FISCAL VIABILITY

Part 1: Audit History

Espiritu Community Development Corporation's previous two audits have demonstrated the fiscal sustainability of the organization. They provide insight as to changes and key trends that have occurred within the organization over the last two years. It also shows the resolve of the management to get a handle on all financial affairs of the school district. The independent auditors also reviewed all the accounting processes and procedures and feels that they meet the required acceptable standards. There are no serious outstanding issues from the past two years and the preliminary audits for the fiscal year 2010 do not indicate any challenges.

According to the audit reports Espiritu had an instance of material weakness reported in fiscal year 2008 and no control deficiencies reported in fiscal year 2009. Fiscal year '08 indicated that a material weakness was found in financial reporting due to the interest payable on Espiritu's bond not being accrued to reflect a year end liability. This item was rectified the following year as indicated by the fiscal year '09 audit report. The finding from fiscal year '08 was a financial statement finding, unrelated to federal awards, which does not require a corrective action plan; Espiritu has not been required to create a corrective action plan since fiscal year 2007's audit report. There has been no record as of yet indicating a recurrence of any weakness identified by external auditors during their year end reviews. These independent audits indicate that the internal controls of the organization are proper, and that management is committed to correcting errors or weaknesses as soon as they arise.

The last two years have been marked by net losses incurred by the organization. Espiritu has incurred losses of $291K and $445K in fiscal year '08 and fiscal year '09, respectively. Although, fiscal year '07 saw Espiritu achieve a net gain of $318K. This indicates that Espiritu has the ability to remain financially viable and that fiscal year 08 and fiscal year 09 included occurrences that are not expected to reoccur in the near future.

Below is a comparative analysis of the past two year's functional expenses for Espiritu.

ESPIRITU
Comparative Schedule of Functional Expenses
FYE 6/30/09 & 6/30/08

	6/30/2009	6/30/2008	Change
Salaries & Wages	$2,558,519	$2,177,173	**$381,346**
Health Insurance	313,350	241,529	**71,821**
Payroll Taxes	243,737	225,987	**17,750**
Retirement Contribution	197,892	162,428	**35,464**
Total salaries & related	3,313,498	2,807,117	**506,381**

Contributions	434,105	749,815	**(315,710)**
Rent	851,199	670,000	**181,199**
Contracted Services	400,272	678,938	**(278,666)**
Travel & Transportation	36,499	65,162	**(28,663)**
Instructional Aids	75,635	170,998	**(95,363)**
Utilities	157,569	124,252	**33,317**
Insurance	126,847	110,054	**16,793**
Repair & Maintenance	46,115	50,853	**(4,738)**
Communications	89,868	90,183	**(315)**
Interest	557,163	517,065	**40,098**
Supplies & printing	198,905	201,583	**(2,678)**
Food Purchases	243,286	244,196	**(910)**
Student Assessment	512	98,707	**(98,195)**
Other	109,255	92,405	**16,850**
Total functional expenses before depreciation	6,640,728	6,671,328	**(30,600)**
Depreciation	590,880	405,816	185,064
Total Functional Expenses	**$7,231,608**	**$7,077,144**	**$154,464**

The table shows that functional expenses have increased from fiscal year ‘08 to fiscal year ‘09. The major contributing factor is the increase in depreciation. In fact, functional expenses before depreciation actually decreased by approximately $30K. Contributions to non-profit organizations were relatively high over the past two years. In order to improve the fiscal health of the organization, such contributions will be eliminated for fiscal year ‘10 and substantially reduced for future years.

Although salaries and related expenses increased, the organization anticipates these expenses to stabilize in fiscal year ’10 and decrease in the very near future as tough economic times are expected. The salary stabilization can been attributed to a reduction in administrative staff and admin furloughs; thus not hindering teacher quality. Rental expenses have increased because of the new lease for the much needed office space. Besides fulfilling the additional needs, this office space has increased the school district’s exposure to the wider community which should follow with additional enrollment in the years to come.

The net losses for last years has resulted from the increase in depreciation (a non-cash expense) and bond interest payments. In addition, Espiritu generated significant cash flow from operations in spite of higher than normal contributions. Cash flow from operations have consistently exceeded $250K; an excellent indicator of liquidity. Overall, Espiritu is vigilant in controlling its operating expenses and maintaining positive net assets. The student count remains consistent. The only significant

variable is the financial support allocated per student every year, which is something every charter school in the state has to account for.

Espiritu is committed to continually improve its operations and financial position and has instituted processes and procedures to help mitigate actions that could affect its short and long-term future. The items discussed below will help ensure the fiscal viability of the organization for the foreseeable future.

Part 2: Accounting Procedures

In order to maintain sustainable economic growth and educational excellence, Espiritu realizes the need of additional fiscal oversight especially during strenuous economic times. This realization has led to the establishment of a Finance and Independent Audit Committee. The Finance and Independent Audit Committee tries to anticipate fiscal challenges and provide appropriate guidance especially during difficult economic times. The Committee is comprised of senior organizational officials who meet bi-monthly to evaluate and ensure controls over financial affairs to enhance the mission and goals established by the Board of Directors. The Committee also assures that the organization adheres to State and Federal rules and regulations. It reviews all internal and external financial reports, authorized expenses, cash position among other financial activities.

The accounting department has the primary responsibility to alert the organization of any potential financial inadequacies. The accounting department keeps track of the organization's cash position, pending payments and payables summary on a daily basis. The Department is in constant communication with the business and operations manager and department heads/facilitators informing each of their financial position and potential challenges. This enables the department heads/facilitators to track their financial status at a given point and time thus enabling sound decisions. The accounting department compiles regular financial reports for the Finance and Independent Audit Committee's review and analysis.

The Finance and Independent Audit Committee meets on a bi-monthly basis (weekly during challenging financial circumstances) to review the financial reports and providing appropriate guidance to the organization. During these meetings, the committee listens to presentations regarding organizational and departmental budgetary status, cash position, revenue projections, and accounts payable and upcoming expenditures among other items. The Committee also acts as additional oversight and submits timely reports to authorized departmental managers as to the status of the approved budgets and, where necessary, offer assistance to manage overhead costs and operational expenditures in order to sustain budgetary integrity.

During times of financial hardship the committee meets on a weekly basis, acts as fiscal decision maker and is accountable to the Board of Directors. It also makes all the expenditure decisions until such time when the organization's fiscal health has been restored. Additionally, the Board of Directors maintains the ultimate authority for all financial matters and reserves the right to enter into any material financial commitment or lease with external parties.

Due to the frequency of these meetings, the organization has current knowledge of its financial sustainability and, is able to forecast the organization's inability to satisfy its obligations in less than four weeks. This provides enough time for the Board of Directors, the Finance and Independent Audit Committee and senior administrative officials to search for reasonable alternatives to satisfy its monetary commitments.

These procedures outlined here ensure sound and timely decisions and allows the organization to fulfill its mission and goals.

Part 3: Fiscal Authority and decision making process

Espiritu utilizes a decentralized fiscal decision making structure where departmental budgets and normal operating expenditures (not including overhead) are the responsibility of the department heads; however, in times of financial hardship Espiritu utilizes a centralized financial system where the Finance and Independent Audit Committee, comprised of senior administrative officials, will assume responsibility of all financial decision.

Processes and procedures for fiscal oversight and authority are as follows:

Espiritu's budget is the foundation for ensuring fiscal viability. The organization employs standard procedures for measuring performance, planning, and allocating resources. Espiritu is cognizant of its responsibility to maintain fiscally viability and budgetary integrity and as such has appropriate processes and procedures in place.

The department heads/facilitators are responsible for maintaining and monitoring their operating budget. They are required to closely adhere to the guidelines established by the Board of Directors and the Accounting Department. Department Heads/Facilitators, in the process of developing and implementing their budget, must use reasonable assumptions utilizing historical financial data maintained in the organization's accounting system. All budget assumptions are documented to facilitate a thorough analysis and evaluation, not only for the budgetary purposes, but also for tracking the actual revenue and expenditures. Each department head/facilitator has ultimate responsibility for their department's budget.

The administrative overhead budget is established by the Business and operations manager in conjunction with the Accounting Department. The Business and operations manager must use reasonable assumptions of forecasting income and expenses. The business and operations manager, in conjunction with the CEO/Servant Leader and the Finance and Independent Audit Committee has the ultimate responsibility for monitoring administrative overhead costs and budgetary integrity.

Budgets are submitted to the Chief Executive Officer for review and approval. The Chief Executive Officer consults with the Finance and Independent Audit Committee prior to submission to the Board of Directors. The CEO/Servant Leader submits an annual organizational budget to the Board of Directors for their approval.

The business and operations manager and CEO/Servant Leader, along with the Finance and Independent Audit Committee, are responsible for enforcing the approved budget throughout the year and when necessary take actions to rectify the situation. During the year regular audits are conducted to ensure departments are operating within their approved budget.

When a department head/facilitator submits a purchase request along with supporting documentation to the Accounting Department for processing (unless in times of financial hardship – see procedures below), the Accounting Department is responsible for reviewing the department's budgeted-to-actual figures to ensure the request falls within department's approved budget. The Business and operations

manager retains constant communication with the Accounting Department in order to inform them of their budgetary issues. Interim weekly "profit and loss" statements are also provided to the department heads/facilitators so that they are aware of their financial status. If a department is over budget, all expenditure privileges are suspended until further notice unless approval is granted by the Espiritu's Finance and Independent Audit Committee.

In addition, during its regular meetings, the Finance and Independent Audit Committee analyzes departmental and organizational budget-to-actual figures, prepared by the accounting Department At the end of each month the Committee reviews and approves the monthly financial statements prepared by the Accounting Department before they are submitted to the Board of Directors.

During its monthly meetings, the Board of Directors reviews the organization's monthly financial statement and makes necessary recommendations. The Board also reviews the annual financial statements prepared and presented by the external auditor. The Board has the ultimate responsibility of maintaining budgetary integrity for the entire organization.

(Financial Hardship) During the difficult period of financial adversity, Espiritu's Finance and Independent Audit Committee assumes the control over all the fiscal decisions and ensures budgetary integrity. Any and all potential purchases are presented to and approved by the Committee. Also, the Committee maintains the oversight of the organizational budget, account payables, cash flows, and other financial reports. The Board of Directors oversees the Finance and Independent Audit Committee's work.

Part 4: Viability Related to Fundraising

Although Espiritu receives charitable support and conducts minor fundraising activities from time to time, these funds do not constitute a major portion of the overall budget. It amounts to about one percent of the total budget. During the past two fiscal years, the organization has benefited from two donations from NFL Charities totaling $1.5 million. However; these donations are non-recurring and were utilized to make facilities improvements and to build a new multi-purpose athletic field. These contributions were project specific and as such were not utilized to subsidize operations.

Since donations make up a fraction of the organization's overall budget there is little or no risk to the organization's operations if contributions were no longer available.