



Discussion Framework and Testing Results

FINANCIAL FRAMEWORK SUBCOMMITTEE MEETING

SEPTEMBER 27, 2018

Discussion Framework Measures

Going Concern and Default Measures

GOING CONCERN

- ❖ Performance based on absence or presence of certain disclosure in audit
- ❖ Current Calculation*
“Falls Far Below Standard” (one of two ways)
 1. Disclosure in Independent Auditor’s Report and financial statement notes
(Substantial doubt about charter’s ability to continue is raised and is not alleviated by management’s plans)
 2. Disclosure in financial statement notes only
(Substantial doubt about charter’s ability to continue is raised but is alleviated by management’s plans)

DEFAULT

- ❖ Performance based on absence or presence of certain disclosure in audit
- ❖ Current Calculation*
“Falls Far Below Standard”
Audit indicates charter has defaulted on loan

* No “Does Not Meet Standard” target established for this measure.



Unrestricted Days Liquidity Measure

MODIFIED CALCULATION

(Unrestricted Cash +
Other Sources of Liquidity)

Divided by

(Total Expenses - Noncash
Expenses/365)

CALCULATION CONSIDERATIONS

- ❖ Unspent Classroom Site Fund balance at June 30th is considered restricted and, therefore, is removed to arrive at charter's unrestricted cash
- ❖ "Noncash Expenses" include depreciation, amortization and write-offs of loan issuance costs and prepayment penalties



Adjusted Net Income Measure

MODIFIED CALCULATION

Total Revenues

Minus

(Total Expenses – Noncash Expenses)

CALCULATION CONSIDERATIONS

- ❖ “Noncash Expenses” include depreciation, amortization and write-offs of loan issuance costs and prepayment penalties



Lease Adjusted Debt Service Coverage Ratio (DSCR) Measure

MODIFIED CALCULATION

(Adjusted Net Income + Interest Expense +
Facility Lease Expense)

Divided by

(Debt Principal + Interest +
Facility Lease Expense)

CALCULATION CONSIDERATIONS

- ❖ “Adjusted Net Income” used (see previous slide)
- ❖ “Facility Lease Expense” would include facility operating leases and not all operating leases
- ❖ “Debt Principal” includes principal payments associated with bonds/loans for charters that purchase their facilities, as well as other long-term loans obtained by charter and capital leases
- ❖ All amounts are reflective of audited fiscal year



ADM Measure

ADM Measure – Option 1

REASON FOUNDATION (“REASON”)

- ❖ September 2018 report suggested enrollment growth measure
- ❖ Calculation
 1. Identify charter’s annual average daily membership (ADM) growth rate for three most recent fiscal years
 2. Determine three-year average

CALCULATION CONSIDERATIONS

- ❖ Performance Target

Reason suggested setting the threshold between a three-year decline of 3% or 5%
- ❖ Would need to establish calculation for charters with less than four years of ADM



ADM Measure – Option 2

OFFICE OF THE AUDITOR GENERAL (“OAG”)

- ❖ Component of school district “Financial Stress Assessment” conducted by OAG
- ❖ Calculation
 - Considers change in ADM from the first fiscal year and the third fiscal year in a three-year period
 - As an example, for fiscal year 2018, the calculation would look at the difference between the fiscal year 2016 ADM and fiscal year 2018 ADM*
- ❖ Calculation Considerations
 - Would need to establish calculation for charters with less than three years of ADM

SCHOOL DISTRICT SIZE GROUPINGS

- ❖ Very Small = Fewer than 200 ADM
- ❖ Small = 200 to 599 ADM
- ❖ Medium = 600 to 1,999 ADM
- ❖ Medium-Large = 2,000 to 7,999 ADM
- ❖ Large = 8,000 to 19,999 ADM
- ❖ Very Large = 20,000+ ADM

Source: Appendix B of the *Arizona School District Spending – Fiscal Year 2017* report issued by the OAG in March 2018



ADM Measure – Option 2 (OAG School District Targets)

- ❖ Large decrease – Districts with decreases of:
 - Very small and small districts: 15% or more
 - Medium and medium-large districts: 10% or more
 - Large and very large districts: 5% or more

- ❖ Moderate decrease – Districts with decreases of:
 - Very small and small districts: 5% to 14.99%
 - Medium and medium-large districts: 3% to 9.99%
 - Large and very large districts: 2% to 4.99%

- ❖ Increase – Districts with increases of:
 - Very small and small districts: 5% or more
 - Medium and medium-large districts: 3% or more
 - Large and very large districts: 2% or more

- ❖ Steady – Districts with increases or decreases of:
 - Very small and small districts: 4.99% or less
 - Medium and medium-large districts: 2.99% or less
 - Large and very large districts: 1.99% or less

Source: Appendix B of the *Arizona School District Spending – Fiscal Year 2017* report issued by the OAG in March 2018



Other Matters for Consideration

Public Comment: Timely Payment of Bills

➤ Staff Posed Question Last Week by Email

- “If the Financial Framework Subcommittee were to include a measure in the framework that considers whether the charter is timely paying its bills or can timely pay its bills, what should that measure be or what should that measure look at? For the measure you come up with, how would you define ‘meets’/acceptable performance?”

➤ 25 Responses Received; Opinions Varied

- Responses have been included with meeting materials



Four Measures for Consideration*

❖ Three possible measures consider current assets and current liabilities

- Current Ratio

Current Assets divided by Current Liabilities

- Quick Ratio

(Unrestricted Cash + Investments + Receivables) divided by Current Liabilities

- Net Current Assets

Current Assets minus Current Liabilities

❖ Fourth Possible Measure

- Working Ratio

*(Total Expenses – Noncash Expenses – Interest Expense)
divided by Total Revenues*

❖ Current assets are resources that are available, or can readily be available, to pay current liabilities or meet cost of operations

❖ Current liabilities are obligations that are payable within one year from current assets or current resources

* These four measures can be calculated using information from the annual audit.



Recommend Adding Current Ratio

- Ratio Would Consider Whether Charter Is Able to Meet Obligations Payable Within a Year
- Ratio Can Be Calculated Using Information Currently Disclosed in Annual Audit
- Ratio of 1.0 Means Current Assets Equal Current Liabilities; Consider Setting Target Above 1.0



Use of Leverage Ratio

BACKGROUND

- ❖ Leverage ratio mentioned during Subcommittee's September 12th meeting
- ❖ Calculation (All amounts are reflective of audited year)
(Facility Bond or Loan Principal + Facility Interest Expense + Facility or Ground Leases)
all divided by Total Revenues
- ❖ Ratio is applicable to charters that purchase or lease their facilities
- ❖ Ratio of over 20 percent considered high

STAFF RECOMMENDATION

- ❖ Could calculate for all charters
- ❖ Charter's leverage ratio performance considered when charter identified for intervention under the financial framework
 - Information available through audit
 - Could be implemented in FY 2019
- ❖ Lease adjusted DSCR (like the fixed charge coverage ratio) will continue to ascertain charter's ability to cover facility-related costs



Additional Framework Considerations

PER PUPIL SPENDING CALCULATIONS

- ❖ Discussed at September 12th meeting
- ❖ Consider basing calculations on statutorily mandated “School Level Reporting” form
 - “School Level Reporting” begins in FY 2020
 - Draft forms have been released by OAG and ADE
- ❖ Considered when charter identified for intervention under financial framework

OTHER RECENT PUBLIC COMMENT

- ❖ Review of accounts payable aging reports
- ❖ Review timely payment of staff salaries and employee-related expenses
- ❖ Require reporting of certain items (e.g., bankruptcy filing, default, notices received from IRS/ADOR, lawsuits) within a specified number of days
- ❖ Identify specific financial reports that must be submitted by charter in intervention



Charter Holder Testing Summary

Initial Testing Sample Characteristics

❖ Year in Operation (N=20)

- 4th = 5
- 5th – 10th = 3
- 11th – 15th = 3
- 16th or later = 9

❖ Fiscal Year 2018 ADM (N=20)

- Less than 100 = 3
- 100 to 199 = 8
- 200 to 499 = 5
- 500 to 1,000 = 1
- More than 1,000 = 3

❖ School(s) Located Outside of Metropolitan Areas = 5 of 20

❖ Multiple Schools Under the Charter Contract = 5 of 20

❖ Charter Has Facility Debt = 10 of 20

❖ Charter Experiencing Growth = 3 of 20

❖ Charter Had Financial-Related CAP Issues Identified in FY 2017 Audit = 5 of 20



Reviewing Sample Testing Results

- ❖ Adjustments made for noncash expenses explain performance differences on:
 - Unrestricted Days Liquidity measures
 - Net Income and Adjusted Net Income measures

- ❖ Performance differences on Fixed Charge Coverage Ratio and Debt-Adjusted DSCR
 - All amounts in Debt-Adjusted DSCR are reflective of audited fiscal year
 - Debt-Adjusted DSCR focuses on facility-related operating leases (and not all operating leases)

- ❖ ADM measure results may be viewed in conjunction with other measures, such as Adjusted Net Income and Unrestricted Days Liquidity, to determine charter's response to declining ADM

- ❖ Characteristics may be used to identify discussion framework's effect on:
 - Charters in their early or later years of operation
 - Charters based on their ADM
 - Charters that are expanding
 - Charters that lease or purchase their facilities



Summary Table: ADM Measure Testing Results

	Annual ADM Growth						Reason Formula Calculation				OAG Formula Calculation			
	FY18	FY17	FY16	FY15	FY14	FY13	FY18	FY17	FY16	FY15	FY18	FY17	FY16	FY15
Charter A	(3.1%)	16.1%	(7.9%)	0.4%	24.5%	11.6%	1.7%	2.8%	5.7%	12.2%	12.5%	6.9%	(7.6%)	25.0%
Charter B	41.1%	25.2%	97.7%	6.3%	(5.8%)	18.7%	54.7%	43.1%	23.7%	6.4%	76.7%	147.5%	110.2%	0.2%
Charter C	17.3%	48.2%	23.5%	n/a	n/a	n/a	29.6%	n/a	n/a	n/a	73.8%	82.9%	n/a	n/a
Charter D	24.1%	45.1%	57.1%	n/a	n/a	n/a	42.1%	n/a	n/a	n/a	80.0%	127.9%	n/a	n/a
Charter E	(15.0%)	38.5%	(7.4%)	(23.3%)	(9.4%)	(2.7%)	5.4%	2.6%	(13.4%)	(11.8%)	17.7%	28.2%	(29.0%)	(30.5%)
Charter F	8.8%	35.8%	(19.1%)	(20.8%)	(11.7%)	3.2%	8.5%	(1.4%)	(17.2%)	(9.8%)	47.7%	9.8%	(36.0%)	(30.1%)
Charter G	(13.4%)	0.9%	36.2%	n/a	n/a	n/a	7.9%	n/a	n/a	n/a	(12.6%)	37.4%	n/a	n/a
Charter H	(0.4%)	(7.0%)	(5.7%)	(6.5%)	(4.5%)	(15.4%)	(4.3%)	(6.4%)	(5.5%)	(8.8%)	(7.3%)	(12.2%)	(11.8%)	(10.7%)
Charter I	7.2%	(10.4%)	(36.9%)	(6.6%)	1.4%	(4.3%)	(13.4%)	(17.9%)	(14.0%)	(3.2%)	(3.9%)	(43.4%)	(41.0%)	(5.2%)
Charter J	(8.2%)	(3.5%)	(0.9%)	5.3%	0.4%	6.8%	(4.2%)	0.3%	1.6%	4.2%	(11.4%)	(4.4%)	4.3%	5.7%
Charter K	28.1%	(17.9%)	(0.5%)	(27.6%)	(0.4%)	55.7%	3.2%	(15.3%)	(9.5%)	9.2%	5.3%	(18.3%)	(28.0%)	(27.9%)
Charter L	21.3%	12.5%	16.4%	30.2%	n/a	n/a	16.7%	19.7%	n/a	n/a	36.5%	30.9%	51.6%	n/a
Charter M	(17.5%)	15.8%	25.9%	n/a	n/a	n/a	8.1%	n/a	n/a	n/a	(4.4%)	45.8%	n/a	n/a
Charter N	0.8%	0.0%	(2.6%)	0.2%	(3.6%)	(2.5%)	(0.6%)	(0.8%)	(2.0%)	(2.0%)	0.8%	(2.5%)	(2.4%)	(3.4%)
Charter O	23.2%	46.6%	142.0%	n/a	n/a	n/a	70.6%	n/a	n/a	n/a	80.6%	254.8%	n/a	n/a
Charter P	(0.7%)	(6.0%)	(4.0%)	(1.4%)	3.5%	(8.5%)	(3.5%)	(3.8%)	(0.6%)	(2.1%)	(6.6%)	(9.7%)	(5.3%)	2.1%
Charter Q	(13.3%)	(5.1%)	(8.2%)	(2.6%)	(0.5%)	7.4%	(8.9%)	(5.3%)	(3.8%)	1.4%	(17.7%)	(12.9%)	(10.6%)	(3.1%)
Charter R	9.3%	4.1%	(29.2%)	5.7%	12.0%	(3.0%)	(5.3%)	(6.5%)	(3.8%)	4.9%	13.8%	(26.3%)	(25.2%)	18.4%
Charter S	(14.8%)	26.1%	(36.4%)	(14.9%)	1.7%	(16.3%)	(8.4%)	(8.4%)	(16.5%)	(9.9%)	7.5%	(19.8%)	(45.9%)	(13.5%)
Charter T	60.8%	38.1%	55.1%	130.8%	n/a	n/a	51.3%	74.7%	n/a	n/a	122.0%	114.1%	257.9%	n/a



Summary Table: “Other Matters” Testing Results

	Current Ratio			Quick Ratio			Net Current Assets			Working Ratio			Leverage Ratio		
	FY17	FY16	FY15	FY17	FY16	FY15	FY17	FY16	FY15	FY17	FY16	FY15	FY17	FY16	FY15
Charter A	7.57	4.39	3.21	6.38	3.72	2.90	Positive	Positive	Positive	0.89	0.83	0.94	8.0%	6.4%	6.5%
Charter B	0.64	2.54	2.59	0.51	2.02	1.51	Negative	Positive	Positive	0.79	0.82	0.88	13.2%	15.5%	14.7%
Charter C	0.74	1.98	3.78	0.73	1.88	3.64	Negative	Positive	Positive	0.97	0.97	0.96	6.8%	6.1%	2.6%
Charter D	14.09	845.59	No liabilities	12.62	697.54	No liabilities	Positive	Positive	Positive	0.87	0.75	0.87	12.0%	12.3%	---
Charter E	2.73	1.55	1.29	2.55	1.46	1.16	Positive	Positive	Positive	0.71	0.78	0.87	21.1%	23.5%	27.1%
Charter F	0.41	0.37	1.29	0.02	0.08	0.82	Negative	Negative	Positive	0.76	1.07	0.96	16.6%	22.3%	17.1%
Charter G	23.74	11.83	5.64	23.74	11.74	5.57	Positive	Positive	Positive	0.84	0.70	0.85	4.5%	3.6%	5.2%
Charter H	18.68	9.84	7.95	11.66	5.59	4.55	Positive	Positive	Positive	0.96	0.96	0.97	26.5%	15.0%	16.2%
Charter I	7.08	8.95	14.46	6.81	8.44	13.06	Positive	Positive	Positive	0.94	1.13	0.90	0.7%	9.2%	9.9%
Charter J	1.75	2.23	1.36	1.60	2.06	1.19	Positive	Positive	Positive	0.86	0.75	0.75	17.2%	17.4%	15.8%
Charter K	0.00	0.31	0.16	0.00	0.20	0.02	Negative	Negative	Negative	1.16	0.96	1.33	20.2%	33.0%	34.3%
Charter L	0.99	0.68	0.39	0.97	0.67	0.38	Negative	Negative	Negative	0.98	1.00	1.12	20.1%	23.7%	27.7%
Charter M	20.06	1.02	1.11	1.92	0.91	0.77	Positive	Positive	Positive	0.97	0.93	1.48	20.3%	22.4%	44.5%
Charter N	3.27	9.23	2.91	1.99	7.28	1.79	Positive	Positive	Positive	0.91	0.78	0.84	9.4%	18.2%	16.4%
Charter O	0.79	0.83	0.36	0.61	0.75	0.33	Negative	Negative	Negative	0.96	0.84	1.11	13.1%	13.6%	16.2%
Charter P	0.45	0.83	0.97	0.07	0.31	0.51	Negative	Negative	Negative	0.85	0.81	0.79	21.0%	20.1%	20.2%
Charter Q	2.48	2.31	4.82	2.01	1.84	1.75	Positive	Positive	Positive	0.81	0.84	0.85	15.2%	14.2%	12.5%
Charter R	1.44	0.86	1.52	1.41	0.86	1.38	Positive	Negative	Positive	0.91	1.03	1.01	12.8%	4.9%	12.4%
Charter S	0.13	0.25	0.50	0.01	0.09	0.03	Negative	Negative	Negative	0.74	1.23	1.01	13.3%	10.2%	18.1%
Charter T	3.88	2.32	1.48	3.87	2.17	1.40	Positive	Positive	Positive	0.70	0.91	0.86	5.0%	6.0%	4.9%

