Financing strategically is an essential part of systems building. Providing a State and its partners with approaches for a sound and solvent finance strategy is critical. This guide provides an overview of key concepts linking State financing options and systems building. The focus is on defining key state-based financing strategies, providing an overview of practical financial management practices, and reviewing financing forecasting tools.

Finance refers to receiving and allocating funds and conducting analysis designed to build capacity and sustain a system. It is important to consider funding an early childhood education system in new and creative ways. Financing strategically is an approach for States to better use existing and new or ongoing resources, maximizing public revenue and allocating that revenue in new ways. It may mean generating new State revenue, creating or enhancing public-private partnerships, and expanding private sector contributions to the system. Financial management and forecasting are essential practices that help States create and sustain a system. Financing strategically builds a more collaborative system and stronger partnerships.

In today’s world, a well-planned financial effort is necessary to support a vision, standards, and outcomes in an early childhood system. There is pressure to show improved outcomes for young children and ensure that they are ready to succeed in school. There is often a lack of coordination of funding for this age group and for the system that is needed to support positive outcomes. Public funds are limited by target populations and narrowly defined specialized activities required by the funding source. Private and philanthropic initiatives designed to improve quality and accessibility of services are also narrowly targeted, short-term, and often uncoordinated. The result is often a lack of funding for services and supports, as well as disjointed funding, and thus a fragmented early childhood system.1

Revenue Generation Strategies

There are a number of ways to generate revenue to support an early childhood system. This section describes such options as State general revenue, taxing, tax credits, and lotteries. This section of the guide provides descriptions of ways to maximize revenue as well as State examples.

State General Revenue

State general revenue funds are those that are generated through business and property taxation. These funds may be used for any purpose as determined by state authorities.2 States often use general revenue funds to match federal funding, as is required for the Child Care and Development Fund, or as a required funding base to draw down federal funds. General revenue may also be used to go beyond required matching or maintenance-of-effort requirements in early childhood. States frequently use general revenue for state-only programs as well, such as state-sponsored preschools.

State general revenue can be allocated to fund any part of the early childhood system. These allocations may be found as separate line items within organizations, such as education, human services, or consolidated early childhood agencies, and they may also be embedded within formulas, such as state education aid formulas.3

There are numerous examples of States using general revenue to support early childhood, including the following:

- **North Carolina's Smart Start initiative** and Rhode Island's **Starting Right Initiative** are funded partly through general revenue funds.
- Several States use general revenue to support state prekindergarten programs, including Maine, Oklahoma, Texas, and Wisconsin.4
- **Rhode Island** historically allocates more general revenue funds to early care and education than it receives from the federal government. Alaska California, Delaware, Illinois, Massachusetts, Michigan, New York, and Wisconsin have also expended significant amounts of general revenue to support early care and education over the years.5

Taxes

There are several types of taxes that a State might use to generate revenue. A common type of tax is a sales tax, which is a consumption tax imposed by the government on the sale of goods and services. A number of States have dedicated a portion of sales tax income to fund early care and education system initiatives or programs:

- **South Carolina** established preschool for at-risk 4-year-olds as part of an education-improvement bill and funded it with a one-cent increase in sales tax.6
- **Arkansas's** preschool program is also part of an education reform package supported by an Education Trust Fund, which is funded by a dedicated sales tax.7

Another type of tax is the so-called **sin tax**, which is a state-sponsored tax on goods that are considered either physically or morally harmful (such as alcohol, tobacco, and gambling). Several States have been successful in using sin taxes to fund early childhood initiatives.

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• The Arkansas legislature passed a 3-year surtax on beer to enhance funding for early care and education. In fiscal year 2005, the tax was renewed and additional general funds were made available for preschool, increasing the total appropriation to $40 million.  

• California’s First Five program derives nearly all its funds—more than $3 billion so far—from a tax on cigarettes earmarked specifically for public preschool and child health programs.

Tax Credits

There are many types of tax credits. This section reviews personal income tax credits, business income tax credits, and investment and incentive tax credits.

Personal income tax credits are an amount of money that taxpayers are able to subtract from the amount of tax they owe the government. The value of a tax credit depends on what the credit is for; certain types of tax credits are granted to individuals or businesses in specific locations, classifications, or industries. There are examples of personal income tax credits for early childhood, including the following:

• Twenty-six States and the District of Columbia have established a state dependent care tax credit. For example, New York State and New York City have a refundable dependent care tax for eligible families. Families will get extra cash back from the State if their New York State and New York City Child and Dependent Care Credits are worth more than the state and city taxes they owe.

• Louisiana has a school-readiness child care expense tax credit for taxpayers with a qualified dependent under the age of six who attended a child care facility that participates in the quality rating program. The school-readiness child care expense tax credit is in addition to the regular child care expense credit.

Business income tax credits are subsidies that reduce a company's taxes by allowing it to deduct all or part of certain expenses from its income tax bill on a dollar-for-dollar basis. Business tax credits span many areas, including investment, work opportunity, welfare-to-work, alcohol fuels, research and experimentation, low-income housing, and enhanced oil recovery. With regard to early childhood, State activity includes the following:

• Twenty-eight States have established some form of an employer tax credit, which typically allows an employer to claim a corporate tax credit for a percentage of the cost of an employee child care benefit. A business may deduct expenditures for child care programs from its corporate income as reasonable and necessary business expenses before taxes are calculated.

• Maine has a unique tax credit created to improve the quality of child care. If an individual provider spends $10,000 in one year on expenses that significantly improve the quality of care, the provider is able to take a $1,000 tax credit for the next 10 years and a $10,000 credit at the end of 10 years.

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Investment or incentive tax credits are tax deductions for businesses that reflect an amount they reinvest in themselves. Investment tax credits are structured to reward and encourage economic growth. Early childhood examples include the following:

- The Colorado child care contribution tax credit, available against both corporate and personal state income tax, has been in place since 1989. Taxpayers receive a credit worth 25 percent of their contribution, up to $100,000.¹⁶

- The Oregon child care investment tax credit was designed as an investment strategy that used tax credits to generate private sector contributions to child care. Like federal low-income housing tax credits, the Oregon credits are marketed and sold to an investor. Invested funds are then drawn into a single pool that is used to help fund the child care industry. Unlike housing tax credits, which are sold at a price negotiated by an intermediary, taxpayers who purchase Oregon child care credits receive a credit of up to $1 for every $1 contributed.¹⁷

Local Taxes

Local fees and special taxes are taxes that are levied in addition to state and federal taxes. This guide focuses primarily on state-level revenue generation strategies but, in light of growing interest in local leadership for early childhood, it also describes some local efforts that are used to finance early childhood education. These local taxes are frequently property, sales, water, sewer, and school taxes, and occasionally income taxes. Funds generated in this way cover some community services, such as local education, and have been used for early childhood:¹⁸

- Several counties in Florida, including Broward, Duval, Hillsborough, Martin, Miami-Dade, Palm Beach, Pinellas, and St. Lucie, adopted a children’s special taxing district to create new funding for children’s services. This may include paying for improvements in the child care system, professional development opportunities, and other early childhood and child and family supports.¹⁹

- In Oakland, California, a local measure was passed to set aside money to benefit children and youth. Oakland uses a portion of this money to fund several early childhood initiatives including a mental health and development consultant model. This program includes support for consultation in the classroom and child-centered mental health consultation.²⁰

- The City of Seattle, Washington, passed a property tax levy called the Families and Education Levy. The program, administered by the City in collaboration with the Seattle School District, supports funding of programs for school-based and community support to assist with closing the achievement gap of vulnerable populations, professional development opportunities for early care and education teachers, a parent-child home program, and other supports for early learning.²¹

- Texas allows local communities to impose a sales tax that can be used for local initiatives. San Antonio uses local tax dollars for a prekindergarten program.²²

Lotteries

Lotteries raise money through the sale of numbered tickets, with prizes given to the holders of numbers drawn at random. Lotteries are a popular way to fund education; prekindergarten services are included in some States:

- Thirteen States have lotteries with a stated purpose of funding education. Georgia has consistently used lottery proceeds to fund a universal preschool program, and Florida has funded its preschool program partly with lottery dollars.  
- In 2003, the Oklahoma legislature approved a two-part ballot measure to establish an education lottery and enact a constitutional amendment to ensure that all proceeds benefit education from prekindergarten through 12th grade. The Oklahoma State Legislature appropriates 45 percent of funds in the Oklahoma Lottery Education Trust Fund to elementary and secondary education, K–12. Funding can be used to provide compensation for public school teachers, support employees, support early childhood development programs, and the like.
- Tennessee voters have also approved establishment of a lottery and the use of its proceeds for prekindergarten to 12th-grade education.

Gambling or Related Fees

Gambling is playing a game of chance for money or other stakes. States have designated funds from gambling opportunities for early childhood:

- Missouri uses a portion of riverboat gambling fees to fund early care and education services. Missouri considers these fees levied on gamblers and not gambling proceeds.
- Maryland collects gambling fees that go into the Maryland Education Trust Fund. These fund are used to support prekindergarten programs as well as K–12 systems.

Tobacco Settlement Funds

The Tobacco Master Settlement Agreement was entered in November 1998, originally between the four largest United States tobacco companies and the attorneys general of 46 States. Several States, such as Kentucky and Kansas, use a portion of the State’s share of the tobacco settlement to fund early care and education. Kentucky allotted 25 percent of its settlement, or $56 million over two years, beginning in state fiscal year 2000. The State continues to use tobacco settlement funds to support early learning.
Public-Private Strategies, Including Pay for Success

Private resources and expertise can be leveraged to increase the quality and availability of programs and services provided to children from birth to age five. There are many ways to leverage private resources to support early childhood.

- **Hawaii** has leveraged private resources with state and federal dollars to fund *Learning to Grow*. This program provides statewide education outreach to families and license-exempt child care providers to support efforts to enhance children's early learning, healthy development, and high-quality home-based care.30

- **Minnesota** raised and invested private funding to learn about and plan for how to improve its early education system. The project used $20 million in private money to set the foundation for an early learning system.31

**Pay for success, or social impact bonds**, is a relatively new approach to finance that combines funding, program evaluation, and program management. Its goal is to improve social outcomes while more effectively allocating scarce public-sector resources. In one pay-for-success model, the government contracts for a program or initiative to address a societal need. In the start-up mode, philanthropic funders provide the financial resources to pay for the program. In this model, government, service providers, and philanthropic funders agree on targeted outcomes, and independent evaluators monitor program performance.32

Funding for a pay-for-success initiative can come from a number of sources. Should the program achieve the agreed metrics, the government will be able to reimburse the initial funders for their invested capital and reinvest in the program. If the program fails to meet target outcomes, state agencies are not obligated to repay the investors. Under the pay-for-success construct, performance risk is transferred to the private funders. An additional attraction is that these programs often drive fiscal savings along with improved outcomes for the target population.33

One compelling element of pay-for-success or social impact bonds is the combining of some components of results- or performance-based financing and public-private partnerships. New research on pay for success or social impact bonds shows promising practices.34 Some examples of early childhood programs using the pay-for-success model include the following:

- **Utah** established a pay-for-success model for early childhood education for children receiving high-quality preschool. Through a partnership led by United Way of Salt Lake in cooperation with Goldman Sachs and others, the Utah High Quality Preschool Program delivers a high-impact, targeted curriculum to increase school readiness and academic performance among three- and four-year-olds in various community and school settings. The partnership is makes payments based on reduced special education use.35

- **The City of Chicago** has a $16.9 million social impact bond deal to provide early childhood educational services (prekindergarten) to up to 2,620 children for the 2014–15 school year, with additional proposed expansion for 2015–19. The intervention funded by the social impact bond works with both children and their parents through the historic half-day Child-Parent Center (CPC) model. Goldman Sachs’s Social Impact Fund and Northern Trust are serving as the senior lenders, with the J. B. and M. K. Pritzker Family Foundation in a

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33 Ibid.
subordinate position. The program works with preschool children and their parents to improve educational outcomes, providing children with a positive preschool experience and parents with tools to assist with the learning experience. In addition to the proposed intervention goals (readying children for kindergarten, improving third-grade literacy, and reducing the need for special education services), the program has enabled more children to have access to higher-quality preschool experiences.  

Maximizing the Impact of Public Funding

Maximizing the impact of public funds is a financing approach that encourages coordinating and integrating existing public sector funding, the use of shared services, and layering and blending of funds or pooling funds. These strategies can expand a funding base, provide more stable revenues, and provide opportunities to maximize funds for early childhood system building, creating and sustaining an initiative or program.

Coordinating and Integrating Existing Public Sector Funding

Coordinating and integrating existing public sector funding involves taking separate public funding streams that were created to support a specific program and using these funds in a coordinated or integrated way to support system building in early childhood or support an initiative or program. Coordination and integration of public funds often eliminates or minimizes overlap and gaps in services. Some States have sought to improve coordination by restructuring the agencies that administer early childhood funds for integration of public funding.

- Several States have created a governor's children's cabinet or other state-level early childhood agency to ensure coordination and integration of early care and education, including financing issues. In Virginia, the Children's Cabinet is committed to providing coordination oversight across child- and family-serving systems.

- Several States—such as Connecticut, Georgia, Massachusetts, and Washington—have established an entirely new agency to administer all early childhood funds. Others, such as Arkansas and Maryland, have transferred their early childhood programs to one agency. Still others, such as Pennsylvania, have otherwise consolidated their early childhood programs.

- North Carolina created a statewide public-private partnership to manage early care and education funds and improve coordination. North Carolina's partnership for children (Smart Start) supports local entities to advance a high-quality, comprehensive, accountable system of care for early care and education.

Shared Services

Shared services is sharing within an organization or group. Specifically, it refers to one part of an organization or group providing a service that had previously been found in more than one part of the organization or group. Thus, the funding and resourcing of the service is shared.

Shared accountability for results is a fundamental tenet of a shared-services approach. All partners need to ensure that the agreed results are delivered based on defined measures. This approach is emerging as a strategy for maximizing the impact of resources invested in early childhood, primarily for those providing direct services to...
children and their families. This strategy can be seen as supportive of system financing. By providing ways to support a program or provider, it allows funding to be redirected or allocated in different ways. The following are proven results of shared services in early childhood:

- Reduced or shared costs and time through joint purchasing, staff sharing, centralized administration, or some combination
- Shared program or administrative capacity-building through the use of common tools and systems, shared mentoring and supervision, and collaborative improvement processes
- Reinvestment of cost and time savings into enhanced program quality

There are a growing number of emerging and successful shared-services alliances in the early childhood sector. In “intensive” shared-services models, a local or regional network of centers and/or homes collaborates and shares staff to deliver services more efficiently and with greater attention to quality. When organizations come together to participate in a shared service, they are often identified as an alliance. These alliances may use a range of business models to operate.

- Sound Child Care Solutions (SCCS) in Seattle is a local example of shared services. According to its Web site, “SCCS is a consortium of seven child care centers that creates stable child care by sharing administrative, accounting and human resource functions, while simultaneously investing in improved teacher practices by providing ongoing professional development opportunities in alignment with our commitment to undoing institutionalized racism, and providing quality care and education to the children we serve.”
- In Fairfax, Virginia, the Infant Toddler Family Day Care is a shared-services consortium of providers that receive a wide range of supports and services including marketing, training, monthly billing and collections, professional networking, supports to parents, and a substitute pool.
- Quality Care for Children, in Georgia, is a hub for Web-based services that are offered statewide. These shared services include cost savings on food and supplies, templates, and support documents.

Layering or Blending and Braiding Multiple Funding Streams

Layering or blending and braiding multiple funding streams is a process for using multiple funding streams to support a common activity, initiative, or project.

- Blending refers to wrapping funds from two or more funding sources together to fund a specific part of a program or initiative. In blending, costs are not necessarily allocated and tracked by individual funding source.
- When funds are braided, two or more funding sources are coordinated to support the total cost of a service. Revenues are allocated and expenditures tracked by categorical funding source. In braiding, cost-allocation methods are required to assure that there is no duplicate funding of service costs and that each funding source is charged its fair share across the partners.

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At the state level, blending and braiding are financing strategies that federal, state, and local policymakers and program administrators can use to integrate and align discrete categorical funding streams to broaden the impact and reach of services provided. Some early childhood examples include the following:

- **Oregon** passed legislation (HB 3380) to create a diverse-delivery state prekindergarten program and allow multiple types of providers to seek multiple funding streams. The legislation explicitly addresses the goal of using multiple funding streams.

- New York City reorganized its system of contracted child care through EarlyLearn NYC. This program braided funding from child care, Head Start, and state universal prekindergarten to improve access and continuity for low-income children and their families. EarlyLearn NYC has implemented higher program quality standards and redistributed contracts across the city to increase the supply of care in targeted high-need neighborhoods.

- Colorado blends revenues across departments. A data system exists for state and local leaders in Colorado who want to develop comprehensive programs for children and families. The online data tool includes federal and state funding streams and eligibility criteria and identifies the goal area of service delivery. Users can search the database, export Excel files, and produce reports to support efforts to blend and braid federal, state, and local resources to sustain programs.

### Pooling Funds

Pooling funds are funds from many individual investors that are aggregated for the purposes of investment in a program, initiative, or system infrastructure. Many funding streams that support early childhood are categorical and targeted to specific populations of children or fund only specific services for eligible populations. Coordinating different funding sources—including federal, state, private, and local—can provide programs with greater flexibility, enabling them to reach a broader range of children or provide a wider range of services. Coordination at the state level can take different forms, such as pooling flexible funds to create a blended source of funding, or decategorizing funds to remove or realign regulations so they can be blended to provide comprehensive services. These strategies increase access to vital services to those most in need:

- In **Connecticut**, the William Caspar Graustein Memorial Fund supported an Early Childhood Funders Affinity group. The group is comprised of a group of funders—large and small—who make grants to support early care and education in Connecticut. This group has pooled and coordinated funding in areas such as facilities and community engagement.

- In **Missouri**, eight agencies pooled a portion of their funds to fund community partnerships throughout the State. These community partnerships are required to work toward achieving core results for children and families; however, the funds do not restrict them to prescribed services.

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Financial Management

Managing financial resources to achieve goals, objectives, and results that maximize the value of an investment is critical for a long-term horizon in creating a system, project, or initiative in early childhood education. Strategic financial management involves a defined sequence of steps and strategies that include setting goals and objectives, identifying and allocating resources, analyzing data and making financial decisions, tracking the budget for variance, identifying the reasons for any variance, and making corrections as needed. State budget offices use these strategies on a regular basis to ensure that outcomes and results are tracked and achieved. These practices may also be used to manage a local or community project to ensure that the budget is established and managed in an efficient way, and should be incorporated in the work of the state early childhood office.

Setting Goals and Objectives in the Budget Process

Goals help improve the overall effectiveness of budget planning. Objectives are specific steps that are taken to reach the goals. It is critical that there are defined goals and objectives to describe what is to be financed. Several States have developed plans that include goals and objectives (and results and outcomes) to create and sustain an early childhood system. States use this information to inform their early childhood budgets.

For example, Washington State’s Office of Financial Management implements a management framework that includes the proposed strategies in this guide, described in a slightly different way. The Washington State framework includes the following: plan, allocate, manage, analyze, respond, improve, results. The State has goals that agencies use to develop agency strategic plans that match the overall State goals. The state agency strategic plan must describe trends in revenue sources, fund balance changes, and cost pressures that may affect the financial sustainability of the agency. Agencies are required to use the framework in their day-to-day management and to show results.

Measuring for Performance Based on Showing Results

There is a public-sector trend to integrate measuring for performance in the budgeting process. The point is to look for efficiencies and measure results based on performance. Budgeting for results and outcomes links strategic planning, financial planning, performance measures, budgeting, and evaluation. This process also helps link fiscal resources to objectives and goals. The focus is on outcomes and not on organizational structure. The Government Finance Officers Association has provided the following recommendations on how to consider budgeting for results and outcomes.

1. **Determine how much money is available.** The budget should be built on expected revenues. This includes base revenues, new revenue sources, and the potential use of fund balance.
2. **Prioritize results.** The results or outcomes that matter most to citizens should be defined. Elected leaders should determine what programs are most important to their constituents.
3. **Allocate resources among high-priority results.** The allocations should be made in a fair and objective manner.
4. **Conduct analysis to determine what strategies, programs, and activities will best achieve desired results.**

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5. **Budget available dollars to the most significant programs and activities.** The objective is to maximize the benefit of the available resources.

6. **Set measures of annual progress, monitor, and close the feedback loop.** These measures should spell out the expected results and outcomes and how they will be measured.

7. **Check what actually happened.** This involves using performance measures to compare actual versus budgeted results.

8. **Communicate performance results.** Internal and external stakeholders should be informed of the results in an understandable format.⁵⁴

Several States have used results-based budgeting as a way to measure and show the impact of the program or services funded. Examples follow.

- Connecticut, Iowa, and North Carolina have requirements for accountability tracking to report on key indicators related to budgets. These States and their contractors have produce reports that articulate results based on their funding.⁵⁵

- The State of Oregon is implementing a 10-year plan to redesign the way it builds its budget and makes investment decisions. This new design is an outcome-based budget that helps make public resources last and aids decisionmakers in prioritizing public investments that align with the services. This new budgeting system requires the State to set clear budget limits, expectations, and criteria. The process works to build transparency and accountability; budgets will be reviewed by independent teams. Program data are analyzed to ensure that public investments are focused and tied to specific outcomes. Putting this new budgeting system in place requires the State to set clear budget limits, expectations, and criteria.⁵⁶

### Identifying Resources Needed

Identifying resources is the process of evaluating which funding streams and resources are accessible to support the goals and objectives of the system, project, or initiative. The usefulness of current and potential resources can be identified and evaluated through a fiscal analysis study.

A fiscal analysis study or map can provide a report on how funding sources and financing strategies could be used or are used to support key goals and objectives. These studies often provide information on what is presently being spent and the possibility of new sources of funding. A fiscal analysis is a research approach to systematically identify and analyze expenditures. A fiscal analysis or mapping study does the following:

- Identify gaps in current funding and how resources can be more effectively coordinated, maximized, or secured.

- Develop better-coordinated systems of supports and services, including programs and revenue streams that align with key goals and indicators.

- Discover new funding sources that could be leveraged to support programs and services and fund new policy initiatives.

- Maximize funding opportunities through improved coordination and matching and blending of funds.⁵⁷

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The key reason a State, agency, or community coalition completes a fiscal map is “not to find huge pots of money that are being missed, but to look at the funding picture overall to see where there are gaps and redundancies.”

A state example follows:

- The State of Hawaii commissioned a study that summarized how funds align with Hawaii’s framework for an early childhood system; which agencies control key funding sources; and to what extent funding comes from federal, state, or private sources. In addition, the report analyzed how funding sources and financing strategies are and can be used to support Hawaii’s goals for young children.

Analyzing Data and Making Financial Decisions

Analyzing data within the budget process entails considering how funds are allocated and how revenue is obtained. It also includes considering whether goals and objectives are being met within the funding source for the project, initiative, or system. It is important to have accurate and reliable data to make decisions and determine impacts.

It is also important to communicate the financial results once the appropriate financial metrics have been calculated, and to articulate the assumptions that were made throughout the financial analysis process. To ensure that the information and data are understood, a combination of text, graphics, and other visuals may be used to support financial results, data analysis, and key information.

Tracking Variance between Actual and Budgeted

Tracking budgets is important to the success of a program or state initiative. One way to evaluate an initiative’s health is to track the difference between the original plan and what is actually happening. This gap is better known as variance, a comparison of the intended or budgeted amount and the actual amount spent. Variance analysis is the practice of comparing actual results to what was planned or expected. Ensuring that variances in the budget and spending are monitored and addressed is imperative.

Without a clear picture of what the initiative will produce, it is difficult to determine how long it will take or how much it will cost. A sound budget management practice is to review the schedule baseline of the approved budget for a project or initiative, which can then be used as the basis for measuring and reporting budget performance. The cost baseline is the approved time-phased budget that cost performance will be measured against. It is determined by adding the costs for a specific period or phase, which requires assigning costs to project tasks.

Allocating costs to components may be time consuming, but it allows for more detailed and accurate cost-performance reporting. These practices ensure that budgets are tracked, reviewed, adjusted, and managed to certify that outcomes are achieved. Key steps to establish schedule and cost baselines in the budget process include the following:

1. Develop the schedule by identifying the activities and tasks needed to produce each deliverable.

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2. Identify resources for each task.

3. Estimate how long (in hours or days) it will take to complete each task.

4. Estimate the cost of each task, using an average hourly or daily rate for each resource, plus any fixed costs associated with the task.

5. Determine which tasks are dependent on others and then develop the critical path.

6. Develop the cost baseline (a time-phased budget to measure the project's cost performance). To do this, add the estimated costs by task or by time period.

Financial Forecasting

A financial forecast is an estimate of future financial outcomes for an initiative or project. This guide provides basic information on forecasting as well as two examples to assist with forecasting a financial strategy in early childhood system building. Financial forecasting is the practice of projecting the quantitative impact of trends and changes in a working environment on future operations. Therefore, it is an integral part of all ongoing planning efforts. Financial forecasting is important for several reasons:

- Forecasting facilitates planning efforts by quantifying the future costs and benefits of strategic decisions. Thus, budgetary priorities may be evaluated on the basis of their long-term impacts.

- Forecasting clarifies trends, needs, and issues that must be addressed and evaluated in the preparation of budgets. For example, enrollment forecasting may reveal growing student populations and focus attention on the need for increased resource allocations for staff, facilities, or both.

- Forecasting enhances decisionmaking at all levels of administration. Forecasts provide valuable insight into future issues, allowing administrators to be proactive. Forecasting creates the framework for anticipatory management.

Although financial forecasting should be a continuing process, it is of great importance as a component of budget development. Forecasts of projected enrollments, property tax base and revenues, costs associated with salary adjustments, and the like are important elements in setting baseline budgetary guidelines and creating the basis for assumptions used to prepare budgets. Additionally, forecasting provides fiscal impact analysis that may be integrated into the budget development process. Thus, current budgetary decisions may be evaluated for their long-term results.

To prepare for the forecasting process, several steps should be taken to ensure that reliable and useful data are gathered. The following items need to be considered:

- Clarify the intended purpose of the forecast. The prospective audience may require a certain set of data and related assumptions.

- Match the timeframe with the purpose of the forecast. Timeframes for forecasts will vary according to the purpose (i.e., type) of forecast being prepared.

- Ensure the accuracy of basic data. Original source data should be used rather than extrapolated or summarized versions. Sources should be documented and verified if questions concerning data validity arise.

- Specify the underlying assumptions. Assumptions should be explicit in the forecasts, with proper documentation based on actual data.

- Be consistent in calculations. Spreadsheet programs are recommended for preparing forecasts to ensure the accuracy and consistency of calculations.
• **Examine data critically.** A scan of the data may reveal anomalies or errors that could adversely affect forecasts. Further, a comparison of initial values and forecasted values should be completed to ensure the reasonableness of forecasted values.

• **Recognize that forecasting requires insight and intuition.** Some variables or forecasting assumptions will always be a best guess. However, experience provides a basis for this type of estimation.62

### Cost Estimation and Modeling

Cost estimation models are mathematical algorithms or parametric equations used to estimate the costs of initiatives. There are tools that can be used for estimating cost of an initiative, program, or system. For early childhood, tools from the Administration for Children and Families have recently been created to assist with costing out program cost, cost of quality improvement, and professional development systems. States also may explore how the use of these tools may assist with setting payment rates and projecting costs, particularly as revisions to the Child Care and Development Fund permit alternative rate-setting strategies. An overview of the tools follows:

• **The Provider Cost of Quality Calculator** is a new, easy-to-use, dynamic Web-based tool that calculates the cost of quality based on site-level provider data. The tool helps state policymakers understand the costs associated with delivering high-quality early care and education. The tool can demonstrate whether there is a gap between the cost of providing quality services and the revenue sources available to support a program. Information on the size of the gap at different quality levels for various types of providers can inform the design of financial support and incentive packages.63 Ohio, Rhode Island, and Washington have used the calculator to develop a set of dynamic models to estimate the cost of operating early learning programs at various levels of quality consistent with the State’s quality rating and improvement system.64

• **The Cost Estimation Model** is an online tool designed to help state administrators determine costs of implementing all elements of a quality rating and improvement system (QRIS) and explore scale-up options. The tool can be used to estimate the cost per year of phasing in a QRIS, the cost of certain elements, or the overall cost of a fully implemented QRIS.65

• **The Professional Development (PD) System Cost Analysis Tool** helps States and Territories understand current investments and target resources toward PD systems and initiatives that result in a well-qualified early childhood and school-age workforce. The tool can help PD system funders analyze and align investments with States’ and Territories’ priorities and forecast budget needs to advance workforce goals.66

The reauthorization of the Child Care and Development Fund allows for new approaches to financing for child care subsidy programs and provides for the opportunity to use alternative methods to gather data to determine rates paid for child care. The new language requires market surveys to be valid and reliable. There is more emphasis on ensuring that families have access to higher quality of care and proving how rates are determined, set, and implemented.

One alternative method that States may use to determine rates paid for care is use of a cost estimation model. The use of a cost modeling method would allow States to see the true cost of care, including the cost of items such as professional development, materials, staffing ratios and size of a group, program size, enrollment

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changes, and employee compensation and benefits. This new costing methodology will help States understand the true cost of care, beyond what the market is able to charge for a type of care.67

Resources

Financial Forecasting

Cost Estimation Model (n.d.), by the Office of Child Care.
This online tool is designed to help state administrators determine costs of implementing all elements of a quality rating and improvement system and explore scale-up options. The tool can be used to estimate the cost per year of phasing in such a system, the cost of certain elements, or the overall cost of a fully implemented system.

This chapter describes the basics of financial forecasting. It can be used as a learning tool to understanding the fundamentals of forecasting and practice.

A policy brief that describes the linkages between program operating cost and program quality and the impacts that this model has on designing systems.

This tool is designed to help States and Territories understand current investments and target resources for professional development systems and initiatives that result in a well-qualified early childhood and school-age workforce. The tool can help professional development system funders analyze and align investments with State or Territory priorities and forecast budget needs to advance workforce goals.

Provider Cost of Quality Calculator Demonstration (2015), by the Office of Child Care.
The Provider Cost of Quality Calculator is a cost modeling tool that is designed to assist with calculating the cost associated with different aspects of services. The tool helps state policymakers understand the costs associated with delivering high-quality early care and education. The tool can demonstrate whether there is a gap between the cost of providing quality services and the revenue sources available to support a program.

Financial Management

The Government Finance Officers Association provides resources, training, research, and consultation around financing issues related to managing and administering state finances.

Maximizing the Impact of Public Funding

Blending and Braiding Early Childhood Program Funding Streams Toolkit (2013), by Margie Wallen and Angela Hubbard.
The Ounce of Prevention Fund supported the development of a toolkit that lays out the foundation for blending and braiding funding at the program level. The toolkit provides best practices, resources, and examples.

Opportunities Exchange Web site (n.d.), by Opportunities Exchange.
Opportunities Exchange offers consulting support in finding ways to finance early childhood programs and services. The organization also supports the formation of shared-service alliances. The Opportunities Exchange Web site provides resources related to these goals.

Shared Services: A New Business Model to Support Scale and Sustainability in Early Care and Education (2009), by Louise Stoney.
A brief describing aspects of Shared Services as a new business model to support Early Care and Education systems.

Revenue Generation Strategies

2016 Expiring Tax Credits (2015), by the Oregon Legislative Revenue Office.
This legislative research report on tax credits in Oregon provides good background on the rationale for and actual use of several types of child care credits for both individual and corporate taxpayers (see pp 40–54).

Alliance for Early Childhood Finance Web site (n.d.), by the Alliance for Early Childhood Finance.
This Web site features resources to share knowledge, support innovation, and encourage the field of early care and education to explore ways to restructure, simplify, and expand possibilities for financing early childhood education in the United States. The Alliance was established to address the need for deeper, more comprehensive, and more sophisticated exploration of early childhood education finance.

This compendium of articles on governance looks at many issues, including revenue generation.

Extra Credit: How Louisiana is Improving Child Care (2015), by Nancy Duff Campbell, Joan Entmacher, Helen Blake, and Amy K. Matsui.
The National Women's Law Center describes how Louisiana School Readiness Tax Credits have generated millions of dollars in new investments in child care quality. Five separate credits that make up the package are described and resources quantified.

Making Care Less Taxing (2011), by Nancy Duff Campbell, Amy K. Matsui, Julie G. Vogtman, and Anne W. King.
This report covers the 34 child and dependent care tax provisions in effect in 28 States in tax year 2010. The accompanying state report card, Making the Grade for Care, grades those state provisions. Annual update memos are available for tax years 2012, 2013, and 2014.

This study from the Brookings Institution provides an overview of impact bonds, including definitions of the concepts, key players, and structuring of impact-bond transactions; a comprehensive inventory of all 38 active social impact bonds (contracted as of March 1, 2015), as well as some of the social and development impact bonds in the development stage; and an inventory of key policy actions and legislation to support the impact-bond ecosystem. The report also includes analysis of the stakeholder motivations, key facilitating factors, and biggest challenges faced in the 38 social impact bond transactions; a critical examination of 10 positive claims made about impact bonds based on five years of experience worldwide; and an analysis of the potential of impact bonds and possible derivatives, with a particular focus on developing-country contexts. Impact bonds related to early childhood services are included in this document.

Tax Credits for Early Care and Education: Funding Strategy for a New Economy (2011), by Opportunities Exchange.
This issue brief from Opportunities Exchange examines an early childhood education financing strategy that thus far has not received the attention it deserves—the use of tax credits to raise the quality of services and to make high-quality early childhood education more available to low-income and working-poor families.
Using Tax Credits to Promote High Quality Early Care and Education Services (2007), by Louise Stoney and Anne Mitchell.
This paper delves into the feasibility of using the market intervention of tax credits, linked to Quality/accountability measures like a QRIS, to help promote, and partially finance, higher quality early care and education services. It includes examples of successful tax provisions used in other industries.

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