Information on Comments Received

In July and August 2018, on behalf of the Financial Framework Subcommittee ("Subcommittee"), the staff solicited public comment and attended roundtables hosted by A for Arizona and the Arizona Charter Schools Association on the Board's current financial performance framework. The Subcommittee received written feedback from the seven organizations identified below. The written public comment has been included with these meeting materials. Use the links provided in bold font.

- Arizona Agribusiness & Equine Center, Inc. ("**AAEC**")
- Arizona Charter Schools Association ("**ASSOCIATION**")
- BASIS Charter Schools, Inc. ("**BASIS**")
- Jim Hall, Arizonans for Charter School Accountability ("**HALL**")
- Legacy Traditional Schools ("**LTS**")
- Reason Foundation ("**REASON**")
- Reid Traditional Schools ("**REID**")

The remainder of this document summarizes and categorizes the written and oral public comment received in five sections. Oral public comment is reflected in the tables as "General Comment" or "General Comment (multiple)":

- The first section covers public comments specific to certain measures.
- The **second section**, beginning on page 6, covers public comments that speak generally to the financial framework or process overall.
- The **third section**, beginning on page 8, covers public comments specific to interventions that the Board might consider.
- The **fourth section** on page 9 identifies public comment received regarding key financial indicators for charter closure.
- The **final section** on page 10 includes comments in other areas that mostly correlate with communicating a charter operator's finances and board membership structure.

Measure-Specific Public Comment

Issue	Measure	Comment/Summary	Source(s)
Measure Name Should Be Modified for Going Concern Measure	Going Concern	Instead of using the name "Going Concern", consider changing the name of the measure to "Going Concern Risk" or "Going Concern Disclosure" to more accurately capture measure's focus.	General Comment
Going Concern "Falls Far Below" Target Should Be Modified and "Does Not Meet" Target Should Be Added	Going Concern	Move the second box currently under the "Falls Far Below Standard" section up to the "Does Not Meet Standard" section. This distinguishes between audits that have a going concern paragraph in the auditor's report and audits that do not have a going concern paragraph in the auditor's report, but do contain some footnote disclosures. There really is a significant difference between putting that extra paragraph in the auditor's report versus just having a disclosure in the footnotes. The extra paragraph in the auditor's report indicates a substantial doubt in the auditor's mind about whether the entity can continue as a going concern (i.e. a viable organization) for more than a year. If it's just a note in the	LTS

Issue	Measure	Comment/Summary	Source(s)
		financial statements it means the auditor's substantial doubt was alleviated, a less severe issue.	
Non-Cash Expenses Should Be Removed from Total Expenses Used in UDL Calculation	Unrestricted Days Liquidity ("UDL")	Subtract depreciation and amortization from the total expenses used in the calculation. These are noncash expenses (you don't write a check for these) that should not count as expenses in this calculation. Also consider removing any other truly noncash expenses. An example of this would be a noncash loss on advance refunding of a bond, which is a "paper" loss that doesn't get paid for with cash. The days cash calculation in Legacy's bond covenants (and other charters' bond covenants) call for a subtraction of noncash expenses.	LTS General Comment (multiple)
Receivables Should Be Considered in UDL Calculation	Unrestricted Days Liquidity ("UDL")	Cash that hits past June 30 (receivables) needs to be considered.	General Comment
Consider Reducing "Meets" Target or Pairing with Another Measure	Unrestricted Days Liquidity ("UDL")	The main factor driving the decision to have the standard be 30 days is if a school doesn't get their equalization during a month for one reason or another, the school is able to float through the month until they get those monies. However, we have several schools we handle financials for that don't meet this ratio on a year-to-year basis, but would not have any trouble making it through a given month due to their ability to acquire cash in the form of short-term debt, whether this is drawing from a line of credit, receiving a note from an executive director or someone closely aligned with the school, or holding off on paying accounts payable. This ratio could be reduced or paired with a debt-to-equity ratio or current ratio to show a school's ability to quickly acquire cash.	General Comment
More Nuance Necessary for UDL Target	Unrestricted Days Liquidity ("UDL")	No gradation as to how close or far from "Meets Standard" level – 31 days meets and so does 90 days. Would like to see more gradation.	General Comment
Consistent Term Should Be Used for Default Measure	Default	Working clarifications could be made surrounding "material default" vs. "default on material loans". Both terms are used in the descriptions and each term could mean different things. Use "material default" since the overview describes this in some detail.	LTS
Non-Cash Expenses Should Be Removed to Arrive at Net Income	Net Income	Depreciation and amortization should be removed as they are non-cash expenses. Net income test should be based on operating results, BEFORE any loss on refunding bonds. This write-off is an accounting issue only and does not reflect poor operating net income. A bond refunding is a positive transaction	AAEC BASIS General Comment (multiple)

Issue	Measure	Comment/Summary	Source(s)
		that helps future operating results from both an accounting and cash perspective.	
Calculation Should Be Modified to Address Non-Operating Activities	Net Income	Defeased interest, prepayment penalties, extraordinary items and non-recurring items are often recognized "below the line" since they are considered non-operating activities. *CURRENT CALCULATION = Total Revenues – Total Expenses* *PROPOSED CALCULATION = Total Revenues – Total Expenses + Depreciation + Amortization + Defeased Interest + Prepayment Penalties + Extraordinary Items + Non-recurring Items*	BASIS
Net Income "Meets" Target Should Be Modified	Net Income	To receive a "Meets Standard", net income should be higher than $1.	General Comment
Focus on One-Year Loss	Net Income	Concern was raised regarding the current framework's focus on a one-year loss.	General Comment
Net Income versus Cash Flow	Net Income	Look at cash flow over net income as cash flow is a better indicator of financial condition. Both are not necessary.	LTS
FCCR "Does Not Meet" Target Should Be Modified and "Falls Far Below" Target Should Be Added	Fixed Charge Coverage Ratio ("FCCR")	Currently, there's no "Falls Far Below Standard" target. Consider adding a "Falls Far Below Standard" and changing the definition of "Meets Standard" and "Does Not Meet Standard". For example: Meets = Equal to or greater than 1.10 Does Not Meet = 0.9 to 1.10 Falls Far Below = Less than 0.9	LTS
All Non-Cash Expenses Should Be Added Back to Arrive at FCCR	Fixed Charge Coverage Ratio ("FCCR")	Normally, all noncash expenses would be added back in the numerator and not just audited year depreciation and amortization, or the already adjusted change in net assets/net income would be used.	General Comment (multiple)
FCCR Calculation Should Be Modified to Isolate Operating Activities from Non-Operating Activities	Fixed Charge Coverage Ratio ("FCCR")	Defeased interest, prepayment penalties, extraordinary items and non-recurring items should be added back to isolate the operating activities of the charter entity. *CURRENT CALCULATION = (Change in Net Assets + Depreciation + Amortization + Interest Expense + Lease Expense)/(Current Portion of Long Term Debt and Capital Leases + Interest + Lease Expense)* *PROPOSED CALCULATION = (Change in Net Assets + Depreciation + Amortization + Interest Expense + Lease Expense + Defeased Interest + Prepayment Penalties + Extraordinary Items + Non-recurring items)/(Current Portion of Long Term Debt and Capital Leases + Interest + Lease Expense)*	BASIS

Issue	Measure	Comment/Summary	Source(s)
Charters with Bonds Should Be Allowed to Use Performance on Debt Service Coverage Ratio	Fixed Charge Coverage Ratio (“FCCR”)	For charters with bonds, consider using the debt service coverage ratio in lieu of the fixed charge coverage ratio.	General Comment (multiple)
FCCR Calculation Mixes Fiscal Years	Fixed Charge Coverage Ratio (“FCCR”)	Calculation includes both audited year amounts and future amounts. Clean up so that all amounts used are from the same period.	General Comment
FCCR versus Cash on Hand	Fixed Charge Coverage Ratio (“FCCR”)	Cash on hand more of an indicator than the fixed charge coverage ratio.	General Comment
Cash Flow Growth Test Is Not Useful	Cash Flow	The “cash flow” growth test is not useful. Schools that are in a facility or program-expansion mode in a given year will use more cash than they take in and could deplete enough to affect the 3-year cumulative balance. That’s not a bad thing, since typically the following years will show improved results because of the expansion.	AAEC
Year-End Cash Can Fluctuate Based on When Expenses Are Paid and Revenues Are Received	Cash Flow	Cash is a mercurial item that fluctuates at year end based on timing of revenue sources and expense outlays. A school could have a great cash balance at June 30, but a large accounts payable due to holding bills that are then paid in early July, thus reducing the balance to a “real” level. Conversely, a school could have a low cash balance due to the late timing of state revenues or donations.	AAEC General Comment
Restricted Cash/Non-Operating Cash Amounts Should Not Be Included in Cash Flow Calculation	Cash Flow	Restricted Cash is listed in the non-current assets on the balance sheet. It is not included with “Cash and cash equivalents” for a reason. Restricted Cash consists of required deposits associated with long-term debt (Debt Service Reserve Fund, Liquid Reserve Fund, etc.). These funds, also referred to as non-operating cash amounts, are held in trust, and therefore non-accessible to the school. The balance in these funds can change astronomically when a school refinances. Because the ASBCS includes Restricted Cash in its calculation of “Cash Flow”, the results can be very misleading.	REID AAEC
Instead of Overall Cash Flow, Consider Cash from Operations	Cash Flow	Consider a more precise measurement of the changes in cash. Consistent positive cash from operations is ideal. Cash from borrowings can cause cash to increase for a period of time, but if a school isn’t able to generate cash from operations, it won’t last.	LTS
Charters Penalized for Saving and Paying Cash for Capital Items	Cash Flow	One concept taught in personal finance is “delayed gratification” meaning that you save money for things rather than purchase them on credit or time. Delayed gratification is a good business practice. Schools save	General Comment (multiple)

Issue	Measure	Comment/Summary	Source(s)
		money for needed capital items, but can find themselves penalized on the dashboard when they spend the saved money on the needed capital items.	
Cash Flow and UDL Should Be Considered Together	Cash Flow	Negative cumulative cash flow would be pink ("Does Not Meet Standard") unless charter has a certain number of days cash on hand.	General Comment (multiple)
Cash Flow versus UDL	Cash Flow	The cash flow test is not needed because the existing "days cash on hand" test is a better indicator of cash balance, since the measure is relative to the size of the organization (utilizing the expenses in the calculation) and is a good indicator of the school's ability to pay bills.	AAEC General Comment
Cash Flow versus Net Income	Cash Flow	Look at cash flow over net income as cash flow is a better indicator of financial condition. Both are not necessary.	LTS
Consider Adding a Measure that Looks at Enrollment Trend	--	The financial dashboard should include a metric that details the enrollment trend to demonstrate if the school is growing, shrinking or consistently maintaining its student body. Metric also needs to look at the school's response to a drop in students and revenue – is the school being nimble and making adjustments or not? Performance on an enrollment measure may need to consider or be tied to the school's performance on other measures.	ASSOCIATION REASON General Comment (multiple)
Consider Adding Current Ratio Measure	--	A good indicator about whether a school is able to meet its obligations would be the current ratio (current assets divided by current liabilities). A current ratio of 1.0 is tight; ratio should be above 1.0.	General Comment (multiple)
Consider Adding Net Current Assets Measure	--	A better test than cash flow would be a "net current assets" test, which compares current assets (such as accounts payable and receivables that will convert to cash within the next year) with current liabilities (such as accounts payable and notes payable that need to be paid within the next year). Compliance would be more current assets than current liabilities.	AAEC

Framework Overall/General Public Comment

Comment/Summary	Source(s)
Schools should have an area on the dashboard where they could provide commentary on why their dashboard looks a certain way or provide additional relevant information.	ASSOCIATION General Comment (multiple)
Schools have a difficult time explaining financial metrics to parents or other members of the community and the dashboard should be easy to read and understand to those who aren't financial experts.	ASSOCIATION General Comment (multiple)
It seems there are two purposes for the dashboard – 1) communication to the public and 2) Board tracking of the charter schools to watch for possible problems. To use only one dashboard to meet both purposes is difficult.	General Comment (multiple)
The financial framework's roll-up mechanism fails to make important distinctions in performance. The current two summative ratings ("Meets Board's Financial Performance Standard" and "Does Not Meet Board's Financial Performance Standard") could be replaced by four performance levels: • Imminent Risk – Charter is vulnerable to financial distress in the short term (one or more "Falls Far Below" ratings) • High Risk – Charter could be vulnerable to financial distress (no "Falls Far Below" ratings; 3 or 4 "Does Not Meet" ratings) • Moderate Risk – Area(s) for improvement have been identified (no "Falls Far Below" ratings; 1 or 2 "Does Not Meet" ratings) • Low Risk – Charter demonstrates strong financial performance across all metrics (no "Falls Far Below" ratings; no "Does Not Meet" ratings) A longitudinal flag could also be considered that highlights charters that are rated High Risk for consecutive years.	REASON
Financial metrics that are chosen should reflect the stage/maturity cycle of a school. For example, if a school is new, the financial ratios will look very different than those for a mature school or a school that is in its growth stage.	ASSOCIATION General Comment (multiple)
Financial metrics need to be more in line with lender/bondholder requirements. This includes using metrics and calculating the same as a lender.	ASSOCIATION General Comment (multiple)
Financial metrics that are ultimately used need to show the whole picture. The dashboard should be made up of complimentary metrics that lead to an overall rating. A failing score in one area is misleading to the public. Consider rating a school as performing or not by taking all indicators into consideration as opposed to flagging them individually. A deficiency in one area may not cause a concern, but deficiencies in many areas might.	ASSOCIATION General Comment (multiple)
Financial metrics should not be solely based on one point in time (year-end metrics). Perhaps quarterly financial metrics that mirror lender requirements if a school has financing.	ASSOCIATION

Comment/Summary	Source(s)
Metrics for the financial dashboard should be calculated by auditors. For example, auditors can use a checklist/sheet that they fill out which will ensure consistency across all schools.	ASSOCIATION General Comment (multiple)
There are key components of the operational framework that can be indicators of financial distress and should be considered for incorporation in the financial framework, such as timely reporting and payments to the Arizona Department of Revenue and Arizona State Retirement System. The Board might also look at notices or complaints of liability insurance and medical benefits cancellation, and late payroll as those can be indicators of financial distress as well.	BASIS General Comment (multiple)
Consider, as a first step in the framework, categorizing schools as "lower risk" or "higher risk" and having different targets. Higher risk schools might have more stringent targets in some measures because they're more vulnerable to financial problems. Lower risk schools might have less stringent targets in some measures because they're better positioned to withstand financial pressures, thus allowing for growth of high performing, larger, and more stable charter schools. In making a distinction, consider things like number of years in operation, number of campuses/schools, enrollment levels, days cash on hand, and even academic results.	LTS
Consider including a mechanism for "Does Not Meet" to go back to a "Meets" when the issue is resolved or no further action is required. Another idea would be for the charter school to be given a number of days to resolve an issue before a "Meets" is changed to a "Does Not Meet". A "Does Not Meet" functions like a bullseye in communication with the public.	General Comment
Board should utilize spending data to detect possible fraud by targeting schools that: a. Have expenditures greater than revenues b. Have expenses that are less than 80% of revenues c. Spend more on administration and facilities individually than on classroom salaries and benefits	HALL
Arizona State Retirement System unfunded liability should be excluded from any financial metric calculations.	ASSOCIATION General Comment (multiple)
Auditing firms submitting inaccurate information on charter audits should be sanctioned based on the relative importance of the false information into the determination of status on the financial framework.	HALL
The Charter Board, with the assistance of the Auditor General, should conduct unannounced audits of charters that submit inaccurate data on the annual audit.	HALL
The Charter Board needs to perform random financial audits on a regular basis to assure that data submitted on the Annual Financial Report and annual audit are accurate – encouraging charter owners and auditing firms to take greater care in the preparation of these reports.	HALL

Intervention Public Comment

<table>
<tr><th>Issue</th><th>Comment/Summary</th><th>Source(s)</th></tr>
<tr><td>Develop the Infrastructure for Effective Intervention Decisions</td><td>“High Risk” or “Imminent Risk” designations alone (or whatever ratings Board adopts) should never result in automatic closure. Rather, the financial framework is an initial screen that flags charters for further evaluation. After further evaluation it might be evident that a flagged charter should be closed based primarily or even solely on its financial condition.

Flagged charters need to be evaluated in a comprehensive and thorough manner that looks at financial outcomes through four lenses:
1. Local Context – Qualitative factors that aren’t readily apparent in the financial measures. Is there a sound explanation for why a charter underperformed on a given measure?
2. Severity – The extent to which a charter underperformed on a financial measure. For example, did it barely miss the required threshold or did it perform at a level well below it, signaling a serious danger of insolvency?
3. Trends – The extent to which a charter’s fiscal condition has improved or deteriorated over time. In what direction is the charter’s financial health heading?
4. Financial Leadership – The quality of a charter’s plan to address its shortcomings and, if applicable, the extent to which it has executed on proposed strategies in the past. Do the proposed strategies actually address the problem(s) and are they realistic to implement?

From here, decisions about further interventions should be based on a mix of quantitative and qualitative factors. One option is to implement some variation of the process below, which is designed to identify and prioritize distressed charters.
• Step 1: Flagged charters submit a performance response – Consider modifying the current financial performance response to include staffing and expenditure data that indicate the degree to which a charter is “right-sized” (i.e. the costs of a school’s operations are aligned with its enrollment).
• Step 2: Board assesses and prioritizes flagged charters – Consider creating a second-tier evaluation system that integrates outcomes and rates charters using both quantitative and qualitative data. This process could be similar to how rating agencies rate bond issuances, which is described in detail in the report’s “Long-Term Reforms” section.
• Step 3: Additional interventions – Could include review hearings, community feedback and/or third-party financial reviews.</td><td>REASON</td></tr>
</table>

Stages of Intervention	The financial framework should include stages of intervention.	General Comment
Additional Information Provided When Financial Concern Identified	The auditor or school could be required to submit additional information when the framework identifies financial concern about the school. The school would be notified of the concern based on the framework and then would be required to submit a form or questionnaire. This process would be similar to the process followed when a school with a bond fails to meet one or more covenants and is required to bring in a consultant.	General Comment
Conversations with Schools Identified as Requiring Intervention	The Board/staff should dialogue with schools requiring intervention about what is happening and what the school is doing about it.	General Comment
Schools Failing to Meet Financial Expectations Should Lose USFRCS Exemption	All charter schools failing to meet the expectations of the financial framework should have their Uniform System of Financial Records for Charter Schools (USFRCS) exemption revoked.	HALL

Key Financial Indicators – Charter Closure

- Going concern
- Regular reliance on agreements whereby the school takes an advance on state aid payments
- Material default, although not a good advance indicator
- Payroll, taxes, insurance not paid
- Declining enrollment and cash on hand
- Consistent cash losses in the absence of any other funding sources
- Not meeting bond covenants
- Eventually finances show up through academics and operational performance

Other Public Comment

Issue	Comment/Summary	Source(s)
Revise the Non-USFR Compliance Questionnaire	Replace financial reporting questions on the Non-USFR Compliance Questionnaire with the "Budgets" and "Financial Reporting" questions from the USFRCS Compliance Questionnaire. Add the USFRCS Compliance Questions regarding "Accounting Records to the Non-USFR Compliance Questionnaire.	HALL
Request additional information from audits	Require audits to list Instruction, Teacher Salaries, Support, Administration, and Facilities expenses matching the Annual Financial Report expenditure lines.	HALL
Collection of additional information from the AFR	The Charter Board should collect the following data from the Annual Financial Report: a. Regular Instruction 1000 Salaries and Benefits b. Special Education Instruction 1000 Salaries and Benefits c. Total Teacher Salaries d. Total FTE of teachers e. Total Instruction 1000 f. Total Support 2100, 2200 g. Total Administration 2300, 2400, 2500, 2900 h. Total Facilities (Operation of the Plant 2600, Debt Service 5000) i. Total Revenue j. Total Local revenue k. Total M&O expenses l. October 1 enrollment m. Calculate per pupil expenditures for the above categories n. Calculate percent of revenue for the above categories o. Calculate state averages for the above categories	HALL
Publish spending data for informed school choice	Charter Board will publish spending data so parents can make informed school choices. a. Report individual charter spending per pupil on classroom instruction, special education instruction, teacher salary and benefits, extra-curricular activities, athletics, administration, and facilities. b. Report per pupil local revenue (fees and donations). c. Report state average per pupil expenditures for each category as a comparison.	HALL
Publish financial data into School Report Cards	Enhance financial reporting (allow for comparisons; consider incorporating into School Report Cards)	REASON
Third-party related transactions	Method for disclosing third-party related transactions	General Comment (multiple)

Board membership transparency	Transparency of board membership by identifying the number of members and who they are. Guiding questions: • Is it a single-member board? • How many members are family members? • Is this a diverse board?	General Comment (multiple)
Financial dashboards created/updated	Method for communicating to the charter operators and public when the financial dashboards are created/updated.	General Comment (multiple)

Gmail by Google

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

Fwd: ASBCS financial performance comments

1 message

Suzanne Drake <sdrakes@aaechighschools.com> Thu, Jul 12, 2018 at 6:52 PM
To: Andrea.Leder@asbcs.az.gov

Hi Andrea, I discussed with our accountant when I got back to the office and here is our input on the Financial Framework.
Thanks Suzanne!

Sent from my iPhone

Begin forwarded message:

From: Dan Bigler <dbigler@aaechighschools.com>
Date: July 12, 2018 at 6:02:39 PM MST
To: Suzanne Drakes <sdrakes@aaechighschools.com>
Subject: ASBCS financial performance comments

Net Income test should be based on operating results, BEFORE any loss on refunding bonds. This write-off is an accounting issue only and does not reflect poor operating net income. A bond refunding is a positive transaction that helps future operating results from both an accounting and cash perspective.

The "cash flow" growth test is not useful. Schools that are in a facility- or program-expansion mode in a given year will use more cash than they take in and could deplete enough to affect the 3 year cumulative balance. That's not a bad thing, since typically the following years will show improved results because of the expansion.

Also, cash is a mercurial item, that fluctuates at year end based on timing of revenue sources and expense outlays. A school could have a great cash balance at June 30, but a large accounts payable due to holding bills, that are then paid in early July, thus reducing the balance to a "real" level. Conversely, a school could have a low cash balance due to the late timing of state revenues or donations.

A better test would be a "net current assets" test, which compares current assets (such as cash, and receivables that will convert to cash within the next year), with current liabilities (such as accounts payable and notes payable that need to be paid within the next year). Compliance would be more current assets than current liabilities.

Another reason the cash flow test is not needed is that the existing "days cash on hand" test is a better indicator of cash balance, since the measure is relative to the size of the organization (utilizing the expenses in the calculation) and is a good indicator of the school's ability to pay bills.

Whatever cash test is used, it should not include non-operating amounts, such as monies held with a bond trustee for payment of debt service or to fund a construction project. Utilizing those amounts in the cash flow test results in inconsistent measurements from year to year.

Daniel D. Bigler, CPA
Accountant
Arizona Agribusiness & Equine Center, Inc.
602-297-8500

Arizona Charter Schools Association
SUPPORT. ADVOCATE. LEAD.

August 23, 2018

Summary of Financial Framework Roundtable Discussion

The Arizona Charter Schools Association, which represents 86% of all charter schools throughout the state, hosted two roundtable discussion sessions in partnership with the Arizona State Board for Charter Schools. Through these sessions we received a lot of valuable feedback and have condensed the feedback to submit it to the State Board for Charter Schools. Below is the summary of feedback:

- Metrics for the financial dashboard should be calculated by auditors. For example, auditors can use a checklist/sheet that they fill out which will ensure consistency across all schools.
- Financial metrics that are ultimately used need to show the whole picture. The dashboard should be made up of complimentary metrics that lead to an overall rating. A failing score in one area is misleading to the public.
- Financial metrics need to be more in line with lender/bondholder requirements. This includes using metrics and calculating the same as a lender. (Excluding depreciation, etc.)
- Financial metrics should not be solely based on one point in time (yr. end metrics). Perhaps quarterly financial metrics that mirror lender requirements if a school has financing
- Arizona State Retirement System unfunded liability should be excluded from any financial metric calculations
- Schools should have an area on the dashboard where they could provide commentary on why their dashboard looks a certain way. For example, depreciation at its current state hurts a lot of schools and they would like to be able to explain it.
- Schools have a difficult time explaining financial metrics to parents or other members of the community and the dashboard should be easy to read and understand to those who aren't financial experts.
- Financial metrics that are chosen should reflect the stage/maturity cycle of a school. For example, if a school is a new, the financial ratios will look very different than those from a mature school or a school that is in its growth stage.
- Financial dashboard should include a metric that details the enrollment trend to demonstrate if the school is growing, shrinking or consistently maintaining its student body.

The Association is committed to representing the interest of our member schools. In doing so we will have a representative at each financial subcommittee meeting and will continue to provide updates on the subcommittee's progress. If you have questions or concerns on the Financial Dashboard revisions, please reach out to us.

Financial Performance Framework

During the 53rd Second Regular Legislative Session, the budget was passed with language requiring charters to meet the financial performance expectations set forth in the performance framework. This provision gave the Arizona State Board for Charter Schools (Board) the authority to take action against a charter it sponsors based on its Financial Performance Framework. The Board was therefore required to begin a public review process to design a financial framework and adopt rule and policy to which the Board can use for accountability purposes.

The Board has seated a Financial Subcommittee (Subcommittee) to review and update its Financial Performance Framework in light of this additional accountability. To assist the Subcommittee, the Board is requesting comments from stakeholders. Information submitted in response to the following questions will be considered by the Subcommittee.

Email address *

deanna.rowe@basisschools.org

Tell us about yourself

Your first and last name *

DeAnna Rowe

Your mailing address *

7975 N Hayden Road C240, Scottsdale, AZ 85258

Your organization

BASIS Charter Schools, Inc.

Feedback Questions

Identify components of the Board's current Financial Performance Dashboard/Framework that adequately identify a charter's financial status. *

The existing Near-Term Measures are good indicators, but shouldn't necessarily be considered in isolation as adequate for identifying a charter's financial status.

Identify components of the Board's current Financial Performance Dashboard/Framework that do not adequately identify a charter's financial status. *

Net Income and FCCR calculations in their current form. Please consider these proposed revisions:

1. Net Income

Current calculation=Total Revenues-Total Expenses
Proposed calculation=Total Revenues-Total Expenses+ Depreciation + Amortization+ Defeased Interest + Prepayment Penalties + Extraordinary Items + Non-recurring items.
Defeased Interest, Prepayment penalties, extraordinary items and non-recurring items are often recognized “below the line” since they are considered non-operating activities. Add back depreciation and amortization to negate the effects of non-cash type expenses with different capitalization thresholds on the Statement of Activities.

2. Fixed Charge Coverage Ratio

Current calculation= (Change in Net Assets + Depreciation + Amortization + Interest Expense + Lease Expense)/(Current Portion of Long Term Debt and Capital Leases + Interest+Lease Expense)
Proposed calculation=(Change in Net Assets + Depreciation + Amortization + Interest Expenses + Lease Expense + Defeased Interest + Prepayment Penalties + Extraordinary Items + Non-recurring items)/(Current Portion of Long Term Debt and Capital Leases + Interest + Lease Expense)
Add back defeased interest, prepayment penalties, extraordinary items and non-recurring items to isolate the operating activities of the charter entity.

What are key financial indicators that result in a charter's closure? *

Going Concern, Default, and regular reliance on agreements whereby the school takes an advance on state aid payments.

Additional comments? *

There are key components of the Operational Framework that can be indicators of financial distress and should be considered for incorporation in the Financial Framework. As examples: Timely reporting and payments to the Arizona Department of Revenue, Arizona State Retirement System and the Internal Revenue Service. You might also look at notices/complaints of liability insurance and medical benefits cancellation, and late payroll as those can be indicators of financial distress as well.

Arizonans for Charter School Accountability

RECEIVED
AUG 08 2018

Financial Framework Recommendations
August 8, 2018

Summary of Recommendations:

1. Replace financial reporting questions on the Non-USFR Compliance Questionnaire with the "Budgets" and "Financial Reporting" questions from the USFRCS Compliance Questionnaire.
2. Require audits to list Instruction, Teacher Salaries, Support, Administration, and Facilities expenses matching the Annual Financial Report expenditure lines.
3. Add the USFRCS Compliance Questions regarding "Accounting Records" to the Non-USFR Compliance Questionnaire.
4. Require all schools failing to meet the expectations of the Financial Framework to lose the exemption to utilizing the USFRCS.
5. The Charter Board should collect the following data from the Annual Financial Report:
    a. Regular Instruction 1000 Salaries and Benefits
    b. Special Education Instruction 1000 Salaries and Benefits
    c. Total Teacher Salaries
    d. Total FTE of teachers
    e. Total Instruction 1000
    f. Total Support 2100, 2200
    g. Total Administration 2300,2400,2500,2900
    h. Total Facilities (Operation of the Plant 2600, Debt Service 5000)
    i. Total Revenue
    j. Total Local revenue
    k. Total M&O expenses
    l. October 1 enrollment
    m. Calculate per pupil expenditures for the above categories
    n. Calculate percent of revenue for the above categories
    o. Calculate state averages for the above categories
6. Charter Board will utilize spending data to detect possible fraud by targeting schools that:
    a. Have expenditures greater than revenues
    b. Have expenses that are less than 80% of revenue
    c. Spend more on administration and facilities individually than on classroom salaries and benefits.
7. Charter Board will publish spending data so parents can make informed school choices.
    a. Report individual charter spending per pupil on classroom instruction, special education instruction, teacher salary and benefits, extra-curricular activities, athletics, administration, and facilities.
    b. Report per pupil local revenue (fees and donations).
    c. Report state average per pupil expenditures for each category as a comparison.

I. Financial Reporting:

It will not be possible to monitor charter spending without consistent data submissions by all charter holders. Charter owners have been extremely lax in providing complete and accurate information on the three required financial submissions – the annual budget, the annual financial report, and the annual audit.

For example, the most recent submissions by one of the largest charter holders in Arizona, the American Leadership Academy, display a complete disregard for accurately reporting expenditures on all three documents:

1. **The ALA 2019 Adopted Budge**t is full of omissions and inaccuracies:
    a. There are no supply expenditures budgeted for any administrative function, plant operations, or special education. ALA claims that GAAP accounting allows all school supplies to be lumped together.
    b. ALA's lunch program is provided by an outside vendor, Sodexo, yet the only food service expenditures are coded as $1.5 million for supplies with no 3000 purchase services.
    c. ALA has nothing budgeted for Student Support 2100, yet employs counselors, social workers, and health aides whose salaries should be coded as Student Support. These employees are apparently paid out of the Instruction 1000 code.
    d. ALA submitted an adopted budget with these errors July 2018 even after a complaint was filed with the Charter Board December 2017 against these practices. (See Appendix 1)
2. **The ALA 2017 Annual Financial Repo**rt was full of omissions and inaccuracies:
    a. There are no supply expenditures reported for any administrative function, plant operations, or special education.
    b. There are no expenditures posted for:
        i. Food Service
        ii. Extra-curricular activities
        iii. Athletics
        iv. ALA charges for bus transportation. There are no revenues posted for transportation fees 1410. (See Appendix 2 and 3)
3. **The ALA 2017 Annual Audit** lists expenses in just four numbers – program expenses, interest, administration, and fund raising. (See Appendix 4).

It is impossible to know if ALA is spending tax funds responsibly when expenses are simply omitted or miscoded as the company sees fit. fit.

Recommendations:

1. **Replace the financial reporting questions on the non-USFR Compliance Questionnaire with those from the USFRCS Compliance Questionnaire.**

Below are the current requirements:

Was a copy of the adopted budget submitted electronically to the Superintendent of Public Instruction no later than July 18th? **A.R.S. §15-905(E) and §15-183(E)(6)**
Was the Annual Financial Report (AFR) sent to the Superintendent of Public Instruction by October 15th? **A.R.S. §15-183(E)(6) and 15-904(A)**

The USFR Compliance Questionnaire requires that complete and accurate data must be submitted on the Annual Budget and the Annual Financial Report. It would not place any additional burden on charter owners and would force their auditors to required proper reporting.

There should also be questions regarding the required submission of the Classroom Site Narrative since dozens of charters fail to submit the document each year.

USFRCS Compliance Questionnaire recommended additions to the non-USFR Questionnaire:

BUDGETS

1. Were the proposed budget and a notice of public hearing and Governing Board meeting to adopt a budget uploaded for posting on ADE's website no later than 10 days prior to the meeting, and if the school maintains a website, were the proposed budget or budget summary and hearing notification posted on the school's website? **A.R.S. §15-185(M)**
2. Was the adopted budget submitted electronically to the Superintendent of Public Instruction no later than July 18? **A.R.S. §15-905 (E) and §15-183(E)(6)**
3. Was the adopted budget mathematically accurate, and did it include all school expenses?
4. Was a copy of the budget maintained on file at the school?
5. If the school revised the adopted budget, was the revision completed before May 15 and filed with the Superintendent of Public Instruction by May 18?
6. Did the school maintain records to support the number of eligible teachers, eligible teachers' salaries, and employer share of retirement expense to appropriately calculate and distribute the 1.06% teacher salary increase? **(Laws 2017, Chapter 305, §33)**

FINANCIAL REPORTING

1. Was the annual financial report (AFR) sent to the Superintendent of Public Instruction by October 15?
2. Was the AFR signed by the Governing Board?
3. Was a copy of the AFR maintained on file at the school?
4. Did budgeted expenses as reported on the AFR agree with the school's adopted budget or most recently revised adopted budget?
5. Did actual revenues and expenses as reported on the AFR agree with the school's accounting records?
6. Was all required information included in the AFR?
7. Was disclosure in the notes to the financial statements adequate, and were all pertinent notes incorporated as an integral part of the financial statements?
8. Was adequate documentation retained to support amounts in the financial statements (if the school is not the primary reporting entity – was adequate documentation retained to support revenue and expenses in the charter school)?
9. ***Was the** Classroom Site Fund Narrative **submitted to the Superintendent of Public Instruction by November 15?***
10. ***Did the expenses reported on the** Classroom Site Fund Narrative **agree with the CSF expenses reported in the annual financial report?***

Require expenses listed on the Annual Audit to provide audited details concerning:

a. Teacher salaries and benefits
b. Total Instruction 1000 expenses

c. Total Support expenses 2100, 2200
d. Total Administrative expenses 2300, 2400, 2500, 2900
e. Total Facilities expenses (Plant 2600 and Debt Service 5000)

II. Fraud Prevention:

The current ASBCS Financial Framework, Annual Audit, and Non-USFR Compliance Questionnaire did not identify the fraud being perpetrated at the Starshine Academy.

The Starshine Academy auditors, Holcomb & Shreeve, did not find deficiencies in internal controls or noncompliance of Government Audit Standards in the 2017 audit:

"Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. ***Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be a significant deficiency... The results of our tests did not disclose any instances of noncompliance or other matters that are required to be reported under Government Auditing Standards."***

But in actuality, the owner of Starshine Academy, Trish McCarty, was utilizing school funds for personal use at an alarming rate. The Arizona State Board for Charter Schools finally investigated Starshine after the U.S. Bankruptcy Court found wide-spread fraud. According to U.S. Bankruptcy Court documents:

"...the UST has recently learned that instead of using this time in bankruptcy as an opportunity to address the school's shortcomings and implement a cohesive plan to restructure its debt, Patricia McCarty, in a gross abuse of her authority as the owner of Starshine, has been using Starshine funds to pay for travel and other personal expenses that have nothing to do with the operation of the school. Among other things, while Starshine was operating under the protection of the Bankruptcy Court, it appears that Ms. McCarty was using Starshine funds to pay for two Hawaiian vacations, one European vacation, and numerous other trips around the country."

Board President Kathy Senseman commented after the vote to close Starshine "This is the most egregious case I have ever read about a charter school so I am very happy that we have a vote to revoke the charter of Starshine Academy." (Transcript of the March 20th meeting is at: https://asbcs.az.gov/board-staff-information/meeting-dates-materials)

The 2017 Starshine Audit and Compliance Questionnaire did not detect this massive fraud. An audit utilizing the Uniform System of Financial Records for Charter Schools Compliance Questionnaire would have found the fraud immediately.

The USFRCS (Uniform System of Financial Records for Charter Schools) was developed by the Auditor General to require schools to use basic accounting principles to prevent waste and fraud. The USFRCS is not a punishment thrust upon charters (or school districts) – it is a valuable tool to assure that public funds are being properly spent and provides a clear guide for administrators, office managers, and staff so that the school expends funds appropriately. The USFRCS provides common sense requirements like:

- Utilizing revenue and expense codes consistent with the line items on the Annual Financial Report.
- Every purchase is made through a numbered purchase order, approved by multiple employees and verified by a receipt.
- Limits on revolving funds, petty cash transactions, and travel reimbursements.
- Oversight of all expenditures by the Governing Board

Recommendations:

400 charters have closed since 1994, many because of financial difficulties. 100 charter holders lost money in 2017 and there are over 40 charters in danger of closing next year because financial mismanagement. The Charter Board needs to make exemptions to following the USFRCS a privilege granted charters that are in good financial condition and spend tax funds appropriately, namely in the classroom. Charters that are not meeting the Board's Financial Framework or are spending more money on administration or buildings than in the classroom should be required to follow the USFRCS. All new charters should be required to follow the USFRCS for at least three years to prove they have a strong foundation in fiscal responsibility before being granted a waver.

If the Board is unwilling to revoke the USFRCS exemption, then the Compliance Questionnaire for charters not meeting the Financial Framework should be expanded to include basic requirements like purchase orders, multiple signers and controls, and receipt verification of purchases.

1. Incorporate the accounting guidelines from the USFRCS Compliance Questionnaire into the Non-USFR Compliance Questionnaire

The Annual Audit Non-USFR Compliance Questionnaire should include the following Accounting Records questions from the USFRCS Questionnaire. They reflect accepted business practices that would help prevent owners and employees from spend tax funds without records and receipts. Providing proper accounting records would require no additional burden for any efficiently run organization.

Proposed additional questions for the Non-USFR Compliance Questionnaire:

ACCOUNTING RECORDS

8. Did the school properly reconcile its accounting records to the bank account records and is the reconciliation properly supported?
9. Were accounting records maintained in accordance with the USFRCS Chart of Accounts?
10. Were the responsibilities of initiating, approving, and recording journal entries separated among employees, or were adequate alternative procedures in place?
11. Were journal entries approved by an authorized school administrator before being recorded in the accounting records?
12. Were prenumbered and numerically controlled journal entry forms prepared for all journal entries?

2. **All charter schools failing to meet the expectations of the Financial Framework should have the USFR exemption revoked.** In reality, all charters should have to follow the USFRCS except for procurement requirements, which have been removed by statute in 2018. There is no burden placed on charter owners by using the accounting codes in the USFRCS or following accounting procedures consistent with the USFR. Allowing charters to use GAAP allows charters to inconsistently code expenditures when reporting on the USFR based Annual Financial Report.

III. Monitoring Charter School Expenditures

Charter schools are funded primarily through the general fund, not property taxes. The Arizona Republic Editorial Board on May 20, 2018 wrote: " We should have every right to know exactly how that money is spent."

The Arizona Department of Education, The Arizona Auditor General and the Arizona State Board for Charter Schools have never monitored charter spending. The Charter Board receives assurance every year through an internal annual audit that the charter company is solvent and has adequate cash reserves but without monitoring *how* charters spent tax funds there is no way of telling if vast sums are being stolen, like in the cases of the Bradley Academy and the Starshine Academy.

1. Compiling Charter Spending:

The Arizona Department of Education provided Arizonans for Charter School Accountability with data files for the 2017 charter Annual Financial Report in Excel format. It is very easy to create a master Excel file to determine all charter expenditures. The Charter Board, as the only authorized agency to regulate and supervise charter schools in Arizona, needs to request this data and compile spending that includes expenditures for:

a. Regular Instruction 1000 Salaries and Benefits
b. Special Education Instruction 1000 Salaries and Benefits
c. Total Teacher Salaries
d. Total FTE of teachers
e. Total Instruction 1000
f. Total Support 2100, 2200
g. Total Administration 2300,2400,2500,2900
h. Total Facilities (Operation of the Plant 2600, Debt Service 5000)
i. Total Revenue
j. Total Local revenue
k. Total M&O expenses
l. October 1 enrollment
m. Calculate per pupil expenditures for the above categories
n. Calculate percent of revenue for the above categories
o. Calculate state averages for the above categories

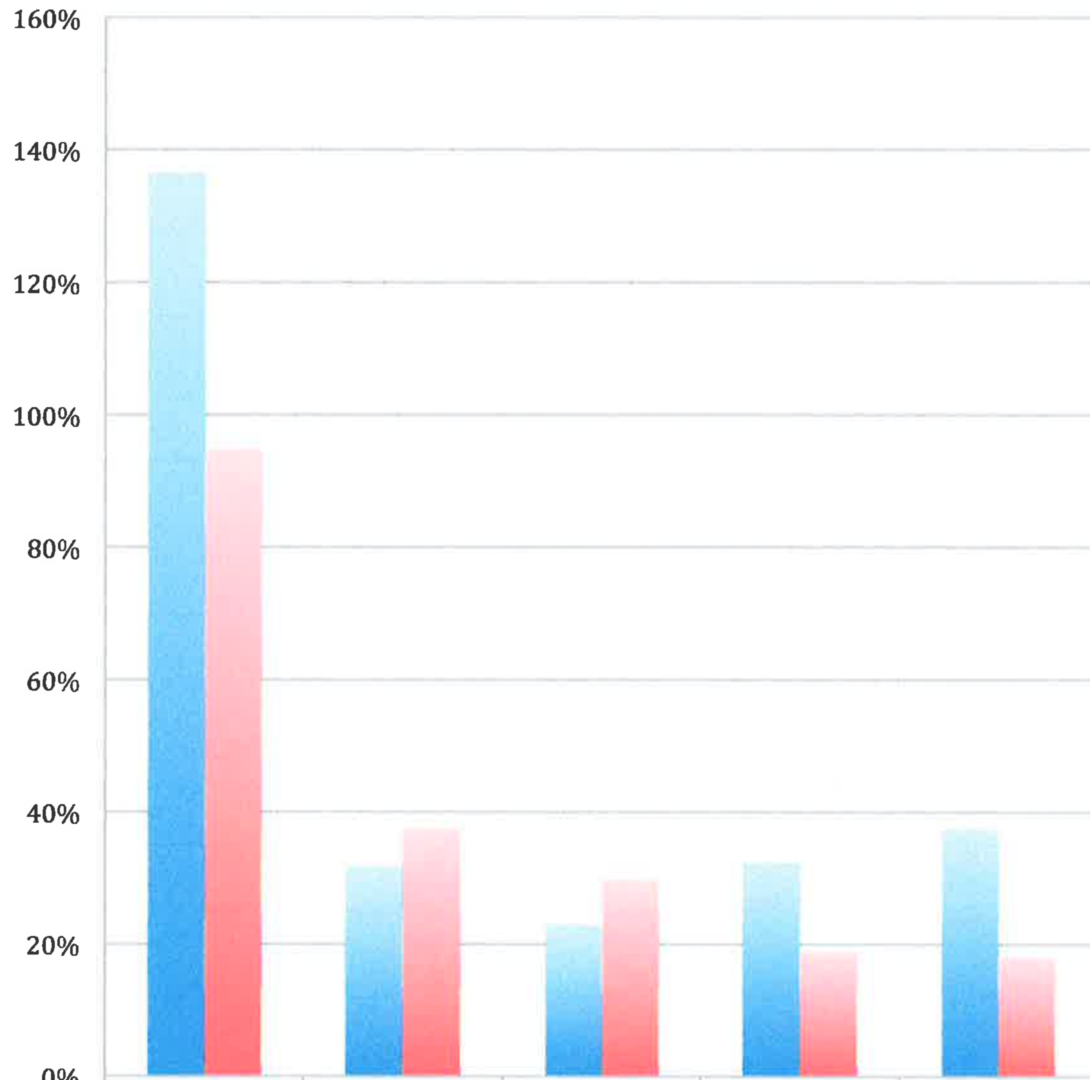
This data is available on the Annual Financial Reports and the October 1 Enrollment Reports. No new reporting would be required of charter holders.

The Charter Board reporting on charter school spending serves many purposes. First, how a charter school expends funds has a direct relationship to the quality of education provided. If a charter school is failing academically, one of the most important questions to ask is "How are you using your tax resources in the classroom to improve instruction and student performance?"

Monitoring spending also would allow the Board to monitor classroom spending in relationship to areas where charter owners may be making inappropriate expenditures – excess supplies, unreasonable purchase service expenditures, or high administrative costs and facilities costs.

If the Charter Board would have examined the Starshine Academy's 2017 spending they would have seen many red flags that could indicate that funds were being misappropriated. The graph below shows the expenditures made by the Starshine Academy in 2017, six months before the Charter Board closed them for gross mismanagement of public funds:

Starshine Academy Expenditures as Percent of Revenue 2017 Compared to State Averages



	Total M&O	Total Classroom	Classroom Salary/Benefits	Administration	Facilities
Starshine Average % Revenue	137%	32%	23%	32%	38%
State Average % Revenue	95%	37%	30%	19%	18%

The Starshine Academy's 2017 expenditures show a number of red flags that should trigger regulatory action by the Charter Board:

1. Most importantly, Starshine overspent their revenue by 137% indicating a failing business
2. Starshine expended significantly more on administration than on classroom salaries and benefits
3. Starshine expended significantly more on facilities than on classroom instruction

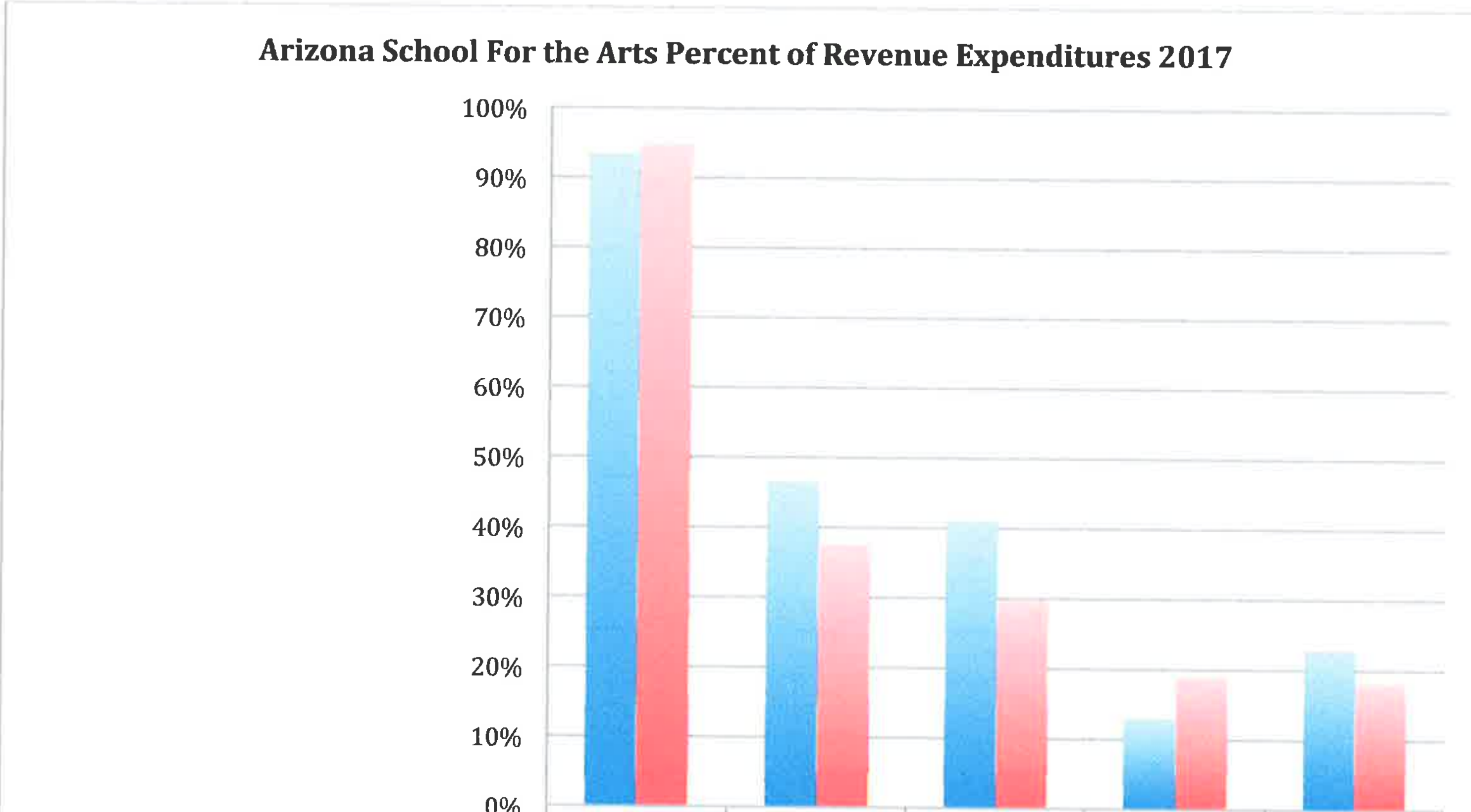
Recommendations:

The Charter Board should establish red flags that would require charter owners to explain expenditures or trigger an external audit.

Spending Red Flags:

1. Overspending – M&O expenditures exceeds total Revenue
2. Spending more on administration than in the classroom
3. Spending more on facilities than in the classroom
4. Charters spending more on both administration and facilities than in the classroom should immediately trigger an external audit.
5. Charters that spend less than 80% of revenues should also be red flags for investigation. For example, the Educational Options Foundation had revenues of $5,445,600 in 2017 but only expended $2,301,975. Some of the excess profits were used by the non-profit to buy a $1.3 million luxury home, instead of spending in the classroom. (See Appendix 5)

Tracking charter expenditures benefits charter owners. Well-run charters, like the Arizona School for the Arts, could brag about spending significantly more in the classroom and on classroom salaries than on administration or facilities than most charter schools in the state.

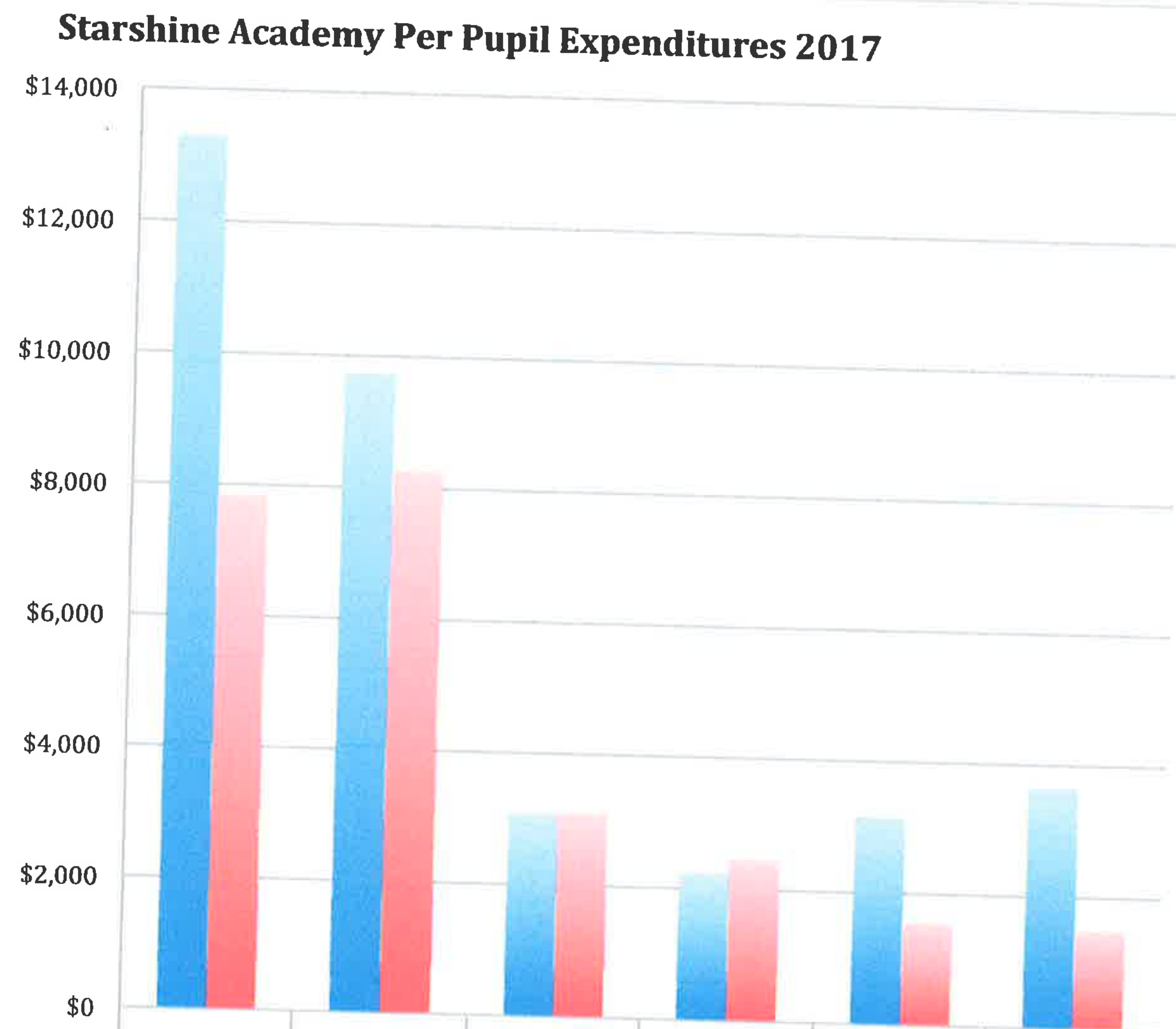


	Total M&O	Total Classroom	Classroom Salary/ Benefits	Admin	Facilities
Arizona School For The Arts % Revenue	93%	47%	41%	13%	23%
State Average % Revenue	95%	37%	30%	19%	18%

Note:

Expenditures could also be compared on a per pupil basis but there could be inequities since hundreds of small charters receive more funding in the form of the small school adjustment than larger charter holders, and therefore have more to spend per pupil.

Never the less, using the example of the Starshine Academy, per pupil expenditures still pinpoint the owners spending less in the classroom than on administration or facilities.



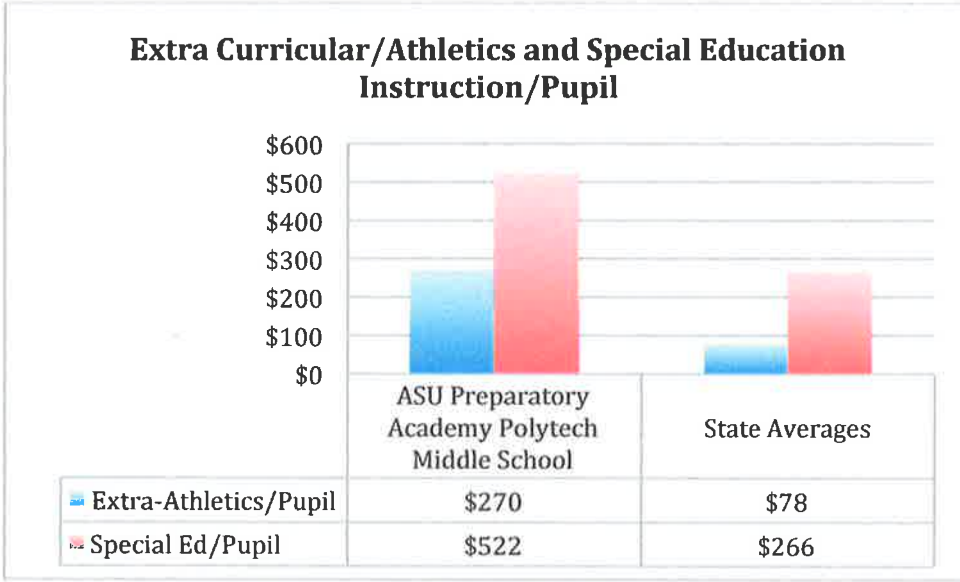
	Total M&O	Total Revenue	Total Classroom	Classroom Salary/ Benefits	Administration	Facilities
StarShine Academy Per pupil	$13,290	$9,732	$3,092	$2,236	$3,151	$3,653
State Average per pupil	$7,830	$8,259	$3,095	$2,456	$1,560	$1,493

Providing Parents with Spending Data:

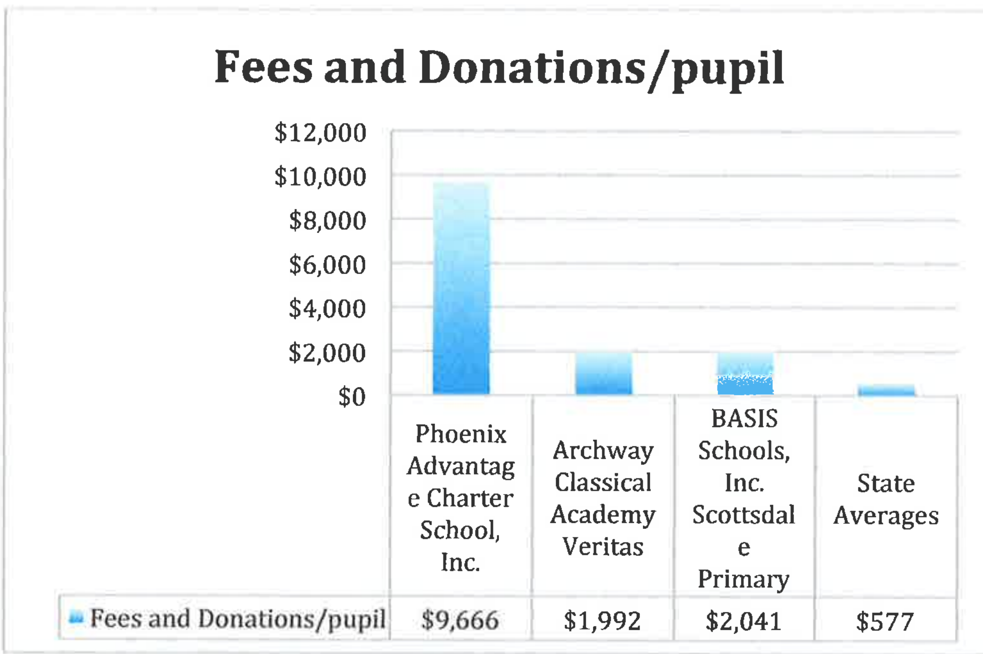
HB 2663 was passed last year that requires districts to post the percentage of every dollar spent in the classroom:

> "EACH SCHOOL DISTRICT SHALL PROMINENTLY POST ON ITS WEBSITE HOME PAGE A COPY OF ITS PROFILE PAGES THAT DISPLAYS THE PERCENTAGE OF EVERY DOLLAR SPENT IN THE CLASSROOM BY THAT SCHOOL DISTRICT FROM THE MOST RECENT STATUS REPORT ISSUED BY THE AUDITOR SCHOOL DISTRICT FROM THE MOST RECENT STATUS REPORT ISSUED BY THE AUDITOR"

Classroom spending information should be available for charter schools as well. Because of the great variations in charter programs and parent expectations, it would useful for parents to also know how much the charter schools spend on extra-curricular activities, athletics, and special education along with instruction, administration and facilities expenditures. It would also be useful for parents to see how much their school collects in fees and donations compared to other charter schools in the state.



	ASU Preparatory Academy Polytech Middle School	State Averages
Extra-Athletics/Pupil	$270	$78
Special Ed/Pupil	$522	$266



	Phoenix Advantage Charter School, Inc.	Archway Classical Academy Veritas	BASIS Schools, Inc. Scottsdale Primary	State Averages
Fees and Donations/pupil	$9,666	$1,992	$2,041	$577

(Phoenix Advantage Charter School had over $3.4 million in donations in 2017 – a red flag for possible money laundering that Charter Board staff should investigate, if spending was examined) Parents would be able to determine how much more they are paying in fees and donations compared to the average charter school. Spending data would allow parents to make better school choice decisions.

Jim Hall
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Appendix 1

American Leadership Academy 2019 adopted budget

CHARTER SCHOOL American Leadership Academy COUNTY Maricopa CTDS NUMBER 0787250

EXPENSES 1000 Schoolwide Project		Salaries 6100	Employee Benefits 6200	Purchased Services 6300, 6400, 6500	Supplies 6600	Other 6800	Totals: Prior Year 2018	Totals: Budget Year 2019	% Increase/Decrease
100 Regular Education									
1000 Instruction	1.	18,145,470	3,084,730		2,522,158		17,834,375	23,752,358	33.2
Support Services									
2100 Students	2.						0	0	
2200 Instruction	3.						0	0	
2300 General Administration	4.	809,800	136,856				6,319,861	946,656	-85.0
2400 School Administration	5.	4,876,859	834,937				5,192,542	5,711,796	10.0
2500 Central Services	6.			7,567,608			0	7,567,608	
2600 Operation & Maintenance of Plant	7.	1,032,890	182,917				1,135,279	1,215,807	10.0
2900 Other Support Services	8.						0	0	
3000 Operation of Noninstructional Services	9.				1,518,981		1,554,938	1,518,981	-2.3
4000 Facilities Acquisition & Construction	10.						0	0	
5000 Debt Service	11.					14,704,814	15,589,685	14,704,814	-5.7
610 School-Sponsored Cocurricular Activities	12.				95,831		0	95,831	
620 School-Sponsored Athletics	13.	202,991	32,479		232,145		0	467,615	
630, 700, 800, 900 Other Programs	14.						0	0	
Subtotal (lines 1-14)	15.	25,069,010	4,271,919	7,567,608	4,369,115	14,704,814	47,596,680	55,981,466	17.6
200 Special Education									
1000 Instruction	16.	1,506,844	278,516	1,096,803			2,093,181	2,882,163	37.7
Support Services									
2100 Students	17.						0	0	
2200 Instruction	18.						0	0	
2300 General Administration	19.						0	0	
2400 School Administration	20.						0	0	
2500 Central Services	21.						0	0	
2600 Operation & Maintenance of Plant	22.						0	0	
2900 Other Support Services	23.						0	0	
3000 Operation of Noninstructional Services	24.						0	0	
4000 Facilities Acquisition & Construction	25.						0	0	
5000 Debt Service	26.						0	0	
Subtotal (lines 16-26)	27.	1,506,844	278,516	1,096,803	0	0	2,093,181	2,882,163	37.7
400 Pupil Transportation	28.	405,667	65,255		451,123		838,223	922,045	10.0
530 Dropout Prevention Programs	29.						0	0	
540 Joint Career & Technical Ed. & Vocational Ed. Center	30.						0	0	
550 K-3 Reading	31.	353,898	48,264				365,601	402,162	10.0
Subtotal (lines 15 and 27-31)	32.	27,334,419	4,663,954	8,664,411	4,820,238	14,704,814	50,893,685	60,187,836	18.3
Classroom Site Projects (from page 3, line 40)	33.	3,782,098	615,692	0	0		3,716,921	4,397,790	18.3
Instructional Improvement Project (from page 2, line 5)	34.						227,468	240,152	5.6
Structured English Immersion Project (from page 4, line 11)	35.	0	0	0	0	0	0	0	
Compensatory Instruction Project (from page 4, line 22)	36.	20,415	3,266	0	0	0	0	23,681	
Federal and State Projects (from page 2, line 32)	37.						1,815,969	1,923,112	5.9
Total (lines 32-37)	38.	31,136,932	5,282,912	8,664,411	4,820,238	14,704,814	56,654,043	66,772,571	17.9

Appendix 2

American Leadership Academy Annual Financial Report 2017

CHARTER SCHOOL American Leadership Academy COUNTY Maricopa CTDS NUMBER 078725000

Expenses Instructions 1000 Schoolwide Project		Salaries 6100	Employee Benefits 6200	Purchased Services 6300, 6400, 6500	Supplies 6600	Other 6800	Totals: Budget	Totals: Actual	Totals: Prior Year Actual	% Increase Decrease in Actual
100 Regular Education										
1000 Instruction	1.	9,657,867	1,429,511		1,707,597		14,278,224	12,794,975	10,112,825	26.52%
2000 Support Services										
2100 Students	2.						1,466,540	0	438,812	-100.00%
2200 Instruction	3.						1,283,508	0	0	0.00%
2300 General Administration	4.	2,995,151	479,579				2,260,999	3,474,730	3,273,342	6.15%
2400 School Administration	5.	2,709,214	382,233	349,034		149,739	3,399,098	3,590,220	3,204,746	12.03%
2500 Central Services	6.						0	0	0	0.00%
2600 Operation & Maintenance of Plant	7.	819,151	115,864				857,227	935,015	836,756	11.74%
2900 Other Support Services	8.						0	0	0	0.00%
3000 Operation of Noninstructional Services	9.						153,060	0	44,773	-100.00%
4000 Facilities Acquisition & Construction	10.						0	0	0	0.00%
5000 Debt Service	11.					10,444,921	10,413,678	10,444,921	10,316,392	1.25%
610 School-Sponsored Cocurricular Activities	12.						0	0	0	0.00%
620 School-Sponsored Athletics	13.						0	0	0	0.00%
630, 700, 800, 900 Other Programs	14.						0	0	0	0.00%
Subtotal (lines 1-14)	15.	16,181,383	2,407,187	349,034	1,707,597	10,594,660	34,112,334	31,239,861	28,227,646	10.67%
200 Special Education										
1000 Instruction	16.	904,874	232,995	1,333,533			1,852,239	2,471,402	2,402,481	2.87%
2000 Support Services										
2100 Students	17.						0	0	0	0.00%
2200 Instruction	18.						0	0	0	0.00%
2300 General Administration	19.						0	0	0	0.00%
2400 School Administration	20.						0	0	0	0.00%
2500 Central Services	21.						0	0	0	0.00%
2600 Operation & Maintenance of Plant	22.						0	0	0	0.00%
2900 Other Support Services	23.						0	0	0	0.00%
3000 Operation of Noninstructional Services	24.						0	0	0	0.00%
4000 Facilities Acquisition & Construction	25.						0	0	0	0.00%
5000 Debt Service	26.						0	0	0	0.00%
Subtotal (lines 16-26)	27.	904,874	232,995	1,333,533	0	0	1,852,239	2,471,402	2,402,481	2.87%
400 Pupil Transportation	28.	489,629	60,875		331,186		865,984	881,690	798,739	10.39%
530 Dropout Prevention Programs	29.						0	0	0	0.00%
540 Joint Career & Technical Ed. & Vocational Ed. Center	30.						0	0	0	0.00%
550 K-3 Reading	31.						265,506	0	231,250	-100.00%
Subtotal (lines 15 and 27-31)	32.	17,575,886	2,701,057	1,682,567	2,038,783	10,594,660	37,096,063	34,592,953	31,660,116	9.26%
Classroom Site Project (from page 4, line 14)	33.	2,310,107	164,232	91,603	0		2,548,331	2,365,942	2,228,649	6.16%
Instructional Improvement Project (from page 5, line 5)	34.						170,381	292,783	235,483	24.33%
Structured English Immersion Project (from page 6, line 14)	35.	0	0	0	0	0	0	0	0	0.00%
Compensatory Instruction Project (from page 6, line 28)	36.	0	0	0	0	0	0	0	0	0.00%
Federal and State Projects (from page 9, line 30)	37.						1,671,104	2,210,455	1,291,159	71.20%
Total (lines 32-37)	38.						41,485,879	39,462,133	35,415,407	11.43%

Appendix 3

American Leadership Academy Revenue 2017 AFR

CHARTER SCHOOL American Leadership Academy COUNTY Maricopa

Instructions

REVENUE		ACTUAL	
1000 Local Sources			
1. 1310 Tuition from Individuals			1.
2. 1320 Tuition from Other Arizona Schools or Districts			2.
3. 1410 Transportation Fees from Individuals			3.
4. 1420 Transportation Fees from Other Arizona Schools or Districts			4.
5. 1500 Earnings on Investments			5.
6. 1600 Food Service (from Food Service AFR, line 2)		0	6.
7. 1700 School Activities		431,736	7.
8. Other Revenue from Local Sources (specify)	Donations	1,009,082	8.
9. Subtotal (lines 1-8)		1,440,818	9.
2000 Intermediate Sources			
10. 2100 Unrestricted			10.
11. 2200 Restricted			11.
12. Other Revenue from Intermediate Sources (specify)			12.
13. Subtotal (lines 10-12)		0	13.
3000 State Sources			
14. 3110 State Equalization Assistance		37,224,037	14.
15. 3130-3150 Other Unrestricted			15.
16. 3200 Restricted		2,726,173	16.
17. 3900 Revenue for/on Behalf of the School			17.
18. Other Revenue from State Sources (specify)	AZCSP	250,000	18.
19. Subtotal (lines 14-18)		40,200,210	19.
4000 Federal Sources			
20. 4100, 4300 Unrestricted/Restricted Received Directly from the Federal Government			20.
21. 4200, 4300 Unrestricted/Restricted Received from the Federal Government through the State			21.
22. 4700 Revenue Received from the Federal Government through Other Intermediate Agencies			22.
23. 4800 Federal Impact Aid			23.
24. 4900 Revenue for/on Behalf of the School		2,162,073	24.
25. Other Revenue from Federal Sources (specify)			25.
26. Subtotal (lines 20-25)		2,162,073	26.
27. **TOTAL REVENUE FROM ALL SOURCES (lines 9, 13, 19, and 26)**		43,803,101	27.

Appendix 4. American Leadership Academy 2017 Audit Revenue and Expenses

AMERICAN LEADERSHIP ACADEMY, INC.
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2017

	Unrestricted	Temporarily Restricted	Total
Revenues, Gains, and Other Support:			
Equalization and governmental revenues	$ 43,371,365	$ 0	$ 43,371,365
Grants and contributions	181,016		181,016
Other	252,622		252,622
Total Revenues, Gains, and Other Support	43,805,003	0	43,805,003
Expenses and Losses:			
Program services			
Instruction and operation	38,178,675		38,178,675
Interest expense	2,289,824		2,289,824
Supporting services			
Administration	1,692,512		1,692,512
Fundraising	103,323		103,323
Total Expenses	42,264,334	0	42,264,334
Increase (decrease) in net assets	1,540,669		1,540,669
Net Assets (deficit) at beginning of year	3,450,989		3,450,989
Net Assets (deficit) at end of year	$ 4,991,658	$ 0	$ 4,991,658

Appendix 5. 67th Avenue Learning Center "school site" purchased by Educational Options Foundation 2018.

Financial Performance Framework

During the 53rd Second Regular Legislative Session, the budget was passed with language requiring charters to meet the financial performance expectations set forth in the performance framework. This provision gave the Arizona State Board for Charter Schools (Board) the authority to take action against a charter it sponsors based on its Financial Performance Framework. The Board was therefore required to begin a public review process to design a financial framework and adopt rule and policy to which the Board can use for accountability purposes.

The Board has seated a Financial Subcommittee (Subcommittee) to review and update its Financial Performance Framework in light of this additional accountability. To assist the Subcommittee, the Board is requesting comments from stakeholders. Information submitted in response to the following questions will be considered by the Subcommittee.

Email address *

arizcsa1000@gmail.com

Tell us about yourself

Your first and last name *

Jim Hall

Your mailing address *

10640 N. 28th Ave Suite C-205-3

Your organization

Arizonans for Charter School Accountability

Feedback Questions

Identify components of the Board's current Financial Performance Dashboard/Framework that adequately identify a charter's financial status. *

See response in additional comments.

Identify components of the Board's current Financial Performance Dashboard/Framework that do not adequately identify a charter's financial status. *

See response in additional comments.

What are key financial indicators that result in a charter's closure? *

See response in additional comments.

Additional comments? *

It has come to our attention that 28 charter holders have not posted the required Open Meeting Law notices on their websites. These schools were referred to the Ombudsman Office of the Attorney General over a year ago and still have no school board information on their websites. Four additional schools have not posted any notices for board meetings in 2018.
It should be noted that all of the compliance questionnaires included in the annual audits for these schools erroneously reported that all Open Meeting Laws had been followed. Major auditing firms - Joel D. Huber, Henry+Horn, Holcomb & Shreeve, Lorenzo PC, John C. Todd and others responded “Yes” regarding these questions about school websites when there was no mention of school boards on their websites at all:
OPEN MEETING LAW A.R.S. § 38-431.01 and § 38-431.02 (See also Attorney General Opinion I00-009)
1. Did the school conspicuously post a statement on its website stating where all public notices of its meetings will be posted, including the physical and electronic locations?
2. Did the school post all public meeting notices on its website?

The Charter Board relies on the audit exclusively to rate the Financial Framework for each school. The submission of false information by these firms brings into question the veracity of the complete audit and the usefulness of the data presented for the Financial Framework.

Formal complaints have been filed with the Charter Board regarding these schools and accounting firms.

Recommendations:
1. Auditing firms submitting inaccurate information on charter audits should be sanctioned based on the relative importance of the false information into the determination of status on the Financial Framework.
2. The Charter Board, with the assistance of the Auditor General, should conduct unannounced audits of charters that submit inaccurate data on the annual audit.
3. The Charter Board needs to perform random financial audits on a regular basis the assure that data submitted on the Annual Financial Report and annual audit are accurate - encouraging charter owners and auditing firms to take greater care in the preparation of these reports.

This form was created inside of State of Arizona.

Google Forms

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The Board has seated a Financial Subcommittee (Subcommittee) to review and update its Financial Performance Framework in light of this additional accountability. To assist the Subcommittee, the Board is requesting comments from stakeholders. Information submitted in response to the following questions will be considered by the Subcommittee.

Email address *

corey.kennedy@vertexeducation.com

Tell us about yourself

Your first and last name *

Corey Kennedy

Your mailing address *

3125 S Gilbert Rd, Chandler, AZ 85286

Your organization

Vertex Education / Legacy Traditional Schools

Feedback Questions

Identify components of the Board's current Financial Performance Dashboard/Framework that adequately identify a charter's financial status. *

I think each of the components of the framework gets at the right issues, but could be fine tuned to be better. See additional comments section below.

Identify components of the Board's current Financial Performance Dashboard/Framework that do not adequately identify a charter's financial status. *

I'd look at cash flow over net income as a better indicator of financial condition, so I'm not sure both are necessary.

What are key financial indicators that result in a charter's closure? *

Cash, cash, cash. Consistent cash losses in the absence of any other sources is the key indicator. Material default would be an obvious one, but at that point financial problems are pretty far down the road, so it's not a great advance indicator.

Additional comments? *

Overall, I'd suggest considering how as a first step in the framework schools could be categorized as "lower risk" or "higher risk" and have different targets. Higher risk schools might have more stringent targets in some measures because they're more vulnerable to financial problems. Lower risk schools might have less stringent targets in some measures because they're better positioned to withstand financial pressures, thus allowing for growth of high performing, larger, and more stable charter schools. In making such a distinction, I'd consider things like the number of years in operation, number of campuses/schools, enrollment levels, days cash on hand, and even academic results.

Aside from that, I think a number of improvements to the existing framework are needed:

1a Going Concern
--I would move the second box currently under "Falls Far Below Standard" section up to the "Does Not Meet Standard" section.
--This distinguishes between audits that have a going concern paragraph in the auditor's report and audits that do not have a going concern paragraph in the auditor's report, but do contain some footnote disclosures. There really is a significant difference between putting that extra paragraph in the auditors' report versus just having a disclosure in the footnotes. The extra paragraph in the auditor's report indicates substantial doubt in the auditor's mind about whether the entity can continue as a going concern (i.e. a viable operation) for more than a year. If it's just a note in the f/s it means the auditor's substantial doubt was alleviated, a less severe issue.

1b Unrestricted Days Liquidity
--I would add to the definition a subtraction from total expenses for depreciation and amortization. These are noncash expenses (you don't write a check for these) that should not count as expenses in this calculation.
--I would also consider adding a reduction for any other truly noncash expenses. An example of this would be a noncash loss on advance refunding of a bond, which is a "paper" loss that doesn't get paid for with cash.
--I can tell you that the days cash calculation in Legacy's and all other bond covenants that I've seen call for a subtraction of depreciation and amortization from expenses (and really any other noncash expenses...such as a loss on advance refunding of a bond).

1c Default
--I think there are some wording clarifications that could be made surrounding "material default" vs. "default on material loans." Both terms are used in the descriptions and each term could mean different things. I'd just make it consistently say "material default" since the

overview describes this in some detail.

2a Net Income
--I question whether this measure is needed, at least when there's already a cash flow measurement that I would consider to be a better measure.

2b Cash Flow
--Consider a more precise measurement of the changes in cash. Consistent positive cash from operations is ideal. Cash from borrowings can cause cash to increase for a period of time, but if a school isn't able to generate cash from operations, it won't last.

2c Fixed Charge Coverage Ratio
--Consider changes to the definitions of meets, does not meet, and falls far below. Currently there's no falls far below outcome. I'd suggest something like this:
Meets = equal to or greater than 1.10
Does Not Meet = 0.9 to 1.10
Falls Far Below = less than 0.9

reason FOUNDATION

BEYOND TEST SCORES: A CENTRAL ROLE FOR FINANCIAL HEALTH IN EVALUATING ARIZONA'S CHARTER SCHOOLS

by Aaron Garth Smith
September 2018

Reason Foundation's mission is to advance a free society by developing, applying and promoting libertarian principles, including individual liberty, free markets and the rule of law. We use journalism and public policy research to influence the frameworks and actions of policymakers, journalists and opinion leaders.

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EXECUTIVE SUMMARY

School districts across the U.S. face fiscal distress, yet financial health remains on the sidelines of state accountability systems, with few consequences for mismanaging education dollars and putting students, teachers, and taxpayers at risk. In recent years, the charter sector has led the way in promoting greater transparency, with numerous authorizers adopting financial performance frameworks that track and report on key measures of financial health. The Arizona State Board for Charter Schools (ASBCS) adopted its own framework in 2012, which provides clear performance expectations and rates charters on financial outcomes. With the recent passage of HB 2663, which allows ASBCS to close charters that fail to meet these financial standards, now is a critical time to assess how this framework is working and implement needed improvements.

Our analysis finds that:

#1 The Financial Performance Framework's roll-up mechanism fails to make important distinctions in performance.

#2 Closed charter schools are more likely to be financially distressed schools with low enrollment.

#3 Arizona's three performance frameworks—academic, financial and operational—are disconnected.

Several reforms can improve ASBCS's financial performance framework in the short term. The most important areas to address are the framework's roll-up mechanism and creating the infrastructure needed to close financially distressed charters in a manner that is fair, transparent, and accounts for local context. To do so, Arizona should revamp its summative ratings and create a more nuanced infrastructure to better assess flagged charters, which could involve creating a second-tier evaluation system that incorporates both quantitative and qualitative data (see Table ES1) and enlisting the support of an objective, third-party financial reviewer before closure decisions are made. Importantly, Arizona should also add enrollment growth as a sustainability measure of financial performance that flags charters with substantive declines over a three-year period. Not only is enrollment often related to financial distress, but it also provides valuable insight into whether a charter is using tax dollars to meet the needs of a community.

TABLE ES1: DESCRIPTIONS OF REVAMPED SUMMATIVE RATINGS

Rating	Description
Imminent Risk	Charter is vulnerable to financial distress in the short term.
High Risk	Charter could be vulnerable to financial distress.
Moderate Risk	Area(s) for improvement have been identified.
Low Risk	Charter demonstrates strong financial performance across all metrics.

In the long term, policymakers in Arizona and beyond should consider reforms to realize the full potential of financial data. Because measures of financial health capture important information about school quality that test-based accountability metrics miss, they should have a central role in evaluating performance, especially for schools of choice where parents can hold educators directly accountable for meeting their child's needs. Parents choose schools based on more than just test scores, valuing concerns such as school safety, discipline, learning environment, and special programs. Since schools are financed based on enrollment, a focus on financial health and measures of demand is a focus on parental satisfaction.

The tax-exempt bond market for charter schools provides valuable insight into how financial measures can be integrated with current accountability systems or used to reimagine how schools are evaluated altogether. The most important lesson that policymakers can learn is how ratings agencies integrate financial health and the underlying demand signals in their assessments. In the context of state accountability systems, not only would this ensure that tax dollars are being used responsibly, it would also recognize how well schools satisfy parents. By unlocking the full potential of financial data, Arizona has the opportunity to become a national model for charter school evaluation that moves beyond test scores.

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PART 1

INTRODUCTION

Arizona's approach to charter school authorizing has cultivated astounding results. In recent years, the state's charter students have demonstrated substantial gains across all 4th and 8th grade NAEP subjects tested, outpacing the growth of students in the state's traditional school districts and the U.S. average.[1] In fact, Arizona's charter schools now score on par with students in high-performing states such as Massachusetts and New Hampshire, despite having more challenging demographics.[2] But what's most remarkable is that they're clearly satisfying parent demands as an increasing number of families are choosing charters over other options: in the 2014–15 school year, nearly 1 in 5 Arizona public school students attended a charter, and wait-lists as long as 20,000 students have been reported.[3]

A primary feature of Arizona's approach is its low barriers to entry, which allow promising operators to implement innovative educational models with relatively fewer bureaucratic hurdles compared to authorizing practices in other states. Inevitably, some operators fall short of meeting parent and community needs and close as a result, and while these

1 Ladner, Matthew. "The Case for School Choice in 2018." Reason Foundation. Los Angeles. 23 Jan. 2018. Panel presentation.

2 Ibid.

3 Ladner, Matthew. "In Defense of Education's 'Wild West'" *EducationNext* 18 (2018) *EducationNext.org*. Web. <http://educationnext.org/in-defense-educations-wild-west-charter-schools-thrive-four-corners-states/> 25 June 2018.

failures can be disruptive, they're also a sign of a healthy ecosystem that empowers parents to decide whether a school flourishes or shutters its doors. According to Matthew Ladner of the Charles Koch Institute, "The conclusion is that parents are taking the lead and closing schools they don't desire. And they do this with an absolutely brutal efficiency that no state bureaucracy will ever emulate."

Of course, this doesn't mean that authorizers have no role to play in overseeing charters and the tax dollars that support them, especially in instances where parents have clearly spoken. An example of this need is the abrupt closure of the Discovery Creemos Academy in January, which left hundreds of families in search of a new school and many teachers without jobs.[4] At the time, Arizona law didn't allow the Arizona State Board for Charters Schools (ASBCS) to close charters for financial reasons, and Discovery Creemos Academy remained open despite showing substantial signs of fiscal distress years before it closed, including substantial enrollment losses.

School districts across the U.S. face fiscal distress, yet financial health remains on the sidelines of state accountability systems, with few consequences for mismanaging education dollars and putting students, teachers, and taxpayers at risk. In recent years, the charter sector has led the way in promoting greater transparency, with numerous authorizers adopting financial performance frameworks that track and report on key measures of financial health. The Arizona State Board for Charter Schools adopted its own framework in 2012, which provides clear performance expectations and rates charters on financial outcomes. With the recent passage of HB 2663, which allows ASBCS to close charters that fail to meet these financial standards, now is a critical time to assess how this framework is working and implement needed improvements.

4 Philip, Agnel and Ricardo Cano. "Dozens of Arizona charter schools are at risk of closing due to financial woes." *The Republic*. 1 March 2018. AZCentral.com. Web. <www.azcentral.com/story/news/local/arizona-education/2018/03/01/arizona-charter-schools-risk-closing-due-financial-woes/364727002/> 25 June 2018.

PART 2

UNDERSTANDING FINANCIAL TRANSPARENCY

A robust system of financial transparency comprises three primary components that work together to provide timely and user-friendly data for stakeholders such as parents, superintendents, and legislators:

1) **Allocation Transparency:** The distribution of education revenues, including the collection of formulas and provisions that determine funding allotments at both the district and school levels and the actual resources they receive.
2) **Expenditures Transparency:** How education dollars are ultimately spent by districts and schools, highlighting the various categories of outlays that consume these resources, such as administrative salaries and capital expenses.
3) **Financial Health Transparency:** The short- and long-term viability of districts and schools and the extent to which they're susceptible to financial distress, accounting for factors such as debt obligations, liquidity, and revenue trends.

These elements of financial transparency can be used to explore critical questions about the foundation of public education, including:

- Are resources allocated in a manner that accounts for student need?
- To what extent are tax dollars being used productively?
- Are funding streams fair and efficient?
- Is spending aligned with educational strategy?
- Are education dollars reaching the students they're intended for?
- Are the financial practices of districts and schools financially sustainable?

Providing stakeholders with the infrastructure to address such inquiries can help them make more-informed evaluations and decisions, but most states neglect each component of financial transparency to at least some degree. For example, it's virtually impossible to find data that overlay spending with outcomes to measure productivity,[5] and expenditures are rarely reported at the school level even though research has found widespread problems with district allocation practices.[6] But perhaps most problematic is the lack of attention given to financial health, which has consequences in classrooms and communities including chronic underperformance, bankruptcy, and even closure. Unfortunately, financial distress is common, as superintendents and board members often put short-term political gains ahead of long-term viability, as Marguerite Roza, Amber Northern, and Michael Petrilli explain:[7]

> *Districts go insolvent primarily because there are insufficient counter-pressures on their leaders to stay fiscally solvent. Existing leaders are often rewarded—through elections, appointments, or re-appointments—when they make promises that obligate monies down the road. Employees of the system often push for higher salaries, expanded benefits, retirement sweeteners, and other advantages that districts simply can't afford, but that*

5 Roza, Marguerite. "Leveraging Productivity for Progress: An Imperative for States." Edvance Research Inc., 2013. Web. <http://edunomicslab.org/wp-content/uploads/2015/03/state-imperative-SEAF.pdf> 16 June 2018. 10-15.

6 Roza, Marguerite. *Educational Economics: Where Do School Funds Go?* Washington, D.C.: Urban Institute Press, 2010. 47-60. Print.

7 Roza, Marguerite, Amber M. Northern, and Michael J. Petrilli. "Sensible Responses to Insolvent School Districts." *Flypaper*. Thomas B. Fordham Institute. 12 Aug 2015. Web. <https://edexcellence.net/articles/sensible-responses-to-insolvent-school-districts> 11 June 2018.

union-friendly boards agree to anyway. Such long-term obligations are largely what put districts in the hole.

An example of this is Los Angeles Unified School District (LAUSD), which for years has ignored dire warnings about its unsustainable structural deficit that could overwhelm its core operations and lead to state-takeover.[8] LAUSD leaders have failed to address ballooning pension and benefit obligations while overseeing a hiring surge despite significant enrollment declines.[9] But LAUSD isn't alone. Places such as Chicago, Detroit and Philadelphia face fiscal challenges of their own as decades of mismanagement have put districts and students across the U.S. at risk, with little transparency or accountability.[10]

2.1 FINANCIAL TRANSPARENCY IN THE CHARTER SECTOR

Measures of financial health are usually assigned to the sidelines of state reporting and accountability systems, despite the dire consequences of fiscal mismanagement. But in recent years the charter sector has taken positive steps toward greater transparency as many authorizers use some form of a financial performance framework to evaluate outcomes.[11] This helps ensure that charters are good stewards of tax dollars and operate in a financially sustainable manner that avoids the same fiscal cliffs that many districts are teetering over. According to the National Association of Charter School Authorizers (NACSA), performance frameworks allow charters to know what's expected of them and can be used to inform decisions throughout the term of a charter contract.[12] NACSA recommends that authorizers establish frameworks in three separate areas to evaluate performance:[13]

8 Snell, Lisa, Aaron Garth Smith, Tyler Koteskey, Marc Joffe, and Truong Bui. "A 2018 Evaluation of LAUSD's Fiscal Outlook: Revisiting the Findings of the 2015 Independent Review Panel." Reason Foundation, 2018. Web. <https://reason.org/wp-content/uploads/2018/06/2018-evaluation-of-lausd-fiscal-outlook.pdf> 13 June 2018.

9 Ibid.

10 Roza et. al. "Sensible Responses to Insolvent School Districts."

11 National Association of Charter School Authorizers, and Local Initiatives Support Corporation. "Charter Lenders and Charter Authorizers: Can We Talk?" 2015. Web. <http://www.qualitycharters.org/wp-content/uploads/2015/05/LendersAuthorizersReport_final.pdf> 10 June 2018. 21

12 National Association of Charter School Authorizers. "Core Performance Framework and Guidance." 2013. Web. <http://www.qualitycharters.org/wp-content/uploads/2016/01/CorePerformanceFrameworkAndGuidance.pdf> 10 June 2018.

13 Ibid.

1. **Academics:** The success of the educational program
2. **Operational:** Organizational effectiveness
3. **Financial:** The financial viability of a school

The role of the financial framework in particular is to assess the financial stability of charters and highlight those that are experiencing difficulties or might be trending in this direction.[14] This is done by measuring both near-term and long-term measures of financial health, such as financial flexibility and debt obligations. The following sections analyze and recommend short-term enhancements to Arizona's financial performance framework, and also explore how financial health transparency might evolve to play a more central role in informing performance in K-12 education in the long term.

[14] Ibid. 42.

PART 3

ARIZONA'S FINANCIAL PERFORMANCE FRAMEWORK

3.1 OVERVIEW

In 2012, the Arizona State Board for Charter Schools adopted its own financial framework, which is intended to "communicate the Board's expectations for ensuring that all charter holders in its portfolio are viable organizations with strong fiscal management practices"[15] without infringing upon a charter's autonomy in determining how funds are spent.[16] ASBCS's financial framework consists of three near-term measures that indicate a charter's financial position for the upcoming year, and three sustainability measures that are meant to depict a charter's financial position over time.[17] These measures and their accompanying performance targets are provided in Table 1.

15 "Interpreting the Financial Performance Dashboard." Arizona State Board for Charter Schools. asbcs.az.gov. 2016. Web. <https://asbcs.az.gov/sites/default/files/documents/files/Interpreting%20the%20Financial%20Dashboards%208-2016.pdf> 10 June 2018.

16 "Financial Performance Framework and Guidance." Arizona State Board for Charter Schools. asbcs.az.gov. 10 October 2017. Web. <https://asbcs.az.gov/sites/default/files/documents/files/Financial%20Guidance%20Document%20Approved%2010-2017.pdf> 10 June 2018. 2.

17 Ibid.

TABLE 1: ASBCS'S FINANCIAL FRAMEWORK MEASURES

Indicator Type	Measure	Description	Performance Target
Near-Term	Going Concern	Risk that charter holder will cease operations within a year.	No going concern issue identified in the charter's annual audit.
	Unrestricted Days Liquidity	How many days a charter can pay its expenses without an influx of cash.	At least 30 days.
	Default	Whether a charter has been issued a formal notice of default by a lender.	No default on material loans.
Sustainability	Net Income	Examines whether a charter's revenues exceed its expenses.	Greater than or equal to $1.
	Fixed Charge Coverage Ratio	Whether a charter has sufficient cash flow to cover fixed obligations or charges.	Greater than or equal to 1.1.
	Cash Flow	Change in cash balance from one fiscal year to another.	Three-year cumulative cash flow is positive.

Source: "Interpreting the Financial Performance Dashboard." Arizona State Board for Charter Schools. asbcs.az.gov. 2016. Web. <https://asbcs.az.gov/sites/default/files/documents/files/Interpreting%20the%20Financial%20Dashboards%208-2016.pdf> 10 June 2018.

For each measure and its accompanying performance targets, ASBCS has developed ratings that are used to evaluate a charter's financial situation as described in Table 2. These individual ratings are then rolled up to determine two summative ratings: the Board's Financial Performance Standard and the Board's Financial Performance Expectations. To meet the Board's standard, a charter must not receive more than one *Does Not Meet Standard* rating and cannot receive any *Falls Far Below Standard* ratings in the most recent audit reporting package. A charter's financial performance standard rating for the most recent audited fiscal year and the prior audited fiscal year are then used to determine whether it meets the Board's expectations. A charter does not meet this threshold if it either fails to meet the Board's standard for two consecutive years or receives one or more *Falls Far Below Standard* ratings in the most recent year's audit.[18]

18 Ibid. 5.

TABLE 2: FINANCIAL PERFORMANCE FRAMEWORK RATINGS

Measure	Possible Ratings	Description
Going Concern	Meets Standard	The most recent audit reporting package does not include an explanatory paragraph in Independent Auditor's Report or disclosures in the note to the financial statements.
	Falls Far Below Standard	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.
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.
Default	Meets Standard	Charter holder is not in default on material loans.
	Falls Far Below Standard	Charter holder is in default on material loans.
Net Income	Meets Standard	Net income is greater than or equal to $1.
	Does Not Meet Standard	Net income is zero or negative.
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.
Cash Flow	Meets Standard	Three-year cumulative cash flow is positive.
	Does Not Meet Standard	Three-year cumulative cash flow is negative.

Source: "Financial Performance Framework and Guidance." Arizona State Board for Charter Schools. asbcs.az.gov. 10 October 2017. Web. <https://asbcs.az.gov/sites/default/files/documents/files/Financial%20Guidance%20Document%20Approved%2010-2017.pdf> 10 June 2018. 8-14.

Charters that fail to meet ASBCS's financial expectations are required to submit a financial performance response at specified times such as five-year interval reviews, contract renewal, and expansion requests.[19] ASBCS may also consider a charter's financial performance at other times, such as when a charter receives an "F" under the state accountability system and when a charter fails to meet the standards set forth in the academic performance framework for three consecutive years.[20] Importantly, recent legislation empowers ASBCS to close charters that fail to meet its financial performance standards,[21] although the infrastructure to exercise this authority hasn't been established.

3.2 ANALYSIS AND FINDINGS

Historical data obtained from ASBCS and publicly available reports[22] were used to analyze the financial performance outcomes of Arizona charter schools as well as the framework itself. Table 3 summarizes the financial performance outcomes for Arizona's charters from FY 14 to FY 16.

TABLE 3: ARIZONA CHARTER SCHOOLS, FINANCIAL PERFORMANCE FRAMEWORK OUTCOMES, FROM FY14 TO FY16

Indicator	Measure	Year	Meets	Does Not Meet	Falls Far Below	Total	% Far Below and/or %Does Not Meet
Near Term	Going Concern	2014	359	N/A	35	394	8.9%
		2015	380	N/A	24	404	5.9%
		2016	398	N/A	12	410	2.9%
		TOTAL	1137	N/A	71	1208	5.9%
	Unrestricted Days Liquidity	2014	268	78	48	394	32.0%
		2015	301	62	41	404	25.5%
		2016	316	54	40	410	22.9%
		TOTAL	885	194	129	1208	26.7%
	Default	2014	389	N/A	5	394	1.3%
		2015	403	N/A	1	404	0.2%
		2016	407	N/A	3	410	0.7%
		TOTAL	1199	N/A	9	1208	0.7%
Sustain-ability	Net Income	2014	236	158	N/A	394	40.1%
		2015	250	154	N/A	404	38.1%
		2016	294	116	N/A	410	28.3%
		TOTAL	780	428	N/A	1208	35.4%
		2014	220	160	N/A	380	42.1%

[19] Ibid. 17-22.

[20] Ibid.

[21] Arizona HB 2663 <https://www.azleg.gov/legtext/53leg/2r/bills/hb2663p.pdf>

[22] Calculations based on data obtained from ASBCS include financial performance framework outcomes and school closure data. Publicly available enrollment data were obtained from http://www.azed.gov/accountability-research/data/. Any errors or omissions are my own.

Indicator	Measure	Year	Meets	Does Not Meet	Falls Far Below	Total	% Far Below and/or %Does Not Meet
	Fixed Charge Coverage Ratio	2015	246	148	N/A	394	37.6%
		2016	268	130	N/A	398	32.7%
		TOTAL	734	438	N/A	1172	37.4%
	Cash Flow	2014	203	191	N/A	394	48.5%
		2015	213	191	N/A	404	47.3%
		2016	330	80	N/A	410	19.5%
		TOTAL	746	462	N/A	1208	38.3%
Overall	Meets Board's Financial Performance Standard	2014	184	210	N/A	394	53.3%
		2015	224	180	N/A	404	44.6%
		2016	272	138	N/A	410	33.7%
		TOTAL	680	528	N/A	1208	43.7%
	Meets Board's Financial Performance Expectations	2014	226	168	N/A	394	42.6%
		2015	268	136	N/A	404	33.7%
		2016	293	117	N/A	410	28.5%
		TOTAL	787	421	N/A	1208	34.9%

Data Source: Calculations based on data provided by ASBCS.

Three key takeaways emerge from this assessment.

#1 The Financial Performance Framework's roll-up mechanism fails to make important distinctions in performance.

Arizona's financial performance framework captures key measures of financial health and provides useful insights, but its roll-up mechanism is a blunt instrument that fails to meaningfully differentiate performance levels. Between FY14 and FY16, on average nearly 44% of charters evaluated did not meet the Board's financial standard.

While the labeling itself is not problematic—underperforming charters *should* be identified as such—the roll-up mechanism does not distinguish between charters in imminent danger of financial distress and those that need to improve sustainability metrics for long-term financial health. Of the 138 charters that did not meet ASBCS's financial standard in 2016, 44 received one or more *Falls Far Below* ratings on the framework's more serious near-term indicators, and the remaining 94 received two or more *Does Not Meet* ratings. Substantial variation in performance is observed in this group, ranging from a charter that missed out on two sustainability measures to a charter that failed all six measures including three *Falls Far Below* ratings. Lumping these performance levels together diminishes the framework's usefulness as an evaluative tool for ASBCS by making it difficult to identify charters that might require additional attention, as the financial challenges are overstated for some charters and understated for others. As a result, stakeholders might be misled by the summative ratings as there is greater variation in performance than what is presented.

This lack of nuance also poses challenges in evaluating mature charters that have more complex accounting requirements. For example, in recent years BASIS Schools has refinanced debt in order to take advantage of low interest rates, a financial strategy that has saved the network millions of dollars and benefited its students.[23] But because GAAP accounting rules require these expenses to be written off immediately, BASIS incurs a one-time accounting loss for each refinance, thus affecting its Net Income and Fixed Charge Coverage Ratio measures.[24] This has resulted in the charter failing to meet the Board's standard for several years, despite the fact that the charter is not financially vulnerable. In fact, BASIS earned a BB rating[25] from the credit agency Standard & Poor's in 2015 after undergoing intense review that scrutinized its financials and myriad other outcomes that are indicative of financial health, and a recent *U.S. News Report* ranking of public schools lists BASIS as having the top seven public high schools in Arizona and the five best high schools in the entire U.S.[26] The inclusion of BASIS among financially underperforming charters exemplifies the financial framework's lack of meaningful differentiation.

#2 Closed charter schools are more likely to be financially distressed schools with low enrollment.

Financial problems are often the root cause of charter failure. Table 4 shows the financial outcomes in the year preceding closure for charters that shutdown between FY14 and FY16. When compared with the overall financial data shown above in Table 3, it is clear that the financial health of these charter schools is substantially worse than for charters overall.[27] For example, 29% of closed charter schools received a *Falls Far Below* rating for Unrestricted Days Liquidity in their year preceding closure compared to an average of about 11% for all charters, and 75% of closed charters schools failed the Cash Flow measure

23 Based on conversations with BASIS leadership.

24 Ibid.

25 Because of the way charters are rated—ratings agencies generally place substantial weight on industry risk, which isn't indicative of an individual charter's financial performance—ratings for BASIS and charters are generally deflated by factors outside of their control.

26 See https://www.usnews.com/education/best-high-schools/arizona/rankings

27 Data for closed charters were examined at the school level while financial accountability ratings are assigned to charter holders, which sometimes have multiple schools. However, in most instances, charter holders have only one school.

versus an average of about 38% for all charters. In total, three-quarters of closed charter schools did not meet the Board's financial standard in the fiscal year preceding closure.

TABLE 4: FINANCIAL PERFORMANCE FRAMEWORK OUTCOMES FOR ARIZONA CHARTERS CLOSED BETWEEN FY 14 AND FY 16

Indicator	Measure	Meets	Does Not Meet	Falls Far Below	Total	% Far Below and/or %Does Not Meet
Near Term	Going Concern	38	N/A	18	56	32.1%
	Unrestricted Days Liquidity	28	12	16	56	50.0%
	Default	54	N/A	2	56	3.6%
Sustainability	Net Income	24	32	N/A	56	57.1%
	Fixed Charge Coverage Ratio	19	32	N/A	51	62.7%
	Cash Flow	14	42	N/A	56	75.0%
Overall	Meets Board's Financial Performance Standard	14	42	N/A	56	75.0%

Data Source: Calculations based on data provided by ASBCS. Financial outcomes for closed charters are for the fiscal year immediately preceding closure. In several instances these data were not available and outcomes for two years prior were used instead. Closed charters without published financial outcomes were not included in this table. Summative figure for Unrestricted Days Liquidity reflects charters that received either *Falls Far Below* or *Does Not Meet*.

A primary cause of financial distress is low enrollment, which often approximates a charter's ability to meet the needs of the community it serves effectively. Because charters are schools of choice, those that fail to satisfy parents are unlikely to attract and retain enough students to generate the revenue needed to be financially stable. In Arizona, this appears to be a force behind the financial problems of many closed schools. A plurality of the 56 charters that shut their doors between FY14 and FY16—about 43%—cited enrollment as the primary cause as shown in Table 5. In fact, the median enrollment for these schools was only 59 students, with just four serving 200 students or more as shown in Table 6. To put this in perspective, the median charter school in Arizona in FY17 enrolled

235 students and more than half enrolled 200-plus students. Importantly, approximately two-thirds of closed charters experienced flat or declining enrollment in their final year of operation with just more than half experiencing drops of 5% or more.[28] This is especially notable as it occurred during a time period when statewide charter enrollment grew substantially.

TABLE 5: CAUSES OF CLOSURE FOR ARIZONA CHARTER SCHOOLS CLOSED BETWEEN FY14 AND FY16

Reason for Closure	Count
Low Enrollment	24
Charter Contract Expired, No Application Submitted	6
Charter Not Renewed	5
Renewal Condition/Close Site	5
Merged with Another School Site or Converted to District School	5
Surrendered Under Duress or Financial Issues	4
Facility Issues	3
Failing to Meet Academic Standards	2
Other	2

Source: Calculations based on data provided by ASBCS. Categories with similar nomenclature were merged and the "Other" category was used to simplify data.

TABLE 6: ENROLLMENT DATA FOR CLOSED CHARTERS AND ALL ARIZONA SCHOOLS

	Closed Charters FY 14-FY 16	AZ Charters FY 17
Total Schools	56	541
Median Enrollment	59	235
200+ Students	4 (7%)	307 (56.7%)

Source: Calculations based on data provided by ASBCS and from http://www.azed.gov/accountability-research/data/.

28 Several closed charters did not have the enrollment data required for this analysis and are not included in enrollment figures.

#3 Arizona's performance frameworks are disconnected.

ASBCS's three performance frameworks—financial, academic and operational—largely function in silos, as is the case for virtually all frameworks employed by authorizers throughout the country. Although it makes sense to group the respective measures by performance area, the manner in which data are reported and evaluated fails to illustrate a comprehensive and streamlined picture of performance. This trifurcated approach makes it difficult to unearth important trends that might lend valuable insight into a charter's performance, and leaves stakeholders to connect the dots themselves as needed.

For example, financial measures might capture important signals about parental priorities, such as specialized curricula and school safety, that might not be evident in test scores (e.g. a performing arts school might have only average test scores yet be highly popular with parents, resulting in strong enrollment demand and solid financial health). And persistently poor operational governance might be indicative of larger issues that spill over into classrooms. For most stakeholders, the natural inclination is to focus primarily on test scores while using financial and operational data in a supporting role. But as the following sections will illustrate, this approach to evaluation misses a significant opportunity to more accurately convey whether a charter is serving its community effectively and using tax dollars with fidelity.

PART 4

RECOMMENDATIONS

The power of financial data is yet to be fully tapped by U.S. education systems, not only to flag districts and charters that are on the verge of fiscal distress but also to highlight those that are meeting parental demands effectively and using tax dollars in a financially responsible manner. Arizona has an opportunity to pioneer the tapping of this potential. Policymakers should pursue four short-term basic reforms to increase transparency, provide ASBCS with a more practical evaluation tool, and work toward more cutting-edge and long-term changes. Such improvements would make Arizona a national model for transparency in public education.

4.1 SHORT-TERM REFORMS

Reform #1: Revamp the Summative Ratings

Perhaps the most important short-term change is to revamp the financial framework's summative ratings, which currently muddle transparency by failing to meaningfully differentiate among performance levels. The current summative ratings could be replaced by four performance levels as shown in Table 7: Low Risk, Moderate Risk, High Risk, and Imminent Risk. The label "Risk" conveys a central purpose of the framework, which is to approximate the degree to which a charter's financial position and institutional practices make it vulnerable to failure. Regardless of nomenclature, increasing the number of ratings labels will enhance transparency for parents, taxpayers and ASBCS by providing a more nuanced assessment of performance. Table 8 shows the ratings and their respective performance levels, which are based on historic data and the need to more effectively differentiate between charters that are at significant risk for closure and those that simply need to strengthen performance to ensure long-term sustainability.

TABLE 7: DESCRIPTIONS OF REVAMPED SUMMATIVE RATINGS

Rating	Description
Imminent Risk	Charter is vulnerable to financial distress in the short term.
High Risk	Charter could be vulnerable to financial distress.
Moderate Risk	Area(s) for improvement have been identified.
Low Risk	Charter demonstrates strong financial performance across all metrics.

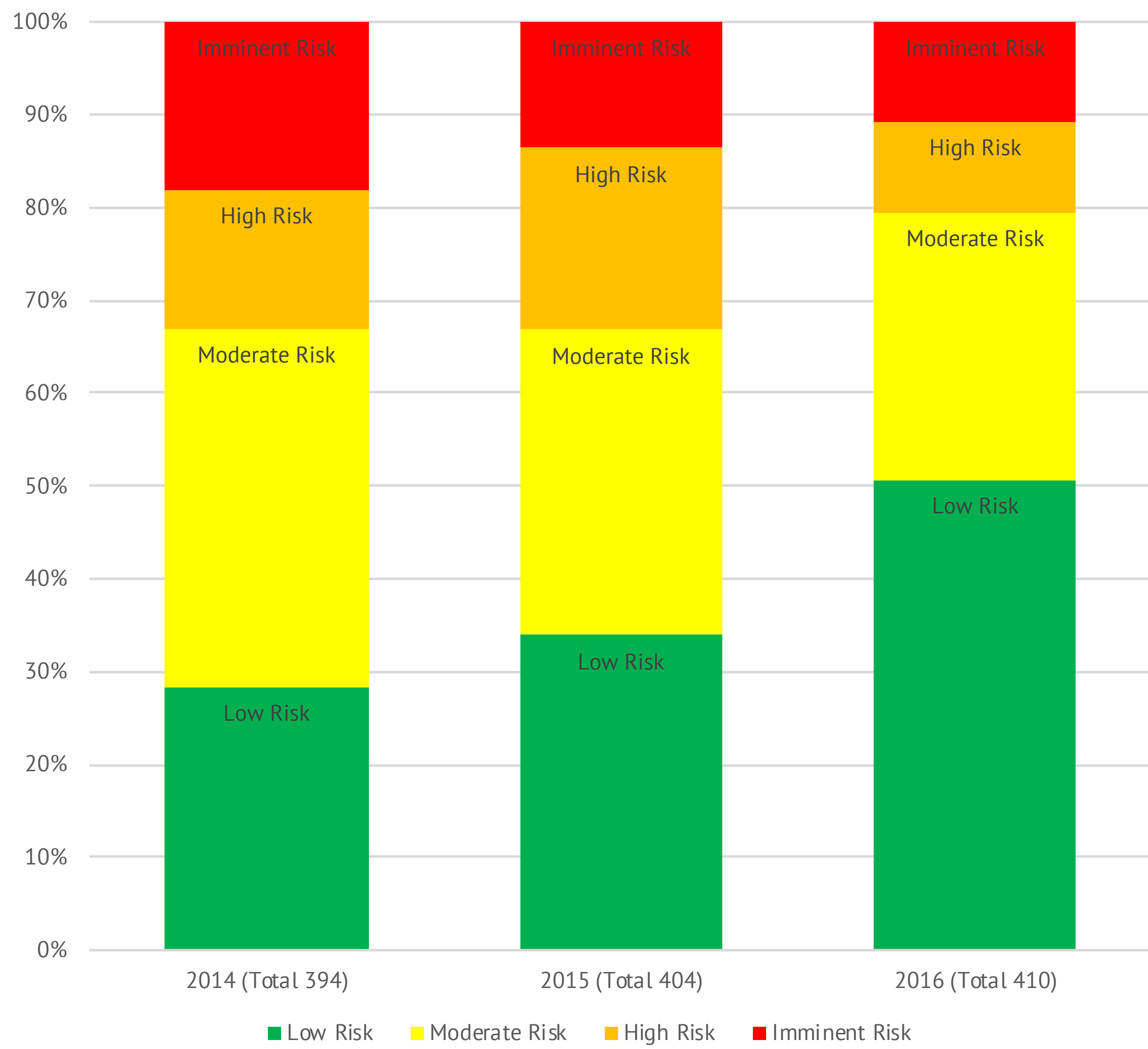
TABLE 8: REVAMPED SUMMATIVE RATINGS PERFORMANCE LEVELS

Rating	Financial Performance Area
Imminent Risk	One or more *Falls Far Below*
High Risk	No *Falls Far Below* Three or Four *Does Not Meet*
Moderate Risk	No *Falls Far Below* One or two *Does Not Meet*
Low Risk	No *Falls Far Below* No *Does Not Meet*

Note: ASBCS could also consider integrating a longitudinal flag that highlights districts that are rated High Risk for consecutive years. For example, a district rated High Risk for two or three consecutive years without improving could be flagged for possible interventions.

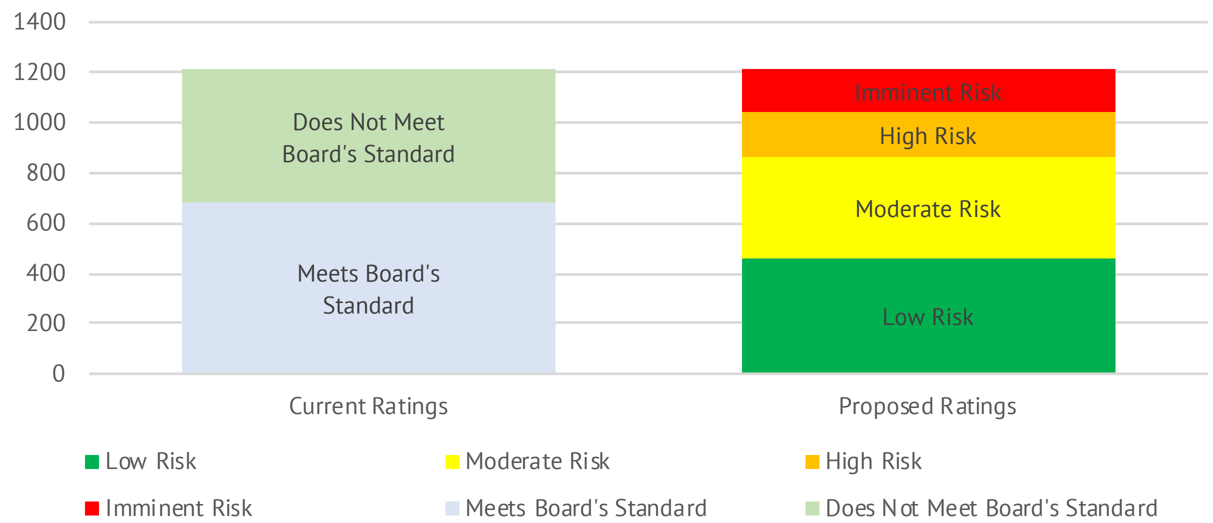
Applying these ratings to actual FY14–FY16 data yields the modeled results displayed in Figure 1, and Figure 2 compares the aggregate of these ratings with those generated by ASBCS's current methodology during the same time period. Notably, the proposed methodology flags an average of about 14% of charters as *Imminent Risk* and 15% as *High Risk*, indicating the severity of level of each group's shortcomings while also providing ASBCS with a more practical starting point to further evaluate outcomes with 44 charters in the most serious category in FY16. In comparison, the current financial performance standards identified an average of 44% of charters for financial underperformance, including 138 flagged in FY 16, a group with substantial variation in performance as previously noted. To assess the revamped ratings, when charters that closed between FY14 and FY16 are isolated and the proposed standards are applied to their financial outcomes in the year preceding closure, about 64% are flagged as either *Imminent Risk* or *High Risk* as shown in Figure 3. This indicates that even though the new standards flag substantially fewer charters overall, those that are the most financially unstable are still likely to be captured, which would help ASBCS to direct resources more efficiently and provide a fairer evaluation of performance.

FIGURE 1: FY14-FY16 MODELED FINANCIAL RATINGS USING PROPOSED METHODOLOGY



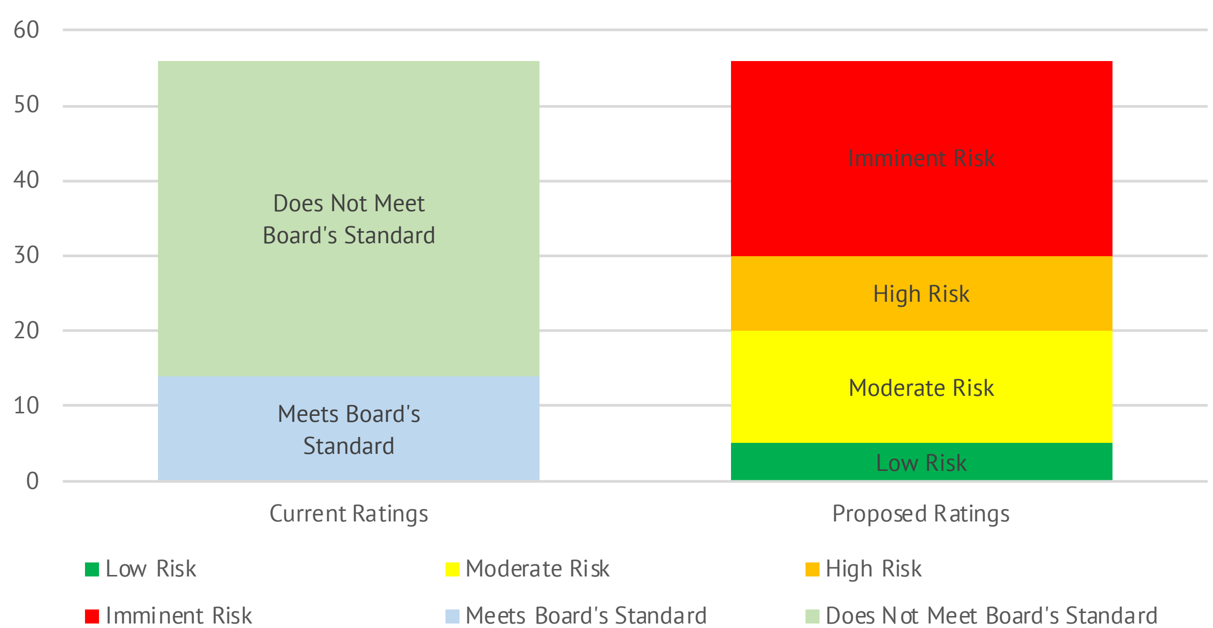
Source: Calculations based on data provided by ASBCS using the revamped performance levels described in Table 8.

FIGURE 2: FY14-FY16 FINANCIAL OUTCOMES FOR ALL ARIZONA CHARTERS: CURRENT RATINGS VS. PROPOSED RATINGS:



Source: Calculations based on data provided by ASBCS. Proposed Ratings were calculated using the revamped performance levels described in Table 8.

FIGURE 3: FINANCIAL OUTCOMES FOR CHARTERS CLOSED BETWEEN FY14-FY16: CURRENT RATINGS VS. PROPOSED RATINGS



Source: Calculations based on data provided by ASBCS. Proposed Ratings were calculated using the revamped performance levels described in Table 8.

Reform #2: Add Enrollment Growth as a Sustainability Measure of Financial Performance

Enrollment is an especially critical metric for schools of choice because they can't rely on residential assignment to fill seats. Not only is enrollment often related to financial distress, it also provides valuable insight into whether a charter is using tax dollars to meet the needs of a community. This is why enrollment is a factor that ratings agencies consider when assessing a charter's risk as detailed in section 4.2 below. As such, ASBCS should incorporate enrollment growth as a measure in its financial performance framework. This would serve as a useful flag for financial risk and also provide rich context when evaluating the financial data of charters flagged for possible intervention.

For example, a *High Risk* charter with declining enrollment might have more difficulty becoming financially healthy than one that has stable or growing enrollment. One option is to include enrollment growth as a sustainability measure of performance by assigning *Does Not Meet* to charters based on an average of enrollment growth in each of the three most recent years as shown by the example in Table 9. Evaluating enrollment trends over a three-year horizon allows for normal variation in student populations, including atypical events that might not be indicative of problems, while also giving newer charters time to stabilize before they're evaluated on this measure. Setting the performance threshold at somewhere between a decline of 3%–5% seems to strike a good balance for a cut-point. A more aggressive threshold might flag enrollment losses that charter leaders can readily adjust to, while a less aggressive threshold might fail to highlight charters with potentially deep structural issues that could make right-sizing difficult or unlikely. Of the 348 charters that were rated in FY16 and had the enrollment data required for this calculation, 24.7% had a decline of 3% or more and 17.5% had a decline of 5% or more.

Additionally, ASBCS should also explore ways to collect and report on waitlist and student retention data for informational purposes, which would provide even greater context for performance as they similarly indicate a charter's ability to meet parent needs and achieve financial stability. These figures aren't currently collected in any official capacity by the state, even though charter leaders should have them readily available. To be sure, collecting these data might present logistical challenges that need to be worked out, including considerations such as methodology and verification, but ASBCS should begin taking steps to assess how this could be done. This would further increase transparency and ensure that these data are front-and-center when ASBCS evaluates outcomes.

TABLE 9: EXAMPLE ENROLLMENT GROWTH CALCULATION
The annual enrollment growth in the example data below are -10%, 2.2%, and -8.7% for an average annual growth rate of -5.5%. For example, the growth between the 2014–15 and 2015–16 school years would be calculated as (225–250)/250. This charter would be assigned a *Does Not Meet* rating for the Enrollment Growth metric.
2017–18 Enrollment (Current): 210
2016–17 Enrollment: 230
2015–16 Enrollment: 225
2014–15 Enrollment: 250

Reform #3: Enhance Financial Reporting

ASBCS's reporting dashboards allow stakeholders to access data by individual charter school for all three performance frameworks. While this is a good start, some relatively minor adjustments can make this information even more accessible and functional. Most importantly, it's currently not possible to compare outcomes across schools, which means that policymakers and campus leaders can't easily do things such as benchmark performance levels or summarize statewide data by measure and summative rating (e.g. the percentage of charters that received *Meets Standard* for Unrestricted Days Liquidity). ASBCS should create an interactive report that shows the outcomes and ratings by measure for every charter in Arizona, which should also include pertinent summary data.[29] To make it easier to access, this information could also be integrated with Arizona's Accountability & Research website, and each performance framework rating could be added to the state's School Report Cards in order to increase transparency even further.

Reform #4: Develop the Infrastructure for Effective Intervention Decisions

The recent passage of HB 2663 allows ASBCS to close charters that aren't meeting the standards set forth in its financial performance framework, substantively increasing the financial metric's importance.[30] Policymakers should give careful consideration as to how this policy shift is implemented, especially given the aforementioned problems with the current methodology. Importantly, *High Risk* or *Imminent Risk* designations alone (or whatever ratings ASBCS adopts) should never result in automatic closure. Rather, the

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29 Texas provides an example of what this could look like. https://pryor.tea.state.tx.us/Tea.CharterFirst.Web/Public/OverallStats.aspx

30 Arizona HB 2663 <https://www.azleg.gov/legtext/53leg/2r/bills/hb2663p.pdf>

financial performance framework is an initial screen that flags charters for further evaluation by ASBCS. However, after further evaluation it might be evident that a flagged charter should be closed based primarily or even solely on its financial condition in instances where a charter school is clearly financially unviable. ASBCS should develop the infrastructure needed to systematically evaluate flagged charters in a comprehensive and thorough manner that looks at financial outcomes through four lenses:

- ***Local Context:*** *Qualitative factors that aren't readily apparent in the financial measures.* Is there a sound explanation for why a charter underperformed on a given measure?

- ***Severity:*** *The extent to which a charter underperformed on a financial measure.* For example, did it barely miss the required threshold or did it perform at a level well below it, signaling a serious danger of insolvency?

- ***Trends:*** *The extent to which a charter's fiscal condition has improved or deteriorated over time.* In what direction is the charter's financial health heading?

- ***Financial Leadership:*** *The quality of a charter's plan to address its shortcomings and, if applicable, the extent to which it has executed on proposed strategies in the past.* Do the proposed strategies actually address the problem(s) and are they realistic to implement?

At this point, decisions about further interventions should be based on a mix of quantitative and qualitative factors. One option is to implement some variation of the process described below, which is designed to identify and prioritize distressed charters.

Step 1: Flagged Charters Submit a Performance Response

In general, charter authorizers should seek to minimize bureaucratic requirements that divert scarce resources away from a school's core mission, which is especially important for small charters and those struggling to improve. However, requiring flagged charters to submit a Financial Performance Response similar to the one currently used by ASBCS gives them a platform to provide local context and updated financial data, and potentially avoid other resource-consuming interventions. To promote fairness and transparency, these responses could be publicly reported online and could provide ASBCS with a valuable reference point in the event a charter continues to struggle financially in the future.

ASBCS should consider revising its current Financial Performance Response to also include staffing and expenditure data that indicate the degree to which a charter is "right-sized" (i.e. the costs of a school's operations are aligned with its enrollment). Although an authorizer should never impose requirements on how a charter spends its dollars, any conversation around financial health is incomplete without this information, which is especially important for smaller schools and those with declining enrollments. For example, the staffing patterns of a charter with 500 students should look substantially different from one with 100 students, and charters with declining enrollments need to adjust expenditures to reflect this reality. The key is to look at staffing patterns and convert dollars spent on everything from extra-curricular activities to custodial services to per-pupil figures, which will help charter leaders identify outlier expenses and evaluate trade-offs in potential cuts.[31] The bottom line is that a charter's operations should reflect the dollars it has available to spend. Bringing awareness to these patterns is a valuable first step toward financial health for operators who can then seek creative opportunities to become more efficient. For ASBCS, recognizing an inability to right-size over the course of several years is a red flag for financially distressed charters that continue to fall short of financial sustainability.

Step #2: ASBCS Assesses and Prioritizes Flagged Charters

Once underperforming charters have been identified by the financial performance framework, ASBCS will need to determine which are in need of additional interventions. Although the financial performance framework alone provides valuable information, additional structures could be developed to help assess flagged charters in a systematic manner. One option is to create a second-tier evaluation system that integrates outcomes and rates charters using both quantitative and qualitative data.

At first glance this might seem redundant, but there are several advantages to this approach. First, not all flagged charters will require additional interventions, and ASBCS will need to prioritize those that are most at risk. Providing structure to this process will help ensure fairness and also give ASBCS an opportunity to develop greater familiarity with flagged charters. Second, because flagged charters represent a relatively small subset of

31 Roza, Margeurite. "Now Is a Great Time to Consider the Per-Unit Cost of Everything in Education." *Stretching the School Dollar: How Schools and Districts Can Save Money While Serving Students Best.* Eds. Frederick M. Hess and Eric Osberg. Cambridge: Harvard Education Press, 2010. 71-96. Print. Note: Putting expenses in per-pupil terms is an easy exercise, although this might be limited by the school-level financial data available.

the overall charter population, a more nuanced rubric can be developed that incorporates qualitative information, accounts for the Performance Response described in Step #1, and analyzes performance based on the aforementioned four lenses. Lastly, a second-tier evaluation system would also be a good opportunity to streamline performance outcomes such that financial, academic, and operational data are assessed together before decisions are made about further interventions. ASBCS could develop a second-tier evaluation process similar to how rating agencies rate bond issuances, as described in detail in section 4.2. If ASBCS goes in this direction, the Financial Performance Response described in Step #1 could be adjusted to allow charters to respond to any failed measures in the academic and operational frameworks, also giving them the opportunity to provide evidence of positive outcomes not captured by these data, such as college acceptance rates, norm-referenced test data, and indicators of parent satisfaction.

Step #3: Additional Interventions

Charters identified in Step #2 would be subject to additional interventions, which could include:

- **Review Hearings** (In-person meetings to review outcomes and plans to address shortcomings.)
- **Community Feedback** (Efforts to collect feedback from parents, school staff, and members of the community.) This could take the form of public testimony, town hall meetings, and a comprehensive survey administered by a third-party organization.
- **Third-Party Financial Reviews** (Contracting with financial experts to provide a third-party evaluation of a charter's financial health.) A benefit of this approach is that it would provide technical expertise and help insulate the process from political influence. See section 4.2 for additional information on what this might look like.

Having the infrastructure in place to effectively assess flagged charters ensures that ASBCS has the information needed to make decisions that put kids first.

4.2 LONG-TERM REFORMS

Recent steps by ASBCS and other authorizers to improve transparency are positive moves, but financial health should have a much larger role in informing the performance of both charters and traditional public schools. Current approaches to accountability focus mainly on high-stakes testing data, as is the case with Arizona's A–F Letter Grades system, on which ASBCS's academic performance framework is largely based. While it's true that test results convey valuable information, a primary criticism of test-centric accountability is that it narrowly defines school quality, incentivizing educators to make curricular adjustments that favor tested content at the expense of untested content.[32] This is exemplified by a Center on Education Policy study of 349 school districts after No Child Left Behind was enacted. It found that 62% of elementary schools had increased instructional time for English language arts and/or math, while 44% had cut time on one or more subjects or activities including science, social studies, art and music.[33]

"In other words, schools are incentivized to target their programs and finances to providing things that parents don't necessarily prioritize in choosing schools, creating an existential problem for schools of choice by fundamentally altering their educational models."

The problem with this shift in priorities is two-fold: research shows little relationship between changes in test scores and improvements in later-life outcomes,[34] and parents tend to place little importance on test scores when choosing schools, instead prioritizing factors such as student safety, discipline, and a school's learning environment.[35] In other words, schools are incentivized to target their programs and finances to providing things that parents don't necessarily prioritize in choosing schools, creating an existential problem

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32 Green, Jay P. "Futile Accountability Systems Should Be Abandoned." *Education Next* 17 (2017) *educationnext.org*. Web. < http://educationnext.org/futile-accountability-systems-should-be-abandoned-forum-greene/> 10 June 2018.

33 Center on Education Policy. "Choices, Changes, and Challenges: Curriculum and Instruction in the NCLB Era." Web. 2007. <https://www.cep-dc.org/displayDocument.cfm?DocumentID=312>10 June 2018>.

34 Hitt, Colin, Michael Q. McShane and Patrick J. Wolf. "Do Impacts on Test Scores Even Matter? Lessons from Long-Run Outcomes in School Choice Research." Web. American Enterprise Institute, 2018. <http://www.aei.org/wp-content/uploads/2018/04/Do-Impacts-on-Test-Scores-Even-Matter.pdf> 10 June 2018.

35 Kelley, James P., and Benjamin Scafidi. "More than Scores: An Analysis of Why and How Parents Choose Private Schools." Web. EdChoice, 2013. < https://www.edchoice.org/wp-content/uploads/2015/07/More-Than-Scores.pdf> 10 June 2018.

for schools of choice by fundamentally altering their educational models. Of course, state policymakers are bound by federal mandates that dictate things such as testing requirements and the structure of accountability systems. Nevertheless, policymakers and authorizers can begin taking steps toward putting financial health at the center of performance evaluation, which would not only promote greater transparency with tax dollars but also allow a more comprehensive picture of performance to emerge that goes beyond mere test scores and provides educators with the flexibility needed to meet parental demands. The tax-exempt bond market provides insight into what this could look like.

4.21 The Tax-Exempt Bond Market for Charter School Facilities

Charters are increasingly turning toward the tax-exempt bond market as a lower-cost source of facilities financing. The tax-exempt bond market for charters has had more than 1,100 transactions since the first issuance in 1998, and Arizona charters have been especially active with 49 issuances between 2015 and 2017 alone, tied with California for most among the states during this time period.[36] Overall, 53% of bonds are rated at issuance, a practice that has accelerated in recent years.[37] While the overall default rate for charter bonds is 5%, more than three-quarters of these were unrated at the time of issuance and the annual trend has been declining as rating agencies have developed more advanced methodologies that better integrate financial and academic outcomes.[38]

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Charters are increasingly turning toward the tax-exempt bond market as a lower-cost source of facilities financing.

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[36] “Understanding P3 Financing for Public Charter School Construction.” The Bond Buyer. Webinar. 16 May 2018. Presentation.

[37] Berry, Wendy. “Charter School Bond Issuance: A Complete History, Volume 3.” Charter School Advisors and Local Initiatives Support Corporation, 2015. Web. <http://www.lisc.org/media/filer_public/70/28/7028ad74-0040-49cc-9b5b-d988d738781e/2015_charter_school_bond_issuance_v3.pdf> 10 June 2018. 2.

[38] Ibid. 1-2

Notably, the default rate for bonds with an Investment Grade rating is only 1.2%, and Local Initiatives Support Corporation (LISC) has found that defaulting charters tend to have lower enrollments and underperform academically.[39] According to LISC, “Academic performance is a fundamental factor in charter school underwriting. It drives enrollment, financial strength and charter renewal.”[40] This link between educational quality and financial health reveals an important relationship: investors and communities care about the same questions regarding school quality, including:

- How effectively is a charter meeting parent needs?
- Is a charter outperforming other local schools?
- Are charter leaders making sound financial decisions that minimize long-term risk and maximize the productivity of tax dollars?

There’s more to bond ratings than esoteric alphanumeric scores, because what’s good for investors—quality instruction, competent leadership, sustainable debt obligations, etc.—is also good for parents and taxpayers. Rating agencies have improved their methodologies over the years, thanks in large part to engaging stakeholders such as educators, authorizers and state officials, and now policymakers can learn from their practices. Standard & Poor’s methodology provides an example of what the rating process looks like.

Example: Standard & Poor’s Methodology for Rating Tax-Exempt Charter Bonds

The core of S&P’s analysis is composed of the enterprise and financial analytical frameworks as summarized in Table 10.[41] Each risk profile contains factors that are scored based on measures that are assigned one of six ratings from “extremely strong” to “highly vulnerable”, which correspond to numeric values of 1 to 6. Since S&P finds that some factors have a greater effect on credit quality than others, weights are assigned to reflect these differences. Additionally, S&P incorporates positive and negative considerations into each measure’s rating as applicable, which provides them with the flexibility necessary to account for conditions that aren’t formally included in the rubric, but may result in a stronger or weaker score for a given measure. Some examples of these considerations are given in the explanations below.

[39] Ibid. 3.

[40] Ibid.

[41] “U.S. Public Finance Charter Schools: Methodology and Assumptions.” S&P Global Ratings, 2017. Web. <https://www.spratings.com/documents/20184/908554/USPF+Charter+School+Criteria12017/5ebab49e-5dd0-410d-8bae-66a7cec923e6> 10 June 2018.

TABLE 10: STANDARD &POOR'S ANALYTICAL FRAMEWORKS

Enterprise Profile			**Financial Profile**		
Factor	Weight	Measures	Factor	Weight	Measures
Economic Fundamentals	10%	-School age population	Financial Performance	45%	-Lease-adjusted MADS coverage -Excess margin -Total revenue
Industry Risk	40%	-Economic cyclicality -Competitive risk and growth	Liquidity and Financial Flexibility	25%	-Unrestricted days' cash on hand -Unrestricted reserves/debt
Market Position	30%	-Demand & competition -Statutory framework -Charter standing -Academic quality	Debt Burden	30%	-Lease-adjusted MADS burden -Debt to capitalization
Management and Governance	20%	-Strategic positioning -Risk management -Organizational effectiveness -Governance			

Source: "U.S. Public Finance Charter Schools: Methodology and Assumptions." S&P Global Ratings, 2017. Web. <https://www.spratings.com/documents/20184/908554/USPF+Charter+School+Criteria12017/5ebab49e-5dd0-410d-8bae-66a7cec923e6> 10 June 2018.

The Enterprise Framework

The enterprise profile assesses the non-financial aspects of a charter school and includes four factors as described below.

Economic Fundamentals: Measures the size and growth of a charter's service-area demographics to help determine sustainability. The primary gauge of this is school-aged population growth, with an increase of more than 5% scored as "extremely strong" and decline of 5% or more as "highly vulnerable."

Industry Risk: Provides a general baseline of risk that is common to all charter schools and is based on barriers to entry, the development of competing substitutes, and revenue diversity.

Market Position: Assesses a charter's performance in relation to other schools in its service area as a gauge of long-term success. S&P considers "demand & competition" to be the most critical component of market position and uses four primary metrics to measure this: enrollment, enrollment growth, wait-list size as a percentage of enrollment, and retention rate. Academic quality is also closely examined using state test results and outcomes such as SAT scores and graduation rates. Other considerations that might result in a stronger or weaker score include receiving a prestigious award from a state or national organization, enrollment volatility, and failure to meet state minimum standards for a grade level.

Management and Governance: Measures the strength of a charter's management team and the level of oversight provided by its governance structure. This includes evidence of articulating and achieving goals, instituting policies that effectively recognize and mitigate risks, and maintaining sufficient internal controls.

The Financial Framework

The financial profile assesses the financial strength of a charter school and includes three factors as described below.

Financial Performance: Assesses how a charter's debt servicing capability could be affected by recent and projected earnings and cash flow.[42] The most important measure of this is "Lease-adjusted maximum annual debt service (MADS) coverage," which is the number of times an organization could cover its lease-adjusted MADS from operating and non-operating cash flows. Excess margin and total revenue are also evaluated as components of financial performance. Additionally, an example of a positive consideration that could result in a stronger score is a demonstrated ability to reduce expenses without affecting quality.

Liquidity and Financial Flexibility: Assesses how cash flow and unrestricted reserves may affect debt servicing capability using two measures: Unrestricted days' cash on hand and unrestricted reserves to debt, with the former receiving greater weight.

Debt Burden: Assesses the extent to which liabilities may affect a charter's ability to service its debt. Lease-adjusted MADS as a percent of total revenue is the primary measure, with debt to capitalization considered as a secondary factor. An example of a negative consideration that might result in a weaker score is underfunded post-employment benefits obligations.

[42] Ibid.

Putting It All Together

Once the resulting framework scores have been tabulated, they are combined to determine the initial indicative rating as shown in Table 11. But the final score assigned to a charter—the indicative rating—is only established after a few additional steps.

TABLE 11: COMBINING THE ENTERPRISE PROFILE AND FINANCIAL PROFILE SCORES

		Financial Profile					
		Extremely Strong (1)	Very Strong (2)	Strong (3)	Adequate (4)	Vulnerable (5)	Highly Vulnerable (6)
Enterprise Profile	Extremely Strong (1)	a+	a+	a+	a	bbb+/bbb	bb+/bb
	Very Strong (2)	a+	a+	a+	a-	bbb/bbb-	bb/bb-
	Strong (3)	a+	a+	a	bbb+/bbb	bbb-/bb+	bb-
	Adequate (4)	a	a/a-	a-/bbb+	bbb/bbb-	bb	b+
	Vulnerable (5)	bbb+	bbb/bbb-	bbb-/bb+	bb	bb-	b
	Highly Vulnerable (6)	bbb-	bb	bb-	b+	b	b-

Source: "U.S. Public Finance Charter Schools: Methodology and Assumptions." S&P Global Ratings, 2017. Web. <https://www.spratings.com/documents/20184/908554/USPF+Charter+School+Criteria12017/5ebab49e-5dd0-410d-8bae-66a7cec923e6> 10 June 2018. Note: S&P scores are represented as lower-case letters only when conveying initial indicative ratings. Final ratings are represented as upper-case letters.

First, S&P makes any applicable adjustments to the initial profile assessments as outlined in Table 12. For example, a charter's financial assessment framework would be negatively adjusted by up to two assessment levels if its contingent liabilities are greater than unrestricted reserves. Similarly, if a charter's market position is assessed as "highly vulnerable", its enterprise framework would automatically receive the same rating to reflect the substantial risk of this score.

TABLE 12: EXAMPLES OF ADJUSTMENTS MADE TO THE INITIAL PROFILE ASSESSMENT

Framework	Reason	Adjustment
Enterprise	Regulatory review or oversight that identified deficiencies	Enterprise profile assessment generally negatively adjusted by up to two assessment levels
	Country risk assessment for U.S. is “4”, “5”, or “6”	Enterprise profile assessment generally capped at “adequate”, “vulnerable” or “highly vulnerable”
	Economic fundamentals or market position is assessed as “highly vulnerable”	Enterprise profile generally assessed “highly vulnerable” if economic fundamentals or market position presents sufficient risk
Financial	Contingent liabilities greater than unrestricted reserves, or lack of appropriate insurance coverage could cause this	Financial profile assessment generally negatively adjusted by up to two assessment levels
	Negative financial policies assessment if two or more of the following five factors are identified as negative and deemed a credit risk: transparency and disclosure, investment allocations and liquidity, debt profile, contingent liability principles, and legal structure	Financial profile assessment generally would be negatively adjusted by one assessment

Source: “U.S. Public Finance Charter Schools: Methodology and Assumptions.” S&P Global Ratings, 2017. Web. <https://www.spratings.com/documents/20184/908554/USPF+Charter+School+Criteria12017/5ebab49e-5dd0-410d-8bae-66a7cec923e6> 10 June 2018.

Next, S&P applies any applicable overriding factors. For example, high unrestricted reserves could result in an indicative rating that is one notch higher, while violation of regulatory requirements set by the charter authorizer or state legislature could result in an indicative rating that is up to three notches lower. Similarly, if certain conditions are observed, S&P might place a cap on the indicative rating. This means that an indicative rating could not exceed a given level even with positive overriding factors. For example, factors that could cap the indicative rating include significant academic weakness, rapid enrollment decline, and negative unrestricted assets. Finally, a holistic analysis is performed to illustrate a comprehensive picture of creditworthiness, which can result in a positive or negative adjustment of the indicative rating by one notch or no change whatsoever.

4.22 Three Key Insights from Ratings Agencies

As S&P's methodology shows, some aspects of credit ratings might not apply in the context of evaluating charter performance. For example, industry risk accounts for a significant share of its Enterprise Profile's risk assessment, but doesn't reflect the actual performance of any charter in particular, so states would thus have no need to incorporate this information. Nevertheless, policymakers have much to learn from ratings agencies when reimagining performance evaluation. These lessons might be applied narrowly (i.e. to charters only) or broadly (i.e. to all public schools) and could range from simply integrating financial health measures more effectively into current evaluation systems to completely overhauling test-centric accountability altogether within the confines of federal restraints. Regardless, financial health data contain important clues about performance that are waiting to be uncovered.

Key Insight #1: A Central Role for Financial Health and Measures of Demand

Ratings agencies provide insight into what a robust and fully integrated performance framework might look like. Naturally, financial health is an integral component of credit ratings, since investors want to limit their exposure to risk, and scores reflect financial vulnerabilities such as expanding too rapidly via debt or maintaining insufficient levels of cash reserves. According to HR Ratings, "Limited expertise from the management team will be reflected in the financial statements, severely hindering the issuer's financial flexibility."[43] Over the years ratings agencies have learned how to incorporate academic outcomes to project financial performance, which has helped improve the quality of their methodologies. But just as academic outcomes help investors assess financial health, the inverse is also true: financial health can help assess educational quality.

Parent satisfaction is an especially critical variable that ratings agencies consider, since it is a key driver of enrollment and thus operating revenue. This is done by analyzing demand signals such as application volume, wait lists, student retention rates, and enrollment trends. Demand signals provide valuable information about educational quality that are otherwise difficult to capture. After all, parents place different values on school attributes, and when empowered with choice they make nuanced evaluations and tradeoffs that testing data alone simply can't capture—one family might prioritize academic

[43] HR Ratings. "Charter Schools Credit Risk Evaluation." HR Ratings. Web. <https://www.sec.gov/Archives/edgar/data/1628352/000162835215000013/Exhibit2Charter.pdf> 12 June 2018.

specialization, another might seek out robust extracurricular opportunities to bolster college applications, while still another wants a safe learning environment free from bullying. These complex decisions are reflected in a charter's demand signals, which ultimately feed into financial health.

For policymakers, allowing financial health to play a more prominent role in evaluation isn't about cobbling together disparate pieces of separate puzzles, but using complementary sources of information to illustrate a picture of performance with greater depth and clarity. States should consider financial health as more than just dollars and cents and work toward integrating these outcomes with other measures of performance, not only to ensure that schools are good stewards of public resources but also to capture the underlying demand signals that indicate parent satisfaction and quality.

Key Insight #2: Accounting for Local Context

Ratings agencies give careful consideration to a charter's local environment, which directly affects financial health. According to Moody's, it is "critical to evaluate a school relative to its most direct competitors, whether these are public, private or other charter schools,"[44] since this provides insight about a school's current and future market position. However, this involves more than simply comparing the test scores of charters against those of their local districts, as some authorizers already do. Ratings agencies analyze the competitive environment of a charter's immediate geographic area including enrollment trends, academic outcomes, and demographic factors such as migration patterns, housing, transportation and age distribution. From an investor's perspective, a high-performing charter in an underserved community is well-positioned to generate and sustain enrollment, as is a different charter that effectively delivers specialized offerings. Conversely, operators that enter saturated markets, underperform relative to local schools, and fail to differentiate their offerings are more vulnerable to financial distress. For parents, accounting for a school's local environment addresses an important concern: the performance of their child's schools relative to other local schools, especially those at which their child could potentially enroll. Not only is this the most meaningful comparison, but it promotes the productive use of education dollars by rewarding charters that successfully launch in underserved communities and those that implement innovative models to meet student needs.

44 Ibid.

Key Insight #3: Independent and Competing Methodologies

The credit ratings industry is a highly regulated market with barriers to entry that artificially restrict competition, factors that have helped earn it some well-deserved criticism in recent years, especially after the Great Recession.[45] But despite these and other flaws, it still provides a glimpse of how a system of independent and competing evaluators could flourish in K-12 education, especially in comparison to current models of top-down accountability that are characterized by rigidity, politicization, and unintended consequences.

A model of independent and competing agencies such as non-profits, academics, analytics firms or other for-profit institutions would provide a few key benefits. First, unlike current state accountability systems, independent agencies would be insulated from political forces and free to home in on what's most important: whether schools are meeting the needs of students and using tax dollars responsibly. Such a system could be structured in a manner that eliminates potential conflicts of interest, and comprehensive performance analyses could be published to show exactly how scores are derived. This approach would also allow measures of quality that aren't readily standardized across school systems—and thus difficult or impossible to integrate with current approaches to accountability—to be used as indicators of performance. For example, college acceptance data, AP passing rates and long-term outcomes could all be introduced, as well as factors that differentiate a school's programmatic offerings, including a renowned arts program, foreign language immersion, and character development. Lastly, specialized agencies would have the expertise to effectively incorporate complex financial metrics and develop more-advanced models of evaluation over time. Since their reputations would be tied to the quality of their analyses, there would be a strong incentive to continuously refine the methodologies employed and deliver quality information that is both thorough in detail and accessible for parents.

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45 For a thorough account of the credit ratings industry's shortcomings as well recommended solutions see: Joffe, Marc. "Unfinished Business: Despite Dodd-Frank, Credit Rating Agencies Remain the Financial System's Weakest Link." Reason Foundation, 2018. Web. <https://reason.org/wp-content/uploads/2018/02/dodd-frank-credit-rating-agencies-system-weak-link.pdf> 10 June 2018.

PART 5

CONCLUSION

With the recent passage of HB 2663, now is a critical time for Arizona to assess how it evaluates charter schools. ASBCS's financial performance framework, created in 2012, is a good step toward improving financial health transparency, but there are important reforms that policymakers should consider. In the short-term, the most important areas to address are the framework's roll-up mechanism and creating the infrastructure needed to close financially distressed charters in a manner that is fair, transparent, and accounts for local context. To do so, Arizona should revamp its summative ratings and create the infrastructure needed to assess flagged charters, which could involve creating a second-tier evaluation system that incorporates both quantitative and qualitative data and working with third-party agencies to evaluate outcomes before closure decisions are made.

An analysis of historical outcomes reveals that several reforms can improve ASBCS's financial performance framework in the short term, but Arizona policymakers shouldn't stop there as the full potential of financial data is yet to be tapped. Because these measures of financial health capture important information about school quality that test-based accountability metrics miss, they should have a central role in evaluating performance, especially for schools of choice.

The tax-exempt bond market for charter schools provides valuable insight into how financial measures can be integrated with current accountability systems or used to reimagine how schools are evaluated altogether. In the long term, the most important lesson that policymakers can learn from the tax-exempt bond market is how ratings agencies integrate financial health and the underlying demand signals in their assessments. In the context of state accountability systems, not only would this ensure that tax dollars are being used responsibly, it would also account for measures of quality that parents want. By unlocking the full potential of financial data, Arizona has the opportunity to become a national model for charter school evaluation that moves beyond test scores.

ABOUT THE AUTHOR

Aaron Garth Smith is an education policy analyst at Reason Foundation, a nonprofit think tank advancing free minds and free markets. Prior to joining Reason, Aaron was senior director of analytics at YES Prep Public Charter Schools, a nationally renowned charter management organization serving over 12,000 students in Houston. His writing has appeared in various publications including *Education Week*, *Orange County Register* and *Los Angeles Business Journal* and he has worked in numerous states on school finance reform.

Financial Performance Framework

During the 53rd Second Regular Legislative Session, the budget was passed with language requiring charters to meet the financial performance expectations set forth in the performance framework. This provision gave the Arizona State Board for Charter Schools (Board) the authority to take action against a charter it sponsors based on its Financial Performance Framework. The Board was therefore required to begin a public review process to design a financial framework and adopt rule and policy to which the Board can use for accountability purposes.

The Board has seated a Financial Subcommittee (Subcommittee) to review and update its Financial Performance Framework in light of this additional accountability. To assist the Subcommittee, the Board is requesting comments from stakeholders. Information submitted in response to the following questions will be considered by the Subcommittee.

Email address *

sharvey@reidtraditional.com

Tell us about yourself

Your first and last name *

Steve Harvey

Your mailing address *

14841 N Black Canyon Hwy, Phoenix, AZ 85023

Your organization

Reid Traditional Schools, Inc.

Feedback Questions

Identify components of the Board's current Financial Performance Dashboard/Framework that adequately identify a charter's financial status. *

Net Income

Identify components of the Board's current Financial Performance Dashboard/Framework that do not adequately identify a charter's financial status. *

Cash Flow; and Unrestricted Days Liquidity (see comments as to why)

What are key financial indicators that result in a charter's closure? *

Going Concern

Additional comments? *

A. Cash Held by Trustee, which is listed in Current Assets on our balance sheet, is the 12th equalization payment paid by the state at the end of June, which is intercepted by the trustee, and disbursed to our school in July. This delayed disbursement has a great impact on our cash at year-end, and because it is not included in the ASBCS' calculation of "Unrestricted Days Liquidity" and "Cash Flow", the results can be very misleading.

B. Restricted Cash is listed in the non-current assets on our balance sheet. It is not included with "Cash and cash equivalents" for a reason. Restricted Cash consists of required deposits associated with long-term debt (Debt Service Reserve Fund, Liquid Reserve Fund, etc.). These funds are held in trust, and therefore non-accessible to the school. The balance in these funds can change astronomically when a school re-finances. Because the ASBCS includes Restricted Cash in its calculation of "Cash Flow" and "Unrestricted Days Liquidity", the results can be very misleading.