



# Arizona State Board for Charter Schools

## Financial Performance Framework and Guidance

---

As Revised on ~~October 10, 2017~~DATE

### Historical Note:

Effective: August 13, 2012  
Revision effective October 10, 2017, DATE

Board Approval Date: August 13, 2012; September 9, 2013, October 15, 2013, October 14, 2014, June 13, 2016, October 10, 2017, DATE

Revised: September 9, 2013, October 15, 2013, October 14, 2014, June 13, 2016, October 10, 2017, DATE

Section	Page Number
Financial Performance Framework Structure	2
Using of the Financial Performance Framework Measures in Detail	4
Appendix A – Financial Performance Framework	8
Appendix B – Financial Expectations Not Met: Charter Holder Action & Board Consideration	15
Appendix C – Financial Performance Response & Evaluation	17
Appendix D – Definition of Terms	23
	24

---

Support and funding for the development of the Arizona State Board for Charter Schools Performance Framework, which includes the Academic Framework, Operational Framework and Financial Framework, were provided by NACSA and through its Fund for Authorizing Quality.



Additional funding to support the implementation of the Performance Framework was provided by:

- Governor Brewer’s Office of Education Innovation
- Arizona Community Foundation
- Stand for Children
- Rodel Charitable Foundation of Arizona
- Arizona Virtual Academy

---

The Arizona State Board for Charter Schools Performance Framework is licensed under a Creative Commons Attribution-Noncommercial-ShareAlike license.

Considerable portions of this document are reproduced from work created and shared by the National Association of Charter School Authorizers, available under a Creative Commons Attribution-Noncommercial-ShareAlike license at <http://www.qualitycharters.org/>. Copyright ©2013 National Association of Charter School Authorizers (NACSA)

A Creative Commons license permits noncommercial re-use of content when proper attribution is provided. This means you are free to copy, display and distribute this work, or include content from the application in derivative works, under the following conditions:

**Attribution** You must clearly attribute the work to the National Association of Charter School Authorizers, and provide a link back to the publication at <http://www.qualitycharters.org/>.

**Noncommercial** You may not use this work for commercial purposes, including but not limited to any type of work for hire, without explicit prior permission from NACSA.

**Share Alike** If you alter, transform, or build upon this work, you may distribute the resulting work only under a license identical to this one.

For the full legal code of this Creative Commons license, please visit [www.creativecommons.org](http://www.creativecommons.org). If you have any questions about citing or reusing NACSA content, please contact us.

## 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 financial performance rating determinations.

### **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 the 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.

## **Measures**

Measures are the general means to evaluate an aspect of an indicator. Six measures are used in the financial framework: Going Concern, Unrestricted Days Liquidity, Default, 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 measure 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 charter holder.

### *Does Not Meet Standard*

The charter holder’s performance on this measure signals a moderate financial risk to the charter holder and does not meet the Board’s expectation. This measure may require follow up depending on the interplay with other measures. Charter holders not meeting the standard in more than one measure are required to submit a financial performance response as addressed in the “Evaluation and Intervention” section of this document and Appendix B. Not meeting the standard may have an adverse impact on the consideration of the renewal application package and other requests made by the charter holder or at times when disciplinary action is considered. Charter holders may also be limited in their ability to expand their operations.

### *Falls Far Below Standard*

The charter holder’s performance on this measure signals a potentially significant financial risk to the charter holder and is far below the Board’s expectation. Charter holders are required to submit a financial performance response as addressed in the “Evaluation and Intervention” section of this document and Appendix B. Falling far below the standard may have an adverse impact on the consideration of the renewal application package and other requests made by the charter holder or at times when disciplinary action is considered. Charter holders may be limited in their ability to expand their operations.

## **USING USE OF 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 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:

<b>Non-profit</b>	<b>For-profit</b>	<b>Governmental</b>
Statement of Financial Position	Balance Sheet	Statement of Net Assets
Statement of Activities and Changes in Net Assets <sup>1</sup>	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-sponsored charter holders. Information about how to access the annual audit reporting packages through ASBCS Online is available on the [Board’s website](#).

### **Evaluation and Intervention**

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 annually using the charter holder’s most recent audit reporting package and a determination is made as to whether the charter holder met the Board’s financial performance standard for the audited fiscal year and whether the charter holder met the Board’s financial performance expectations. A charter holder that does not meet the Board’s financial performance expectations may be required to submit a financial performance response.

#### Meets the Board’s Financial Performance Standard

To meet the financial performance standard, the charter holder must receive no “Falls Far Below Standard” ratings and no more than one “Does Not Meet Standard” rating using the most recent

---

<sup>1</sup> This statement may also be referred to as the “statement of activities”.

annual audit. A charter holder that receives two or more “Does Not Meet Standard”, one or more “Falls Far Below Standard”, or both based on the charter holder’s most recent audit reporting package does not meet the Board’s financial performance standard.<sup>2</sup>

Meets the Board’s Financial Performance Expectations

As shown in the table below, a charter holder’s financial performance for the most recent audited fiscal year and the prior audited fiscal year are used to determine whether the charter holder meets the Board’s financial performance expectations.

Previous Audit	Most Recent Audit	Meets Board’s Financial Performance Expectations?
<b>MEETS</b> financial performance standard	<b>MEETS</b> financial performance standard	<b>Yes</b>
<b>DOES NOT MEET</b> financial performance standard	<b>MEETS</b> financial performance standard	<b>Yes</b>
<b>MEETS</b> financial performance standard	<b>DOES NOT MEET</b> financial performance standard; <b>no measure receives “Falls Far Below Standard”</b>	<b>Yes</b>
<b>MEETS</b> financial performance standard	<b>DOES NOT MEET</b> financial performance standard; <b>1 or more measures receive “Falls Far Below Standard”</b>	<b>No</b>
<b>DOES NOT MEET</b> financial performance standard	<b>DOES NOT MEET</b> financial performance standard	<b>No</b>

Financial Performance Dashboard

A charter holder’s financial performance is represented in a dashboard format, which summarizes the charter holder’s performance on each measure. The financial performance dashboard (“dashboard”) reflects financial performance for the two most recent audited years, identifies whether the performance meets the Board’s expectations, and becomes publicly available through ASBCS Online after the audit is reviewed and the financial data entered by

---

<sup>2</sup> 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 or the consolidated/combined entity to meet the Board’s financial performance expectations will result in the charter holder being required to submit a financial performance response.

Board staff.<sup>3</sup> Information about how to access and interpret the dashboards is available on the [Board's website](#).

#### Financial Eligibility for Expansion Requests

A charter holder is eligible to submit or, as applicable, to be the receiving party in the expansion requests identified below if all of the following are true:

1. A dashboard for the charter holder is available through ASBCS Online<sup>4</sup>.
2. The charter holder has no measure rated "Falls Far Below Standard" for the most recent fiscal year presented on the charter holder's dashboard.
3. 75 percent or more of all Associated Charters (defined below) have no measure rated "Falls Far Below Standard" for the most recent fiscal year presented on the Associated Charters' dashboards. If one or more Associated Charters are excluded for financial performance purposes, then 100 percent of the remaining Associated Charters must have no measure rated "Falls Far Below Standard" for the most recent fiscal year presented on the Associated Charters' dashboards.
4. The charter holder meets the academic and operational eligibility requirements.

Expansion requests include:

- Adding a new ~~charter~~ school that is currently not in operation under an existing charter contract
- Increasing the number of students the charter holder may serve at its school(s)
- Adding or changing to an Arizona Online Instruction (AOI) program of instruction
- Increasing the grade levels the charter holder is approved to serve
- Replicating an existing charter
- Transferring a charter school from an existing charter contract to its own charter contract<sup>5</sup>
- Transferring a charter school or charter contract from the current charter holder to an existing charter holder with a different dashboard<sup>6</sup>

For eligibility determination purposes, an Associated Charter is:

- A charter operated by a charter holder that contracts with the same education service provider.
- A charter operated by the same charter holder.
- A charter operated by a charter holder with at least 50 percent of the officers, directors, members or partners in common, as reflected in the charter contract.

An Associated Charter may be excluded if the Associated Charter is in its first year of operation and has not yet submitted its first audit reporting package to the Board.

---

<sup>3</sup> In those instances where the Board receives financial statements that cover multiple and different charter holder entities, the charter holder's dashboard will include both the charter holder's financial performance and the financial performance of the consolidated/combined entity. (See also footnote 2.)

<sup>4</sup> The Board must have received the charter holder's first audit reporting package for the charter holder to be eligible to submit an expansion request. If the audit reporting package has been submitted but a dashboard is not available through ASBCS Online, please contact your Education Program Manager.

<sup>5</sup> The eligibility requirements apply whether the charter school is being transferred to its own charter contract that will be held by a charter holder with the same name or with a different name as the existing charter holder.

<sup>6</sup> For these requests, only the financial performance of the receiving charter holder is considered when determining eligibility.

If during the processing of one of the expansion requests identified above the Board receives the next audit reporting package for the charter holder, Associated Charter(s) or both, then Board staff will update the applicable dashboard(s) and reevaluate the charter holder's eligibility based on the most recent audit reporting package(s). For a charter holder determined to no longer be financially eligible, Board staff will notify the charter holder and close the request.

#### Review of Charter Holders' Financial Performance

A charter holder's financial performance will be considered by the Board at the following times:<sup>7</sup>

- When considering a charter contract renewal request submitted by the charter holder
- During five-year interval review~~s~~
- Upon receipt of information that a charter school operated by the charter holder has been assigned a letter grade of "F" under the state accountability system
- If a charter school operated by a charter holder has failed to meet the Board's academic performance standard for three consecutive years
- Addition of a new school that is currently not in operation under an existing charter contract<sup>8</sup>
- Increase in the number of students the charter holder may serve at its school(s)<sup>8</sup>
- Addition of or change to an AOI program of instruction<sup>8</sup>
- Increase in the grade levels the charter holder is approved to serve<sup>8</sup>
- Replication of an existing charter<sup>8</sup>
- Transfer of a charter school from an existing charter contract to its own charter contract held by a charter holder with a different name than the existing charter holder<sup>8</sup>
- Transfer of a charter school or charter contract from the current charter holder to an existing charter holder with a different dashboard<sup>8</sup>
- Transfer of the charter contract from another sponsor to the Board
- ~~When~~ When the Board makes decisions related to a charter holder's academic performance, a charter holder's compliance with its charter and state and federal laws~~, or~~
- ~~when~~ When a new charter application package is submitted by an officer, director, partner, member or charter representative of the charter holder<sup>9</sup>

#### Financial Performance Response

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.
- 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 that meets the Board's financial performance expectations will be waived from submitting a financial performance response at the times identified in the "Review of Charter

---

<sup>7</sup> At the time of consideration by the Board, the most current audited financial information will be provided.

<sup>8</sup> The Board has established financial eligibility criteria for this request (see "Financial Eligibility for Expansion Requests" section).

<sup>9</sup> In these situations, a charter holder will be able to address its financial performance at the Board meeting, but an opportunity will not be built in to the process for the charter holder to provide a written response in advance of the meeting.

Holders' Financial Performance" section and in Appendix B. A charter holder that does not meet the Board's financial performance expectations at the times identified in the "Review of Charter Holders' Financial Performance" section and in Appendix B will be required to submit a financial performance response if, as applicable, the charter holder meets the eligibility requirements identified in the "Financial Eligibility for Expansion Requests" section. For more information regarding the financial performance response, please see Appendix C.

For requests involving the transfer of a charter school or charter contract from a current charter holder to a charter holder with a different dashboard, both the current charter holder and the eligible receiving charter holder must meet the Board's financial performance expectations to be waived from submitting a financial performance response. If the receiving charter holder meets the eligibility requirements, but one or both charter holders do not meet the Board's financial performance expectations, then the charter holder(s) that does not meet the Board's financial performance expectations will be required to submit a financial performance response.

If only one year of financial performance is available, a charter holder seeking to submit an expansion request must meet the Board's financial performance standard in order to be waived from submitting a financial performance response.

## MEASURES IN DETAIL

This section describes each of the measures included in the financial framework. A charter holder's financial performance is evaluated annually 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.

### 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 Liquidity – Near-Term Indicator

**Definition:** *The unrestricted days liquidity measure indicates how many days a charter holder can pay its expenses without an 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 reserve is a common best practice. The unrestricted days liquidity measure translates into a more readily understandable number a charter holder's unrestricted cash balance and available balances from other sources of liquidity disclosed in the annual audit reporting package, including lines of credit. 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<sup>10</sup>.

<sup>10</sup> 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 Liquidity: (Unrestricted Cash + Other Sources of Liquidity\*) divided by (Total Expenses/365)**

\* "Other Sources of Liquidity" is defined as available balances from any sources of liquidity other than cash that are disclosed in the annual audit reporting package and may include, but not be limited to, lines of credit.

[Note: The Classroom Site Fund cash carryover balance at June 30<sup>th</sup> would be considered restricted cash and, therefore, would be removed as part of identifying a charter holder's unrestricted cash as of June 30<sup>th</sup>.]

**Meets Standard:**

30 or more days liquidity

**Does Not Meet Standard:**

At least 15 days liquidity but fewer than 30 days liquidity

**Falls Far Below Standard:**

Fewer than 15 days liquidity

**Basis for Target Level:** Having access to cash or other sources of liquidity 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 or other liquidity 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 of cash or other liquidity, 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. 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.

**2a. 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.

**2b. 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 liquidity 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 three-year cumulative cash flow. For information regarding the underlying factors that have contributed to the annual 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.

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.

<b>Cash Flow Calculation Example</b>
<p>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</p>
<p>Add together the FY2012 Cash Flow, FY2011 Cash Flow, and FY2010 Cash Flow to determine the three-year cumulative cash flow.</p>

**Source of Data:** Audited statement of financial position.

<i>2b. Cash Flow: One-Year Cash Flow = Current Year Total Cash less Prior Year Total Cash</i>
<p><i>Meets Standard:</i></p> <p><input type="checkbox"/> Three-year cumulative cash flow is positive</p>
<p><i>Does Not Meet Standard:</i></p> <p><input type="checkbox"/> Three-year cumulative cash flow is negative</p>
<p><i>Falls Far Below Standard:</i></p> <p>No “Falls Far Below Standard” target established for this measure</p>

**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.

**2c. 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 interest 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.

<p><i>2c. 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)</i></p> <p><i>* Net Income After Tax would be used when calculating the ratio for for-profit charter holders.</i></p>
<p><i>Meets Standard:</i></p> <p><input type="checkbox"/> Fixed Charge Coverage Ratio is equal to or exceeds 1.10</p>
<p><i>Does Not Meet Standard:</i></p> <p><input type="checkbox"/> Fixed Charge Coverage Ratio is less than 1.10</p>
<p><i>Falls Far Below Standard:</i></p> <p>No "Falls Far Below Standard" target established for this measure</p>

**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.

**INSERT APPENDICES**

