

## Finance & Operations: 6 Key Things Every School Leader Should Know

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Here at EdTec, we have the fortune of working with many school leaders, both seasoned and new to the charter world, which allows us to see the most effective school leadership practices. Many new school leaders have brought successful strategies implemented in their classrooms to their new roles as executive directors. Inevitably, however, there are aspects of managing a school that fall outside their comfort zones, such as finance and operations. While most grow to develop skill sets in these areas, going into the job with the full knowledge base required to successfully run a charter is nearly impossible. This article highlights six questions that routinely come up from directors who have had to adapt to unfamiliar financial and operational demands of their new position, especially in this unpredictable economic climate.

### **1. Reading financials: What key indicators should I expect a business manager or back-office provider to explain?**

The following indicators should be examined when building or revisiting your school's budget. You should understand these concepts to gain a sufficient understanding of your school's financial situation:

- **Fund Balance vs. Cash Balance:** The fund balance is the net worth or equity of the school. This is measured by its total assets (all that the school owns that has a monetary value and enhances its worth) minus its total liabilities (all that the school owes in debts and obligations). In other words, it is the net amount of money the school has accumulated over its lifetime. The fund balance is a good indication of the long-term financial health of a school. Similar sounding, but distinct is the cash balance: the amount of cash the school has in the bank at a given time. Keep in mind that your fund balance will likely not equal your cash balance, since: 1) much of the school's revenue may be deferred, and 2) your fund balance represents *all* of your assets, not just cash. (Assets include cash and encompass receivables or land or equipment that is being depreciated.) When examining a cash flow statement, the projected cash balances are key indicators of whether your school can meet its obligations on time. If that balance is positive, you will be able to pay your bills and employees on time; if it is negative, you will not, and will need to figure out a way to manage those shortfalls through negotiating with vendors or borrowing money.
- **Budget Year-to-Date (YTD) vs. Actuals YTD:** On a monthly basis, examine what your school's spending patterns are. Your expenses will not always be spent equally throughout the year, but a business manager should be able to indicate whether or not the school is on track to meet its budget. Actuals YTD will show you how you are spending in reality, while Budget YTD will indicate how you are supposed to be spending based on the budget most recently approved by your board. The variance between these two numbers will show you how far you are deviating from your planned budget. Your business manager should be able to explain why these variances exist, and whether or not they are a concern. Note that if your latest budget is out of date, these variances may not be meaningful and it is therefore more important to be looking at the variances between your actuals and your updated forecast.
- **Discretionary Funds vs. Fixed Costs:** When it comes to your budget, you need to have a sense of what is within and outside of your control. If an unexpected change happens and you must

reallocate funds as a result, where do those funds come from in the budget? While you may have little flexibility in how much the school pays for fixed costs such as rent and district oversight fees, other items that are not set in stone by contract such as school supplies or professional development may provide some flexibility.

- **Accruals:** Accrued expenses are liabilities and are recognized on your books before they are paid for, while accrued revenues are assets and are recognized on your books before they are received (Remember, this is a big reason for the difference between fund balance and cash balance). Depending on the accounting system your school uses, accruals can be booked differently. Despite the differences, however, it's essential to know that – come June 30<sup>th</sup> – there will be a significant percentage of 2011-12 funds that the school is still owed, but those funds won't actually be received until the following fiscal year. Accruals are those amounts that are still remaining past June 30<sup>th</sup> that count as 2011-12 revenue. The same applies for expenses that are incurred before June 30<sup>th</sup>, but paid out after June 30<sup>th</sup>. Ask your business manager to explain how this is recorded, and how it impacts the school's financial statements.

## **2. Managing expenses: What are the big-ticket items to keep in mind when starting to plan for next year?**

While you might stress over whether you should budget \$5K or \$10K for professional development, an additional set of textbooks, or extra office supplies, it is important to remember that these are smaller-scale, discretionary expenses. Other more rigid, bigger-ticket items determine the amount left over for those discretionary items. Taking the time to address the big-ticket items that are within your control well before the start of a new school year will enable you to maximize the amount of funds that remain for day-to-day programmatic expenses, and any extras you can afford.

- **Special Education encroachment costs** typically fall somewhere in the wide range of \$300-\$1,000/ADA if the charter acts as a school of the district for Special Ed purposes. If you are unhappy with the services received for the associated costs, then don't view this as a set cost in the long term; evaluate how the district compares to becoming your own LEA and joining a charter SELPA.
- **Rent** costs can vary wildly depending on the terms of your school's lease. Evaluate whether the school's current space is serving its needs well. If it is, explore whether there might be room to negotiate lower rent for the coming year. If it isn't, explore what other options may be available within your area.
- **Custodial services** represent a significant decision point for schools: in-house personnel or outsourced provider? While hiring an in-house custodian is the option that likely affords you more flexibility, it also requires benefits and employer contributions, as well as the cost of custodial supplies. On the flip side, using a custodial service may simply be less of a headache, allowing the school to keep a smaller staff focused on the instructional program. If pursuing this option, make sure the vendor can provide service at the hours the school needs, and is offering competitive prices for the area.
- **Food service**, like custodial service, offers the potential to extend staffing into areas that are non-instructional. Outsourcing food service, which can be provided through the district or an independent provider, allows the school to streamline its personnel. But if you want to provide specific food offerings, and have the capacity to set up the necessary systems in-house that can properly track state and federal meal reimbursement, it can be a service the school may wish to provide.

These items may not be the glamorous side of running a school, but they do make up a greater percentage of expenses than you may realize. Evaluate options for these services in the long-term, so that greater revenue is left for the programmatic needs of your school.

### **3. Examining this year's budget: Is an operating loss acceptable? How much?**

California's budget plan includes an automatic "trigger" that will cut K-12 funding if state revenues do not meet the optimistic revenue projections used to balance the budget. Because year-to-date state revenues are trending below projections, you should be planning for an approximate \$250-\$300 per ADA cut to the published General Block Grant rates. Forecasting this revenue loss will obviously have a negative impact on your operating income, making it critical for you to make the appropriate off-setting adjustments to the rest of your budget *now*. You should be making any necessary expense cuts in order to maintain a balanced budget and an operating income that will meet your authorizer's requirements for minimum reserves. Note that the longer in the year you wait to make cuts to ongoing expenses, the less effective they are in preserving your operating income. Because it is relatively early in the school year, making the hard decisions now will save you headaches later when it is too late to make any fiscally meaningful changes.

While projecting an operating loss should never be taken lightly, if you've already made all the cuts possible and cannot cut further without significantly jeopardizing your program, projecting a loss may be a last resort only if you have a healthy enough fund balance to sustain the loss. If you have a positive fund balance that is larger than your projected current year loss, your fund balance will at least remain positive at the end of the year, after taking this year's hit. If you find yourself in this position, it will be crucial to work with your board and financial advisors to examine two specific areas as you consider how much of a loss can be sustained:

- **Cash:** What are the cash projections throughout the coming year? If cash flow looks tight from month to month, spending decisions should be determined more by short-term obligations than annual budget considerations. If cash balances are healthy, however, assessing cash flow is not quite as imperative to your overall approach to budgeting.
- **Fund Balance:** Has the school accrued substantial reserves from prior years resulting in a positive, strong fund balance? If so, tolerating a loss in this year's budget will not jeopardize the school's long-term financial health, if there are essential elements to your program that cannot be sacrificed. However, your school will not be able to sustain this approach for long; there are no guarantees as to when funding rates will increase.

Although charter schools may be faced with a brutal funding decrease this year, you can stay informed and in control by budgeting conservatively and making the appropriate cuts early to balance your budget. Accepting an operating loss for the year should be an absolute last resort, and only if your school has the fund balance to sustain it.

### **4. Cash flow financing: How do I evaluate options if my school is in need of cash?**

Given low funding rates and the extreme deferrals throughout 2011-12, you are responsible for evaluating whether borrowing is the right solution for your school. There are four crucial questions to ask:

- How much does the school need to borrow?
- How long will the school have to repay?
- What is the interest rate?
- What other fees (e.g. origination or management) are involved?

Managing limited funds can be one of your more stressful financial responsibilities as a school leader. Start with the basic questions above, reflecting on where your personal knowledge of the options lies. It is also important to consider these criteria:

- What is my total dollar expense for getting cash upfront including all fees (i.e. the cost of borrowing money)?
- What is the annualized percentage interest rate associated with the funding?
- Compare apples-to-apples; that is, if you are weighing multiple borrowing options, make sure to evaluate all options on an annualized percentage basis so that you are making an informed decision based on comparable measures.

Throughout this process, continue to ask the bigger picture questions that have implications for your school down the road:

- Why am I short on cash? Is it a temporary issue, or is it systemic within the school's financial planning?
- Does borrowing cash now put me in a position to need to borrow again in the near future?
- Where in the budget can I make cuts to balance the additional cost of borrowing money?
- What is my long-term plan to develop cash reserves to reach sustainability?

### **5. Getting your ducks in a row: What do auditors look for?**

Contrary to common expectations, auditors do not focus on whether your school is doing a good job. Rather, auditors' main function is to evaluate whether your school is telling the truth about the job that it's doing. This means that they assess the accuracy and compliance of your school's attendance records, financial statements, and some procedural items such as resolutions passed by the board and the financial controls in place at the organization. In the end, auditors make a determination about whether your school is at risk of no longer being a "going concern" (meaning the school is able to continue operations in the foreseeable future), but the bulk of their work is to ensure that your school is fairly stating all financial information.

If you are a new school leader, you may be looking for the auditor to tell you that the school is doing a *great* job. More likely, if things are going well, they will inform you that the school is doing a *sufficient* job and is in compliance. For example, if things are not going well in the auditors' eyes, their reason will not be that attendance is too low; instead, their reason may be that attendance is *inaccurate* according to the reports submitted versus the daily records. The setup and organization of attendance files, documentation of invoices and payments, backup for any deposits made, contracts or MOUs signed for the year, and board agendas/minutes/resolutions are all items that require substantial record-keeping for auditing purposes. Make sure whoever oversees operations at your school is continuously evaluating the compliance of these auditable items throughout the year.

### **6. Juggling deadlines: What are the essential "to-do" items for charter school compliance?**

New directors consistently ask EdTec about the numerous deadlines they need to meet to stay compliant. While we provide our schools with a compliance calendar, all schools can manage their operations by organizing their needs into the following buckets, and having one individual within the organization take responsibility for ensuring that the deadline is met:

- **General Requirements:** From applying for your CDS code and charter number to SARC Reports and Annual Information Surveys to charter renewals, charters are responsible for fulfilling a wide range of requirements.

- **Attendance and Assessment Data:** Examples include CALPADS, CBEDS, PENSEC and 20-day reports (for new or growing schools), P-reports, and monthly attendance reports. Additionally, bell schedules and instructional minute calendars must be set on an annual basis.
- **Applications for Funding:** Not all schools will access all funding opportunities, but examples of sources that require an application include the LEA Plan, School Wide Plan and Consolidated Application for Title funding, PCSGP for start-up schools, CSR for K-3 schools operating prior to 2008-09, SB740 for facilities and ASES for after-school programs. Outside of applications strictly tied to specific funding sources, programs like Prop 39 (for facilities) and the Revolving Loan (for any school in its first term) require charters to follow a designated timeline.
- **Reporting Needs:** Most funding sources, such as those listed above, require the filing of a report. These are generally spelled out in the CDE's request for applications (RFA) for the funding. Additionally, authorizers require the submission of annual budgets, interim reports, unaudited actuals, etc.
- **Board Governance:** Governance questions, while ideally fielded by your board chairman, often fall to you as the executive director. On an annual basis, a board should pass various resolutions (such as uniform complaint procedures and financial policies) and complete the Form 700 for conflict of interest issues.
- **Human Resources and Payroll:** TB tests, credentialing documentation, and employee contracts should be addressed annually.

Don't be discouraged by the amount of information there is to digest! By asking the right questions of your board, business manager or back-office service provider, these tasks can be appropriately addressed and your processes streamlined so that you can focus on maintaining a great educational program! 

*Thanks to the new directors that we have worked with, for putting forward the questions that are necessary to ask in order to build a strong charter school.*