Financial Performance Framework Guidance Document

Delaware Department of Education

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Financial Performance Framework Guidance

Charter schools have the autonomy to manage their finances consistent with state and federal law; however, authorizers must ensure that the schools they authorize are financially stable. Authorizers, by renewing or not renewing a charter school, determine whether that school is not only academically and operationally sound, but also financially viable. The Financial Performance Framework gauges both near term financial health and longer term financial sustainability.

The portion of the framework 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. These schools may require additional review and immediate corrective action on the part of the Delaware Department of Education (DDOE).

The portion of the framework that tests a school's longer term financial sustainability are designed to depict a school's financial position and viability over time. Schools meeting the desired standards demonstrate a low-risk of financial distress in the future. Schools that fail to meet the standards are at high risk for financial hardship in the future.

The Financial Performance Framework is designed to be a stand-alone document that clearly identifies each school's financial standing in the context of the eight measures.

USING THE FRAMEWORK

Collecting Evidence

Sources. All charter schools are required to submit an independent annual financial audit using accrual-based accounting that provides the following information:

- Audited balance sheet*
- Audited income statement*
- The notes to the audited financial statements
- Authorized enrollment information
- Actual enrollment information
- Annual Debt schedule, indicating the total principal and interest due

*Throughout this document financial statements will be referred to in the common, for profit, nomenclature. Statements reported in nonprofit or governmental audits use the following corresponding names:

Generic (For Profit)	Non Profit	Governmental
Balance Sheet	Statement of Financial Position	Statement of Net Assets
Income Statement	Statement of Activities and Changes in Net Assets	Statement of Activities

Comprehensive Analysis

If a school receives two or more ratings of “Does Not Meet Standard” or one or more ratings of “Falls Far Below Standard” the DDOE will conduct a comprehensive review of the school’s finances.

When a school qualifies for an additional review, it may be either in immediate distress, financially trending negatively, or both. The school also could have made a strategic financial decision that resulted in ratings that qualified them for additional review, but upon additional questioning has sufficient reasons for the financial results in the given year and is not in immediate distress or negative financial trending.

<u>1. NEAR-TERM INDICATORS</u>

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: Statement of Net Position

Near Term
1.a. Current Ratio: **Current Assets divided by Current Liabilities**
❖ ***Meets Standard:*** ☐ **Current Ratio is greater than 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)** **Note: For schools in their first or second year of operation, the current ratio must be greater than 1.1.**
❖ ***Does Not Meet Standard:*** ☐ **Current Ratio is between 0.9 and 1.1** **Or** ☐ **Current Ratio is between 1.0 and 1.1** ***and*** **one-year trend is negative**
❖ ***Falls Far Below Standard:*** ☐ **Current ratio is less than 0.9**

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 tells authorizers whether or not the school has sufficient cash to meet its obligations. This critical measure takes on additional importance in states and localities where the timing of school payments is irregular and/or can be delayed.

Source of Data: Statement of Net Position and Statement of Activities

Near Term
1.b. Unrestricted Days Cash: **Unrestricted Cash divided by (Total Expenses/365)**
❖ ***Meets Standard:*** ☐ **60 Days Cash** **or** ☐ **Between 30 and 60 Days Cash *and* one-year trend is positive** **Note: For schools in their first or second year of operation, they must have a minimum of 30 Days Cash.**
❖ ***Does Not Meet Standard:*** ☐ **Days Cash is between 10 and 30 days** **Or** ☐ **Days Cash is between 30 and 60 days *and* one-year trend is negative**
❖ ***Falls Far Below Standard:*** ☐ **Less than 10 Days Cash**

1.c. Enrollment Variance – Near Term Indicator

Definition: *Enrollment variance tells authorizers whether or not the school is meeting its authorized enrollment, thereby generating sufficient revenue to fund ongoing operations.*

Overview: The enrollment variance depicts actual versus authorized 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. It is critical to capture this information as early in the school year as possible to determine whether an authorizer 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.

Source of Data:

- Authorized enrollment in approved charter
- Actual enrollment

Near Term
1.c. Enrollment Variance: Actual Enrollment divided by Authorized Enrollment
❖ ***Meets Standard:*** ☐ **Enrollment Variance equals or exceeds 95% in the most recent year** **Note: For schools open less than three years, Enrollment Variance must be equal to or exceed 95% for each year of operation.**
❖ ***Does Not Meet Standard:*** ☐ **Enrollment Variance is between 80% and 95% in the most recent year**
❖ ***Falls Far Below Standard:*** ☐ **Enrollment Variance is less than 80% in the most recent year**

1.d. Debt Default – Near Term Indicator

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

Overview: Each authorizer can determine the exact application of this definition. Authorizers 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. This metric addresses whether or not a school is meeting its loan covenants and/or is delinquent with its debt service payments. A school which cannot meet the terms of its loan may be in financial distress.

Source of Data: Notes to the audited financial statements

Near Term
1.d. Default
❖ ***Meets Standard:*** ☐ **School is not in default of loan covenant(s) and/or is not delinquent with debt service payments**
❖ ***Does Not Meet Standard:*** ☐ **Not Applicable**
❖ ***Falls Far Below Standard:*** ☐ **School is in default of loan covenant(s) and/or is delinquent with debt service payments**

2. SUSTAINABILITY INDICATORS

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.

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.

Source of Data: 3 years of audited Statements of Activities

Sustainability
2.a. Total Margin: **Net Income divided by Total Revenue** **Aggregated Total Margin:** **Total 3 Year Net Income divided by Total 3 Year Revenues**
❖ ***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%, the trend is positive for the last two years, *and* the most recent year Total Margin is positive** **Note: For schools open less than three years, the annual Total Margin must be positive.**
❖ ***Does Not Meet Standard:*** ☐ **Aggregated Three-Year Total Margin is greater than -1.5%, but trend does not meet standard**
❖ ***Falls Far Below Standard:*** ☐ **Aggregated Three-Year Total Margin is less than -1.5%** **or** ☐ **Current year Total Margin is less than -10%**

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 Statement of Net Position

Sustainability
2.b. Debt to Asset Ratio: **Total Liabilities divided by Total Assets**
❖ ***Meets Standard:*** ☐ **Debt to Asset Ratio is less than 0.90**
❖ ***Does Not Meet Standard:*** ☐ **Debt to Asset Ratio is between 0.90 and 1.0**
❖ ***Falls Far Below Standard:*** ☐ **Debt to Asset Ratio is greater than 1.0**

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. The preferred result is greater than zero.

Source of Data: 3 years of Statements of Net Position.

Sustainability
2.c. Cash Flow **Three-Year Cash Flow =** $(\boldsymbol{Year\ 3\ Total\ Cash}) - (\boldsymbol{Year\ 1\ Total\ Cash})$ **One-Year Cash Flow =** $(\boldsymbol{Year\ 1\ Total\ Cash}) - (\boldsymbol{Year\ 0\ Total\ Cash})$
❖ ***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** **Note: For schools in their first or second year of operation, they must have positive cash flow.**
❖ ***Does Not Meet Standard:*** ☐ **Three-year cumulative cash flow is positive, but trend does not meet standard**
❖ ***Falls Far Below Standard:*** ☐ **Three year cumulative cash flow is negative**

2.d. Debt Service Coverage Ratio – Sustainability Indicator

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

Overview: 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.

Source of Data:

- Net income: Statement of Activities
- Depreciation expense: notes to the financial statements
- Interest expense: Statement of Revenues, Expenditures and Changes in Fund Balances
- Principal and interest payments: notes to the financial statements

Sustainability
2.d. Debt Service Coverage Ratio: **(Net Income + Depreciation + Interest Expense)/(Principal and Interest Payments)**
❖ ***Meets Standard:*** ☐ **Debt Service Coverage Ratio is equal to or exceeds 1.10**
❖ ***Does Not Meet Standard:*** ☐ **Debt Service Coverage Ratio is less than 1.10**
❖ ***Falls Far Below Standard:*** ☐ **Not applicable**

OVERALL RATING METHODOLOGY

Charter schools will receive an overall rating of "Meets Standard", "Does Not Meet Standard" or "Falls Far Below Standard" based on the following criteria.

❖ Meets Standard

- The school receives a rating of "Meets Standard" on every measure of the Financial Performance Framework.
  OR
- A school receives one or more ratings of "Does Not Meet Standard" and the authorizer's analysis determines that the failure(s) resulted from a strategic financial decision which does not threaten the school's future viability.
  OR
- The school is not in immediate financial distress.

❖ Does Not Meet Standard

- The school is in danger of immediate financial distress.
- The school receives two or more ratings of "Does Not Meet Standard" and the authorizer's analysis determines that the failure(s) threaten the school's future viability.
- The school receives one or more ratings of "Falls Far Below Standard" and the authorizer's analysis determines that the failure(s) threaten the school's future viability.

❖ Falls Far Below Standard

- The school is in immediate financial distress and is trending negatively.
- The school receives two or more ratings of "Falls Far Below Standard" and the authorizer's analysis determines that the failure(s) threaten the school's future viability.

SAMPLE FINANCIAL PERFORMANCE REVIEW REPORT

Delaware Financial Performance Framework Report
ABC Charter School

For each measure, a school receives one of three ratings:

Meets Standard
Does Not Meet Standard
Falls Far Below

Rating targets for each measure may be referenced on the attached Financial Performance Framework.

Each measure is weighted equally with discretion of the Authorizer incorporated to determine an overall rating for the school on Financial Performance. School performance on each measure is presented below.

1. NEAR TERM INDICATORS

Measure 1a. Current Ratio (Working Capital Ratio):

Current Assets divided by Current Liabilities

2010-11	2011-12
2.05	2.34

Measure 1b. Unrestricted Days Cash:

Unrestricted Cash divided by (Total Expenses / 365)

2010-11	2011-12
65	85

Measure 1c. Enrollment Variance:

Actual Enrollment as of September 30 divided by Authorized Enrollment

2010-11	2011-12
92%	97%

Measure 1d. Default

2010-11	2011-12
No	No

2. SUSTAINABILITY INDICATORS

Measure 2a. Total Margin:

Net Income divided by Total Revenue

2010-11	2011-12
4.50%	6.26%

Measure 2b. Debt to Asset Ratio:

Total Liabilities divided by Total Assets

2010-11	2011-12
.50	.38

Measure 2c. Cash Flow

2010-11	2011-12
$129,853	$204,714

Measure 2d. Debt Service Coverage Ratio:

(Net Income + Depreciation + Interest Expense) / (Principal and Interest Payments)

2010-11	2011-12
N/A	N/A

SUMMARY AND OVERALL RATING

ABC Charter School

Year	1.a.	1.b.	1.c.	1.d.	2.a.	2.b.	2.c.	2.d.	OVERALL RATING
10-11	M	M	D	M	M	M	M	NA	M
11-12	M	M	M	M	M	M	M	NA	M