

# **Fiscal Year 2018 Financial Analysis Report Technical Guide**

**December 17, 2018**



## Table of Contents

<b>About the DC Public Charter School Board</b> .....	<b>3</b>
<b>DC PCSB's Financial Analysis Report</b> .....	<b>4</b>
<b>Financial Report Cards</b> .....	<b>5</b>
<b>School Profile</b> .....	<b>5</b>
<b>Key Financial Metrics</b> .....	<b>5</b>
Change in Net Assets Margin.....	5
Aggregated Three-Year Margin .....	6
Days of Cash on Hand.....	7
Cash Flow from Operations Margin .....	7
Current Ratio .....	7
Debt Ratio .....	7
Debt Service Coverage Ratio.....	8
Primary Reserve Ratio .....	8
Enrollment Variance .....	8
Unresolved Prior Year Audit Findings .....	8
Debt Compliance Issue – Financial .....	9
Debt Compliance Issue – Reporting .....	9
<b>Comments from the School</b> .....	<b>9</b>
<b>Functional Expenses</b> .....	<b>10</b>
<b>Financial Position and Financial Activities</b> .....	<b>10</b>
Financial Position .....	10
Financial Activities .....	10
Revenues/Expenses per Student.....	10
<b>Audit Findings</b> .....	<b>11</b>
Statement Opinion .....	11
Material Weakness.....	11
Statement of Non-Compliance .....	11
Modified Program Opinion (Uniform Guidance).....	11
Program Material Weakness (Uniform Guidance).....	11
Findings and Questioned Costs .....	12
Unresolved Prior Year Findings.....	12
Going-Concern Issue.....	12
Debt-Compliance Issue.....	12
<b>DC PCSB Observations</b> .....	<b>12</b>
<b>Management Organizations</b> .....	<b>12</b>
<b>Data Sources</b> .....	<b>13</b>
Data Processing .....	13
<b>Additional Data Tables</b> .....	<b>14</b>

## About the DC Public Charter School Board

In school year 2017-18, the DC Public Charter School Board (DC PCSB) oversaw 66 Local Education Agencies (LEAs) at 118 campuses, which served nearly 45,000 students from every ward of the city. The organization's mission is to provide high-quality public school options for District of Columbia students, families, and communities through four functions:

- *A comprehensive review application process* – ensures that the DC PCSB approves only those charter school applications that will prepare and train students for postsecondary experiences and individual career paths.
- *Effective oversight* – holds schools to high standards for results, with extensive reviews and data collection, and makes oversight decisions with the best interests of students in mind.
- *Meaningful support* – provides clear feedback and increased oversight to low-performing schools, and rewards consistently high-performing schools with more autonomy.
- *Active engagement of stakeholders* – solicits community input and strives to be responsive to and transparent with all who are affected by and have an impact on DC PCSB and public charter schools.

DC PCSB's vision is to lead the transformation of public education in DC and to serve as a national model for charter school authorizing and accountability.

A Board of seven with a professional staff of approximately 45 is responsible for the oversight and management of the organization's mission and vision. Board members are nominated by the mayor and confirmed by the DC Council.

## **DC PCSB's Financial Analysis Report**

The School Reform Act (SRA) requires that DC PCSB revoke the charter of any public charter school that (1) has engaged in a pattern of nonadherence to generally accepted accounting principles (GAAP); (2) has engaged in a pattern of fiscal mismanagement; and/or (3) is no longer economically viable. Further, each DC public charter school is required to conduct annually a thorough audit of its finances and operations. School must choose a third-party auditor from a list of auditors approved by DC PCSB, the Office of the Chief Financial Officer (OCFO), and the Office of the State Superintendent of Education (OSSE). DC PCSB, with support and counsel from OCFO and OSSE, analyzes and summarizes the information in these audits to produce the Financial Analysis Report (FAR) which presents consistent and transparent information about DC public charter schools' finances and operations.

Each year, DC PCSB convenes a task force of school leaders, business managers, and charter support organizations to give input into the FAR's methodology, design, and production process.

The most critical section of the FAR is the Financial Report Card for each school, including data on the school's management organization, if applicable. Additional data tables and narrative commentary on the key trends and opportunities of DC public charter schools' finances provide context and analysis. Each of these is included in more detail within the technical guide, as necessary.

The FAR Technical Guide outlines DC PCSB's process for producing the FAR. It was created so that school leaders, data managers, families, and other stakeholders would understand the FAR's content, methodology, and scope.

## Financial Report Cards

The FAR includes one Financial Report Card<sup>1</sup> for each LEA, regardless of how many campuses or facilities the LEA operates. DC PCSB does not publish Financial Report Cards for schools that closed at the end of the fiscal year, as the completion of these schools' final year audits is typically significantly delayed due to dissolution activities.

### School Profile

The top bar of the Financial Report Card includes profile information for each LEA, specifically:

Name: The FAR Report Card refers to each LEA by its familiar name, which may be the registered name of the non-profit corporation that holds the school's charter, or may be a "doing business as" name.

Opened: This refers to the LEA's first year of academic operations.

School Quality Report Rating: DC PCSB's academic report card, rating is reported.

Management Organization: If the school contracts with a school management organization, the School Profile bar will identify the name of the organization.

Going Concern: If the auditor has noted a Going Concern, the School Profile bar will include a prominent indicator. A Going Concern indicates that the auditor has questioned the ability of the school to continue operations.

### Key Financial Metrics

The primary focus of the Financial Report Card is the Key Financial Indicators. Each school's performance on these indicators is compared to its prior year results and the sector median.

The Key Financial Indicators are:

#### Change in Net Assets Margin

This is an indicator of the school's ability to keep expenses aligned with revenue throughout the fiscal year, relative to the size of its budget. It is calculated as:

$$\text{Change in Net Assets Margin} = \frac{\text{Operating Revenues} - \text{Operating Expenses}}{\text{Operating Revenues}}$$

---

<sup>1</sup> The FY 2017 FAR Report Cards are available here: <http://www.livebinders.com/play/play?id=2383674>

DC PCSB expects this change to be above 0%, while changes below -5% may be cause for concern.

#### Aggregated Three-Year Margin

This metric measures over the long-term whether a school's revenues are exceeding its expenses. It is calculated as:

$$\text{Aggregated Three - Year Margin} = \frac{\text{3 - year Operating Revenues} - \text{3 - year Operating Expenses}}{\text{3 - year Operating Revenues}}$$

Where:

$$\text{3 - year Operating Revenues} = \sum \text{Operating Revenues (CY, PY - 1, PY - 2)}$$

$$\text{3 - year Operating Expenses} = \sum \text{Operating Expenses (CY, PY - 1, PY - 2)}$$

And:

CY = Current year  
PY-1 = Year prior to current year  
PY-2 = Year prior to PY-1

DC PCSB expects schools' Aggregated Three-Year Margins to be above 0.0%. Aggregated Three-Year Margins below -1.5% may be cause for concern.

#### Days of Cash on Hand

This metric measures the number of days of expenses a school can pay with cash on hand. It is calculated as:

$$\text{Days of Cash on Hand} = \frac{\text{Unrestricted Cash and Cash Equivalents}}{(\text{Operating Expenses} - \text{Total Depreciation and Amortization}) / 365 \text{ Days}}$$

DC PCSB expects schools to have at least 45 days of cash on hand. Fewer than 15 days of cash on hand may be cause for concern. Cash equivalents should include investments that can be easily liquidated with little or no penalty (e.g., Certificates of Deposit, mutual funds, etc.).

#### Cash Flow from Operations Margin

This metric measures whether a school's operations are generating or using cash. It is calculated as:

$$\text{Cash Flow from Operations Margin} = \frac{\text{Net Cash (Used In) Provide by Operating Activities}}{\text{Operating Revenues}}$$

DC PCSB expects schools' Cash Flow from Operations Margins to be above 0%. Cash Flow from Operations Margins below -2% may be cause for concern.

#### Current Ratio

This metric measures the financial resources available to meet a school's short-term obligations. "Current" defines the time period as the following 12 months. It is calculated as:

$$\text{Current Ratio} = \frac{\text{Total Current Assets}}{\text{Total Current Liabilities}}$$

DC PCSB expects schools' Current Ratios to be above 1.0; Current Ratios below 0.9 may be cause for concern.

#### Debt Ratio

This metric measures how leveraged a school is, or the extent to which a school relies on borrowed funds to finance its operations. It is calculated as:

$$\text{Debt Ratio} = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

DC PCSB expects schools' Debt Ratios to be below 0.5; Debt Ratios above 0.9 may be cause for concern.

#### Debt Service Coverage Ratio

This metric is a measure of surplus available for debt servicing to interest and principal. It is calculated as:

#### *Debt Service Coverage Ratio*

$$= \frac{\text{Change in Unrestricted}^2 \text{ Net Assets}^3 \text{ before Interest Expense}^4 \text{ and Depreciation and Amortization}}{\text{Principal Payments on Notes Payable in Current Year} + \text{Total Interest Expense}}$$

DC PCSB expects schools' Debt Service Coverage Ratios to be above 1.2. Debt Service Coverage Ratios below 1.0 may be cause for concern.

#### Primary Reserve Ratio

This metric compares a school's net asset size relative to its operating budget – a measure of financial strength. It is calculated as:

$$\text{Primary Reserve Ratio} = \frac{\text{Unrestricted Net Assets and Temporarily Restricted Net Assets}}{\text{Operating Expenses}}$$

DC PCSB expects schools' Primary Reserve Ratios to be above 0.25; Primary Reserve Ratios below 0.00 may be cause for concern.

#### Enrollment Variance

This metric is a measure of a school's ability to accurately forecast its enrollment. Because per student funding accounts for the majority of schools' funding, inaccurate enrollment forecasting can have a strong effect on financial performance and school stability. It is calculated as:

$$\text{Enrollment Variance} = \frac{\text{Audited Enrollment} - \text{Budgeted Enrollment}}{\text{Budgeted Enrollment}}$$

DC PCSB expects schools' Enrollment Variance to be above 0%. Enrollment Variances below -5% may be cause for concern.

#### Unresolved Prior Year Audit Findings

This indicator notes whether the school's auditor disclosed that audit findings from a prior year have not been corrected. Each school's auditor reviews the prior year's audit

---

<sup>2</sup> Changes in Temporarily restricted net assets have been omitted.

<sup>3</sup> Changes in certain non-cash income statement accounts have been omitted (amortization of debt issuance costs, unrealized gains/losses, and deferred rent).

<sup>4</sup> Total interest expense should not include interest on capital lease payments or amortization of debt issuance costs.



findings to ensure that the school has taken appropriate measures to resolve findings.

DC PCSB expects that schools promptly and conclusively address audit findings. Unresolved Prior Year Audit Findings may be cause for concern.

#### Debt Compliance Issue – Financial

This indicator notes whether the school's auditor disclosed that the school was not in compliance with certain financial covenants required by its debt agreements, specifically covenants related to financial metrics. While the lender may have waived the violation, a debt compliance issue may prelude insolvency.

#### Debt Compliance Issue – Reporting

This indicator notes whether the school's auditor disclosed that the school was not in compliance with certain financial covenants required by its debt agreements, specifically covenants related to financial reporting. If the school has received a waiver of the violation by the audit's completion, DC PCSB will consider debt compliance issues related to reporting to be resolved, and will not include the issue in the Key Financial Metrics.

### **Comments from the School**

Schools are encouraged to provide comments regarding their financial and operational strength, challenges, and future plans. These comments are limited to approximately 1,000 characters; when requested by the school, DC PCSB will aim to provide more space for further comments. DC PCSB may edit schools' comments for length and clarity, but not for content, except in rare cases.

## Functional Expenses

The Functional Expenses chart provides informational data on each LEA's allocation of resources between the major funding categories shown below. Spending in each category is also compared to the median spending allocation for all DC public charter schools:

- Salaries and benefits;
- Direct student costs, including contracted instructional services and food service;
- Occupancy, including rent, facility depreciation and amortization, and interest expense on facility debt; and
- General expenses, including office expenses, professional fees, non-facility depreciation and amortization, and non-facility interest expense. General expenses may also include management fees, if applicable.

## Financial Position and Financial Activities

The Financial Report Card also includes financial results for the past two fiscal years, specifically:

### Financial Position

The Financial Position table includes:

- Total Assets;
- Current Assets (i.e., assets available to the school within the following 12 months);
- Total Liabilities;
- Current Liabilities (i.e., liabilities coming due within the following 12 months); and
- Net Asset Position (i.e., the difference of Total Assets minus Total Liabilities).

### Financial Activities

The Financial Activities table includes:

- Revenues and Support, including all federal funding (both entitlement and competitive), state/local funding (DC per pupil funding, including foundational amounts, facilities funding, and categorical add-ons), grants and contributions (private grants, cash contributions, in-kind contributions, and competitive government grants), and other income;
- Expenses, including program services, general and administrative, and fundraising expenses;
- Non-operating revenue or expense, such as gains or losses on investments; and
- Change in Net Assets, i.e., surplus or deficit.

### Revenues/Expenses per Student

For each LEA, DC PCSB calculates the following metrics, including the sector median:

- DC Funding per Student;

- Philanthropic Funding per Student, including competitive government grants;
- Total Revenues per Student; and
- Expenses per Student.

## **Audit Findings**

School management is responsible for maintaining and reporting accurate, comprehensive financial information. In conducting the annual audit, the external auditor verifies the school's effectiveness in doing so. Audit findings address areas of nonconformity with GAAP and other financial reporting or management requirements. In issuing a finding, the auditor must define the condition, cause and effect, and recommendation for addressing the area of concern.

### **Statement Opinion**

The auditor issues an opinion letter on the basic financial statements. An *unmodified* opinion means the auditor is satisfied professionally that the statements present fairly the financial position of the school and the results of operations. Should there be areas of doubt, the opinion may be *modified*, *adverse*, or *disclaimed*.

### **Material Weakness**

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the school's financial statements will not be prevented, or detected and corrected, in a timely manner.

### **Statement of Non-Compliance**

The auditor tests for compliance with certain provisions of laws, regulations, contracts, and grant agreements. Non-compliance could have a direct and material effect on the determination of financial statement amounts.

### **Modified Program Opinion (Uniform Guidance)**

When expenditures of federal funds are greater than \$750,000, the auditor performs an extended review and issues an opinion letter on compliance with the requirements of laws, regulations, contracts, and grants applicable to each of the school's major federal programs. A *modified* opinion indicates instances of noncompliance.

### **Program Material Weakness (Uniform Guidance)**

In planning and performing the audit defined above, the auditor considers internal control over compliance with the requirements of applicable laws, regulations, contracts, and grants. A material weakness in internal control indicates that there is a reasonable possibility of material non-compliance with a

requirement of a federal program that will not be prevented, or detected and corrected, on a timely basis.

#### Findings and Questioned Costs

The auditor discloses audit findings that are important enough to merit attention by those charged with governance, with documentation of corrective action plans noting the responsible party.

#### Unresolved Prior Year Findings

The auditor discloses prior year audit findings that have not been corrected.

#### Going-Concern Issue

The auditor indicates that the financial ability of the school to continue in the coming year is questioned.

#### Debt-Compliance Issue

The auditor discloses that the school was not in compliance with certain debt covenants. A debt-compliance issue may prelude insolvency.

### **DC PCSB Observations**

In addition to standardized financial metrics and qualitative components of the audit, DC PCSB synthesizes important, individualized information from each school's audit. Where necessary for clarity, DC PCSB may add information from other sources, such as the school's foundational documents (e.g., charter agreement). Each LEA is given the opportunity to review and give input into the draft DC PCSB Observations before the publication of the FAR.

DC PCSB Observations may address:

- Financial trends;
- Related party transactions;
- Facility information, such as financing arrangements, ownership, or construction work in progress;
- Future plans that may significantly affect the school's financial results, such as
  - additional campuses or facilities; and
- Additional information about audit findings.

### **Management Organizations**

Approximately 17 DC public charter schools operate with school management organizations (MO). Per the Public Charter School Fiscal Transparency Amendment Act of 2015, an MO is:

an entity that a public charter school may identify in its charter petition or petition for charter revision with which the public charter school contracts to provide management or oversight services regarding the school's expenditures, administration, personnel, or instructional methods. The term "school management organization" does not include an entity with which a public charter school contracts solely to provide administrative support services, such as: (A) Payroll processing or information technology services; (B) Academic support services; or (C) Temporary management services recommended by the eligible chartering authority to improve the performance of a public charter school.

LEAs with MOs receive an additional supplementary table with information about the school-MO relationship. The table includes:

- MO name and tax status;
- Link to the MO's most recent public financial reports, if applicable;
- The name, title, and total compensation of the MO's highest paid employee, if known;
- The goods and services provided by the MO, as well as the cost of those services, including cost as a percentage of the school's total revenue;
- DC PCSB comments on the school-MO relationship; and
- School comments on the school-MO relationship.

## **Data Sources**

The FAR's primary data source is each school's annual financial audit, which is prepared in accordance with DC PCSB's Guidelines and Expectations for audited financial statements. Here are the [Guidelines and Expectations for Public Charter School Audited Financial Statements for Fiscal Year 2018](#).

Additional data sources may include school foundational documents (e.g., charter agreement) and publicly available reports (e.g., school management organizations' IRS Forms 990).

## **Data Processing**

Upon completion of its audit, each school submits the audit and a standardized data entry form via the Hub to DC PCSB. DC PCSB reads each audit, verifies the accuracy of the data against the audit, and follows up with each school as necessary. DC PCSB drafts each school's Financial Report Card and asks the school to review the draft for accuracy. Upon validation, DC PCSB updates its database and the Financial Report Cards to incorporate any corrections. Finally, DC PCSB generates additional data tables, described below, and writes commentary on the key trends in DC public charter schools' financial results.

## **Additional Data Tables**

In addition to school-specific data, DC PCSB compiles aggregated and comparative data for greater transparency and ease of use by external stakeholders. These tables exclude data for schools that closed at the end of the fiscal year, as the completion of these schools' final year audits is typically significantly delayed due to dissolution activities.

Aggregated reports provide combined data for all DC public charter schools (i.e., the sum of all schools' results in a particular metric). Aggregated data tables include:

- Statement of Financial Position;
- Statement of Activities;
- Statement of Cash Flows;
- Statement of Functional Expenses; and
- Long-Term Debt.

Comparative reports provide a single table comparing each school's results in a particular metric. Comparative data tables include:

- Cash, Assets, and Liabilities;
- Revenues and Expenses;
- Sources of Revenue;
- Net Asset Position over time;
- Cash Position and Future Debt;
- Philanthropic Revenue; and
- Distribution of Expenses.

DC PCSB also provides an index of schools operating with school management organizations.