Discussion Financial Framework – Intervention

Background

Under the current financial framework, if a charter does not meet the Board's financial expectations at the times identified in the financial framework[1], then the charter must submit a financial performance response[2], which provides the charter with the opportunity to explain its performance and submit current financial data.

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 Board the authority to take action against a charter it sponsors based on the Board's financial framework. At its September 27, 2018 meeting, the Financial Framework Subcommittee proposed three summative performance levels for the financial framework. The table below describes the three summative performance levels and the ongoing oversight that would continue to occur under each.

	Good Standing	Adequate Standing	Intervention
Description	No measures rated Below Standard or Approaches Standard	No measures rated Below Standard and one or more measures rated Approaches Standard	One or more measures rated Below Standard
Ongoing Oversight	▪ Annual audit conducted by CPA, which is reviewed in accordance with Board rules ▪ Regularly scheduled site visits (e.g., 5-year interval reviews) ▪ Eligibility[3] and compliance checks for amendments and other requests		

Identifying Intervention Efforts (Reason Foundation)

For those charters whose financial performance places them in the "Intervention" level, the Subcommittee must define the Board's intervention efforts. In its September 2018 report, "Beyond Test Scores: A Central Role for Financial Health in Evaluating Arizona's Charter Schools", the Reason Foundation stated the Board "should develop the infrastructure needed to systematically evaluate flagged charters 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 under performed 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?

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[1] Charters' financial performance is considered by the Board at various times over the contract term, including during five-year interval reviews, in conjunction with expansion requests and in considering whether to renew the charter contract (see current financial framework for complete list).

[2] Under the current financial framework, for each measure that failed to meet the target, the charter must answer three questions in its response: 1) Why did we not meet the measure's target in the audited fiscal year; 2) What specifically have we done to improve our performance so that it's possible to meet the measure's target in the next fiscal or a subsequent fiscal year; and 3) What can we provide to support our analysis?

[3] Currently, a charter that has at least one Falls Far Below Standard rating (Below Standard in discussion framework) on its dashboard is ineligible for expansion. The current financial framework defines "expansion" to include replicating, adding a new school, increasing the number of students the charter may serve and expanding the grades the charter is approved to offer.

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?

Proposal for Discussion

The following is being provided as a starting point for Subcommittee discussion.

- All charters whose financial performance places them in the "Intervention" level would be required to submit an initial financial response.
- The charter's performance on the financial framework's measures and information from the initial financial response would be used to place the charter into one of three intervention tiers (see table below).
    - The tier a charter is placed in would be based less on the passage of time and more on the charter's actual performance on the financial framework's measures individually and overall (e.g., the extent to which a charter underperformed on a measure, the number of measures where the charter failed to "meet" the target).
    - This means that in its first year of intervention, a charter could be placed in the highest intervention tier (Tier 3).

	Tier 1 (Lowest)	Tier 2 (Middle)	Tier 3 (Highest)
Financial Reporting Frequency	No additional reporting required; next year's audit would be reviewed	End-of-year reporting required; due in August	Quarterly reporting required until next year's audit received
Governing Board Meeting Minutes	No	Required to submit until next year's audit received	Required to submit until next year's audit received
Submission of Financial Improvement Plan Developed and Approved by Governing Board	No	No	Yes
Staff Meeting with Charter Officials	No	Optional	Yes
Student Count Visit[4]	Time Permitting	Yes	Yes

Although mentioned in conjunction with intervention at prior Subcommittee meetings, this proposal does not incorporate per pupil spending information or performance on the leverage ratio[5].

<u>DISCUSSION QUESTIONS</u>

[4] Staff proposes visiting all schools operated by charters identified for Tier 2 or Tier 3 interventions. The purpose of this visit would be to conduct a physical count of students and compare the information observed and obtained onsite with the number of students reported to the Arizona Department of Education. Staff would notify the ADE's Audit Unit of any material discrepancies identified. If a school was visited during the year through another process (e.g., interval review), a second visit would not be conducted. Time permitting staff could also visit all schools operated by charters identified for Tier 1 interventions.

[5] The leverage ratio formula is (Facility Bond or Loan Principal + Facility Interest Expense + Facility or Ground Leases) all divided by Total Revenues. A ratio of over 20% is considered high.

1. What specific items should be included in the charter's initial financial response (e.g., explanation for why targets not met, current year budget-to-actual financial reports)?
2. What circumstances would warrant more frequent financial reporting (e.g., quarterly reporting) by a charter?
3. What circumstances would warrant an in-person meeting between staff and charter officials to discuss the charter's financial situation?
4. What other factors should be considered when determining which intervention tier a charter would be placed in?
5. What financial-related information and documentation do Board members want to receive when the Board considers the renewal application package for a charter in "Intervention"?