Digging Deeper into Problems Encountered in the Business Office

1. Reporting to the board, especially the Finance Committee

Support of board committees is a key element of the CFO's job. Some new CFOs do not understand this.

2. Reporting financials internally

The business office should provide budget reports to the head and department chairs within a week after the end of every month. (July and August reports are dispensable due to minimal activity.) These will be the basis of reports to the Finance Committee and the board as a whole.

All these parties need this information to know if the school or department is on track to meet its respective budget target. The information provides the basis for fiscal restraint or opportunist funding shifts during a school year.

General ledger**:** This consists of the hundreds of accounts in which a school records each piece of financial activity. The activity includes a tuition payment for an eighth-grader, a gift to the annual fund, and dividends received from investments. On the expense side, the activity includes the biweekly payment of salary to an English teacher, purchase of art supplies, and payment to the electricity provider.

3. Organizing documents

The myriad of information handled by the business office should be organized with teamwork and continuity in mind. Another person should be able to step in and find a tax report or a software agreement. This "library" approach to documents is practiced at law firms, physician practices, and other businesses. Organizing documents in folders takes time – whether in a computer or a filing cabinet. Without the effort, the CFO eventually loses the ability to access information when needed.

4. Complex spreadsheets

I recommend not creating overly complex spreadsheets. These may have a dozen or more tabs and formulas that pull from external files. I suspect the ones I encountered were created by my predecessor's predecessor. In key places they contained *frozen* or manually entered values ("*plugs*") without any indication of the source of the calculations. This mega-spreadsheet may work for the person who writes it and uses it on a regular basis. The creator's successor will likely find it impenetrable.

Operating budget**:** This is the school's plan for revenues and expenses for the fiscal year. Usually a school develops a rough draft of the next year's operating budget in the late fall. This allows the board to set tuition rates, the financial aid target, and the salary pool in

January/February. The board typically adopts the final budget in May/June or in September/October.

Frozen value: In Excel, this is when the formula by which a number is calculated is removed from a cell, and only the value is retained. The trail for the calculation of the value is thereby lost. Freezing a group of numbers may be necessary to create reports or to copy them to another file, but the formulas should be retained in the master file.

Plug**:** This is accounting slang for a "reconciling entry," a manual adjustment to a calculation in order to tie out financial statements that don't agree to the penny. Ideally, plug entries should be for immaterial amounts and temporary. It isn't worth the time to search for a $1.31 variance between two financial statements when reports need to be sent to the Finance Committee in 15 minutes. The risk of this plug entry is that it may mask multiple large errors that net out to $1.31. When used in a spreadsheet, there should be an identifier and a comment explaining the "reconciling entry." The plug should be replaced with the correct value when there is time to research the variance.

6. Accounting and GAAP

For the internal operation of the school, most schools maintain a different set of financial statements than those produced under GAAP for the external audit. The degree of variance with GAAP varies from school to school. The best practice is a continual source of debate within the profession.

GAAP for nonprofits was developed for external reporting. The advancement office needs to be familiar with GAAP guidelines for gifts and donor restrictions. The board may wish to see certain reports, such as the Statement of Financial Position (aka balance sheet) in GAAP format. For the most part, the business office should keep GAAP within the office.

GAAP is an ever-evolving creature. It is promulgated by FASB (Financial Accounting Standards Board), and is revised every several years. Sometimes the revisions are significant.

GAAP has moved away from cash activity in certain areas. For example, pledges are recognized as revenue even though the payments may not be received for several years in the future. Depreciation is an expense, even though it is not a cash event.

There are uses of cash that are *not* captured in a GAAP operating statement. The purchase of a capitalized item (truck, data server, or replacement boiler) is not an operating expense in GAAP. Nor is the repayment of debt principal an operating expense in GAAP.

Most schools keep an eye on their cash level over the course of the year. This is easier to do when internal operating reports are based on cash activity. Businesses in the for-profit world are required by the IRS to state their revenues and expenses on either an accrual basis or a cash basis. Schools do not have this standard. Even a school using cash-based internal reporting is likely not doing so on a purely cash basis. With accounting for prepayments and accruals, this school is more accurately on a "modified-cash" basis for its internal reports.

***GAAP*:** This stands for Generally Accepted Accounting Principles. These are a common set of accounting principles, standards, and procedures that companies must use in their certified external audit. Most schools go through this audit process to have an independent set of eyes attest to the accuracy of the school's financial records. This reassures the board and the school's constituents. Foundations and lending institutions typically require a school to provide a copy of the certified outside audit.

7. Providing for capital replacement

There is an old saying: "Every student who passes through a school takes a brick away at graduation." The fact is that the physical plant and equipment eventually wear out. Schools provide for the cost of reversing this erosion in their internal operating budgets in several different ways.

- Some schools, per GAAP, include the annual charge to depreciation as an expense line. Depreciation is a non-cash activity. Therefore, a balanced operating budget frees up cash that can be used for capital expenditures.

- Some schools include their actual expenditures on major capital repairs, renovations, and replacements as an expense line in the budget.

- Some schools set up an expense line that transfers a set amount of money to a designated capital reserve. This reserve fund is tapped in the current year or in the future for capital purchases. The annual level of funding depends on the school's perceived need (and what it can afford) over the foreseeable future. This is the PPRRSM approach (Provision for Plant Replacement, Renewal, and Special Maintenance).

Whichever approach the school chooses to use, it is vital to prepare and monitor the capital budget just as carefully as the operating budget. The plan should be based on program and facility needs. The capital budget should be approved by the board (perhaps the Facilities Committee). Changes to the capital budget should be reported to the board.

***Capital budget*:** This is the school's plan for purchasing capital items during a fiscal year. Examples include replacing a roof, repaving a parking lot, and adding a 14-passenger van to the fleet. The annual capital budget usually does not include major new construction. New buildings are typically paid for from campaign proceeds, debt, unrestricted funds, or a combination of the three.

If you have questions about the terms or topics above, please don't hesitate to contact Jim Pugh at jimpugh46@gmail.com.