

Charter School Finance and Business Operations: *An Introductory Primer*

December 17, 2019

Contents

1. EdOps and Our Mission
2. Charter School Finances and Budgeting Basics
3. Charter School Environment and Structure
4. Final Tips
5. Appendix

EdOps and Our Mission

For the past 17 years EdOps has been providing critical business support services so schools can focus on educating children



~25,000

~\$600MM

\$150MM+

Students served

Operating budget \$ under management

Facility financing supported last 3 years



EdOps partners with schools to help them navigate the array of financial and operational challenges each one faces



FINANCE & ACCOUNTING



STUDENT DATA



STRATEGIC CONSULTING



FACILITIES SUPPORT



OPERATIONS

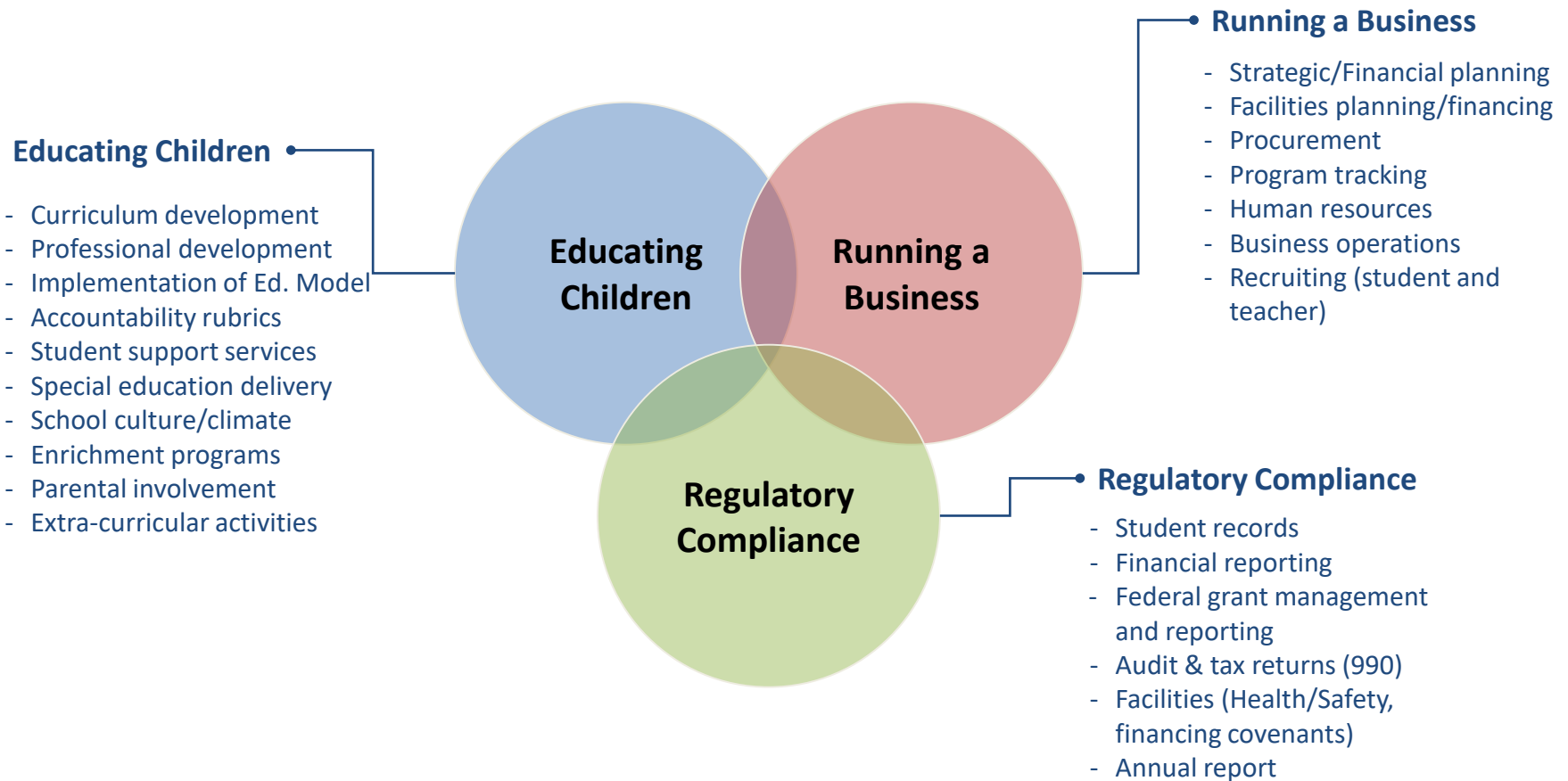


HUMAN RESOURCES

- Focus on financial back office and business operations including human resources and student data, as well as facilities finance and strategic consulting
- Proven service solutions tailored to each school
- MBAs and CPAs comprise firm partners and senior staff
- Currently work with ~80 schools across the country (3 in Maryland) and have worked with more than 70 applicant schools


We would like to share some of what we've learned

Public charter schools are extremely complicated businesses, requiring a broad set of skills and expertise



Founders are passionate about education but rarely excited about running a complex and highly regulated business

Reasons to get up in the morning...



**Educating
Children**

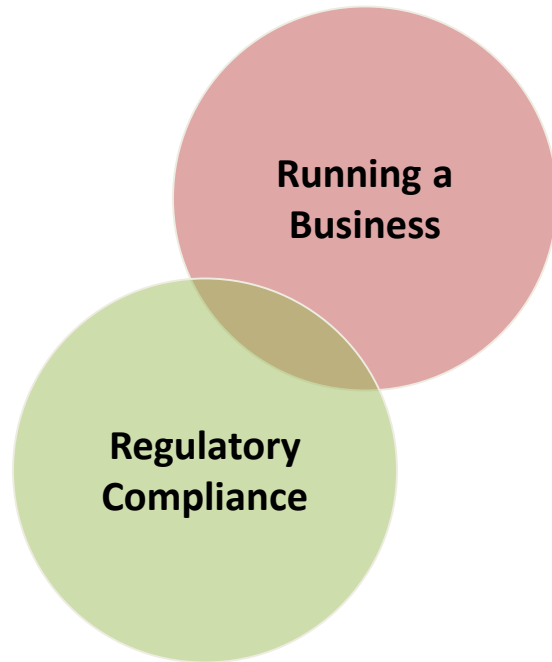
...reasons to go back to bed



**Running a
Business**

**Regulatory
Compliance**

However, structuring and running the business well is essential to the success and longevity of the school



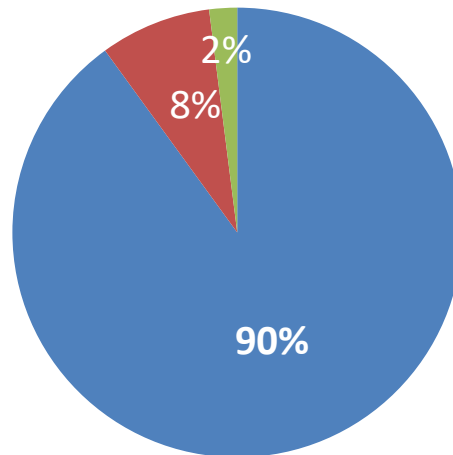
- Successful business operations enable and support the school's primary educational mission.
- The majority of charter school failures (nationally) include or are caused by fiscal mismanagement.
- Top academic performance typically goes hand-in-hand with top financial performance.
- Donors (foundations) want to ensure their investments will be well managed and leveraged.

Charter School Finances & Budgeting Basics

State and local revenue, staffing expense, and facilities expense dominate the budget; focus on getting these categories correct

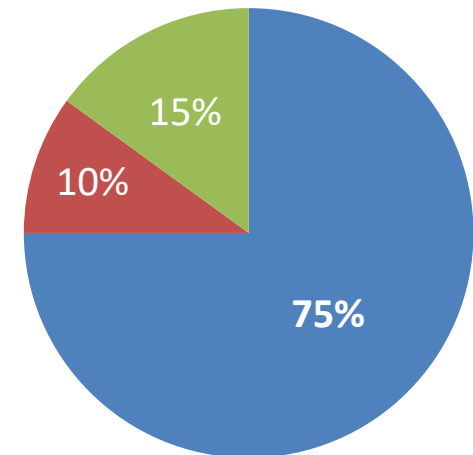
Revenue

- **State and local**
 - Per pupil funding
 - Local grants
 - Local programs
- **Federal**
 - Formulaic
 - Start up
 - Competitive
 - Programs
- **Private (non-public)**
 - Grants
 - Contributions
 - Activity fees
 - School sales
 - Other
 - Interest
 - Rent
 - Gains
 - Misc
 - In kind



Expense

- **Staffing**
 - Salaries
 - Payroll Taxes
 - Benefits
 - Other
- **Facilities**
 - Rent
 - Operating costs
- **Other**
 - Direct student
 - G&A
 - Office
 - Business
 - In Kind
 - Interest
 - Depreciation



Per-pupil funding can vary from year to year and is based on city and state budgeting process

As an example, here is the per-pupil funding in Baltimore City in recent years:

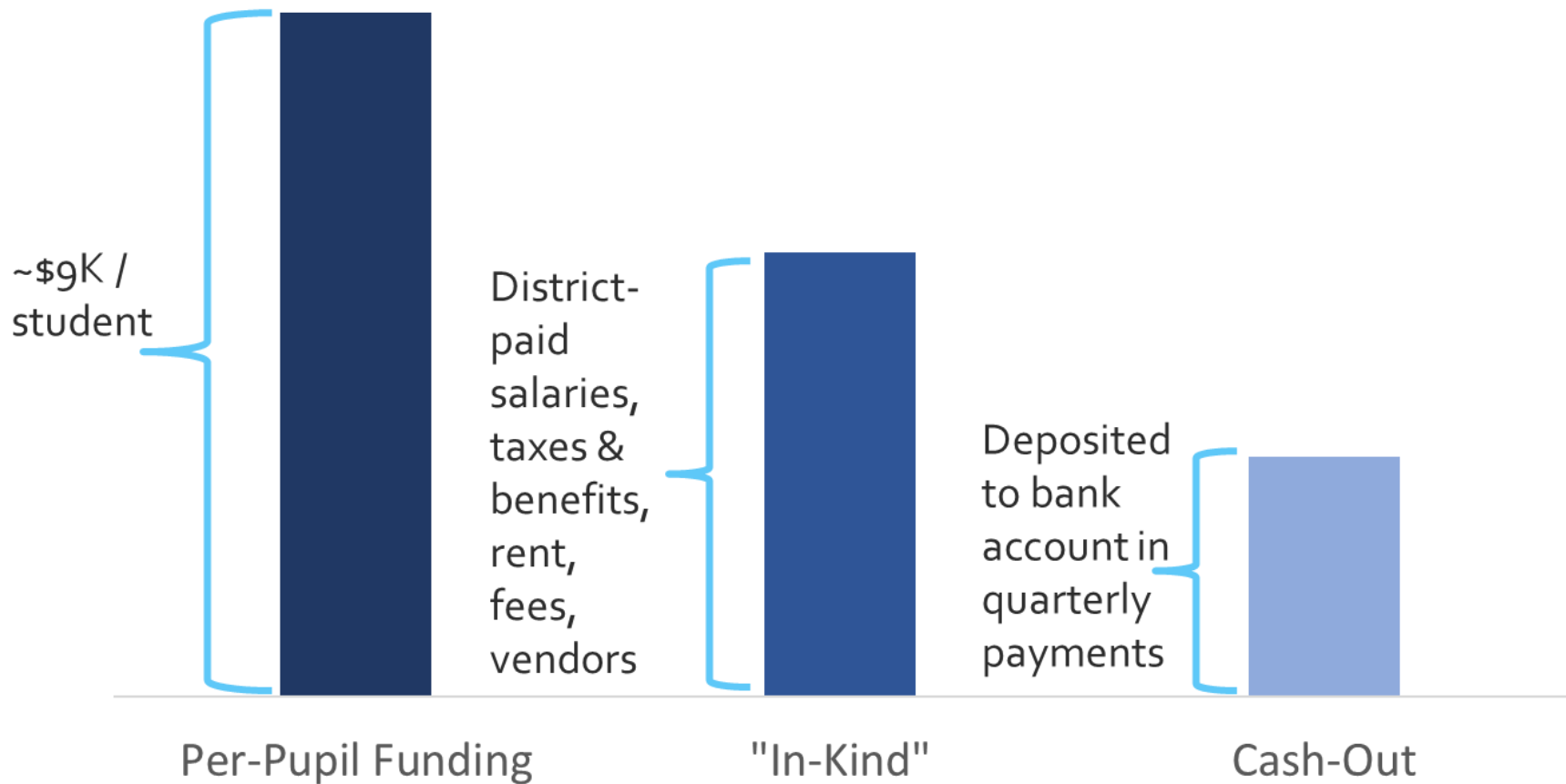
SY14-15	SY15-16	SY16-17	SY17-18	SY18-19	SY19-20	SY20-21
Past	Past	Past	Past	Past	Current	Future
9,556	9,387	9,251	9,327	9,002	9,199	?

Because 90% of revenue is driven by students, lost students can dramatically change the shape of a school

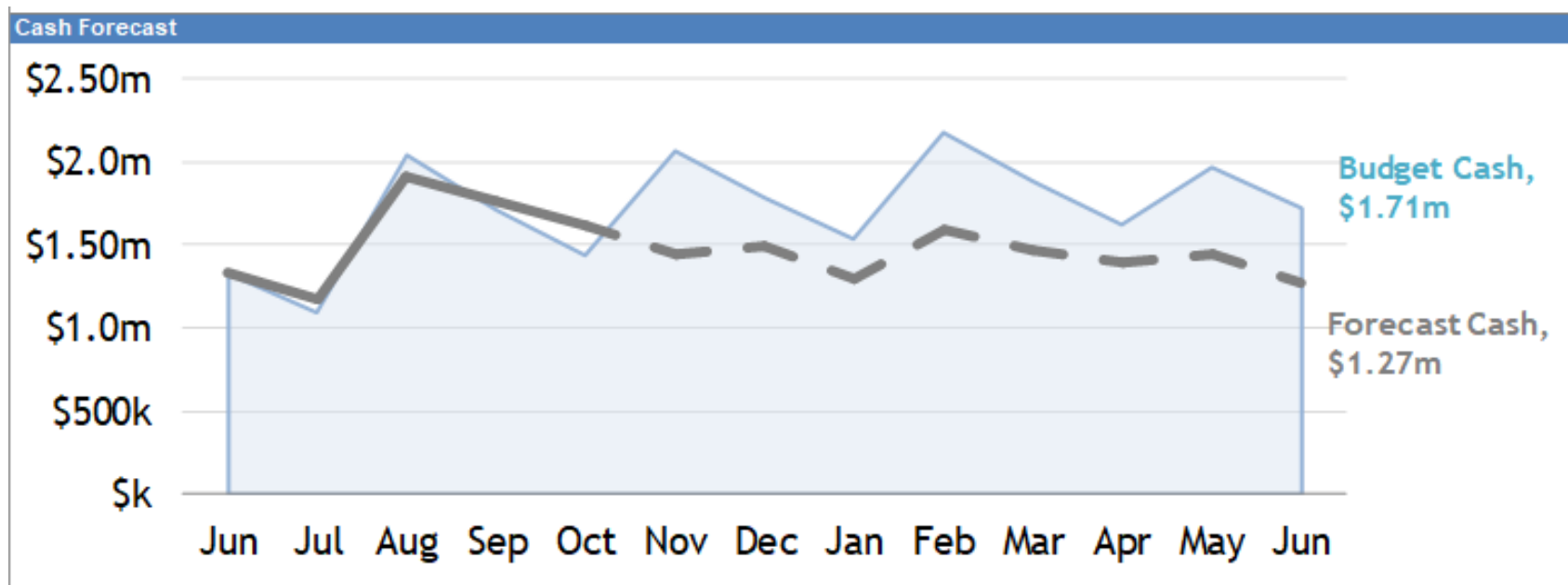
Lost Students	Lost Revenue	Potential Resolution
10	90,000	Lay off 1-2 staff members
11	99,000	
12	108,000	
20	180,000	Cut multiple staff positions and/or non-essential programs
25	225,000	
30	270,000	
50	450,000	Major reductions to staff; attempt to renegotiate facilities commitments
60	540,000	
70	630,000	

Schools can attempt to close the gap by raising additional private grants and donations, but this is usually difficult. A successful fundraising effort can take multiple years to bear fruit.

Per-pupil is largest funding source, but is not fully received as cash



Per-pupil “cash-out” payments are received four times per year, which causes schools’ cash flow to resemble a sawtooth pattern



“Cash is king.” It is critical to frequently monitor your cash position and projected cash flow in future months. Be especially mindful of low points during the year.

School Budget vs. Operator Budget

OPERATOR BUDGET

Funded by left-over balance of per-pupil revenue LESS cost of district employees and any other district expenses

SCHOOL BUDGET

- Almost entirely staffing-related; can also include rent, fees and vendor pmts
 - Requirements for certain positions, per MD code
 - For the most part, charters do not have control over salaries & benefits
-
- May incorporate private fundraising
 - Charters have much more control over this budget

In Practice: School vs. Operator?

FY2018 Organization Budget			
Income Statement	SY15-16	SY16-17	SY17-18
Account	Past	Current	Future
Revenue			
04 · State and Local Revenue	2,100,000	3,210,000	4,480,000
05 · Federal Revenue	200,000	200,000	200,000
06 · Private Revenue	375,000	250,000	325,000
Total Revenue	2,675,000	3,660,000	5,005,000
Operating Expense			
07 · Staff-Related Expense	1,980,000	2,850,000	4,100,000
08 · Occupancy Expense	300,000	320,000	350,000
09 · Student Expense	135,000	150,000	185,000
09 · General & Admin	190,000	205,000	210,000
09 · Contingency	13,375	18,300	25,025
Total Operating Expense	2,618,375	3,543,300	4,870,025
Net Operating Income	56,625	116,700	134,975
Interest, Depreciation			
1X · Depreciation, Amortization,	20,000	30,000	40,000
Total Expenses	2,638,375	3,573,300	4,910,025
Net Income	36,625	86,700	94,975

Mostly per-pupil; starts on school budget, leftovers for operator budget; Also includes SWD (school budget)

Title I & Title II on school budget, Title V-b (CSP) on operator budget
Private fundraising part of operator budget ONLY

Mostly district staff, and thus, part of school budget; can include additional staff in operator budget

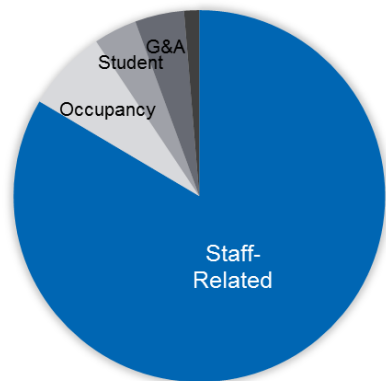
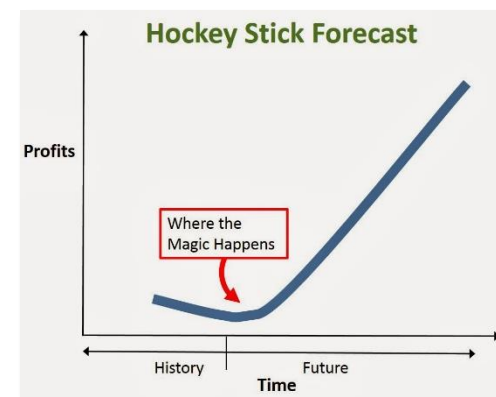
Can include expenses from both budgets, depending on how they were procured (via district or internally)

Budget Sanity Check: the Three R's



Reflective: Does it reflect your priorities and broad goals?

Realistic: Is the budget possible given historical trends and knowledge about future spending and revenue?



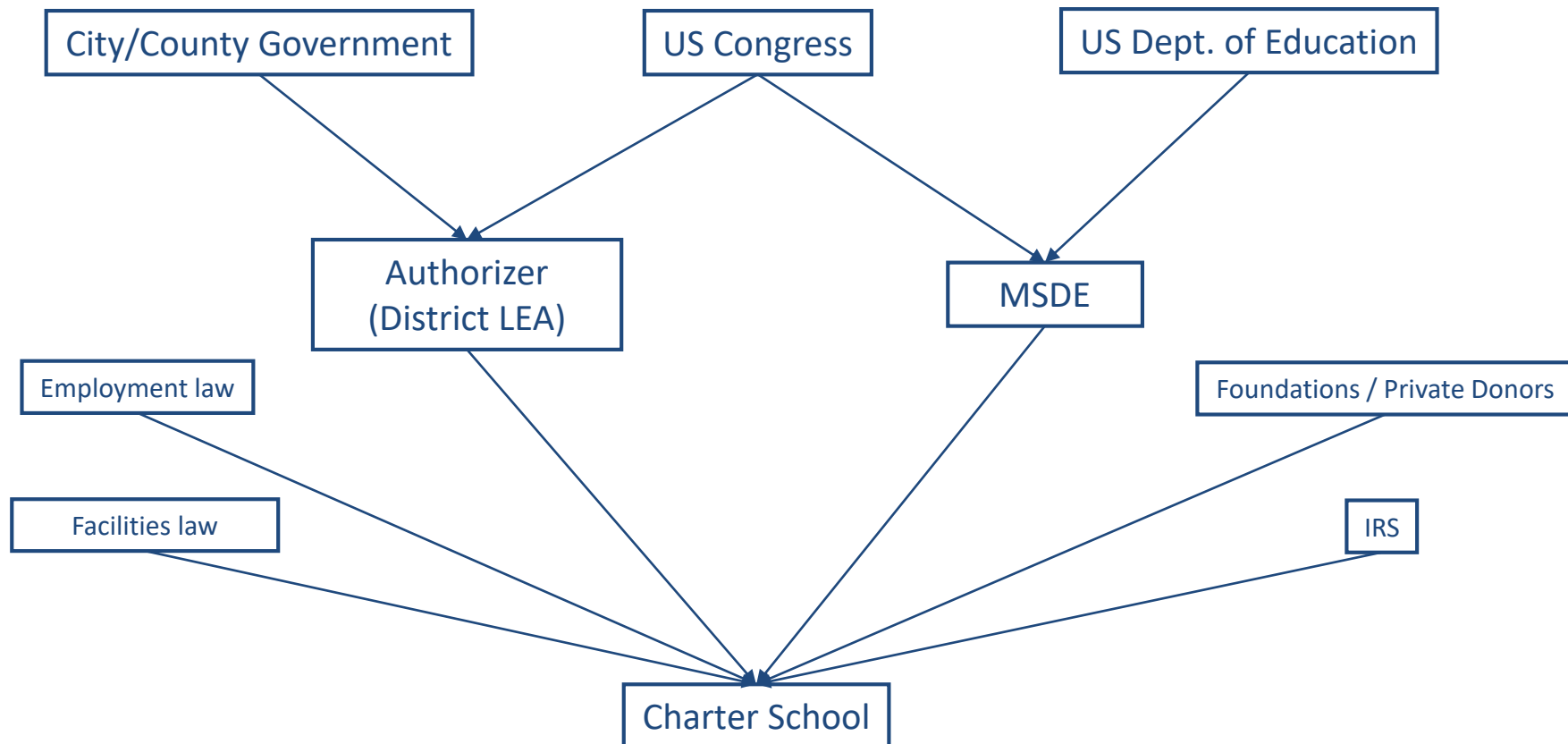
Ratios: How does the budget compare with the broad spending metrics for other charter schools?

While each school's budget will be unique, there are several industry 'rules of thumb' that you can use when building it, such as:

- Operating Income: **5-10%** of revenue for newer schools, **0-3%** of revenue for mature schools
- Cash flow: maintain **positive** cash flow throughout the year
- Cash on hand: eventually **3 months**, closer to 2 months for newer schools
- Long-term sustainability: total **net savings should be growing** over time
- Comply with all **your debt covenants**, if you have debt

Charter School Environment & Structure

Maryland charter schools are authorized by local school districts, but are subject to regulatory and compliance impacts from other agencies



Financial and compliance risks are managed daily by the executive team and overseen by the board

Financial

- Fraud/Theft/Loss
- Cash flow/insolvency
- Reporting and forecasting weaknesses
- Unsustainable model

Compliance

- School district rules and procedures
- Employment regulations
- Debt covenants
- Federal funds (esp. CSP start-up grant)

Governance

- Board ineffective or dysfunctional
- Weak oversight
- Weak strategic guidance

Management

- Poor plans and strategies
- Poor execution
- Poor process or policies
- High turnover

Manage risks with internal controls, policies, processes, oversight, audits—there is no substitute for paying attention

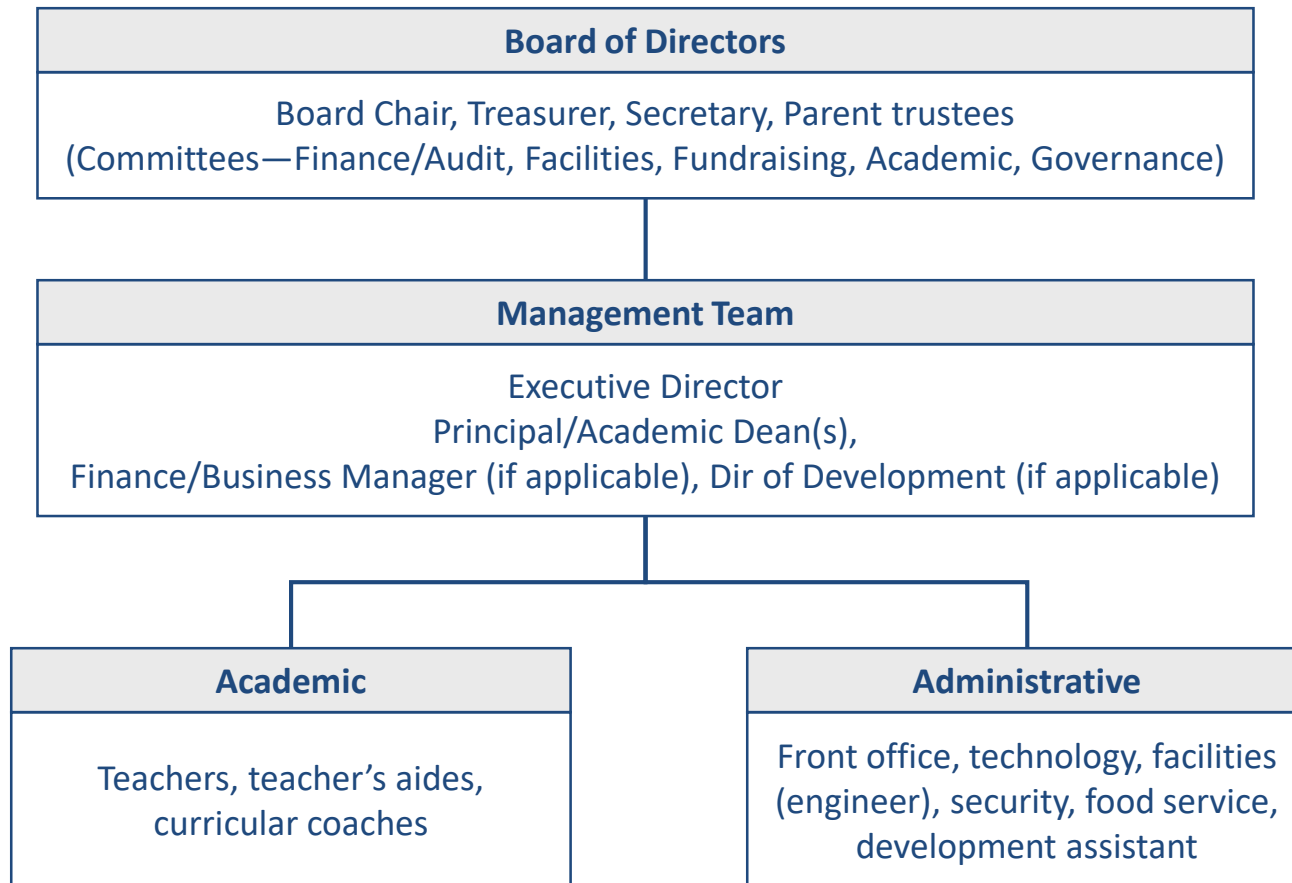
- Create sound budgets; live within budget and adjust to changes throughout year
- Forecast forward – supplement backward-looking statements (Plan 5 years fwd-minimum)
- Carry adequate insurance
- Secure & inventory FFE
- Minimize use of cash
- Separation of duties
- Background checks
- Internal review

- Know the rules or leverage professionals who do
- Use checklists of key requirements to ensure you are meeting them
- Reach out to governing bodies for deliverable and submission deadlines
- Build productive relationships with school district offices

- Ensure the board membership has the skills you need—legal, financial, strategic planning, academic, governance, fundraising
- Most board work done in committees
- Be actively involved—support and question
- Work through impasses and govern as a unified body
- Govern don't manage

- Ensure plans and strategies are sound
- Monitor execution
- Create or vet policies
- Recruit, hire, supervise and retain high-quality staff

Governance structure and composition are critical—the board bears ultimate responsibility; management executes day-to-day



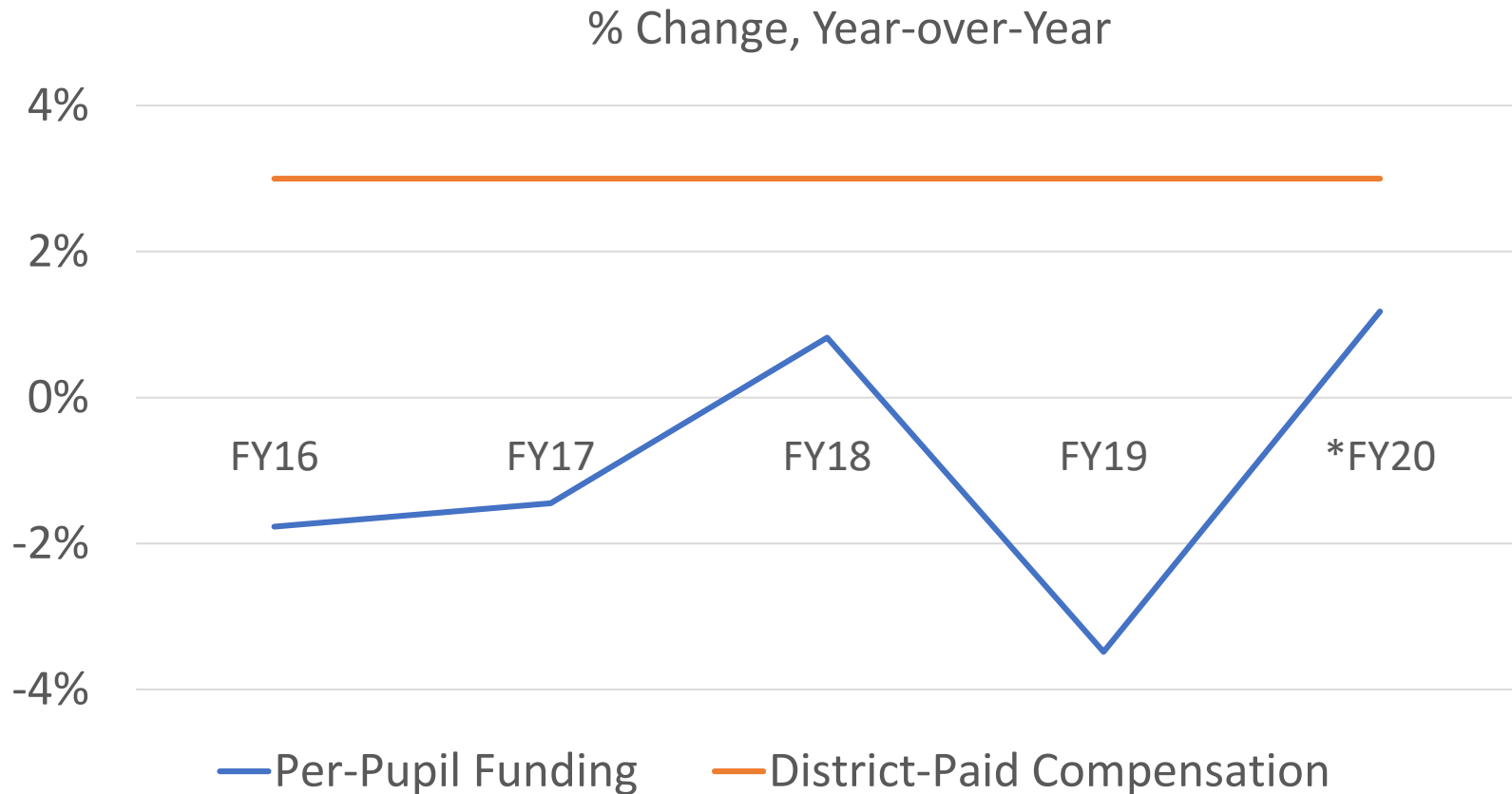
Final Tips

Founding team members should be aware of key facts and trends impacting Maryland public charter schools

- Local school district is the charter authorizer
- Local school district is the LEA
- Charter school teachers, principals and some support staff are employees of the school district and represented by local bargaining units
 - Charters can apply for waivers to certain requirements
- The school district handles “centralized” functions like HR, payroll, federal grants, some SpEd compliance and PD
- No per-pupil facilities allowance or other dedicated facilities funding; securing a long-term permanent facility is a huge challenge

In Baltimore City, per-pupil funding has been largely flat over the past 5 years, while district-paid staff salaries and benefits have increased 3-4% per year

- Charter schools have little control over either input



Following these final pointers will help your school's launch and early years be a financial success

- Build a Surplus! Non-profit does not mean no savings
 - Build an operating reserve
 - Build equity for a future facility
 - Show a bank that you have the ability to service debt
- Add a contingency to your budget
 - This is your first time; you are going to make mistakes
 - Assume a contingency of at least 1% of revenue
- Establish a line-of-credit early
 - Banks give you money when you have money
 - Banks don't give you money when you are desperate
- Do not promise a student-to-teacher ratio in your application
 - Student-to-teacher ratio is the biggest lever in your budget
 - Allow yourself the flexibility to change your mind

Contact Information

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Appendix

Financial statements communicate a school's performance during a period, as well as what it owns and what it owes

Income Statement



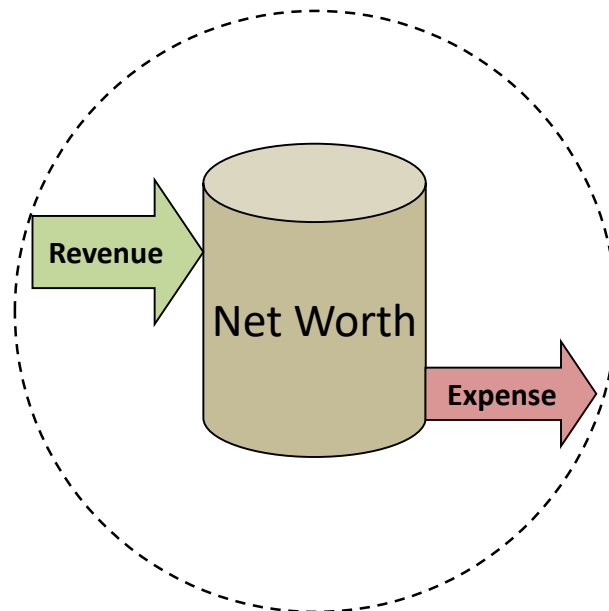
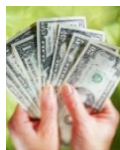
Revenue



Expense



Net
Income



Balance Sheet



Assets



Liabilities



Net
Worth



- A Budget vs. Actuals (BVA) report is an income statement for a given period compared to a plan (or budget) for the same period
- A Balance Sheet shows what the school owns, owes, and the difference—the net worth or equity
- A Cash Flow Statement hones in on changes in cash over a period, adjusting for non-cash items that are included in the income statement

Regardless of the chart of accounts used, ideally the income statement will be grouped by economic drivers

Revenue

• State and local

- PPF — Per pupil funding – primary revenue
- Local grants } Students With Disabilities / Special Education
- Local programs }

• Federal

- Formulaic } ESEA (Title 1, 2), IDEA, CSP start-up
- Start up }
- Competitive
- Programs

• Private (non-public)

- Grants } Fundraising
- Contributions }

- Activity fees
- School sales
- Other } The importance of these categories depends on the school's model – it is significant for some, trivial for others. Some schools have significant paid aftercare, for example.
- Interest
- Rent
- Gains
- Misc

- In kind — Donated services or physical items

Expense

• Staffing

- Salaries } Largest expense to school
- Payroll Taxes } Retirement (403b or 401k plan), health, dental, disability
- Benefits }
- Other — Staff events, recruiting, PD

• Facilities

- Rent — If building is not owned
- Operating costs — Utilities, contracted services, supplies

• Direct student

• G&A

- Office } Textbooks, curriculum, uniforms, field trips, assessments, athletics, etc.
- Business } Supplies, copiers, telecom/internet, insurance, accounting, audit, IT, legal

• In Kind

• Interest

• Depreciation

Donated services or physical items

Generally related to financing for an owned building but also for LOC or capital lease

Both for operating assets and facility assets (building or LH improvements) Amortization, a similar non-cash expense, may be recorded as well

Sample Income Statement (and Budget vs. Actual)

Statement	Year-To-Date		
	Actual	Budget	Variance
Revenue			
State and Local Revenue	4,301,780	4,207,145	94,635
Federal Revenue	89,456	209,441	(119,985)
Private Grants and Donations	286,668	187,500	99,168
Earned Fees	18,988	20,570	(1,582)
Total Revenue	4,696,891	4,624,656	72,235
Expenses			
Salaries	2,503,188	2,616,858	113,670
Benefits and Taxes	756,323	830,995	74,672
Contracted Staff	126,784	85,263	(41,521)
Staff-Related Costs	152,360	57,040	(95,320)
Rent	241,671	314,432	72,760
Occupancy Service	87,385	92,782	5,397
Direct Student Expense	206,167	262,786	56,620
Office & Business Expense	437,281	291,508	(145,773)
Contingency	0	23,116	23,116
Total Expenses	4,511,158	4,574,780	63,621
Operating Income	185,733	49,876	135,857
Extraordinary Expenses			
Depreciation and Amortization	48,561	56,858	8,297
Total Extraordinary Expenses	48,561	56,858	8,297
Net Income	137,172	(6,982)	144,154

Balance sheet organization is generally standard—assets, liabilities, and net worth

Assets

- **Cash** — Generally several bank accounts; sometimes a portion is restricted
- **Receivables** — Revenue earned ahead of cash payment for funding from all sources including grants (private or federal), programs, pledges, or miscellaneous items
 - Local
 - State
 - Federal
 - Private
- **Other current assets** — Cash disbursed that is not yet an expense (or in the case of deposits will likely be returned)
 - Prepays
 - Deposits
 - Advances
- **Operating assets** — Cash disbursed for items with multi-year economic lives – expensed as depreciation over the economic life
- **Facility assets**

Liabilities and equity

- **Payables** — Invoices received for products or services that need to be paid
- **Credit accounts** — Similar to payables, generally credit cards
- **Accrued expenses** — Expenses incurred that have not been paid or invoiced by party owed
- **Payroll liabilities**
- **Unearned revenue**
- **Short-term debt** — Generally related to facilities, though sometimes to line of credit
- **Long-term debt**
- **Net Assets** — School's net worth or equity—restrictions are time or use based
 - Unrestricted
 - Restricted

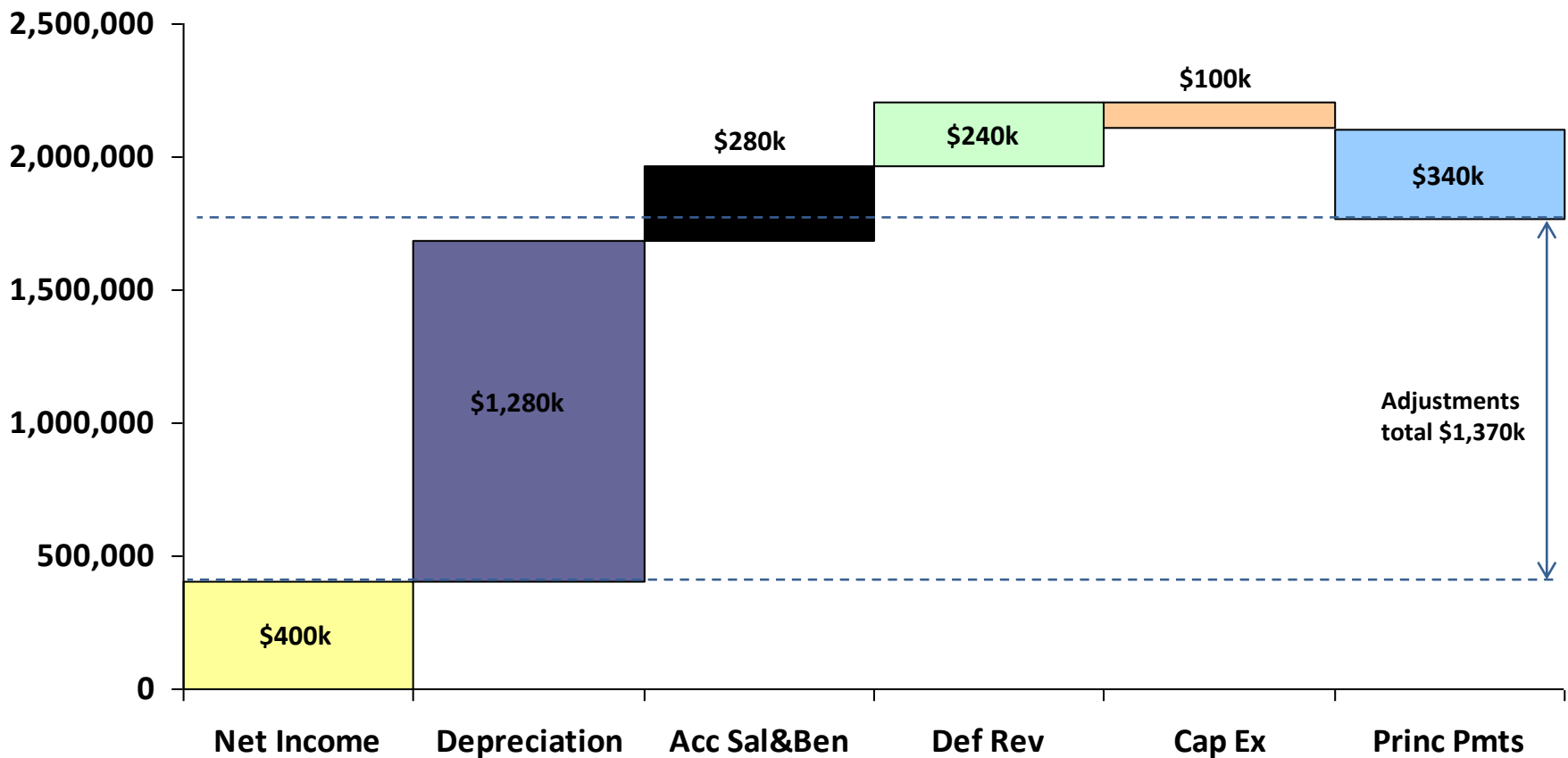
Sample Balance Sheet

Balance Sheet	6/30/2018	4/30/2019
sets	Last Year	Current
Assets		
Current Assets		
Cash	232,380	41,184
Accounts Receivable	106,604	408,418
Other Current Assets	25,236	15,195
Intercompany Transfers	0	0
Total Current Assets	364,221	464,797
Noncurrent Assets		
Facilities, Net	2,533	422
Operating Fixed Assets, Net	149,446	127,734
Total Noncurrent Assets	151,979	128,157
Total Assets	516,200	592,954
Liabilities and Equity		
Last Year		
Current		
Liabilities and Equity		
Current Liabilities		
Accounts Payable	69,941	118,626
Other Current Liabilities	73,565	17,019
Accrued Salaries and Benefits	49,435	0
Total Current Liabilities	192,941	135,645
Equity		
Unrestricted Net Assets	348,012	313,491
Net Income	(34,521)	137,172
Total Equity	313,491	450,662
Long-Term Liabilities		
Other Long-Term Liabilities	9,768	6,647
Total Long-Term Liabilities	9,768	6,647
Total Liabilities and Equity	516,200	592,954

The cash flow statement is also critical—a graphical representation can be helpful to promote understanding

The cash flow statement shows sources and uses of cash not reflected in the income statement

Reconciliation of Net Income to Net Cash Flow for Fiscal Year



Sample Cash Flow Statement

Cash Flow Statement	Actual	Budget	Variance
Net Income	137,172	(6,982)	144,154
Cash Flow Adjustments			
Add Depreciation	48,212	56,522	(8,311)
Operating Fixed Assets	(24,389)	(33,333)	8,944
Other Operating Activities	(341,195)	(38,666)	(302,529)
Suspense	(7,873)	0	(7,873)
Facilities Project Adjustments	(3,122)	(7,302)	4,180
Total Cash Flow Adjustments	(328,368)	(22,779)	(305,589)
Change in Cash	(191,196)	(29,761)	(161,435)