Financial Performance Framework Recommended Revisions

The Financial Performance Framework (FPF) has four near-term and four long-term financial measures used to help measure the financial stability of SPCSA sponsored charter schools. The current version of the Financial Performance Framework was adopted in October 2017.

This set of recommended revisions was developed to improve the effectiveness and efficiency of the measurement system and to consider the nuances of schools at different stages of their lifecycle. They were also designed to address key questions related to financial oversight of public charter schools:

1. Are best practices being followed?
2. What is the financial health of the school?
3. Is there integrity and fidelity in what is being reported to the board?

The recommendations are the culmination of best practices from national financial experts and practitioners in lending and investment markets, from the National Association of Charter School Authorizer Core Performance Framework guidance[1] and from school leaders within the SPCSA portfolio.

PROPOSED FPF RECOMMENDED REVISIONS

General Recommended Revisions

Staff recommends using accrual-based accounting financial statements for measuring financial performance of the SPCSA charter schools.

To accomplish this, staff recommends:

- Continuing to use the audited financial statements but focusing on measurements using financial information which may be found in the Government-Wide statements (sometimes called School-Wide statements). The two key documents would be the Statement of Net Position and the Statement of Activities. Both of these statements are prepared using accrual-based accounting. To further accomplish this, Staff is reviewing various Government-Wide financial statements in order to establish minimum line items to appear in the Government-Wide statements.

- Referring to the Fund Financial Statements, which are based on modified accrual accounting, along with the Management's Discussion and Analysis as needed.

- Monitoring school financial performance throughout the year by reviewing and analyzing charter school quarterly financial statements.

- Preparing, publishing and updating a Frequently Asked Question (FAQ) document to provide consistent written clarification to schools regarding the FPF.

[1] See page 45,Sources https://www.qualitycharters.org/wp-content/uploads/2016/01/CorePerformanceFrameworkAndGuidance.pdf

- Updating the Financial Performance Framework Workbook to reflect all changes approved by the board. Updates would include the names of primary measuring source documents to reflect the recommended revisions.

Specific Recommended Revisions

Indicator 1: Near Term Measures

Near Term Measure 1 – Current Ratio

A. **Purpose**: To measure whether a school has enough current resources to pay its current debts.
B. **Metric (Formula)**: Current Ratio (CR) = current assets / current liabilities.
C. **Recommendation**: No changes

Near Term Measure 2 – Unrestricted Days Cash-on-Hand Ratio

A. **Purpose**: To measure how many days a school can pay its operating expenses without requiring an additional inflow of cash.
B. **Metric**:
   1. Unrestricted Days Cash-On-Hand (DCOH) = (Unrestricted Cash + Equivalents) / Average Daily Expense.
   2. The Average Daily Expense = (Annual Expense – Annual Depreciation – Annual Amortization) / 365 Days
   3. Restricted Cash is cash the use of which is restricted by federal or statutory law or by regulations or by a contract enforceable by a non-school party.
C. **Recommendation**: Change Meets Standard rating threshold
   1. Change: Add the following exceptions—only for schools not showing an operating deficit—to change DCOH targets (thresholds). Schools showing operating deficits will be held to the 60-day standard.
   2. From: 60 days for all years
   3. To: Year 1 schools: 15 days; Year 2 schools: 30 days; Year 3+ schools: 60 days.
D. **Recommendation:** Change Meets Standard rating threshold
   1. Change from: "Between 30 and 60 days of cash and one-year trend is positive."
   2. To: "Between 30 and 60 days of cash and one-year trend is positive, unless supporting documentation indicated UDCOH may decline during the year in question due to an approved budget use of cash—only for schools not showing an operating deficit."
E. **Recommendation:** Confirm need to show Unrestricted Cash line item and amounts to ensure accuracy, as opposed to using one Cash line item which may not include Unrestricted Cash.

Near Term Measure 3 – Enrollment Forecast Accuracy

A. **Purpose**: To measure whether a school is meeting its enrollment projections and thereby generating sufficient revenue to fund ongoing operations.
B. **Metric**:
   a. Actual Enrollment / Projected Enrollment
   b. Actual Enrollment = certified count day numbers
   c. Projected Enrollment = charter school board-approved budgeted enrollment
C. **Recommendation**: Change Meets Standard thresholds

1. Adjust “Meets Standards” measurement thresholds—only for schools not showing an operating deficit—to meet or exceed:
2. Year 1: 90.0% accuracy;
3. Year 2: 92.5% accuracy;
4. Year 3+: 95% accuracy

Near Term Measure 4 – Debt Default

A. **Purpose**: To confirm whether a school is meeting its loan obligations.
B. **Metric**: School is not in default of loan covenant(s) and is not delinquent with debt service payments.
C. **Recommendation:** No changes

Indicator 2: Sustainability Measures

Sustainability Measure 1 – Total Margin

A. **Purpose**: To measure the operating surplus (or deficit) a school generates from its total revenues. It indicates whether the school is operating within its available resources.
B. **Metric** (aka Formula(s)):
    1. Total Three Year Total Margin = Total Three-Year Surplus / Total Three Year Revenue
    2. Total Three-Year Surplus = Total Three-Year Revenue - Total Three-Year Expenditures
    3. Current Year Total Margin = Current Year Surplus / Current Year Revenue
    4. Current Year Surplus = Current Year Revenue - Current Year Expenditures
C. **Recommendation**: Change accounting basis of Metrics
   Use the accrual statements (the “Government-Wide” or “School-Wide” statements) when measuring financial performance in this area. No other changes are recommended to the Total Margin measure. This means that the amounts in the Other Financing Sources like Capitalized Expenses which appear on the Fund Financial Statements as modified accrual accounting activity will not impact the financial performance measurements.

Sustainability Measure 2 – Debt to Asset Ratio

A. **Purpose**: To measure the amount of debt a school owes versus the assets they own.
    1. Similar to a Loan-to-Value Ratio.
B. **Metric**: Total Liabilities/ Total Assets
C. **Recommendation**: Amend Metric
    1. From: Total Liabilities/ Total Assets
    2. To: (Total Liabilities – Net Pension Liability)/ Total Assets
    3. Reverse out Net Pension liability from Total non-current liabilities balance as far as the liability is assumed by the State and is not a direct liability of the school.
D. **Recommendation**: Confirm that employer pension contribution expenses are not backed out from the Statement of Activities.

Sustainability Measure 3 – Cash Flow

A. **Purpose**: To measure the growth in a school's cash balance
B. **Metric**:
    1. Multi-Year Cumulative Cash Flow = Year 3 Total Cash – Year 1 Total Cash
    2. One Year Cash Flow = Year 2 Total Cash – Year 1 Total Cash
C. **Recommendations:** Amend Target
    1. A rating within this section may be adjusted for large capital investments—only for schools not showing an operating deficit.
    2. For schools in their first or second year of operation, the term "multi-year cumulative cash flow" refers to the "cumulative cash flow."

Sustainability Measure 4 – Debt Service Coverage Ratio

A. **Purpose**: To measure a school's ability to cover its debt obligations.
B. **Metric**:
    1. Debt Service Coverage Ratio = Applicable Cashflow / Debt Service
    2. Applicable Cashflow = Net Income + Interest Expense + Depreciation + Amortization
    3. Debt Service = Principal Payments + Interest Payments
C. **Recommendation**: Amend Measure and Metric
   Add a facility Lease Service Coverage Ratio (LSCR) for schools leasing campuses or facilities and for schools leasing some facilities or some campuses while also having facility debt on other campuses. Schools with only facility debt will still be measured using the Debt Service Coverage Ratio. Purpose: To measure the growth in a school's cash balance.
D. **Recommendation**: Amend narrative
    a. From: "Depreciation expense is added back to the net income because it is a non-cash transaction and does not actually cost the school money."
    b. To: "Depreciation expense and Amortization are added back to the net income because they are non-cash transactions."