



COLORADO  
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# CHARTER SCHOOL FINANCE FOR DUMMIES

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# Quiz Time!

## True or False?

1. The only thing you need to look at with a charter applicant's budget is whether it shows a deficit.
2. Schools have autonomy over their budgets, so it isn't your place to deny *a charter applicant* in part because their budget includes salaries for teachers that are 70% below market rate.
3. Schools have autonomy over their budgets, so it isn't your place to tell *an established school* it must pay its teachers more.
4. An unqualified opinion means that a school is in a strong financial position.
5. It is a bad thing for a school to have a "going concern opinion."
6. It doesn't matter if you calculate restricted days cash on hand versus unrestricted days cash on hand.
7. If a school runs a one-year deficit, the authorizer should automatically place the school on intervention.
8. The higher a school's current ratio (current assets/current liabilities), the better.
9. You should only use *audited* financial information to monitor schools.

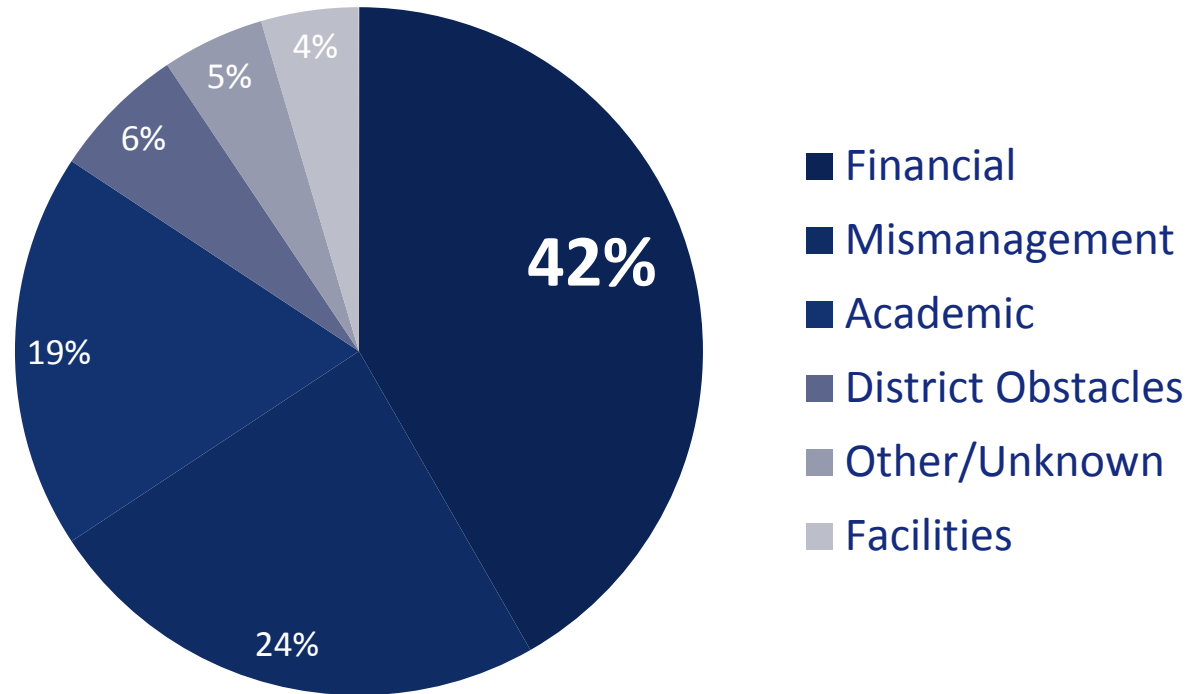
# Goals

At the end of this session, you will be able to:

- Understand the points at which an authorizer needs to understand and evaluate schools' finances
- Calculate ratios to quickly test a school's short-term and long-term viability
- Identify red flags in a financial statement
- Understand the basics of how to read an audit

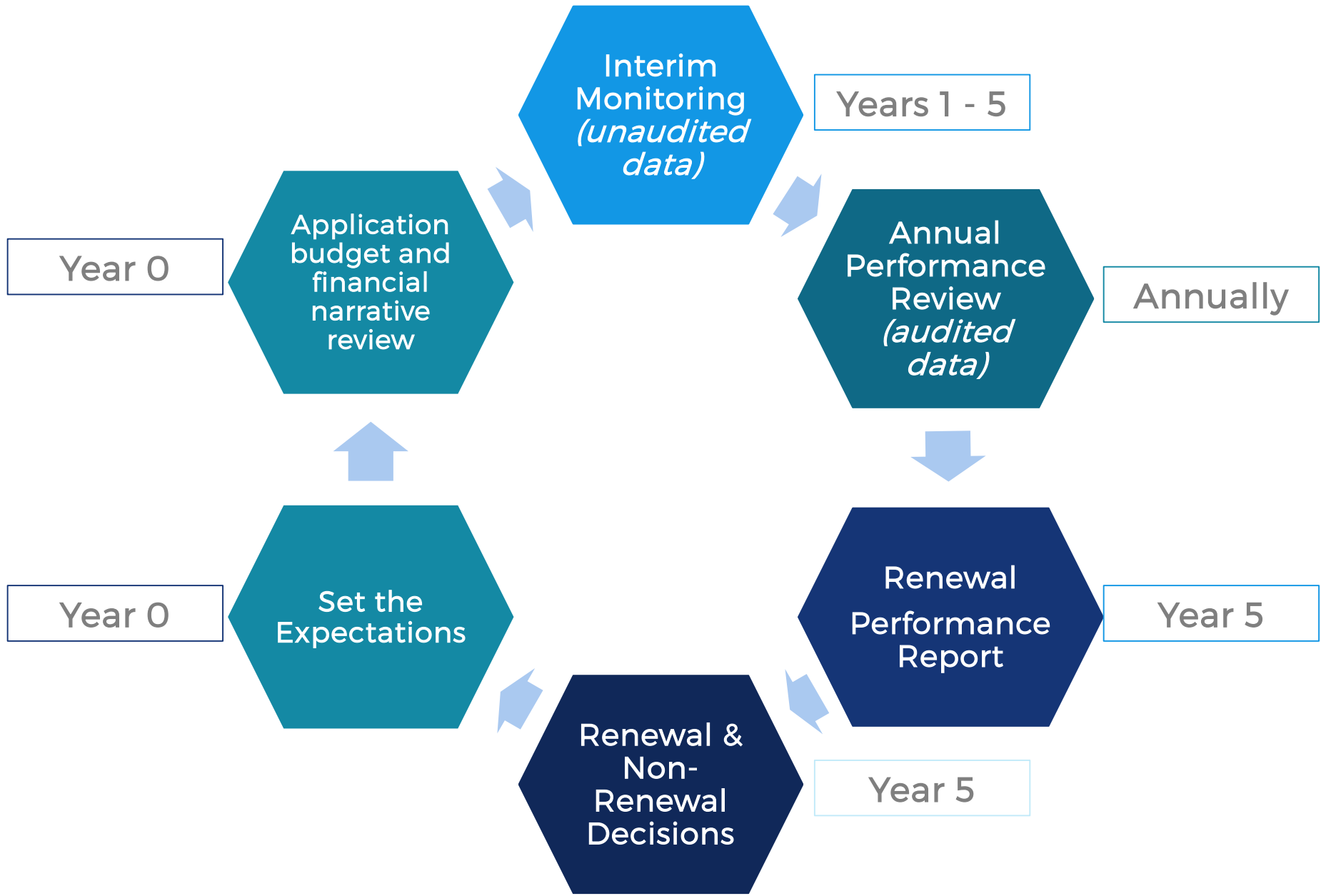
# Why do I need to understand finance?

According to the Center for Education Reform, **42%** of charter school closures can be attributed to **financial deficiencies**.

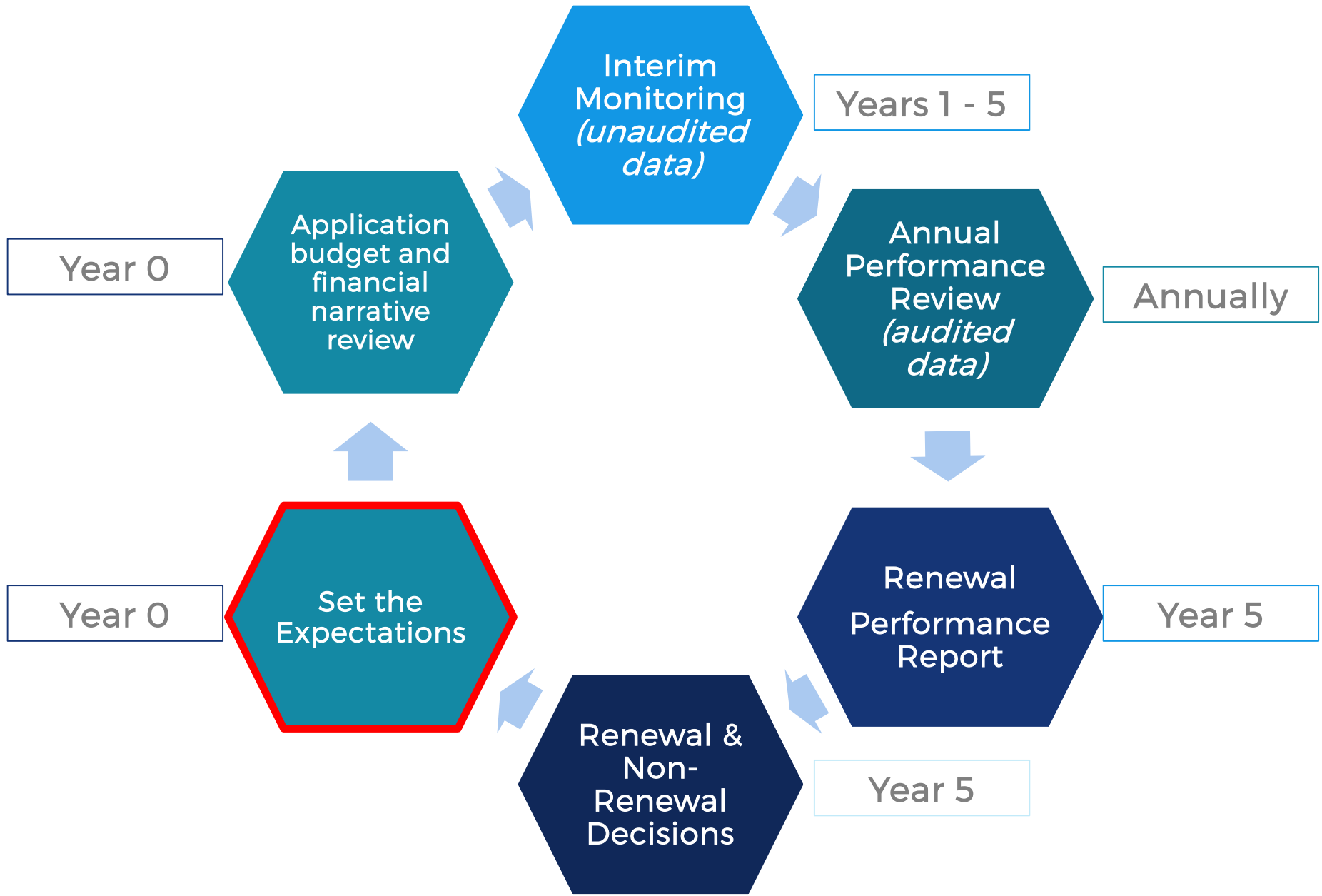


Source: Center for Education Reform, 2011

# When do I need to understand finance?



# When do I need to understand finance?



# Performance Framework Components

Academic

Is the academic program a success?

Financial

Is the school financially viable?

Organizational

Is the organization effective and well-run?



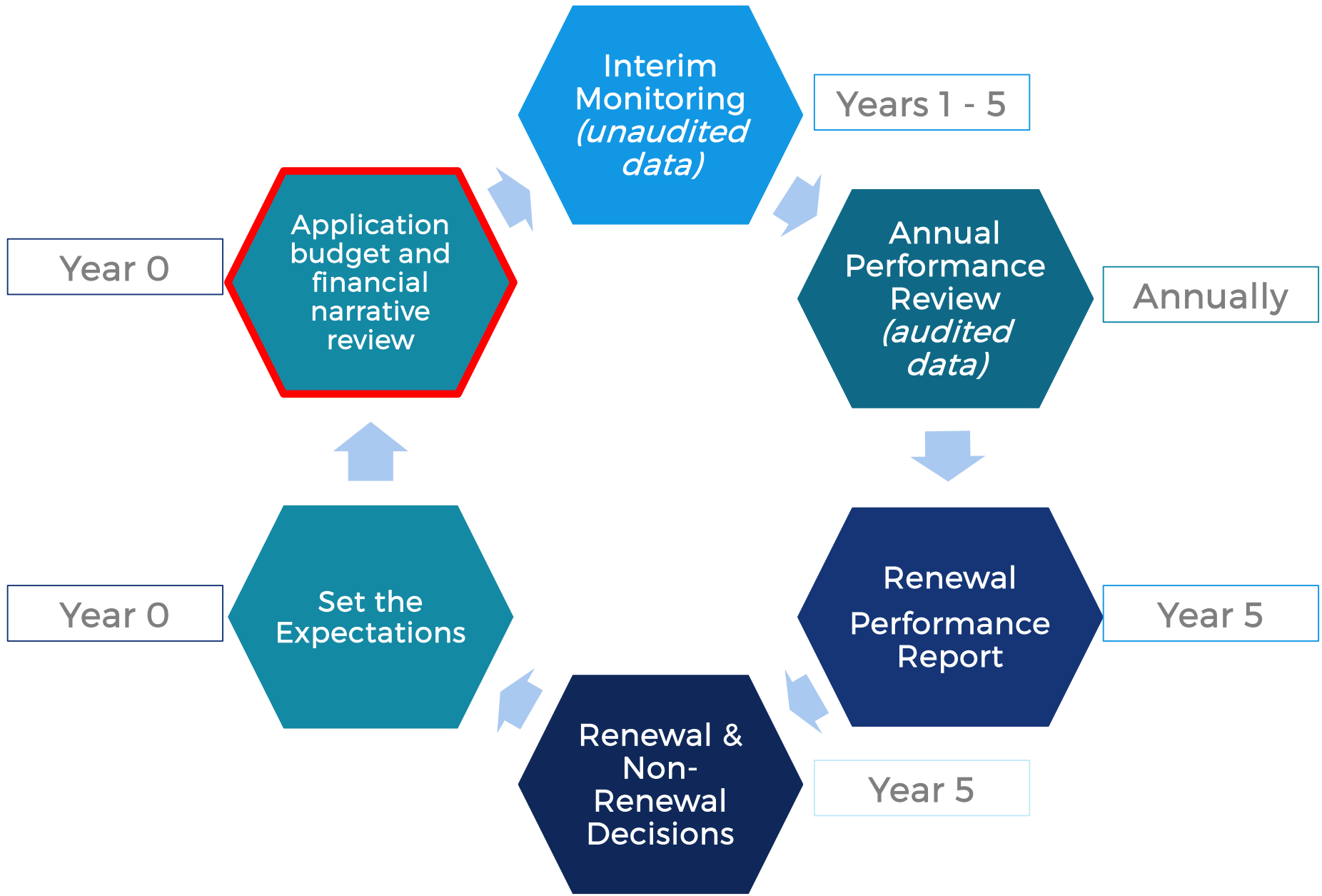
# Core Financial Framework Measures

Measure	Metric
<b>Near Term Measures</b>	
1.a	Current ratio
1.b	Unrestricted days cash on hand
1.c	Enrollment variance
1.d	Default
<b>Sustainability Measures</b>	
2.a	Total margin
2.b	Debt to asset ratio
2.c	Cash flow
2.d	Debt service coverage ratio

# Financial Performance Framework Highlights

- Targets based on best practices in non-profit finance
- Focused on dollars and cents; not process. The organizational framework looks at financial management and GAAP.
- A school that does not meet the target on a measure may or may not be at risk of financial failure; authorizers **MUST** do follow-up investigation
- Primarily used once a year with audited financial information
- **Must** be used in conjunction with organizational performance framework and ongoing financial monitoring

# When do I need to understand finance?



# APPLICATION REVIEW TOP 10

1. Does the applicant know when the money is coming?
2. Does the applicant understand the constraints of various funding sources?
3. Do the applicant's resource allocation ratios align with best practices?
4. Does the applicant fund all initiatives she describes in her narrative?
5. Does the applicant have reasonable enrollment projections?
6. What are the applicant's contingency plans should the school experience a budget shortfall?
7. Does the applicant include plans for fundraising or fundraising commitments?
8. Does the applicant include a description of fiscal controls and management policies? An annual process for budget development?
9. Does the applicant demonstrate knowledge of skills needed among board and staff members to support school's financial health?
10. Will the applicant meet standard on your financial performance framework?

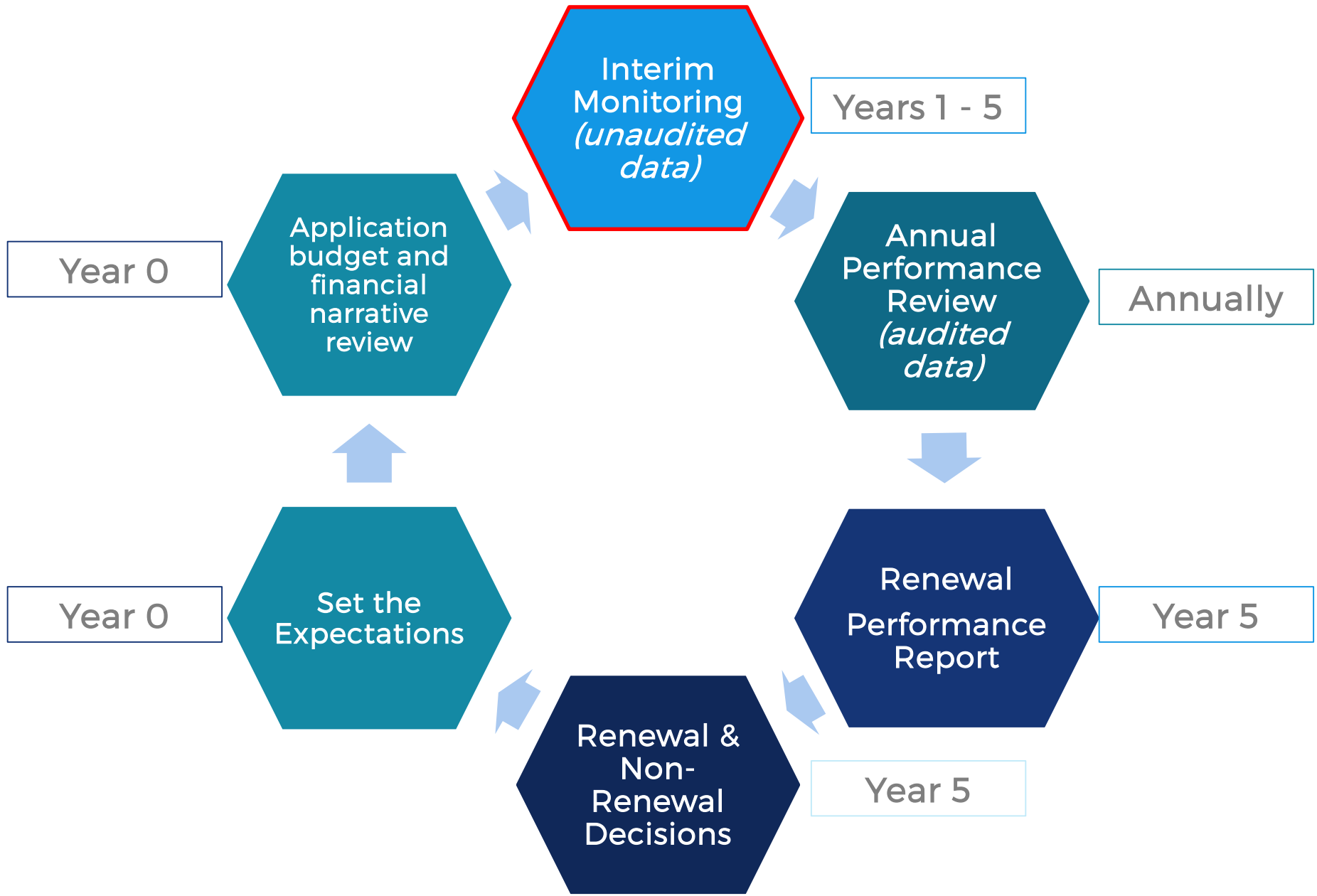
# APPLICATION REVIEW: BUDGET RUBRIC RATIO ANALYSIS

## Performance Against Framework

Ending Cash Balance

Days Cash on Hand	Year 1	Year 2	Year 3	Year 4	Year 5
<i>Cash</i>	\$191,769	\$392,390	\$385,372	\$341,950	\$416,776
<i>Total Expenses</i>	\$2,942,543	\$3,535,819	\$3,492,457	\$4,528,862	\$3,410,614
<i>Days Cash on Hand</i>	24	41	40	35	60
Total Margin and Aggregated 3 Year TM	Year 1	Year 2	Year 3	Year 4	Year 5
<i>3 YR Aggregated Net Income</i>	NA	NA	\$379,082	\$150,189	\$24,386
<i>Net Income</i>	\$185,469	\$200,620	-\$7,017	-\$43,422	\$74,825

# When do I need to understand finance?



# Interim Monitoring

## Enrollment Variance Ratio

- Typically largest revenue source
- Tells authorizer if school is meeting projected enrollment
- Measured by comparing projected enrollment to actual enrollment

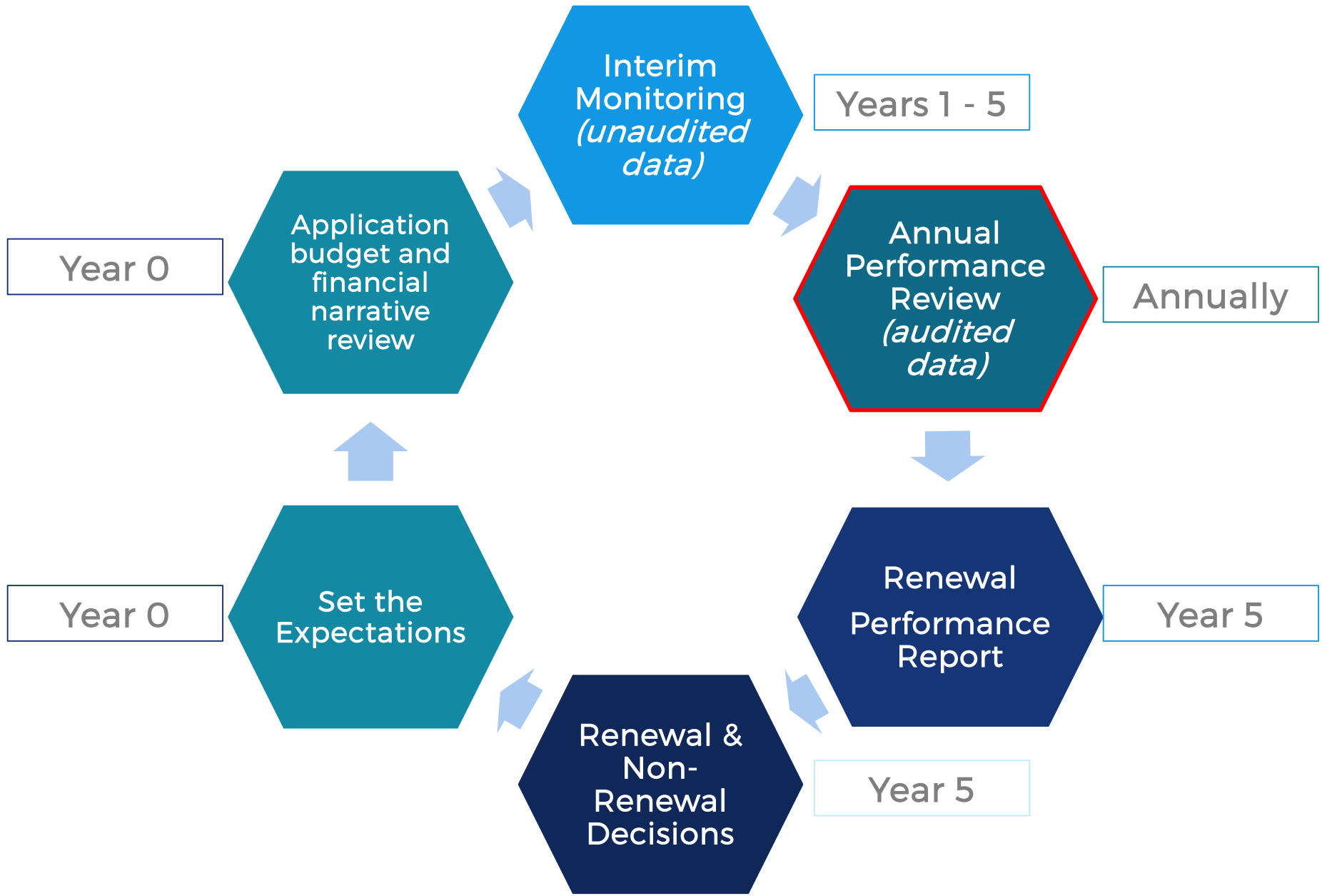
## Current Ratio

- Depicts the relationship between a school's current assets (what they own) and current liabilities (what they owe) in the next 12 months
- Ratio of 1.1 or above means it owns more than owes
- Good sign of ability to meet obligations

## Unrestricted Days Cash on Hand

- Indicates how many days a school can pay its expenses without another inflow of cash
- Best practice (from NACSA and other authorizers) recommends that schools have 30-60 days of unrestricted cash on hand
- Particularly important given the cyclical nature of reimbursements and fund restrictions

# When do I need to understand finance?





# Annual Performance Review

## Enrollment Variance Ratio

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# Annual Performance Review

## 3-Year Aggregate Net Income

- Measures the difference between a school's revenues and expenses (includes non-cash expenditures such as depreciation and amortization)
- Indicates whether a school operates with a surplus or a deficit in a given time period
- Important because schools cannot operate at a deficit for sustained periods of time without risk of closure
- Calculated by Sum of Net Incomes for most recent three years from audited financial statements
- Our office also looks at this metric quarterly to see how schools are trending
- 3 year aggregate net income = sum of net income for most recent 3 years

## Debt Service Coverage Ratio

- Indicates a school's ability to cover its debt obligations in the next year based on its current net income
- Depicts a school's ability to pay obligations once non-cash expenditure (depreciation) and interest expense are added back
- This is divided by the total Principal and Interest payments due in the coming year to understand if the income generated is enough to meet those obligations

## Debt Default

- School must meet all debt obligations
- Review notes from audited financial statements
- Will not be evaluated until audit is completed

## Debt to Asset Ratio

- Measures the amount of liabilities a school owes versus the assets they own
- Measures the extent to which the school relies on borrowed funds to finance its operations
- Long term version of the current ratio; compares schools total assets to their total liabilities
- A lower debt to asset ratio generally indicates stronger health

# ANNUAL REPORT: PUTTING IT ALL TOGETHER

## Performance Against Framework

Is the organization in sound fiscal health?

2.1. Short term Health: Does the school demonstrate the ability to pay its obligations in the next 12 months?

*Meets Standard*

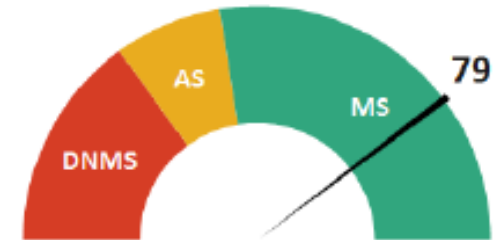
2.2. Long term Health: Does the organization demonstrate long term financial health?

*Approaching Standard*

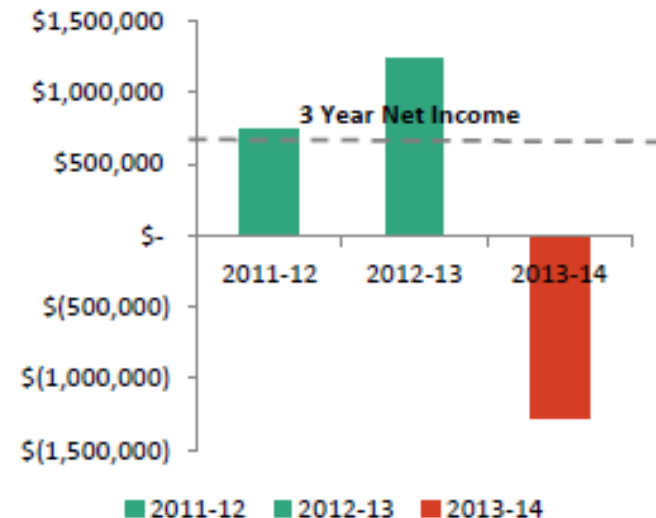
2.3. Does the organization demonstrate it has adequate financial management and systems?

*Does Not Meet Standard*

## Days Cash on Hand



## Three-Year Net Income



# Components of an Audit

- Auditor's Letter
- Financial Statements
- Notes to the Financial Statements
- Management Letter
- *Going Concern Opinion*

# Auditor's Letter

- **Unqualified Opinion** – Fairly stated and in accordance with GAAP.
- **Qualified Opinion** – One or two areas that the organization is not following GAAP.
- **Adverse Opinion** – Material misstatements of the financials and nonconformance with GAAP.
- **Disclaimer Opinion** – Inability to form an opinion.

## Language to look for in an unqualified opinion:

“In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of \_\_\_\_\_, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.”

# Financial Statements

- Two years of the statements of activity and financial position.
- Total revenue, expense, and surplus or deficit.
- Total assets, liabilities, and net assets.
- Current assets and current liabilities.
- Net Assets and Fund balance
- Unrestricted days of cash on hand

# Notes to the Financial Statements

- Summary of significant accounting policies.
- Budget process and information.
- Details to specific items in the financial statements:
  - Summary of capital assets (buildings, equipment, etc.)
  - Summary of loans and debt.
- Information about pension plans or other benefits
- Long-term lease obligations.

# Where do I find the evidence?

## NOTE 6 - LINE OF CREDIT

In 2014, the School entered into default on its bank borrowing, which included the line of credit. The School requested, and the bank agreed, that the bank forbear from exercising its remedies under the loan documents and allow the School to operate for a limited time under a budget provided by the School to the bank. At June 30, 2014 and 2013, the balance of the line of credit was \$237,211 and \$333,333, respectively.

## NOTE 8 - LONG-TERM DEBT ACTIVITY (Continued)

(c) Educational Facilities Revenue Bond, Series 2009A - Taxable

As a result of the issuance of bonds, the School is required to establish that certain funds be held by a trustee for the payment of principal, interest and cash reserves. These funds consist of the following:

	2014	2013
Bond Principal Fund:	\$ 90,000	\$ 80,017
Bond Interest Fund:	345,518	348,941
Bond Reserve Fund:	<u>781,400</u>	<u>781,400</u>
	<u>\$1,216,918</u>	<u>\$1,210,358</u>

At June 30, 2014, the debt service requirements of loans payable for school activities were as follows:

<u>Year Ending</u>	<u>Principal</u>	<u>Interest</u>	<u>Service</u>
June 30, 2015	\$ 169,357	\$ 764,876	\$ 934,233
June 30, 2016	175,777	755,566	931,343
June 30, 2017	191,264	741,860	933,124
June 30, 2018	202,124	727,497	929,621
June 30, 2019-and thereafter	<u>8,563,052</u>	<u>10,245,486</u>	<u>18,808,538</u>
	<u>\$ 9,301,574</u>	<u>\$ 13,235,285</u>	<u>\$ 22,536,859</u>

Total interest expense during the years ended June 30, 2014 and 2013 was \$771,894 and \$733,132, respectively.

Needed for **debt default** calculation

Needed for **debt service coverage ratio** calculation



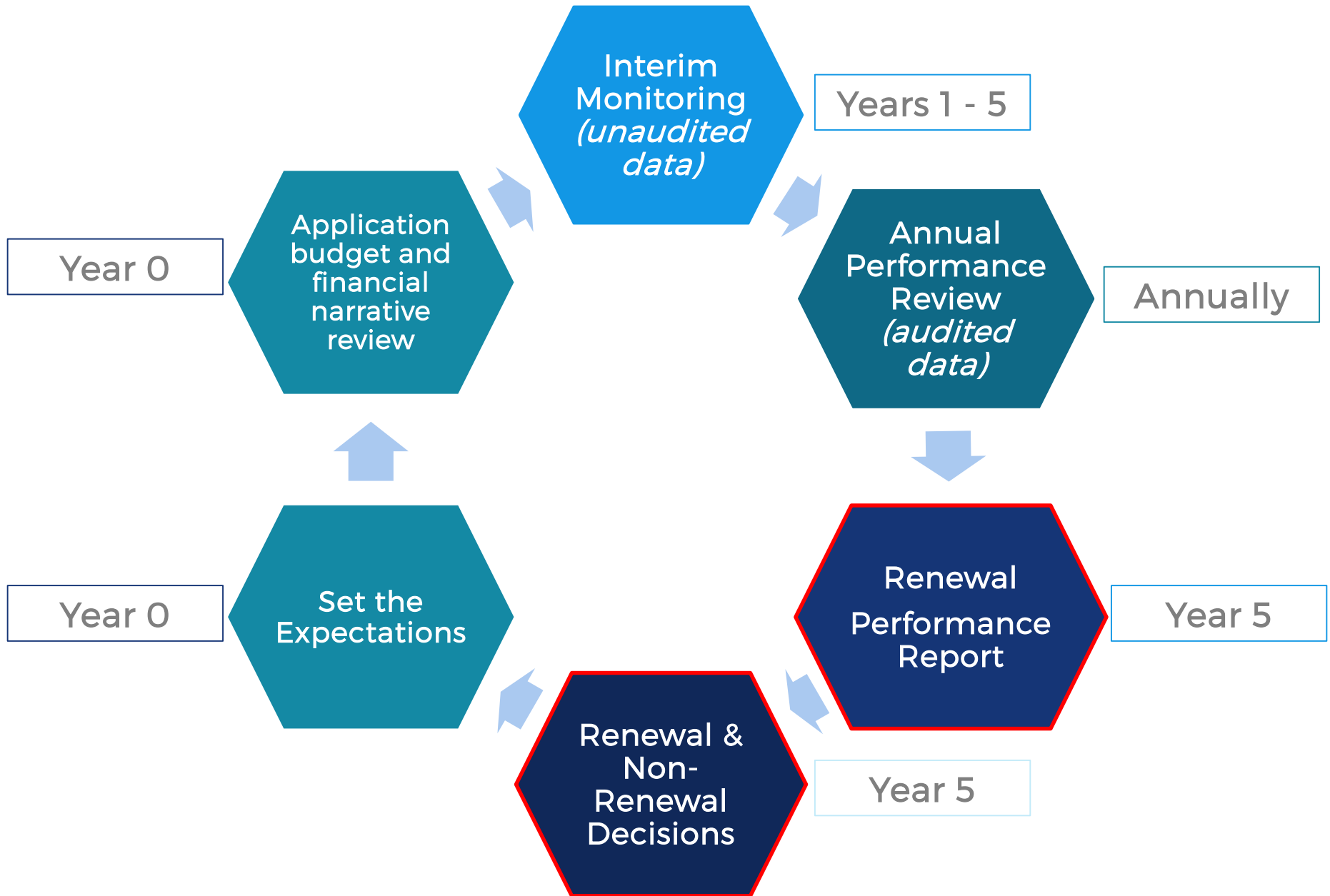
# Management Letter

- Mechanism for the auditor to share suggestions for improvements and best practices.
- Assessment of the Quality of Internal Controls.
  - Areas where internal processes and procedures may impact the ability for accurately recorded financials.
  - Ensures for analysis of proper separation of duties and checks and balances for financial integrity.
- Significant operational inefficiencies
  - Areas where the organization can clearly improve efficiencies or effectiveness or operations.

# What Exactly is a Going Concern Anyway?

- The “**going concern principle**” is the assumption that a nonprofit will remain in operation for the foreseeable future.
- A “**going concern opinion**” on an audit is when the auditor finds significant information to the contrary. Examples could include:
  - A negative trend of significant losses
  - Inability to make payments on loans and other obligations
  - Excessive long-term commitments
  - Legal proceedings that put the organization at risk

# When do I need to understand finance?



# RENEWAL REPORT

Performance Against Framework						
Is the organization in sound fiscal health?						
Financial Evaluation	2009-2010	2010-11	2011-12	2012-13	2013-14	CRR
2.1. Short term Health: Does the school demonstrate the ability to pay its obligations in the next 12 months?	<i>Does Not Meet Standard</i>	<i>Meets Standard</i>	<i>Approaching Standard</i>	<i>Meets Standard</i>	<i>Meets Standard</i>	<i>Meets Standard</i>
2.2. Long term Health: Does the organization demonstrate long term financial health?	<i>Meets Standard</i>	<i>Approaching Standard</i>	<i>Does Not Meet Standard</i>	<i>Approaching Standard</i>	<i>Does Not Meet Standard</i>	<i>Does Not Meet Standard</i>

The renewal report should include school's response to address progress made in areas of deficiency for most recent school year evaluated.

# Quiz Review!

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