DAVID Y. IGE
GOVERNOR

CATHERINE PAYNE
CHAIRPERSON

STATE OF HAWAII
STATE PUBLIC CHARTER SCHOOL COMMISSION
(ʻAHA KULA HOʻĀMANA)
1111 Bishop Street, Suite 516, Honolulu, Hawaii 96813
Tel: (808) 586-3775 Fax: (808) 586-3776

RECOMMENDATION SUBMITTAL

DATE OF SUBMITTAL: March 17, 2017 ***(updated on March 22, 2017)***

MEETING DATE: March 23, 2017

TO: Catherine Payne, Chairperson
Performance and Accountability Committee

FROM: Sione Thompson, Executive Director

AGENDA ITEM: IV. Presentation and Action on Financial Performance Framework for State Public Charter School Contract, effective July 1, 2017

I. DESCRIPTION

Presentation and action on the Financial Performance Framework ("FPF") for the State Public Charter School Contract ("Contract"), effective July 1, 2017.

II. AUTHORITY

Act 130, Hawai`i Revised Statutes (HRS) Chapter 302D mandates that the State Public Charter School Contract be executed with each charter school and incorporate a performance framework for the schools.

Further, HRS §302D-7(2) states that the financial performance of all operating public charter schools overseen by the Commission, according to the performance expectations for public charter schools are set forth in HRS Charter 302D.

III. BACKGROUND

Thirty-three charter schools entered into its first Charter Contract on November 21, 2013. The second Charter contract became effective on July 1, 2014 and will expire on June 30, 2017. The newest charter school (34th school) was awarded a five-year contract on May 8, 2014.

All Hawai`i's charter schools contracts include a performance framework which the Commission uses to evaluate their performance in three content-specific areas: academic, financial, and organizational. Each framework contains measures that the Commission uses to evaluate the performance of the charter schools in its portfolio. All three frameworks are collectively used as a single evaluation tool.

The FPF has remained the same since the Commission adopted the framework in November 2013. On September 10, 2015, the Commission approved a single overall financial rating to better factor financial performance of a school into the contract renewal criteria and process.

IV. DISCUSSIONS WITH STAKEHOLDERS

The Commission staff presented the proposed FPF to school leaders and stakeholders for discussions and feedback.

- March 1, 2017 at Connections Public Charter School in Hilo (18 people in attendance, representing 10 public charter schools)
- March 2, 2017 at the Hawai`i State Art Museum in Honolulu with live broadcast via WebEx (10 people in attendance and 10 participants via WebEx representing 16 public charter schools and 3 new public charter schools)

V. DECISION MAKING STATEMENT

The proposed FPF adopts a risk assessment model as part of ongoing oversight and monitoring of charter schools' fiscal activities, and renewal decision-making. The model aligns the framework to the unique funding and governance environment for charter schools in the State of Hawai`i. This risk-based approach will help identify areas of strength and weakness, highlighting controls that are designed to mitigate risks.

The risk assessment will focus on six indicators, or measures based on the National Association of Charter School Authorizers (NACSA) standards. Each indicator will be assessed on a scale from 1 to 5, with 1 being the lowest risk and 5 the highest risk. All six indicators will collectively make up a school's overall risk level. The annual risk assessment result for a school will be determined using a balanced weighted formula utilizing the individual scores calculated for each indicator as follows:

(*Current Ratio x 0.10) + (Unrestricted Days Cash x 0.35) + (Debt to Asset Ratio x 0.10) + (Cash Flow x 0.10) + (Total Margin x 0.25) + (Budget Variance x 0.10)*

1. Current Ratio

The current ratio shows the relationship between a school's current assets and current liabilities. Current assets are balance sheet accounts (e.g. cash, receivables) that include the value of all assets that are expected to be converted to cash through normal operations within the current fiscal year. Current liabilities represent obligations (e.g. payables, accrued payroll, accrued vacation) that are payable in cash within a fiscal year. This ratio gives an indication of a school's ability to pay its obligations over the next twelve months. A school may be at-risk if it is unable to meet its current obligations.

This indicator accounts for **10 percent** of a school's aggregate final risk assessment.

2. Unrestricted Days of Cash on Hand

The unrestricted days of cash on hand provides the number of days a school can pay its current expenses without another inflow of cash. Cash balances fluctuate since schools can expend and receive money on an almost daily basis. It indicates whether a school maintains a sufficient cash balance to meet its cash obligations. A school may be at-risk if there is insufficient cash to meet its cash obligations.

The indicator looks at a fixed point in time (the time the financial statement is prepared) and a trend over a period of time. Although this indicator is at a fixed point in time, it tells whether a school may have challenges in meeting its cash obligations. Note that this indicator looks at unrestricted cash, not cash that already has been earmarked for a specific purpose, such as renovations or facilities.

This indicator accounts for **35 percent** of a school's aggregate final risk assessment.

3. Debt to Asset Ratio

The Debt to Asset Ratio compares a school's financial liabilities against the assets it owns. A lower ratio generally indicates stronger financial health. A higher ratio indicates that the school may be at-risk of not being able to pay back its debts. It is generally accepted indicator of potential long-term financial issues.

This indicator accounts for **10 percent** of a school's aggregate final risk assessment.

4. Cash Flow

Cash Flow measures a school's change in cash balance from one period to another. This indicator is similar to days' cash on hand, but it provides insight into a school's long-term stability, as it helps to assess a school's sustainability over a period of time in an uncertain funding environment. A positive cash flow over time generally indicates increasing financial health and sustainability.

This indicator and accounts for **10 percent** of a school's aggregate final risk assessment.

5. Total Margin

Total Margin measures the surplus or deficit a school yields out of its total revenues. This indicator is important because a school cannot operate at a deficit for a sustained period of time without the risk of closure. The intent of this indicator is not for the schools to be profitable, but is important for charter schools to operate within its available resources in a particular year and to build a reserve to support growth and sustainability.

This indicator is calculated by dividing net income by total revenue and accounts for **25 percent** of a school's aggregate final risk assessment.

6. Budget Variance

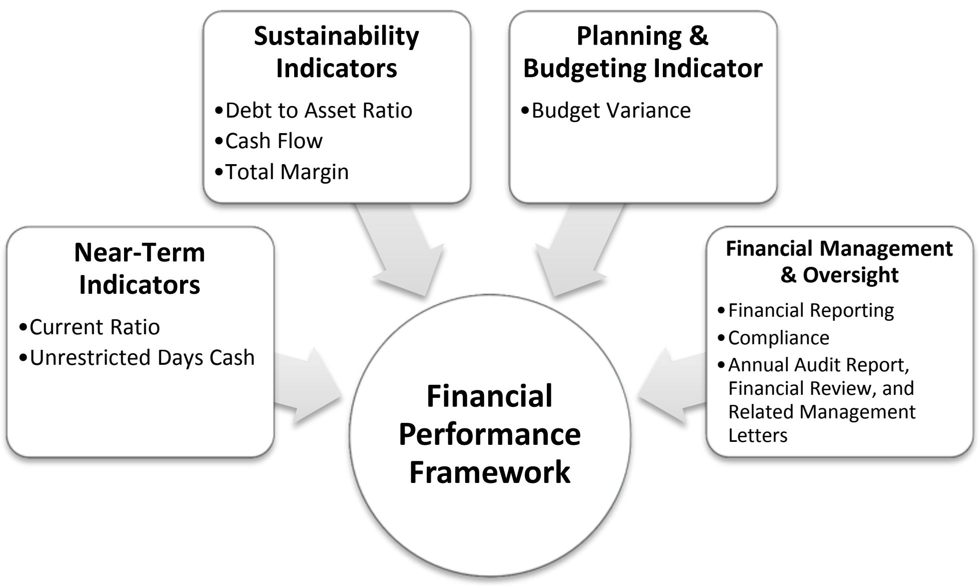
The budget variance depicts actual versus projected incoming revenues for a fiscal year. This indicator is important because revenues drive the development of a school's budget. While the per-pupil funding is the primary revenue source for charter schools, there are other sources (e.g. federal funds, grants, other state funds) that provide the basis for determining costs such as staffing and supplies. A budget based on revenues that are significantly more than its actual revenues may be at-risk of not meeting all of its budgeted expenses. Budgeted revenues that do not exceed actual revenues would not have a significant impact to the risk assessment rating scale.

This indicator accounts for **10 percent** of a school's aggregate final risk assessment.

Exhibit 1

EXHIBIT B.1.
PROPOSED FINANCIAL PERFORMANCE FRAMEWORK

The Financial Performance Framework (“Framework”) serves as a tool for the Commission to assess the financial health and viability of charter schools in its portfolio. The framework intends to provide a financial frame of reference based on current and past financial performance of charter schools. The indicators used in the framework are based on industry standard financial measures (e.g. ratios, variances) designed to be viewed in the aggregate with other complementary and supplementary information (e.g. timely and accurate financial and reporting practices, management practices). No single indicator or point in time data point gives a full picture of the financial situation of a school. Taken together, however, the indicators provide a qualitative assessment of the school’s near-term financial health, mid-term capacity, and long-term financial sustainability.



Risk-Based Approach

The framework adopts a risk assessment model as part of ongoing oversight and monitoring of charter schools’ fiscal activities, and renewal decision-making. The model aligns the framework to the unique funding and governance environment for charter schools in the State of Hawai`i. This risk-based approach will help identify areas of strength and weakness, highlighting controls that are designed to mitigate risks.

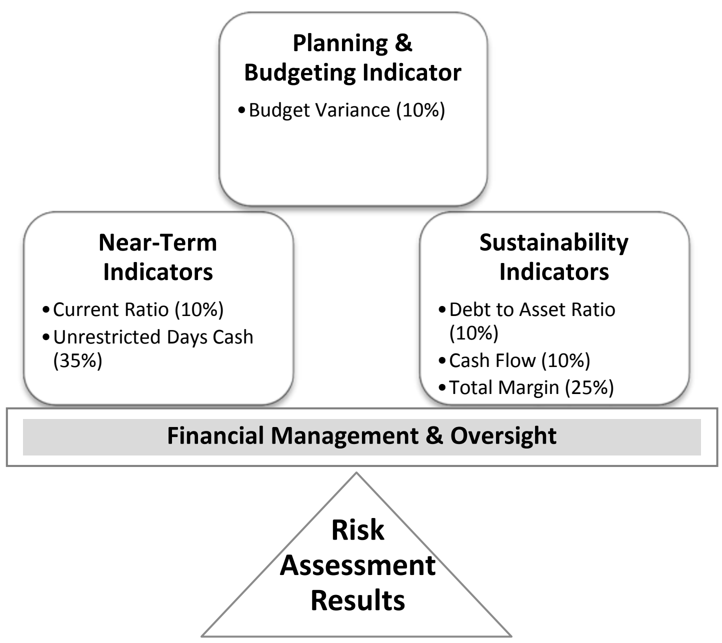
School(s) will be closely monitored if there is heightened risk of financial problems. Financial monitoring may include, but not limited to, request for reports or other documentation, inquiries through written or telephone communications, desk audits, or on-site visits, announced or otherwise. Moreover, a school may be requested to develop an appropriate corrective action plan in accordance with the Intervention Protocol **(Exhibit D)** to address any monitoring issues identified during the risk assessment. The corrective action plan provides a school an opportunity to explain the issue(s); identify measurable solution(s); identify person(s) who will be responsible for each solution; set timelines; and monitor the progress of the corrective action plan.

Annual Risk Assessment Process

The annual risk assessment evaluates whether the financial viability of a school is at-risk based on the Commission's review of financial information which will be drawn from the school's annual audited financial statements or financial review. The inclusion of a "component unit" (an affiliated non-profit entity) may apply when a school's annual audited financial statements include the presentation of reporting the audited component unit. The Commission's assessment may also include other financial information and/or a more detailed examination of the school's financial position and practices, as needed. The Commission may also consider the more current and more detailed information to determine whether the risk assessment result is still applicable throughout the assessment period and the degree to which it is, in fact, an indication of financial risk or distress or mitigation.

The risk assessment will focus on six indicators, or measures based on the National Association of Charter School Authorizers (NACSA) standards. Each indicator will be assessed on a scale from 1 to 5, with 1 being the lowest risk and 5 the highest risk. All six indicators will collectively make up a school's overall risk level. The annual risk assessment result for a school will be determined using a balanced weighted formula utilizing the individual scores calculated for each indicator as follows:

(Current Ratio x 0.10) + (Unrestricted Days Cash x 0.35) + (Debt to Asset Ratio x 0.10) + (Cash Flow x 0.10) + (Total Margin x 0.25) + (Budget Variance x 0.10)



The individual and final risk assessment results will be represented as one of five categories based on the school's risk assessment calculations as color-coded below and will be rounded to the nearest whole number.

Low	Acceptable	Moderate	High	Significant
1	2	3	4	5

Near Term Indicators

Current Ratio

Current Ratio = Current Assets ÷ Current Liabilities

The current ratio shows the relationship between a school's current assets and current liabilities. Current assets are balance sheet accounts (e.g. cash, receivables) that include the value of all assets that are expected to be converted to cash through normal operations within the current fiscal year. Current liabilities represent obligations (e.g. payables, accrued payroll, accrued vacation) that are payable in cash within a fiscal year. This ratio gives an indication of a school's ability to pay its obligations over the next twelve months. A school may be at-risk if it is unable to meet its current obligations.

This indicator accounts for **10 percent** of a school's aggregate final risk assessment.

Low	Acceptable	Moderate	High	Significant
Ratio is greater than (>) 1.5	Ratio is between 1.35 – 1.5	Ratio is between 1.2 – 1.35	Ratio is between 1.0 – 1.2	Ratio is less than (<) 1.0

Unrestricted Days of Cash on Hand

Unrestricted Days Cash = Days Cash ÷ [(Total Expenses – Depreciation Expense) ÷ 365]

The unrestricted days of cash on hand provides the number of days a school can pay its current expenses without another inflow of cash. Cash balances fluctuate since schools can expend and receive money on an almost daily basis. It indicates whether a school maintains a sufficient cash balance to meet its cash obligations. A school may be at-risk if there is insufficient cash to meet its cash obligations.

The indicator looks at a fixed point in time (the time the financial statement is prepared) and a trend over a period of time. Although this indicator is at a fixed point in time, it tells whether a school may have challenges in meeting its cash obligations. Note that this indicator looks at unrestricted cash, not cash that already has been earmarked for a specific purpose, such as renovations or facilities.

This indicator accounts for **35 percent** of a school's aggregate final risk assessment.

Low	Acceptable	Moderate	High	Significant
Days Cash is more than 60 days and having an upward or downward trend over three years or more	Days Cash is between 50 – 60 days and having an upward or downward trend over three years or more	Days Cash is between 30 – 50 days and having an upward or downward trend over three years or more	Days Cash is between 20 – 30 days and having an upward or downward trend over three years or more	Days Cash is less than 20 days and having a downward trend over three years or more

Sustainability Indicators

Debt to Asset Ratio

Debt to Asset Ratio = Total Liabilities ÷ Total Assets

The Debt to Asset Ratio compares a school's financial liabilities against the assets it owns. A lower ratio generally indicates stronger financial health. A higher ratio indicates that the school may be at-risk of not being able to pay back its debts. It is generally accepted indicator of potential long-term financial issues.

This indicator accounts for **10 percent** of a school's aggregate final risk assessment.

Low	Acceptable	Moderate	High	Significant
Ratio is less than (<) 0.2	Ratio is between 0.2 – 0.4	Ratio is between 0.4 – 0.5	Ratio is between 0.5 – 0.75	Ratio is greater than (>) 0.75

Cash Flow

Cash Flow = Year-end Cash Balance – Beginning Year Cash Balance

Cash Flow measures a school's change in cash balance from one period to another. This indicator is similar to days' cash on hand, but it provides insight into a school's long-term stability, as it helps to assess a school's sustainability over a period of time in an uncertain funding environment. A positive cash flow over time generally indicates increasing financial health and sustainability.

This indicator and accounts for **10 percent** of a school's aggregate final risk assessment.

Low	Acceptable	Moderate	High	Significant
Current Year Cash Flow is positive (+) and having an upward trend over three years or more	Current Year Cash Flow is positive (+) and having an upward or a down trend over three years or more	Current Year Cash Flow is either positive or negative (+/-) and having an upward or a downward trend over three years or more	Current Year Cash Flow is negative (-) and having an upward or a downward trend over three years or more	Current Year Cash Flow is negative (-) and having a downward trend over three years or more

Total Margin

Total Margin = Net Income ÷ Total Revenue

Total Margin measures the surplus or deficit a school yields out of its total revenues. This indicator is important because a school cannot operate at a deficit for a sustained period of time without the risk of closure. The intent of this indicator is not for the schools to be profitable, but is important for charter schools to operate within its available resources in a particular year and to build a reserve to support growth and sustainability.

This indicator is calculated by dividing net income by total revenue and accounts for **25 percent** of a school's aggregate final risk assessment.

Low	Acceptable	Moderate	High	Significant
Current Year Margin is positive (+) and having an upward trend over three years or more	Current Year Margin is positive (+) and having an upward or a downward trend over three years or more	Current Year Margin is either positive or negative (+/-) and having an upward or a downward trend over three years or more	Current Year Margin is negative (-) and having an upward or a downward trend over three years or more	Current Year Margin is negative (-) and having a downward trend over three years more

Planning & Budgeting

Budget Variance

Budget Variance = Actual Total Revenues ÷ Projected Total Revenues in the Charter School's Board-Approved Budget

The budget variance depicts actual versus projected incoming revenues for a fiscal year. This indicator is important because revenues drive the development of a school's budget. While the per-pupil funding is the primary revenue source for charter schools, there are other sources (e.g. federal funds, grants, other state funds) that provide the basis for determining costs such as staffing and supplies. A budget based on revenues that are significantly more than its actual revenues may be at-risk of not meeting all of its budgeted expenses. Budgeted revenues that do not exceed actual revenues would not have a significant impact to the risk assessment rating scale.

This indicator accounts for **10 percent** of a school's aggregate final risk assessment.

Low	Acceptable	Moderate	High	Significant
Variance is greater than (>) 99%	Variance is between 96% – 98%	Variance is between 94% – 95%	Variance is between 91% – 93%	Variance is less than (<) 90%

Financial Management and Oversight

Compliance

The Commission ensures that the school complies with applicable laws, rules, regulations and provisions of the charter contract relating to financial reporting requirements, and to financial management and oversight expectations as evidenced by an annual independent audit or review, including but not limited to:

- Complete and on-time submission of financial reports, including annual budget, revised budgets (if applicable), periodic financial reports as required by the authorizer and any reporting requirements if the board contracts with an Education Service Provider (ESP)
- On-time submission and completion of the annual independent audit and corrective action plans, if applicable
- No charging of tuition
- Adequate management and financial controls
- All reporting requirements related to the use of public funds
- An unqualified audit opinion
- An audit devoid of significant findings and conditions, material weaknesses or significant internal control weaknesses
- An audit that does not include a going concern disclosure in the notes or an explanatory paragraph within the audit report

The Commission may require a school to develop an appropriate corrective action plan pursuant to the Intervention Protocol **(Exhibit D)** to address any compliance issues identified through continuous monitoring in accordance with **§302D-17 Ongoing oversight and corrective actions;**

> (a) An authorizer shall continually monitor the performance and legal compliance of the public charter schools it oversees, including collecting and analyzing data to support ongoing evaluation according to the charter contract.

As provided in the Charter Contract:

> 14.1 Monitoring. The Commission shall continually monitor the performance and legal compliance of the School. The Commission shall have the authority to conduct or require oversight activities that enable the Commission to fulfill its responsibilities, so long as those responsibilities are consistent with the intent of Ch. 302D, HRS, and adhere to the terms of this Contract.

Exhibit 2

Example of the Annual Risk Assessment Worksheet

	Near Term		Sustainability			Planning & Budgeting	Risk Assessment Results
Indicators	**Current Ratio**	**Unrestricted Days Cash**	**Debt to Assets**	**Cash Flow**	**Total Margin**	**Budget Variance**	
Risk	Inability to meet current obligations	Insufficient cash to meet cash obligations	Not being able to pay back its debt	Financial instability over time	Closure risk when operating at a deficit for a sustained period	Unable to meet budgeted expenses	
Risk Index	More than 1.5 = 1 1.35-1.5 = 2 1.20-1.35 = 3 1.0-1.2 = 4 Less than 1.0 = 5	More than 60 days, up/downward trend = 1 50-60 days, up/downward trend = 2 30-50 days, up/downward trend = 3 20-30 days, up/downward trend = 4 Less than 20 days, downward trend = 5	Less than 0.20 = 1 0.20-0.40 = 2 0.40-0.50 = 3 0.50-0.75 = 4 More than 0.75 = 5	(+) CF, upward trend = 1 (+) CF, up/down trend = 2 (+/-) CF, up/down trend = 3 (-) CF, up/down trend = 4 (-) CF, downward trend = 5	(+) Margin, upward trend = 1 (+) Margin, up/down trend = 2 (+/-) Margin, up/down trend = 3 (-) Margin, up/down trend = 4 (-) Margin, downward trend = 5	Over 99% = 1 96%-98% = 2 94%-95%- = 3 91%-93% = 4 Less than 90% = 5	**1 = Low** **2 = Acceptable** **3 = Moderate** **4 = High** **5 = Significant**

Official School Name	Org ID	2018	Risk Rating	2016	2017	2018	Risk Rating	2018	Risk Rating	2016	2017	2018	Risk Rating	2016	2017	2018	Risk Rating	2018	Risk Rating	
Alaka`i O Kaua`i Charter School	558																			
Connections Public Charter School	396																			
Hakipu`u Learning Center	546																			
Halau Ku Mana Public Charter School	540																			
Hawai`i Academy of Arts & Science Public Charter School	561																			
Hawai`i Technology Academy	551																			
Innovations Public Charter School	548																			
Ka `Umeke Ka`eo	562																			
Ka Waihona O Ka Na`Auao Public Charter School	545																			
Kamaile Academy Public Charter School	275																			
Kamalani Academy	553																			
Kanu O Ka `Aina New Century Public Charter School	397																			
Kanuikapono Public Charter School	564																			
Kapolei Charter School	555																			
Kawaikini New Cnetury Public Charter School	565																			
Ka`u Learning Academy	552																			
Ke Ana La`Ahana Public Charter School	549																			
Ke Kula `O Nawahiokalani`Opu`u Iki, LPCS	563																			
Ke Kula `O Samuel M. Kamakau, LPCS	547																			
Ke Kula Niihau O Kekaha Learning Center	556																			
Kihei Charter School	554																			
Kona Pacific Public Charter School	566																			
Kua O Ka La New Century Public Charter School	557																			
Kualapu`u School: A Public Conversion Charter	411																			
Kula Aupuni Niihau A Kahelehani Aloha (KANAKA)	466																			
Lanikai Elementary Public Charter School	320																			
Laupahoehoe Community Pubic Charter School	377																			
Malama Honua Public Charter School	550																			
Myron B. Thompson Academy	544																			
Na Wai Ola (Waters of Life) Public Charter School	398																			
SEEQS: The School For Examining Essential Questions of Sustainability	567																			
University Laboratory School	543																			
Volcano School of Arts & Sciences	560																			
Voyager: A Public Charter School	541																			
Waialae Elementary Public Charter School	149																			
Waimea Middle Public Conversion Charter School	394																			
West Hawai`i Explorations Academy	399																			