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## **AGENDA ITEM: Financial Performance Framework**

### **Background**

During the 53<sup>rd</sup> 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 its financial framework. Over the summer, the Board seated a Financial Framework Subcommittee (“Subcommittee”) with the goal of reviewing and updating its existing financial framework in light of this additional accountability.

### **Development of Subcommittee Recommended Financial Framework**

On behalf of the Subcommittee, in July and August 2018, staff solicited public comment and attended roundtables hosted by A for Arizona and the Arizona Charter Schools Association on the Board’s current financial framework.

Between August and November 2018, the Subcommittee held six public meetings and informally and formally solicited feedback from stakeholders. Over the three-month period, numerous charters participated in the Subcommittee meetings, provided feedback or both, as did the Arizona Charter Schools Association, Arizonans for Charter School Accountability, the Grand Canyon Institute and the Reason Foundation. In addition, the Arizona Office of the Auditor General presented to the Subcommittee on the statutorily required school district receivership and solvency reviews and the Auditor General’s school district financial stress assessment. Throughout the framework’s development, the Subcommittee was advised by a panel of three outside experts in charter school accounting, auditing and financing.

### **Key Elements of Subcommittee Recommended Financial Framework**

- Measures and Measure Ratings (see Exhibit A)
  - Six measures are Going Concern, Default, Unrestricted Days Liquidity, Adjusted Net Income, Lease Adjusted Debt Service Coverage Ratio, and Average Daily Membership (“ADM”).
  - Noncash expenses have been removed from the applicable measure calculations to capture charters’ true economic performance.
  - Measure ratings have been modified to better describe the level of performance reflected – Meets Standard, Approaches Standard, and Below Standard.
  - “Below Standard” target has been established for each measure.
- Summative Performance Ratings (see Exhibit B)
  - Three summative performance ratings have been developed to better describe the level of performance reflected and better identify charters that warrant the Board’s attention.
  - The summative performance ratings are Good Standing, Adequate Standing and Intervention.
  - Summative performance rating determinations are made annually using information from the most recent audit submitted to the Board and the charter’s ADM data.
- Intervention Process (see Exhibit C)
  - The financial intervention process applies to those charters that receive an “Intervention” summative performance rating, provides an opportunity for these charters to demonstrate improved financial performance, and allows the Board to take action if these charters do not demonstrate improved performance. An intervention process flowchart has been included on page EC.7.

### **Subsequent Written Public Comment**

At its October 23, 2018 meeting, the Subcommittee directed staff to solicit public comment on the proposed framework and to bring the public comment and Subcommittee recommendation to the full Board in December 2018. The five written responses received have been included as Exhibit D.

# Exhibit A: Measures and Measure Targets

## 1. Going Concern

<u>Calculation</u>	Performance rating based on absence or presence of certain disclosure in audit
<b>Measure Ratings</b>	<p><b>Meets Standard:</b> The most recent audit reporting package does not include explanatory paragraph in Independent Auditor’s Report or disclosure in the notes to the financial statements</p> <p><b>Below Standard (in one of two ways):</b> 1. Disclosure in Independent Auditor’s Report and financial statement notes <i>(Substantial doubt about charter’s ability to continue is raised and is not alleviated by management’s plans)</i></p> <p><b>OR</b></p> <p>2. Disclosure in financial statement notes only <i>(Substantial doubt about charter’s ability to continue is raised but is alleviated by management’s plans)</i></p>
<b>Rating Adjustments</b>	None
<b>Definitions</b>	None
<b>Calculation Considerations</b>	None

## 2. Default

<u>Calculation</u>	Performance rating based on absence or presence of certain disclosure in audit
<b>Measure Ratings</b>	<p><b>Meets Standard:</b> Charter holder is not in default on material loans or facility agreements or both</p> <p><b>Below Standard:</b> Charter holder is in default on material loans or facility agreements or both</p>
<b>Rating Adjustments</b>	None
<b>Definitions</b>	None
<b>Calculation Considerations</b>	None

### 3. Unrestricted Days Liquidity

<u>Calculation</u>	(Unrestricted Cash + OTHER SOURCES OF LIQUIDITY) divided by [(Total Expenses – NONCASH EXPENSES)/365]
<b>Measure Ratings</b>	<p><b>Meets Standard:</b> 30 or more days liquidity</p> <p><b>Approaches Standard:</b> At least 15 days liquidity but fewer than 30 days liquidity</p> <p><b>Below Standard:</b> Fewer than 15 days liquidity</p>
<b>Rating Adjustments</b>	None
<b>Definitions</b>	<p>OTHER SOURCES OF LIQUIDITY = Available balances from any sources of liquidity other than cash that are disclosed in the annual audit reporting package and may include, but not be limited to, lines of credit.</p> <p>NONCASH EXPENSES = May include depreciation, amortization and write-offs of loan issuance costs and prepayment penalties.</p>
<b>Calculation Considerations</b>	The unspent Classroom Site Fund balance at June 30 <sup>th</sup> is considered restricted, and, therefore, is removed to arrive at the charter holder’s Unrestricted Cash.

### 4. Adjusted Net Income

<u>Calculation</u>	Total Revenues minus (Total Expenses – NONCASH EXPENSES)
<b>Measure Ratings</b>	<p><b>Meets Standard:</b> Adjusted net income is greater than or equal to \$1</p> <p><b>Approaches Standard:</b> Adjusted net income is zero or negative <u>and</u> adjusted net income divided by total revenue is between 0 and negative 4.99 percent</p> <p><b>Below Standard:</b> Adjusted net income is negative <u>and</u> adjusted net income divided by total revenue is less than or equal to negative 5 percent</p>
<b>Rating Adjustments</b>	None
<b>Definitions</b>	NONCASH EXPENSES = May include depreciation, amortization and write-offs of loan issuance costs and prepayment penalties.
<b>Calculation Considerations</b>	None

## 5. Lease Adjusted Debt Service Coverage Ratio

Calculation (ADJUSTED NET INCOME + Interest Expense + Facility Lease Expense) divided by (DEBT PRINCIPAL + Interest + Facility Lease Expense)

**Measure Ratings** **Meets Standard:**  
Lease adjusted debt service coverage ratio exceeds 1.10

**Approaches Standard:**  
Lease adjusted debt service coverage ratio is between 1.0 and 1.10

**Below Standard:**  
Lease adjusted debt service coverage ratio is less than 1.0

**Rating Adjustments** None

**Definitions** ADJUSTED NET INCOME = See measure 4 on page 2

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

**Calculation Considerations** None

## 6. Average Daily Membership (“ADM”)

<u>Calculation</u>	Averages annual percent change in 100 <sup>th</sup> day ADM for the three most recent completed fiscal years
<b>Measure Ratings</b>	<p><b>Meets Standard (in one of two ways):</b></p> <p>1. Charter holder has <u>increase</u></p> <p style="text-align: center;"><b>OR</b></p> <p>2. Charter holder has <u>decrease</u> of:</p> <ul style="list-style-type: none"> <li>▪ SMALL: 4.99% or less</li> <li>▪ MEDIUM: 4.99% or less</li> <li>▪ LARGE: 2.99% or less</li> </ul> <p><b>Approaches Standard:</b></p> <p>Charter holder has <u>decrease</u> of:</p> <ul style="list-style-type: none"> <li>▪ SMALL: 5% to 14.99%</li> <li>▪ MEDIUM: 5% to 14.99%</li> <li>▪ LARGE: 3% to 9.99%</li> </ul> <p><b>Below Standard:</b></p> <p>Charter holder has <u>decrease</u> of:</p> <ul style="list-style-type: none"> <li>▪ SMALL: 15% or more</li> <li>▪ MEDIUM: 15% or more</li> <li>▪ LARGE: 10% or more</li> </ul>
<b>Rating Adjustments</b>	<ul style="list-style-type: none"> <li>▪ A charter holder’s “Approaches Standard” or “Below Standard” rating on the ADM measure will be <u>increased by one rating category</u> if the charter holder received <u>no “Below Standard” ratings and no more than one “Approaches Standard” rating on the financial framework’s other five measures</u>. Under this scenario, an initial “Approaches Standard” on the ADM measure would become a “Meets Standard” and an initial “Below Standard” would become an “Approaches Standard”.</li> <li>▪ A charter holder’s “Approaches Standard” or “Below Standard” rating on the ADM measure will be <u>unchanged</u> if the charter holder received <u>one or more “Below Standard” ratings, two or more “Approaches Standard” ratings or both on the financial framework’s other five measures</u>.</li> </ul>
<b>Definitions</b>	<p>SMALL = Charter holder with fewer than 200 ADM</p> <p>MEDIUM = Charter holder with 200 to 599 ADM</p> <p>LARGE = Charter holder with 600 or more ADM</p>
<b>Calculation Considerations</b>	<ul style="list-style-type: none"> <li>▪ <i>ADM Adjustment</i> – Board staff will adjust the annual ADM for the fiscal years used in the calculation when a) a school transfers from a multi-school charter contract to its own contract, b) a school operating under a multi-school charter contract closes, or c) the charter holder reduces the grade levels served at its charter school.</li> <li>▪ <i>Second/Third Year Charters</i> – The targets identified in the “Measure Ratings” section will be applied to charter holders with only two years of ADM available (percent change from year 1 to year 2) or charter holders with three years of ADM available (two-year average).</li> </ul>
<b>Other Consideration</b>	In instances where a charter holder entity has multiple charter contracts with the Board and the Board receives audited financial statements that aggregate the financial activities of all the charter contracts, Board staff will note on each charter contract’s financial performance dashboard the overall ADM performance of the charter holder entity using the ratings described on the next page. The charter holder entity’s performance will not affect the individual charter contract’s performance on the ADM measure.

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

### **First-Year and Second-Year Financial Site Visits**

#### **FIRST YEAR**

Since only one year of ADM data would be available, the ADM measure will not be applicable for first-year charter contracts. Board staff will visit all new schools approved through the new application, replication application or amendment processes in the fall of their first year of operation. Prior to that visit, Board staff would compare enrollment projections identified in the application or amendment request to the school's estimated count or, if available, actual ADM. During the visit, Board staff would meet with school officials and review documentation to ascertain the school's current financial situation and, if applicable, discuss adjustments made or planned due to lower than projected enrollment.

#### **SECOND YEAR**

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

## Exhibit B: Summative Performance Ratings

Summative Rating	Description
Good Standing	No measure rated Below Standard and no more than one measure rated Approaches Standard
Adequate Standing	No measure rated Below Standard and two or more measures rated Approaches Standard
Intervention	One or more measures rated Below Standard <u>OR</u> Three consecutive years in Adequate Standing

### Financial Eligibility for Expansion Requests<sup>1</sup>

A charter holder with a summative performance rating of “Good Standing” or “Adequate Standing” IS ELIGIBLE to submit expansion requests.

A charter holder with a summative performance rating of “Intervention” IS NOT ELIGIBLE to submit expansion requests.

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<sup>1</sup> The effect of the Financial Framework Subcommittee’s recommendation is to replace references in the Board’s current financial framework to “no measure rated ‘Falls Far Below Standard’” with “not received a summative performance rating of ‘Intervention’”. The Financial Framework Subcommittee made no other changes to the “Financial Eligibility for Expansion Requests” section found on page 6 and page 7 of the Board’s *Financial Performance Framework and Guidance*.

## Exhibit C: Financial Intervention Process

For those charters whose financial performance receives an INTERVENTION RATING, this appendix specifies the Board's financial intervention process (see page EC.7 for an intervention process flowchart). Defined terms are identified in all capital letters. The definitions may be found in *Appendix A: Definition of Terms*.

### Step 1 – Charter Holder Submits INITIAL FINANCIAL RESPONSE

Based on the most recent audit, each charter holder that receives an INTERVENTION RATING will be required to submit an INITIAL FINANCIAL RESPONSE to the Board.<sup>1</sup> The charter holder will be notified of the INITIAL FINANCIAL RESPONSE requirement and the submission deadline through the letter sent after the audit has been reviewed. The submission deadline will be set 30 calendar days from the audit letter's date.<sup>2</sup>

The INITIAL FINANCIAL RESPONSE will be used to assess changes in the charter holder's financial performance and health since June 30<sup>th</sup> and to ascertain if the charter holder's failure to meet one or more measure targets was a result of a one-time event or indicates a possible underlying structural problem with the charter holder's financial performance.

A charter holder's failure to timely submit the INITIAL FINANCIAL RESPONSE or to timely submit a complete INITIAL FINANCIAL RESPONSE will be noted on the charter holder's operational performance dashboard.

Efforts will be made to have the INITIAL FINANCIAL RESPONSE accessible from the charter holder's financial performance dashboard.

### Step 2 – Board Staff Reviews INITIAL FINANCIAL RESPONSE

Using the QUARTERLY FINANCIAL REPORT(s) included with the INITIAL FINANCIAL RESPONSE, Board staff will determine the charter holder's current performance and compare Board staff's results to the charter holder's calculation results.<sup>3</sup>

Board staff will review the charter holder's INITIAL FINANCIAL RESPONSE, the charter holder's financial performance dashboard(s) and audits, the charter holder's average daily membership ("ADM") as reported to the Arizona Department of Education ("Department"), and, if applicable, submissions made under the MANDATORY REPORTING RULE. Based on that review, within 30 calendar days of the INITIAL FINANCIAL RESPONSE's receipt<sup>4</sup>, Board staff will prepare STAFF'S REPORT ON INITIAL FINANCIAL RESPONSE.

As applicable, STAFF'S REPORT ON INITIAL FINANCIAL RESPONSE will identify any calculation differences identified.

Prior to the implementation of the financial framework, Board staff will develop the rubric that will be used to review each INITIAL FINANCIAL RESPONSE and post the rubric on the Board's website.

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<sup>1</sup> After the charter holder's INITIAL FINANCIAL RESPONSE has been reviewed, the charter holder will be notified of subsequent submission requirements (see Step 3).

<sup>2</sup> If the 30<sup>th</sup> day falls on a Saturday, Sunday or holiday, the deadline date will be moved to the next business day.

<sup>3</sup> For the Default measure, in addition to reviewing information disclosed in the INITIAL FINANCIAL RESPONSE, Board staff will consider, if applicable, any submissions made by the charter holder under the MANDATORY REPORTING RULE.

<sup>4</sup> If the 30<sup>th</sup> day falls on a Saturday, Sunday or holiday, the date will be moved to the next business day.

Efforts will be made to have STAFF’S REPORT ON INITIAL FINANCIAL RESPONSE accessible from the charter holder’s financial performance dashboard.

**Step 3 – Charter Holder Placed in Intervention Tier, Notified of Quarterly Reporting Requirements**

Board staff will place the charter holder in the intervention tier that aligns with the criteria established by the Board (see below) and notify the charter holder in writing of: a) the charter holder’s intervention tier; b) the intervention tier’s QUARTERLY FINANCIAL REPORT requirements and QUARTERLY REPORTING DEADLINES<sup>5</sup>; and c) the availability of the STAFF’S REPORT ON INITIAL FINANCIAL RESPONSE.

A charter holder’s failure to timely submit the intervention tier’s subsequent QUARTERLY FINANCIAL REPORT(s) or to timely submit complete QUARTERLY FINANCIAL REPORT(s) will be noted on the charter holder’s operational performance dashboard.

Efforts will be made to have all QUARTERLY FINANCIAL REPORTS accessible from the charter holder’s financial performance dashboard.

Board staff will conduct a STUDENT COUNT VISIT of each school operated by a charter holder identified for Tier 1 intervention.

**Intervention Tiers**

The Board has defined two intervention tiers for the financial framework, which are described in the table below.

	Description
<b>Intervention Tier 1</b>	<ul style="list-style-type: none"> <li>▪ Going Concern measure <u>or</u> Default measure rated Below Standard <u>and</u> zero or more measures rated Approaches Standard in the audited fiscal year</li> </ul> <p style="text-align: center;"><u>OR</u></p> <ul style="list-style-type: none"> <li>▪ Two or more measures rated Below Standard <u>and</u> zero or more measures rated Approaches Standard in the audited fiscal year</li> </ul>
<b>Intervention Tier 2</b>	<ul style="list-style-type: none"> <li>▪ One measure other than the Going Concern measure or Default measure rated Below Standard <u>and</u> zero or more measures rated Approaches Standard in the audited fiscal year</li> </ul>

Board staff will also consider the following when identifying the charter holder’s intervention tier.

- **INITIAL FINANCIAL RESPONSE** – The following scenarios are based on STAFF’S REPORT ON INITIAL FINANCIAL RESPONSE.
  - If STAFF’S REPORT ON INITIAL FINANCIAL RESPONSE identifies a “No” as the answer to the question that asks, “Do the charter holder’s proposed or implemented actions address the problems that contributed to or caused the charter holder’s underperformance on the financial

<sup>5</sup> The QUARTERLY REPORTING DEADLINES for the QUARTERLY FINANCIAL REPORTS are standardized for all charter holders regardless of intervention tier.

framework's measures and are they realistic to implement?", then at Step 3 the charter holder would automatically be placed in Tier 1 intervention.

- If the charter holder's INITIAL FINANCIAL RESPONSE supports that the charter holder has cured the default, then at Step 3 the charter holder would either be:
  - Removed from the intervention process if the Default measure was the only measure that the charter holder received a Below Standard on for the audit fiscal year; or
  - Placed in Tier 2 intervention instead of Tier 1 intervention if the charter holder had received a Below Standard on only one other measure for the audit fiscal year.
- Operational Performance Issues – If one of the scenarios identified below is applicable to a charter holder, then at Step 3 the charter holder would automatically be placed in Tier 1 intervention.
  - For the audit fiscal year, the charter holder was required to submit an audit corrective action plan for a) failure to pay taxes or contributions due to the Internal Revenue Service, Arizona Department of Revenue, Arizona Department of Economic Security or Arizona State Retirement System, b) failure to have sufficient cash at year-end to cover the charter holder's unspent Classroom Site Fund balance, or c) failure to maintain worker's compensation insurance or liability insurance.
  - For the audit fiscal year, the current fiscal year or both, the Board has substantiated a complaint involving late payroll checks to employees, failure to make 401K deposits, or health insurance or liability insurance cancelation due to nonpayment.
  - For the audit fiscal year, the current fiscal year or both, the charter holder has made submissions under the MANDATORY REPORTING RULE.
- "Intervention" to "Adequate Standing" to "Intervention" – A charter holder whose performance fluctuates from "Intervention" to "Adequate Standing" and then back to "Intervention" will automatically be placed in Tier 1 intervention each subsequent time the charter holder is identified for intervention.

#### **Step 4 – Board Staff Reviews Subsequent QUARTERLY FINANCIAL REPORT(s) Through QUARTER 3**

For each QUARTERLY FINANCIAL REPORT submitted subsequent to the INITIAL FINANCIAL RESPONSE and prior to the JUNE 30<sup>TH</sup> QUARTERLY FINANCIAL REPORT, Board staff will determine the charter holder's current performance and compare Board staff's results to the charter holder's calculation results.<sup>6</sup> Within 30 calendar days of the QUARTERLY FINANCIAL REPORT's receipt<sup>7</sup>, Board staff will notify the charter holder in writing of a) the next submission deadline and b) any calculation differences identified.

#### **Step 5 – Status Determination Made After JUNE 30<sup>TH</sup> QUARTERLY FINANCIAL REPORT Reviewed**

Board staff will review the JUNE 30<sup>TH</sup> QUARTERLY FINANCIAL REPORT in the same manner as the previously submitted QUARTERLY FINANCIAL REPORTS (see Step 4). After the JUNE 30<sup>TH</sup> QUARTERLY FINANCIAL REPORT has been reviewed, Board staff will determine whether the charter holder will be determined to be Not on Probation or On Probation using the table found on page EC.5.

<sup>6</sup> For the Default measure, Board staff will consider, if applicable, any submissions made by the charter holder under the MANDATORY REPORTING RULE.

<sup>7</sup> If the 30<sup>th</sup> day falls on a Saturday, Sunday or holiday, the date will be moved to the next business day.

A charter holder determined to be On Probation will be required to submit the following to the Board:

- A FINANCIAL ACTION PLAN developed and approved by the charter holder’s governing board since the charter holder’s efforts in the current year were unsuccessful.<sup>8</sup>
- QUARTERLY FINANCIAL REPORTS until the current year’s audit is received.<sup>9</sup>

Within 45 calendar days of the JUNE 30<sup>TH</sup> QUARTERLY FINANCIAL REPORT’s receipt, Board staff will notify the charter holder in writing of the charter holder’s status and, for a charter holder determined to be On Probation, the submission requirements and submission deadlines.

For a charter holder determined to be On Probation, the charter holder’s failure to timely submit the FINANCIAL ACTION PLAN, QUARTERLY FINANCIAL REPORTS or both will be noted on the charter holder’s operational performance dashboard, as will the charter holder’s failure to timely submit complete QUARTERLY FINANCIAL REPORT(s).

Efforts will be made to have the notification sent to the charter holder identifying its probation status accessible from the charter holder’s financial performance dashboard, as well as submissions made by a charter holder determined to be On Probation.

**Table Summarizing Applicability of Intervention and Probation Requirements**

	<b>Requirement Applicability</b>
<b>INITIAL FINANCIAL RESPONSE</b>	Tier 1 and Tier 2
<b>QUARTERLY FINANCIAL REPORTS required through June 30<sup>th</sup></b>	Tier 1 and Tier 2
<b>STUDENT COUNT VISIT</b>	Tier 1
<b>Submission of FINANCIAL ACTION PLAN Developed and Approved by Governing Board</b>	On Probation
<b>QUARTERLY FINANCIAL REPORTS required until next year’s audit received</b>	On Probation

<sup>8</sup> Board staff will acknowledge receipt of the FINANCIAL ACTION PLAN, but will not evaluate it (see also “Defining Financial Performance Expectations” section).

<sup>9</sup> QUARTERLY FINANCIAL REPORTS will be reviewed using the process identified in Step 4.

	Not on Probation	On Probation
<b>Tier 1</b>	<p>Based on the JUNE 30<sup>th</sup> QUARTERLY FINANCIAL REPORT, the Board’s MANDATORY REPORTING RULE, and the Board’s complaint process <u>all the following are true</u>:</p> <ol style="list-style-type: none"> <li>1. The measure(s) rated “Below Standard” in the audit year will likely improve to at least an “Approaches Standard” when calculations are completed using the charter holder’s next audit.</li> <li>2. None of the financial framework’s other measures will likely receive a “Below Standard” when calculations are completed using the charter holder’s next audit.</li> <li>3. Since Board staff made the determination in Step 3, the Board has not substantiated any complaints involving late payroll checks to employees, failure to make 401K deposits, or health insurance or liability insurance cancelation due to nonpayment.</li> <li>4. Since Board staff made the determination in Step 3, the charter holder has not been required to make submissions under the MANDATORY REPORTING RULE.</li> </ol>	<p>Based on the JUNE 30<sup>th</sup> QUARTERLY FINANCIAL REPORT, the Board’s MANDATORY REPORTING RULE, and the Board’s complaint process <u>one or more of the following are true</u>:</p> <ol style="list-style-type: none"> <li>1. One or more of the measures rated “Below Standard” in the audit year will likely continue to be rated “Below Standard” when calculations are completed using the charter holder’s next audit.</li> <li>2. One or more of the financial framework’s other measures will likely receive a “Below Standard” when calculations are completed using the charter holder’s next audit.</li> <li>3. Since Board staff made the determination in Step 3, the Board has substantiated at least one complaint involving late payroll checks to employees, failure to make 401K deposits, or health insurance or liability insurance cancelation due to nonpayment.</li> <li>4. Since Board staff has made the determination in Step 3, the charter holder has been required to make submissions under the MANDATORY REPORTING RULE.</li> </ol>
<b>Tier 2</b>	<p>Based on the JUNE 30<sup>th</sup> QUARTERLY FINANCIAL REPORT, the Board’s MANDATORY REPORTING RULE, and the Board’s complaint process <u>all the following are true</u>:</p> <ol style="list-style-type: none"> <li>1. The measure rated “Below Standard” in the audit year will likely improve to at least an “Approaches Standard” when calculations are completed using the charter holder’s next audit.</li> <li>2. None of the financial framework’s other measures will likely receive a “Below Standard” when calculations are completed using the charter holder’s next audit.</li> <li>3. Since Board staff made the determination in Step 3, the Board has not substantiated any complaints involving late payroll checks to employees, failure to make 401K deposits, or health insurance or liability insurance cancelation due to nonpayment.</li> <li>4. Since Board staff made the determination in Step 3, the charter holder has not been required to make submissions under the MANDATORY REPORTING RULE.</li> </ol>	<p>Based on the JUNE 30<sup>th</sup> QUARTERLY FINANCIAL REPORT, the Board’s MANDATORY REPORTING RULE, and the Board’s complaint process <u>one or more of the following are true</u>:</p> <ol style="list-style-type: none"> <li>1. The measure rated “Below Standard” in the audit year will likely continue to be rated “Below Standard” when calculations are completed using the charter holder’s next audit.</li> <li>2. One or more of the financial framework’s other measures will likely receive a “Below Standard” when calculations are completed using the charter holder’s next audit.</li> <li>3. Since Board staff made the determination in Step 3, the Board has substantiated at least one complaint involving late payroll checks to employees, failure to make 401K deposits, or health insurance or liability insurance cancelation due to nonpayment.</li> <li>4. Since Board staff made the determination in Step 3, the charter holder has been required to make submissions under the MANDATORY REPORTING RULE.</li> </ol>
<b>Other</b>		<p>Charter holder that receives an INTERVENTION RATING for a) three consecutive fiscal years <u>or</u> b) three of the last five fiscal years with the other two fiscal years in “Adequate Standing”.</p>

## DEFINING FINANCIAL PERFORMANCE EXPECTATIONS

With the passage of Laws 2018, Ch. 285, A.R.S. § 15-183 now requires the Board’s performance framework include “the financial expectations of the charter school” and now allows the Board to consider if the charter holder has failed to “Meet the financial performance expectations set forth in the performance framework or any improvement plans” when the Board makes renewal and revocation decisions. Board staff has proposed the definitions below for Subcommittee consideration.

<b>Statutory Term</b>	<b>Proposed Definition</b>
Meets the Board’s Financial Performance Expectations	Charter holder Not on Probation
Does Not Meet the Board’s Financial Performance Expectations	Charter holder On Probation
Improvement Plans	Submissions made by a charter holder in Tier 1 or Tier 2 intervention

Under Step 5, Board staff will update the charter holder’s financial performance dashboard to reflect the charter holder’s probation status (see table below).

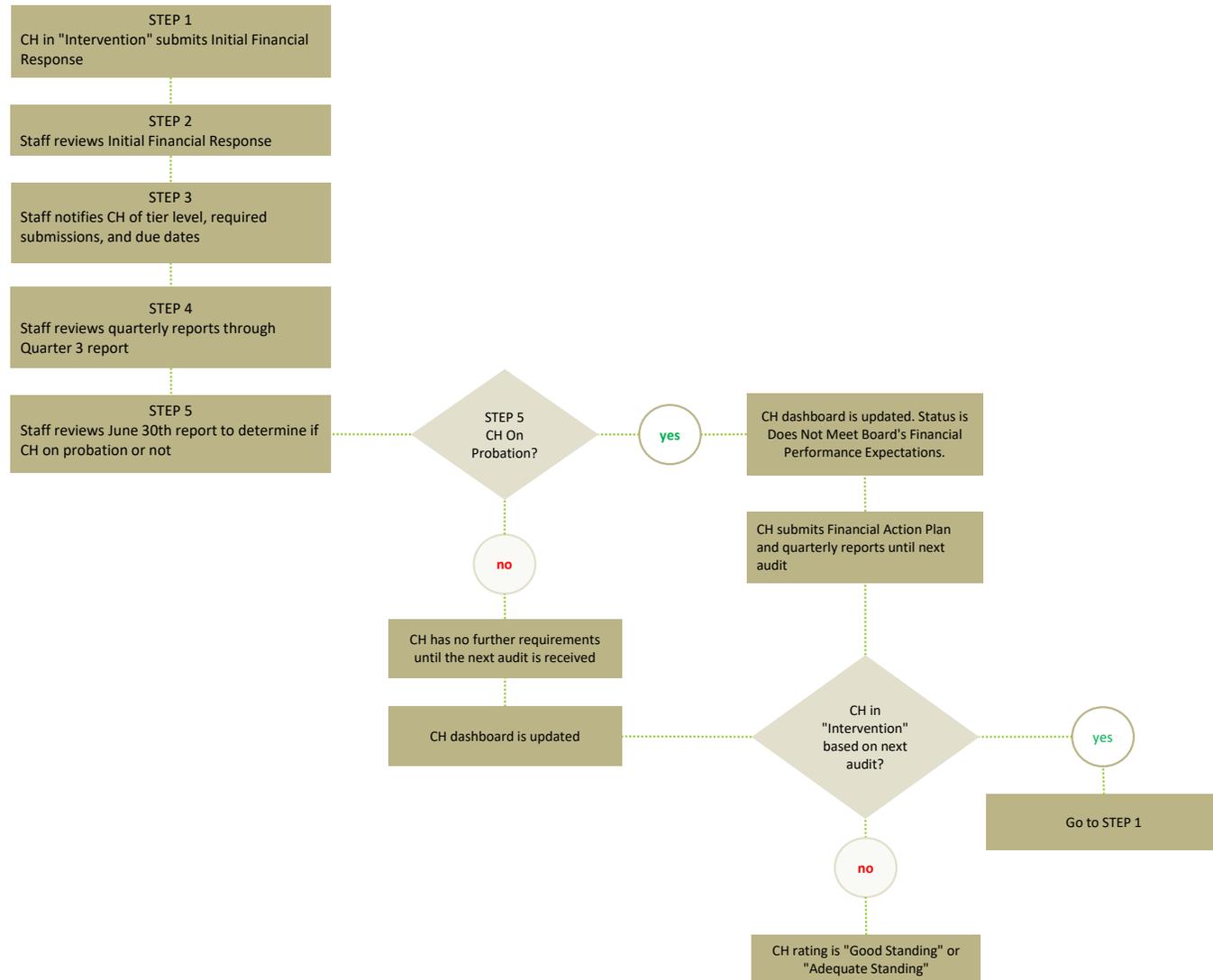
<b>Intervention Status</b>	<b>Dashboard Displays:</b>
Not on Probation	Intervention process completed: No further response required; pending review of next audit
On Probation	Intervention process completed: Does Not Meet Board’s Financial Performance Expectations

For a charter holder to move from Does Not Meet the Board’s Financial Performance Expectations to Meets the Board’s Financial Performance Expectations, an audit submitted by the charter holder must receive a “Good Standing” or “Adequate Standing” rating, which would remove the charter holder from intervention.

Once all determinations under Step 5 have been made, Board staff will report to the Board at a public meeting the audit year performance and JUNE 30<sup>TH</sup> QUARTERLY FINANCIAL REPORT performance by measure for each charter holder that Does Not Meet the Board’s Financial Performance Expectations.

When the Board considers the renewal application package for or considers other action related to a charter holder that Does Not Meet the Board’s Financial Performance Expectations, Board staff will provide to the Board a copy of the charter holder’s FINANCIAL ACTION PLAN and either a) the JUNE 30<sup>TH</sup> QUARTERLY FINANCIAL REPORT (if the next audit has not been received) and, if applicable, any subsequent QUARTERLY FINANCIAL REPORT(s) submitted to the Board by the charter holder or b) if the next audit has been received, any subsequent QUARTERLY FINANCIAL REPORT(s) submitted to the Board by the charter holder, if applicable.

# Financial Intervention Process Flowchart



## APPENDIX A: DEFINITION OF TERMS

**FINANCIAL ACTION PLAN** – The plan, which must be developed and approved by the charter holder's governing board, details the specific steps being taken by the charter holder to improve its financial performance in the fiscal year that begins on the July 1<sup>st</sup> following the JUNE 30<sup>TH</sup> QUARTERLY FINANCIAL REPORT and identifies milestones that the charter holder will use throughout the fiscal year to benchmark its performance against. This requirement only applies to a charter holder identified as On Probation (see table on page EC.5).

**INITIAL FINANCIAL RESPONSE** – In its response a charter holder must: 1) provide the charter holder's annual budget for the current fiscal year and the charter holder's budget for each quarter in the current fiscal year (budget could be allocated based on expected revenue and expenditure flows rather than equally across the four quarters); 2) provide a QUARTERLY FINANCIAL REPORT for each of the QUARTERS COVERED BY INITIAL FINANCIAL RESPONSE; 2) provide a schedule of debt and lease obligations and the current outstanding balances for each; 3) summarize the factors that caused or contributed to the charter holder's financial performance in the audit fiscal year; and 4) summarize the specific actions taken or being taken to improve the charter holder's financial performance in the current fiscal year.

**INTERVENTION RATING** – Under the financial framework, a charter holder receives a summative performance rating of intervention if the charter holder's most recent audit identifies a) one or more measures rated Below Standard or b) three consecutive years of a summative performance rating of Adequate Standing.

**JUNE 30<sup>TH</sup> QUARTERLY FINANCIAL REPORT** – The report submitted for QUARTER 4 must include the following:

1. An unaudited balance sheet (statement of financial position) that identifies the charter holder's results at June 30<sup>th</sup> and the charter holder's unrestricted and restricted cash balances. Minimally, the charter holder's restricted cash balance must include the charter holder's unspent Classroom Site Fund monies.
2. An unaudited income statement (statement of activities) that identifies the charter holder's results for the year ended June 30<sup>th</sup>.
3. The charter holder's budget that includes actual results versus budgeted results for the quarter.
4. The charter holder's calculation of its performance on all six of the financial framework measures.

**MANDATORY REPORTING RULE** – In accordance with Board administrative rule<sup>1</sup>, a charter holder must report the following items to the Board within 10 business days of receipt or occurrence:

1. Any notice from a lender or landlord regarding default.
2. Notice of legal filings associated with bankruptcy.
3. Any notice from the Internal Revenue Service, Arizona State Retirement System, Arizona Department of Revenue, or Arizona Department of Economic Security regarding a tax lien, levy or garnishment.
4. Correspondence from an insurance provider related to cancellation of health or liability insurance due to nonpayment.

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<sup>1</sup> Although this rule will be promulgated at the same time as the financial framework rules, the rule will apply to all charter holders and not just those identified under the financial framework for intervention.

5. Notice of termination of line of credit whether initiated by financial institution or charter holder when replacement credit line is not in effect.
6. Withdrawals from debt service reserve funds.

**QUARTER 1** – The period covering July 1<sup>st</sup> through September 30<sup>th</sup>.

**QUARTER 2** – The period covering October 1<sup>st</sup> through December 31<sup>st</sup>.

**QUARTER 3** – The period covering January 1<sup>st</sup> through March 31<sup>st</sup>.

**QUARTER 4** – The period covering April 1<sup>st</sup> through June 30<sup>th</sup>.

**QUARTERLY FINANCIAL REPORT** – Each report submitted for QUARTER 1, QUARTER 2, and QUARTER 3 must include the following:

1. An unaudited balance sheet (statement of financial position) that identifies the charter holder’s results at the quarter end date and the charter holder’s unrestricted and restricted cash balances. Minimally, the charter holder’s restricted cash balance must include the charter holder’s unspent Classroom Site Fund monies.
2. An unaudited income statement (statement of activities) that identifies the charter holder’s results year-to-date for the quarter end date.
3. The charter holder’s budget for the applicable quarter that includes actual results versus budgeted results.
4. The charter holder’s calculation of its performance on the Default, Unrestricted Days Liquidity, Adjusted Net Income and Average Daily Membership measures.

**QUARTERLY REPORTING DEADLINES** – The submission deadlines for QUARTERLY FINANCIAL REPORTS submitted subsequent to the INITIAL FINANCIAL RESPONSE are standardized for all charter holders regardless of intervention tier and are as follows:

QUARTER 1	Due by October 30 <sup>th</sup>
QUARTER 2	Due by January 30 <sup>th</sup>
QUARTER 3	Due by April 30 <sup>th</sup>
QUARTER 4	Due by July 30 <sup>th</sup>

**QUARTERS COVERED BY INITIAL FINANCIAL RESPONSE** – The date of the audit letter will determine the quarters that must be addressed in the INITIAL FINANCIAL RESPONSE.

<u>Audit Letter Date</u>	<u>Quarters Covered</u>
Between October 1 <sup>st</sup> and December 30 <sup>th</sup>	QUARTER 1
Between December 31 <sup>st</sup> and March 30 <sup>th</sup>	QUARTER 1, QUARTER 2
Between March 31 <sup>st</sup> and June 29 <sup>th</sup>	QUARTER 1, QUARTER 2, QUARTER 3
After June 29 <sup>th</sup>	QUARTER 1, QUARTER 2, QUARTER 3, QUARTER 4

**STAFF'S REPORT ON INITIAL FINANCIAL RESPONSE** – The report prepared by Board staff after Board staff completes its review of the charter holder's INITIAL FINANCIAL RESPONSE. The report will answer each of the questions identified below and briefly explain the basis for each answer.

- Is there a sound explanation for why the charter holder underperformed on the financial framework's measures? *[Note: Answer to this question will be based on Board staff's review of the charter holder's summary of the factors that caused or contributed to the charter holder's financial performance in the audit fiscal year, the charter holder's audits and the charter holder's ADM reports.]*
- Did the charter holder perform at a level just below or well below the financial framework's measure(s) targets? *[Note: Answer to this question will be based on Board staff's review of the charter holder's audit year financial performance dashboard.]*
- In what direction is the charter holder's financial health heading? *[Note: Answer to this question will be based on Board staff's review of the charter holder's QUARTERLY FINANCIAL REPORT(s), the charter holder's last three dashboards (if applicable), the charter holder's audits and the charter holder's ADM reports.]*
- Do the charter holder's proposed or implemented actions address the problems that contributed to or caused the charter holder's underperformance on the financial framework's measures and are they realistic to implement? *[Note: Answer to this question will be based on Board staff's review of the charter holder's INITIAL FINANCIAL RESPONSE, including the charter holder's summary of the specific actions taken or being taken to improve the charter holder's financial performance in the current year, the charter holder's audits and the charter holder's ADM reports.]*

**STUDENT COUNT VISIT** – For each charter holder identified for Tier 1 intervention, Board staff will visit each school operated by the charter holder 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 ("Department"). Board staff will notify the Department of any material discrepancies identified. If a school was visited during the fiscal year through another process (e.g., interval review), a second visit will not be conducted. Time permitting, Board staff could also visit schools operated by charter holders identified for Tier 2 interventions.

# Exhibit D: Written Public Comment



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

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## Fin Framework Feedbk

1 message

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**judy white** <judy@midtownprimaryschool.com>  
To: Charter School Board <charterschoolboard@asbcs.az.gov>

Thu, Oct 25, 2018 at 9:19 AM

It looks well thought out and predictive of needed intervention. The intervention flow looks fair and provides steps to get it fixed. Thank you for your hard work on this.

--

Judy White  
Principal  
Midtown Primary School  
4735 N 19th Ave  
Phz AZ 85015  
602-265-5133



Charter School Board - ASBCS &lt;charterschoolboard@asbcs.az.gov&gt;

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## Public Comment - Financial Framework

1 message

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**Binky Michele Jones** <bjones@ombudsman.com>

Wed, Oct 31, 2018 at 10:42 AM

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

Recommendation to add language to ADM "Meets Standard" measure to clearly state that Charter Holder **has maintained ADM year over year** or has increased. A charter should be viewed in good standing if they are maintaining ADM as well as increasing. This additional language will ensure the public understands that maintaining or increasing ADM is the target.

Remember that a small school with a capacity of 90 students may not have the ability to increase ADM year over year but it should be celebrated that they maintain ADM, especially if they graduate 20% or more students in any given year.

Thank you for the opportunity to submit feedback,

*Binky Michele Jones*

Regional Vice President, Ombudsman Educational Services

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Charter School Board - ASBCS &lt;charterschoolboard@asbcs.az.gov&gt;

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**public comment on dashboard**

1 message

**MaryEllen Halvorson** <dr.meh@live.com>

Wed, Oct 31, 2018 at 11:06 AM

To: "charterschoolboard@asbcs.az.gov" &lt;charterschoolboard@asbcs.az.gov&gt;

I feel very strongly that once a problem has been resolved, the dashboard box should return to green for the following reasons:

1. Dashboards should communicate to parents and the public how the school is currently operating.
2. A dashboard box can turn pink for a wide variety of reasons within that category. Some of those reasons are very minor and some are more serious. Parents and the public don't know the exact reason and often assume the worst.
3. The proposed system would make it obvious which schools resolve problems quickly and which schools consistently operate in a manner that creates problems. Also, there would be a reward for resolving problems quickly.
4. The Charter Board and staff could quickly know if a school needs to fix something. Leaving the box pink forever means the staff or Board Member must do research to see exactly what the problem was and if it was resolved. That takes time.

Thank you for considering my comment.

Mary Ellen Halvorson  
[2965 Pleasant Valley Drive](#)  
[Prescott, AZ 86305](#)

928 420 2951



Charter School Board - ASBCS &lt;charterschoolboard@asbcs.az.gov&gt;

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**RE: Public Comment on Recommended Financial Framework**

1 message

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**Henry Fortino** <hfortino@fortinocpa.com>  
To: Charter School Board <charterschoolboard@asbcs.az.gov>

Fri, Nov 2, 2018 at 1:59 PM

Below are my comments on the recommended framework.

1. Going concern – Would recommend that below standard measure 2 be moved to approaches standard since if substantial doubt is raised but alleviated then it shouldn't be on the same level as not alleviated.

6. ADM – Would eliminate this entirely because it only reflects revenue. Cash flow overall is what is most important and we are already measuring that with 3 and 4.

Thanks,

Henry J. Fortino, CPA, PC  
[3801 N. Campbell Ave. STE A](#)  
[Tucson, Arizona 85719](#)

Phone 1-520-393-3233

Fax 1-520-881-7392

[www.fortinocpa.com](http://www.fortinocpa.com)



**From:** Charter School Board <charterschoolboard@asbcs.az.gov>  
**Sent:** Thursday, October 25, 2018 8:48 AM  
**To:** Charter School Board - ASBCS <charterschoolboard@asbcs.az.gov>  
**Subject:** Public Comment Sought on Subcommittee's Recommended Financial Framework

At its October 23, 2018 meeting, the Financial Framework Subcommittee ("Subcommittee") accepted the measures, measure targets, summative performance ratings, interventions and financial performance expectations and recommended that the full Board move forward with administrative rulemaking for implementing the Financial Performance Framework ("Framework") proposed by the Subcommittee. Further, the Subcommittee directed staff to solicit public comment on the proposed Framework and to bring the public comment and Subcommittee recommendation to the full Board in December 2018.

The Subcommittee's proposed measures and measure targets, proposed summative performance ratings, and proposed intervention process and financial performance expectations may be accessed at <https://asbcs.az.gov/public-comment>.

**Posting period: October 25, 2018 – November 13, 2018**

Please submit your feedback in writing to the Board during the posting period using one of the following options:

1. Written comments may be emailed to [charterschoolboard@asbcs.az.gov](mailto:charterschoolboard@asbcs.az.gov).
2. Written comments may be mailed to the Arizona State Board for Charter Schools, P.O. Box 18328, Phoenix, AZ 85005
3. Written comments may be delivered to the Board office located at [1616 W. Adams St., Suite 170, Phoenix, AZ 85007](#)

For all responses please provide the following information:

- First and last name
- Mailing Address
- E-mail Address
- Organization (optional)

## Charter School Board Staff



**Arizona State Board for Charter Schools**

**P.O. Box 18328, Phoenix, Arizona 85005**

**Phone: (602) 364-3080**

**Website: [asbcs.az.gov](https://asbcs.az.gov)**

**Facebook: [www.facebook.com/asbcsaz](https://www.facebook.com/asbcsaz)**

**Newsletter: <https://asbcs.az.gov/news-events>**



Charter School Board - ASBCS &lt;charterschoolboard@asbcs.az.gov&gt;

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**PUBLIC COMMENT - RECOMMENDED FINANCIAL FRAMEWORK**

1 message

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**MCamacho@ypic.com** <MCamacho@ypic.com>  
To: charterschoolboard@asbcs.az.gov  
Cc: BGrossenburg@ypic.com, AHuizar@ypic.com

Tue, Nov 6, 2018 at 4:35 PM

Good afternoon,

After reviewing the measures, measure targets, summative performance ratings, and interventions and financial performance expectations, I have the following comments/questions:

1. For how long can a school be in "Intervention" status before other major consequences come into play. According to the flowchart, it seems like a school can be in Intervention status indefinitely.
2. When is this being implemented?
3. What is the reasoning for these additional measures?
4. This is very tight control on charter schools. Additional paperwork, time, and costs (auditors will most likely charge more to report on these measures) are being demanded of charter schools. Hoping additional funding is provided to charter school to cover expenses associated with this process.

Thank you for the opportunity to provide input.

Martha Camacho

[mcamacho@ypic.com](mailto:mcamacho@ypic.com)

3834 W. 16<sup>th</sup> Street

Yuma, AZ 85364

## Yuma Private Industry Council, Inc.

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### Martha Camacho

Accounting and Finance Manager

**Office:** (928) 329-0990 x165

**Fax:** (928) 329-4462

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