BUILDING A BUSINESS

Cash versus accrual accounting

Jane, the new director of the Early Learning Center, has approached Margaret, a CPA, about preparing the center's federal income tax return.

"I assume you use the cash method of accounting rather than the accrual method?" says Margaret.

"Yes," says Jane. "Should we be using the other?"

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It's a reasonable question—a distinction that's important for anyone in business to understand.

Cash accounting

In cash accounting you record parents' fees and other income when you receive it. Thus, if a parent's fee is due Oct. 6 and you receive the money any time in October, your bookkeeping would show it as part of your October income. But if a parent doesn't pay until Nov. 1, the payment would show up on the books as November income.

In addition, you record wages and expenses when you issue the check. Thus, if you pay a teacher Oct. 27 and she deposits the check either before the end of the month or in November, it counts as an October expense. As another example, if you get a bill for computer repair in October but you don't pay it until mid-November, your bookkeeping would show it as a November expense.

Cash accounting is the common choice for many small businesses, including child care facilities, because it's simple. You track money as it goes into and out of your bank account, allowing you to see your current balance. You probably manage your personal finances with this method.

Accrual accounting

In the accrual method, you record income when you send the invoice and record expenses when they're billed, regardless of when the income comes in and when you pay the expenses.

This method is usually better for businesses that sell merchandise and maintain an inventory. The owner or manager can see the sales and debts for each month in the bookkeeping ledger, thus knowing how the business is doing financially. It requires more careful bookkeeping, and it provides a long-term view.

One drawback to this method is that it may show more money earned than you actually have in the bank, thus not indicating your true cash flow.

Bad debt

Assume that a family owes you $2,000 for child care services in September. They promised to pay Oct. 1 but instead left with no forwarding address. Under both accounting methods, you have a bad debt.

Under the cash method, you have nothing to record. You never received the $2,000 income. You have a loss, but it's not on the ledger. It's not recorded anywhere, unless you keep a separate notebook for payments due. It may also exist in your head as a wish that you had not extended credit to that family.

Under the accrual method, you record the $2,000 as a receivable in September. When you don't get that amount in October, you deduct it that month as a bad debt. The result is zero—the same as with the cash method.

What if the family wrote you a check for $2,000, and the check bounced? If the family never makes good on the check, it's a bad debt. Under both methods, you recorded the amount, and now you deduct the $2,000 as a bad debt, resulting in a zero.

At tax time, your accountant will need to see your income and expenses set up in the cash accounting method. QuickBooks™ software allows you to easily switch between the two methods. If you are a sole proprietor (family-based caregiver, for example), your accountant will report income, expenses, and bad debts on Schedule C of IRS Form 1040: “Profit or Loss from Business.” Partnerships will use Form 1056, and corporations will use Form 1120.

If you need help in choosing the right method for your business or have questions, consult a CPA or other tax professional. ■

BUILDING A BUSINESS

Ethics: What's a conflict of interest?

The nonprofit Youngtown child care program has decided to sell a donated tract of land that is not needed for the program. George, a real estate agent and member of the program's board, offers to buy the tract. "I'll buy it and save you the hassle," he says.

Jill, the board chair, says, "Thanks, George, I know you're trying to help. But in fairness to our program, I think we need to get an independent appraisal and find an independent sales agent."

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In this scenario, Jill recognizes the potential for George's inability to be impartial in determining a purchase price. In other words, he faces competing interests—what's best for the program versus what he stands to gain for himself (when he sells or develops the tract).

The situation is known in ethics as a **conflict of interest**. The result of such conflicts in behavior and choices could compromise the program's integrity and the public trust.

Ideally, for-profit and nonprofits spell out rules against conflicts of interest in an employee handbook. The rules identify such conflicts and prescribe consequences for engaging in them.

Because such conflicts can be hard to pinpoint, here are additional examples:

- A teacher uses evenings and weekends to starts a child care program almost identical to the one where she is employed.
- A part-time financial manager accepts a free trip to a resort from a vendor and then selects the vendor as the source of the program's supplies.
- A training consultant recommends her boyfriend's company to install a new fence around the playground without disclosing their relationship.
- A secretary accepts a higher paying job at a child care center a few blocks away. On her last day at work, her now-former boss says, "I'll pay you $50 for every parent from there that you send to us."

Conflicts of interest arise from a person's desire for financial gain, career advancement, or extension of help to family and friends. It can also arise from simple ignorance of ethics. Resolving such conflicts can take many forms:

Third-party evaluation. In the example with George above, the board chair appoints a qualified independent individual or firm to handle the land appraisal and sale.

Removal. The teacher above who is forming a competing program resigns, is fired, or abandons her competing program.

Policy of no gifts/trips. The program sets a policy that employees do not accept gifts or trips and sets consequences, such as losing one's job. Exceptions can be allowed, such as permitting a gift whose value falls below a certain dollar amount, such as flowers or a coffee mug from grateful parents.

Disclosure. The training consultant informs the program about her relationship with the boyfriend.

Recusal. The training consultant also recuses herself (abstains) from any decisions about the new fence.

For more information, see *Examples of Conflicts of Interest and Guidelines for Action*, on the website of Monash University in Melbourne, Australia, www.monash.edu/policy-bank/hr/conduct-compliance/examples. See also *Conflict of Interest* in the Texas Workforce Commission's online resource, The A to Z of Personnel Policies at www.twc.state.tx.us/news/efte/table_of_contents-az.html. ■

BUILDING A BUSINESS

Who gives the most to charities?

No, it's not foundations or corporations. It's individuals.

According to the annual report of Giving USA, Americans gave more than $390 billion to U.S. charities in 2016—72 percent by individuals, 15 percent by foundations, and 5 percent by corporations. The remaining 8 percent came from bequests.

Total giving rose 2.7 percent over 2015, and giving by individuals grew at a higher rate than other sources of giving.

The entire report is available for download at www.givingusa.org.

Fundraising author and consultant Andy Robinson lists five steps for attracting individual donors to your nonprofit program:

1. **Identify prospects.** Tip: It's not always the wealthy people. Look around at the people you already know. Who among them cares about children and education? Do they have money to give—even an occasional $25?
2. **Educate and cultivate your prospects.** Invite them to have lunch with your children, read a story to them, or play with the babies. Invite them to an event, such as an Olympic play day. Give them a tour. "When people experience your work firsthand, they will be inspired to give," Robinson writes.
3. **Ask for support.** "The most effective way to ask is face to face." Arrange an appointment and be clear about the purpose of your visit. "The great skill in fundraising is listening—not talking—so prepare questions in advance."
4. **Thank and recognize those that give.** Send a handwritten note, and have a child in your program write (or draw) a note. With donors' permission, publish a list of their names in your newsletter or have them stand up to be recognized at an event.
5. **Involve them more deeply in your work.** Ask them to volunteer in the classroom, serve on your board, or appoint them to committees. Consider the old saying, "If you want advice, ask for money. If you want money, ask for advice."

To read the article by Robinson, see *Attention Nonprofits: 5 Secrets to Attract Donors* at Entrepreneur.com, www.entrepreneur.com/article/233106. ■