NATIONAL CHARTER SCHOOL RESOURCE CENTER
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A USER'S GUIDE TO FISCAL OVERSIGHT:

A Toolkit for Charter School Governing Boards

The National Charter School Resource Center (NCSRC) is dedicated to supporting the development of high-quality charter schools. The NCSRC provides technical assistance to sector stakeholders and has a comprehensive collection of online resources addressing the challenges charter schools face. The website hosts reports, webinars, and newsletters focusing on facilities, funding opportunities, authorizing, English learners, special education, military families, board governance, and other topics. The NCSRC is funded by the U.S. Department of Education and led by education consulting firm Safal Partners.

National Charter School Resource Center (http://www.charterschoolcenter.ed.gov/)

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Introduction

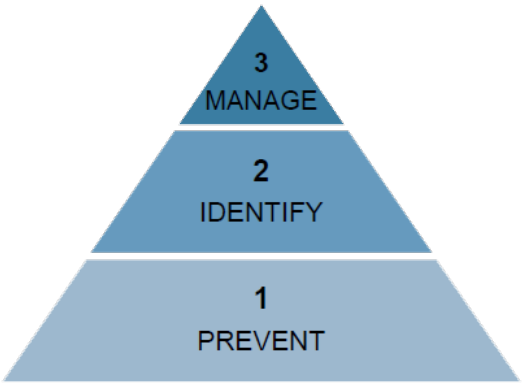
Purpose and Use of this Toolkit

The purpose of this toolkit is to equip charter governing boards to exercise proper fiscal oversight. When charter schools close, it is generally due to a mix of financial, operational, and academic problems. Poor financial performance is often the most important factor in many closures.

This toolkit compiles best practices and recommendations based on a comprehensive literature review and interviews with subject matter experts, including authorizers, charter support organizations (CSOs), charter management organizations (CMOs), funders, attorneys, and charter finance specialists. The toolkit also draws from established findings on fraud and governance from the broader nonprofit sector.

Each subsection of this toolkit contains a set of checklists examining how to: 1) prevent, 2) identify, and 3) manage common financial issues. Of these, schools should aim first to prevent financial problems. However, the level of oversight and the complexity of each school's financial oversight system will depend on its specific needs. In some cases, detection and prevention may be the same since effective detection can deter potential fraud. Other stakeholders, such as school leaders and developers, can use the sections on 'prevention' to uncover potential school-level vulnerabilities.

Figure 1: Toolkit Framework



While the toolkit includes best practices, because specific needs depend on individual and state contexts, boards who use this toolkit should also be sure to consult their state law, accountant, legal counsel and authorizer, as appropriate, to determine appropriate oversight.

Scope of Fiscal Responsibility

Both authorizers and governing boards are key stakeholders responsible for ensuring a school* is financially viable and able to pursue its primary educational goals. While some responsibilities of the board and the authorizer overlap, the activities of one do not reduce or replace the other's responsibilities, as each has different information about the school. To effectively oversee charter schools, authorizers must understand what constitutes strong financial oversight practices by schools. Likewise, the governing boards of schools need to understand their responsibilities and

how their authorizer expects the board to oversee their school's financial operations. Please see the accompanying Authorizer Fiscal Oversight Toolkit for more information.

Boards of Trustees

The board of trustees (also the 'governing board' or 'charter board') is the governing authority of the school or network of schools. It has ultimate responsibility for the school's financial stability and integrity. A charter school authorizer permits each charter school to operate as a public school. Because the entire governing board oversees the charter, each board member, not just the treasurer or members of the finance committee, has a fiduciary responsibility. Among other roles, the governing board has the responsibility to ensure:[1]

- Effective financial oversight;
- Realistic budgeting and monitoring of budgets;
- Appropriate internal controls and procedures;
- Timely and accurate financial reporting; and
- Adequate financial resources.

Compared to authorizers, governing boards have a greater degree of information and authority over the financial state of their schools. They are best positioned for the prevention, early identification, and management of problems, should they arise.

* When we refer to a "school", we are referring to the non-profit organization that holds the charter. However, there are exceptions to the non-profit structure. For example, in California, some charters are structured as public schools under California law. In Arizona, an individual may hold a charter contract. In most circumstances, a charter is held by a non-profit organization overseen by that school's governing board.

Types of Financial Issues

There are two major areas that cause financial issues for charter schools: financial insolvency and fraud. This toolkit distinguishes poor financial performance from fraud because the oversight practices and recommendations differ for each.

1. Lack of Financial Health and Sustainability

While cases of fraud may receive more attention, poor financial management is more common than financial misfeasance or fraud.[2] The financial health and sustainability of a school require effective financial management by the school's board and leadership to establish the viability of the school. The Center for Education Reform identifies the two major drivers of financial failure for charter schools:[3]

- **Under enrollment**: Failing to attract enough students constrains the school's main source of revenue, since public funding is tied directly to enrollment. Schools that over-estimate enrollment may suffer from underlying quality issues. Under enrollment is further complicated when schools fail to adjust budgets and expenditures, especially if enrollment drops during the school year.
- **Inadequate funding**: In many states, charter schools are considered their own district or local education agency (LEA). This can create financial obligations for individual charter schools that most individual district-managed schools do not face. Regardless of LEA-status under each state's charter law, generally, charter schools receive fewer dollars than the local traditional district schools.[4] In particular, charter schools do not receive facilities funding in most states; they must spend operating funds on facilities costs, which constrains their operating budget. External risks, such as declines in charter school funding, exacerbate this issue and increase the probability of deficit and default. Depending on location, inadequate funding for specialized populations, such as students with disabilities and English learners, increases the challenge.

Other common issues that charter schools face include:

- A lack of financial expertise among the board or management;
- Facility-related issues, including insufficient equity, unsustainably high rent, and poor lease terms;
- Cash flow challenges related to delays in per pupil payments;
- Failure to properly anticipate and cover funding gaps; and
- Inadequate fundraising or unrealistic fundraising expectations.

2. Fraud and Misfeasance

Fraud is defined as deceiving or misrepresenting or as the crime of using dishonest methods to take something valuable.[5] While it may ultimately lead to financial distress, fraud is distinct from poor financial management because it includes the underlying intent to deceive or misrepresent.[6] Most relevant for this toolkit, it often takes the form of financial misfeasance or malfeasance[1]. Some prior cases of charter school fraud have included:

1 Malfeasance is any intentional conduct that is wrongful or unlawful and is at a higher level of wrongdoing than nonfeasance (failure to act where there was a duty to act) or misfeasance (conduct that is lawful but inappropriate).

- Asset misappropriation, including fraudulent check disbursements or expense reimbursements;
- Conflict of interest in procurement of services or facilities, such as related party transactions or self-dealing;
- Management companies that fail to deliver contracted services; and
- Inflation of enrollment figures and falsified attendance records.

It is impossible to eliminate the risk of fraud or mismanagement, and collusion increases the difficulty of detection, especially when school leaders or board trustees collude to manipulate documentation and reporting. However, strong internal controls and a properly-implemented checks and balances system mitigates this risk. At the school-level, the board must determine the most appropriate prevention and detection measures. A cost-benefit analysis may help identify weak points and policies to mitigate the greatest risks.

FINANCIAL OVERSIGHT: HEALTH AND SUSTAINABILITY

Prevention

While schools cannot anticipate every threat, proper planning and budgeting will strengthen a school's resilience to internal and external risks. Proper stewardship of public funds is primarily contingent on financial literacy, budgeting, monitoring, and risk management. By focusing on preventative measures, schools and authorizers can take a proactive approach to financial management.

1. Ensure Financial Literacy

- ☐ *Ensure that the board includes members with sufficient financial knowledge to make informed decisions about the school budget and financial management*.
- ☐ *Set minimum requirements for finance committee members and administrators who engage with financial matters*.
  Minimum requirements may include prior accounting or financial management experience and demonstrated financial literacy such as interpreting financial reports. Boards should prioritize operational and education finance experience over other types of financial expertise, such as investment banking or real estate development experience.
- ☐ *Invest in financial training for the board.*
  Members of the finance committee should provide or coordinate board-wide financial training; they can also leverage CSO trainings. All board members should be able to read and interpret financial statements.

2. Proper Budgeting and Forecasts

- ☐ *Approve a conservative budget*.
  Charter schools should budget conservatively. In particular, schools should estimate per pupil funding and fundraising carefully. Per pupil funding projections should be based on the last two years of expenditure by district and state charter school law funding provisions.[7] Consider the current fiscal and funding environment and make adjustments accordingly. To prevent overreliance on a nonguaranteed funding source, in the absence of donor commitments, boards should assume minimal fundraising.
- ☐ *Approve a long-term financial plan.*
  The long-term financial plan is usually a 5-year budget for assumed per pupil revenues, capital projects, and operating expenses. Update forecasts as changes occur.

- ☐ *Benchmark the school's budget and expenses to comparable schools.*
  Research per pupil expenses for charter schools in similar settings. Understand how the school's expenses differ from other schools because of a specific situation or mission (e.g. a focus on special education).[8]
- ☐ *Regularly review and update the budget and its underlying assumptions as material changes occur.*
  Conduct quarterly reviews of the budget unless problems prompt monthly reviews. Adjust the budget to reflect developments that may affect expected income or expenses. Some key assumptions include projected enrollment, staffing, wages and benefits, facility costs, and non-personnel costs for students' needs.[9] Verifying assumptions may include management review, comparisons to similar institutions, or confirmation of assumptions through local charter school networks. Eighty percent of assumptions should be comparable to similar schools.[10]
- ☐ *Ensure that the school relies primarily on public per pupil funding for revenue*.
  For ongoing expenses, schools should not rely on fundraising, donations, or grants. Instead, they should use per pupil funding to ensure that revenue sources are stable in the long-term. With large, one-time grants, boards should create a strategy to transition off of grant funds as grant-funded programs are completed.
- ☐ *Understand budget sensitivity and the thresholds at which the school approaches a deficit.*
  Boards can complete a sensitivity analysis to show how different variables of the budget link to one another and how they respond if the assumed values are different than expected. For example, what is the enrollment number at which the school approaches a deficit?
- ☐ *Maintain sufficient cash reserve bala*nces.
  Each board should determine the appropriate level of cash reserves to cover potential budget shortfalls or under enrollment and the appropriate amounts to maintain annually and at various times in the lifecycle of a charter school. Cash reserves also bolster creditworthiness to lenders when the school is ready to borrow. A commonly recommended target across experts and those we interviewed is about 5-10%[11] of the budget. Retaining excessive funds in reserve can also be perceived as evidence a school is not using per pupil funds as intended (i.e., on students). If cash reserves exceed 10% of the budget, boards should have a plan to spend down excess reserves unless the large reserve is part of an appropriate long-term strategy, such as a facilities purchase or major upgrade.

3. Regular Monitoring Practices

- ☐ *Review interim financial reports on a cash and accrual basis*.

Boards should review reports monthly. Statements should be analyzed both *horizontally* and *vertically*. A horizontal analysis compares ratios and figures over time. A vertical analysis compares each expense as a percentage of the whole. Financial reports include statement of activities (income statement), budget status report (budget vs. actual), statement of financial position (balance sheet), cash flow projections, enrollment (forecast vs. actual), and annual debt schedule if applicable. *(Discussed in further detail in the Identify section.)*

- ☐ *Use a financial dashboard*.[12]
  A financial dashboard is a dynamic overview of the school's current financial status using key aggregated data. Boards should customize the dashboard to their school's needs, but

some important indicators are in the Identify section (Section I.B.) below. Detailed guidance on creating a financial dashboard is in the Toolbox.

- ☐ *Institute regular, independent and qualified financial audits*.
  Boards should monitor the implementation of auditor recommendations. We recommend that boards use independent auditors, who can provide an unbiased evaluation of the school's finances. Boards should evaluate auditors on criteria including experience, staff qualifications, references, professional affiliations, technical abilities, peer review opinions, and fees.[13] For larger boards, creating an audit committee separate from the finance committee may provide an additional layer of checks and balances.[14] The audit service provider should be changed every three to five years to ensure independence.[15]
- ☐ *Monitor the sources of revenue*.
  Boards should monitor quarterly state revenue forecasts for potential state funding rescissions.[16] In particular, boards should look at restricted funds such as grants and title funding to ensure that the school follows all spending restrictions and is prepared for the eventual end of any significant, but temporary, funding flows.
- ☐ *Ensure a timely submission of required documents.*
  Boards should ensure that school leaders create a master calendar for the timely and proper submission of required reporting.
- ☐ *Review and approve any large purchases and contracts to ensure alignment with adopted budget*.
  Every board should define what constitutes a 'large', or irregular, purchase as schools will vary in spending patterns. Once they define spending thresholds, boards should establish and communicate a clear process of approvals for large purchases.
- ☐ *Maintain tax-exempt status*.
  Eighty-seven percent of charter schools are nonprofits[17] ; 501(c)(3) organizations have additional requirements to fulfill. The board should ensure that proper filing requirements are submitted and avoid restricted activities, such as lobbying. Please see the Toolbox for a list of resources for maintaining 501(c)(3) status.
- ☐ *Annual staff salary and structure rev*iew.
  A payroll audit should verify the payouts against contracts and ensure that the school is routing employee paychecks to the correct designations.[18] Paying unreasonably high salaries may also endanger tax-exempt status.

4. Regular Risk Management

- ☐ *Ensure that the school has adequate insurance coverage*.
  Confirm that the school has the appropriate insurance coverage necessary for the operation of the school. The required types of insurance and minimum policy limits differ according to state law. Insurance policies should be revisited annually or as schools grow to ensure coverage is sufficient for the school's current scale and operations. Some types of insurance that boards should consider include general liability, directors and officers, student accident, property, workers' compensation, unemployment compensation, motor vehicle, and errors and omissions insurance.[19]

- ☐ *Identify the greatest potential risks and run through risk scenarios*.
  Create a systematic process for risk assessment. The process of identifying potential risks will help determine the most suitable prevention measures for the school. Potential risk scenarios can include: lower than expected enrollment, public budget cuts, drop in fundraising, delayed state funding, and increases in facility costs and repairs.
- ☐ *Implement additional controls where necessary*.
  Once the board identifies potential risks, they should implement extra preventative measures for the greatest and most relevant risks, such as closer monitoring or increasing operating reserves.

Identification

Governing boards should fully understand and monitor all tools used by authorizers to evaluate their school's financial health. The National Association of Charter School Authorizers (NACSA) Financial Performance Framework is a core framework of financial monitoring primarily for authorizers. The framework is used in this toolkit as a starting point for boards to understand how authorizers will evaluate their school's financial performance and to identify potential problems. Boards may choose to use different ratios or calculations, but proper oversight should include indicators for school revenues, liquidity, and debt. The checklist below is a simplified version of the NACSA Financial Performance Framework with additional factors that may be red flags. The detailed Framework with measures and specific criteria is in Appendix A.

Using the Checklist

Boards can use the checklist below to identify areas of concern and as a template for an annual financial review. Many of these indicators are based on data available in the annual financial audit. NACSA's performance framework categorizes the checklist into 'near-term' and 'sustainability' measures. Failing 'near-term' standards will show that the school is in immediate financial distress, while failing 'sustainability' standards indicates that the school is trending towards financial distress.

Each measure has up to two classifications that indicate risk: 'does not meet standard' or 'falls far below standard.' However, no single response that indicates risk is a standalone 'red flag' or a hard trigger for action. When a target is missed, the first response should be to understand the underlying reason. A holistic look at the school should ultimately guide the level of concern. If a school has two or more ratings of 'does not meet standard' or one or more of 'falls far below standard,' boards should gather more information, such as year-to-date financial statements, year-to-date budget variance reports, and updated budget projections.

1. Near-term Measures

A. Current Ratio: ***Current assets divided by current liabilities***

- ☐ Does not meet standard: Less than or equal to 1.0 or between 1.0 and 1.1 with negative one-year trend.
- ☐ Falls far below standard: Less than or equal to 0.9.

B. Unrestricted Days Cash: ***Unrestricted cash divided by ([Total expenses minus depreciation expense]/365)***

- ☐ Does not meet standard: Between 15-30 days or between 30-60 days with negative one-year trend.

- ☐ Falls far below standard: Fewer than 15 days.

C. ENROLLMENT VARIANCE: *Actual enrollment divided by enrollment projection*

- ☐ Does not meet standard: Between 85-95% in the most recent year.
- ☐ Falls far below standard: Less than 85% in the most recent year.

D. DEFAULT

- ☐ Falls far below standard: School is in default or delinquent on debt service payments.

2. SUSTAINABILITY MEASURES

A. TOTAL MARGIN AND AGGREGATED TOTAL MARGIN
Total Margin: *Net income divided by total revenue*

Aggregated Total Margin: *Total three-year net income divided by total three-year revenue*

- ☐ Does not meet standard: Aggregated three-year total margin greater than -1.5%, but trend is negative for last two years.
- ☐ Falls far below standard: Aggregated three-year total margin is less than or equal to -1.5%, or most recent year total margin is less than -10%.

B. DEBT TO ASSET RATIO: ***Total liabilities divided by total assets***

- ☐ Does not meet standard: Between 0.9 and 1.0.
- ☐ Falls far below standard: Greater than 1.0.

C. CASH FLOW

- ☐ Does not meet standard: Multi-year cumulative cash flow is positive, but trend is negative.
- ☐ Falls far below standard: Multi-year cumulative cash flow is negative.

D. DEBT SERVICE COVERAGE RATIO: *(Net income + Depreciation + Interest expense)/(Annual principal, interest, and lease payments)*

- ☐ Does not meet standard: Less than 1.1.

3. ADDITIONAL NON-NACSA MEASURES

OTHER WARNING SIGNS[20]

- ☐ *Significant variation in actuals to budgeted figures.*
  May indicate that budget projections are not realistic, or there are significant changes in the environment. Ensure that forward estimates are adjusted accordingly.
- ☐ *Constant accounts receivable throughout the year*.
  Constant accounts receivables indicate that the school is not collecting invoiced amounts properly.
- ☐ *Constant or increasing accounts payable.*
  Constant accounts payable indicates that the school is not making payments as requested.
- ☐ Constant or steadily increasing *payroll taxes and retirement balances*.
  Constant or steadily increasing payroll taxes and retirement balances may indicate that the school is not making the appropriate contributions.
- ☐ *Significantly higher expenses than district average or similar institutions* (e.g. per pupil, per pupil occupancy, and instructional expense).

- ☐ *Qualified opinions on the financial audit*.
  Any qualified opinions from the auditor indicate that the information was limited in scope or did not meet Generally Accepted Accounting Principles (GAAP).
- ☐ *Presence of short-term or bridge loans to cover shortfalls from cash flow constraints.*

Management

Boards must be actively involved in the management of financial issues and properly address any issues in a timely and effective manner. While specific actions vary according to the issue, the checklist below outlines important considerations. Year-end deficits and insufficient funds are immediate problems, but financial problems often point to a greater underlying issue that may require fundamental changes.

1. Determine the Severity of the Problem

- ☐ *Identify the root cause(s) of the financial problem*.
  In many cases, financial insolvency stems from several underlying problems. For example, if a school is facing under-enrollment, there may be multiple reasons, including poor academic quality, insufficient marketing and outreach, or the lack of fit to the surrounding community. The board should conduct a thorough review of the financial statements and the school, including interviews with school staff and leadership, to identify all of the factors that may have contributed to the problem.
- ☐ *Estimate the cost of mitigation*.
  The board should take into account both immediate and longer-term costs in determining the cost of mitigation. A school facing financial insolvency may need immediate access to capital. Immediate costs include all costs of avoiding default, which may include short-term borrowing. Longer-term considerations may include the cost of replacing leadership or staff, fundraising, marketing and outreach, finding a new facility, or replacing vendors.

2. Create a Strategy to Address Issues

- ☐ *Create a short-term management strategy*.
  In the short-term, the board should focus on accessing liquidity channels, including fundraising or loans. In most cases, accessing a loan takes about 2-3 months. Therefore, it is important to act as soon as possible. The board should also revisit the approved budget to cut costs wherever possible and reallocate funds.
- ☐ *Create a long-term management strategy*.
  Bringing in external experts as necessary, the board should create a conservative, multi-year plan for increasing revenue or decreasing expenses. For example, the board may seek to build enrollment through improvements in educational programming or recruitment and community engagement. The first consideration should be the addition of support systems and proper controls. While financial issues may not necessitate a change in management, it should at least merit a review of management competencies.

3. Additional Controls

- ☐ *Ensure implementation of appropriate financial controls.*
  The board should institute financial controls to address the triggers to prevent reoccurrence.

TOOLBOX: *Financial Health and Sustainability*

- New York State Education Department (NYSED): Fiscal Oversight by the Board of Trustees Webinar

  This comprehensive webinar hosted by NYSED addresses internal controls for charter schools, basic fiscal literacy for boards, creating a financial dashboard, and mitigating fiscal risk. The slides from the webinar can be accessed here.
- California Charter Schools Association: Charter School Financial Management Guide

  This updated 2015 guide features planning tools for boards, highlighting important considerations.
- BoardOnTrack and ExED: Financial Oversight Toolkit

  This toolkit provides best practices of financial oversight with primers covering roles and responsibilities and general financial management.
- Charter School Growth Fund (CSGF): Facility Affordability Tool

  CSGF offers a tool that boards can use to answer the question: "how much building can I afford?".
- ExED: Fiscal Policies and Procedures Handbook

  A sample policies and procedures handbook that boards can use to create policies and procedures.
- Charter School Tools: Financial Management

  Charter School Tools has compiled a comprehensive set of resources on financial management, including audit checklists, sample expense reports, and sample finance guidelines.
- State University of New York (SUNY): Fiscal Templates

  SUNY's collection of fiscal resources includes charter revision, renewal financial, and annual budget and audit templates for charter school boards.

Information for boards of 501(c)(3) status schools:

- National Council of Nonprofits: Protect your nonprofit's tax-exempt status and Annual Filing Requirements for Nonprofits

  Guidance documents for organizations on considerations to maintain non-profit status.
- Internal Revenue Service Guidance: Charter School Reference Guide

  Charter-specific information on maintaining 501(c)(3) status while contracting with a management company.

FINANCIAL OVERSIGHT: FRAUD AND MISFEASANCE

Prevention

Both charter schools and those who oversee them have responsibilities to prevent fraud. Schools need to have strong practices in place and ensure that they are uniformly carried out. Governing boards must be aware of what strong financial practices look like and implement appropriate controls and practices.

1. Practice a Culture of Fiscal Accountability

- ☐ *Create a financial policies and procedures manual and a written code of fiscal conduct, which is shared with all employees.*
  In many cases, financial insolvency stems from several underlying problems. For example, if a school is facing under-enrollment, there may be multiple reasons, including poor academic quality, insufficient marketing and outreach, or the lack of fit to the surrounding community. The board should conduct a thorough review of the financial statements and the school, including interviews with school staff and leadership, to identify all of the factors that may have contributed to the problem.
- ☐ *Commit to compliance*
  Lax practices negate strong policies. The board must ensure that the school as a whole is carrying out articulated financial policies.

2. Ensure Transparency and Accountability

- ☐ *Establish multiple layers of accountability in the reporting structure.*
  There should be multiple layers of financial oversight. Boards should arrange for layers of accountability. For example, staff who oversee bank accounts and other assets, and who process and track accounts receivable and payable, should report to a business or finance or operations manager who oversees these tasks. The complexity of a school's staff can vary, but every school should adopt layers of oversight. The manager should report up to the Executive Director or Head of School, who reports directly to the Board of Trustees.
- ☐ *Set up a separation of duties.*
  No single individual should have control over two or more phases of a financial transaction or business operation. For small schools, the board can either outsource activities, such as bookkeeping, or increase the frequency of board review of records.[21]
- ☐ *Introduce a checks and balances policy.*
  The board should require multiple signatures on all checks and disbursements over a determined threshold and every authorization of payment.

3. Practice Proper Procurement and Contracting

- ☐ *Create a conflict of interest policy.*
  Guard against any potential self-dealing transactions through which school staff or board members benefit financially from contracts with the school. The policy should articulate full disclosure, board abstention from discussion and voting, and staff abstention from decision-making.[22]
- ☐ *Institute a procurement policy.*
  Establish evidence of market rate compensation through comparative shopping for services or multiple bids, arm's length negotiation, and board independence.[23] There should be threshold amounts for purchases that require board approval.

4. Restrict Access to Funds

- ☐ *Establish a credit card policy.*
  Restrict credit cards usage to a limited number of staff members. Ensure that any school-issued credit cards are used only for viable school purposes and not for personal expenses. The credit limit should be monitored to remain at a sufficiently low level. The school should avoid using debit cards because they are cash equivalents.
- ☐ *Create a fund disbursement policy.*
  Restrict credit cards usage to a limited number of staff members. Ensure that any school-issued credit cards are used only for viable school purposes and not for personal expenses. The credit limit should be monitored to remain at a sufficiently low level. The school should avoid using debit cards because they are cash equivalents.[24]
- ☐ *Set up a policy for cash receipt and disbursement.*
  Documentation such as pre-numbered receipts should verify all funds collected. All cash should be stored in a secure location before deposit, and deposits should be made promptly. Cash registers should track all sales.[25]
- ☐ *Enact a reimbursement policy.*
  Reimbursement of expenses should be prudent, transparent, and subject to the school's standard financial practices. The school should consider adopting federal or state reimbursement rates for expenses on charter school business to ensure that expenses are within a reasonable range.[26]

5. Inspect Human Resources

- ☐ *Review salary schedule of highly-compensated employees.*
  Boards are responsible for reviewing and approving staff salaries and school leader compensation. They should ensure the salary structure aligns with industry standards and is not excessive when compared to other charter schools. If salaries are higher, the board should properly document the reasons for the variance, as charter school salaries may differ from those in traditional public schools for legitimate reasons.
- ☐ *Ensure that the appropriate systems for employees are in place.*
  Boards should make sure that management maintains appropriate human resources systems such as hiring (e.g. conducting background checks on all potential employees before making an offer) and payroll (ensuring accurate reporting of employee hours).

6. Review and Maintain Accurate Records and Accounts

- ☐ *Understand accounting standards.*
  Schools should be fully familiar with statewide accounting standards (e.g. Financial Accounting Standards Board in New York, the more restrictive Government Accounting Standards Board in New Jersey and the still more restrictive controls in Hawaii that regulate charter schools as governmental entities).
- ☐ *Reconcile financial records to prevent accounting fraud.*
- ☐ *Verify enrollment figures through site visits or by conducting board meetings at the school.*
- ☐ *Document all transactions.*
- ☐ *Review of bank accounts and reconciliation.*
  Authority to open and close accounts should be restricted, and boards should monitor account statements monthly to ensure that fraud does not persist and for the presence of unknown accounts.

7. Ensure Proper External Audits

- ☐ *Contract an external auditor.*
  Annually contract with an external auditing firm, which should conduct an independent audit of the school's financial records, including a sampling of transactions and other metrics and compare self-reported financials to audited financials, looking for any discrepancies, misrepresented revenues or expenses and any unreconciled or unrecorded liabilities.

8. Protect and Encourage Whistleblowing

- ☐ *Create a whistleblower hotline or reporting procedures.*
  Tips from internal sources are the main method of fraud detection for all organizations. The school should clearly communicate internal reporting procedures for fraud or misconduct. Allowing anonymous complaints may increase the likelihood of reporting but should prompt as much detail as possible because follow-up may be difficult.
- ☐ *Institute a whistleblower protection policy.*
  A clearly communicated policy protects any individuals who report suspicious activity from retaliation by school management.

9. Implement Automated Controls

- ☐ *Turn on automatic notifications.*
  Make sure that multiple board members receive electronic notifications for bank account activity and balance thresholds.[27]

Identification

Despite the variety of fraud cases, instances of financial fraud in charter schools have consistent themes of inadequate internal controls, lax practices, and insufficient oversight at the management, board, and authorizer levels. We have included the most prevalent areas of weakness as common indicators of concern below.[28] While the presence of these indicators does not confirm fraud, the presence of one or more requires further investigation. Any board actions related to the investigation of fraud may be subject to public scrutiny under the Freedom of Information Law or become publicly available in other ways (e.g., report of authorizer findings, notification of school

probation, etc.). To fulfill oversight responsibilities, boards must be diligent in identifying and investigating any suspicious activity.

1. Common Warning Signs in Financial Records

- ☐ *Unusual and unexplained drops in profit or cash reserves.*
- ☐ *Lack of original receipts for reimbursement of expenses.*
- ☐ *Missing and disorganized documentation, such as vendor contracts.*
- ☐ *Large and unexplained increases in payments, management fees, or salaries.*

2. Common Warning Signs in Fiscal Practices

- ☐ *Concentration of authority*
  Financial practices that concentrate too much authority in a single person, rather than layers of responsibility (e.g., the person who incurred the expense signs off on approval for payment).
- ☐ *Little to no transparency.*
- ☐ *An unqualified individual managing the school's finances.*
- ☐ *Lack of implementation of written financial policies.*
- ☐ *Weak checks and balances policies.*
  Weak policies include caps on staff authority to sign checks that are set too high or not at all (e.g., no additional signatories required for large checks).
- ☐ *Weak authorizer oversight.*
  The school's authorizer is not attentive to problems as they arise in the financial reporting from the school or to the monitoring of fiscal matters.

Management

Boards have a duty to conduct a fair and thorough investigation of any evidence of fraud. Below are several recommendations, organized by phases, for boards responding to potential fraud or misfeasance.

1. Initial Allegation or Suspicion

- ☐ *Clearly document and carefully maintain records of all actions and decisions.*
  Documentation ensures that the oversight bodies have fulfilled all of their responsibilities and can support any future investigation.

2. Investigation

- ☐ *Alert and escalate.*
  If boards identify discrepancies or fiscal problems, internal or external financial experts should conduct a more intensive analysis. For example, if the board identifies an inappropriate or questionable expense, the board should review additional purchase orders for a period (e.g., a year). The board should escalate from a sampling to a more thorough forensic approach until the matter is sufficiently clear.
- ☐ *Gather evidence.*
  The school leadership and board should take ownership of the problem and engage in fact finding.
- ☐ *Interview individuals in the school and take notes on statements.*

- ☐ *Look for discrepancies.*
  Attempt to understand and reconcile any disparities among records and materials (e.g., receipts, purchase orders, coding of expenses, accounts, financial statements, related party transactions). Review audited financials, compare them to self-reported statements and accounts, and focus particularly on auditor notes and, where relevant, third-party transactions.

TOOLBOX: *Fraud and Misfeasance*

- Association of Certified Fraud Examiners: Managing the Business Risk of Fraud and Sample Fraud Policy
  While not specific to the charter sector, this document contains key considerations and recommendations for internal fraud.
- Council of Nonprofits: Internal Controls for Nonprofits.
  This site offers multiple resources applicable to all charter schools to create responsible internal controls to prevent fraud and mismanagement.
- American Institute of Certified Public Accountants: Sample Whistleblower Policy
  This document provides a sample whistleblower policy but should be amended to pertinent state laws.

FINANCIAL SPOTLIGHT

New Schools

New schools are the most financially vulnerable. The greatest potential issues are similar to those of established schools: facilities and enrollment. However, due to the absence of previous information on enrollment and expenses, as well as constrained cash flows, external risks are of greater concern. Research shows that ineffective schools may demonstrate financial issues in the first few years before showing any indication of poor academic performance.[29] Financial vulnerability may stem from early-stage failure to attract sufficient enrollment and a lag in performance data. While there may be schools with financial issues that are high-performing academically, severe financial issues ultimately impact all areas of performance.

ROLE OF THE BOARD

- ☐ *Be actively involved in financial management if necessary.*
  If there are too few staff members to provide adequate separation of duties, the founding board may need to be involved in the day-to-day cash management, the signing of checks, and review of statements on a weekly basis. However, this should only be the case with capacity constraints. More mature boards should not be involved in day-to-day management practices.
- ☐ *Monitor cash flows more frequently*
  Because new schools are more likely to be cash poor, the board should increase the frequency of monitoring cash flows from quarterly to monthly reviews.
- ☐ *Develop a strategy to transition off of initial grants and fundraising and create intermediate benchmarks to monitor progress.*
- ☐ *Institute proper internal controls from the beginning.*
  Smaller organizations tend to develop informal methods of operating which continue as they grow. Proper internal controls should be put in place to anticipate growth.

TOOLBOX: *New Schools*

The following documents provide additional information for boards about the recommendations provided in this section:

- Colorado League of Charter Schools: New School Financial Resources
  Tools for founding boards including a budgeting worksheet, financial transaction checklist, and guide to reviewing key documents.
- National Resource Center on Charter School Finance and Governance: Cost Estimation Tool
  This tool helps start-up charter school boards identify and estimate the range of costs and timing of expenditures during the first years of operation.
- Charter School Business Management: Division of Financial Responsibilities
  A clear outline of the different responsibilities of the finance team, school leadership team, finance committee, and board of trustees.
- Walton Family Foundation: School Business Plan Template
  This document provides the main considerations for charter school developers including an outline for a business plan.
- SUNY: Charter School Business Plan Requirements
  This document outlines the business plan required by SUNY including ways to demonstrate organizational capacity and key documents.

Management Companies

It is important that boards preserve the ability to exercise complete oversight over how school funds are used. Also, boards must retain authority over the budget and decision-making. Most educational service providers are structured as nonprofit organizations, also called charter management organizations (CMOs), while others are for-profit, or education management organizations (EMOs). Management companies can provide either selective services or comprehensive management. The scope can include educational and administrative services, including accounting, procurement, and reporting.[30] Boards must keep the company accountable for performance across the provided services.

1. Bidding for a Management Company

- ☐ *Consider the management company as a vendor.*
  Boards should treat management companies as organizations that work for the board, rather than the other way around. Therefore, boards should closely scrutinize all contracts and related financials.

- ☐ *Conduct full due diligence of the management company.*
  Look for and require evidence of the provider's prior successes and challenges. Speak to current clients of the management company and authorizers of schools they operate to gain their perspective on the relationship and the operator's track record.

2. ENTERING INTO A MANAGEMENT AGREEMENT

- ☐ *Ensure independent board fiscal oversight.*
  Look for the assignment and allowance of full board fiscal oversight in the management agreement. The agreement should not exclude the board from access to financial documentation and authority over the budget.
- ☐ *Carefully and thoroughly read the management agreement.*
  Legal counsel review is essential. The board should retain separate and independent legal counsel for the review of the management agreement.
- ☐ *Conduct arm's length negotiations.*
  There should be a clear separation of the contractor from the board, and the board should prohibit the contractor from selecting, approving, compensating, or employing board members. The school should avoid any conflicts of interest or the appearance of conflicts of interest.
- ☐ *Introduce controls around school asset ownership.*
  Boards should be careful to protect all assets such as facilities, instructional materials, furnishings, equipment, and intellectual property.
- ☐ *Clarify compensation and financial affairs.*
  Check for a clear compensation schedule, including all fees and bonuses. Clarify what funds will be available for the company's operational use and what will happen if expenses exceed revenue.
- ☐ *Think about renewal and termination terms.*
  Termination provisions should favor the board rather than the management company. Ensure that there are no large financial penalties for terminating the relationship and that there are no 'poison-pill' penalties to terminating the management agreement.[31] Preferably, the length of the contract should be no more than the length of the charter contract, terminating annually or every few years to give the board more flexibility. The renewal provisions should keep the management company accountable for performance.

3. MANAGEMENT RELATIONSHIP

- ☐ *Consider school networks.*
  Make sure that there are appropriate checks and balances within the board if there is one board over a network of schools.
- ☐ *Oversee the management of funds.*
  Ensure board oversight over the proper management of funds if the management company manages the day-to-day financial operations of the school. If one of the functions of the management company is to pay school bills, the school funds may be diverted into an account controlled by the management company from the school bank account.
- ☐ *Determine a limit for management fees.*

Ensure that the management fees do not exceed the revenue of the school. Depending on the services provided, CMO management fees are typically 3-10% of school revenues. EMO fees tend to be higher at 10-20% of revenue.[32]

TOOLBOX: *Management Companies*

- Michigan Association of Public School Academies: Marketplace for Service Providers
  This portal connects schools to quality providers by product/service and region.
- Charter School Tools: Provider Evaluation Instrument and EMO Disengagement
  The first tool can help boards evaluate the contract compliance and functional performance of CMOs, EMOs, and any other service provider. The second tool is a checklist boards can use to transition away from an EMO.
- Walton Family Foundation: Hiring a Management Company
  This document provides an overview of areas related to contracting with an EMO or CMO.
- Bill and Melinda Gates Foundation: Succession Planning in CMOs Report, Case Studies, and Worksheet
  This set of resources provides guidance on creating a comprehensive and detailed succession plan from lessons learned in the field.

CONCLUSION

While this toolkit targets governing boards, fiscal oversight is important for all charter school stakeholders. In implementing the recommendations above, it is important for boards to partner with both their authorizer and the school's management to ensure the proper communication of policies throughout the school. However, boards should remember to focus exclusively on fiduciary governance rather than day-to-day financial management. A clear division of roles between the board and school administration facilitates the successful functioning of the school. In this way, charter schools as a whole can better serve the public to whom they are ultimately accountable.

Quick Reference Guide

BOARD FISCAL OVERSIGHT

Full fiscal oversight must consider both the general financial health of the school and the risk of fraud.

Financial Health and Sustainability *Effective financial management to avoid default*	**Fraud and Misfeasance** *Good governance to mitigate fraud risk*
Prevent • Ensure sufficient **financial literacy** within board. • Review, update, and approve a conservative **budget** and **forecasts**, checking the budget, underlying budget assumptions, and the long-term financial plan. • Regularly **monitor** the school's financial position, including interim financial reports on a cash and accrual basis, revenue sources, large purchases, financial reporting, and tax-exempt status. • **Manage risks** by ensuring appropriate insurance coverage and implementing additional controls where necessary.	Prevent • Practice a **culture of fiscal accountability**. • Set up policies and procedures to ensure **transparency** and **accountability**. • Practice proper **procurement** and **contracting**. • **Limit access** to school funds. • Review **human resources** policies. • Review and maintain **accurate records and accounts**. • Contract **independent financial audits**. • Protect and encourage whistleblowing. • Turn on **automated** controls.
Identify • Use a **rubric** to assess the immediate and longer-term financial state of the school, such as the NACSA Core Performance Framework. • Scan for other **warning signs**, such as large variations between budgets and actuals, significantly high expenses, qualified audit opinions, and bridge loans.	Identify • Look for warning signs in **financial record**s, such as sudden drops in profit or cash, no receipts, missing documentation, and large increases in payments or salaries. • Look for warning signs in a school's **fiscal practices**, such as the concentration of authority, no transparency, unqualified financial management, no implementation of policies, weak checks and balances, and unresponsive school leadership.
Manage • **Respond** immediately to financial issues by identifying the root cause and estimating the cost of mitigation. • Create a short-term and long-term **management strategy**, which will most likely include accessing liquidity and then increasing revenue or decreasing expenses in the long run. • Implement **financial controls** to prevent future reoccurrence.	Manage • Upon **initial suspicion**, clearly document all decisions and designate the appropriate investigative body. • Conduct **thorough investigation** to understand whether the issue should be escalated or a crime has been committed.

Appendix A: Detailed NACSA Financial Performance Framework

1. Near-term Measures

	Meets	Does not Meet	Far Below
A. Current Ratio *Current assets divided by current liabilities*	• Greater than or equal to 1.1; *or* • Between 1.0 and 1.1 and positive one-year trend.	• Between 0.9 and 1.0 or equal to 1.0; *or* • Between 1.0 and 1.1 with negative one-year trend.	• Less than or equal to 0.9
B. Unrestricted *Days Cash Unrestricted cash divided by ([Total expenses minus depreciation expense]/365)*	• 60 days cash; *or* • Between 30 and 60 days cash and one-year trend is positive.	• Between 15-30 days cash; *or* • Between 30 and 60 days cash and one-year trend is negative.	• Fewer than 15 days cash.
C. Enrollment Variance *Actual enrollment divided by enrollment projection*	• Equals or exceeds 95% in most recent year.	• Between 85-95% in the most recent year.	• Less than 85% in the most recent year.
D. Default	• Not in default of loan and/or not delinquent with debt payments.	Not applicable	• In default of loan and/or delinquent with debt service payments.

2. Sustainability Measures

	Meets	Does not Meet	Far Below
A. Total Margin *Net income divided by total revenue* Aggregated Total Margin *Total three-year net income divided by total three-year revenue*	• Aggregated three-year total margin is positive and most recent year total margin is positive; *or* • Aggregated three-year total margin is greater than -1.5%, trend is positive for last two years, and the most recent year total margin is positive.	• Aggregated three-year total margin is greater than -1.5%, but trend does not meet standard.	• Aggregated three-year total margin is less than or equal to -1.5%; *or* • Most recent year total margin is less than -10%.
B. Debt to Asset Ratio *Total liabilities divided by total assets*	• Less than 0.9.	• Between 0.9 and 1.0.	• Greater than 1.0.
C. Cash Flow *Multi-year cash flow* *One-year cash flow*	• Multi-year cash flow is positive and one-year cash flow is positive each year; *or* • Multi-year cash flow is positive, cash flow positive in one of two years, and cash flow in most recent year positive.	• Multi-year cash flow positive, but trend does not 'meet standard'.	• Multi-year cash flow is negative.
D. Debt Service Coverage Ratio *(Net income + Depreciation + Interest Expense)/ (Annual principal, interest, and lease payments)*	• Equal or exceeds 1.1.	• Less than 1.1.	Not applicable

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