Charter School Performance Standards Financial Performance & Sustainability

Introduction

The Utah State Charter School Board's (Board) *Charter School Performance Standards* (CSPS): *Financial Performance & Sustainability* is intended as tool for charter school governing boards to evaluate their financial performance, as well as a tool for the Board to meet its statutory obligation of ongoing monitoring. Charter school governing boards have the autonomy to manage school finances consistent with state and federal law; however, the Board must ensure that the schools it authorizes are financially stable. The *CSPS Financial Performance & Sustainability* provides charter schools and the Board tools to recognize schools currently in or trending towards financial difficulty and to more proactively evaluate or address the problem. The *CSPS* was derived through a review of NACSA's Core Performance Framework and Guidance document, and discussions with charter school business administrators, USOE personnel, and others with expertise in the field. While the *CSPS* does not specifically mirror any single source, it was created to provide a clear picture of a school's past financial performance, current financial health, and potential financial trajectory.

Performance Measures Structure

The *CSPS Financial Performance & Sustainability* gauges both near-term financial health and longer-term financial sustainability. The *CSPS* includes five main levels of information: Indicators, Measures, Metrics, Targets, and Ratings.

Indicators

The *CSPS Financial Performance & Sustainability* include two indicators, or general categories, used to evaluate charter schools' financial performance.

1. Near-Term : The portion of the standards that tests a school's near-term financial health is designed to depict the school's financial position and viability in the upcoming year. Schools meeting the desired standards demonstrate a low risk of financial distress in the coming year. Schools that fail to meet the standards may currently be experiencing financial difficulties and/or are at high risk for financial hardship in the near term.

2. Sustainability : The standards also include longer-term financial sustainability measures and are designed to depict a school's financial position and viability over time. Schools that meet the desired standards demonstrate a low risk of financial distress in the future. Schools that fail to meet the standards may be at high risk for financial hardship in the future.

Each indicator has measures, metrics, targets, and ratings.

Measures

Measures are the means to evaluate an aspect of an indicator. Seven measures are used in the standards: Current Ratio, Unrestricted Days Cash, Enrollment Variance, Total Margin, Debt to Asset Ratio, Cash Flow, and Debt Service Coverage Ratio.

Metrics

Metrics are the methods for quantifying a measure.

Targets

Targets are the thresholds that signify success for a specific measure. The basis for forming many of the targets is industry standard, which is the commonly accepted target level for the ratio in financial analysis. Differences in the Utah charter school financing and funding environment have been considered and included in alterations from industry standard, where necessary.

Ratings

For each measure a school receives one of four ratings based on evaluation of the established metrics.

Exceeds Standard: The school's performance on this measure does not signal a financial risk and exceeds the State Charter School Board's standard. A school that exceeds the standard based on an initial review requires no follow-up action.

Meets Standard: The school's performance on this measure does not signal a financial risk and meets the State Charter School Board's standard. A school that meets the standard based on an initial review requires no follow-up action.

Does Not Meet Standard: The school's performance on this measure signals a potential financial risk and does not meet the State Charter School Board's expectation. If a school does not meet standards based on an initial review of the school's financials, the State Charter School Board will follow up to determine if the school is truly a financial risk. Schools that are a financial risk based on an underlying structural problem with the school's financial performance, as compared to a one-time event, will be placed on Warning Status consistent with R277-481. Schools that do not meet the standard across more than one measure may be placed on Probation Status.

Falls Far Below Standard: The school's performance on this measure signals a significant financial risk and does not meet the State Charter School Board's expectation. If a school falls far below standards based on an initial review of the school's financials, the State Charter School Board will follow up to determine the severity of the risk. Schools that are a significant financial risk based on an underlying structural problem with the school's financial performance, as compared to a one-time event, will be placed on Probation Status consistent with R277-481.

The *CSPS Financial Performance & Sustainability* is designed to be a stand-alone document that clearly identifies each school's financial standing in the context of the seven measures. However, if a school receives an initial "Does Not Meet Standard" or "Falls Far Below Standard" rating on any one measure, it may or may not be in financial distress. The *CSPS Financial Performance & Sustainability* is meant to flag potential problem areas for further investigation.

Collecting Evidence

The *CSPS Financial Performance & Sustainability* is a monitoring tool that provides the Board with key data to assess the financial health and viability of a charter school and to determine whether deeper analysis or monitoring is required. The *CSPS Financial Performance & Sustainability* summarizes a charter school's current financial health while taking into account the school's financial trends over a period of three years. The measures are designed to be complementary, as no single measure gives a full picture of the financial situation of a school. Together they provide a comprehensive assessment of the school's financial health based on a school's historic trends, near term financial situation, and future viability.

Data Sources

- Audited statement of financial position
- Audited statement of activities
- Audited statement of cash flows
- Annual Financial Report
- Notes to the audited financial statements
- Charter school governing board-approved budget with enrollment targets
- Fall enrollment information (Oct. 1 count)
- Annual debt schedule indicating the total principal and interest due (provided by the school)

Indicator – Financial performance and sustainability		
Measure	**Metric**	**Standard**
Unrestricted days cash	(Unrestricted cash ÷ (Total Annual Operating Expenses – Depreciation Expense)) / 365	30 days with a positive trend
Current ratio	Current Assets / Current Liabilities	1.0 with a positive trend
Enrollment variance	Oct. 1 enrollment ÷ Budgeted enrollment (projection)	95%
Debt to asset ratio	Total Liabilities / (Total Assets – Depreciation Expense)	≤ 0.9
Debt service coverage ratio	(Net Income + Depreciation + Interest Expense) ÷ (Annual Principal, Interest, and Lease Payments)	1.1
Cash flow (multi-year)	Average of (Current FY Total Cash - Prior FY Total Cash) and (Prior FY Total Cash - 2 Prior FY Total Cash)	Positive
Total margin (aggregated 3 year)	Net Income / Total Revenue	Positive
Occupancy Costs	((Total Operation and Maintenance Costs "2600" – Property Costs "700") + Debt Services) / Total Operating Revenues	28%

Measures in Detail

Each of the measures included in the *CSPS Financial Performance & Sustainability* are described in the following pages. It is important to note that the framework excludes measures of how a school manages and expends its funds, as the framework is not designed to evaluate a school's spending decisions. The measures focus on the overall expenses of a school versus the offsetting revenues. In addition, this framework does not include indicators of strong financial management practices, which are laid out in the *CSPS Governing Board Performance & Stewardship*. The *CSPS Financial Performance & Sustainability* analyzes the financial performance of a charter school, not its processes for managing that performance.

Indicator 1: Near-Term Measures

- Current Ratio
- Unrestricted Days Cash
- Enrollment Variance

Unrestricted Days Cash

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

The unrestricted days cash ratio tells 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.

Data source

- Audited statement of financial position. Note that if cash is restricted due to legislative requirements, donor restrictions, or other reasons, the restriction should be listed in the audit.

Basis for target level
At least one month 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, a 60-day threshold was set for schools to meet the standard. Schools showing a growing cash balance from prior years, and who have enough cash to pay at least one month's expenses, also meet the standard. If a school has fewer than 15 days of cash on hand, it will not be able to operate for more than a few weeks without another cash inflow and is at high risk for immediate financial difficulties.

Measure 1a Unrestricted Days Cash: Unrestricted Cash divided by ([Total Expenses minus Depreciation Expense]/365)
Exceeds Standard: ☐ Days Cash is greater than 60
Meets Standard: ☐ 60 Days Cash Or ☐ Between 30 and 60 Days Cash and one-year trend is positive *Note: Schools in their first or second year of operation must have a minimum of 30 Days Cash*
Does Not Meet Standard: ☐ Days Cash is between 15 – 30 days Or ☐ Days Cash is between 30 – 60 and one-year trend is negative
Falls Far Below Standard: ☐ Fewer than 15 Days Cash

Current Ratio

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

The current ratio measures a school's ability to pay its obligations over the next 12 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.

Data source

- Audited statement of financial position. Note that regardless of what is listed by the auditor as current assets, restricted cash and prepaid expenses are included as current for this metric.

Basis for target level

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 target to meet standard. A current ratio that is less than or equal to 0.9 is a serious financial health risk, based on common standards.

Measure 1b Current Ratio: Current Assets divided by Current Liabilities
Exceeds Standard: ☐ Current ratio is greater than or equal to 1.2
Meets Standard: ☐ 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 (i.e., current year ratio is higher than last year's) *Note: For schools in their first or second year of operation, the current ratio must be greater than or equal to 1.1*
Does Not Meet Standard: ☐ Current ratio is between 0.9 and 1.0 or equals 1.0 Or ☐ Current ratio is between 1.0 and 1.1 and one-year trend is negative (i.e., current year ratio is lower than last year's)
Falls Far Below Standard: ☐ Current ratio is less than or equal to 0.9

Enrollment Variance

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

Data source

- Projected enrollment (Charter school governing board-approved enrollment budget for the year in question)
- Actual enrollment (fall enrollment information – Oct. 1 counts)

Basis for target level
Enrollment variance of 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.

Measure 1c Enrollment Variance: Actual Enrollment divided by Enrollment Projection in Charter School Governing Board-Approved Budget
Exceeds Standard: ☐ Enrollment Variance equals or exceeds 100 percent in the most recent year
Meets Standard: ☐ Enrollment Variance is between 95 – 99 percent in the most recent year
Does Not Meet Standard: ☐ Enrollment Variance is between 85 – 95 percent in the most recent year
Falls Far Below Standard: ☐ Enrollment Variance is less than 85 percent in the most recent year

Indicator 2: Sustainability Measures

- Debt to Asset Ratio
- Debt Service Coverage Ratio
- Cash Flow
- Total Margin and Aggregated Three-Year Total Margin
- Occupancy Costs

Debt to Asset Ratio

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.

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.

Data source
- Audited statement of financial position

Measure 2a Debt to Asset Ratio: Total Liabilities divided by Total Assets less depreciation
Exceeds Standard: ☐ Debt to Asset Ratio is less than 0.8
Meets Standard: ☐ Debt to Asset Ratio is between 0.8 and 0.9
Does Not Meet Standard: ☐ Debt to Asset Ratio is between 0.9 and 1.0
Falls Far Below Standard: ☐ Debt to Asset Ratio is greater than 1.0

Basis for target level
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 indicates a financially healthy balance sheet, both in the assets and liabilities, and the implied balance in the equity account.

Debt Service Coverage Ratio

Definition: The debt service coverage ratio indicates a school's ability to cover its debt obligations in the current year.

This ratio measures whether or not a school can pay the principal and interest due on its debt based on the current year's net income. Depreciation expense is added back to the net income because it is a non-cash transaction and does not actually cost the school money. The interest expense is added back to the net income because it is one of the expenses an entity is trying to pay, which is why it is included in the denominator.

Data source

- Net income: audited statement of activities
- Depreciation expense: audited statement of activities and/or cash flow statement
- Interest expense: audited cash flow statement and/or statement of activities
- Annual principal and interest obligations: provided from the school

Measure 2b Debt Service Coverage Ratio: (Net Income + Depreciation + Interest Expense) / (Annual Principal, Interest, and Lease Payments)
Exceeds Standard: ☐ Debt Service Coverage Ratio is greater than or equal to 1.2
Meets Standard: ☐ Debt Service Coverage Ratio is greater than or equal to 1.1
Does Not Meet Standard: ☐ Debt Service Coverage Ratio is less than 1.1
Falls Far Below Standard: ☐ Not applicable

Cash Flow

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

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 multi-year cumulative cash flow and annual cash flow.

Data source

- Three years of audited statements of financial position

Basis for target level

A positive cash flow over time generally indicates increasing financial health and sustainability of a charter school.

Measure 2c Cash Flow: Multi-Year Cash Flow = Average of Current FY Total Cash - Prior FY Total Cash and Prior FY Total Cash - 2 Prior FY Total Cash One-Year Cash Flow = Current FY Total Cash - Prior FY Total Cash
Exceeds Standard: ☐ Not applicable
Meets Standard: ☐ Multi-Year Cumulative Cash Flow is positive and One-Year Cash Flow is positive *Note: Schools in their first or second year of operation must have a positive cash flow.*
Does Not Meet Standard: ☐ Multi-Year Cumulative Cash Flow is positive, but trend does not "Meet Standard"
Falls Far Below Standard: ☐ Multi-Year Cumulative Cash Flow is negative

Total Margin and Aggregated Three-Year Total Margin

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

The total margin measures whether 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 charter schools 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 the standard.

Data source

- Three years of Audited statements of activities

Basis for target level
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 operating expenditure or other planned expense.

Measure 2d Total Margin: Net Income divided by Total Revenue Aggregated Total Margin: Total Three-Year Net Income divided by Total Three-Year Revenues
Exceeds Standard: ☐ Not applicable
Meets Standard: ☐ 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 percent and the trend is positive for the last two years *Note: For schools in their first or second year of operation, the cumulative Total Margin must be positive*
Does Not Meet Standard: ☐ Aggregated Three-Year Total Margin is greater than -1.5 percent, but does not “Meet Standard”
Falls Far Below Standard: ☐ Aggregated Three-Year Total Margin is less than or equal to -1.5 percent Or ☐ The most recent year Total Margin is less than -10 percent

Occupancy Costs

Definition: Occupancy costs measures the amount an entity is paying, as a percent of total expenditures, for the purchase, operation, *and maintenance* of real estate assets used to accomplish its mission. A percentage that is too high indicates the entity is utilizing too much of its resources to provide and maintain its facilities.

Excessive occupancy costs undermine a school's ability to provide and sustain adequate levels of services to students and support teachers and other requirements of a successful educational program.

Data source

- Total Operation and Maintenance costs (2600), Property under Operation and Maintenance costs (700), total debt services, and total actual revenue from the AFR

Basis for target level
Data ranges for FY2012 and FY2013

Measure 2e Occupancy Costs: Facility Costs less Property plus Debt Services divided by Total Revenue
Exceeds Standard: ☐ Occupancy Costs is less than or equal to 22%
Meets Standard: ☐ Occupancy Costs is less than or equal to 28% and greater than 22%
Does Not Meet Standard: ☐ Occupancy Costs is less than or equal to 32% and greater than 28%
Falls Far Below Standard: ☐ Occupancy Costs is greater than 32%

Glossary

Assets: A probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events. These economic resources can be tangible or intangible.

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.

Basis of Accounting: This refers to the methodology and timing of when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements.

Cash Basis: A basis for accounting whereby revenues are recorded only when received, and expenses are recorded only when paid without regard to the period in which they were earned or incurred.

Current Assets: Resources that are available, or can readily be made available, to meet the cost of operations or to pay current liabilities.

Current Liabilities: Those obligations that are payable within one year from current assets or current resources.

Debt: An obligation resulting from the borrowing of money or from the purchase of goods and services. Debts of the entity include bonds, accounts payable, and other liabilities.

Debt Service: The cash that is required for a particular time period to cover the repayment of interest and principal on a debt. Debt service is often calculated on a yearly basis.

Debt Service Default: Occurs when the borrower has not made a scheduled payment of interest or principal.

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 of the entity in conformity with Generally Accepted Accounting Principles.

Fiscal Period: Any period at the end of which an entity determines its financial position and the results of its operations.

General Fund: The general fund is used to account for the general financial activities of the entity when reporting under governmental accounting. The general fund is used for funds not required to be accounted for in another account.

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 Generally Accepted Accounting Principles (GAAP) to state and local governments is the Governmental Accounting Standards Board.

Interest Payable: A liability account reflecting the amount of interest owed by the entity. In governmental funds, interest is to be recognized as an expenditure in the accounting period in which it becomes due and payable, and the liability is to be recorded as interest payable at that time. In proprietary and trust funds, interest payable is recorded as it accrues, regardless of when payment is actually due.

Interim Financial Statement: A financial statement prepared before the end of the current fiscal period and covering only financial transactions during the period to date.

Liabilities: Probable future sacrifices of economic benefits, arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. The term does not include encumbrances.

Margin: The difference between revenues and expenses. The margin can refer to the gross margin (operating revenues less operating expenses) or the total margin (see Total Margin).

Net Assets: The difference between assets and liabilities.

Net Income: A term used in accounting for proprietary funds to designate the excess of total revenues and operating transfers in divided by total expenses and operating transfers out for an accounting period.

Principal: The amount of the loan excluding any interest.

Statement of Activities: A government-wide financial statement that reports the net (expense) revenue of its individual functions. An objective of using the net (expense) revenue format is to report the relative financial burden of each of the reporting government's functions on its taxpayers.

Statement of Cash Flows: A GAAP financial statement for proprietary funds that provides relevant information about the cash receipts and cash payments of a government during a period. It categorizes cash activity as resulting from operating, noncapital financing, capital financing, and investing activities.

Statement of Activities and Changes in Net Assets: The financial statement that is the GAAP operating statement for pension and investment trust funds. It presents additions and deductions in net assets held for pension benefits and investment pool participants. It reconciles net assets held at the beginning and end of the financial period, explaining the relationship between the operating statement and the balance sheet.

Statement of Net Assets: A government-wide financial statement that reports the difference between assets and liabilities as net assets, not fund balances or equity. Assets are reported in order of liquidity, or how readily they are expected to be converted to cash and whether restrictions limit the government's ability to use the resources. Liabilities are reported based on their maturity, or when cash is expected to be used to liquidate them. Net assets are displayed in three components: invested in capital assets, net of related debt; restricted; and unrestricted.