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California Department of Education
Executive Office
SBE-002 (REV. 01/2011)

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MEMORANDUM

DATE: April 1, 2014

TO: MEMBERS, State Board of Education

FROM: TOM TORLAKSON, State Superintendent of Public Instruction

SUBJECT: Financial Condition of State Board of Education-Authorized Charter Schools.

Summary of Key Issues

This Information Memorandum provides a summary and analysis of the financial condition of the State Board of Education (SBE)-authorized charter schools that covers the fiscal year (FY) 2012–13 and through the second interim projections for the FY 2013–14. As a charter authorizer, the SBE must provide oversight monitoring of the schools it authorized. The SBE has delegated this responsibility to the California Department of Education (CDE). In the course of oversight monitoring, if the CDE finds that a charter school failed to meet generally accepted accounting principles or engaged in fiscal mismanagement, it provides recommendations to the SBE to take appropriate action, as deemed necessary, including issuing a notice of violation or revocation.

The 23 SBE-authorized charter school sites in operation for 2013–14 are required to submit financial reports and budgetary updates to the SBE. The FY financial reporting cycle begins with a budget submitted to the SBE by July 1. Budgetary reports, known as interim reports (due December 15 and March 15) are submitted during the FY to update the budget. After the end of the FY, each charter school must report an annual financial report (known as unaudited) on or before September 15 with the submittal of the final independent audit report by December 15, which completes the FY reporting cycle.

All SBE-authorized charter schools filed the required FY 2013–14 financial reports to date and submitted their audit report for the FY 2012–13. Each SBE-authorized charter school received an unqualified audit opinion with no significant audit findings noted. An unqualified opinion means that the auditor has opined that the charter school's financial statements are fairly presented, are free of material misstatements, and have been prepared in accordance with generally accepted accounting principles. The CDE reviews the audit report in assessing trends, ratios, and significance of any footnote disclosures.

Since the audit is a review of prior year fiscal activities, the CDE uses the financial reports, budgetary updates, and pertinent budget assumptions provided by the charter schools in its overall assessment of a charter school's current and projected financial condition, fiscal sustainability, and appropriateness of fiscal management practices.

Specifically, CDE staff reviewed the charter school budgets to identify, manage, and focus on signs exhibited of fiscal decline and possible fiscal mismanagement. CDE staff used as a guide, the general themes of the state's budget reporting and monitoring system used for school districts; that process requires school districts to self-certify its financial condition as positive, qualified, or negative related to its current and projected financial condition. For the SBE-authorized charter schools, CDE staff considered these and other factors that included, but are not limited to, measuring the adequacy of managing cash, debt levels, sustainability of budget operations, trends in enrollment and attendance, reasonableness of revenue and expenditure projections and assessing the multiyear projected financial position of the charter school. For a definition of fiscal terms used in the review, refer to Attachment 1, p.2.

The CDE analysis included a review of the independent audit report and audit notes for the FY 2012–13, the budgetary updates for the FY 2013–14 as reported on the first and second interim reports, and supplementary reports and budget information provided by the charter school.

The CDE also reviewed for compliance to the fiscal conditions specified in the charter school's Memorandum of Understanding (MOU) with the SBE that include, but were not limited to, compliance with reserve levels as follows:

Each charter school's MOU states that the charter school is expected to maintain reserves at a level at least equivalent to a school district of similar size as identified in *California Code of Regulations*, Title 5 (5 CCR) Section 15450.

School Average Daily Attendance	Expected Reserves
0 – 300	Greater of 5%* or \$61,000
301 – 1,000	Greater of 4%* or \$61,000

*Percentage applied to total expenditures and other financing uses.

Financial Condition of SBE-Authorized Charter Schools

For purposes of preparing this summary report, the SBE-authorized charter schools were each grouped into one of three categories, based on the financial characteristics of each school. These categories serve as the basis for the level of monitoring and subsequent action taken by the CDE. A charter school is categorized by good, fair, or poor financial condition. The definitions for each category are described below. There are twenty charters in good financial condition, two charters are in fair financial condition, and one charter is in poor financial condition. The financial highlights for all SBE-authorized charter schools that are in operation for the FY 2013–14 are summarized in Attachment 2.

Good Financial Condition

Twenty SBE-authorized charter schools are considered to be in good financial condition. Schools in this group have demonstrated an ability to operate with a balanced budget, maintain stable enrollment and attendance ratios, manage cash liquidity and maintain low debt levels, maintain positive fund balances, and have met the recommended reserve levels specified in their MOU. The CDE will continue to monitor these charter schools as they report during the FY 2013–14. The charter schools in good financial condition are:

- Aspire Vanguard College Preparatory Academy
- Barack Obama Charter School
- Dixon Montessori Charter School
- Everest Public High Charter School
- High Tech (HT) Charter School operating six sites: (HT Elementary Chula Vista, HT Elementary North County, HT Middle Chula Vista, HT High Chula Vista, HT High North County, and HT Middle North County)
- Ingenium Charter School
- Lifeline Education Charter School
- Livermore Valley Charter Preparatory High
- Mission Preparatory Charter School
- New West Middle Charter School
- Pacific Technology School–Santa Ana
- Ridgecrest Charter School
- River Montessori Elementary Charter School
- School of Arts and Enterprise Charter School
- Today's Fresh Start Charter School

Fair Financial Condition

Two SBE-authorized charter schools are considered to be in fair financial condition. Charter schools in this group are showing some signs of fiscal distress and need to take appropriate action to address the decline in financial condition. Specifically, charter schools in fair financial condition may have out-of-balance (deficit spending) budgets, declining enrollment or attendance ratios, cash liquidity that is not adequate, debt levels that are high, declining or low fund balances, or reserves levels that are below the levels recommended in the MOU. The charter schools in fair financial condition are:

- San Francisco Flex Academy (SFFA)
- Western Sierra Collegiate Academy (WSCA)

CDE staff has informed the charter schools in this group about the concerns the CDE has regarding their fiscal condition and has discussed the objectives of maintaining fiscal sustainability and building reserves up to the recommended amounts by a certain period. The CDE has issued a letter to SFFA identifying the specific items of concern and will continue to closely monitor the school. If the fiscal condition of the school does not improve, the CDE will recommend to the SBE to take appropriate actions.

CDE staff will not be sending a letter to WSCA as its only issue of operating deficits is the cost of financing 30-year revenue bonds (rates of 8.25 to 9.00 percent) that were obtained for the purchase and renovation of the WSCA Rocklin campus. WSCA has successfully been renewed with Rocklin Unified School District effective July 1, 2014.

Additional financial data and information for WSCA is outlined on Attachment 1.

Poor Financial Condition

One SBE-authorized charter school is considered to be in poor financial condition. A charter school in this group is in danger of jeopardizing their fiscal operations going forward. Timely and appropriate action by the charter school is critical in addressing and mitigating the serious decline in financial condition. Specifically, a charter school in poor financial condition has negative fund balances and no reserves. It also does not have adequate cash levels and has high debt levels. The charter school in poor financial condition is:

- Synergy Charter School (SCS)

CDE staff has informed this charter school in this group about the concerns the CDE has regarding its fiscal condition and has discussed the objectives of maintaining fiscal sustainability and building reserves up to the recommended amounts by a certain period. The CDE issued a letter of concern to SCS identifying the specific financial items of concern and requested a corrective action plan. SCS submitted the plan to CDE on April 2, 2014. SCS addressed details on how the negative fund balance will be eliminated beginning in 2014–15. CDE has determined that estimated average daily

attendance and budget projections are reasonable. As the plan is implemented if there are still deficiencies and CDE determines that the charter school's actions are not sufficient, further action may be needed. Additional financial data and information for the school in this group is outlined on Attachment 1.

Attachment 1: State Board of Education-Authorized Charter Schools
in Fair or Poor Financial Condition (9 Pages)

Attachment 2: State Board of Education-Authorized Charter Schools Financial
Highlights (2 Pages)

California Department of Education District, School & Innovation Branch

Charter Schools Division

State Board of Education–Authorized Charter Schools
in Fair or Poor Financial Condition



CALIFORNIA
DEPARTMENT OF
EDUCATION

Definition of Fiscal Indicators

Deficit Spending

Deficit spending occurs when the charter school's expenditures exceed its revenues. A school's operational unrestricted budgets should be balanced and ideally provide for growth in fund balance and reserves. Deficit spending depletes fund balances and reserves and as such, must be addressed or it will lead to an insolvent financial position.

Fund Balance

The unrestricted fund balance of a charter school should be positive. At a minimum, the school's unrestricted fund balances should be at a level to provide for reserves required in the Memorandum of Understanding (MOU). If cause of the negative fund balance is not addressed in a timely and appropriate manner, the school could be in jeopardy of financial insolvency that increases the likelihood of revocation. A negative fund balance is indicative of a poor financial condition.

Reserves for Economic Uncertainty

MOU terms are written with the expectation that each charter school set aside reserves at the greater of four to five percent (dependent on average daily attendance) of expenditures or a floor amount that is adjusted for inflation. The current inflation adjusted floor amount is \$61,000. Reserves below the minimum levels are indicative of a poor financial condition.

Attendance Ratio

The attendance ratio is calculated by dividing the average daily attendance (ADA) from the second period apportionment (P-2) by the fall October enrollment count. Generally, the average attendance ratio is between 93 to 96 percent.

Debt Ratio

The debt ratio is calculated by dividing the total liability by the total assets. The debt ratio measures a school's level of financial risk. A debt ratio of more than 1.0 indicates that the school has more debts than assets. Schools with a high debt ratio have limited options for short-term financing and generally will pay more in financing and interest costs.

Working Capital Ratio

The working capital ratio is calculated by dividing current assets by current liabilities. The working capital ratio, also known as current ratio, measures cash liquidity and whether the school has enough short term assets to cover its short-term debt. A ratio of less than 1.0 means current assets are less than current liabilities. A school with a ratio below 0.8 may have difficulty paying its bills on a timely manner. A current ratio of 1.2 or higher is considered to represent good short-term liquidity.

Fair Financial Condition

Charter schools in fair financial condition are showing some signs of fiscal distress and need to take appropriate action to address the decline in financial condition. Specifically, charter schools in fair financial condition may have budgets that are out of balance (deficit spending), declining enrollment or attendance ratios, cash liquidity that is not adequate, debt levels that are high, declining or low fund balances, or reserve levels that are below the levels recommended in the MOU. The charter schools identified as being in fair financial condition are:

- San Francisco Flex Academy (SFFA)
- Western Sierra Collegiate Academy (WSCA)

SFFA

Charter Term Expires: 6/30/2015

Grades Served: 9–12 2012–13 P–2 ADA: 129

Fiscal Concerns

SFFA is part of the Flex Public Schools (FPS), a non-profit public benefit corporation that oversees two charter schools, SFFA and Silicon Valley Flex Academy (SVFA). SFFA is authorized by the State Board of Education (SBE), while SVFA is authorized by the Santa Clara County Office of Education. FPS exclusively contracts with K12 Classroom LLC (K12) to provide curriculum and administrative services for both charter schools.

Since beginning operations in Fiscal Year (FY) 2010–11, SFFA has always relied on K12 for support of its budget. SFFA student population is not adequate to generate enough state funds to support SFFA expenditure budget. Specifically, for the FY 2010–11 through 2012–13, K12 has supported the SFFA budget by \$4.2 million in total. SFFA is only able to report balanced budgets because K12 reduces the costs of their services (in the form of budget credits) to SFFA in an amount sufficient enough to zero out any accumulated deficits, hence SFFA projected zero net operations and zero ending fund balances.

SFFA management indicated that the K12 contract agreement calls for the budget credits to be repaid back to K12 only under certain improved financial conditions, which are unlikely to materialize. The provisions for budget credits were also disclosed in the audit report of SFFA and were listed as a liability. SFFA projects continued use of budget credits through the end of its charter term (June 30, 2015). SFFA projects the total accumulated K12 budget credits will be about \$7 million over five-year term of SFFA.

Financial Highlights

FY / Source	Total Revenues*	Total Expenditures*	Net Operating Surplus (Deficit)	Working Capital Ratio	Debt Ratio	Attendance Ratio	Ending Fund Balance	Any Reserves/ Is it Adequate
2011–12 Audit	\$1,360,260	\$1,360,260	Zero	1.00	1.00	73.6%	Zero	No / No
2012–13 Audit	\$1,252,137	\$1,252,137	Zero	1.00	1.00	86.0%	Zero	No / No
2013–14 Budget	\$2,861,166	\$2,861,166	Zero	NA	NA	83.9%	Zero	No / No
2013–14 2 nd Interim	\$2,405,701	\$2,405,701	Zero	NA	NA	87.4%	Zero	No / No

NA = Not Applicable

* Reported net of budget credits

Charter School Update

SFFA management and the K12 West Region Finance Manager have indicated to the California Department of Education (CDE) that the budget credits accumulated to date have been written off by K12. Further, SFFA management has also confirmed that services and budget credits will continue to be provided by K12 for the remainder of the term of the charter.

CDE Follow Up

CDE staff reviews and generally agrees with the reasonableness of the assumptions used in developing the multiyear projection (MYP). However, to ensure proper oversight, CDE issued a letter to the charter identifying the fiscal concerns related to the budget credit provisions and the declining of enrollment and ADA. The CDE will continue to monitor the progress of the budget reductions, changes to the contractual obligations by K12, enrollment, and attendance improvements and recommend to the SBE to take appropriate action, as deemed necessary.

WSCA

Charter Term Expires: 6/30/2014*

Grades Served: 6–12 2012–13 P–2 ADA: 526

Fiscal Concerns

WSCA is part of the Rocklin Academy (RA), a non-profit public benefit corporation that oversees three charter schools, RA, RA at Meyers Street, and WSCA. WSCA is authorized by the SBE, while the other two charters are authorized by the Rocklin Unified School District (RUSD).

WSCA budget has been out of balance since FY 2010–11 and WSCA reported ongoing deficit spending for both FY 2011–12 (\$623,278) and FY 2012–13 (\$215,350). The main reason for the deficit is the cost of financing 30-year revenue bonds (rates of 8.25 to 9.00 percent) used to purchase and renovate the WSCA Rocklin campus. The debt service costs are projected to be \$964,399 and \$943,263 for the FYs 2014–15 and 2015–16, respectively. WSCA had an approved material revision in March 2012 to add grade six to their program. WSCA is anticipating increased ADA (34 percent growth from 528 to 706) by the end of FY 2013–14 to help fund these debt service costs.

Fiscal Highlight

FY / Source	Total Revenues	Total Expenditures	Net Operating Surplus (Deficit)	Working Capital Ratio	Debt Ratio	Attendance Ratio	Ending Fund Balance	Any Reserves/ Is it Adequate
2011–12 Audit*	\$3,377,440	\$4,000,718	(\$623,278)	0.97	1.14	95.3%	\$(1,308,033)	No / No
2012–13 Audit*	\$4,239,201	\$4,454,551	(\$215,350)	0.43	1.17	97.3%	\$(1,523,383)	No / No
2013–14 Budget	\$5,760,064	\$5,998,429	(\$238,365)	NA	NA	95.0%	\$624,207	Yes / Yes
2013–14 2 nd Interim	\$5,831,539	\$5,830,038	\$1,501	NA	NA	96.0%	\$992,789	Yes / Yes

NA = Not Applicable

*Audited ending balances include accruals not included on a fund basis statement

Charter School Update

WSCA provided the CDE with an MYP that reflects the budget adjustments, increased ADA, and projected fund balance and reserves through FY 2015–16. WSCA is anticipating significant growth in enrollment after a filing of a material revision with the CDE to increase its current enrollment cap.

*WSCA was successfully renewed under the authorization of RUSD effective July 1, 2014.

CDE Follow Up

CDE staff reviewed and generally agrees with the reasonableness of the assumptions used in developing the MYP. The CDE will continue to monitor the enrollment trends, the school's budget adjustments to enrollment changes, compliance with revenue bond covenants, bond-rating changes, and recommend to the SBE to take appropriate action, as deemed necessary.

Poor Financial Condition

A charter school in poor financial condition is in danger of jeopardizing its fiscal operations going forward. Timely and appropriate action by the charter school is critical in addressing and mitigating the serious decline in financial condition. Specifically, a charter school in poor financial condition has a negative fund balance and no reserves. They also do not have adequate cash levels and debt levels are high. The charter school in poor financial condition is:

- Synergy Charter School (SCS)

SCS

Charter Term Expires: 6/30/2017
 Grades Served: 6–12 P–2 ADA: 84

Fiscal Concerns

SCS reported deficit spending of \$194,158 during FY 2012–13 and is projecting continued deficit spending at \$195,400 with a negative fund balance until FY 2015–16. A negative fund balance trend is an indicator that demonstrates poor fiscal management practices and, if unabated, may result in financial insolvency and SBE action. Further, with a negative fund balance, the recommended reserves are not available to be set aside as specified in the MOU.

SCS also reported the total amount of \$1,500,000 in 2012–13 Revenue Anticipation Notes, Series A that \$500,000 was paid and \$1,000,000 will be due by September 2014. The SCS debt ratio reported for the FY 2012–13 at 1.14 is high. The SCS reliance on borrowing affected the cash flow and a high debt ratio could jeopardize the school's ability to obtain financing and may result in higher financing cost.

Fiscal Highlight

FY / Source	Total Revenues	Total Expenditures	Net Operating Surplus (Deficit)	Working Capital Ratio	Debt Ratio	Attend Ratio	Ending Fund Balance	Any Reserves/ Is it Adequate
2012-13 Audit	\$994,835	\$1,188,993	(\$194,158)	1.91	1.14	94.3%	(194,158)	No / No
2013–14 Budget	\$2,496,751	\$2,310,885	\$185,866	NA	NA	96.0%	\$116,535	Yes / Yes
2013–14 2 nd Interim	\$1,837,844	\$2,172,102	(\$334,258)	NA	NA	91.8%	(\$528,416)	No / No

NA = Not Applicable

Charter School Update

SCS is anticipating that enrollment will increase from 84 students to 185 students by the end of FY 2013–14. A three-year plan includes adding a grade level each year and increasing enrollment by 75 students. It is anticipated that the revenue generated from this enrollment growth and from the economy of scale will remove the need for further cash flow financing. SCS is projecting the fund balance to reflect a positive \$294,633 with a 10 percent reserve by the end of FY 2015–16.

CDE Follow Up

CDE staff reviewed and generally agrees with the reasonableness of the assumptions used in developing the MYP. However, to ensure proper oversight, the CDE issued a letter of concern to this charter school identifying the specific financial items of concern and requested a corrective action plan. SCS submitted the plan to CDE on April 2, 2014. SCS addressed details on how the negative fund balance will be eliminated beginning in 2014–15. CDE has determined that estimated average daily attendance and budget projections are reasonable. As the plan is implemented if there are still deficiencies and CDE determines that the charter school's actions are not sufficient, further action may be needed.