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California Department of Education
Executive Office
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MEMORANDUM

DATE: April 1, 2015

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) 2013–14 and through the second interim projections for the FY 2014–15. 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 must provide recommendations to the SBE to take appropriate action, as deemed necessary, including issuing a notice of violation or revocation.

The 20 SBE-authorized charter school sites in operation for 2014–15 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 2014–15 financial reports to date and submitted their audit report for the FY 2013–14. 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, 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 reviewed the charter school budgets to identify, manage, and focus on signs of fiscal decline and possible fiscal mismanagement. As a guide, CDE uses the general themes of the state's budget reporting and monitoring system used for school districts;

that process requires school districts to self-certify their financial condition as positive, qualified, or negative related to 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 multi-year 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 reports and audit notes for the FY 2013–14, the budgetary updates for the FY 2014–15 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 Memorandum of Understanding (MOU) that include, but were not limited to, compliance with reserve levels as follows:

The MOU requires the charter school 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 Section 15450.

School Average Daily Attendance	Expected Reserves
0 – 300	Greater of 5%* or \$64,000
301 – 1,000	Greater of 4%* or \$64,000

*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 as good, fair, or poor financial condition. The definitions for each category are described below. There are twelve charters in good financial condition, one charter is in fair financial condition, and two charters are in poor financial condition. The financial highlights for all SBE-authorized charter schools that are in operation for the FY 2014–15 are summarized in Attachment 2.

Good Financial Condition

Twelve SBE-authorized charter schools are considered to be in good financial condition. A school in good financial condition has demonstrated an ability to operate with a balanced budget, maintain stable enrollment and attendance ratios, manage cash liquidity, maintain a low debt level, maintain a positive fund balance, and has met the recommended reserve level specified in the MOU. The CDE will continue to monitor

these charter schools as they report during the FY 2014–15. The charter schools in good financial condition are:

- Barack Obama 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
- Magnolia Science Academy Santa Ana
- Mission Preparatory Charter School
- New West Middle Charter School
- Ridgecrest Charter School
- School of Arts and Enterprise Charter School
- Thrive Public School
- Today's Fresh Start Charter School

Fair Financial Condition

One SBE-authorized charter school is considered to be in fair financial condition. A charter school in fair financial condition is showing some signs of fiscal distress and needs to take appropriate action to address the decline in financial condition. Specifically, a charter school in fair financial condition may have an out-of-balance (deficit spending) budget; declining enrollment or attendance ratio; cash liquidity that is not adequate; debt level that is high; a declining or a low fund balance; or a reserve level that is below the level required in the MOU. The charter school in fair financial condition is:

- San Francisco Flex Academy (SFFA)

CDE staff has informed this charter school 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 SFFA identifying the specific items of concern and has requested additional information. If the CDE determines that the charter school's

additional information is not sufficient, the CDE may recommend that the SBE consider further action which may include issuing a notice of violation to the school. Additional financial data and information for the school are outlined on Attachments 1 and 2.

Poor Financial Condition

Two SBE-authorized charter schools are considered to be in 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 reserve. The school also does not have an adequate cash level and has a high debt level. The charter schools in poor financial condition are:

- Anahuacalmecac International University Preparatory High School (AIUPHS)
- Synergy Charter School (SCS)

CDE staff has informed each of these charter schools 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 has issued Letters of Concern to AIUPHS and SCS identifying the specific financial items of concern and has requested a corrective action plan from each of the schools. If the CDE determines that the charter school's actions are not sufficient, the CDE may recommend that the SBE consider further action, which may include issuing a notice of violation to the school. Additional financial data and information for these schools are outlined on Attachments 1 and 2.

Attachment(s)

Attachment 1: State Board of Education-Authorized Charter Schools
in Fair or Poor Financial Condition (8 Pages)

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

California Department of Education
Services for Administration, Finance, Technology
and Infrastructure 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 budget should be balanced and ideally provide for growth in fund balance and reserves. Deficit spending depletes fund balance 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 balance should be at a level to provide for reserves required in the Memorandum of Understanding (MOU). If cause of a 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 \$64,000. Reserves below the minimum level are indicative of a poor financial condition.

Attendance Ratio

The attendance ratio is calculated by dividing the second period report of average daily attendance (ADA) for the Second Principal (P-2) Apportionment 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 liabilities 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 cost.

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 in a timely manner. A current ratio of 1.2 or higher is considered to represent good short-term liquidity.

Fair Financial Condition

A charter school in fair financial condition is showing some signs of fiscal distress and needs to take appropriate action to address the decline in financial condition. Specifically, a charter school in fair financial condition may have a budget that is out of balance (deficit spending), declining enrollment or attendance ratio, cash liquidity that is not adequate, a debt level that is high, a declining or low fund balance, or a reserve level that is below the level required in the MOU. The charter school identified as being in fair financial condition is:

- San Francisco Flex Academy (SFFA)

SFFA

Charter Term Expires: 6/30/2020
Grades Served: 9–12
2013–14 P-2 ADA: 102

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 the beginning of operations in Fiscal Year (FY) 2010–11, SFFA has had a zero ending fund balance with no reserves. SFFA is only able to report a balanced budget 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. The 2014–15 annual audit notes that K12 covered all shortfalls by budget credits. By agreement, K12 is to provide budget credits to SFFA at an amount that zeros out accumulated deficits. Such accumulated credits are to be repaid back to K12 only under certain improved financial conditions, which are unlikely to materialize.

SFFA's projected enrollment and ADA for FY 2014–15 are 120 and 104, respectfully. SFFA's first period report of ADA for the FY 2014–15 First Principal (P-1) Apportionment was 78.7. This significant decline in ADA will affect the charter school's funding for FY 2014–15.

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?
2012-13 Audit	\$1,252,137	\$1,252,137	Zero	1.00	1.00	86.0%	Zero	No / No
2013-14 Audit	\$868,214	\$868,214	Zero	1.00	1.00	84.9%	Zero	No / No
2014-15 Budget	\$2,228,992	\$2,228,992	Zero	NA	NA	86.9%	Zero	No / No
2014-15 2 nd Interim	\$1,649,145	\$1,649,145	Zero	NA	NA	88%	Zero	No / No

NA - Not Applicable

* Reported net of budget credits

Charter School Update

K12 is proposing to end the service with SFFA by June 30, 2015. K12 intends to forgive the accumulated balance of any remaining balanced budget credits if specified conditions are met. If services provided by K12 are discontinued, SFFA projects a reduction of its personnel, management, and technology expenditures which would result in a positive ending fund balance for FY 2015-16.

SFFA was granted an approval on its renewal petition by the SBE at its meeting on March 12, 2015. The five-year charter term starts July 1, 2015, through June 30, 2020.

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, the CDE issued a Letter of Concern on April 22, 2015, identifying the fiscal concerns and has requested additional information to be submitted by May 18, 2015. The CDE will continue to monitor the enrollment trends, the school's budget adjustments to enrollment changes, and recommend to the SBE to take appropriate action, as deemed necessary.

Poor Financial Condition

Charter schools in poor financial condition are in danger of jeopardizing their fiscal operations going forward. Timely and appropriate action by the charter schools are critical in addressing and mitigating the serious decline in financial condition. Specifically, charter schools in poor financial condition have negative fund balances, no reserves, do not have adequate cash levels and debt levels are high. The charter schools in poor financial condition are:

- Anahuacalmecac International University Preparatory High School (AIUPHS)
- Synergy Charter School (SCS)

AIUPHS

Charter Term Expired: 6/30/2019
 Grades Served: 9–12
 2013–14 P-2 ADA: NA

Fiscal Concerns

AIUPHS opened in fall 2014 and is projecting deficit spending of \$186,496 with a negative fund balance of \$186,496 for FY 2014–15. A negative fund balance trend is an indicator of 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 required in the MOU.

Financial 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?
2013–14 Audit	NA	NA	NA	NA	NA	NA	NA	NA
2014–15 Budget	\$1,387,415	\$1,350,611	\$36,804	NA	NA	95%	\$53,631	Yes / No
2014–15 2 nd Interim	\$1,056,807	\$1,243,303	(\$186,496)	NA	NA	95.9%	(\$186,496)	No / No

NA - Not Applicable

Charter School Update

AIUPHS's P-1 ADA was 105.57, which is 11.28 lower than projected at First Interim of FY 2014–15, and significantly reduces the revenues. Title I, special education master plan, and the charter school facility grant funding were either deducted or not received, all of which contributed to a substantial drop in revenues. Furthermore, a 28 percent increase in certificated salary expenditures leads to projected deficit spending and a negative fund balance of \$186,496.

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 on April 22, 2015, identifying the fiscal concerns and has requested a Corrective Action Plan (CAP) to be submitted by May 18, 2015. The CDE will continue to monitor the enrollment trends, the school's budget adjustments to enrollment changes, and recommend to the SBE to take appropriate action, as deemed necessary.

SCS

Charter Term Expires: 6/30/2017
 Grades Served: 6–12
 2013–14 P-2 ADA: 179

Fiscal Concerns

SCS reported deficit spending of \$104,672 with a negative fund balance of \$695,687 during FY 2014–15. A negative fund balance trend is an indicator of 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 required in the MOU.

SCS also reported the total amount of \$1,600,000 in 2013–14 Revenue Anticipation Notes which will be due by September 2015. The SCS debt ratio reported for the FY 2013–14 at 1.25 is high. SCS's reliance on borrowing affected its cash flow and a high debt ratio could jeopardize the school's ability to obtain financing which may result in higher financing costs.

Financial 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?
2013–14 Audit	\$1,802,676	\$2,199,533	(\$396,857)	1.36	1.25	89.0%	(\$591,015)	No / No
2014–15 Budget	\$2,679,303	\$2,544,743	\$134,560	NA	NA	95.2%	(\$431,162)	No / No
2014–15 2 nd Interim	\$1,817,669	\$1,922,341	(\$104,672)	NA	NA	95%	(\$695,687)	No / No

NA - Not Applicable

Charter School Update

SCS's P-1 ADA was 189.58 and SCS projected P-2 ADA at 187 at Second Interim of FY 2014–15. SCS's projected revenues for Second Interim will be approximately \$218,671 less than projected due to ADA declines. In addition, SCS anticipates an additional budget deficit of \$104,672 for FY 2014–15. The projected ending fund balance is (\$695,687) by FY 2014–15.

Public Charter Schools Grant Program (PCSGP) funds were used to pay for and support certificated and classified salaries and benefits that should have been paid for out of the Local Control Funding Formula general purpose entitlement; CDE is requiring that SCS repay the \$248,196 in grant funds used for salary expenses. Therefore, it is inconceivable that SCS will restore sufficient fund balances and fiscal solvency by the end of charter term, June 30, 2017.

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, CDE issued a Letter of Concern on February 6, 2015, identifying the fiscal concerns and requested a CAP to be submitted by February 12, 2015. SCS submitted a CAP February 12, 2015, and a revised CAP on March 17, 2015, without evidence of SCS Board approval. CDE determined the CAP did not adequately provide the following:

- Specific information of how SCS plans to recruit and retain new students.
- A legally binding written commitment or confirmation with regard to the partnership with ACRE Development to procure a new and expanded site for SCS.
- A detailed back-up plan of location to a new facility if a partnership with ACRE Development does not exist.
- SCS Board minutes reflecting approval of the March 17, 2015, CAP.

The CDE will continue to monitor the enrollment trends, the school's budget adjustments to enrollment changes, and recommend to the SBE to take appropriate action, as deemed necessary.