Financial Performance Framework

DETERMINING A CHARTER HOLDER'S PERFORMANCE UNDER THE FRAMEWORK

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Introduction

The annual statutorily required audits conducted by independent certified public accountants and the average daily membership ("ADM") calculations completed by the Arizona Department of Education ("Department") using student attendance data submitted to the Department by the charter holder provide the information necessary to determine a charter holder's performance on the Financial Performance Framework's ("financial framework") six measures.

For each measure, this document identifies how performance is calculated and where to find the information used to determine a charter holder's performance. This charter holder resource should be used together with the *Measures and Summative Performance Ratings Guide* available on the Board's website in the "Financial Performance Framework" section.

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. The financial statement names used in non-profit and for-profit audits are identified below.

Non-profit	For-profit
Statement of Financial Position	Balance Sheet
Statement of Activities and Changes in Net Assets (referred to as Statement of Activities)	Income Statement
Statement of Cash Flows	Statement of Cash Flows

Going Concern

Accounting principles require charter holder management to evaluate their entity's ability to continue operating. The assumption is that the entity intends and is able to continue to engage in its activities. If management's evaluation identifies no conditions or events that raise substantial doubt about their entity's ability to continue operating, then no further action is required of management and no disclosure is required in the entity's financial statements. However, if conditions or events are identified that do raise substantial doubt, then management must evaluate its plans related to these conditions or events, determine whether its plans alleviate the substantial doubt about the entity's ability to continue operating, and make certain disclosures in the entity's financial statements.

Under auditing standards, the charter holder's independent CPA audits the conclusion reached by management.

Substantial Doubt Raised and Not Alleviated by Management's Plans

If the charter holder's audit raises substantial doubt about the charter holder's ability to continue operating and this doubt is not alleviated by management's plans (see example on next page), then the charter holder receives a "Below Standard" on this measure. Under this scenario, the Independent Auditor's Report will include an "emphasis of matter" or similar paragraph that begins "The accompanying financial statements have been prepared assuming…" If the "emphasis of matter" paragraph does not include this language, see the "Substantial Doubt Raised and Alleviated by Management's Plans" subsection.

Board of Directors
[redacted]
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Emphasis-of-Matter Regarding Going Concern
The accompanying financials statements have been prepared assuming that the School will continue as a going concern. As discussed in Note 8 to the financial statements, the School has suffered significant deficits in unrestricted net assets, has a net deficiency in net assets, and current liabilities significantly exceeded current assets as of June 30, 2018 that raise substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 8. The financial statments do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to that matter.

Other Reporting Required by *Government Auditing Standards*
In accordance with *Government Auditing Standards*, we have also issued our report dated February 20, 2019, on our consideration of [redacted] internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering [redacted] internal control over financial reporting and compliance.

Substantial Doubt Raised and Alleviated by Management's Plans

If the charter holder's audit raises substantial doubt about the charter holder's ability to continue operating and this doubt is alleviated by management's plans, then the charter holder receives a "Below Standard" on this measure. <u>Under this scenario, disclosure will typically only be made in the notes to the audited financial statements (see examples below).</u>

Inter-school Loan Commitments and Funding Requirements

The School has sustained a sizeable loss and negative cash flow from operations for the year ended June 30, 2018. Management believes that this is a result of significant start-up costs associated with the School and lower than expected enrollment. The School has also used substantial amounts of borrowed cash in building and equipping its campus facilities (see Notes 5 and 6). As of June 30, 2018, the School had approximately $435,000 of unrestricted cash and approximately $13,844,000 of outstanding debt. These factors initially indicated that future cash flows may not be sufficient for the School to meet its obligations as they become due in the ordinary course of business for a period of twelve months following the date these financial statements are available to be issued.

The [redacted] structure obligates the members to support each other financially in order to continue to service the Bonds payable and meet all Bond Covenants. As a member of the [redacted] the School has the ability to borrow funds from the other members of the [redacted]. The School and the members of the [redacted] maintain resolutions whereby the School and the members can borrow from and lend to each other, as may be needed. The [redacted] resolutions require that the loans mature within sixty months and that the loan amounts not exceed $500,000 to any one school without additional board approval. The [redacted] resolution, as amended, requires that the loans mature within sixty months and that the loan amounts not exceed $1,250,000 to any one school without additional board approval. [redacted] and the School's resolutions, as amended, require that the loans mature within eighty-four months and that the loan amounts not exceed $2,000,000 to any one school without additional board approval.

Management believes that as a result of the [redacted] agreement noted above, the structure of the Series 2016 Bonds (first principal payment not due to bond holders until July 1, 2020), and the realized increase in enrollment for the for the 2018-2019 school year, the School currently has sufficient cash and financing commitments to meet its obligations as they become due in the ordinary course of business for a period of twelve months following the date these financial statements are available to be issued.

NOTE 12 NET ASSET DEFICIT – MANAGEMENT PLAN

The financial statements have been prepared as a going concern basis which assumes that will continue in operation for the foreseeable future and will be able to discharge its liabilities and commitments in the normal course of operations.

The financial statements reflected a net loss of $1,359,122 for the year ended June 30, 2018. This is a $1,343,984 improvement from the prior year. Additionally, as of that date, its total liabilities exceeded total assets by $7,740,960. While total liabilities exceeded total assets the percentage of negative equity improved. The percentage of negative equity change from FY15 to FY16 was -154%, from FY16 to FY17 was -72%, and from FY17 to FY18 was -20%.

Management has evaluated these conditions and believes the organization has sufficient plans to continue operations and meet bond debt obligations over at least the next 12 months. However, management has also determined that increases in net assets are necessary for the next several years to increase cash flow which will be used to eliminate current liabilities. Details of the management plan include disposing of some assets, a reduction of expenses, and an increase in revenue. These changes are part of a longer-term plan to strengthen financial position.

In some cases (see example below), disclosure in the notes to the audited financial statements may be accompanied by an "emphasis of matter" disclosure in the Independent Auditor's Report. This "emphasis of matter" disclosure will differ from the one addressed in the "Substantial Doubt Raised and Not Alleviated by Management's Plans" subsection as it will not include "The accompanying financial statements have been prepared assuming..." language.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of as of June 30, 2018, and the results of its operations, changes in members equity and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 10 to the financial statements, the School has suffered recurring losses and has a deficiency in member's equity. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note 10. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 18, 2018 on our consideration of the School's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and

NOTE 10 - GOING CONCERN

As of June 30, 2018, the School has incurred significant decreases in member's equity such that the School has a total member's equity (deficit) of $221,429. The School continues to advertise to increase student enrollment in an effort to resolve the equity deficit and operate within a feasible budget. The ability of the School to continue as a going concern is dependent upon its success with these endeavors. The financial statements do not include any adjustments that might be necessary if the School is unable to continue as a going concern.

As evidenced in this subsection, there is no standard location or identifying phrase for these disclosures. Therefore, it may be necessary to read through all financial statement notes and not rely on the presence or absence of a certain heading.

Default

Agreements charter holders have with lenders and landlords include terms and requirements, sometimes referred to as covenants. Covenants may require the charter holder to meet certain financial ratios or to timely submit financial reports. Failure to timely make payments or comply with other covenants <u>may</u> result in the lender or landlord issuing a notice of default. Any time a lender or landlord issues a notice of default, the loan or facility agreement is considered material under the financial framework.

If the charter holder's audit (typically the notes to the audited financial statements) indicates a lender's or landlord's decision to issue a notice of default to the charter holder (see examples below), then the charter holder receives a "Below Standard" on this measure.

NOTES TO FINANCIAL STATEMENTS
June 30, 2014

NOTE 8 – NOTES PAYABLE

The School's debt at June 30, 2014 is as follows:

Promissory note payable to a financial institution with an original amount of $ 100,000 and an interest rate of 10.00%. Monthly payments of interest only through October 3, 2014, when the entire amount of accrued interest and principal is due in a balloon payment. The note is unsecured.	$ 100,000
Promissory note payable to a financial institution with an original amount of $ 50,000 and an interest rate of 10.00%. Monthly payments of interest only through October 3, 2014, when the entire amount of accrued interest and principal is due in a balloon payment. The note is unsecured.	50,000
Promissory note payable to an individual with an original amount of $ 26,930 and no interest rate. Monthly payments of $ 500 until the note is paid off. There is no maturity date. The note is unsecured.	5,067
Promissory note payable to a financial institution with an original amount of $ 160,000 and an interest rate of 10.00%. The entire amount of accrued interest and principal was due in a balloon payment on January 15, 2014. The note is currently in default. The default interest rate is 20%. The note is unsecured.	160,000
Promissory note payable to a financial institution with an original amount of $ 50,000 and an interest rate of 10%. All accrued interest and principal was due in a balloon payment in March 2014. Currently this note is in default and is subject to a default interest rate of 15%. The note is unsecured.	50,000

NOTE 4 – NOTE PAYABLE

On September 29, 2017, the School entered into a promissory note with a related party in the amount of $344,505. The funds were primarily for cash flow purposes. Pursuant to the promissory note the School will make monthly payments of interest only for the first two years and principal and interest payments amortized over the final three years. The note will mature on October 1, 2023. The loan is in default to the terms of the promissory note. All interest payments in default bear interest at a rate of 20%.

IDA Loan in Default
As described in Note 3, is in violation of numerous debt covenants under the loan agreement with the IDA. Consequently, the Trustee of IDA may elect to demand payment on the entire balance outstanding due to the violations of provisions in the loan agreement. As neither the IDA nor the Trustee, acting on behalf of the IDA, has waived or subsequently lost the right to demand repayment for more than one year, nor is there a grace period available in which the probability of compliance is reasonable, all amounts due under the loan agreement have been classified as current liabilities. No principle or interest payments have been applied to the outstanding bond balance since June 30, 2009 except as noted above under *Partial Exchange and Distribution to Holders*.

Unrestricted Days Liquidity

The Unrestricted Days Liquidity ("UDL") measure indicates a charter holder's available reserve by identifying how many days' expenses can be paid without another influx of cash. To receive a "Meets Standard" on this measure, the charter holder must have 30 or more days liquidity.

How Is It Calculated

The available reserve is the cash the charter holder has at June 30th <u>after</u> any amounts restricted for specific purposes have been removed <u>plus</u> any other sources of liquidity that the charter holder has access to that are sufficiently disclosed in the audit.

The formula for calculating the UDL is

$$\frac{\text{(Unrestricted Cash + Other Sources of Liquidity)}}{\text{[(Total Expenses – Noncash Expenses)/365]}}$$

Each component of the formula is discussed in further detail below, and an example is provided.

Unrestricted Cash

The calculation begins with the "cash" or "cash and cash equivalents" identified on the charter holder's audited statement of financial position. All restricted cash must be removed to arrive at the charter holder's unrestricted cash. The charter holder's year-end Classroom Site Fund cash carryover balance is considered restricted under the financial framework. For most charter holders, the Classroom Site Fund carryover, which is disclosed in the compliance questionnaire completed by the auditor, will be the only restriction the charter holder has to its cash balance.

Other Sources of Liquidity

The calculation also considers other sources of liquidity available to the charter holder, such as available balances on lines of credit. To be included in the calculation, the other liquidity sources must be clearly disclosed in the audited financial statements. To determine whether investments, bond reserve funds, or the balance of the June 30th state equalization payment held by a trustee are considered other liquidity sources, see below.

Investments

Unrestricted investments will be considered as an "other source of liquidity" if they are identified on the audited statement of financial position as current assets. If the audited statement of financial position does not identify current assets, but only includes total assets, then only investments that are unrestricted and have maturity dates of one year or less based on information disclosed in the notes to the audited financial statements will be considered as other liquidity. If the notes to the audited financial statements do not include sufficient information to make a determination, then none of the investments are considered as other liquidity.

Bond Reserve Funds

Bond reserve funds available to cover general operating expenses will be considered as other liquidity. Reserve funds for specific expenses, such as repairs or insurance, are not considered in the measure's calculation. If the audited financial statements indicate a reserve fund for general operational purposes exists, but only include a total dollar amount for all reserve funds, then none of the reserve funds balance is considered as other liquidity.

Balance of June 30th State Equalization Held by Trustee

In some cases, a charter holder's state equalization payments may go first to a third party, such as a trustee, before the balance is forwarded to the charter holder. At times, these third parties are unable to forward to the charter holder the balance of the June 30th payment prior to the end of the fiscal year. As a result, this amount may not be identified as cash and cash equivalents on the charter holder's financial statements. Some charter holders and auditors identify this as cash held by trustee, for example, and explain in the notes to the audited financial statements what this amount represents. When this information is sufficiently disclosed in the audited financial statements, the balance of the June 30th state equalization payment will be considered as other liquidity.

Total Expenses and Noncash Expenses

The calculation begins with the total expenses identified on the charter holder's audited statement of activities. Noncash expenses, which, according to the financial framework, may include depreciation, amortization and write-offs of loan issuance costs and prepayment penalties, are subtracted from total expenses. The resulting adjusted total expenses are then used in this measure's calculation.[1]

Depreciation and Amortization

Depreciation is the allocation of a fixed asset's costs over the useful life of the asset. Fixed assets include items such as buildings, furnishings and vehicles. 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. Depreciation and amortization are noncash expenses. Although charter holders are required by accounting principles to record depreciation and, as applicable, amortization in their accounting records, these "expenses" do not use cash. Therefore, they are removed from this measure's calculation.

The charter holder's depreciation expense and, as applicable, amortization expense are disclosed on the audited statement of cash flows. They may also be included on the audited statement of activities, in the notes to the audited financial statements or, if applicable, on the audited statement of functional expense. In instances where amortization is applicable, instead of individual amounts, one amount may be disclosed in the audit that includes both depreciation and amortization.

Unrestricted Days Liquidity Calculation Example

STEP 1. DETERMINE UNRESTRICTED CASH

Statement of Financial Position
As of June 30, 2018

ASSETS

Current Assets		
Cash and Cash Equivalents	$	398,627
Grants and Funds Receivable		28,555
Total Current Assets		427,182

7. Did the school have sufficient cash at year-end to cover the carry over monies, and what was the Classroom Site Fund cash carryover balance at year-end?	Yes	CSF cash carryover balance at year end: $47,771

The charter holder's unrestricted cash would equal "cash and cash equivalents" minus the Classroom Site Fund cash carryover balance at year-end (identified in the compliance questionnaire).

Unrestricted Cash = $350,856
[$398,627 minus $47,771]

STEP 2. IDENTIFY OTHER SOURCES OF LIQUIDITY

NOTE 7 – LINES OF CREDIT:

The School has a bank credit card with a limit of $29,000, which it uses to pay operating expenses. At June 30, 2018, the annual interest rate was 14.99% for amounts resulting from purchases not repaid within a single operating cycle. The outstanding credit card balance at June 30, 2018 was $1,371.

The School has a retail credit card with a limit of $12,400, which it uses to pay operating expenses. At June 30, 2018, the annual interest rate was 21.99% for amounts resulting from purchases not repaid within a single operating cycle. The outstanding credit card balance at June 30, 2018 was $-0-.

The notes to the audited financial statements indicate the charter holder has two lines of credit. The charter holder's other sources of liquidity would equal the total available balance for the two credit lines.

Other Liquidity = $40,029
[($29,000 plus $12,400) minus $1,371]

[1] See also the "Temporarily Restricted Assets and Other Considerations" subsection.

STEP 3. DETERMINE ADJUSTED EXPENSES AND DAILY EXPENSES

Expenses			
Program Expenses	3,104,501	-	3,104,501
Management and General	378,919	-	378,919
Total Expenses	3,483,420	-	3,483,420

Statement of Cash Flows
Year Ended June 30, 2018

Cash Flows Provided (Used) by Operating Activities	
Increase in Net Assets	$ 43,041
Adjustments to Reconcile Change in Net Assets to Net Cash from Operating Activities:	
Depreciation	16,410
Changes in Assets and Liabilities:	
Grants and Funds Receivable	(18,580)
Prepaid Expense	1,048
Due to Related Party	12,586
Accounts Payable	7,066
Accrued Payroll and Related Expenses	8,720
Net Cash Provided (Used) by Operating Activities	70,291

Adjusted expenses equal total expenses (audited statement of activities) minus noncash expenses. For this charter holder, depreciation would be a noncash expense.

Adjusted Expenses=$3,467,010 [$3,483,420 minus $16,410]

Daily expenses equal adjusted expenses divided by 365.

Daily Expenses = $9,498.66 [$3,467,100 divided by 365]

STEP 4. UNRESTRICTED DAYS LIQUIDITY CALCULATION

To calculate the charter holder's Unrestricted Days Liquidity, divide the sum of the charter holder's unrestricted cash and other liquidity by the charter holder's daily expenses.

Unrestricted Days Liquidity = 41.15

$350,856 *[from Step 1]* plus $40,029 *[from Step 2]*
$9,498.66 *[from Step 3]*

Adjusted Net Income

The Adjusted Net Income measure considers whether a charter holder is operating within its available resources. To receive a "Meets Standard" on this measure, the charter holder's adjusted net income must be at least $1.

How Is It Calculated

The formula for calculating adjusted net income is

Total Revenues – (Total Expenses – Noncash Expenses)

If the charter holder's adjusted expenses (total expenses minus noncash expenses) exceed its revenues, resulting in negative adjusted net income, or the charter holder's adjusted expenses equal its revenues, then the following additional calculation is completed:

(Adjusted Net Income/Total Revenues) x 100

Each component of the formula is discussed in further detail below, along with guidance on how to handle different financial statement presentations. Finally, an example is provided.

Total Revenues

The calculation uses total revenues as identified on the charter holder's audited statement of activities (see also the "Temporarily Restricted Assets and Other Considerations" subsection below).

Total Expenses and Noncash Expenses

The calculation begins with the total expenses identified on the charter holder's audited statement of activities (see also the "Temporarily Restricted Assets and Other Considerations" subsection below). Noncash expenses, which, according to the financial framework, may include depreciation, amortization and write-offs of loan issuance costs and prepayment penalties, are subtracted from total expenses. The resulting adjusted total expenses are then used in this measure's calculation.

Depreciation and Amortization

Depreciation is the allocation of a fixed asset's costs over the useful life of the asset. Fixed assets include items such as buildings, furnishings and vehicles. 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. Depreciation and amortization are noncash expenses. Although charter holders are required by accounting principles to record depreciation and, as applicable, amortization in their accounting records, these "expenses" do not use cash. Therefore, they are removed from this measure's calculation.

The charter holder's depreciation expense and, as applicable, amortization expense are disclosed on the audited statement of cash flows. They may also be included on the audited statement of activities, in the notes to the audited financial statements or, if applicable, on the audited statement of functional expense. In instances where amortization is applicable, instead of individual amounts, one amount may be disclosed in the audit that includes both depreciation and amortization.

Temporarily Restricted Assets and Other Considerations

Temporarily Restricted Assets

A charter holder may receive contributions (e.g., tax credits) or grant funding that are restricted in their use. Because of the restriction, these monies must be accounted for differently than monies received without restrictions (e.g., state equalization). Depending upon how the change in temporarily restricted net assets is presented on the audited financial statements, adjustments may be needed to the amount used for total revenues.

In the example on the next page on the left, the amount used for total revenues would be $1,673,987 [$1,663,359+$46,301-$35,673]. The adjustments must be made to ensure the accurate amount is used. Like the example on the left, the example on the right (see next page) also includes temporarily restricted items. However, in the example on the right, no adjustments are necessary; the applicable amounts from the "Total" column would be used.

STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2016

UNRESTRICTED	
Revenues:	
State equalization assistance	$1,397,002
Classroom site funds	87,009
Instructional improvement funds	7,537
Federal and State grants	16,243
Contributions	10,049
School activities	68,790
Supply sales	13,322
Miscellaneous	27,734
Total Unrestricted Revenue	1,627,686
Net assets released from restriction:	
Satisfaction of program restriction	35,673
Total Revenue	1,663,359
Expenses:	
Program Services	
Salaries and benefits	1,078,524
Purchased services	299,440
Rent and occupancy costs	173,895
Supplies	50,608
Interest	2,772
Miscellaneous	9,708
Depreciation	10,824
Management and General	
Salaries and benefits	23,000
Purchased services	23,008
Miscellaneous	11,623
Total Expenses	1,683,402
(Decrease) in unrestricted net assets	(20,043)
TEMPORARILY RESTRICTED NET ASSETS	
Changes in temporarily restricted net assets:	
Contributions for extracurricular activites	46,301
Net assets released from restriction	(35,673)
Increase in temporarily restricted net assets	10,628
(Decrease) in net assets	(9,415)

STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2016

	Unrestricted	Temporarily Restricted	Total
REVENUE			
Per Pupil State Funding	$ 1,360,869	$ -	$ 1,360,869
Contributions and Grants	18,543	15,713	34,256
Student Fees	192	-	192
Other Governmental Assistance	421,343	-	421,343
Fundraising	9,752	-	9,752
Other Revenue	27,491	-	27,491
Total Revenue	1,838,190	15,713	1,853,903
EXPENSES			
Program Services	1,595,548	-	1,595,548
Management and General	153,567	-	153,567
Fundraising	5,447	-	5,447
Total Expenses	1,754,562	-	1,754,562
CHANGE IN NET ASSETS	83,628	15,713	99,341
Net Deficit - Beginning of Year	(192,398)	-	(192,398)
NET ASSETS (DEFICIT) - END OF YEAR	$ (108,770)	$ 15,713	$ (93,057)

OTHER CONSIDERATIONS

In some cases, items that occurred during the fiscal year may be reported on the audited statement of activities or income statement in a separate section. This may be done, for example, due to the uniqueness of the item being reported (e.g., a gain or loss on the disposal of equipment) or due to the corporate structure of the entity (e.g., corporate income taxes). Because expenses are considered when calculating unrestricted days liquidity, as many of the adjustments as possible are made to revenues instead of expenses to avoid unnecessarily skewing the charter holder's performance. In some cases, though, the items are clearly expenses. When those items are identified, the amount used for total expenses must be modified. An amount for total expenses that is lower than the total expenses identified in the audit will not be used. If the charter holder's audit includes a provision for income taxes, then that amount is added to expenses. If the charter holder's audit includes a benefit for income taxes, then that amount is added to revenues.

The examples on the next page include an "Other Income (Expense)" section and one example includes a "Provision for income taxes" line item. For the example on the left, $3,777,789 [$3,763,194 plus $14,595 (gain on sale)] would be used for total revenues for fiscal year 2018 and $3,719,542 [$3,673,993 plus $31,149 (interest expense) plus $14,400 (income taxes)] would be used for total expenses, resulting in net income of $58,247. For the example on the right, $1,390,085 would be used for total revenues and $1,400,002 [$1,358,326 plus $41,676 (interest expense) would be used for total expenses, resulting in a net loss of $9,917.

Statements of Income and Retained Earnings

	Years Ended June 30, 2018	2017
REVENUE:		
State equalization program	$ 3,300,892	$ 3,272,325
Other state revenue	270,367	236,493
Contract revenue and other	191,935	237,115
	3,763,194	3,745,933
EXPENSES:		
Student activities	791,492	823,096
Payroll and related	1,356,756	1,565,605
Purchased services	352,594	232,554
Supplies	140,568	100,575
Depreciation	93,429	135,633
Occupancy costs	738,311	713,504
General and administration	200,843	187,995
	3,673,993	3,758,962
Income (Loss) from operations	89,201	(13,029)
OTHER INCOME (EXPENSE):		
Gain on sale of property and equipment	14,595	72,292
Interest expense	(31,149)	(12,766)
	(16,554)	59,526
Income before provision for income taxes	72,647	46,497
Provision for income taxes	14,400	6,300
Net Income	58,247	40,197

Statement of Income and Member's Equity
For the Year Ended June 30, 2018

SUPPORT AND REVENUE	
Governmental	$ 1,389,283
Other revenue	802
Total support and revenue	1,390,085
EXPENSES	
Salary and related	826,803
Occupancy	376,144
Field Trips	10,558
Depreciation	2,349
Professional Fees	70,761
Supplies, printing and general	48,399
Insurance	11,232
License fees, dues and subscriptions	2,206
Training and development	6,406
Advertising	3,468
Total expenses	1,358,326
Income (loss) from operations	31,759
OTHER INCOME/(EXPENSE)	
Interest expense	(41,676)
Net Income (Loss)	(9,917)

Adjusted Net Income Calculation Example

STEP 1. IDENTIFY TOTAL REVENUES AND EXPENSES

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2018 AND 2017

	2018	2017
Changes in unrestricted net assets:		
Revenues:		
Governmental	$ 600,578	617,475
Other	9,002	1,380
Total unrestricted revenues	609,580	618,855
Net assets released from restrictions:		
Satisfaction of program restrictions	2,759	2,078
Total net assets released from restrictions	2,759	2,078
Total unrestricted revenues and other support	612,339	620,933
Expenses:		
Program services	522,872	504,386
Support Services		
Management and general	120,918	123,287
Total expenses	643,790	627,673
Increase (decrease) in unrestricted net assets	(31,451)	(6,740)
Changes in temporarily restricted net assets:		
Contributions	2,156	1,662
Net assets released from restrictions	(2,759)	(2,078)
(Decrease) in temporarily restricted net assets	(603)	(416)
Increase (decrease) in net assets	(32,054)	(7,156)

To arrive at the charter holder's total revenues, adjustments must be made due to the information identified in the "Changes in temporarily restricted net assets" section of the audited financial statement.

Total Revenues = $611,736

[$612,339 plus $2,156 minus $2,759]

The charter holder's total expenses equal the "Total Expenses" identified on the audited financial statement.

Total Expenses = $643,790

STEP 2. DETERMINE ADJUSTED EXPENSES

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2018 AND 2017

	2018	2017
Cash flows from operating activities:		
Change in net assets	$ (32,054)	(7,156)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	$\boxed{1,439}$	1,607
(Increase) decrease in due from the State of Arizona	(15,447)	3,564
Increase in accounts payable and accrued expenses	69	1,719
Net cash provided (used) by operating activities	(45,993)	(266)

Adjusted expenses equal total expenses minus noncash expenses. For this charter holder, depreciation would be a noncash expense.

Adjusted Expenses = $642,351
[$643,790 minus $1,439]

STEP 3. ADJUSTED NET INCOME CALCULATION

To calculate the charter holder's Adjusted Net Income, subtract the charter holder's adjusted expenses from the charter holder's total revenues.

Adjusted Net Income = ($30,615)

$611,736 *[from Step 1]* minus $642,351 *[from Step 2]*

STEP 4. PERCENT CALCULATION (REQUIRED WHEN ADJUSTED NET INCOME IS NEGATIVE)

When a charter holder has negative adjusted net income, a calculation is done that considers the charter holder's adjusted net income divided by the charter holder's total revenues.

Adjusted Net Income/Total Revenues = (5%)

Step A: $\dfrac{\text{(\$30,615) [from Step 3]}}{\text{\$611,736 [from Step 1]}}$

Step B: **The quotient from Step A is then multiplied by 100**

Lease Adjusted Debt Service Coverage Ratio

The Lease Adjusted Debt Service Coverage Ratio ("Lease Adjusted DSCR") measure considers how easily debt principal, interest and facility costs can be paid as they become due. To receive a "Meets Standard" on this measure, the charter holder's ratio must exceed 1.10.[2]

How Is It Calculated

The formula for calculating the Lease Adjusted DSCR is

$$\frac{\text{(Adjusted Net Income + Interest Expense + Facility Lease Expense)}}{\text{(Debt Principal + Interest + Facility Lease Expense)}}$$

Each component of the formula is discussed in further detail below, and an example is provided.

[2] A ratio of less than 1.0 means the charter holder is unable to cover its facility and debt costs for the year without dipping into savings or borrowing additional funds.

Adjusted Net Income

The charter holder's dollar amount performance on the Adjusted Net Income measure is used for this component of the Lease Adjusted DSCR.

Interest Expense and Interest

Interest expense reflects the charter holder's cost of borrowing for the audited fiscal year. For the Lease Adjusted DSCR's calculation, the same amount is used for interest expense and interest. Generally, interest expense is disclosed in the notes to the audited financial statements. It may also be included on the audited statement of activities or, if applicable, on the audited statement of functional expense. In the absence of its disclosure in one of these places, the interest paid amount disclosed on the audited statement of cash flows is used.

To the extent that the disclosure is sufficient to make it possible, the Lease Adjusted DSCR calculation is only concerned with interest/interest expense related to bonds, loans and capital leases.

Facility Lease Expense

Facility lease expense includes operating leases where, at the end of the lease, ownership of the facility does not transfer to the charter holder. Typically, the audited fiscal year's facility lease expense is disclosed in the notes to the audited financial statements. However, facility or occupancy costs may also be disclosed on the audited statement of activities or, if applicable, the audited statement of functional expense.

The Lease Adjusted DSCR is concerned with the amount associated with the facility only and not the related expenses for property taxes and common area maintenance or with other services that may be included as part of a services agreement with an outside entity. Further, the Lease Adjusted DSCR is concerned only with facility operating leases and not equipment or other operating leases a charter holder may have. If the audit does not provide sufficient detail to determine the charter holder's facility lease expense amount, then the full amount disclosed, regardless of what it includes, will be used in the calculation.

Debt Principal

Debt principal includes principal payments associated with bonds or loans for a charter holder that purchases its facilities, principal payments associated with other long-term loans obtained by the charter holder, and principal payments associated with capital leases. The charter holder's debt principal payments for the audited fiscal year are disclosed on the audited statement of cash flows. Amounts owed on lines of credit or credits cards are not included in the calculation, assuming the audit provides sufficient detail to distinguish these payments from other debt payments made.

Lease Adjusted DSCR Calculation Example

STEP 1. IDENTIFY ADJUSTED NET INCOME

STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2018

UNRESTRICTED	
Revenues:	
State equalization assistance	$ 4,996,024
Classroom site funds	352,456
Instructional improvement funds	29,592
Federal and State grants	1,127,631
National school lunch program (federal)	519,974
Contributions	212,444
Extracurricular activities contributions	14,940
Miscellaneous	14,407
Total Revenue	7,267,468
Expenses:	
Program Services	
Salaries and benefits	3,651,351
Purchased services	1,581,881
Rent and occupancy costs	464,061
Supplies	446,607
Interest	309,242
Miscellaneous	71,583
Depreciation	111,072
Management and General	
Salaries and benefits	119,297
Purchased services	110,896
Total Expenses	6,865,990
Increase in net assets	401,478

The charter holder's dollar amount performance on the Adjusted Net Income measure is used for this component of the Lease Adjusted DSCR.

Total Revenues=$7,267,468

Total Expenses=$6,865,990
Adjusted Expenses=$6,754,918

Adjusted Net Income=$512,550
[$7,267,468 minus
($6,865,990 minus $111,027)]

STEP 2. IDENTIFY INTEREST EXPENSE/INTEREST

Interest expense related to the notes payable for the fiscal year ended June 30, 2018 totaled $309,242

The notes to the audited financial statements identify the charter holder's interest expense/interest.

Interest Expense/Interest = $309,242

STEP 3. IDENTIFY FACILITY LEASE EXPENSE

Operating leases – The School leases buildings and equipment under the provisions of long-term lease agreements classified as operating leases. During the fiscal year ended June 30, 2018, the School made the required lease payments totaling $237,004. As of June 30, 2018, the total remaining payments under noncancelable operating leases were as follows:

The notes to the audited financial statements identify the charter holder's building and equipment lease expense. Since the amount associated with the building lease is not identified separately from the equipment lease expense, the total will be used in the calculation for facility lease expense.

Facility Lease Expense = $237,004

STEP 4. IDENTIFY DEBT PRINCIPAL

Cash flows from financing activities:	
Net borrowings on credit card payable	3,265
Repayments on notes payable	(277,278)
Net cash (used) by financing activities	(274,013)

The amount used for debt principal would be found in the "financing activities" section of the audited statement of cash flows.

Debt Principal = $277,278

STEP 5. LEASE ADJUSTED DSCR CALCULATION

To calculate the charter holder's Lease Adjusted DSCR divide the sum of the charter holder's adjusted net income, interest expense and facility lease expense by the sum of the charter holder's debt principal, interest and facility lease expense.

Lease Adjusted DSCR = 1.29

$512,550 *[from Step 1]* plus $309,242 *[from Step 2]* plus $237,004 *[from Step 3]*
$277,278 *[from Step 4]* plus $309,242 *[from Step 2]* plus $237,004 *[from Step 3]*

Average Daily Membership

The Average Daily Membership measure considers the charter holder's student count over time since the student count, which is referred to as average daily membership or ADM, drives the State funding the charter holder receives. For this measure, charter holders are categorized as either "small" (fewer than 200 ADM), "medium" (200 to 599 ADM) or "large" (600 or more ADM).

How Is It Calculated

The Average Daily Membership measure considers the most recent four fiscal years of ADM data available and is calculated in two steps.

Step 1: Calculate the annual growth rates
(Calculation Note: "Year 1" would be the most recent year and "Year 4" would be the "oldest" year.)

Year 1 Growth Rate = [(Year 1 – Year 2)/Year 2] x 100

Year 2 Growth Rate = [(Year 2 – Year 3)/Year 3] x 100
Year 3 Growth Rate = [(Year 3 – Year 4)/Year 4] x 100

Step 2: Calculate the three-year average
(Year 1 Growth Rate + Year 2 Growth Rate + Year 3 Growth Rate)/3

To receive a "Meets Standard" on the Average Daily Membership measure, the average calculated in Step 2 either must show an increase, a decrease of 4.99% or less for charter holders categorized as small and medium, or a decrease of 2.99% or less for charter holders categorized as large.

ADM Data

To determine a charter holder's performance on the Average Daily Membership measure, the Board uses the ADM calculations completed by the Arizona Department of Education ("Department") using student attendance data submitted to the Department by the charter holder. The measure calculation uses the charter holder's 100th day ADM as reported on the Department's ADMS46-1 report, which may be accessed at http://www.ade.az.gov/Districts/EntitySelection.asp.[3]

Average Daily Membership Calculation Example

STEP 1. CALCULATE THE ANNUAL GROWTH RATES

Fiscal Year 2019

100th ADM

	Non AOI		AOI FT		AOI PT	
Grade	ADM	Cumulative	ADM	Cumulative	ADM	Cumulative
*PS	0.000	0.000	0.000	0.000	0.000	0.000
KG	14.840	14.840	0.000	0.000	0.000	0.000
1	26.775	41.615	0.000	0.000	0.000	0.000
2	21.810	63.425	0.000	0.000	0.000	0.000
**3	18.528	81.954	0.000	0.000	0.000	0.000
4	21.700	103.654	0.000	0.000	0.000	0.000
5	13.510	117.164	0.000	0.000	0.000	0.000
6	15.000	132.164	0.000	0.000	0.000	0.000
7	0.000	132.164	0.000	0.000	0.000	0.000
8	0.000	132.164	0.000	0.000	0.000	0.000
***UE	0.000	132.164	0.000	0.000	0.000	0.000

	Non AOI		AOI FT		AOI PT	
Grade	ADM	Cumulative	ADM	Cumulative	ADM	Cumulative
9	0.000	0.000	0.000	0.000	0.000	0.000
10	0.000	0.000	0.000	0.000	0.000	0.000
11	0.000	0.000	0.000	0.000	0.000	0.000
****12	0.000	0.000	0.000	0.000	0.000	0.000

Name	Total	Non-AOI
*Total PreSchool with Disabilities	0.000	0.000
** Total K-3 Group B Add-On	81.954	81.954
***Total K-UE	132.164	132.164
****Total 9-12	0.000	0.000
Total All Grades	132.164	132.164

Fiscal Year 2018

100th ADM

	Non AOI		AOI FT		AOI PT	
Grade	ADM	Cumulative	ADM	Cumulative	ADM	Cumulative
*PS	0.000	0.000	0.000	0.000	0.000	0.000
KG	17.480	17.480	0.000	0.000	0.000	0.000
1	22.360	39.840	0.000	0.000	0.000	0.000
2	26.240	66.080	0.000	0.000	0.000	0.000
**3	21.000	87.080	0.000	0.000	0.000	0.000
4	22.240	109.320	0.000	0.000	0.000	0.000
5	17.000	126.320	0.000	0.000	0.000	0.000
6	5.000	131.320	0.000	0.000	0.000	0.000
7	0.000	131.320	0.000	0.000	0.000	0.000
8	0.000	131.320	0.000	0.000	0.000	0.000
***UE	0.000	131.320	0.000	0.000	0.000	0.000

	Non AOI		AOI FT		AOI PT	
Grade	ADM	Cumulative	ADM	Cumulative	ADM	Cumulative
9	0.000	0.000	0.000	0.000	0.000	0.000
10	0.000	0.000	0.000	0.000	0.000	0.000
11	0.000	0.000	0.000	0.000	0.000	0.000
****12	0.000	0.000	0.000	0.000	0.000	0.000

Name	Total	Non-AOI
*Total PreSchool with Disabilities	0.000	0.000
** Total K-3 Group B Add-On	87.080	87.080
***Total K-UE	131.320	131.320
****Total 9-12	0.000	0.000
Total All Grades	131.320	131.320

Fiscal Year 2017

100th ADM

	Non AOI		AOI FT		AOI PT	
Grade	ADM	Cumulative	ADM	Cumulative	ADM	Cumulative
*PS	0.000	0.000	0.000	0.000	0.000	0.000
KG	11.825	11.825	0.000	0.000	0.000	0.000
1	29.969	41.794	0.000	0.000	0.000	0.000
2	22.924	64.719	0.000	0.000	0.000	0.000
**3	25.000	89.719	0.000	0.000	0.000	0.000
4	21.000	110.719	0.000	0.000	0.000	0.000
5	7.000	117.719	0.000	0.000	0.000	0.000
6	8.000	125.719	0.000	0.000	0.000	0.000
7	0.000	125.719	0.000	0.000	0.000	0.000
8	0.000	125.719	0.000	0.000	0.000	0.000
***UE	0.000	125.719	0.000	0.000	0.000	0.000

	Non AOI		AOI FT		AOI PT	
Grade	ADM	Cumulative	ADM	Cumulative	ADM	Cumulative
9	0.000	0.000	0.000	0.000	0.000	0.000
10	0.000	0.000	0.000	0.000	0.000	0.000
11	0.000	0.000	0.000	0.000	0.000	0.000
****12	0.000	0.000	0.000	0.000	0.000	0.000

Name	Total	Non-AOI
*Total PreSchool with Disabilities	0.000	0.000
** Total K-3 Group B Add-On	89.719	89.719
***Total K-UE	125.719	125.719
****Total 9-12	0.000	0.000
Total All Grades	125.719	125.719

The most recent four fiscal years of ADM data available are used to calculate the charter holder's annual growth rates. For this calculation, Year 1 is fiscal year 2019 and Year 4 is fiscal year 2016.

Annual Growth Rates:

Fiscal Year 2019 = 0.64%
[(132.164 minus 131.320) divided by 131.320] multiplied by 100]

Fiscal Year 2018 = 4.46%
[(131.320 minus 125.719) divided by 125.719] multiplied by 100]

Fiscal Year 2017 = 9.60%
[(125.719 minus 114.710) divided by 114.710] multiplied by 100]

[3] To create the financial performance dashboards, the Board does not access the individual ADMS46-1 reports, but rather receives a spreadsheet from the Department that includes all charter holders' ADM. This spreadsheet is provided after the close of the applicable fiscal year.

Fiscal Year 2016

100th ADM

Grade	Non AOI ADM	Non AOI Cumulative	AOI FT ADM	AOI FT Cumulative	AOI PT ADM	AOI PT Cumulative
*PS	0.000	0.000	0.000	0.000	0.000	0.000
KG	13.010	13.010	0.000	0.000	0.000	0.000
1	21.350	34.360	0.000	0.000	0.000	0.000
2	26.496	60.856	0.000	0.000	0.000	0.000
**3	24.854	85.710	0.000	0.000	0.000	0.000
4	11.000	96.710	0.000	0.000	0.000	0.000
5	9.000	105.710	0.000	0.000	0.000	0.000
6	9.000	114.710	0.000	0.000	0.000	0.000
7	0.000	114.710	0.000	0.000	0.000	0.000
8	0.000	114.710	0.000	0.000	0.000	0.000
***UE	0.000	114.710	0.000	0.000	0.000	0.000

Grade	Non AOI ADM	Non AOI Cumulative	AOI FT ADM	AOI FT Cumulative	AOI PT ADM	AOI PT Cumulative
9	0.000	0.000	0.000	0.000	0.000	0.000
10	0.000	0.000	0.000	0.000	0.000	0.000
11	0.000	0.000	0.000	0.000	0.000	0.000
****12	0.000	0.000	0.000	0.000	0.000	0.000

Name	Total	Non-AOI
*Total PreSchool with Disabilities	0.000	0.000
** Total K-3 Group B Add-On	85.710	85.710
***Total K-UE	114.710	114.710
****Total 9-12	0.000	0.000
Total All Grades	114.710	114.710

STEP 2. CALCULATE THE THREE-YEAR AVERAGE

To calculate the charter holder's Average Daily Membership performance, divide the sum of the charter holder's annual growth rates (from Step 1) by three.

Three-Year Average = 4.90%

0.64% plus 4.46% plus 9.60%
3

Other Considerations

Charter Holder's ADM Grouping Fluctuates

As noted above, this measure categorizes charter holders as either small (fewer than 200 ADM), medium (200 to 599 ADM) or large (600 or more ADM). A charter holder's performance on the Average Daily Membership measure considers the charter holder's size grouping and growth rate average.

Should the charter holder's ADM be such that the charter holder's size grouping varies across one or more of the fiscal years used in the calculation, performance on this measure will be determined using the charter holder's size grouping based on the audited fiscal year ADM.

Second and Third Year Charter Holders

For a charter holder with only two years of ADM data available, the Average Daily Membership measure will consider the charter holder's annual growth rate.

For a charter holder with only three years of ADM data available, the Average Daily Membership measure will consider the average of the charter holder's two annual growth rates.

ADM Adjustments

Adjustments will be made to the ADM for the fiscal years used in the calculation when:

- The charter holder reduces the grade levels served at its charter school;
- A school transfers from a multi-school charter contract to its own charter contract; or
- A school operating under a multi-school charter contract closes.

The Department's ADMS46-1 report will be used when adjustments are required due to reduced grade levels. The Department's ADMS45-1 report will be used when adjustments are required due a school transfer or school closure.