



PRESENTS

THE BOTTOM LINE ESSENTIALS: FINANCE

FINANCIAL HEALTH, COMPLIANCE,
FINANCIAL TRANSPARENCY

JULY 17, 2015 | Melissa Carollo, LAPCS Finance & Operations Director

FINANCIAL HEALTH

What are your financial statements really telling you?

- Balance Sheet/Statement of Financial Position
 - Your school's ability to:
 - Manage Debt
 - Maintain and manage assets & facilities
 - Maintain appropriate liquidity
- Profit & Loss/Income Statement
 - Your school's ability to:
 - Maintain a reliable revenue stream
 - Cover your operating costs
 - Maintain consistent surpluses/address deficits

FINANCIAL HEALTH ANALYSIS (PAST)

- Documents needed for analysis
 - 2-3 years of:
 - Audited financial statements
 - Management letters
 - Form 990
 - Detailed Income Statement, Balance Sheet, Cash Flows, Functional Expenses
 - Final Trial Balance

FINANCIAL HEALTH KEY RATIOS / INDICATORS

- Debt to Asset Ratio = $\frac{\text{Total Liabilities}}{\text{Total Assets}}$
 - Indicates the % of your assets that are financed through debt
 - High debt to asset ratio may indicate a low borrowing capacity
 - Low Risk = <0.5
 - Medium Risk = 0.51 – 0.99
 - High Risk = > 1.0

FINANCIAL HEALTH KEY RATIOS / INDICATORS

- Debt to Net Asset Ratio = $\frac{\text{Total Liabilities}}{\text{Total Unrestricted Net Assets}}$
 - Measures how much you are relying on debt
 - High ratio could reduce your school's borrowing capacity
 - The closer you get to a ratio of 1.0 the riskier

FINANCIAL HEALTH KEY RATIOS / INDICATORS

- Fixed Asset Ratio = $\frac{\text{Property and Equipment}}{\text{Total Assets}}$
 - Indicates how much of your assets are fixed, which are not liquid and cannot readily be converted to cash
 - Low Risk = < 0.5
 - High Risk = > 0.5

FINANCIAL HEALTH KEY RATIOS / INDICATORS

- Capitalization Ratio = $\frac{\text{Total Net Assets}}{\text{Total Assets}}$
 - Measures your ability to meet financial obligations
 - Indicates the relative proportion of capital (net assets) that can be used to finance new assets
 - Optimal ratio is 31% or higher

FINANCIAL HEALTH ANALYSIS (PRESENT)

What are the roles of the people tasked with the financial health of your school?

- Finance Team (Staff)
 - Maintain reliable revenue streams/cover costs
 - Maintain consistent surpluses/address defecits
 - Create appropriate internal controls to reduce potential of fraud
- Board (Chair/Treasurer/Others)
 - Evaluate the Finance Team's ability to:
 - Manage the numbers/maintain healthy finances
 - Survive the annual audit/keep the fiscal house in order
 - Raise money through contributions

FINANCIAL HEALTH KEY RATIOS / INDICATORS

- Working Capital Ratio = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$
 - Indicates your ability to meet short-term obligations
 - Low Risk = > 3.0
 - Medium Risk = 1.4 – 2.9
 - High Risk = < 1.4

FINANCIAL HEALTH KEY RATIOS / INDICATORS

- Months of Cash = $\frac{\text{Cash} + \text{Cash Equivalents}}{\text{Average Monthly Expenses}}$
 - Indicates your ability to pay debts as they are due
 - Low Risk = > 6 months
 - Medium Risk = 3-6 months
 - High Risk = < 3 months

FINANCIAL HEALTH KEY RATIOS / INDICATORS

- % Unrestricted Net Assets to Total Expenses =
$$\frac{\text{Unrestricted Net Assets}}{\text{Total Expenses}}$$
 - Measures resources available to use for emergencies or contingencies
 - A ratio of 10% or more indicates that the school has adequate reserves to deal with emergencies
- Occupancy Ratio =
$$\frac{\text{Occupancy Expenses}}{\text{Total Revenues}}$$
 - Measures amount of total percentage of facility costs as a function of revenues
 - A ratio of 10% to 15% is preferable. 20% is the absolute maximum

FINANCIAL HEALTH KEY RATIOS / INDICATORS

- Cost per General Education Student =
$$\frac{\text{Total Expenses}}{\text{\# of Gen Ed Enrollment}}$$
- Cost per Special Education Student =
$$\frac{\text{Total Expenses}}{\text{\# of SpEd Enrollment}}$$
- % of SpEd Students =
$$\frac{\text{SpEd Enrollment}}{\text{Total Student Enrollment}}$$
- Occupancy Cost per Student =
$$\frac{\text{Occupancy Cost}}{\text{Student Enrollment}}$$

FINANCIAL HEALTH KEY RATIOS / INDICATORS

- Fundraising Efficiency Ratio = $\frac{\text{Fundraising Expenses}}{\text{Contributions}}$
 - Shows how much the school spends to generate \$1.
 - 0.35 and lower is reasonable
- % Salaries to Expenses = $\frac{\text{Salaries} + \text{Benefits} + \text{Payroll Taxes}}{\text{Total Expenses}}$
- % of Management Fee to Expenses = $\frac{\text{Management Fee}}{\text{Total Expenses}}$
- % of Per Pupil Revenues to Total Revenues = $\frac{\text{GenEd} + \text{SpEd Per Pupil Revenue}}{\text{Total Enrollment}}$

COMPLIANCE: INTERNAL CONTROLS FOR SMALL TEAMS

- Develop Finance Policies and Procedures Manual that outlines your internal controls
 - Your Finance Manual should:
 - Protect the assets of the school
 - Ensure the maintenance of accurate records of the school's financial activities;
 - Provide a framework of operating standards and behavioral expectations;
 - Ensure compliance with federal, state, and local legal and reporting requirements.

COMPLIANCE: INTERNAL CONTROLS FOR SMALL TEAMS

- Segregation of duties
 - This can be a challenge for a small organization when the Finance Team consists of one or two people.
 - It is important to implement strong internal controls, even though they may be cumbersome.
 - Make sure that you follow whatever internal controls are set in your board approved finance policies and procedures.
 - Implementation often requires CEO/ED/Head of School and Board participation.

COMPLIANCE: INTERNAL CONTROLS FOR SMALL TEAMS

- Best Practices
 - The person processing checks should not be the person approving payments or signing checks
 - Bank statements should be opened and reviewed by someone other than the person reconciling the accounts
 - Set a limit for checks that can be issued with only one signature
 - Implement a procedure for purchasing and purchasing authorization (contract limits, number of bids required)
 - Do NOT use a debit card that is connected to the operating account. When possible, secure a company credit card.

COMPLIANCE: INTERNAL CONTROLS FOR SMALL TEAMS

- Best Practices
 - Set very strict policies regarding credit card use and have a credit card policy signed by anyone authorized to use the credit card or who has a company credit card
 - Determine your fixed asset threshold and follow it.
 - Develop Expense Policies and have signed by anyone who may be submitting business expenses for reimbursement.
 - Set a budget policy and timeline that includes the Finance Committee (who will review and edit prior to board presentation and approval)
 - Open a separate bank account (or sweep account) for any automatic debits (Payroll, Vendor ACH Debits)

COMPLIANCE: BEING PREPARED FOR YOUR AUDIT

- An audit is one of the most important methods a school can use to protect its financial assets as it provides a formal check of the school's financial records and policies & procedures.
- Charter law requires that schools follow GAAP and obtain an annual audit conducted by an independent auditor.
- Schools that expend over \$750,000 in Federal funding obtained during the fiscal year are also required to obtain an A-133 Single Audit conducted by an independent auditor that encompasses both financial and compliance components.

COMPLIANCE: BEING PREPARED FOR YOUR AUDIT

- Practicing responsible financial management throughout the year and being prepared for the annual audit will keep the school's audit fees (and the finance team's stress level) down.
- Conducting a "self-audit" during the year in advance of the actual audit can identify areas for improvement and correction in advance of the audit.
- During the audit, self-reporting is always better than any "misses" being discovered.

COMPLIANCE: BEING PREPARED FOR YOUR AUDIT

- Audit Process Overview
 1. Understand financial deliverables/requirements per charter authorizer throughout the year.
 2. Find the "right" auditor
 3. Prepare interim testing in last quarter for Q1 – Q3, if possible.
 4. Close the books and prepare all requested schedules and analyses in July/August.
 5. Prepare for the commencement of audit fieldwork in August/September
 6. Receive and review draft financial statements and management letters in September/October
 7. Receive finalized financial statements and management letter

COMPLIANCE: BEING PREPARED FOR YOUR AUDIT

- What the auditors may review
 1. Finance policies and procedures to assess whether proper internal controls are in place and followed
 2. Employee Manual to understand which policies affect finances and test whether they are followed.
 3. Student records to confirm revenues are not requested/received for imaginary children
 4. HR files to ensure compliance with all laws and that no imaginary staff are being compensated.
 5. Trial balance to ensure all numbers are correct
 6. Cash disbursements to ensure expenses are legitimate and substantiated, and were made in accordance with GAAP and the schools policies

COMPLIANCE: BEING PREPARED FOR YOUR AUDIT

- What the auditors may review (continued)
 7. Cash disbursement for new fiscal year to date of audit to ensure no unrecorded liabilities.
 8. Bank reconciliations (and request balance confirmations from banking institutions) to ensure cash assets reported on the balance sheet are accurate and recorded properly and account for outstanding/stale checks.
 9. Revenue reconciliation to analyze amounts earned on an accrual basis and amounts owed in AR
 10. Quarterly payroll reconciliations to ensure compensation expenses are properly recorded and tie to the Form 941 submitted to the IRS

COMPLIANCE: BEING PREPARED FOR YOUR AUDIT

- What the auditors may review (continued)
 11. Accrued expense schedule to ensure expenses are recorded in the proper period
 12. Prepaid expenses (see above)
 13. Accounts payable schedule (see above)
 14. Fixed asset depreciation schedule to ensure all assets are recorded properly and depreciated according to GAAP and policies and procedures
 15. Budget vs. actual to analyze variances and assess how well the school budgeted for the year
 16. Actuals of prior year vs current year to analyze variances

COMPLIANCE: BEING PREPARED FOR YOUR AUDIT

- What the auditors may review (continued)
 17. Board and Finance Committee minutes to ensure key decisions are being made at appropriate levels
 18. Statement of Functional Expenses as to be reported on the Form 990 to ensure healthy distribution for the school.

COMPLIANCE: BEING PREPARED FOR YOUR AUDIT

- Best Practices
 - Confirm the trail balance per the previous fiscal year
 - Prepare for the audit throughout the year
 - Negotiate with the auditors if/when possible regarding recommendations in the management letter.
 - Implement an organizational system to have only one place for the source documentation for each financial transaction to be filed (Exception: check disbursements)

FINANCIAL TRANSPARENCY

DEFINITION

timely, meaningful and reliable disclosures about a school's financial performance



FINANCIAL TRANSPARENCY



What are the challenges?
Ex: Student Activities Funds, Co-mingling

FINANCIAL TRANSPARENCY



Solutions?

QUESTIONS?

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