Arizona State Board for Charter Schools

Financial Performance Framework and Guidance

Revised October 15, 2013
Revised September 9, 2013
Adopted August 13, 2012

Section	Page Number

Financial Performance Framework Structure	2
Using the Financial Performance Framework	4
Measures in Detail	6
Financial Performance Response	12
Appendix A – Financial Performance Framework	14
Appendix B – Financial Expectations Not Met: Charter Holder Action & Board Consideration	16
Appendix C – Financial Performance Response & Evaluation	20
Appendix D – Definition of Terms	24

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

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

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

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Financial Performance Framework Guidance

Charter holders have the autonomy to manage their finances consistent with state and federal law and the charter contract. The purpose of the Financial Performance Framework ("financial framework") is to communicate the State Board for Charter Schools' ("Board") expectations for ensuring that all charter holders in its portfolio are viable organizations with strong fiscal management practices. To this end, the financial framework focuses on outcomes or performance goals not necessarily established in law.

The Board, in its oversight of charter holders and the schools that they operate, strives not to be over-reaching, but also recognizes the need to protect the public's interests. Because charter schools are public schools they must maintain the public's trust that they are implementing their education program as set out in the charter, spending public funds responsibly, and adhering to laws and charter requirements regarding their operations. However, the Board is aware of the delicate balance between appropriate oversight and infringement on autonomy.

In developing the financial framework, the Board remained conscious of its limited resources to implement the financial framework. The Board was also mindful of its commitment to maintaining current levels of data collection so as not to unnecessarily burden the charter holders with requirements to submit additional information for financial performance rating determinations.

FINANCIAL PERFORMANCE FRAMEWORK STRUCTURE

The financial framework, which has been included as Appendix A, gauges both near-term financial health and longer term financial sustainability. The portion of the financial framework that tests a charter holder's near-term financial health is designed to depict the charter holder's financial position and viability for the upcoming year. The portion of the financial framework that tests a charter holder's longer term financial sustainability is designed to depict the charter holder's financial position and viability over time. Charter holders meeting the desired standards demonstrate a low risk of financial distress. Charter holders not meeting the desired standards may currently be experiencing financial difficulties and/or may be at a higher risk for financial hardship in future.

The financial framework includes five main levels of information: Indicators, Measures, Metrics, Targets, and Ratings. In addition to the information found below, the financial framework's measures, metrics, targets, and ratings are further described in the "Measures in Detail" section of this guidance.

Indicators

Indicators are general categories of financial performance used to identify the financial information that best reflects the current financial status of a charter holder versus the information that better depicts the future financial viability of the charter holder. Near-Term Indicators and Sustainability Indicators are used in the financial framework.

Measures
Measures are the general means to evaluate an aspect of an indicator. Six measures are used in the financial framework: Going Concern, Unrestricted Days Liquidity, Default, Net Income, Cash Flow, and Fixed Charge Coverage Ratio.

Metrics
Metrics are a means for evaluating measures. As an example, the formula for evaluating Net Income is total revenues less total expenses.

Targets
Targets are the thresholds set to determine whether performance for a specific measure has been met or not. Using the Net Income measure again, the Board has set the target for the "Meets Standard" rating as Net Income is greater than or equal to $1.

Ratings
For each measure a charter holder receives one of three ratings based on whether the charter holder met the target.

Meets Standard
The charter holder's performance on this measure does not signal a financial risk to the charter holder and meets the Board's expectation. Meeting the standard requires no follow up action by the charter holder.

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

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

USING THE FINANCIAL PERFORMANCE FRAMEWORK

Collecting Evidence

The annual statutorily required audits conducted by independent certified public accountants provide the information necessary to determine a charter holder's financial performance. In accordance with the parameters established in the Board's Strategic Plan, the financial framework uses information already collected by the Board to assess charter holders' financial performance and does not require charter holders to provide additional information for rating determinations.

The following information from the annual audit reporting packages will be used:

- Independent Auditor's Report on the financial statements
- Audited statement of financial position
- Audited statement of activities and changes in net assets
- Audited statement of cash flows
- Notes to the audited financial statements
- Applicable compliance questionnaire

Since a large percentage of the Board's charter contracts are with non-profit entities, throughout this document the financial statements will be referred to using non-profit terminology. Statements reported in for-profit or governmental audits use the following corresponding names:

Non-profit	For-profit	Governmental
Statement of Financial Position	Balance Sheet	Statement of Net Assets
Statement of Activities and Changes in Net Assets[1]	Income Statement	Statement of Activities
Statement of Cash Flows	Statement of Cash Flows	Statement of Cash Flows (Note: This statement is required only under certain circumstances.)

Through ASBCS Online, the Board has provided online public access to the audit reporting packages of Board and State Board of Education sponsored charter holders. Information about how to access the annual audit reporting packages through ASBCS Online is available on the Board's website.

[1] This statement may also be referred to as the "statement of activities".

Evaluation and Intervention
The established targets are used to determine whether the charter holder is meeting each measure based on the available existing data. The evaluation is completed annually using the charter holder's most recent audit reporting package. A charter holder that receives two or more "Does Not Meet Standard" and/or one or more "Falls Far Below Standard" based on the charter holder's most recent audit reporting package does not meet the Board's financial performance expectations.[2]

A charter holder's financial performance will be used by the Board during the term of the charter:

- To stipulate the conditions which waive the charter holder from any submission requirements related to its financial operations.
- To stipulate the conditions which require the charter holder to submit additional information or clarification that will be used to inform the Board's decision-making.

A charter holder's financial performance will be considered by the Board as follows:[3]

- Renewal
- Five-year interval reviews
- New School Site Notification Requests
- Arizona Online Instruction Program of Instruction Amendment Requests
- Replication
- Transfer of the charter contract from another sponsor to the Board
- Academic Intervention Schedule
- Failing School designations

A charter holder that meets the Board's financial performance expectations will be waived from submitting a financial performance response at the times identified in the bullets above. A charter holder that does not meet the Board's financial performance expectations at the times identified in the bullets above will be required to submit a financial performance response. Please see Appendix B regarding what the charter holder must do and how that information will be used by the Board. For more information regarding the financial performance response, please see the "Financial Performance Response" section of this document.

Because financial health can affect a charter holder's ability to meet the obligations of its charter contract and applicable laws, a charter holder's financial performance may also be reviewed at other times when the Board makes decisions related to a charter holder's academic and/or operational performance. In these situations, a charter holder will be able to address its financial performance at the Board meeting, but an opportunity will not be built in to the process for the charter holder to provide a written response in advance of the meeting.

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[2] In those instances where the Board receives financial statements that cover multiple and different charter holder entities, the charter holder's performance will be evaluated under the financial framework using the charter holder specific financial information and the financial information for the consolidated/combined entity. Failure of the individual charter holder <u>or</u> the consolidated/combined entity to meet the Board's financial performance expectations will result in the charter holder being required to submit a financial performance response.

[3] At the time of consideration by the Board, the most current audited financial information will be provided.

MEASURES IN DETAIL

This section describes each of the measures included in the financial framework. A charter holder's financial performance is evaluated annually using the charter holder's most recent audit reporting package. It is important to note that the financial framework excludes measures of how a charter holder manages and expends its funds as the financial framework is not designed to evaluate a charter holder's spending decisions. For example, there are no measures that address what portion of the costs are for direct instruction; rather the measures focus on the overall expenses versus the offsetting revenues. The financial framework analyzes the financial performance of a charter holder, not its processes for managing that performance.

1a. Going Concern – Near-Term Indicator

Definition: Going concern is the idea that the charter holder will continue to engage in its activities for the foreseeable future.

Overview: Auditing standards require an auditor to evaluate an organization's ability to continue operating for the next year. If the auditor has substantial doubt about whether the organization will operate for at least the next year, then the independent auditor's report would include a paragraph explaining this concern and information, including management's plans, would be disclosed in the notes to the audited financial statements. The auditor's consideration of management's plans may alleviate the "substantial doubt" about the organization's ability to continue operating. In those instances, the auditor may disclose in the notes to the audited financial statements the conditions and events that initially caused the auditor to believe there was substantial doubt, but wouldn't include a paragraph in the independent auditor's report.

Source of Data: Independent Auditor's Report on the financial statements and the notes to the audited financial statements.

1a. Going Concern
Meets Standard: ☐ The most recent audit reporting package does not include explanatory paragraph in Independent Auditor's Report or disclosure in the notes to the financial statements
Does Not Meet Standard: No "Does Not Meet Standard" target established for this measure
Falls Far Below Standard (in one of two ways): ☐ Independent Auditor's Report for the most recent audit reporting package includes an explanatory paragraph and disclosure is included in notes to the financial statements or ☐ Disclosure included in notes to the financial statements for the most recent audit reporting package, but no modification to Independent Auditor's Report

Basis for Target Level: If the audit reporting package includes a going concern disclosure in the independent auditor's report or the notes to the audited financial statements, then the independent auditor has concerns about the charter holder's viability. A charter holder in this situation may have difficulty meeting operational and academic obligations required under law and its charter contract.

1b. Unrestricted Days Liquidity – Near-Term Indicator

Definition: *The unrestricted days liquidity measure indicates how many days a charter holder can pay its expenses without an influx of cash.*

Overview: Unexpected costs arise when operating a charter school. Additionally, circumstances outside of the charter holder's control may impact the amount and timing of funding received from the State and other sources. Therefore, maintaining a reserve is a common best practice. The unrestricted days liquidity measure translates into a more readily understandable number a charter holder's unrestricted cash balance and available balances from other sources of liquidity disclosed in the annual audit reporting package, including lines of credit. Please note that the Board will not round numbers when determining a charter holder's financial performance on this measure.

A.R.S. §15-977 limits how Classroom Site Fund (CSF) monies may be spent. Therefore, if a charter holder does not spend all of the CSF monies it received during the fiscal year, then at the end of the year, the charter holder needs to have enough cash in the bank to cover the unspent portion from current and prior years ("carryover"). Since the CSF carryover monies may only be used for the purposes specified in statute, any year-end CSF cash carryover balance will be removed when determining the charter holder's unrestricted cash.

Source of Data: Audited statement of financial position, audited statement of activities and changes in net assets, notes to the audited financial statements, and compliance questionnaire[4].

1b. Unrestricted Days Liquidity: (Unrestricted Cash + Other Sources of Liquidity*) divided by (Total Expenses/365) **** "Other Sources of Liquidity" is defined as available balances from any sources of liquidity other than cash that are disclosed in the annual audit reporting package and may include, but not be limited to, lines of credit.*** ***[Note: The Classroom Site Fund cash carryover balance at June 30th would be considered restricted cash and, therefore, would be removed as part of identifying a charter holder's unrestricted cash as of June 30th.]***
Meets Standard: ☐ 30 or more days liquidity
Does Not Meet Standard: ☐ At least 15 days liquidity but fewer than 30 days liquidity
Falls Far Below Standard: ☐ Fewer than 15 days liquidity

Basis for Target Level: Having access to cash or other sources of liquidity equaling at least 30 days of operating expenses is a standard minimum for any organization. In the event of unforeseen circumstances (e.g., unexpected costs, changes to State funding), 30 days of cash or other liquidity would help the charter holder make payroll, pay the rent, and keep the charter school's doors open until the charter holder receives its next State equalization payment or until

[4] For fiscal years prior to and including 2011, the year-end Classroom Site Fund cash carryover was not required to be disclosed in the audit reporting package. Beginning with fiscal year 2012, the year-end CSF cash carryover must, at a minimum, be disclosed in the Classroom Site Fund section of the applicable compliance questionnaire.

other funding is secured. If a charter holder has fewer than 15 days of cash or other liquidity, should unforeseen circumstances arise, the charter holder may have difficulty making its next payroll and meeting other obligations before receiving its next influx of cash.

1c. Default – Near-Term Indicator

Definition: Default indicates that a lender has issued a formal notice of loan default to the charter holder.

Overview: In addition to making timely payments, financial institutions may include other terms and requirements (sometimes referred to as "covenants") in their agreements with charter holders. Individuals who make loans to charter holders may establish agreements with similar requirements. Failure to make timely payments or comply with debt covenants does not automatically result in a formal notice of default being issued by the lender and therefore would not be considered a "material" default. However, in those cases where formal notice of default has been issued by the lender, this measure will be rated "Falls Far Below Standard".

Source of Data: Notes to the audited financial statements.

1c. Default: Defined as in True Default on Obligations
Meets Standard: ☐ Charter holder is not in default on material loans
Does Not Meet Standard: No "Does Not Meet Standard" target established for this measure
Falls Far Below Standard: ☐ Charter holder is in default on material loans

Basis for Target Level: A charter holder that has received formal notice of default from a lender may be at higher risk of financial distress and may have difficulty meeting its operational and academic obligations required under law and the charter contract.

2a. Net Income – Sustainability Indicator

Definition: Net income, which equals total revenues less total expenses, looks at whether or not a charter holder is operating within its available resources.

Overview: The net income measure identifies whether a charter holder operates at a surplus (total revenues exceed total expenses) or a deficit (total expenses exceed total revenues). It should be noted that a charter holder may make a strategic choice to operate at a deficit for a year. Continued deficits for a sustained period of time could adversely affect the charter holder's ability to meet its obligations.

Source of Data: Audited statement of activities and changes in net assets.

2a. Net Income: Total Revenues less Total Expenses
Meets Standard: ☐ Net income is greater than or equal to $1
Does Not Meet Standard: ☐ Net income is zero or negative
Falls Far Below Standard: No "Falls Far Below Standard" target established for this measure

Basis for Target Level: Positive net income contributes to the charter holder's reserve. Having a reserve gives the charter holder more flexibility in responding as situations arise that are outside of the charter holder's control. The targets established for this measure focus on whether the charter holder operated during the fiscal year with a surplus or deficit rather than the magnitude of the surplus or deficit.

2b. Cash Flow – Sustainability Indicator

Definition: The cash flow measure shows the change in a charter holder's cash balance from one fiscal year to another.

Overview: This measure is similar to the unrestricted days liquidity measure, but looks at longer term financial stability versus near-term financial health. Since cash flow fluctuations from year-to-year can have a long-term impact on the charter holder's financial health, this measure assesses both three-year cumulative cash flow and annual cash flow. For information regarding the underlying factors that have contributed to the cash flow fluctuations experienced by the charter holder, please review the audited statement of cash flows. If the Board has received only one or two audit reporting packages at the time of review, the charter holder's financial performance under this measure will be evaluated using the information available.

Cash Flow Calculation Example

Calculate the annual cash flow:
FY2012 Cash Flow = FY2012 Total Cash – FY2011 Total Cash
FY2011 Cash Flow = FY2011 Total Cash – FY2010 Total Cash
FY2010 Cash Flow = FY2010 Total Cash – FY2009 Total Cash

Add together the FY2012 Cash Flow, FY2011 Cash Flow, and FY2010 Cash Flow to determine the three-year cumulative cash flow.

The three-year cumulative cash flow could also be calculated by subtracting FY2009 Total Cash from FY2012 Total Cash. However, if the three-year cumulative cash flow is positive, you will still need to know the annual cash flows in order to determine whether the charter holder receives a "Meets Standard" or "Does Not Meet Standard".

In determining a charter holder's performance on this measure the first time, you will need to have the most recent four fiscal years of audited statements of financial position. After the initial calculations have been made, for subsequent fiscal years, you will only need to add the most current fiscal year's cash flow information to and remove the oldest fiscal year's cash flow information from the calculation. For each fiscal year, the cash flow equals the current year's total cash minus the prior year's total cash. Adding the cash flow for each of the three fiscal years together will provide the three-year aggregate cash flow. The "Cash Flow Calculation Example" textbox found on this page shows how to calculate the cash flow measure using fiscal year 2012 as the most recent audited fiscal year available.

Source of Data: Audited statement of financial position.

2b. Cash Flow: One-Year Cash Flow = Current Year Total Cash less Prior Year Total Cash
Meets Standard (in one of two ways): ☐ Three-year cumulative cash flow is positive *and* cash flow is positive each year or ☐ Three-year cumulative cash flow is positive, cash flow is positive in two of three years, *and* cash flow in the most recent year is positive
Does Not Meet Standard (in one of two ways): ☐ Three-year cumulative cash flow is negative or ☐ Three-year cumulative cash flow is positive, but does not meet "Meets Standard"
Falls Far Below Standard: No "Falls Far Below Standard" target established for this measure

Basis for Target Level: Cash flow should be greater than zero as a positive cash flow over time generally indicates increasing financial health and sustainability of the charter holder.

2c. Fixed Charge Coverage Ratio – Sustainability Indicator

Definition: The fixed charge coverage ratio looks at the amount of cushion in the charter holder's cash flow to cover fixed obligations or charges.

Overview: Fixed charges represent the charter holder's fixed financial commitments. These charges occur regardless of changes in revenue or other circumstances that may affect the charter holder's financial situation, which is why the term "fixed" is used. For this ratio, fixed charges would include lease payments, loan payments, and interest.

The ratio includes interest and lease expense in both the numerator and denominator even though it appears that in the end they would cancel each other out. This has been done for two reasons. First, because the ratio components are more encompassing, it helps in determining the true cushion in cash flow to cover fixed obligations. Second, if the ratio's numerator included only change in net assets, depreciation and amortization and the denominator was unchanged, the ratio would solve for a charter holder's ability to meet lease and interest expense payments after it has already paid lease and interest expense, because lease and interest expense have already been deducted to arrive at the change in net assets.

The individual ratio components are described in more detail below:

- *Change in Net Assets* – The change in net assets results from revenues, expenses and the release of assets from restrictions. For for-profit charter holders, the ratio would use net income after tax instead of change in net assets.
- *Depreciation* – Depreciation is the allocation of a fixed asset's costs over the useful life of the asset and involves the movement of costs from the statement of financial position to the statement of activities and changes in net assets. Fixed assets include items such as buildings, furnishings and vehicles. Depreciation is known as a noncash expense. Although charter holders are required to record this expense in their

accounting records, depreciation does not use cash. Therefore, depreciation is added back into the ratio's numerator.

- *Amortization* – Amortization is similar to depreciation but it involves the allocation of an intangible asset's costs over a period of time. Intangible assets include items such as bond issuance costs. Although charter holders are required to record this expense, as applicable, in their accounting records, amortization does not use cash. Therefore, amortization is added back into the ratio's numerator.
- *Interest Expense* – Interest expense reflects the charter holder's cost of borrowing for the fiscal year. As a result of the accounting method charter holders are required to use, interest expense may not equal the amount of interest paid to lenders. Interest paid reflects the cash paid to lenders for interest and may be higher or lower than the interest expense for the fiscal year. In calculating the ratio, the dollar amount used for "interest expense" would also be used for "interest".
- *Lease Expense* – Lease expense includes facility leases and operating leases where at the end of the lease ownership of the item does not transfer to the charter holder.
- *Current Portion of Long-Term Debt and Capital Leases (CPLTDCL)* – The CPLTDCL includes the portion of debt that must be paid by the charter holder within the next fiscal year. The "current portion of long-term debt" would include bond/loan payments for charter holders that own their facilities, as well as payments related to other long-term loans obtained by the charter holder and capital leases.

Please note that the Board will not round numbers when determining a charter holder's financial performance on this measure.

<u>Source of Data</u>:

- Changes in Net Assets – Audited statement of activities and changes in net assets.
- Depreciation and Amortization – Audited statement of cash flows and/or notes to the audited financial statements.
- Interest Expense – Notes to the audited financial statements. Interest expense may also be available on the audited statement of activities and changes in net assets, if the statement includes sufficient detail, or the statement of functional expense, if available. If interest expense cannot be determined, interest paid may be used and is found on the statement of cash flows.
- Lease Expense – Notes to the audited financial statements.
- Current Portion of Long-Term Debt and Capital Leases – Audited statement of financial position.

2c. Fixed Charge Coverage Ratio: (Change in Net Assets* + Depreciation + Amortization + Interest Expense + Lease Expense)/(Current Portion of Long-Term Debt and Capital Leases + Interest + Lease Expense)   **** Net Income After Tax would be used when calculating the ratio for for-profit charter holders.***
Meets Standard: ☐ Fixed Charge Coverage Ratio is equal to or exceeds 1.10
Does Not Meet Standard: ☐ Fixed Charge Coverage Ratio is less than 1.10
Falls Far Below Standard: No "Falls Far Below Standard" target established for this measure

Basis for Target Level: Financially healthy entities have a cushion in cash flow coverage. The 1.1 used in the "meets" target is typical for non-profit organizations. Since capitalized expenses, such as buses and equipment, are not included in the statement of activities and changes in net assets, they need to be covered by the cushion in cash flow or through outside financing. Another benefit of excess cash flow is that a charter holder can build up cash and equity to purchase larger assets, such as a building. Since banks will only finance up to a certain amount of the building, the difference needs to be funded by the charter holder. The only way to build up cash/equity is through retention of the earnings cushion or from an injection of equity from an outside source. Charter holders that operate where fixed charges are only covered at 1:1 will not have the same flexibility as those that generate cash flow in excess of that level.

FINANCIAL PERFORMANCE RESPONSE[5]

As indicated in the "Evaluation and Intervention" section of this document, a charter holder that does not meet the Board's financial performance expectations will be required to submit a financial performance response at specified times (see also Appendix B). The Board has not prescribed the specific information that must be submitted, but the charter holder's financial performance response should focus on each measure where the charter holder received a "Does Not Meet Standard" or "Falls Far Below Standard". The charter holder's financial performance response should not address all measures in the financial framework unless the charter holder failed to meet the standard for all measures. Board staff will evaluate the financial performance response using the evaluation criteria found in Appendix C. In preparing the financial performance response that will be submitted to the Board, the charter holder should evaluate its own financial situation and, for those measures where the charter holder failed to meet the standard, determine the information that will best explain the charter holder's situation and efforts to improve. For more information on the financial performance response, please see Appendix C.

[5] This section and Appendix C may also be useful to charter holders as part of their ongoing efforts to monitor financial performance. For example, a charter holder may use the information in this section to improve its financial performance, so that by the time it must undergo a five-year interval review or apply for renewal, its financial performance will be such that it will be waived from being required to submit a financial performance response.

APPENDICES

Appendix A **Financial Performance Framework**

Appendix B **Financial Expectations Not Met: Charter Holder Action & Board Consideration**

Appendix C **Financial Performance Response & Evaluation**

Appendix D **Definition of Terms**

Appendix A

Financial Performance Framework

Board Strategic Plan Objective: All charter holders in the portfolio are viable organizations with strong fiscal management practices.

1. NEAR-TERM INDICATORS

1a. Going Concern
Meets Standard: ☐ The most recent audit reporting package does not include explanatory paragraph in Independent Auditor's Report or disclosure in the notes to the financial statements
Does Not Meet Standard: No "Does Not Meet Standard" target established for this measure
Falls Far Below Standard (in one of two ways): ☐ Independent Auditor's Report for the most recent audit reporting package includes an explanatory paragraph and disclosure is included in notes to the financial statements or ☐ Disclosure included in notes to the financial statements for the most recent audit reporting package, but no modification to Independent Auditor's Report

1b. Unrestricted Days Liquidity: (Unrestricted Cash + Other Sources of Liquidity*) divided by (Total Expenses/365) **** "Other Sources of Liquidity" is defined as available balances from any sources of liquidity other than cash that are disclosed in the annual audit reporting package and may include, but not be limited to, lines of credit.*** ***[Note: The Classroom Site Fund cash carryover balance at June 30th would be considered restricted cash and, therefore, would be removed as part of identifying a charter holder's unrestricted cash as of June 30th.]***
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

1c. Default: Defined as in True Default on Obligations
Meets Standard: ☐ Charter holder is not in default on material loans
Does Not Meet Standard: No "Does Not Meet Standard" target established for this measure
Falls Far Below Standard: ☐ Charter holder is in default on material loans

2. SUSTAINABILITY INDICATORS

2a. Net Income: Total Revenues less Total Expenses
Meets Standard: ☐ Net income is greater than or equal to $1
Does Not Meet Standard: ☐ Net income is zero or negative
Falls Far Below Standard: No "Falls Far Below Standard" target established for this measure

2b. Cash Flow: One-Year Cash Flow = Current Year Total Cash less Prior Year Total Cash
Meets Standard (in one of two ways): ☐ Three-year cumulative cash flow is positive *and* cash flow is positive each year or ☐ Three-year cumulative cash flow is positive, cash flow is positive in two of three years, *and* cash flow in the most recent year is positive
Does Not Meet Standard (in one of two ways): ☐ Three-year cumulative cash flow is negative or ☐ Three-year cumulative cash flow is positive, but does not meet "Meets Standard"
Falls Far Below Standard: No "Falls Far Below Standard" target established for this measure

2c. Fixed Charge Coverage Ratio: (Change in Net Assets* + Depreciation + Amortization + Interest Expense + Lease Expense)/(Current Portion of Long-Term Debt and Capital Leases + Interest + Lease Expense) **** Net Income After Tax would be used when calculating the ratio for for-profit charter holders.***
Meets Standard: ☐ Fixed Charge Coverage Ratio is equal to or exceeds 1.10
Does Not Meet Standard: ☐ Fixed Charge Coverage Ratio is less than 1.10
Falls Far Below Standard: No "Falls Far Below Standard" target established for this measure

Appendix B

Financial Expectations Not Met: Charter Holder Action & Board Consideration

For charter holders that do not meet the Board's financial performance expectations, the table below specifies by monitoring, expansion or transfer area what the charter holder must do and how that information will be used by the Board in its decision-making. This table in no way precludes the Board from considering a charter holder's financial performance at other times or from assigning interventions, including when the Board makes decisions related to a charter holder's operational and/or academic performance.

	Charter Holder Action	Board Consideration
Academic Intervention Schedule (Monitoring)	Financial performance will be reviewed for a charter holder that must submit "Required Information" in any year of the Academic Intervention Schedule beginning with Year 3.[1] If the charter holder must submit "Required Information" based on its academic performance and the charter holder does not meet the Board's financial performance expectations, the charter holder must submit a financial performance response that addresses each measure where the charter holder received a "Does Not Meet Standard" or a "Falls Far Below Standard". For additional information regarding the financial performance response, please see Appendix C.	Board staff will review the financial performance response and evaluate it in accordance with Appendix C. The charter holder's financial performance response and the evaluation instrument completed by staff will be provided to the Board when the Board considers the charter holder's academic performance. Additionally, a table showing the charter holder's financial data and financial performance for the last three audited fiscal years will be included in the staff report provided to the Board. The charter holder's financial performance may be considered by the Board as an aggravating factor in its decision-making.
Arizona Online Instruction (AOI) Program of Instruction Amendment Request (Expansion)	The charter holder must submit: • A financial performance response that addresses each measure where the charter holder received a "Does Not Meet Standard" or a "Falls Far Below Standard". For additional information regarding the financial performance response, please see Appendix C. • A start-up budget to cover expenses projected to occur during the start-up period (until August 1 of the year the school opens). • An operational budget to cover the first-year of operations. • For each budget, a separate document describing assumptions for each line item, to include disaggregated costs, and basis for determining those costs. Demonstrate through the assumptions that the amounts listed are viable and adequate for the start-up period and first year of operation.	Board staff will review the financial performance response and evaluate it in accordance with Appendix C. Additionally, Board staff will review the start-up and operational budgets and assumptions. The charter holder's financial performance response, including the start-up budget, operational budget and assumptions, as well as the evaluation instrument completed by staff will be provided to the Board when the Board considers the amendment request. Additionally, a table showing the charter holder's financial data and financial performance for the last three audited fiscal years will be included in the staff report provided to the Board. The charter holder's financial performance may be considered by the Board as an aggravating factor in its decision-making.

[1] A charter holder's first audit must be submitted by either November 15th or March 31st of the charter holder's second year of operation. As such, the charter holder's financial performance would likely not be available when the charter holder is notified in its second year that it must submit required information under the Board's Academic Intervention Schedule. If the charter holder's academic performance results in the charter holder being placed on an agenda for Board consideration, the charter holder's financial performance, if known, will be provided to the Board at that time.

	If the charter holder submits the amendment request prior to the Board receiving the charter holder's first audit reporting package, then the charter holder must submit: • Internal, unaudited financial statements for the fiscal year(s) to date. • A start-up budget to cover expenses projected to occur during the start-up period (until August 1 of the year the school opens). • An operational budget to cover the first-year of operations. • For each budget, a separate document describing assumptions for each line item, to include disaggregated costs, and basis for determining those costs. Demonstrate through the assumptions that the amounts listed are viable and adequate for the start-up period and first year of operation.	
Failing School Designation (Monitoring)	The charter holder must submit a financial performance response that addresses each measure where the charter holder received a "Does Not Meet Standard" or a "Falls Far Below Standard". For additional information regarding the financial performance response, please see Appendix C.	Board staff will review the financial performance response and evaluate it in accordance with Appendix C. The charter holder's financial performance response and the evaluation instrument completed by staff will be provided to the Board when the Board considers whether to revoke or restore the charter of the failing school. Additionally, a table showing the charter holder's financial data and financial performance for the last three audited fiscal years will be included in the staff report provided to the Board. The charter holder's financial performance may be considered by the Board as an aggravating factor in its decision-making.
Five-Year Interval Review (Monitoring)	The charter holder must submit a financial performance response that addresses each measure where the charter holder received a "Does Not Meet Standard" or a "Falls Far Below Standard". For additional information regarding the financial performance response, please see Appendix C.	Board staff will review the charter holder's financial performance response and evaluate it in accordance with Appendix C. A copy of the completed evaluation instrument will be placed in the charter holder's DMS in ASBCS Online.
New School Site Notification Request (Expansion)	The charter holder must submit: • A financial performance response that addresses each measure where the charter holder received a "Does Not Meet Standard" or a "Falls Far Below Standard". For additional information regarding the financial performance response, please see Appendix C. • A start-up budget to cover expenses projected to occur during the start-up	Board staff will review the financial performance response and evaluate it in accordance with Appendix C. Additionally, Board staff will review the start-up and operational budgets and assumptions. The charter holder's financial performance response, including the start-up budget, operational budget and assumptions, as well as the evaluation instrument completed by staff will be provided to the Board if the Board

	period (until August 1 of the year the school opens). • An operational budget to cover the first-year of operations. • For each budget, a separate document describing assumptions for each line item, to include disaggregated costs, and basis for determining those costs. Demonstrate through the assumptions that the amounts listed are viable and adequate for the start-up period and first year of operation. If the charter holder submits the notification request prior to the Board receiving the charter holder's first audit reporting package, then the charter holder must submit: • Internal, unaudited financial statements for the fiscal year(s) to date. • A start-up budget to cover expenses projected to occur during the start-up period (until August 1 of the year the school opens). • An operational budget to cover the first-year of operations. • For each budget, a separate document describing assumptions for each line item, to include disaggregated costs, and basis for determining those costs. Demonstrate through the assumptions that the amounts listed are viable and adequate for the start-up period and first year of operation.	considers the notification request. Additionally, a table showing the charter holder's financial data and financial performance for the last three audited fiscal years will be included in any staff report provided to the Board. The charter holder's financial performance may be considered by the Board as an aggravating factor in its decision-making.
Renewal Application Package (Monitoring)	The charter holder must submit a financial performance response that addresses each measure where the charter holder received a "Does Not Meet Standard" or a "Falls Far Below Standard". For additional information regarding the financial performance response, please see Appendix C.	Board staff will review the financial performance response and evaluate it in accordance with Appendix C. The charter holder's financial performance response and the evaluation instrument completed by staff will be provided to the Board when the Board considers the charter holder's renewal application package. Additionally, a table showing the charter holder's financial data and financial performance for the last three audited fiscal years will be included in the staff report provided to the Board. If the charter holder is not meeting the Board's academic performance expectations and/or is not complying with statutory and contractual requirements, the charter holder's financial performance may be considered as an aggravating factor by the Board in its decision about whether or not to renew the charter contract.

Replication Application Package (Expansion)	The charter holder must submit: • A financial performance response that addresses each measure where the charter holder received a "Does Not Meet Standard" or a "Falls Far Below Standard". For additional information regarding the financial performance response, please see Appendix C. • A start-up budget to cover expenses projected to occur during the start-up period (until August 1 of the year the school opens). • A three-year operational budget to cover expenses projected to occur during the first three years of operation. • For each budget, a separate document describing assumptions for each line item, to include disaggregated costs, and basis for determining those costs. Demonstrate through the assumptions that the amounts listed are viable and adequate for the start-up period and first three years of operation. The templates for the replication start-up budget and three-year operational budget are available on the Board's website.	Board staff will review the financial performance response and evaluate it in accordance with Appendix C. Additionally, Board staff will review the start-up and operational budgets and assumptions. The charter holder's financial performance response, including the start-up budget, operational budget and assumptions, as well as the evaluation instrument completed by staff will be provided to the Board when the Board considers the replication application package. Additionally, a table showing the charter holder's financial data and financial performance for the last three audited fiscal years will be included in the staff report provided to the Board. The charter holder's financial performance may be considered by the Board as an aggravating factor in its decision-making.
Transfer Application Package Involving the Transfer of the Charter Contract from Another Sponsor to the Board (Transfer)	For charter holders currently sponsored by the State Board of Education (SBE), the charter holder must submit a financial performance response that addresses each measure where the charter holder received a "Does Not Meet Standard" or a "Falls Far Below Standard". For additional information regarding the financial performance response, please see Appendix C. *Charter holders that want to transfer their charter contracts to the Board from an authorizer other than the SBE should contact the Board at (602) 364-3080 for the requirements.*	Board staff will review the financial performance response and evaluate it in accordance with Appendix C. The charter holder's financial performance response and the evaluation instrument completed by staff will be provided to the Board when the Board considers the charter holder's transfer application package. Additionally, a table showing the charter holder's financial data and financial performance for the last three audited fiscal years will be included in the staff report provided to the Board. If the charter holder is not meeting the Board's academic performance expectations and/or is not complying with statutory and contractual requirements, the charter holder's financial performance may be considered as an aggravating factor by the Board in its decision about whether or not to transfer the charter contract.

Appendix C

Financial Performance Response & Evaluation

Financial Performance Response

A charter holder that does not meet the Board's financial performance expectations will be required to submit a financial performance response at specified times (see Appendix B). For those charter holders required to submit a financial performance response, the table below includes examples of items that the charter holder may want to consider addressing. The Board has not prescribed the specific information that must be submitted, but the charter holder's financial performance response should focus on each measure where the charter holder received a "Does Not Meet Standard" or "Falls Far Below Standard". The charter holder's financial performance response should not address all measures in the financial framework unless the charter holder failed to meet the standard for all measures.

In preparing the financial performance response, the charter holder should evaluate its own financial situation and, for those measures where the charter holder failed to meet the standard, determine the information that will best explain the charter holder's situation and efforts to improve. Although listed separately in the table, to some extent, certain measures may relate to one another. Therefore, in the financial performance response, it may be appropriate for the charter holder to refer to its performance under a measure that met the standard when addressing a measure that did not meet or fell far below the standard.

Please note that the examples included in the table below are just that. The information in the table is not meant to be exhaustive, but serves as a starting point to assist charter holders. By including the table, the Board is not intending to limit what a charter holder may address in its response.

Measure	For Ratings of "Does Not Meet" or "Falls Far Below" Consider Demonstrating…
1a. Going Concern	❖ The issue resulting in the auditor's "going concern" designation has been resolved or is in the process of being resolved.
1b. Unrestricted Days Liquidity	❖ The charter holder has access to other sources of liquidity, including related parties, to augment liquidity needs. ❖ The charter holder expects a receipt of cash from a grant, etc.
1c. Default	❖ The charter holder is no longer in default. ❖ The charter holder's efforts to resolve the lender's concerns, so that the default status can be lifted.
2a. Net Income	❖ The net loss was from non-recurring events that will not occur in future periods. ❖ The charter holder has reduced expenses to meet the minimum requirement in future periods. ❖ Student counts for the charter holder will increase in future periods to result in positive change in net assets.
2b. Cash Flow	❖ The charter holder meets the other financial requirements and had positive cash flow for the most recent year. ❖ The charter holder has sufficient cash to fund cash deficiencies for the foreseeable future. ❖ The charter holder has increased revenue or reduced expenses that will result in positive cash flow in the next fiscal year.
2c. Fixed Charge Coverage Ratio	❖ The charter holder has sufficient cash to augment cash flow to fund fixed charges for the foreseeable future. ❖ The charter holder's income is expected to improve which will result in "Meets" for the Fixed Charge Coverage Ratio in the next fiscal year. ❖ The charter holder's fixed charges are expected to decline which will result in a "Meets" for the Fixed Charge Coverage Ratio.

Evaluation Criteria for Financial Performance Response

The following criteria will be used to evaluate the financial performance response submitted by the charter holder. Charter holders are submitting the financial performance response based upon those measures that received a "Does Not Meet Standard" or "Falls Far Below Standard". Each charter holder's financial performance response will be unique.

GOING CONCERN

Provide evidence demonstrating:

- The issue resulting in the auditor's "going concern" designation has been resolved or is in the process of being resolved.

ACCEPTABLE	NOT ACCEPTABLE	
Meets	Does Not Meet	Falls Far Below
The financial performance response explains the reason(s) for the going concern designation identified in the audited fiscal year and the charter holder's efforts to cure the situation in the current or subsequent fiscal year. The information and analysis included supports and helps explain the statements made by the charter holder in the financial performance response.	The financial performance response explains the reason(s) for the going concern designation identified in the audited fiscal year or explains the charter holder's efforts to cure the situation in the current or subsequent fiscal year, but not both. The information and/or analysis included provide limited support for the statements made by the charter holder in the financial performance response.	The financial performance response does not address the measure or only restates the sentence from the table found in the "Financial Performance Response" section of Appendix C or similar information.

UNRESTRICTED DAYS LIQUIDITY

Provide evidence demonstrating:

- The charter holder has access to other sources of liquidity, including related parties, to augment liquidity needs.
- The charter holder expects a receipt of cash from a grant, etc.
- Other information specific to the charter holder's situation.

ACCEPTABLE	NOT ACCEPTABLE	
Meets	Does Not Meet	Falls Far Below
The financial performance response explains the reason(s) for the charter holder having fewer than 30 days of cash or other liquidity in the audited fiscal year and the charter holder's efforts to improve in this area in the current or subsequent fiscal year. The information and analysis included supports and helps explain the statements made by the charter holder in the financial performance response.	The financial performance response explains the reason(s) for the charter holder having fewer than 30 days of cash or other liquidity in the audited fiscal year or explains the charter holder's efforts to improve in this area in the current or subsequent fiscal year, but not both. The information and/or analysis included provide limited support for the statements made by the charter holder in the financial performance response.	The financial performance response does not address the measure or only restates the sentence from the table found in the "Financial Performance Response" section of Appendix C or similar information.

DEFAULT

Provide evidence demonstrating:

- The charter holder is no longer in default.
- The charter holder's efforts to resolve the lender's concerns, so that the default status can be lifted.

ACCEPTABLE	NOT ACCEPTABLE	
Meets	Does Not Meet	Falls Far Below
The financial performance response explains the reason(s) for the charter holder's default identified in the audited fiscal year and the charter holder's efforts to cure the situation in the current or subsequent fiscal year. The information and analysis included supports and helps explain the statements made by the charter holder in the financial performance response.	The financial performance response explains the reason(s) for the charter holder's default identified in the audited fiscal year or explains the charter holder's efforts to cure the situation in the current or subsequent fiscal year, but not both. The information and/or analysis included provide limited support for the statements made by the charter holder in the financial performance response.	The financial performance response does not address the measure or only restates the sentence from the table found in the "Financial Performance Response" section of Appendix C or similar information.

NET INCOME

Provide evidence demonstrating:

- The net loss was from non-recurring events that will not occur in future periods.
- The charter holder has reduced expenses to meet the minimum requirement in future periods.
- Student counts for the charter holder will increase in future periods to result in positive change in net assets.
- Other information specific to the charter holder's situation.

ACCEPTABLE	NOT ACCEPTABLE	
Meets	Does Not Meet	Falls Far Below
The financial performance response explains the reason(s) for the charter holder's negative net income in the audited fiscal year and the charter holder's efforts to attain positive net income in the current or subsequent fiscal year. The information and analysis included supports and helps explain the statements made by the charter holder in the financial performance response.	The financial performance response explains the reason(s) for the charter holder's negative net income in the audited fiscal year or explains the charter holder's efforts to attain positive net income in the current or subsequent fiscal year, but not both. The information and/or analysis included provide limited support for the statements made by the charter holder in the financial performance response.	The financial performance response does not address the measure or only restates the sentence from the table found in the "Financial Performance Response" section of Appendix C or similar information.

CASH FLOW

Provide evidence demonstrating:

- The charter holder meets the other financial requirements and had positive cash flow in the most recent year.
- The charter holder has sufficient cash to fund cash deficiencies for the foreseeable future.
- The charter holder has increased revenue or reduced expenses that will result in positive cash flow in the next fiscal year.
- Other information specific to the charter holder's situation.

ACCEPTABLE	**NOT ACCEPTABLE**	
Meets	Does Not Meet	Falls Far Below
The financial performance response explains the reason(s) for the charter holder not meeting the cash flow measure's targets in the audited fiscal year and the charter holder's efforts to improve in this area in the current or subsequent fiscal year. The information and analysis included supports and helps explain the statements made by the charter holder in the financial performance response.	The financial performance response explains the reason(s) for the charter holder not meeting the cash flow measure's targets in the audited fiscal year or explains the charter holder's efforts to improve in this area in the current or subsequent fiscal year, but not both. The information and/or analysis included provide limited support for the statements made by the charter holder in the financial performance response.	The financial performance response does not address the measure or only restates the sentence from the table found in the "Financial Performance Response" section of Appendix C or similar information.

FIXED CHARGE COVERAGE RATIO

Provide evidence demonstrating:

- The charter holder has sufficient cash to augment cash flow to fund fixed charges for the foreseeable future.
- The charter holder's income is expected to improve which will result in "Meets" for the Fixed Charge Coverage Ratio in the next year.
- The charter holder's fixed charges are expected to decline which will result in a "Meets" for the Fixed Charge Coverage Ratio.
- Other information specific to the charter holder's situation.

ACCEPTABLE	**NOT ACCEPTABLE**	
Meets	Does Not Meet	Falls Far Below
The financial performance response explains the reason(s) for the charter holder's fixed charge coverage ratio being less than 1.10 in the audited fiscal year and the charter holder's efforts to improve in this area in the current or subsequent fiscal year. The information and analysis included supports and helps explain the statements made by the charter holder in the financial performance response.	The financial performance response explains the reason(s) for the charter holder's fixed charge coverage ratio being less than 1.10 in the audited fiscal year or explains the charter holder's efforts to improve in this area in the current or subsequent fiscal year, but not both. The information and/or analysis included provide limited support for the statements made by the charter holder in the financial performance response.	The financial performance response does not address the measure or only restates the sentence from the table found in the "Financial Performance Response" section of Appendix C or similar information.

Appendix D

Definition of Terms

AUDIT – A systematic collection of the sufficient, competent evidential matter needed to attest to the fairness of management's assertions in the financial statements or to evaluate whether management has efficiently and effectively carried out its responsibilities. The auditor obtains this evidential matter through inspection, observation, inquiries, and confirmations with third parties.

AUDIT REPORTING PACKAGE – The annual audit required by A.R.S. §15-914 includes several components, including the financial statements, a report on internal control and compliance required under auditing standards, the applicable compliance questionnaire(s), and the management letter, if one is issued by the audit firm. For a charter holder that expends more than $500,000 in federal awards (e.g., federal grants), the audit reporting package submitted would include additional information and documents.

COMPLIANCE QUESTIONNAIRE – As part of the annual audit required by A.R.S. §15-914, the auditor must complete the appropriate compliance questionnaire(s). The compliance questionnaires assist the Board in determining whether a charter holder is complying with certain legal and contractual requirements. The Board currently issues three compliance questionnaires – the Legal Compliance Questionnaire, the USFRCS Compliance Questionnaire[1], and the Procurement Compliance Questionnaire. For most charter holders, the Legal Compliance Questionnaire is the only compliance questionnaire that must be completed.

FINANCIAL AUDIT – An audit made by an independent external auditor for the purpose of issuing an audit opinion on the fair presentation of the financial statements in conformity with GAAP. Refer to AUDIT.

FISCAL YEAR – The twelve-month period that begins on July 1st and ends on June 30th.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) – These are the uniform minimum standards for financial accounting and reporting. They govern the form and content of the financial statements of an entity. GAAP encompass the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. They include not only broad guidelines of general application, but also detailed practices and procedures. The primary authoritative body on the application of GAAP for most charter holders is the Financial Accounting Standards Board.

NOTES TO THE AUDITED FINANCIAL STATEMENTS – Sometimes referred to as disclosure notes, the notes follow immediately after the financial statements. In addition to summarizing certain accounting policies used by the charter holder, the financial statements may include information regarding leases the charter holder has entered into, loans the charter holder has received (sometimes referred to as “notes”) and its compliance with loan terms, and restrictions on the charter holder’s cash.

STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS – This financial statement shows what made up the charter holder’s revenue and expenses for the fiscal year. Generally, revenue is shown by type and expenses are shown by program type (i.e., program services, management and general). This statement also shows whether a charter holder operated at a surplus (total revenues exceed total expenses) or a deficit (total expenses exceed total revenues), as well as the change in net assets. This statement is also referred to as the income statement (for-profit) or the statement of activities (governmental).

STATEMENT OF CASH FLOWS – This financial statement shows where the charter holder’s cash came from and how the cash was used during the fiscal year. It categorizes cash activity as resulting from operating, investing, and capital and related financing activities.

[1] USFRCS stands for Uniform System of Financial Records for Charter Schools.

STATEMENT OF FINANCIAL POSITION – This financial statement shows the charter holder's assets, liabilities, and net assets as of June 30th. Assets are what the charter holder owns, liabilities are what the charter holder owes, and net assets are the difference between the two. Net assets represent any surpluses (total assets exceed total liabilities) or deficits (total liabilities exceed total assets) that have accumulated since the charter holder was formed. This statement is also referred to as the balance sheet (for-profit) or the statement of net assets (governmental).

STATEMENT OF FUNCTIONAL EXPENSE – This financial statement shows a detailed breakdown of expenses by expense type and by program and supporting services. While not required for charter holder audits, some audit reporting packages received by the Board include this additional statement.