WASHINGTON STATE
Charter School Commission
STUDENTS • INNOVATION • TRANSPARENCY

FINANCIAL PERFORMANCE FRAMEWORK

Introduction

The Washington State Charter School Commission (Commission) collaborated with NACSA, in partnership with CliftonLarsonAllen (CLA), in the development of the Commission's Financial Performance Framework (FPF). The starting point for the draft was NACSA's Core Financial Performance Framework (Core FPF), which is based on best practices in charter school and non-profit finance. NACSA reviewed publically available information related to Washington State charter law to determine if any of the measures in NACSA's Core FPF would need to be modified given Washington's legislative, political, and financial charter school environment. Some of the information reviewed includes:

- Publically available information from the Washington State Board of Education www.sbe.wa.gov/charters.php
- Publically available information from the Washington State Charter School Association www.wacharter.org
- Publically available information from the Washington State Governor's Office www.governor.wa.gov/issues/education/commission/
- Initiative 1240
- Spokane Public Schools Authorizer Application

The Washington charter law states that authorizers must develop and follow chartering policies and practices that are consistent with the principles and standards for quality charter authorizing developed by NACSA (WAC 180-19-030 (3)(b)(iii), Chapter 28A.710 RCW).

Why a Financial Framework

The Financial Performance Framework is a reporting tool that provides the Commission with the necessary data to assess the financial health and viability of charter schools in its portfolio for the purposes of an annual review. The framework summarizes a charter school's financial health while taking into account the school's financial trends over a period of three years. The measures are designed to be complementary. No single measure gives a full picture of the financial situation of a school. Taken together, however, the measures provide a comprehensive assessment of the school's financial health and viability based on a school's historic trends, near-term financial situation, and future viability.

One of the Commission's core responsibilities with respect to charter schools is to protect the public interest. The Financial Framework is the primary lever for carrying out this responsibility with respect to the allocation of public funds to charter schools. The indicators for the financial framework are as follows.

1.a Current Ratio (Near-Term)
1.b Unrestricted Days Cash (Near-Term)
1.c Debt Default (Near-Term)
2.a Total Margin (Sustainability)
2.b Debt to Asset Ratio (Sustainability)
2.c Cash Flow (Sustainability)
Enrollment Variance (Informational)

For each of the measures, targets are based on authorizer best practices, industry standards, and ratios that reflect the financial health of the school. The Commission will use data from the year-end audited financial statements for each school along with current financial data gathered through quarterly financial reports to calculate each measure. In order to depict the overall financial health of the school, these calculations are based on all funds of the school (not just the general fund).

The Commission believes that the life stage of a school should be taken into considerations when reviewing the financial viability of schools. Therefore, a number of the financial measures have two sets of targets. One set for schools in year 1 or 2 of operation and one set for schools in year 3 or beyond.

Ratings

The Financial Framework ratings are either Meets Standard, or Does Not Meet Standard (WAC 108-30-030). The Commission will consider any relevant context for the school's financial position that informs the causes for any perceived financial shortcomings. Appropriate monitoring and /or intervention will be determined, in part, by how the rating on the measure in question fits within the school's overall financial performance based on all evidence examined.

Meets Standard

A Meets rating indicates sound financial viability based on the overall financial record. The school may have already met the absolute Financial Performance Framework standard based on the financials under review, or, any concerns have been adequately addressed based on additional information such that the Commission concludes that performance indicates sound financial viability.

Does Not Meet Standard

A Does Not Meet rating means that even based on the most current financial information (recent audited financials and more current unaudited financials), the school is not currently meeting the standard, and/or concerns previously identified and of heightened monitoring and/or intervention have not been adequately corrected and/or, if not currently manifested, have been of a depth or duration that warrants continued attention. A Does Not Meet rating indicates that upon evidence from the performance framework, quarterly reports, notice of concerns, and investigation and review, the Commission identifies significant financial risk such that heightened monitoring and/or intervention are warranted. Appropriate monitoring and or interventions will be determined on a case by case basis, and, in part, by how the rating on the standard in question fits within the school's overall performance on the financial framework.

The overall final rating of a school will document the Commission's assessment of the school's financial viability based on cumulative evidence from the quarterly reviews, State Auditor and independent audits, annual budgets, cash on hand, the performance framework, and/or more detailed examination of the school's financial position, as needed.

Additionally, while the Commission provides oversight to charter schools, many of the state and federal fiscal accountability and reporting requirements will be monitored and/or audited by the Office of the Superintendent of Public Instruction (OSPI) and State Auditor's Office (SAO) program staff. Charter schools will be required to submit to the Commission, OSPI, SAO program review and audit reports, and independent audit reports, so that all agencies may work in collaboration regarding state and federal compliance.

There are a number of ways for the Commission to collect data to evaluate a charter school's financial viability and to determine what rating a school deserves on any given measure as well as a rating for the framework as a whole. The Commission is in the process of developing approaches that are most appropriate for evaluating each section of the Financial Performance Framework based on the Commission's values, capacity, Washington environment, and collaborative efforts with OSPI and the SAO. See the following resources for assistance in meeting appropriate reporting and financial viability obligations.

- Commission Reporting Calendar
- Commission Charter Tools Online Reporting System
- Commission Quality Assurance Ladder of Concern
- Commission on-site Charter School Site Visit Guide
- OSPI website at: k12.wa.us
- SAO website at : http://www.sao.wa.gov

Measures

1. a. Current Ratio – Near Term Indicator

***Definition**: The current ratio depicts the relationship between a school's current assets and current liabilities.*

Overview: The current ratio measures a school's ability to pay its obligations over the next twelve months. A current ratio of greater than 1.0 indicates that the school's current assets exceed its current liabilities, thus indicating ability to meet current obligations. A ratio of less than 1.0 indicates that the school does not have sufficient current assets to cover the current liabilities and is not in a satisfactory position to meet its financial obligations over the next 12 months.

Source of Data: Audited balance sheet

<table>
<tr><th colspan="2">Near Term</th></tr>
<tr><th colspan="2">1.a. Current Ratio:

Current Assets divided by Current Liabilities</th></tr>
<tr><th colspan="2">Rating</th></tr>
<tr><td>Meets:
☐ Stage 1 (Years 1-2): Current Ratio is greater than or equal to 1.0
☐ Stage 2 (Year 3 and beyond): Current Ratio is greater than or equal to 1.1
Or,
☐ Current Ratio is between 1.0 and 1.1 and one-year trend is positive (current year ratio is higher than last year's)
Or,
Stages 1 and 2: Any concerns have been adequately addressed based on additional information such that the Commission concludes that performance against the standard indicates sound financial viability.</td><td>Does Not Meet:
☐ Stages 1 and 2: Upon evidence from the performance framework, quarterly reports, notice of concerns, and investigation and review, the Commission identifies significant financial risk such that heightened monitoring and/or intervention are warranted.</td></tr>
</table>

Guidelines for Target Level and Ratings: The general rule of thumb for a current ratio is that it should be a minimum of 1.0. An upward trend of a current ratio that is greater than 1.0 indicates greater financial health, hence the greater than or equal to 1.1 to meet standard. A current ratio less than 0.9 is a serious financial health risk, based on common standards.

1. b. Unrestricted Days Cash – Near Term Indicator

Definition: *The unrestricted days cash on hand ratio indicates how many days a school can pay its expenses without another inflow of cash.*

Overview: The unrestricted days cash ratio indicates whether or not the school has sufficient cash to meet its cash obligations. Depreciation expense is removed from the total expenses denominator because it is not a cash expense.

Source of Data: Audited balance sheet and income statement. Note that if cash is restricted due to legislative requirements, donor restrictions, or others, the restriction should be listed in the audit.

Near Term	
1.b. Unrestricted Days Cash: **Unrestricted Cash divided by ((Total Expenses- Depreciation Expense)/365)**	
Rating	
Meets: ☐ **Stage 1 (Years 1-2): 30 Days Cash** ☐ **Stage 2 (Year 3 and beyond): 60 Days Cash** **or** ☐ **Between 30 and 60 Days Cash *and* one-year trend is positive** **Or,** **Stages 1 and 2: Any concerns have been adequately addressed based on additional information such that the Commission concludes that performance against the standard indicates sound financial viability.**	***Does Not Meet:*** ☐ **Stages 1 and 2: Upon evidence from the performance framework, quarterly reports, notice of concerns, and investigation and review, the Commission identifies significant financial risk such that heightened monitoring and/or intervention are warranted.**

Guidelines for Target Level and Ratings: At least one month's of operating expenses cash on hand is a standard minimum measure of financial health of any organization. Due to the nature of charter school cash flow and the sometimes irregular receipts of revenue, a 60 day threshold was set for stage-two schools to meet the standard, though schools showing a growing cash balance from prior years and who have enough cash to pay at least one month's expenses are also financially stable enough and show positive trending, therefore meeting standard. If a school has less than 15 days of cash on hand, they will not be able to operate for more than a few weeks without another cash inflow, and are at high risk for immediate financial difficulties.

1. c. Debt Default – Near Term Indicator

Definition*: Debt default indicates if a school is not meeting debt obligations or covenants.*

Overview: This metric addresses whether or not a school is meeting its loan covenants and/or is delinquent with its debt service payments. Additionally, a school that is holding employee 403b contributions to aid cash flow could be considered in default. A school that cannot meet the terms of its loan may be in financial distress. Dependent on the debt environment, the Commission may consider a school in default only when it is not making payments on its debt, or when it is out of compliance with other requirements in its debt covenants. The Commission will have to monitor the debt environment to determine if violations of debt covenants should be considered qualifications for falling below or far below standards.

Source of Data: Notes to the audited financial statements

Near Term	
1. d. Default	
Rating	
Meets: ☐ **Stages 1 and 2: School is not in default of loan covenant(s) and/or is not delinquent with debt service** **Or,** **Stages 1 and 2: Any concerns have been adequately addressed based on additional information such that the Commission concludes that performance against the standard indicates sound financial viability.**	***Does Not Meet:*** ☐ **Stages 1 and 2: Upon evidence from the performance framework, quarterly reports, notice of concerns, and investigation and review, the Commission identifies significant financial risk such that heightened monitoring and/or intervention are warranted.**

Guidelines for Target Level and Ratings: Schools that are not meeting financial obligations, either through missed payments or violations of debt covenants, are at risk of financial distress.

2. a. Total Margin and Aggregated Three-year Total Margin – Sustainability Indicator

Definition: *Total margin measures the deficit or surplus a school yields out of its total revenues; in other words, whether or not the school is living within its available resources.*

Overview: The total margin measures if a school operates at a surplus (more total revenues than expenses) or a deficit (more total expenses than revenues) in a given time period. The total margin is important to track as schools cannot operate at deficits for a sustained period of time without risk of closure. Though the intent of a school is not to make money, it is important for charters to build, rather than deplete, a reserve to support growth or sustain the school in an uncertain funding environment.

The aggregated three-year total margin is helpful for measuring the long-term financial stability of the school by smoothing the impact of single-year fluctuations on the single year total margin indicator. The performance of the school in the most recent year, however, is indicative of the sustainability of the school, thus the school must have a positive total margin in the most recent year to meet standard.

Source of Data: Three years of audited income statements

<table>
<tr><td colspan="2">Sustainability</td></tr>
<tr><td colspan="2">2.a. Total Margin: Net Income divided by Total Revenue

Aggregated Total Margin: Total 3 Year Net Income divided by Total 3 Year Revenues</td></tr>
<tr><td colspan="2" align="center">Rating</td></tr>
<tr><td>Meets:
☐ Stage 1 (Years 1-2): Total Margin must be positive in both years
☐ Stage 2 (Year 3 and beyond): Aggregated Three-Year Total Margin is positive and the most recent year Total Margin is positive,
Or,
☐ Aggregated Three-Year Total Margin is greater than -1.5%, the trend is positive for the last two years, and the most recent Total Margin is positive
Or,
Stages 1 and 2: Any concerns have been adequately addressed based on additional information such that the Commission concludes that performance against the standard indicates sound financial viability.</td><td>Does Not Meet:
☐ Stages 1 and 2: Upon evidence from the performance framework, quarterly reports, notice of concerns, and investigation and review, the Commission identifies significant financial risk such that heightened monitoring and/or intervention are warranted.</td></tr>
</table>

Guidelines for Target Level and Ratings: General preference in any industry is that total margin is positive, but organizations can make strategic choices to operate at a deficit for a year for a large capital expenditure or other planned expense. The targets set allow for flexibility over a three-year timeframe in the aggregate total margin, but require a positive total margin for the current year to meet standard. A margin in any year of less than -10 percent or an aggregate three-year total margin less than -1.5 percent is an indicator of financial risk.

2. b. Debt to Asset Ratio – Sustainability Indicator

Definition: *The debt to asset ratio measures the amount of liabilities a school owes versus the assets they own; in other words, it measures the extent to which the school relies on borrowed funds to finance its operations.*

Overview: The debt to asset ratio compares the school's liabilities to its assets. Simply put, the ratio demonstrates what a school owes against what it owns. A lower debt to asset ratio generally indicates stronger financial health.

Source of Data: Audited balance sheet

Sustainability	
2.b. Debt to Asset Ratio: **Total Liabilities divided by Total Assets**	
Rating	
Meets: **☐ Stages 1 and 2: Debt to Asset Ratio is less than 0.90** **Or,** **Stages 1 and 2: Any concerns have been adequately addressed based on additional information such that the Commission concludes that performance against the standard indicates sound financial viability.**	***Does Not Meet:*** **☐ Stages 1 and 2: Upon evidence from the performance framework, quarterly reports, notice of concerns, and investigation and review, the Commission identifies significant financial risk such that heightened monitoring and/or intervention are warranted.**

Guidelines for Target Level and Ratings: A debt to asset ratio greater than 1.0 is a generally accepted indicator of potential long-term financial issues, as the organization owes more than it owns, reflecting a risky financial position. A ratio less than 0.9 indicate a financially healthy balance sheet, both in the assets and liabilities, and the implied balance in the equity account.

2. c. Cash Flow – Sustainability Indicator

Definition: *The cash flow measure indicates a school's change in cash balance from one period to another.*

Overview: Cash flow indicates the trend in the school's cash balance over a period of time. This measure is similar to days cash on hand, but indicates long-term stability versus near-term. Since cash flow fluctuations from year to year can have a long-term impact on a school's financial health, this metric assesses both three-year cumulative cash flow and annual cash flow. Similar to total margin, this measure is not intended to encourage amassing resources instead of deploying them to meet the mission of the organizations, but rather to provide for stability in an uncertain funding environment.

Source of Data: Three years of audited balance sheets

Sustainability	
2.c. Cash Flow **Multi-Year Cash Flow = (Year 3 Total Cash) - (Year 1 Total Cash)** **One Year Cash Flow = (Year 2 Total cash) - (Year 1 Total Cash)**	
Rating	
Meets: ☐ **Stage 1 (Year 1): N/A** ☐ **Stage 1 (Year 2): Positive one-year Cash Flow** ☐ **Stage 2 (Year 3 and beyond): Multi-Year Cumulative Cash Flow is positive *and* Cash Flow is positive each year,** **Or,** ☐ **Multi-Year and most recent year Cash Flows are positive** **Or,** **Stages 1 and 2: Any concerns have been adequately addressed based on additional information such that the Commission concludes that performance against the standard indicates sound financial viability.**	***Does Not Meet:*** ☐ **Stages 1 and 2: Upon evidence from the performance framework, quarterly reports, notice of concerns, and investigation and review, the Commission identifies significant financial risk such that heightened monitoring and/or intervention are warranted.**

Guidelines for Target Level and Ratings: A positive cash flow over time generally indicates increasing financial health and sustainability of a charter school.

Enrollment Variance – Near Term Indicator

NOTE: This measure is informational only.

Definition: *Enrollment variance indicates whether or not the school is meeting its enrollment projections. As enrollment is a key (often* the *key) driver of revenue, variance is important to track the sufficiency of revenues generated to fund ongoing operations.*

Overview: The enrollment variance depicts actual versus projected enrollment. A school budgets based on projected enrollment but is funded based on actual enrollment; therefore, a school that fails to meet its enrollment targets may not be able to meet its budgeted expenses. Though enrollment is not the singular driver of revenues for a school, it is highly correlated at a minimum. As school budgets are generally designed to match expenses with projected revenues, a poor enrollment variance is a substantial indicator of potential financial issues. It is critical to capture this information as early in the school year as possible to determine whether you may need to take action or intervene in some way.

Schools less than five years old may have greater fluctuations in their enrollment because they have not yet established themselves in the community. However, mature schools with large, unexplained fluctuations in enrollment may be in financial distress if they are not able to adjust accordingly. Often, financially stable schools will purposefully underestimate enrollment so that they may budget more conservatively.

Many authorizers in the field use enrollment variance as a way to not only evaluate a charter school's financial health, but also to monitor how savvy the school's board and management are at forecasting. Thus, while enrollment variance is a primary measure of financial health, it can also be seen as a secondary measure for organizational aptitude.

Source of Data:

- Projected enrollment – Charter school board-approved budget for the year in question
- Actual enrollment

Near Term	
Enrollment Variance: **Actual Enrollment divided by Enrollment Projection in Charter School Board-Approved Budget**	
Rating	
Meets: ☐ **Stage 1 and 2: Enrollment Variance equals or exceeds 95%** **Or,** **Stages 1 and 2: Any concerns have been adequately addressed based on additional information such that the Commission concludes that performance against the standard indicates sound financial viability.**	***Does Not Meet:*** ☐ **Stages 1 and 2: Upon evidence from the performance framework, quarterly reports, notice of concerns, and investigation and review, the Commission identifies significant financial risk such that heightened monitoring and/or intervention are warranted.**

Guidelines for Target Level and Ratings: Enrollment variance less than 85 percent indicates that a significant amount of funding on which a school set its expense budget is no longer available, and thus the school is at a significant financial risk. Schools that achieve at least 95 percent of projected enrollment generally have the operating funds necessary to meet all expenses, and thus are not at a significant risk of financial distress.

Follow-Up/Additional Information that the Commission may Request

Measure	Additional Information to Request	Look For
1.a Current Ratio	Monthly financial statements	Monthly current ratio trending upwards
1.b Days Cash	Actual to-date cash flow and cash flow projections through the end of the fiscal year. Monthly financial statements	Increases in unrestricted cash and days cash on hand approaching the target *Note: It is important to review the cash flow monthly due to irregular funding streams*
1.c Debt Default	Copies of default-related documents the school received from the lender	Proof that the school is no longer in default, the lender has waived covenants, or the school has a plan to meet the covenants
2.a Total Margin	Revised budget Monthly (new) budget variance report	Budget demonstrates a net surplus and few, if any, variances are present
2.b Debt to Asset Ratio	Action plan and updated budget to increase the school's Net Assets Monthly financial statements	Monthly debt to asset ratio trending upwards Alignment among the action plan, budget, and financial statements
2.c Cash Flow	Actual to-date cash flow and cash flow projections through the end of the fiscal year	Increases in cash balance over the course of the year
Enrollment Variance	Budget revised to reflect lower enrollment Monthly (new) budget variance reports	Budget demonstrates a net surplus and few, if any, variances are present *Note: Review that the school has adjusted staffing expenses to align with enrollment*