hold annual meeting	New strategic plan
Review basic financials		Board elections; officer elections	
		Create and approve annual budget	
		Performance review for management	
		Board self-evaluation	

Best Practices

Monthly	Quarterly	Annually	Every 3-5 Year
Review sub-committee reports	Board education event	Board Training	Appoint sub-committee to review bylaws or key policies as needed
Member newsletter	Member event of some kind	Short member survey	More detailed member survery
		Strategic planning	Customer surbery

to pay for the expected cost of healthcare. Most likely, this would not be an easy process, and some big changes might be needed that could take several years to implement. Maybe co-op members would be willing to trade off mileage reimbursement for healthcare. Or maybe the co-op could grow revenue enough to afford both. In any case, if it were truly a key goal of the co-op, the board could use the strategic planning process to put them on the right path, working effectively together toward this important shared goal.

Concluding Thoughts

MEASURE, **MONITOR** and **MANAGE** are the three financial duties of a member of the board of directors. It is a big task, but luckily there are many cooperative organizations and peers out there to help you do your best job. Never be afraid to ask for help and remember that your knowledge and perspective as a caregiver and as a member-owner are a tremendous asset for your cooperative. Developing your financial skills will only enable you to contribute more. Measure, monitor and manage: with these in mind, every board member can contribute to the financial success of the co-op.

APPENDIX A

Sample Homecare Income Statement

	Dollars
Revenue	
Caregiving Services-Private pay	800,000
Caregiving Services-Public pay	200,000
Billable Mileage	15,000
Total Revenue	1,015,000
Costs of Goods Sold	
Payroll expenses-caregiving	630,000
Payroll taxes	59,850
Paid time off	12,000
Employee health insurance	-
Supplies, caregiving	800
Other Fringe	15,750
Mileage	40,000
Total COGS	758,400
Gross Margin	256,600
Operating Expenses	
Payroll-admin	100,000
FICA/FUTA/SUTA-admin	9,500
Marketing	**20,000**
Advertising	18,000
Website	2,000
Professional Services	**7,600**
Bookkeeping	4,200
Legal	2,500
Acccounting	900
Audit	-
Board Expenses	**2,350**
Annual Meeting	1,800
Facilitator	300
Training	250
Recruitment	**10,200**
Advertising	7,200
Bonuses	3,000

Office Expenses	**18,715**
Rent	12,000
Telephone/internet	2,400
Utilities	2,400
Office Supplies	1,200
Postage	340
Furniture	250
Repair and maintenance	125
General and Admin	**26,530**
Insurance, liability, & property	12,000
Supplies	3,300
Training	2,500
Workers Compensation	1,500
Software	1,200
Misc	1,000
Bank fees	850
Bad debt	55
Employee records, screening	2,200
License and permits	1,925
Total Expenses	194,895
Net Operating Income	61,705
Other Income/Expense	
Interest	3,500
Net Income before Taxes	58,205