



# **Be Prepared: Non-Profit Charter School Financial Statements are Changing**

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# AGENDA

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- Introduction
- How are annual financial statements used?
- Leases
- Net Asset Classes
- Investment Return
- Expense Reporting
- Liquidity and availability of resources
- Cash flow
- What should I start to think about now to be prepared?



# INTRODUCTION

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- Who Are We?
- Who Are You?
  - Facility situations?
  - Single charter vs. CMO network?
  - Classroom vs. non classroom?
  - Etc.



# INTRODUCTION

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Will I be impacted? And how?

- This will depend on many factors including such things as:
  - ❖ Lease agreements
  - ❖ Donors and fundraising being done
  - ❖ Role of your board in designating assets
  - ❖ Will you be seeking financing or grants?
  - ❖ Are you part of a charter network that combines financial statements?
  - ❖ How you currently report your “functional expenses”

Talk to your business office/back office and auditor!



# INTRODUCTION

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- Why Change?
  - More transparency into certain fiscal items
  - Allows donors, lenders and creditors to have better picture of the school's fiscal health
  - May allow charters to “tell their financial story” better
- When?
  - Guidelines phased in over time
  - Certain areas will change as soon as FY 2018-19
  - Other areas won't change for a few more years
  - Details are shown later in specific slides



# CHARTER SCHOOL FINANCIAL STATEMENTS

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Charter schools are subject to a variety of fiscal reporting requirements including:

- Regular reports to the Board of Directors
- Interim financial reports
- Unaudited actuals
- Audits
- Tax returns
- Non classroom based funding determinations

The reports are often in many different formats:

- Profit and loss or 'dashboard' or other forms for the Board
- Reports generated from accounting system
- SACS format reports
- District format for interim reports
- State "alternative form" for unaudited actuals
- Audit with financial statements
- Tax returns (990 and 199)



# CHARTER SCHOOL FINANCIAL STATEMENTS

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## CONSIDERATIONS FOR CHARTER SCHOOL FINANCIAL STATEMENTS

- ✓ How well do the various different reports line up?
- ✓ When you prepare the unaudited actuals, how will that impact the audit process or possible audit adjustments?
- ✓ When must certain items be completely aligned?
  - For example, fund balances on unaudited actuals and audits
- ✓ Do the different reports tell different 'stories' or are they consistent?
- ✓ How informed is your authorizer about the various different statements?
- ✓ Almost all records are public, so be aware of who may be accessing these
  - For example, be cautious about what the 990s say as these are easily retrieved as public records WITHOUT a public records request and are usually part of investigations of charter schools
- ✓ Be sure you are disclosing transactions correctly and consistently for all the various reports
  - For example, the audit and 990s should have all "related party transactions"



# HOW THE NEW GUIDANCE IMPROVES Not For Profit (NFP) ACCOUNTING

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- Improves communication of financial performance and condition to stakeholders
- Reduces cost and complexities in preparing financial statements.
- Simplifies the face of the financial statements
- Enhances footnote disclosures
- Provides more relevant information about resources and the changes in those resources



# HOW THE NEW GUIDANCE IMPROVES NFP ACCOUNTING

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Helpful to users, such as donors, grantors, creditors, and others in assessing a not-for-profits:

- Availability of resources to meet cash needs for general expenditures
- Liquidity and financial flexibility
- Financial performance
- Service efforts and ability to continue providing services
- Execution of stewardship responsibility and other aspects of its management's performance



# CHANGES TO NOT-FOR PROFIT FINANCIAL REPORTING

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- After 20 years, stakeholders have voiced concerns:
  - Complexities in the use of the required three classes of net assets
  - Deficiencies in information needed to assess liquidity
  - Inconsistencies in information provided about expenses
  - Limited usefulness of the statement of cash flows



# LEASES

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## **Effective:**

- Those with bonds: Fiscal Year 2019-2020
- All others: 2020-2021

## **Current Reporting:**

- Operating leases
  - Statement of Activities impact only
- Capital leases
  - Reported as a financed purchase

## **New Reporting:**

- Operating leases
  - Right to use asset, and future payment liability
  - Statement of Activities impact will be relatively the same
  - Considerations: Variable vs. Fixed lease payments, current vs. long-term, bond/loan covenants
- Financing leases
  - Reported as a financed purchase
  - Criteria for determining financing lease is essentially the same as current criteria for capital lease



# LEASES

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## Important Considerations for Leases:

- Distinction between capital and operating lease is critical under current methodology
  - May be an area of audit focus
- Determining whether a lease exists will be critical in new methodology
  - Term?
  - Renewal arrangements?
- Lessees and Lessors may modify arrangements to take advantage of new methodology
- Probably not much difference between a private landlord and district (public agency) landlord for purposes of these guidelines
- Prop 39 facilities would likely NOT be considered a lease



# NFP FS Phase I

## Effective for Fiscal Year 2018-19

### Net Asset Classes:

- Classification scheme
- Disclosure of board designated net assets
- Underwater endowments
- Expirations of capital restrictions

### Investment Return/Expenses:

- Expense by nature; analysis of expenses by function and nature
- Netting of investment expenses against investment return
- Disclosure of netted investment expenses
- Enhanced disclosures about cost allocations

### Operating measures:

- Modest improvements to disclosures about availability

### Liquidity/Availability:

- Quantitative disclosures about availability
- Qualitative disclosures about liquidity
- Consideration of alternatives suggested by stakeholders (e.g., classified balance sheet)

### Statement of cash flow:

- Methods of presenting operating cash flows (direct/indirect)

# NFP FS Phase II

### Operating Measures—all other elements of proposal, including:

- Whether to require intermediate measure (s)
- Whether and how to define such measure(s), and what items should or should not be included in the measure(s)
- Alternative disaggregation approaches suggested by stakeholders

### Statement of Cash Flows:

- Realignment of certain items



# NET ASSETS CLASSES

## Current GAAP

- Unrestricted
- Temp. Restricted
- Perm. Restricted

## Revised

- Without Donors Restrictions\*
- With Donors Restrictions

## Disclosure

- Amount, Purpose, and type of board designations\*\*
- Nature and amount of donors restrictions

\* Can disaggregate further

\*\* New disclosure requirement



# RESTRICTED NET ASSETS

## With 'Donor' Restrictions:

- Federal Funds:

- Title I, NSLP, IDEA, etc.

- State Funds—a few examples:

- College and Career Grant
- Lottery
- Prop 39 Energy Grant

- Local Funds:

- Donations or grants for a specific purpose, may have timeline also

- Deferred Revenue vs. Temp Restricted
- Ideally restricted funds are spent within the same fiscal year, especially federal funds, but that is not always possible.



# KEY PROVISIONS OF THE NEW STANDARD

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## **Investment Return**

- Net presentation of investment expenses against investment return on the statement of activities
- No longer required to disclose investment expenses that have been netted

## **Expenses**

- Required to present expenses by nature as well as function
- Analysis showing the relationship between functional and natural classification for all expenses



# EXPENSE REPORTING

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- Analysis by both nature and function provides information about
  - Stewardship of resources
  - Fixed and variable costs
- Report expenses on the face of the financial statements or in the footnotes by:
  - Function
  - Natural Classification (object code)
  - Analysis (disaggregate function by nature)
- Requires disclosure of all expenses in one location (except netted investment costs)



# EXPENSE REPORTING

	Educational Program	Mgmt and General	Fund Raising	Supporting Subtotal	Total Expense
Salaries and benefits	\$13,025	\$1,130	\$960	\$2,090	\$15,115
Grants to other organizations	4,750				4,750
Supplies and Travel	2,402	213	540	753	3,155
Services and professional fees	2,250	200	390	590	2,840
Office and occupancy	2,210	218	100	318	2,528
Depreciation	2,810	250	140	390	3,200
Interest	335	27	20	47	382
Total expense	\$27,782	\$2,038	\$2,150	\$4,188	\$31,970



# EXPENSE REPORTING

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- Requires qualitative disclosures about methods used to allocate costs among program and support functions
- Provides enhanced guidance on allocations from Management & General expenses:
  - **Direct Conduct** of programs or other supporting activities requires allocation from M&G
  - **Direct Supervision** of programs or other supporting activities requires allocation from M&G



# EXPENSE REPORTING

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- Required to provide enhanced disclosures about the method(s) used to allocate costs among program and support functions
- Improved definition of management and general activities
- Provides guidance on the types of costs that can be allocated among program and/or support functions and those that should not be allocated



# EXPENSE REPORTING

## Sample footnotes- Note X Methods Used for Allocation of Expenses from Management and General Activities

The financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Organization. Those expenses include depreciation and amortization, the president's office, communications department, and information technology department. Depreciation is allocated based on the square footage, the president's office is allocated based on estimates of time and effort, and the information technology department is allocated based on estimates of time and costs of specific technology utilized.

The financial statements report certain categories of expenses that are attributable to more than one program or supporting function. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include depreciation, interest and office and occupancy, which are allocated on a square-footage basis, as well as salaries and benefits, which are allocated on the bases of estimates of time and effort.



# LIQUIDITY AND AVAILABILITY OF RESOURCES

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- Current disclosures provide limited information
- Feedback received on Exposure Draft was mixed:
  - Support for qualitative disclosures
  - Concern about implementation and audit costs
- Separated liquidity and availability into two separate objectives:
  - Liquidity – *qualitative* disclosure of liquidity risk and management
  - Availability – *quantitative* disclosure using information on the balance sheet



# LIQUIDITY AND AVAILABILITY OF RESOURCES

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- The FASB approved the following two objectives:
  - **Qualitative** information - how the Charter manages its liquid available resources and its liquidity risk (in the notes)
  - **Quantitative** information - communicates the availability of financial assets at the balance sheet date to meet cash needs for general expenditures within one year (on the face and/or in the notes)



# LIQUIDITY AND AVAILABILITY OF RESOURCES

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Requires enhanced disclosures to improve the usefulness of information to assess:

- Limits on the use of resources (liquidity, financial flexibility and allocation of resources) imposed by:
  - The governing board
  - Donors
- Methods to manage liquidity to meet near-term demands for cash
- Types of resources used to carry out operating activities
- Accounting policies and methods to allocate costs between program and supporting activities



# LIQUIDITY AND AVAILABILITY OF RESOURCES

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- Classified balance sheet provides quantitative disclosures on availability:
  - Label current and non-current assets and liabilities
  - Segregation of assets whose use is limited
  - However, the balance sheet may contain non-financial assets
- Availability is affected by:
  - The nature of the item
  - External limits imposed by donors, grantors, law and contracts
  - Internal limits imposed by Board decisions



# LIQUIDITY AND AVAILABILITY OF RESOURCES

- Quantitative disclosures could be provided in chart form:

Financial assets, at year-end	\$234,410
Less: Contractual or donor-imposed restrictions making financial assets unavailable for general expenditure within one year:	
Restricted by donor with time or purpose restrictions	(11,940)
Subject to appropriation and satisfaction of donor restrictions	(174,700)
Investments held in annuity trust	(4,500)
Board Designations:	
Quasi-endowment fund, primarily for long-term investing	(36,600)
Less amount set aside for liquidity reserve:	(1,300)
Financial assets available within one year to meet cash needs for general expenditures with one year	\$5,370



# So what do I do now?

## Things to start thinking about:

- ✓ What is the role of the board, and what info will my board need to understand these changes?
- ✓ What do I need to think about for my authorizer? Will they understand this or will they need explanations?
- ✓ What changes to board policy and/or accounting policies will be needed?
- ✓ How will my leases be categorized?
- ✓ How might the consolidation or set up of more than one charter in a CMO be affected?
- ✓ Will I be seeking large grants, donations or financing in the near future?
- ✓ Consider the nature of your expenses—what function does each perform?



# Q&A

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