edtec CONNECT
Fall 2015 Volume 8

New School Year Resolution: Managing Finances Wisely

By John Westerlund, Client Manager, EdTec Inc. and Brandon Paige, Director of Finance, Lighthouse Community Charter School

Much like a New Year's resolution, a new school year can bring a renewed desire to become more involved in managing your school's finances. Inevitably, however, there are aspects of managing a school that fall outside the comfort zones of school leaders and board members, such as finance and operations. While most grow to develop skill sets in these areas, it can take time to develop those skill sets, and for those brand new school leaders, going into the job with the full knowledge base required to successfully run a charter can feel impossible. But there is hope! This article highlights questions that routinely come up from directors who have had to adapt to the unfamiliar financial and operational demands of their position.

1. What key concepts do I need to know to monitor my school's financial position?
The following indicators should be examined when building or managing your school's budget. You should understand these concepts to gain a sufficient understanding of your school's financial situation:

• **Balance Sheet vs. Income Statement:** In financial accounting, the balance sheet and income statement are the two most important types of financial statements. A balance sheet lists the assets and liabilities of the school as of a certain date. These may include receivables and payables (see accruals below). An income statement, also called a profit and loss (P&L) statement, is a report for revenues and expenses over a specific time period, usually a fiscal year.

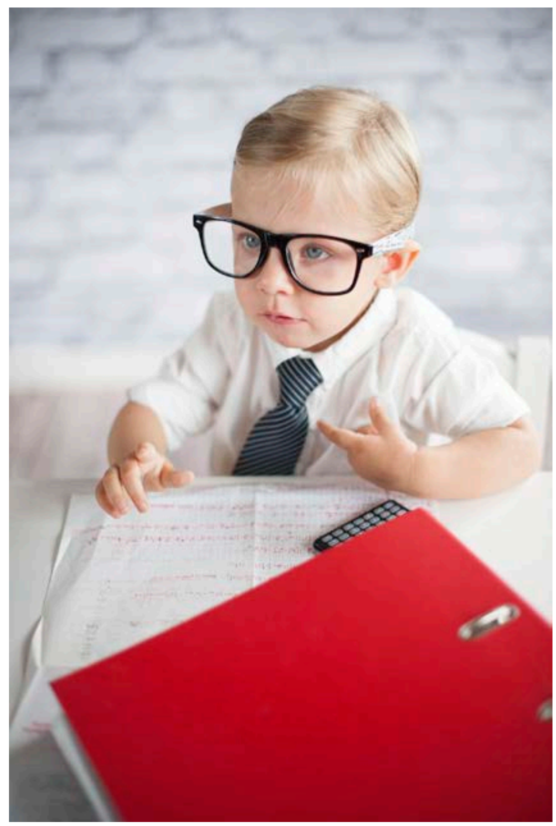
• **Operating Income:** The most basic financial indicator you will need to monitor on an ongoing basis is your school's operating income, which is derived from the income statement. This figure is simply the amount of revenues received minus the amount of expenses your school incurs in a given fiscal year. In the business world, "operating income" and "operating profit" are often used interchangeably.

• **Depreciation:** It's also important to understand the effect that depreciation will have on your school's operating income. Depreciation is a method of allocating the cost of a tangible asset over its useful life. If your school purchases technology for $10K that has a useful life of five years, $2K of that expense will be realized each year over the course of those five years. This means that the operating income may only be reduced by $2K each year for accounting purposes, but the full $10K still had to come out of the school's checking account at the time of purchase.

• **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 sum of each year's operating income since inception). 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, because your fund balance represents *all* of your assets, not just cash. Assets include cash and any payables or receivables, or land and equipment that is being depreciated. When examining a cash flow statement, the projected cash balances indicate 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.

• **Accruals:** Accrued expenses are liabilities which are recognized on your books before they are paid for, while accrued revenues are assets which are recognized on your books before they are received. Remember, accruals are 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 at the end of each fiscal year, there will be a significant percentage of current year 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 that count as current year revenue even though they aren't received in the actual current year. The same applies for expenses that are incurred before June 30, but paid out after June 30.

2. What are the big-ticket items to keep in mind when managing this year's expenses and starting to budget for the next?



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, where you will receive the Special Ed revenues and avoid the district's encroachment, but will need to provide the Special Ed services to those students in need.

• **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. Additionally, can you request facilities from the district under Prop 39, or can you seek reimbursement for part of your school's rent through SB 740 or CSFIG?

• **Various services** can represent a significant decision point for schools: in-house personnel or outsourced provider? When sourcing services such as food providers, custodial, back-office, or other consultants, hiring in-house is the option that likely affords you the most flexibility. It also requires benefits and employer contributions, as well as the cost of any associated supplies needed to fulfill that service. On the flip side, using an outsourced provider may provide cost savings and may simply be less of a headache, allowing the school to keep a smaller, more streamlined staff focused on the instructional program, while avoiding the hassles and costs of addressing staff turnover in those areas. If pursuing this option, make sure the vendor is competitively priced for the services or service level being offered and can fulfill the specific needs of the school.

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

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 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, as authorizers will want to see fiscally sound, sustainable projections come time for charter renewal. 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?

Managing limited funds can be one of your more stressful financial responsibilities as a school leader. Given the nature of the timing for charter schools' revenues and expenses, even a positive operating income and fund balance can sometimes lead to cash shortfalls. You are responsible for evaluating whether borrowing is the right solution for your school. There are three 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 and what other fees (e.g. origination or management) are involved?

It's important to think about the long-term implications of the questions above. Any interest or fees will not only limit the amount you can borrow, but will also decrease your operating income for the year. Additionally, it's important to think of those fees in annualized terms. If your school will need to pay 5% in fees to borrow money for two months, that would be comparable to a ~34% annual percentage rate (APR). Evaluating options on an annualized percentage basis will also help you weigh multiple borrowing options, as you are then comparing apples-to-apples.

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.

Financial management can be challenging even in the best of fiscal times. However, keeping these basics in mind can help you meet those new school year resolutions. And remember – never be afraid to ask for help!