

Discussion Financial Framework – Measures, Targets and Proposed Changes

During its meeting on September 27, 2018, the Financial Framework Subcommittee directed Board staff to a) distribute for public comment the measures and targets currently under consideration by the Subcommittee (“discussion framework”) and b) provide all comments received to the Subcommittee at its October 11, 2018 meeting. On September 28, 2018, staff distributed through the newsletter listserv a table identifying the measures, targets and formulas being considered in the discussion framework along with a description on how the discussion framework measure differs from the current framework measure. At the end of the comment window on October 5, 2018, staff received four responses, which have been included in this document beginning on page 9.

For each discussion framework measure, the tables found on page 2 through page 6 provide the formula proposed by the Subcommittee and the ratings and targets used in the current financial framework and the discussion framework proposed by the Subcommittee at its September 27, 2018 meeting. The tables also identify changes proposed by staff to the discussion framework.

- **Language Used for Measure Ratings** – Instead of “Does Not Meet Standard” and “Falls Far Below Standard”, the language has been changed to “Approaches Standard” and “Below Standard”. “Meets Standard” will continue to be used.
- **Colors Used for Measure Ratings** – Instead of green, pink and red, the colors have been changed to green, yellow and red.
- **Measure Targets** – Changes have been proposed to the Going Concern (page 2) and Lease Adjusted Debt Service Coverage Ratio (page 6) targets. In the respective tables, these changes are underlined and *italicized*.
- **Measure Elimination** – Elimination of the Cash Flow measure has been proposed (page 5).

Charts showing the portfolio’s actual performance under the current framework and projected performance under the discussion framework for fiscal years 2017, 2016 and 2015 may be found on page 7.

GOING CONCERN

Performance rating based on absence or presence of certain disclosure in audit

Current Framework

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

Falls Far Below Standard (in one of two ways):

1. 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
2. Disclosure included in notes to the financial statements for the most recent audit reporting package, but no modification to Independent Auditor's Report

Discussion Framework 9/27/18 Subcommittee

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

Falls Far Below Standard (in one of two ways):

1. 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
2. Disclosure included in notes to the financial statements for the most recent audit reporting package, but no modification to Independent Auditor's Report

Proposed Changes to 9/27/18 Discussion Framework

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

Below Standard (in one of two ways):

1. Disclosure in Independent Auditor's Report and financial statements notes
(Substantial doubt about charter's ability to continue is raised and is not alleviated by management's plans)
- OR
2. Disclosure in financial statements only
(Substantial doubt about charter's ability to continue is raised but is alleviated by management's plans)

DEFAULT

Performance rating based on absence or presence of certain disclosure in audit

Current Framework

DEFAULT

Meets Standard:

Charter holder is not in default on material loans

Falls Far Below Standard:

Charter holder is in default on material loans

Discussion Framework 9/27/18 Subcommittee

DEFAULT

Meets Standard:

Charter holder is not in default on material loans

Falls Far Below Standard:

Charter holder is in default on material loans

Proposed Changes to 9/27/18 Discussion Framework

DEFAULT

Meets Standard:

Charter holder is not in default on material loans

Below Standard:

Charter holder is in default on material loans

UNRESTRICTED DAYS LIQUIDITY

(Unrestricted Cash¹ + Other Sources of Liquidity²) divided by [(Total Expenses – Noncash Expenses³)/365]

Current Framework

UNRESTRICTED DAYS LIQUIDITY

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

Discussion Framework 9/27/18 Subcommittee

UNRESTRICTED DAYS LIQUIDITY

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

Proposed Changes to 9/27/18 Discussion Framework

UNRESTRICTED DAYS LIQUIDITY

Meets Standard:

30 or more days liquidity

Approaches Standard:

At least 15 days liquidity but fewer than 30 days liquidity

Below Standard:

Fewer than 15 days liquidity

¹ The unspent Classroom Site Fund balance at June 30th is considered restricted, and, therefore, is removed to arrive at the charter holder's Unrestricted Cash.

² 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.

³ Noncash Expenses may include depreciation, amortization and write-offs of loan issuance costs and prepayment penalties.

ADJUSTED NET INCOME

Total Revenues minus (Total Expenses – Noncash Expenses⁴)

Current Framework

NET INCOME

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

Discussion Framework 9/27/18 Subcommittee

ADJUSTED NET INCOME

Meets Standard:

Adjusted net income is greater than or equal to \$1

Does Not Meet Standard:

Adjusted net income is zero or negative and adjusted net income divided by total revenue is between 0 and negative 4.99 percent

Falls Far Below Standard:

Adjusted net income is negative and adjusted net income divided by total revenue is less than or equal to negative 5 percent

Proposed Changes to 9/27/18 Discussion Framework

ADJUSTED NET INCOME

Meets Standard:

Adjusted net income is greater than or equal to \$1

Approaches Standard:

Adjusted net income is zero or negative and adjusted net income divided by total revenue is between 0 and negative 4.99 percent

Below Standard:

Adjusted net income is negative and adjusted net income divided by total revenue is less than or equal to negative 5 percent

⁴ Noncash Expenses may include depreciation, amortization and write-offs of loan issuance costs and prepayment penalties.

CASH FLOW

One-year cash flow = Current Year Total Cash minus Prior Year Total Cash

Current Framework

CASH FLOW

Meets Standard:

Three-year cumulative cash flow is positive

Does Not Meet Standard:

Three-year cumulative cash flow is negative

Discussion Framework 9/27/18 Subcommittee

CASH FLOW

Meets Standard:

Three-year cumulative cash flow is positive

Does Not Meet Standard:

Three-year cumulative cash flow is negative

Proposed Changes to 9/27/18 Discussion Framework

CASH FLOW

Eliminate measure from financial framework

FURTHER EXPLANATION FOR PROPOSED CHANGES

Based on public comment received for this meeting and previously, as well as staff’s analysis of the relationship between the Cash Flow measure and the discussion framework’s other measures, staff has proposed eliminating the Cash Flow measure. Staff’s analysis indicates the Cash Flow measure does not provide new information for the Board’s consideration, but rather reinforces information already available through discussion framework’s other measures.

	Fiscal Year 2017	Fiscal Year 2016	Fiscal Year 2015
1. # with “Does Not Meet” (Negative Cash Flow) on Cash Flow Measure ⁵	112	80	98
2. # (%) where Cash Flow Was Only Issue (Other Measures Received “Meets”)	23 (20.5%)	28 (35%)	34 (35%)
3. Difference Between #1 and #2 [# (%)]	89 (79.5%)	52 (65%)	64 (65%)
4. Of Those Identified in #3, # (%) that Received One or More “Falls Far Below Standard” on Other Measures	73 (82%)	36 (69%)	52 (81%)

⁵ The number (percent) of charters that met the Cash Flow measure’s target in fiscal year 2017, fiscal year 2016 and fiscal year 2015 was 303 (73%), 330 (80.5%) and 306 (75.7%), respectively.

LEASE ADJUSTED DEBT SERVICE COVERAGE RATIO

(Adjusted Net Income + Interest Expense + Facility Lease Expense) divided by (Debt Principal⁶ + Interest + Facility Lease Expense)

Current Framework

FIXED CHARGE COVERAGE RATIO

Meets Standard:

Fixed Charge Coverage Ratio is equal to or exceeds 1.10

Does Not Meet Standard:

Fixed Charge Coverage Ratio is less than 1.10

Falls Far Below Standard:

No “Falls Far Below Standard” target established for this measure

Discussion Framework 9/27/18 Subcommittee

LEASE ADJUSTED DEBT SERVICE COVERAGE RATIO

Meets Standard:

Lease Adjusted Debt Service Coverage Ratio exceeds 1.10

Does Not Meet Standard:

Lease Adjusted Debt Service Coverage Ratio is between 1.0 and 1.10

Falls Far Below Standard:

Lease Adjusted Debt Service Coverage Ratio is less than 1.0

Proposed Changes to 9/27/18 Discussion Framework

LEASE ADJUSTED DEBT SERVICE COVERAGE RATIO

Meets Standard:

Lease Adjusted Debt Service Coverage Ratio exceeds 1.10

Approaches Standard *(in one of two ways)*:

Lease Adjusted Debt Service Coverage Ratio is between 1.0 and 1.10

OR

Lease Adjusted Debt Service Coverage Ratio is less than 1.0 and Charter Holder received a “Meets Standard” for Unrestricted Days Liquidity

Below Standard:

Lease Adjusted Debt Service Coverage Ratio is less than 1.0 and Charter Holder did not receive a “Meets Standard” for Unrestricted Days Liquidity

FURTHER EXPLANATION FOR PROPOSED CHANGES

Based on verbal feedback and internal conversations, staff has proposed the changes identified above to capture what the Subcommittee wants to accomplish through the new financial framework. **For the first two or three years of audits⁷ reviewed under the new financial framework, staff proposes considering a charter’s performance on the Lease Adjusted Debt Service Coverage Ratio in conjunction with the charter’s Unrestricted Days Liquidity since a cash reserve could also contribute to the charter’s ability to cover its facility and debt obligations. Once the phase-in period concludes, the “Approaches Standard” target would be “Lease Adjusted Debt Service Coverage Ratio is between 1.0 and 1.10” and the “Below Standard” target would be “Lease Adjusted Debt Service Coverage Ratio is less than 1.0”.**

⁶ Debt Principal includes principal payments associated with bonds/loans for a charter that purchases its facilities, as well as other long-term loans obtained by a charter and capital leases.

⁷ The first two years of audits reviewed under the new financial framework could be fiscal year 2019 and fiscal year 2020. The first three years of audits reviewed under the new financial framework could be fiscal year 2019, fiscal year 2020 and fiscal year 2021.

MEASURE-BY-MEASURE PERFORMANCE – CURRENT AND DISCUSSION FRAMEWORKS

Focusing on the proposed remaining five discussion measures, the charts below show the portfolio’s actual performance under the current framework and projected performance under the discussion framework for fiscal year 2017 (415 contracts), fiscal year 2016 (410 contracts) and fiscal year 2015 (404 contracts).

Current Framework

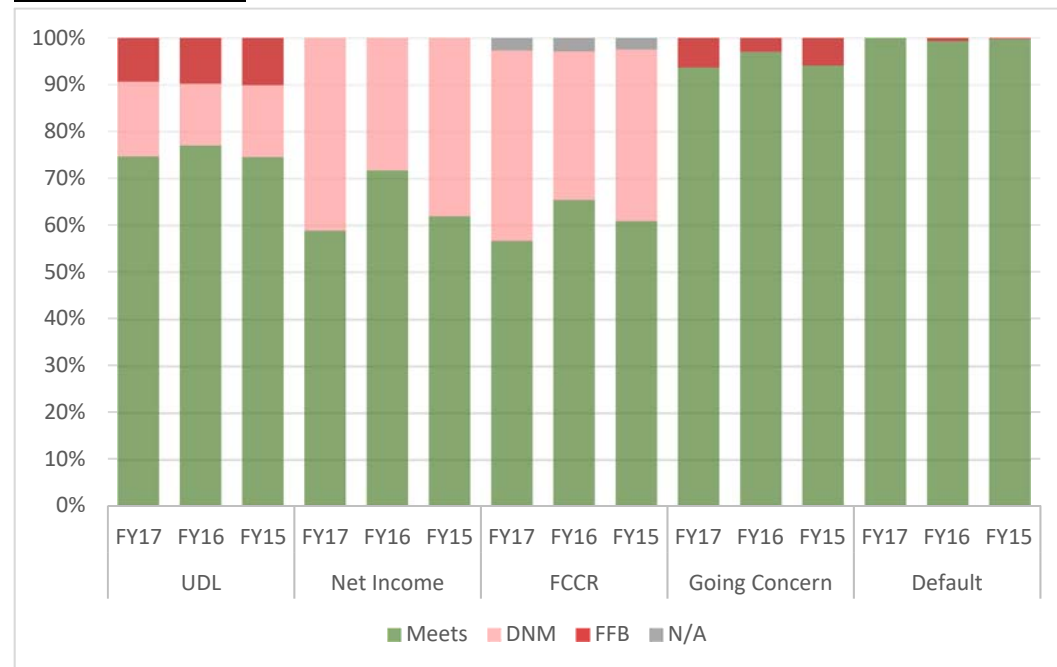
Unrestricted Days Liquidity (“UDL”)
 Net Income
 Fixed Charge Coverage Ratio (“FCCR”)
 Going Concern
 Default

Discussion Framework

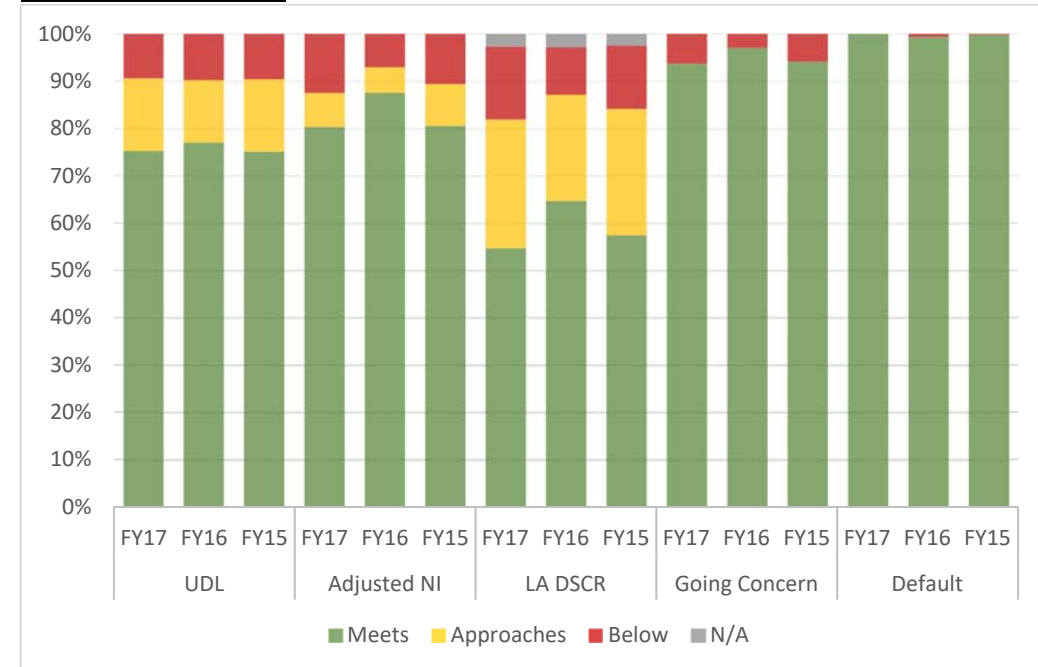
Unrestricted Days Liquidity (“UDL”)
 Adjusted Net Income (“Adjusted NI”)
 Lease Adjusted Debt Service Coverage Ratio (“LA DSCR”)
 Going Concern
 Default

For the discussion framework chart, the percentages identified for the UDL and Adjusted NI reflect adjustments made for depreciation and amortization, but may not capture other noncash expenses since they are not part of the current framework. Even though the LA DSCR uses the current year’s debt principal and the FCCR uses the next year’s debt principal, estimates of the portfolio’s performance on the LA DSCR were included in the discussion framework chart based on the results from the sample testing of the 20 charters.

Current Framework



Discussion Framework



**Public Comment Received Between
September 28, 2018 and October 5, 2018**



Andrea Leder <andrea.leder@asbcs.az.gov>

Re: Financial Framework question

1 message

Dr. Mary Ellen Halvorson <mehalvorson@tricityprep.org>
To: Andrea Leder <andrea.leder@asbcs.az.gov>

Wed, Oct 3, 2018 at 7:51 AM

In that case, I would suggest the framework be changed to encourage charter schools to save and pay cash rather than go into debt. It is financially irresponsible of the framework to reward debt and penalize saving and paying cash.

Mary Ellen Halvorson PhD Ed

Superintendent

Tri-City College Prep High School

5522 Side Road

Prescott, AZ 86301

PH (928) 777-0403

FAX (928) 777-0402

From: Andrea Leder <andrea.leder@asbcs.az.gov>**Sent:** Tuesday, October 2, 2018 4:53:34 PM**To:** Dr. Mary Ellen Halvorson**Subject:** Re: Financial Framework question

It is possible that it would show as negative cash flow for the year.

Andrea Leder

Assistant Director of Operations & Finance



Arizona State Board for Charter Schools

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----- Forwarded message -----

From: **Dr. Mary Ellen Halvorson** <mehalvorson@tricityprep.org>

Date: Mon, Oct 1, 2018 at 4:40 PM

Subject: Financial Framework question

To: charterschoolboard@asbcs.az.gov <charterschoolboard@asbcs.az.gov>

I am a little concerned about the cash flow targets. If a school saves money to purchase something or do some construction that costs so much it makes expenses more than income, would that show as a negative cash flow?

Mary Ellen Halvorson PhD Ed

Superintendent

Tri-City College Prep High School

[5522 Side Road](#)

[Prescott, AZ 86301](#)

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[FAX \(928\) 777-0402](#)



Charter School Board - ASBCS <charterschoolboard@asbcs.az.gov>

Financial Framework Feedback

1 message

Brandon Dahl <Brandon.Dahl@imagineschools.org>

Fri, Oct 5, 2018 at 7:37 AM

To: "charterschoolboard@asbcs.az.gov" <charterschoolboard@asbcs.az.gov>

Subcommittee members,

My name is Brandon Dahl and I'm the regional finance director for Imagine Schools. The only comment I'd like to make about the framework changes is regarding the 3-year cash flow metric.

I've stated this at past meetings and I still believe that this metric does not provide any useful information about a school's health. All it really does is create an arbitrary cash amount goal from a school's audit 3 years ago and encourages schools to hoard their cash in fear of not meeting the metric. I believe at one point there was discussion about removing this metric altogether and I am definitely in support of that.

Thank you for your time.

Brandon Dahl • Regional Finance Director • Imagine Schools – Southwest Group

p [602.547.7965](tel:602.547.7965) • c [602.751.3036](tel:602.751.3036) • brandon.dahl@imagineschools.org



Charter School Board - ASBCS <charterschoolboard@asbcs.az.gov>

FW: Public Comment Sought on Draft Discussion Financial Framework

1 message

Ross.Musil@primaveratech.org <Ross.Musil@primaveratech.org>

Fri, Oct 5, 2018 at 9:50 AM

To: charterschoolboard@asbcs.az.gov

Cc: Damian.Creamer@primaveratech.org, Andrew.Szczepaniak@primaveratech.org

Thank you for the opportunity to comment on the proposed adjustments to the Financial Framework.

We have comments regarding three of the metrics, outlined below. Also, since statistics show new ventures are most at risk within the first few years of existence, we would suggest adding additional strength to some of these financial metrics to ensure that they are being fiscally conservative in the early years of a new contract.

Unrestricted Days Liquidity – “Other Sources of Liquidity” should include Investments in Marketable (Available-for-Sale Securities). These securities can typically be liquidated within a day or two and are a much more effective form of liquidity than access to credit lines, which are currently included. If access to short-term debt is considered a liquidity source, so should highly liquid assets. We would further suggest that the committee require a new (First-Year) Charter to be subject to higher thresholds (>45 Days “Meets”, between 30-45 Days “Does Not Meet”, <30 Days “Falls Far Below”) to ensure that there is sufficient cash available when an unexpected event/expense occurs.

Adjusted Net Income – To clarify the “Does Not Meet Standard”, if Part 1) Adjusted Net Income is negative, then Part 2) should read “adjusted net income divided by total revenue is between zero and NEGATIVE 4.99 percent”. A negative numerator over a positive denominator will yield a negative percentage. For a new Charter, Adjusted Net Income should not be allowed to be negative in consecutive years during the first three years of operation or receives a “Falls Far Below Standard” grade.

Cash Flow – We would also like Investments in Marketable (Available-for-Sale) Securities considered as a part of “Cash for the purposes of this metric. By not including these highly liquid assets as cash, it requires the LEA liquidate investments solely to meet this metric on or before June 30 each year. For a new Charter, One-Year Cash Flow should not be allowed to be negative in consecutive years during the first three years of operation or receives a “Falls Far Below Standard” grade.

If I can be of additional assistance, please do not hesitate to reach out.

Best regards,

Ross Musil

Chief Financial Officer



OFFICE 623.239.0043

2471 N. Arizona Ave.

Chandler, AZ 85225

From: Charter School Board <charterschoolboard@asbcs.az.gov>
Date: Friday, September 28, 2018 at 4:11 PM
To: Charter School Board - ASBCS <charterschoolboard@asbcs.az.gov>
Subject: Public Comment Sought on Draft Discussion Financial Framework

During its meeting on September 27, 2018, the Board's Financial Framework Subcommittee directed Board staff to a) distribute for public comment the measures and targets currently under consideration by the Subcommittee and b) provide all comments received to the Subcommittee at its October 11, 2018 meeting.

Please send your feedback to charterschoolboard@asbcs.az.gov or reply to this email **by noon on Friday, October 5, 2018**. If you believe the Subcommittee should establish different targets for certain groups, such as first-year charters, in your response please identify the specific targets you would set and why you selected the targets you did.

Charter School Board Staff



Arizona State Board for Charter Schools

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Charter School Board - ASBCS <charterschoolboard@asbcs.az.gov>

RE: Public Comment Sought on Draft Discussion Financial Framework

1 message

Katy Cardenas <kcardenas@aznsa.com>

Sat, Sep 29, 2018 at 11:19 AM

To: Charter School Board <charterschoolboard@asbcs.az.gov>, jcraig@anzsa.com, Barbara Degruccio <barbara@aznsa.com>

Good morning,

In reading the notes and statute, do I understand that we may appeal by Oct 5 if the school rating was based on incorrect data? The framework included is for financial data, and our financials were fine, it was the missing data of 40% of our student body for their AZMerit scores. This past week we resubmitted our 915 to the ADE, regarding the missing student data of 8th graders.

The framework proposal changes seem appropriate for fiscal accountability.

Thanks for your time,

Katy Cardenas



A Visual & Performing Arts & Academics

High School and Middle School

Ronald F. Caya, Founder

Katy Ferrell-Cardenas, Executive Dean

Main: (480) 481-9235; Executive Dean's direct voice message 480-947-3917

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From: Charter School Board [mailto:charterschoolboard@asbcs.az.gov]
Sent: Friday, September 28, 2018 4:10 PM
To: Charter School Board - ASBCS
Subject: Public Comment Sought on Draft Discussion Financial Framework

During its meeting on September 27, 2018, the Board's Financial Framework Subcommittee directed Board staff to a) distribute for public comment the measures and targets currently under consideration by the Subcommittee and b) provide all comments received to the Subcommittee at its October 11, 2018 meeting.

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