

# Cracking the Code: Your Guide to Financial Statements

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MARCH 21, 2017  
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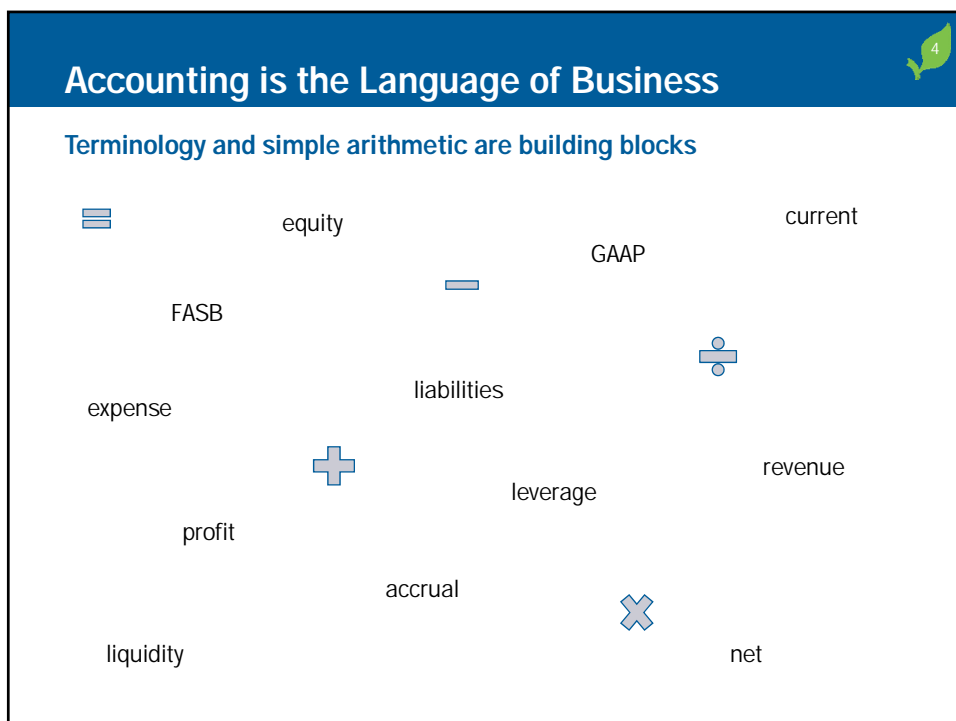
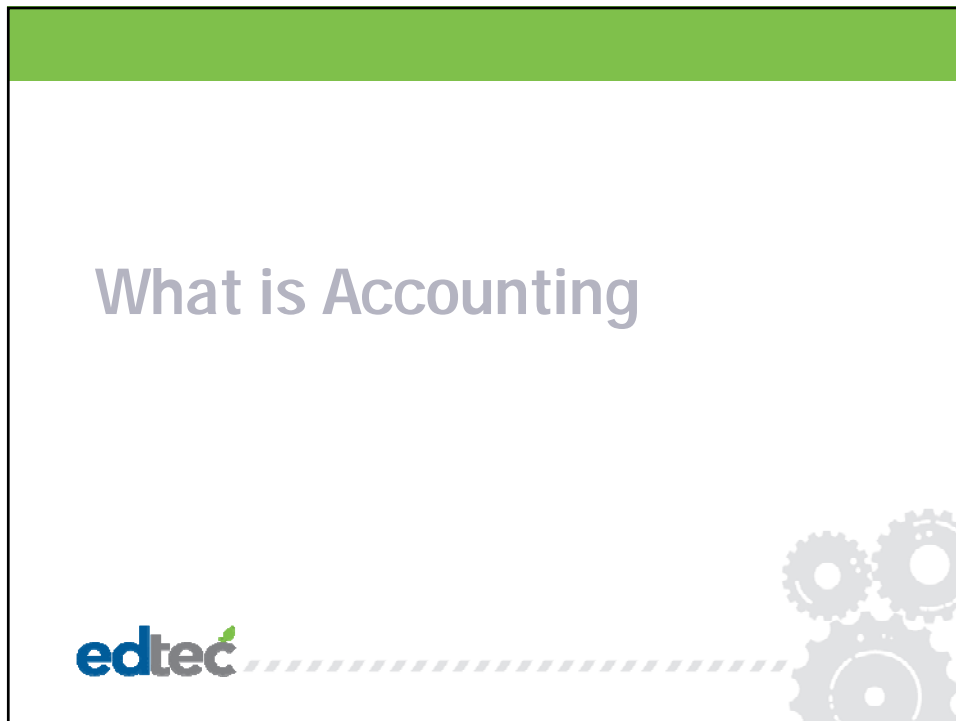


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## Financial Literacy → Fiscal Health

### Evidence-based decision-making for all stakeholders

Planning: board, management

Operations: management, staff

Monitoring: management, board

Reporting: board, independent auditor

Governance/oversight: board, investor, lender, authorizer

A nonprofit board has a fiduciary duty to act as trustee of the organization's assets

## Evolution of Accounting

### Tracking transactions through commerce history, from bartering to the stock exchange

- Inform operations
- Facilitate growth

### Principles and standards upheld by trade associations

- GASB (Government Accounting Standards Board)
  - Governmental entities
- FASB (Financial Accounting Standards Board)
  - Nongovernmental entities
    - For-profit
    - Non-profit, including charter schools

### GAAP (Generally Accepted Accounting Principles)

- FASB Guidelines
- Common set of standards and procedures
- Accrual basis
- Reviewers assured of consistency and accuracy of data

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## Timing Matters: Basis of Accounting

**Two Main Accounting Methods**

- **Cash**
  - Matches when cash is received and spent
  - Revenues recognized when received, expenses when paid
  - No depreciation
  
- **Accrual**
  - Records effect of transaction, regardless of cash impact
  - Revenues recognized when earned, expenses when incurred
  - Complete financial picture: revenues and its associated costs are matched in the same period
  
- **Based on the method, simple math can produce different answers**

2+2=?

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## Example: Cash Apocalypse of 2012-13

33% of State Aid was received after the fiscal year

**SAD Charter School:**

- 400 P-2 ADA
- Funding of \$7,500/ADA
- 67% of funding received by June
- Expenses of \$2.5M all paid by June

Cash Basis		Accrual Basis	
+ Revenues	\$2M	+ Revenues	\$3M
-- Expenses	\$2.5M	-- Expenses	\$2.5M
<b>= Income</b>	<b>-\$0.5M</b>	<b>= Income</b>	<b>+\$0.5M</b>

## Example: Depreciation



**\$1M cash payment for a building with useful life of 30 years**

### Cash Basis

- \$1M recorded as expense
- No building cost in subsequent 29 years

### Accrual Basis

- The expense is spread out across useful life of 30 years ( $\$1M/30 = \$33K$ )
- 1 year occupancy/use of building represents expense incurred

	2012-13
+ Revenues	\$2M
-- Expenses	\$2.5M
-- Building	\$1M
= Income	<b>-\$1.5M</b>

	2012-13
+ Revenues	\$3M
-- Expenses	\$2.5M
-- Depreciation	\$0.033M
= Income	+\$0.467M

## Meet the Statements



## Financials Describe Activities & Position

### Statement of Financial Position

- **a.k.a., Balance Sheet**
  - Frozen snapshot (as of xx date)
  - Reports assets, liabilities & equity

### Statement of Activities

- **a.k.a., Income Statement, Profit & Loss**
  - Time period (e.g., July – June)
  - Reports income, expenses & profits

### Statement of Cash Flows

- **Cash Flow**
  - Time period (e.g., July – June)
  - Impact of activities on cash
  - Organized by operating, investing & financing activities

### Statement of Functional Expenses

- **Program v. Admin**
  - Time period (e.g., July – June)
  - Separates expenses into program, support & fundraising activities

## Required Reporting for Charter Schools

### Monthly

- **Income Statement**
  - YTD Budget vs. Actuals
  - Forecast
- **Cash Flow Projections**
- **Balance Sheet**

### Interims

- **First Interim (July-October)**
- **Second Interim (July-January)**

### Annually

- **Unaudited Actuals**
- **Audited Financials**
  - Income Statement
  - Balance Sheet
  - Cash Flow
  - Functional Expenses
  - Notes, Findings

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## Balance Sheet

**Statement of Financial Position**

**Assets = Liabilities + Net Assets**

Assets are resources of value the organization owns or controls

- Specific order, current to long-term
- Current: within one year

Liabilities are obligations incurred

- Short-term or current liabilities: due within a year
- Long-term liabilities: loan, lease, debt due past twelve months

Net Assets equal the cumulative net income since inception

Leads the financials statements,  
 followed by Income Statement and then Cash Flow

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## What Does the Balance Sheet Tell Us?

**Face Value: "What's our net worth?"**

- What we own vs. what we owe

**Liquidity: "Can we easily pay our bills?"**

- Current assets, current liabilities

**Leverage: "What do we owe to others?"**

- Total liabilities to assets or equity

**Prior Years: "Is our position improving?"**

- Analyze trends in Net Assets, Cash vs. Accounts Payable
- Understand impact of business decisions

Assets	Amount
Cash	\$0.1M
Accounts Receivable	\$1M
Building	\$1M
Total Assets	\$3.1M

Liabilities	Amount
Accounts Payable	\$0.25M
Mortgage	\$0.8M
Total Liabilities	\$1.05M

Equity	Amount
Retained Earnings	\$2M
+ Income	\$0.5M
Total Equity	\$2.05M

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## Income Statement

**Statement of Activities, Profit and Loss (P&L), Statement of Operations**

Revenues – Expenses = Net Income (Change in Net Assets)

Speaks to overall financial performance in an accounting period

- Surplus (revenues > expenses)
- Deficit (revenues < expenses)

Revenues listed first, followed by expenses and change in net assets

- Revenues ordered by size
- Direct expenses followed by indirect/administrative expenses

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## What Does the Income Statement Tell Us?

**Bottom line: "Did we stay within our means?"**

- Profit or loss

**Risk: "Are our revenues diversified?"**

- Main revenue sources and relative contribution
- "Who is invested in our work?"

**Program: "Which programs are self-supporting?"**

- Net positive, net negative, neutral (e.g., after school, food services)

**Prior Years: "Are revenues and expenses structurally balanced?"**

- Analyze trends affecting revenues and expenses
- Recurring v. one-time
- Glean the impact of business strategy
- Track organizational growth

Revenues	Amount
Government revenue	\$2.85M
Local revenue	\$0.05M
Foundation grant	\$0.1M
Total Revenue	\$3M

Expenses	Amount
Salaries	\$1.5M
Benefits	\$0.375M
Supplies	\$0.125M
Services	\$0.533M
Total Expenses	\$2.533M

Net Income	Amount
Net Income	\$0.467M



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### Statement of Cash Flows

Revolves around cash position: mimics cash basis of accounting

Beginning Cash Balance

- + Revenues (cash deposited)
- Expenses (invoices received)

] Income Statement

- + Invoices not yet paid
- Invoices paid a month later
- Loan principal paid
- Revenue accrued, not yet received

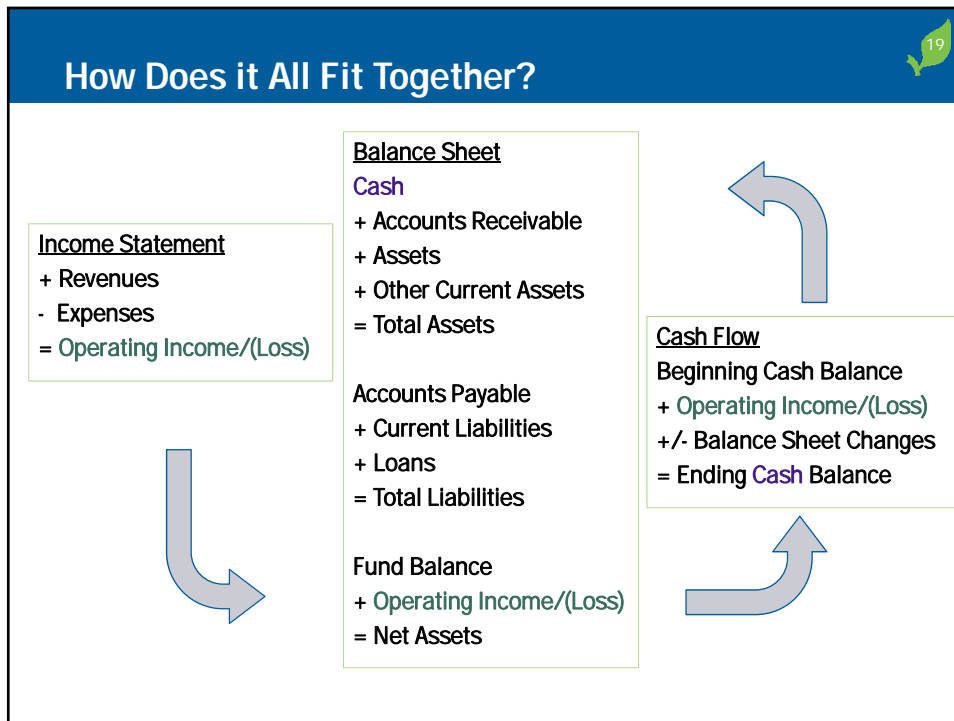
] Balance Sheet

Ending Cash Balance

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### What Does the Cash Flow Tell Us?

<p><b>"Can we pay our bills easily?"</b></p> <ul style="list-style-type: none"> <li>▪ Positive cash from operating or investing activities</li> <li>▪ Reason for financing</li> </ul>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="background-color: #92d050;">Beginning Cash</td><td style="text-align: right;">+\$0.6M</td></tr> <tr><td style="background-color: #92d050;">Operating Activities</td><td></td></tr> <tr><td>Grants</td><td style="text-align: right;">+\$2M</td></tr> <tr><td>Staff salaries and bill payments</td><td style="text-align: right;">-\$2.5M</td></tr> <tr><td style="background-color: #92d050;"><b>Subtotal: Operating</b></td><td style="text-align: right;"><b>-\$0.5M</b></td></tr> <tr><td style="background-color: #92d050;">Investing Activities</td><td></td></tr> <tr><td>Purchase building</td><td style="text-align: right;">-\$1M</td></tr> <tr><td style="background-color: #92d050;"><b>Subtotal: Investing</b></td><td style="text-align: right;"><b>-\$1M</b></td></tr> <tr><td style="background-color: #92d050;">Financing Activities</td><td></td></tr> <tr><td>Line of Credit</td><td style="text-align: right;">+\$0.5M</td></tr> <tr><td>Mortgage loan</td><td style="text-align: right;">+\$0.8M</td></tr> <tr><td>Mortgage payment</td><td style="text-align: right;">-\$0.027M</td></tr> <tr><td style="background-color: #92d050;"><b>Subtotal: Financing</b></td><td style="text-align: right;"><b>\$1.273M</b></td></tr> <tr><td style="background-color: #92d050;">Ending Cash</td><td style="text-align: right;">+\$0.373M</td></tr> </table>	Beginning Cash	+\$0.6M	Operating Activities		Grants	+\$2M	Staff salaries and bill payments	-\$2.5M	<b>Subtotal: Operating</b>	<b>-\$0.5M</b>	Investing Activities		Purchase building	-\$1M	<b>Subtotal: Investing</b>	<b>-\$1M</b>	Financing Activities		Line of Credit	+\$0.5M	Mortgage loan	+\$0.8M	Mortgage payment	-\$0.027M	<b>Subtotal: Financing</b>	<b>\$1.273M</b>	Ending Cash	+\$0.373M
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<p><b>"Are we growing?"</b></p> <ul style="list-style-type: none"> <li>▪ Start-ups or growing organizations often struggle with generating cash from operations</li> </ul>																													
<p><b>"Do we have emergency cash?"</b></p> <ul style="list-style-type: none"> <li>▪ Beginning cash</li> </ul>																													
<p><b>"Has our cash position improved?"</b></p> <ul style="list-style-type: none"> <li>▪ Beginning v. ending cash</li> </ul>																													
<p><b>"Are we investing? Are our investments growing and contributing to cash?"</b></p>																													



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## Time to Apply Your Knowledge

- Check received for Title I revenue
- Check printed for lunch vendor
- Loan proceeds arrive
- Laptop cart purchased
- Revenue accrual
- Check received for accrued revenue

What is the effect on the income statement and balance sheet?

# Financial Statement Analysis



## Analyzing Financial Statements



Liquidity: cash and cash equivalents

Long-term Solvency: ability of the nonprofit to meet its long-term obligations

Leverage: amount of debt used to finance a nonprofit's assets

Profitability: intergenerational equity

Let's use these concepts to analyze a charter's financials

## Ratio Analysis: Liquidity

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Can the organization meet its short-term obligations?  
Can we make payroll?

**Current Ratio = Current Assets / Current Liabilities**

- If less than 1.00x: trouble paying bills on a regular basis
- 2.00x rule of thumb
- High ratio (over 3.00x) not necessarily good: inefficiency

**Working Capital = Current Assets – Current Liabilities**

**Days Cash on Hand = (Cash and Cash Equivalents) / (Total Expenses / 365 days)**

- Need more than 30 days
- Rule of thumb: 2-3 months of cash reserve

## Ratio Analysis: Solvency, Leverage

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Can the organization meet its long-term obligations?  
How much is it leveraged?

**Debt to Asset Ratio = Total Liabilities / Total Assets**

- Rule of thumb: < 0.40x

**Debt to Equity Ratio = Total Liabilities / Net Assets**

- Hopefully under 1.00x, depends on industry, context

## Ratio Analysis: Profitability



Are we able to cover all costs? Are we profitable?

**Profit Margin Ratio = Unrestricted Surplus / Unrestricted Revenues**

- Depends on industry, not an explicit goal for nonprofits
- Profits re-invested into organization

**Intergenerational Equity**

- Facilities
- Compensation

## Wolverine Charter



What stands out about this charter? Any concerns?

## Limitations of Financial Statements

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Standard reports too technical, missing context

Too much information for non-expert decision makers

Major risks and/or opportunities not highlighted

Clean audit means what was tested passed, still management responsibility

Special thanks to Brian Holman!

# Thank you!

**ADDITIONAL QUESTIONS? CONTACT US:**

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## About EdTec

- Founded in 2001 to **develop, support and advance quality charter schools**
- A **social mission-driven** organization, EdTec's social impact spans:
  - 300+** Partner Schools
  - 160K+** Students Supported
  - 380+** Staff Years of Charter Expertise
- Known for **best-in-class business and operations services:**
  - Back-Office Business Services
  - Data Services
  - Charter Development
  - Governance Support