



# Financial Performance Framework

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## **MEASURES AND SUMMATIVE PERFORMANCE RATINGS GUIDE**

Developed based on framework approved on December 10, 2018 and  
administrative rules approved on July 8, 2019

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## Introduction

Arizona Revised Statutes (“A.R.S.”) requires the Arizona State Board for Charter Schools (“Board”), as a sponsoring entity of a charter school, to ground its actions in evidence of the charter holder’s performance in accordance with the Board’s performance framework and requires the Board’s performance framework to include the financial expectations of the charter school. In December 2018, the Board approved its Financial Performance Framework (“financial framework”) and adopted the administrative rules to implement the financial framework on July 8, 2019.

The financial framework communicates the Board’s expectations for ensuring that all charter holders in its portfolio are viable organizations with strong fiscal management practices. The term “charter holder” refers to the entity that has entered into a charter contract with the Board to operate one or more charter schools. It is important to note that the financial framework analyzes the financial performance of the charter holder, not the charter holder’s process for managing that performance.

## Measures

### General Overview

This section describes each of the financial framework’s six measures and identifies the applicable calculations, measure ratings and data sources. Defined terms are italicized and identified in all capital letters. Each measure’s subsection includes the definitions applicable to that measure.

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 under the financial framework.

A charter holder’s performance as evaluated using the financial framework is represented in a dashboard. Through ASBCS Online, the Board has provided online public access to each charter holder’s financial dashboard and the audits of Board-sponsored charter holders. Information about how to access a charter holder’s financial dashboard and annual audits through ASBCS Online is available on the [Board’s website](#).

## Going Concern

<b>Description</b>	Accounting principles require charter holder management to evaluate their entity's ability to continue operating. Under auditing standards, the charter holder's independent CPA then audits the conclusion reached by management.
<b>Dashboard Displays</b>	Going Concern
<b>Calculation</b>	Considers absence or presence of certain disclosure in the audit
<b>Measure Ratings</b>	<p><b>Meets Standard:</b> The most recent audit does not include explanatory paragraph in Independent Auditor's Report or disclosure in the notes to the financial statements <i>(No substantial doubt about the charter holder's ability to continue is raised in the audit)</i></p> <p><b>Below Standard (in one of two ways):</b></p> <ol style="list-style-type: none"> <li>1. Disclosure in Independent Auditor's Report and financial statement notes <i>(Substantial doubt about the charter holder's ability to continue operating is raised in the audit and is not alleviated by management's plans)</i></li> </ol> <p><b>OR</b></p> <ol style="list-style-type: none"> <li>2. Disclosure in financial statement notes only <i>(Substantial doubt about the charter holder's ability to continue operating is raised in the audit, but is alleviated by management's plans)</i></li> </ol>
<b>Data Source</b>	<ul style="list-style-type: none"> <li>▪ Independent Auditor's Report on the financial statements</li> <li>▪ Notes to the audited financial statements</li> </ul>
<b>Rating Adjustments</b>	None
<b>Definitions</b>	None
<b>Calculation Considerations</b>	None

## Default

<b>Description</b>	Failure to make timely payments or comply with other requirements may result in a lender or landlord issuing a notice of default.
<b>Dashboard Displays</b>	Default
<b>Calculation</b>	Considers absence or presence of certain disclosure in the audit
<b>Measure Ratings</b>	<p><b>Meets Standard:</b> Charter holder is not in default on material loans or facility agreements or both</p> <p><b>Below Standard:</b> Charter holder is in default on material loans or facility agreements or both</p>

<b>Data Source</b>	▪ Notes to the audited financial statements
<b>Rating Adjustments</b>	None
<b>Definitions</b>	None
<b>Calculation Considerations</b>	None

### Unrestricted Days Liquidity

<b>Description</b>	Indicates a charter holder’s available reserve by identifying how many days’ expenses can be paid without another influx of cash.
<b>Dashboard Displays</b>	Available Reserve
<b>Calculation</b>	$(\text{Unrestricted Cash} + \text{OTHER SOURCES OF LIQUIDITY}) \text{ divided by } [(\text{Total Expenses} - \text{NONCASH EXPENSES})/365]$
<b>Measure Ratings</b>	<p><b>Meets Standard:</b> 30 or more days liquidity</p> <p><b>Approaches Standard:</b> At least 15 days liquidity but fewer than 30 days liquidity</p> <p><b>Below Standard:</b> Fewer than 15 days liquidity</p>
<b>Data Source</b>	<ul style="list-style-type: none"> <li>▪ Audited statement of financial position (balance sheet)</li> <li>▪ Audited statement of activities (income statement)</li> <li>▪ Audited statement of cash flows (cash flow statement)</li> <li>▪ Notes to the audited financial statements</li> <li>▪ Compliance questionnaire</li> </ul>
<b>Rating Adjustments</b>	None
<b>Definitions</b>	<p>OTHER SOURCES OF LIQUIDITY = Available balances from any sources of liquidity other than cash that are disclosed in the audit and may include, but not be limited to, lines of credit.</p> <p>NONCASH EXPENSES = May include depreciation, amortization and write-offs of loan issuance costs and prepayment penalties.</p>
<b>Calculation Considerations</b>	The unspent Classroom Site Fund (“CSF”) balance at June 30 is considered restricted and, therefore, is removed to arrive at the charter holder’s Unrestricted Cash.

## Adjusted Net Income

<b>Description</b>	Considers whether a charter holder is operating within its available resources. If the charter holder's adjusted expenses exceed its revenues (negative adjusted net income), then performance on this measure also considers the percentage calculated by dividing the charter holder's adjusted net income by its total revenues.
<b>Dashboard Displays</b>	Revenues Exceed Expenses
<b>Calculation</b>	Total Revenues minus (Total Expenses – <i>NONCASH EXPENSES</i> )  [NOTE: If Adjusted Net Income is zero or negative, the Adjusted Net Income is divided by Total Revenues.]
<b>Measure Ratings</b>	<p><b>Meets Standard:</b> Adjusted net income is greater than or equal to \$1</p> <p><b>Approaches Standard:</b> Adjusted net income is zero or negative <u>and</u> adjusted net Income divided by total revenues is between 0 and negative 4.99%</p> <p><b>Below Standard:</b> Adjusted net income is negative <u>and</u> adjusted net income divided by total revenue is less than or equal to negative 5%</p>
<b>Data Source</b>	<ul style="list-style-type: none"> <li>▪ Audited statement of activities (income statement)</li> <li>▪ Audited statement of cash flows (cash flow statement)</li> </ul>
<b>Rating Adjustments</b>	None
<b>Definitions</b>	NONCASH EXPENSES = May include depreciation, amortization and write-offs of loan issuance costs and prepayment penalties.
<b>Calculation Considerations</b>	None

## Lease Adjusted Debt Service Coverage Ratio

<b>Description</b>	Considers how easily debt principal, interest and facility costs can be paid as they become due. 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.
<b>Dashboard Displays</b>	Facility & Debt Costs Covered
<b>Calculation</b>	(Adjusted Net Income + Interest Expense + Facility Lease Expense) divided by ( <i>DEBT PRINCIPAL</i> + Interest + Facility Lease Expense)
<b>Measure Ratings</b>	<p><b>Meets Standard:</b> Lease adjusted debt service coverage ratio exceeds 1.10</p> <p><b>Approaches Standard:</b> Lease adjusted debt service coverage ratio is between 1.0 and 1.10</p>

**Below Standard:**

Lease adjusted debt service coverage ratio is less than 1.0

- Data Source**
- Audited statement of activities (income statement)
  - Audited statement of cash flows (cash flow statement)
  - Notes to the audited financial statements

**Rating Adjustments** None

**Definitions** DEBT PRINCIPAL = Includes principal payments associated with bonds or loans for a charter that purchases its facilities, as well as other long-term loans obtained by a charter holder, and capital leases.

**Calculation Considerations** None

**Average Daily Membership**

**Description** Averages the annual percent change in the charter holder’s student count used for state funding for the three most recent completed school years. The measure considers the most recent four fiscal years of average daily membership (“ADM”) data available.

**Dashboard Displays** Stable or Increasing # of Students

**Calculation**

1. Calculate the annual growth rates  
 [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  
 Year 2 Growth Rate = (Year 2 – Year 3)/Year 3  
 Year 3 Growth Rate = (Year 3 – Year 4)/Year 4
2. Calculate three-year average  
 (Year 1 Growth Rate + Year 2 Growth Rate + Year 3 Growth Rate)/3

**Measure Ratings** **Meets Standard (in one of two ways):**

1. Charter holder has increase

**OR**

2. Charter holder has decrease of:

- SMALL: 4.99% or less
- MEDIUM: 4.99% or less
- LARGE: 2.99% or less

**Approaches Standard:**

Charter holder has decrease of:

- SMALL: 5% to 14.99%
- MEDIUM: 5% to 14.99%
- LARGE: 3% to 9.99%

**Below Standard:**

Charter holder has decrease of:

- SMALL: 15% or more

- MEDIUM: 15% or more
- LARGE: 10% or more

- Data Source**
- ADM calculations completed by the Department using student attendance data submitted to the Department by the charter holder
- Rating Adjustments**
- A charter holder’s “Approaches Standard” or “Below Standard” rating on this measure will be increased by one rating category if the charter holder received no “Below Standard” ratings and no more than one “Approaches Standard” rating on the financial framework’s other five measures. Under this scenario, an initial “Approaches Standard” on this measure would become a “Meets Standard” and an initial “Below Standard” would become an “Approaches Standard.”
  - A charter holder’s “Approaches Standard” or “Below Standard” rating on this measure will be unchanged if the charter holder received one or more “Below Standard” ratings, two or more “Approaches Standard” ratings or both on the financial framework’s other five measures.
- Definitions**
- SMALL = Charter holder with fewer than 200 ADM
- MEDIUM = Charter holder with 200 to 599 ADM
- LARGE = Charter holder with 600 or more ADM
- Calculation Considerations**
- *ADM Adjustment* – Board staff will adjust the annual ADM for the fiscal years used in the calculation when a) the charter holder reduces the grade levels served at its charter school, b) a school transfers from a multi-school charter contract to its own charter contract, or c) a school operating under a multi-school charter contract closes.
  - *Second/Third Year Charters* – For a charter holder with only two years of ADM available, the annual growth rate will be used. For a charter holder with three years of ADM available, the average of the two annual growth rates will be used.

**OTHER CONSIDERATION**

In instances where a charter holder entity has multiple charter contracts with the Board and the Board receives audited financial statements that aggregate the financial activities of all the charter contracts, Board staff will note on each charter contract’s financial performance dashboard the overall ADM performance of the charter holder entity using the ratings described below. The charter holder entity’s performance will not affect the individual charter contract’s performance on the Average Daily Membership measure.

- **Meets Standard:** At least two-thirds of the charter contracts individually received a “Meets Standard.”
- **Approaches Standard:** More than one-third of charter contracts individually received an “Approaches Standard,” less than one-third of charter contracts individually received a “Below Standard,” or both.
- **Below Standard:** More than one-third of charter contracts individually received a “Below Standard.”

**FIRST-YEAR AND SECOND-YEAR FINANCIAL SITE VISITS**

Since only one year of ADM data would be available, the ADM measure will not be applicable for first-year charter contracts. Board staff will visit all new schools approved through the new application, replication or amendment processes in the fall of their first year of operation. Prior to that visit, Board staff would compare enrollment projections identified in the application package or amendment



request to the school's estimated count or, if available, actual ADM. During the visit, Board staff would meet with school officials and review documentation to ascertain the school's current financial situation and, if applicable, discuss adjustments made or planned due to lower than projected enrollment.

Schools will be selected for second-year financial visits based on the results of the first-year visit and first-year audit, as well as the school's second-year estimated count or, if available, actual ADM. Any second-year visits would likely occur in the winter of the school's second year after the prior year's audit has been received or reviewed.

## Summative Financial Performance Ratings

### Good Standing

A charter holder receives a summative financial performance rating of "Good Standing" if the charter holder has no measures rated "Below Standard" and no more than one measure rated "Approaches Standard." A charter holder with a rating of "Good Standing" meets the Board's financial performance expectations.

### Adequate Standing

A charter holder receives a summative financial performance rating of "Adequate Standing" if the charter holder has no measures rated "Below Standard" and two or more measures rated "Approaches Standard." A charter holder with a rating of "Adequate Standing" meets the Board's financial performance expectations.

### Intervention

A charter holder receives a summative financial performance rating of "Intervention" if the charter holder either has a) one or more measures rated "Below Standard" or b) three consecutive years in "Adequate Standing." A charter holder with a rating of "Intervention" must submit information to the Board regarding the charter holder's financial performance.

For additional information regarding the financial intervention process, review the *Financial Intervention Process Guide* available on the [Board's website](#) in the "Financial Performance Framework" section.

## Appendices

- A. Description, Calculation and Data Source for Six Framework Measures
- B. "Meets," "Approaches," and "Below" Standard Ratings for Six Framework Measures

A. Description, Calculation and Data Source for Six Framework Measures

	Going Concern	Default	Unrestricted Days Liquidity	Adjusted Net Income	Lease Adjusted Debt Service Coverage Ratio	Average Daily Membership
<b>Dashboard Displays</b>	Going Concern	Default	Available Reserve	Revenues Exceed Expenses	Facility & Debt Costs Covered	Stable or Increasing # of Students
<b>Description</b>	Accounting principles require charter holder management to evaluate their entity's ability to continue operating. Under auditing standards, the charter holder's independent CPA then audits the conclusion reached by management.	Failure to make timely payments or comply with other requirements may result in a lender or landlord issuing a notice of default.	Indicates a charter holder's available reserve by identifying how many days' expenses can be paid without another influx of cash.	Considers whether a charter holder is operating within its available resources. If the charter holder's adjusted expenses exceed its revenues (negative adjusted net income), then performance on this measure also considers the percentage calculated by dividing the charter holder's adjusted net income by its total revenues.	Considers how easily debt principal, interest and facility costs can be paid as they become due. 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.	Averages the annual percent change in the charter holder's student count used for state funding for the three most recent completed school years. The measure considers the most recent four fiscal years of average daily membership ("ADM") data available. <sup>1</sup>
<b>Calculation</b>	Considers absence or presence of certain disclosure in the audit	Considers absence or presence of certain disclosure in the audit	(Unrestricted Cash + Other Sources of Liquidity) divided by [(Total Expenses – Noncash Expenses)/365] [NOTE: The unspent CSF balance at year-end (June 30) is considered restricted and is removed to arrive at the charter holder's Unrestricted Cash.]	Total Revenues minus (Total Expenses – Noncash Expenses) [NOTE: If Adjusted Net Income is zero or negative, then Adjusted Net Income is divided by Total Revenues.]	(Adjusted Net Income + Interest Expense + Facility Lease Expense) divided by (Debt Principal + Interest + Facility Lease Expense)	1. Calculate Annual Growth Rates ("GR") [NOTE: Year 1 would be the most recent year and Year 4 would be the "oldest" year.] Year 1 GR = (Year 1 – Year 2)/Year 2 Year 2 GR = (Year 2 – Year 3)/Year 3 Year 3 GR = (Year 3 – Year 4)/Year 4  2. Calculate Three-Year Average <sup>2</sup> (Year 1 GR + Year 2 GR + Year 3 GR)/3
<b>Data Source</b>	<ul style="list-style-type: none"> <li>Independent Auditor's Report on the financial statements</li> <li>Notes to the audited financial statements</li> </ul>	<ul style="list-style-type: none"> <li>Notes to the audited financial statements</li> </ul>	<ul style="list-style-type: none"> <li>Audited statement of financial position, audited statement of activities <u>and</u> audited statement of cash flows</li> <li>Notes to the audited financial statements</li> <li>Compliance questionnaire</li> </ul>	<ul style="list-style-type: none"> <li>Audited statement of activities and audited statement of cash flows</li> </ul>	<ul style="list-style-type: none"> <li>Audited statement of activities <u>and</u> audited statement of cash flows</li> <li>Notes to the audited financial statements</li> </ul>	<ul style="list-style-type: none"> <li>ADM calculations completed by the Arizona Department of Education ("Department") using student attendance data submitted to the Department by the charter holder</li> </ul>

<sup>1</sup> Board staff will adjust the annual ADM for the fiscal years used in the calculation when a) the charter holder reduces the grade levels served at its charter school, b) a school transfers from a multi-school charter contract to its own contract, or c) a school operating under a multi-school charter contract closes.

<sup>2</sup> For a charter holder with only two years of ADM available, the annual growth rate will be used. For a charter holder with three years of ADM available, the average of the two annual growth rates will be used.

**B. “Meets,” “Approaches,” and “Below” Standard Ratings for Six Framework Measures**

	Going Concern	Default	Unrestricted Days Liquidity	Adjusted Net Income	Lease Adjusted Debt Service Coverage Ratio	Average Daily Membership <sup>3 4</sup>
<b>Meets Standard</b>	No substantial doubt about the charter holder’s ability to continue is raised in the Independent Auditor’s Report or the notes to the audited financial statements	Charter holder is not in default on material loans or facility agreements or both	30 or more days liquidity	Adjusted net income is greater than or equal to \$1	Lease adjusted debt service coverage ratio exceeds 1.10	1. Charter holder has <u>increase</u> <b>OR</b> 2. Charter holder has <u>decrease</u> of: <ul style="list-style-type: none"> <li>• <i>SMALL</i>: 4.99% or less</li> <li>• <i>MEDIUM</i>: 4.99% or less</li> <li>• <i>LARGE</i>: 2.99% or less</li> </ul>
<b>Approaches Standard</b>	<i>No “Approaches Standard” criteria established for this measure</i>	<i>No “Approaches Standard” criteria established for this measure</i>	At least 15 days but fewer than 30 days liquidity	Adjusted net income is zero or negative <u>and</u> adjusted net income divided by total revenues is between 0% and negative 4.99%	Lease adjusted debt service coverage ratio is between 1.0 and 1.10	Charter holder has <u>decrease</u> of: <ul style="list-style-type: none"> <li>• <i>SMALL</i>: 5% to 14.99%</li> <li>• <i>MEDIUM</i>: 5% to 14.99%</li> <li>• <i>LARGE</i>: 3% to 9.99%</li> </ul>
<b>Below Standard</b>	1. Substantial doubt about the charter holder’s ability to continue operating is raised in the Independent Auditor’s Report and notes to the audited financial statements and is not alleviated by management’s plans <b>OR</b> 2. Substantial doubt about the charter holder’s ability to continue operating is raised in the notes to the audited financial statements, but is alleviated by management’s plans	Charter holder is in default on material loans or facility agreements or both	Fewer than 15 days liquidity	Adjusted net income is negative <u>and</u> adjusted net income divided by total revenues is less than or equal to negative 5%	Lease adjusted debt service coverage ratio is less than 1.0	Charter holder has <u>decrease</u> of: <ul style="list-style-type: none"> <li>• <i>SMALL</i>: 15% or more</li> <li>• <i>MEDIUM</i>: 15% or more</li> <li>• <i>LARGE</i>: 10% or more</li> </ul>

<sup>3</sup> A charter holder’s “Approaches Standard” or “Below Standard” rating on the Average Daily Membership measure will be increased by one rating category if the charter holder received no “Below Standard” and no more than one “Approaches Standard” rating on the financial framework’s other five measures. Under this scenario, an initial “Approaches Standard” on the Average Daily Membership measure would become a “Meets Standard” and an initial “Below Standard” would become an “Approaches Standard.” A charter holder’s “Approaches Standard” or “Below Standard” rating on the ADM measure will be unchanged if the charter holder received one or more “Below Standard” ratings, two or more “Approaches Standard” ratings, or both on the financial framework’s other five measures.

<sup>4</sup> The criteria identified will be applied to charter holders with only two years of ADM available (annual growth rate) or charter holders with three years of ADM available (average of two annual growth rates).