Arizona State Board for Charter Schools

Financial Performance Framework and Guidance

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Financial Performance Framework Guidance

Charter holders have the autonomy to manage their finances consistent with state and federal law and the charter contract. The purpose of the Financial Performance Framework ("financial framework") is to communicate the State Board for Charter Schools' ("Board") expectations for ensuring that all charter holders in its portfolio are viable organizations with strong fiscal management practices. To this end, the financial framework focuses on outcomes or performance goals not necessarily established in law.

The Board, in its oversight of charter holders and the schools that they operate, strives not to be over-reaching, but also recognizes the need to protect the public's interests. Because charter schools are public schools they must maintain the public's trust that they are implementing their education program as set out in the charter, spending public funds responsibly, and adhering to laws and charter requirements regarding their operations. However, the Board is aware of the delicate balance between appropriate oversight and infringement on autonomy.

In developing the financial framework, the Board remained conscious of its limited resources to implement the financial framework. The Board was also mindful of its commitment to maintaining current levels of data collection so as not to unnecessarily burden the charter holders with requirements to submit additional information for the purpose of evaluating the financial performance of the charter holder.

FINANCIAL PERFORMANCE FRAMEWORK STRUCTURE

The financial framework, which has been included as Appendix A, gauges both near-term financial health and longer term financial sustainability. The portion of the financial framework that tests a charter holder's near-term financial health is designed to depict the charter holder's financial position and viability for the upcoming year. The portion of the financial framework that tests a charter holder's longer term financial sustainability is designed to depict the charter holder's financial position and viability over time. Charter holders meeting the desired standards demonstrate a low risk of financial distress. Charter holders not meeting the desired standards may currently be experiencing financial difficulties and/or may be at a higher risk for financial hardship in future.

The financial framework includes five main levels of information: Indicators, Measures, Metrics, Targets, and Ratings. In addition to the information found below, the financial framework's measures, metrics, targets, and ratings are further described in the "Measures in Detail" section of this guidance.

Indicators

Indicators are general categories of financial performance used to identify the financial information that best reflects the current financial status of a charter holder versus the information that better depicts the future financial viability of the charter holder. Near-Term Indicators and Sustainability Indicators are used in the financial framework.

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Measures
Measures are the general means to evaluate an aspect of an indicator. Seven measures are used in the financial framework: Going Concern, Unrestricted Days Cash, Default, Total Liabilities to Equity Ratio, Net Income, Cash Flow, and Fixed Charge Coverage Ratio.

Metrics
Metrics are a means for evaluating measures. As an example, the formula for evaluating Net Income is total revenues less total expenses.

Targets
Targets are the thresholds set to determine whether performance for a specific measure has been met or not. Using the Net Income measure again, the Board has set the target for the "Meets Standard" rating as Net Income is greater than or equal to $1.

Ratings
For each measure a charter holder receives one of three ratings based on whether the charter holder met the target.

Meets Standard
The charter holder's performance on this component does not signal a financial risk to the charter holder and meets the Board's expectation. Meeting the standard requires no follow up action by the Board.

Does Not Meet Standard
The charter holder's performance on this component signals a moderate financial risk to the charter holder and does not meet the Board's expectation. This indicator may require follow up depending on the interplay with other indicators. Charter holders may also be limited in their ability to expand their operations. Charter holders not meeting the standard across more than one area are required to submit additional information as part of a five-year interval review and renewal. Not meeting the standard may have an adverse impact on the consideration of the renewal application package or at other times when disciplinary action is considered.

Falls Far Below Standard
The charter holder's performance on this component signals a potentially significant financial risk to the charter holder and is far below the Board's expectation. Falling far below the standard may have an adverse impact on the consideration of the renewal application package or at other times when disciplinary action is considered. Charter holders are required to submit additional information as part of a five-year interval review and renewal. Charter holders may be limited in their ability to expand their operations.

USING THE FINANCIAL PERFORMANCE FRAMEWORK

Collecting Evidence
The annual statutorily required audits conducted by independent certified public accountants provide the information necessary to determine a charter holder's financial performance. In

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accordance with the parameters established in the Board's Strategic Plan, the financial framework uses information already collected by the Board to assess charter holders' financial performance and does not require charter holders to provide additional information for rating determinations.

The following information from the annual audit reporting packages will be used:

- Independent Auditor's Report on the financial statements
- Audited statement of financial position
- Audited statement of activities and changes in net assets
- Audited statement of cash flows
- Notes to the audited financial statements
- Applicable compliance questionnaire

Since a large percentage of the Board's charter contracts are with non-profit entities, throughout this document the financial statements will be referred to using non-profit terminology. Statements reported in for-profit or governmental audits use the following corresponding names:

Non-profit	For-profit	Governmental
Statement of Financial Position	Balance Sheet	Statement of Net Assets
Statement of Activities and Changes in Net Assets[1]	Income Statement	Statement of Activities
Statement of Cash Flows	Statement of Cash Flows	Statement of Cash Flows (Note: This statement is required only under certain circumstances.)

Through ASBCS Online, the Board has provided online public access to the audit reporting packages of Board and State Board of Education sponsored charter holders. Information about how to access the annual audit reporting packages through ASBCS Online is available on the Board's website.

Evaluation

The established targets are used to determine whether the charter holder is meeting each measure based on the available existing data. The evaluation is completed using the charter holder's most recent audit reporting package.

A charter holder's financial performance will be used by the Board during the term of the charter:

- To stipulate the conditions which waive the charter holder from any submission requirements related to its financial operations; and/or
- To stipulate the conditions which require the charter holder to submit additional information or clarification that will be used to inform the Board's decision-making.

A charter holder's financial performance will be considered by the Board during five-year interval reviews, when making decisions about eligibility for expansion, and in considering

[1] This statement may also be referred to as the "statement of activities".

whether to renew the charter contract. Financial performance will also be evaluated when considering the following expansion requests:

- New School Site Notification Requests
- Arizona Online Instruction Program of Instruction Amendment Requests
- Replication applications[2]
- Transfer applications involving the transfer of the charter contract from another sponsor to the Board

Because financial health can affect a charter holder's ability to meet the obligations of its charter contract and applicable laws, a charter holder's financial performance may also be reviewed at other times when the Board makes decisions related to a charter holder's academic and/or operational performance.

Intervention

For renewal and five-year interval purposes and as part of certain expansion requests[3], a charter holder that receives two or more "Does Not Meet Standard" and/or one or more "Falls Far Below Standard" will be required to submit additional information to the Board.[4] This information will be used by the Board to inform its decision-making. While the charter holder is required to submit additional information, the Board has not prescribed the specific information that must be submitted. The charter holder's response should focus on each area where the charter holder received a "Does Not Meet Standard" or "Falls Far Below Standard". For examples of items that the charter holder may want to consider addressing in or including with its required response, please see "Things to Consider if Required to Submit Additional Information".

As part of requesting to add a site or an Arizona Online Instruction program/school, a charter holder that receives two or more "Does Not Meeting Standard" and/or one or more "Falls Far Below Standard" will be required to submit a budget for the proposed site/program along with the required response referred to in the paragraph above.

If a charter holder submits a request to add a site or an Arizona Online Instruction program/school prior to the Board receiving the charter holder's first audit reporting package, the charter holder will be required to submit internal, unaudited financial statements for the fiscal year(s) to date along with the budget for the proposed site/program.

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[2] After the Board finalizes the academic, operational, and financial performance frameworks, it may review the existing replication eligibility criteria. As part of that review, the Board may determine that a charter holder receiving two or more "Does Not Meet Standard" and/or one or more "Falls Far Below Standard" under the financial framework is not eligible for replication.

[3] A charter holder's financial performance will be reviewed after requests are received to add a site, replicate, add an Arizona Online Instruction program or school, or transfer charter sponsorship to the Board. Please note that after the Board finalizes the academic, operational, and financial performance frameworks, it may review the existing replication eligibility criteria. As part of that review, the Board may determine that a charter holder receiving two or more "Does Not Meet Standard" and/or one or more "Falls Far Below Standard" under the financial framework is not eligible for replication.

[4] In those instances where the Board receives financial statements that cover multiple and different charter holder entities, the charter holder's performance will be evaluated under the financial framework using the charter holder specific financial information and the financial information for the consolidated/combined entity. Failure of the individual charter holder <u>or</u> the consolidated/combined entity to meet the financial framework will result in the charter holder being required to submit additional information under this section.

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As indicated in the "Evaluation" section, a charter holder's financial performance will be provided to the Board when the Board makes decisions related to a charter holder's academic and/or operational performance.

MEASURES IN DETAIL

The next eight pages describe each of the measures included in the financial framework. A charter holder's financial performance is evaluated using the charter holder's most recent audit reporting package. It is important to note that the financial framework excludes measures of how a charter holder manages and expends its funds as the financial framework is not designed to evaluate a charter holder's spending decisions. For example, there are no measures that address what portion of the costs are for direct instruction; rather the measures focus on the overall expenses versus the offsetting revenues. The financial framework analyzes the financial performance of a charter holder, not its processes for managing that performance.

1a. Going Concern – Near-Term Indicator

Definition: Going concern is the idea that the charter holder will continue to engage in its activities for the foreseeable future.

Overview: Auditing standards require an auditor to evaluate an organization's ability to continue operating for the next year. If the auditor has substantial doubt about whether the organization will operate for at least the next year, then the independent auditor's report would include a paragraph explaining this concern and information, including management's plans, would be disclosed in the notes to the audited financial statements. The auditor's consideration of management's plans may alleviate the "substantial doubt" about the organization's ability to continue operating. In those instances, the auditor may disclose in the notes to the audited financial statements the conditions and events that initially caused the auditor to believe there was substantial doubt, but wouldn't include a paragraph in the independent auditor's report.

Source of Data: Independent Auditor's Report on the financial statements and the notes to the audited financial statements.

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1a. Going Concern
Meets Standard: ☐ The most recent audit reporting package does not include explanatory paragraph in Independent Auditor's Report or disclosure in the notes to the financial statements
Does Not Meet Standard: No "Does Not Meet Standard" target established for this measure
Falls Far Below Standard (in one of two ways): ☐ Independent Auditor's Report for the most recent audit reporting package includes an explanatory paragraph and disclosure is included in notes to the financial statements or ☐ Disclosure included in notes to the financial statements for the most recent audit reporting package, but no modification to Independent Auditor's Report

Basis for Target Level: If the audit reporting package includes a going concern disclosure in the independent auditor's report or the notes to the audited financial statements, then the independent auditor has concerns about the charter holder's viability. A charter holder in this situation may have difficulty meeting operational and academic obligations required under law and its charter contract.

1b. Unrestricted Days Cash – Near-Term Indicator

Definition: *The unrestricted days cash ratio indicates how many days a charter holder can pay its expenses without another influx of cash.*

Overview: Unexpected costs arise when operating a charter school. Additionally, circumstances outside of the charter holder's control may impact the amount and timing of funding received from the State and other sources. Therefore, maintaining a cash reserve is a common best practice. The unrestricted days cash ratio translates a charter holder's unrestricted cash balance into a more readily understandable number. Please note that the Board will not round numbers when determining a charter holder's financial performance on this measure.

A.R.S. §15-977 limits how Classroom Site Fund (CSF) monies may be spent. Therefore, if a charter holder does not spend all of the CSF monies it received during the fiscal year, then at the end of the year, the charter holder needs to have enough cash in the bank to cover the unspent portion from current and prior years ("carryover"). Since the CSF carryover monies may only be used for the purposes specified in statute, any year-end CSF cash carryover balance will be removed when determining the charter holder's unrestricted cash.

Source of Data: Audited statement of financial position, audited statement of activities and changes in net assets, notes to the audited financial statements, and compliance questionnaire[5].

[5] For fiscal years prior to and including 2011, the year-end Classroom Site Fund cash carryover was not required to be disclosed in the audit reporting package. Beginning with fiscal year 2012, the year-end CSF cash carryover must, at a minimum, be disclosed in the Classroom Site Fund section of the applicable compliance questionnaire.

1b. Unrestricted Days Cash: Unrestricted Cash divided by (Total Expenses/365) *[Note: The Classroom Site Fund cash carryover balance at June 30th would be considered restricted cash and, therefore, would be removed as part of identifying a charter holder's unrestricted cash as of June 30th.]*
Meets Standard: ☐ 30 or more days cash
Does Not Meet Standard: ☐ At least 15 days cash but fewer than 30 days cash
Falls Far Below Standard: ☐ Fewer than 15 days cash

Basis for Target Level: Having cash on hand equaling at least 30 days of operating expenses is a standard minimum for any organization. In the event of unforeseen circumstances (e.g., unexpected costs, changes to State funding), 30 days of cash would help the charter holder make payroll, pay the rent, and keep the charter school's doors open until the charter holder receives its next State equalization payment or until other funding is secured. If a charter holder has fewer than 15 days cash on hand, should unforeseen circumstances arise, the charter holder may have difficulty making its next payroll and meeting other obligations before receiving its next influx of cash.

1c. Default – Near-Term Indicator

Definition: Default indicates that a lender has issued a formal notice of loan default to the charter holder.

Overview: In addition to making timely payments, financial institutions may include other terms and requirements (sometimes referred to as "covenants") in their agreements with charter holders. Individuals who make loans to charter holders may establish agreements with similar requirements. Failure to make timely payments or comply with debt covenants does not automatically result in a formal notice of default being issued by the lender and therefore would not be considered a "material" default. However, in those cases where formal notice of default has been issued by the lender, this measure will be rated "Falls Far Below Standard".

Source of Data: Notes to the audited financial statements.

1c. Default: Defined as in True Default on Obligations
Meets Standard: ☐ Charter holder is not in default on material loans
Does Not Meet Standard: No "Does Not Meet Standard" target established for this measure
Falls Far Below Standard: ☐ Charter holder is in default on material loans

Basis for Target Level: A charter holder that has received formal notice of default from a lender

may be at higher risk of financial distress and may have difficulty meeting its operational and academic obligations required under law and the charter contract.

2a. Total Liabilities to Equity Ratio – Sustainability Indicator

Definition: The total liabilities to equity ratio reflects how leveraged the charter holder is. Equity, which is sometimes referred to as net worth, equals total assets minus total liabilities. For non-profits, nets assets reflect the charter holder's equity. For for-profits, depending on the charter holder's structure, the ratio would use members' equity, shareholders' equity, or stockholders' equity. The ratio is calculated by dividing total liabilities by net assets.

Overview: The ratio shows the level to which the charter holder is relying on outside funding, such as loans. Therefore, charter holders that lease properties will have lower ratios than charter holders that own and have a loan. A charter holder with a high ratio or a negative ratio may not be able to generate enough cash from operations to satisfy its obligations. Please note that the Board will not round numbers when determining a charter holder's financial performance on this measure.

Source of Data: Audited statement of financial position.

2a. Total Liabilities to Equity Ratio: Total Liabilities divided by Net Assets
Meets Standard: ☐ Total Liabilities to Equity Ratio is positive and less than or equal to 4.0
Does Not Meet Standard: ☐ Total Liabilities to Equity Ratio is positive and greater than 4.0
Falls Far Below Standard: ☐ Total Liabilities to Equity Ratio is negative

Basis for Target Level: Lenders usually prefer low ratios. The "meets" target used by the Board is a fairly standard convention in banking that indicates a fairly leveraged entity. A total liabilities to equity ratio of 4.0 indicates that a charter holder has four times the amount of liabilities than equity, or put another way, for every $1 in equity, the charter holder owes $4.

2b. Net Income – Sustainability Indicator

Definition: Net income, which equals total revenues less total expenses, looks at whether or not a charter holder is operating within its available resources.

Overview: The net income measure identifies whether a charter holder operates at a surplus (total revenues exceed total expenses) or a deficit (total expenses exceed total revenues). It should be noted that a charter holder may make a strategic choice to operate at a deficit for a year. Continued deficits for a sustained period of time could adversely affect the charter holder's ability to meet its obligations.

Source of Data: Audited statement of activities and changes in net assets.

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2b. Net Income: Total Revenues less Total Expenses
Meets Standard: ☐ Net income is greater than or equal to $1
Does Not Meet Standard: ☐ Net income is zero or negative
Falls Far Below Standard: No "Falls Far Below Standard" target established for this measure

Basis for Target Level: Positive net income contributes to the charter holder's reserve. Having a reserve gives the charter holder more flexibility in responding as situations arise that are outside of the charter holder's control. The targets established for this measure focus on whether the charter holder operated during the fiscal year with a surplus or deficit rather than the magnitude of the surplus or deficit.

2c. Cash Flow – Sustainability Indicator

Definition: The cash flow measure shows the change in a charter holder's cash balance from one fiscal year to another.

Overview: This measure is similar to the unrestricted days cash measure, but looks at longer term financial stability versus near-term financial health. Since cash flow fluctuations from year-to-year can have a long-term impact on the charter holder's financial health, this measure assesses both three-year cumulative cash flow and annual cash flow. For information regarding the underlying factors that have contributed to the cash flow fluctuations experienced by the charter holder, please review the audited statement of cash flows. If the Board has received only one or two audit reporting packages at the time of review, the charter holder's financial performance under this measure will be evaluated using the information available.

Cash Flow Calculation Example

Calculate the annual cash flow:
FY2012 Cash Flow = FY2012 Total Cash – FY2011 Total Cash
FY2011 Cash Flow = FY2011 Total Cash – FY2010 Total Cash
FY2010 Cash Flow = FY2010 Total Cash – FY2009 Total Cash

Add together the FY2012 Cash Flow, FY2011 Cash Flow, and FY2010 Cash Flow to determine the three-year cumulative cash flow.

The three-year cumulative cash flow could also be calculated by subtracting FY2009 Total Cash from FY2012 Total Cash. However, if the three-year cumulative cash flow is positive, you will still need to know the annual cash flows in order to determine whether the charter holder receives a "Meets Standard" or "Does Not Meet Standard".

In determining a charter holder's performance on this measure the first time, you will need to have the most recent four fiscal years of audited statements of financial position. After the initial calculations have been made, for subsequent fiscal years, you will only need to add the most current fiscal year's cash flow information to and remove the oldest fiscal year's cash flow information from the calculation. For each fiscal year, the cash flow equals the current year's total cash minus the prior year's total cash. Adding the cash flow for each of the three fiscal years together will provide the three-year aggregate cash flow. The "Cash Flow Calculation Example" textbox found on this page shows how to calculate the cash flow measure using fiscal year 2012 as the most recent audited fiscal year available.

Source of Data: Audited statement of financial position.

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2c. Cash Flow: One-Year Cash Flow = Current Year Total Cash less Prior Year Total Cash
Meets Standard (in one of two ways): ☐ Three-year cumulative cash flow is positive *and* cash flow is positive each year or ☐ Three-year cumulative cash flow is positive, cash flow is positive in two of three years, *and* cash flow in the most recent year is positive
Does Not Meet Standard (in one of two ways): ☐ Three-year cumulative cash flow is negative or ☐ Three-year cumulative cash flow is positive, but does not meet "Meets Standard"
Falls Far Below Standard: No "Falls Far Below Standard" target established for this measure

Basis for Target Level: Cash flow should be greater than zero as a positive cash flow over time generally indicates increasing financial health and sustainability of the charter holder.

2d. Fixed Charge Coverage Ratio – Sustainability Indicator

Definition: The fixed charge coverage ratio looks at the amount of cushion in the charter holder's cash flow to cover fixed obligations or charges.

Overview: Fixed charges represent the charter holder's fixed financial commitments. These charges occur regardless of changes in revenue or other circumstances that may affect the charter holder's financial situation, which is why the term "fixed" is used. For this ratio, fixed charges would include lease payments, loan payments, and interest.

The ratio includes interest and lease expense in both the numerator and denominator even though it appears that in the end they would cancel each other out. This has been done for two reasons. First, because the ratio components are more encompassing, it helps in determining the true cushion in cash flow to cover fixed obligations. Second, if the ratio's numerator included only change in net assets, depreciation and amortization and the denominator was unchanged, the ratio would solve for a charter holder's ability to meet lease and interest expense payments after it has already paid lease and interest expense, because lease and interest expense have already been deducted to arrive at the change in net assets.

The individual ratio components are described in more detail below:

- *Change in Net Assets* – The change in net assets results from revenues, expenses and the release of assets from restrictions. For for-profit charter holders, the ratio would use net income after tax instead of change in net assets.
- *Depreciation* – Depreciation is the allocation of a fixed asset's costs over the useful life of the asset and involves the movement of costs from the statement of financial position to the statement of activities and changes in net assets. Fixed assets include items such as buildings, furnishings and vehicles. Depreciation is known as a noncash expense. Although charter holders are required to record this expense in their accounting records, depreciation does not use cash. Therefore, depreciation is added back into the ratio's numerator.

- *Amortization* – Amortization is similar to depreciation but it involves the allocation of an intangible asset's costs over a period of time. Intangible assets include items such as bond issuance costs. Although charter holders are required to record this expense, as applicable, in their accounting records, amortization does not use cash. Therefore, amortization is added back into the ratio's numerator.
- *Interest Expense* – Interest expense reflects the charter holder's cost of borrowing for the fiscal year. As a result of the accounting method charter holders are required to use, interest expense may not equal the amount of cash paid to lenders. Interest paid reflects the cash paid to lenders for interest and may be higher or lower than the interest expense for the fiscal year. In calculating the ratio, the dollar amount used for "interest expense" would also be used for "interest".
- *Lease Expense* – Lease expense includes facility leases and operating leases where at the end of the lease ownership of the item does not transfer to the charter holder.
- *Current Portion of Long-Term Debt and Capital Leases (CPLTDCL)* – The CPLTDCL includes the portion of debt that must be paid by the charter holder within the next fiscal year. The "current portion of long-term debt" would include bond/loan payments for charter holders that own their facilities, as well as payments related to other long-term loans obtained by the charter holder and capital leases.

Please note that the Board will not round numbers when determining a charter holder's financial performance on this measure.

Source of Data:

- Changes in Net Assets – Audited statement of activities and changes in net assets.
- Depreciation and Amortization – Audited statement of cash flows and/or notes to the audited financial statements.
- Interest Expense – Notes to the audited financial statements. Interest expense may also be available on the audited statement of activities and changes in net assets, if the statement includes sufficient detail, or the statement of functional expense, if available. If interest expense cannot be determined, interest paid may be used and is found on the statement of cash flows.
- Lease Expense – Notes to the audited financial statements.
- Current Portion of Long-Term Debt and Capital Leases – Audited statement of financial position.

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2d. Fixed Charge Coverage Ratio: (Change in Net Assets* + Depreciation + Amortization + Interest Expense + Lease Expense)/(Current Portion of Long-Term Debt and Capital Leases + Interest + Lease Expense)   **** Net Income After Tax would be used when calculating the ratio for for-profit charter holders.***
Meets Standard: ☐ Fixed Charge Coverage Ratio is equal to or exceeds 1.10
Does Not Meet Standard: ☐ Fixed Charge Coverage Ratio is less than 1.10
Falls Far Below Standard: No "Falls Far Below Standard" target established for this measure

Basis for Target Level: Financially healthy entities have a cushion in cash flow coverage. The 1.1 used in the "meets" target is typical for non-profit organizations. Since capitalized expenses, such as buses and equipment, are not included in the statement of activities and changes in net assets, they need to be covered by the cushion in cash flow or through outside financing. Another benefit of excess cash flow is that a charter holder can build up cash and equity to purchase larger assets, such as a building. Since banks will only finance up to a certain amount of the building, the difference needs to be funded by the charter holder. The only way to build up cash/equity is through retention of the earnings cushion or from an injection of equity from an outside source. Charter holders that operate where fixed charges are only covered at 1:1 will not have the same flexibility as those that generate cash flow in excess of that level.

THINGS TO CONSIDER IF REQUIRED TO SUBMIT ADDITIONAL INFORMATION[6]

For those charter holders required to submit information related to their financial performance for renewal or five-year interval purposes or as part of certain expansion requests[7], the table found on the next page includes examples of items that the charter holder may want to consider addressing in or including with its response. The Board has not prescribed the specific information that must be submitted, but the charter holder's response should focus on each measure where the charter holder received a "Does Not Meet Standard" or "Falls Far Below Standard". The charter holder's response should not address all measures in the financial framework unless the charter holder failed to meet the standard for all measures.

In preparing the required response that will be submitted to the Board, the charter holder should evaluate its own financial situation and, for those measures where the charter holder failed to meet the standard, determine the information that will best explain the charter

[6] This section may also be useful to charter holders as part of their ongoing efforts to monitor financial performance. For example, a charter holder may use the information in this section to improve its financial performance, so that by the time it must undergo a five-year interval review or apply for renewal, its financial performance will be such that it will be waived from being required to submit additional information.

[7] If a charter holder submits a request to add a site or an Arizona Online Instruction program/school prior to the Board receiving the charter holder's first audit reporting package, the charter holder will be required to submit internal, unaudited financial statements for the fiscal year(s) to date along with the budget for the proposed site or program.

holder's situation and/or efforts. Although listed separately in the table, to some extent, certain measures may relate to one another. Therefore, in the required response, it may be appropriate for the charter holder to refer to its performance under a measure that met the standard when addressing a measure that did not meet or fell far below the standard.

Please note that the examples included in the table below are just that. The information in the table is not meant to be exhaustive, but serves as a starting point to assist charter holders. By including the table, the Board is not intending to limit what a charter holder may address in or submit with its response.

Measure	For Ratings of "Does Not Meet" or "Falls Far Below" Consider Demonstrating...
1a. Going Concern	❖ The issue resulting in the auditor's "going concern" designation has been resolved or is in the process of being resolved.
1b. Unrestricted Days Cash	❖ The charter holder has access to a line of credit. ❖ The charter holder has access to other sources of liquidity, including related parties, to augment liquidity needs. ❖ The charter holder expects a receipt of cash from a grant, etc.
1c. Default	❖ The charter holder is no longer in default. ❖ The charter holder's efforts to resolve the lender's concerns, so that the default status can be lifted.
2a. Total Liabilities to Equity Ratio	❖ The charter holder's cash flow results in "Meets" for the Fixed Charge Coverage Ratio and is sufficient to meet liabilities. ❖ The charter holder has built up cash and satisfies the "Meets" rating for Unrestricted Days Cash. ❖ The charter holder is profitable and expects to build equity to lower the ratio in future periods.
2b. Net Income	❖ The net loss was from non-recurring events that will not occur in future periods. ❖ The charter holder has reduced expenses to meet the minimum requirement in future periods. ❖ Student counts for the charter holder will increase in future periods to result in positive change in net assets.
2c. Cash Flow	❖ The charter holder meets the other financial requirements and had positive cash flow for the most recent year. ❖ The charter holder has sufficient cash to fund cash deficiencies for the foreseeable future. ❖ The charter holder has increased revenue or reduced expenses that will result in positive cash flow in the next fiscal year.
2d. Fixed Charge Coverage Ratio	❖ The charter holder has sufficient cash to augment cash flow to fund fixed charges for the foreseeable future. ❖ The charter holder's income is expected to improve which will result in "Meets" for the Fixed Charge Coverage Ratio in the next fiscal year. ❖ The charter holder's fixed charges are expected to decline which will result in a "Meets" for the Fixed Charge Coverage Ratio.

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DEFINITION OF TERMS

AUDIT – A systematic collection of the sufficient, competent evidential matter needed to attest to the fairness of management's assertions in the financial statements or to evaluate whether management has efficiently and effectively carried out its responsibilities. The auditor obtains this evidential matter through inspection, observation, inquiries, and confirmations with third parties.

AUDIT REPORTING PACKAGE – The annual audit required by A.R.S. §15-914 includes several components, including the financial statements, a report on internal control and compliance required under auditing standards, the applicable compliance questionnaire(s), and the management letter, if one is issued by the audit firm. For a charter holder that expends more than $500,000 in federal awards (e.g., federal grants), the audit reporting package submitted would include additional information and documents.

COMPLIANCE QUESTIONNAIRE – As part of the annual audit required by A.R.S. §15-914, the auditor must complete the appropriate compliance questionnaire(s). The compliance questionnaires assist the Board in determining whether a charter holder is complying with certain legal and contractual requirements. The Board currently issues three compliance questionnaires – the Legal Compliance Questionnaire, the USFRCS Compliance Questionnaire[8], and the Procurement Compliance Questionnaire. For most charter holders, the Legal Compliance Questionnaire is the only compliance questionnaire that must be completed.

FINANCIAL AUDIT – An audit made by an independent external auditor for the purpose of issuing an audit opinion on the fair presentation of the financial statements in conformity with GAAP. Refer to AUDIT.

FISCAL YEAR – The twelve-month period that begins on July 1st and ends on June 30th.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) – These are the uniform minimum standards for financial accounting and reporting. They govern the form and content of the financial statements of an entity. GAAP encompass the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. They include not only broad guidelines of general application, but also detailed practices and procedures. The primary authoritative body on the application of GAAP for most charter holders is the Financial Accounting Standards Board.

NOTES TO THE AUDITED FINANCIAL STATEMENTS – Sometimes referred to as disclosure notes, the notes follow immediately after the financial statements. In addition to summarizing certain accounting policies used by the charter holder, the financial statements may include information regarding leases the charter holder has entered into, loans the charter holder has received (sometimes referred to as "notes") and its compliance with loan terms, and restrictions on the charter holder's cash.

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[8] USFRCS stands for Uniform System of Financial Records for Charter Schools.

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STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS – This financial statement shows what made up the charter holder's revenue and expenses for the fiscal year. Generally, revenue is shown by type and expenses are shown by program type (i.e., program services, management and general). This statement also shows whether a charter holder operated at a surplus (total revenues exceed total expenses) or a deficit (total expenses exceed total revenues), as well as the change in net assets. This statement is also referred to as the income statement (for-profit) or the statement of activities (governmental).

STATEMENT OF CASH FLOWS – This financial statement shows where the charter holder's cash came from and how the cash was used during the fiscal year. It categorizes cash activity as resulting from operating, investing, and capital and related financing activities.

STATEMENT OF FINANCIAL POSITION – This financial statement shows the charter holder's assets, liabilities, and net assets as of June 30th. Assets are what the charter holder owns, liabilities are what the charter holder owes, and net assets are the difference between the two. Net assets represent any surpluses (total assets exceed total liabilities) or deficits (total liabilities exceed total assets) that have accumulated since the charter holder was formed. This statement is also referred to as the balance sheet (for-profit) or the statement of net assets (governmental).

STATEMENT OF FUNCTIONAL EXPENSE – This financial statement shows a detailed breakdown of expenses by expense type and by program and supporting services. While not required for charter holder audits, some audit reporting packages received by the Board include this additional statement.

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APPENDIX A

FINANCIAL PERFORMANCE FRAMEWORK

FINANCIAL PERFORMANCE FRAMEWORK

ARIZONA STATE BOARD FOR CHARTER SCHOOLS

Board Strategic Plan Objective: All charter holders in the portfolio are viable organizations with strong fiscal management practices.

1. NEAR-TERM INDICATORS

1a. Going Concern
Meets Standard: ☐ The most recent audit reporting package does not include explanatory paragraph in Independent Auditor's Report or disclosure in the notes to the financial statements
Does Not Meet Standard: No "Does Not Meet Standard" target established for this measure
Falls Far Below Standard (in one of two ways): ☐ Independent Auditor's Report for the most recent audit reporting package includes an explanatory paragraph and disclosure is included in notes to the financial statements or ☐ Disclosure included in notes to the financial statements for the most recent audit reporting package, but no modification to Independent Auditor's Report

1b. Unrestricted Days Cash: Unrestricted Cash divided by (Total Expenses/365) ***[Note: The Classroom Site Fund cash carryover balance at June 30th would be considered restricted cash and, therefore, would be removed as part of identifying a charter holder's unrestricted cash as of June 30th.]***
Meets Standard: ☐ 30 or more days cash
Does Not Meet Standard: ☐ At least 15 days cash but fewer than 30 days cash
Falls Far Below Standard: ☐ Fewer than 15 days cash

1c. Default: Defined as in True Default on Obligations
Meets Standard: ☐ Charter holder is not in default on material loans
Does Not Meet Standard: No "Does Not Meet Standard" target established for this measure
Falls Far Below Standard: ☐ Charter holder is in default on material loans

2. SUSTAINABILITY INDICATORS

2a. Total Liabilities to Equity Ratio: Total Liabilities divided by Net Assets
Meets Standard: ☐ Total Liabilities to Equity Ratio is positive and less than or equal to 4.0
Does Not Meet Standard: ☐ Total Liabilities to Equity Ratio is positive and greater than 4.0
Falls Far Below Standard: ☐ Total Liabilities to Equity Ratio is negative

2b. Net Income: Total Revenues less Total Expenses
Meets Standard: ☐ Net income is greater than or equal to $1
Does Not Meet Standard: ☐ Net income is zero or negative
Falls Far Below Standard: No "Falls Far Below Standard" target established for this measure

2c. Cash Flow: One-Year Cash Flow = Current Year Total Cash less Prior Year Total Cash
Meets Standard (in one of two ways): ☐ Three-year cumulative cash flow is positive *and* cash flow is positive each year or ☐ Three-year cumulative cash flow is positive, cash flow is positive in two of three years, *and* cash flow in the most recent year is positive
Does Not Meet Standard (in one of two ways): ☐ Three-year cumulative cash flow is negative or ☐ Three-year cumulative cash flow is positive, but does not meet "Meets Standard"
Falls Far Below Standard: No "Falls Far Below Standard" target established for this measure

2d. Fixed Charge Coverage Ratio: (Change in Net Assets* + Depreciation + Amortization + Interest Expense + Lease Expense)/(Current Portion of Long-Term Debt and Capital Leases + Interest + Lease Expense) **** Net Income After Tax would be used when calculating the ratio for for-profit charter holders.***
Meets Standard: ☐ Fixed Charge Coverage Ratio is equal to or exceeds 1.10
Does Not Meet Standard: ☐ Fixed Charge Coverage Ratio is less than 1.10
Falls Far Below Standard: No "Falls Far Below Standard" target established for this measure