



**North Carolina**  
Total Retirement Plans



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## MEMORANDUM

TO: Teachers' and State Employees' Retirement System (TSERS) Board of Trustees

FROM: Patrick Kinlaw, FSA, Director of Policy, Planning and Compliance

DATE: January 28, 2021

RE: Application of Charter School for Participation in TSERS

Pursuant to G.S. 135-5.3(b3), Discovery Charter School (Discovery) of Durham, NC, was granted provisional entry into TSERS effective July 1, 2019. Following the end of its one-year provisional period, Discovery has applied for continued participation in TSERS.

Pursuant to G.S. 135-5.3(b7), the Board of Trustees (Board) may grant final approval of a charter school's application to participate in TSERS if it finds the following:

- The school has completed an application using the form approved by the Board;
- All members of the Board of Directors of the school have signed a written statement acknowledging and accepting the estimate of the withdrawal liability performed as described under G.S. 135-5.3(b5);
- The school has not been identified as continually low-performing by the State Board of Education (SBOE) as provided in G.S. 115C-218.94; and
- The school's most recent audited financial statements and independent audit report demonstrate that it is financially sound and can meet the financial obligations of participation in TSERS.

Staff of the Retirement Systems Division (RSD) of the Department of State Treasurer recommends the approval of Discovery for continued participation in TSERS. Discovery has complied with the requirements of G.S. 135-5.3. The submitted audit report and financial statements demonstrate that Discovery is financially sound and can meet the financial obligations of participation in TSERS.

### **Application**

Discovery submitted a signed and attested Application for Participation dated August 24, 2020. On this application, Discovery attested that it is obligated to comply with all provisions governing TSERS pursuant to Article I, Chapter 135 of the NC General Statutes and that it has not been identified as continually low-performing by the SBOE. (RSD staff also confirmed that Discovery was not on the SBOE's 2019-2020 list of continually low-performing charter schools.)



### **Signed Acknowledgement and Acceptance of Withdrawal Liability**

Discovery submitted a form dated January 7, 2021, signed by each member of its Board of Directors, acknowledging and accepting the payment of a withdrawal liability in the event that Discovery elects to cease participation in TSERS. This form included the projected amount of the withdrawal liability after five and ten years of participation in TSERS, as estimated by TSERS' consulting actuary pursuant to G.S. 135-5.3(b5).

### **Provisional Participation**

Discovery's provisional participation in TSERS began effective July 1, 2019. During its first year in TSERS, Discovery reported \$412,650.44 in retirement-eligible employee compensation to TSERS for twelve (monthly) payroll reporting periods. The contributions associated with two of these monthly reports were paid late: The contribution associated with the December 2019 payroll period was paid on February 3, 2020, and the contribution associated with the January 2020 payroll period was paid on February 25, 2020. In both cases, Discovery was assessed a late payment penalty of 1% of the contribution. Discovery has expressed its intention to pay the late payment penalty.

### **Financial Review**

Pursuant to G.S. 135-5.3(b3), one year after a charter school is granted provisional entry into TSERS, the charter school shall undergo a financial review. Pursuant to G.S. 135-5.3(b6), the financial review is based on financial statements and independent audit reports held by the Local Government Commission or functionally equivalent financial statements and independent audit reports submitted to the Board by the charter school.

Based on information provided by TSERS' consulting actuary as of December 31, 2019, Discovery had 10 eligible general employees. For its provisional participation year, July 1, 2019, through June 30, 2020, Discovery reported a total of \$412,650.44 in retirement-eligible compensation to TSERS. The total employer contribution rate for TSERS employers for the fiscal year beginning July 1, 2020, covering TSERS retirement, retiree health, disability, and death benefits, is 21.68% of retirement-eligible compensation.

Discovery is largely funded by the SBOE and receives funding in an amount equal to the average per pupil allocation for the average daily membership (ADM) from the local school administrative unit allotments in which the school is located (i.e., Durham County Board of Education) for each student attending Discovery. The school receives an additional amount for each student with special needs who attends the school. Additionally, for each student who resides outside the local school administrative unit jurisdiction and attends the school, the school receives an amount equal to the per-pupil local current expense appropriation to that respective local school administrative unit.

For the fiscal year ended June 30, 2020, Discovery received funding from the Boards of Education for Alamance County, Catawba County, Charlotte/Mecklenburg County, Durham



County, Orange County, Person County, and Wake County. Discovery also receives funding from state and federal grants, student fees and activities, and contributions and donations.

The independent auditor's report for Discovery attached to the audited financial statements for the fiscal year ended 2020 indicates an unmodified financial opinion. Discovery reported an ending fund balance of \$57,478 for the fiscal year ended 2020, the school's first year of operation. The fund balance is sufficient to provide cash flow and a safety net for the employer, and is not currently being utilized as a source of funding to meet its operating costs.

### **Assessing Financial Soundness**

G.S. 135-5.3(b7)(4) provides that the Board may grant final approval of a charter school's application for participation in TSERS if "the charter school's most recent audited financial statements and independent audit report demonstrate that it is financially sound and can meet the financial obligations of participation in the Retirement System."

RSD staff's recommendation to the Board as to the financial soundness of a charter school and its ability to meet the financial obligations of participation in TSERS is based on the following indicators:

- Debt-to-Assets Ratio
  - Target: Debt-to-assets ratio of less than 0.5, which indicates that most of the assets are financed through equity and that total assets exceed total liabilities.
  - Actual: Discovery's audited financial statements indicate that assets exceeded liabilities as of June 30, 2020, resulting in a total net position of \$178,618. The debt-to-assets ratio was 0.0 for the fiscal year ended 2020.
- Student Enrollment
  - Target: ADM variance, defined as current actual year final ADM divided by actual ADM for the prior year, equals or exceeds 1.0.
  - Actual: Because the 2019-2020 school year was Discovery's first year of operation, the ADM variance by definition was equal to 1.0. According to data from Principal's Monthly Reports submitted to the NC Department of Public Instruction, Discovery opened the 2019-2020 school year with 33 seventh-graders and 86 sixth-graders. It ended the 2019-2020 school year with 34 seventh-graders and 84 sixth-graders. It opened the 2020-2021 school year with 40 eighth-graders, 90 seventh-graders, and 58 sixth-graders.



- Fund Balance
  - Target: The most recent audited financial statement should demonstrate a net surplus with few variances present or, alternatively, a sufficient explanation as to how a negative fund balance will be eliminated in the next fiscal year.
  - Actual: Discovery's audited financial statements indicate an excess of revenue over expenditures during the fiscal year ended 2020, resulting in an ending fund balance of \$57,478 at the end of that fiscal year, the school's first year of operation.
- Internal Controls and Governance Measures
  - Target: Segregation of duties related to financial transactions and indication of written policies and procedures regarding operations, accounting, personnel, and academics.
  - Actual: Discovery's independent audit report indicates no deficiencies in internal controls over compliance that would be considered to be material weaknesses.
- Cash Flow
  - Target: Positive cash flow and a minimum of one month of operating expenses cash on hand.
  - Actual: Discovery's audited financial statements report available cash of \$44,684 as of June 30, 2020. Current expenditures from the General Fund were \$399,094 for the fiscal year ended 2020, indicating that the cash on hand exceeded one month's worth of operating expenses from the General Fund.
- Presence of Large Loans Outstanding to Fund Operations
  - Target: If present, the charter school must address the paying down of the outstanding obligation.
  - Actual: Discovery's audited financial statements do not indicate any liabilities existing as of June 30, 2020.