



## OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA

### EVALUATION REPORT

# Charter School Financial Accountability



JUNE 2003

PROGRAM EVALUATION DIVISION

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## OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

June 26, 2003

Members  
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In April 2002, the Legislative Audit Commission directed the Office of the Legislative Auditor to evaluate charter school financial management. Legislators were interested in the extent of charter schools' financial problems and how well the Department of Education and charter school sponsors are overseeing the schools' fiscal performance. Legislators also had questions about the state's program for reimbursing charter schools for building lease expenses.

We found that about one quarter of charter schools were in financial difficulty at the end of fiscal year 2002. A variety of factors contributed to financial problems, and all of the financially troubled charter schools are taking steps to correct their situations. The Department of Education's recent efforts to better assist charter schools have been well received, but we found that some sponsors have a hands-off approach to financial oversight. Charter schools' leases appear to be reasonable, but 11 schools have indirectly used lease aid to acquire school buildings through affiliated nonprofit corporations.

We recommend that the department modify its charter school approval process and take other steps to help charter schools improve their business operations. We also recommend that sponsors' responsibilities be more clearly defined and that the Legislature review its policies regarding charter school board membership and building ownership.

This report was researched and written by Deborah Parker Junod (project manager), David Chein, and Jan Sandberg. The Department of Education, charter schools, and sponsors cooperated fully with our evaluation.

Sincerely,

*/s/ James Nobles*

James Nobles  
Legislative Auditor



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# SUMMARY

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**Although the Legislature has tightened financial controls, about one-quarter of the state's charter schools had financial problems in fiscal year 2002.**

## **Major Findings:**

- About one-fourth of the charter schools open in fiscal year 2002 had financial problems, as indicated by a negative fund balance or deficit spending combined with a low fund balance (pp. 14-17).
- Poor financial planning and insufficient monitoring of actual revenues and spending were key factors underlying financial difficulties. Many problems can be traced to schools opening before they were ready to manage their business operations (pp. 20-22, 31).
- Minnesota's Department of Education (MDE) has initiated several well-received efforts to help charter schools improve financial management. However, charter schools often miss critical financial reporting deadlines, making oversight by MDE and charter school sponsors more difficult (pp. 24-27, 30).
- Neither the law nor contracts between sponsors and their charter schools clearly define a sponsor's financial oversight responsibilities, and many sponsors do not actively oversee and assist their schools (pp. 27-29).

- Charter schools receive state aid to offset the costs of leasing a school building but are prohibited from using state aid to buy a building. In general, charter schools lease appropriate facilities and pay reasonable lease rates. However, 11 charter schools have created affiliated nonprofit corporations that buy a building and then lease it to the charter school (pp. 37-45).

## **Key Recommendations:**

- MDE should ensure that new charter schools have financial management staff and systems in place before being allowed to open and should modify its model charter school contract to include detailed financial management requirements (p. 34).
- MDE should initiate a process to more clearly define the scope and nature of sponsors' financial management responsibilities (p. 35).
- The Legislature should consider amending the law to state that charter school contracts may be terminated for repeated failure to meet state financial reporting deadlines and should review and clarify its policy on charter school building ownership (pp. 35, 46).

## Report Summary

**Charter schools are generally subject to the same financial accountability requirements as school districts.**

Charter schools are publicly funded schools formed by parents, teachers, or community members. In fiscal year 2003, Minnesota had 76 charter schools. Each school is governed by a board of directors elected by the school's staff and students' parents. Charter schools must have a sponsor, such as a school district or university, that is charged with overseeing the school's academic and fiscal performance. The relationship between a charter school and its sponsor is defined by a contract that should describe, among other things, the academic program, expected student outcomes, and the school's administration.

For the most part, charter schools are subject to the same financial accountability requirements regarding use of state and federal funds as school districts. For example, charter schools must maintain financial records, have a financial audit at the end of each fiscal year, and submit detailed financial data and audit reports to MDE.

We evaluated the extent of financial problems at charter schools, the reasons for them, and the sufficiency of oversight provided by MDE and sponsors. We also assessed the state's program for reimbursing charter schools for building lease expenses.

**Some charter schools have been ill equipped to manage their finances.**

### **Charter Schools Are Vulnerable to Financial Problems, But the Proportion of Charter Schools in Statutory Operating Debt Has Declined**

As a key indicator of a charter school or school district's fiscal status, MDE measures the end-of-year general fund balance as a percentage of annual general fund expenditures. If the percentage is  $-2.5$  percent or worse, the school is considered to be in statutory

operating debt (SOD). The proportion of charter schools in SOD declined from 19 percent in fiscal year 2000 to 12 percent in fiscal year 2002, when about 10 percent of traditional school districts were in SOD.

Because low fund balances place charter schools at financial risk, we used criteria broader than SOD status to identify charter schools that ended fiscal year 2002 in financial difficulty (e.g., an annual operating deficit combined with a low fund balance). In all, 16 charter schools met the criteria, accounting for 24 percent of 68 charter schools open in fiscal year 2002. Two of the 16 schools have closed.

### **A Variety of Factors Contributed to Financial Problems, Particularly Poor Financial Planning and Tracking**

A unique set of circumstances led to problems at each of the schools in financial difficulty, but we found that poor financial planning and insufficient monitoring of actual revenues and expenditures were general problems. For example, some charter schools used budgets that were not sufficiently detailed or were based on unrealistic assumptions. Some charter schools did not understand the extent of their financial problems and missed opportunities to make mid-year corrections. In some cases, the school director or board members did not grasp the importance of ongoing financial monitoring; in other cases, the director and board were not able to obtain reliable financial reports from their own accounting systems or from their contractors. Other factors contributing to financial problems included poorly functioning school boards, misunderstandings regarding state requirements, and insufficient resources to handle unexpected expenses. We recommend that MDE enhance training offered to charter school board members and that the Legislature reconsider the

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**The Minnesota Department of Education has increased its efforts to help charter schools, but needs to ensure that new schools have adequate financial systems in place before they open.**

requirement that a majority of school board members be teachers.

### **Some Charter Schools Opened Without Sufficient Capacity to Manage School Finances**

Quite often, charter schools attributed their financial problems to early mistakes and to having administrators and boards that were unprepared to manage a school's business operations. MDE approves charter school applications on the basis of a written proposal, and then charter schools generally spend at least 9 months in a planning stage to implement it. However, neither MDE nor sponsors formally assess new schools' readiness to open. We recommend that MDE require charter schools to demonstrate that they have financial expertise, systems, and controls in place before students arrive.

### **New MDE Efforts to Improve Charter School Financial Management May Be Affected by Budget Cuts**

MDE monitors charter schools' compliance with laws governing the distribution and use of education aid, and in recent years has implemented several well-received efforts to better assist charter schools. For example, to address historical problems with over reporting enrollment (and receiving too much funding), the legislature directed MDE to monitor enrollment reports on a quarterly basis and adjust aid payments as needed. MDE staff also initiated an early intervention effort to identify charter schools and school districts at risk of falling into SOD. MDE staff went to the at-risk schools and used budget and financial data to demonstrate the need to increase revenues, make appropriate spending cuts, and change fiscal policies. In addition, MDE staff have made

concerted efforts to improve the quality and timeliness of ad-hoc assistance.

Charter school officials generally gave MDE high marks for the training and technical assistance it provides. It is not clear, however, that MDE will be able to sustain its current level of assistance in the wake of budget cuts. For example, MDE recently eliminated the full-time position that had been allocated to charter school financial management, replacing it with quarter-time assignments to four other staff.

### **Charter Schools Were More Likely to Miss Financial Reporting Deadlines Than School Districts**

As an accountability tool, charter schools are required to submit fiscal year financial data files to MDE by November 30 of each year and financial audit reports by December 31. Although they have improved, charter schools have a poor record of meeting these reporting deadlines compared to school districts. For example, about 29 percent of charter schools missed MDE's November 30, 2002, deadline for posting summarized audit data via the Internet compared to about 14 percent of school districts. Also, 29 percent of charter schools missed the December 31, 2002, deadline to submit financial audit reports compared to 12 percent of school districts.

Charter schools' timeliness has improved. Among 56 charter schools open in fiscal years 2001 and 2002, the percentage of late and missing audits declined from 63 percent for fiscal year 2001 to 29 percent for fiscal year 2002. We recommend that the Legislature consider amending charter school law to explicitly allow sponsors to terminate contracts for repeated failure to meet financial reporting deadlines.

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**Many charter school sponsors had little interaction with the schools they sponsored.**

**Sponsors Vary in the Extent to Which They Oversee Financial Management, in Part Because Their Role Is Not Clearly Defined**

State law gives sponsors general responsibilities to monitor a school's fiscal status and to evaluate its overall performance. A charter school must have a contract with its sponsor, and both parties can use the contract to spell out specific terms of financial oversight. However, few of the contracts we reviewed set forth specific obligations or expectations regarding the charter school's fiscal performance (e.g., budget or training requirements). The contracts also did not clarify how the sponsor would oversee financial management.

Among the 11 sponsors included in our review, interactions with charter schools ranged from a hands-off approach to more active efforts to understand schools' operations and financial status. Most of the sponsors—a mix of school districts and educational institutions—limited their oversight to receipt of the annual financial audit and perhaps an annual meeting. These sponsors provided little active assistance. Other sponsors were more active, requiring more frequent financial reports or having a charter school liaison visit the school or attend board meetings. The level and nature of assistance that sponsors should provide was a point of contention between some schools and their sponsors, and several of the charter schools were considering seeking a new sponsor. We recommend that MDE initiate a process to more clearly define sponsors' responsibilities.

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**The Legislature needs to review and clarify its lease aid policy for charter schools.**

**Lease Aid Is an Important Revenue Source, But Some Charter Schools Are Using It to Indirectly Buy School Buildings**

Charter schools are not allowed to issue bonds or levy taxes to pay for building space. Instead, the state provides lease aid that reimburses charter schools for a large portion of building lease costs if the lease terms are deemed reasonable. Charter school administrators view lease aid as essential to charter schools' financial viability; without it, they would have to rely on general education aid to pay for a facility. In general, we found that charter schools lease appropriate facilities and pay reasonable lease rates.

Although state law prohibits charter schools from using state funds to acquire buildings, 11 charter schools have established affiliated nonprofit building corporations that issued bonds or obtained loans to acquire school buildings. Charter schools then leased the building from the affiliated corporation. Many of the charter schools and sponsors we interviewed advocated allowing charter schools that have demonstrated sound fiscal and academic performance over several years to buy buildings directly. They argued that ownership can be more cost-effective in the long run. On the other hand, other officials were concerned that charter school boards and administrators may lack the sophisticated financial management skills required to arrange bond deals. Because use of nonprofit building corporations has introduced a gray area in the states' policy on building ownership, we recommend that the Legislature review and clarify the policy on use of state funds to buy charter school buildings.

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# Introduction

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**I**n 1991, Minnesota became the first state to authorize charter schools as an option within its public education system. Charter schools are publicly funded, nonsectarian schools formed by parents, teachers, or community members. Each charter school is governed by a board of directors, the members of which are elected by students' parents and the schools' staff. Within certain legal guidelines, the board governs the school's mission, education program, and administration. Every charter school also must have a sponsor, such as a school district or college, that is supposed to oversee the school's academic and fiscal performance.

While charter schools are often perceived to be largely free from state control, Minnesota's regulation of charter schools has increased in recent years, particularly in the area of financial management. Spurred by several incidences of charter schools closing amid allegations of financial mismanagement and conflicts of interest, the Legislature changed the law in 2001 to make charter schools follow the same financial accountability and audit requirements as school districts. Along with sponsors, Minnesota's Department of Education (MDE)<sup>1</sup> is responsible for overseeing charter schools.

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**Charter schools are publicly-funded schools formed by parents, teachers, or community members.**

In April 2002, the Legislative Audit Commission directed the Office of the Legislative Auditor to evaluate charter school financial management. We started our evaluation in February 2003 after completing other projects that the Commission had requested. Legislators were interested in current information on the extent of financial problems at charter schools, the reasons for them, and the sufficiency of oversight provided by MDE and sponsors. Legislators also had questions about the state's program for reimbursing charter school building lease expenses. In addition to providing background information on Minnesota's charter schools, our review addressed the following questions:

- **To what extent have Minnesota charter schools experienced financial difficulties?**
- **What are the underlying causes of any financial problems, and how have charter schools responded?**
- **How effectively have the state and sponsors monitored charter school financial management and helped schools avoid or rectify financial difficulties?**
- **Is the lease-aid program an effective way to help charter schools obtain school facilities?**

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<sup>1</sup> Minnesota's education agency had been named the Department of Children, Families, and Learning. The 2003 Legislature changed the department's name to the Minnesota Department of Education, effective May 2003. We refer to the agency under its new name throughout the text of the report. However, we use the Department of Children, Families, and Learning in footnotes and table notes when we cite source documents published prior to the name change.

To assess charter schools' financial status, we analyzed financial and student data reported to MDE for fiscal years 2000 through 2002. To identify charter schools in financial difficulty, we developed selection criteria, based primarily on the extent of deficit spending and year-end fund balances. Applied to fiscal year 2002 financial data, 16 of 68 charter schools met our criteria. Two of the schools had closed by the time we started our review, so our in-depth work focused on the remaining 14 charter schools.

To understand the circumstances contributing to financial difficulties, efforts to improve their financial status, and the roles sponsors and MDE played in resolving problems, we interviewed school directors, school board chairs, and sponsor representatives for each of the 14 charter schools in the financial difficulty group. We also reviewed annual reports, financial audit reports, sponsor evaluations, and other documents. In addition, we asked MDE staff and others to identify several charter schools that have demonstrated strong financial management practices, and we interviewed administrators at these schools.

To assess the extent to which MDE and sponsors monitor charter schools' financial status and help charter schools resolve financial problems, we relied on interviews with charter school administrators, MDE staff, and sponsor representatives. Our work with sponsors focused on the 11 organizations that sponsored the 14 schools we reviewed in depth. In total, these 11 organizations sponsored about half of the charter schools open in fiscal year 2002. In addition, we reviewed the law; MDE policies, training materials, and staffing data; and various documents related to charter school sponsorship.

To evaluate lease aid, we interviewed MDE staff about the lease aid program and analyzed data collected by MDE on lease terms and lease aid revenue for schools operating in fiscal year 2003. To determine the reasonableness of lease expenditures, we compared charter schools' rates to rates that the State of Minnesota pays for leased office space. We also included questions about facilities and lease aid in our interviews with charter school administrators and board chairpersons. Finally, we interviewed officials from 14 additional charter schools to learn more about their facilities and leases.

We focused our work on charter schools that met our criteria indicating financial difficulty. But because we selected schools based on numerical indicators, we may have missed charter schools with poor financial management practices if their fiscal year 2002 financial data did not meet our criteria. Still, we believe that the issues we identified at the 14 selected schools would likely apply to other troubled charter schools as well. We did not audit or otherwise review charter school financial records in detail.

The report is divided into three chapters. In Chapter 1, we present data on charter school openings and closures, and we describe the process for starting a charter school, financial accountability requirements, and oversight mechanisms. In Chapter 2, we address the extent of charter schools' financial problems, how problems have been addressed, and the sufficiency of MDE and sponsors' oversight and assistance. In Chapter 3, we discuss how charter schools have used state lease aid.

# Background

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## SUMMARY

*Charter schools are publicly funded schools that are governed by their own boards of directors. The number of charter schools open in Minnesota has grown from 1 in fiscal year 1993 to 76 in fiscal year 2003. Another 13 charter schools are planning to open in fiscal year 2004, and 16 charter schools have closed since 1993. Charter schools in Minnesota must have a sponsoring organization. School districts sponsored about half of the charter schools operating in 2003, and colleges and universities sponsored 30 percent. State law requires sponsors and the Minnesota Department of Education to oversee charter school financial management, but it provides little guidance as to how the agencies should carry out the oversight function. In 2001, the Legislature enacted several measures aimed at improving charter school financial management and accountability, including a requirement to annually submit a financial audit report to the Department of Education.*

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In 1991, Minnesota became the first state to authorize charter schools (originally called “outcome based schools”).<sup>1</sup> Charter schools are publicly funded, nonsectarian schools that are formed by parents, teachers, or community members to foster innovative, quality education. Charter schools receive state aid, primarily based on the number of students enrolled, but they function autonomously in terms of mission and administration, and they are exempt from some statutes and rules pertaining to school districts. Each charter school is governed by a board of directors whose members are elected by the parents of children enrolled at the school and the staff employed by the school. In fiscal year 2002, charter schools received about \$105 million in funding, primarily state and federal education aid.<sup>2</sup>

As background for our evaluation of charter school financial accountability, this chapter addresses the following questions:

- **How many charter schools are operating in Minnesota, and how many have closed?**
- **How are charter schools governed, and what state laws regarding financial management apply to them?**

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<sup>1</sup> *Laws of Minnesota* (1991), ch. 265, art. 9, sec. 3.

<sup>2</sup> Charter schools and school districts follow the state fiscal year that runs from July 1 through June 30, so traditional fall to spring school years coincide with fiscal years.

To answer these questions, we reviewed state laws, legislative research reports, enrollment data provided by the Minnesota Department of Education (MDE), and other program documents. We also interviewed officials from charter schools and MDE.

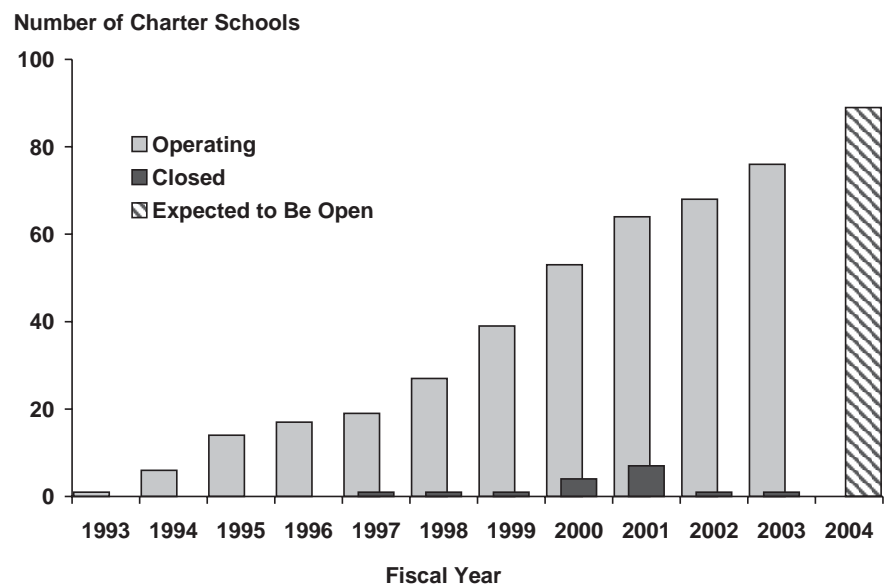
## CHARTER SCHOOLS OPERATING IN MINNESOTA

As shown in Figure 1.1, since first authorized, the number of charter schools operating has increased each year. The 1991 law authorizing charter schools limited the number of schools to eight. The Legislature gradually raised the cap in subsequent years and removed it entirely in 1997. In fiscal year 2003, 76 charter schools were open for the full school year with students enrolled.<sup>3</sup> As of June 2003, another 13 schools are planning to open in fiscal year 2004.

Since the first charter school opened in September 1992, 16 charter schools have closed under a variety of circumstances. As shown in Table 1.1, insolvency was the predominant underlying cause for most closures. Only one of the sixteen charter schools closed while fiscally healthy; its board decided to end operations

**Minnesota had  
76 charter  
schools operating  
in fiscal year  
2003.**

**Figure 1.1: Charter Schools Operating and Closed, FY1993-2003, and Expected to Be Open, FY2004**



NOTE: "Operating" includes charter schools that were open for all or part of the fiscal year. One school closed in September 2002. It is counted as operating in fiscal year 2002 and closed in fiscal year 2003.

SOURCE: Office of the Legislative Auditor analysis of Department of Education data.

<sup>3</sup> One school, Mexica Multicultural, closed in September 2002 due to low enrollment. It is not included in the count of 76 charter schools operating in fiscal year 2003.



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**Most of the 16 charter schools that have closed did so because of financial problems.**

because the school's start-up grant funding had ended and projected enrollment would not be sufficient to support program costs. The remaining fifteen schools closed because of varying degrees of poor financial management and insolvency. Key issues in these closures included over reporting of enrollment and inability to repay the state for excess aid, lower than expected enrollment coupled with overspending, and errors associated with special education funding.<sup>4</sup> In some cases, the financial management problems appeared to result from mistakes made by school administrators more skilled in developing education programs than in financial management. In other cases, however, evidence suggests that school administrators or management companies made more egregious financial management errors, including repeated overstatements of enrollment, failure to maintain accurate books and records or pay taxes, and the commitment to building leases that were clearly not in the schools' best interests. The Legislature's changes to charter school law in 2001, discussed below, were intended to address some of these problems by putting tighter controls over charter school financial management.

## STARTING A CHARTER SCHOOL

To open a charter school, an applicant (such as a group of parents, teachers, or community members) must obtain a sponsor, create a cooperative or nonprofit corporation, and complete the MDE application process. One of the first things charter school developers need to do is find an organization, often a school district or university, that will sponsor the school. The sponsor must then file an affidavit with MDE stating its intent to authorize a charter school.<sup>5</sup> MDE's approval of this affidavit is required for the start-up process to continue.<sup>6</sup>

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**A charter school must have a sponsor, such as a school district or university.**

MDE requires charter school applicants to complete a lengthy, multi-part application that includes, among other things, information on the individuals proposing to develop the school; statements of the school's vision and mission; accountability measures for two academic and two nonacademic goals; a proposed school calendar; a proposed budget; a statement assuring that the school will meet special education requirements; a letter of intent from the sponsor (or copy of a school board's resolution to sponsor); and a federal grant application.<sup>7</sup> Under the assessment process used through May 2003, MDE staff reviewed each application, prepared a summary, and sent both to the Charter School Advisory

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<sup>4</sup> The link between reported enrollment and revenue is discussed in more detail later in this chapter.

<sup>5</sup> If an applicant applies to a school district to sponsor a charter school, the school district board must vote within 90 days on whether to sponsor the charter school. If the school district board votes not to sponsor a charter school, state law allows the applicant to appeal to MDE. MDE may help the applicant find another sponsor, or it may elect to sponsor the charter school itself. MDE has elected to sponsor seven charter schools. *Minn. Stat.* (2002), §124D.10, subd. 4.

<sup>6</sup> *Minn. Stat.* (2002), §124D.10, subd. 4.

<sup>7</sup> Department of Children, Families, and Learning, *State of Minnesota Consolidated Charter School Authorization and Title V Public Charter School Grant Application* (Roseville, MN: 2003).

**Table 1.1: Charter School Closures**

<u>Charter School and Dates of Operation</u>	<u>Sponsor</u>	<u>Reasons for Closure</u>
Prairie Island <i>Sept. 1994 – Aug. 1996</i>	Red Wing School District	Insolvency related to low enrollment and loss of financial support from the Prairie Island Tribe.
Dakota Open School <i>Sept. 1994 – Jan. 1998</i>	Department of Education	Poor financial management involving misreported enrollment.
Frederick Douglass Academy <i>Sept. 1994 – April 1999</i>	Minneapolis Public Schools	Poor financial management involving misreported enrollment, unreasonable lease, and poor financial records.
Summit School for the Arts <i>Sept. 1997 – Apr. 2000</i>	Chisago Lakes School District	Poor financial management related to overspending and misuse of special education funds.
Success Academy <i>Sept. 1997 – May 2000</i>	St. Paul Public Schools	Poor financial management by management company involving overspending and misreported enrollment.
Toivola-Meadowlands <i>Sept. 1993 – June 2000</i>	St. Louis County School District	Low enrollment and poor financial management involving overspending that was largely related to high facility maintenance costs.
Right Step Academy <i>Sept. 1995 – Aug. 2000</i>	St. Paul Public Schools	Poor financial management by management company involving delinquent taxes and poor financial records.
Central Minnesota Deaf <i>Sept. 1997 – Dec. 2000</i>	St. Cloud Public Schools	Low enrollment and poor financial management involving overspending.
PEAKS – Faribault <i>Sept. 1999 – Mar. 2001</i>	Alexandria Technical College	Poor financial management by school founders involving unreasonable lease, misreported enrollment, and special education errors.
Strategies for Success <i>Sept. 1998 – May 2001</i>	St. Paul Public Schools	Poor financial management by management company involving misreported enrollment.
Fort Snelling Academy <i>Sept. 2000 – June 2001</i>	Normandale Community College	Poor financial management involving overspending and misreported enrollment.
Learning Adventures <i>Sept. 1998 – June 2001</i>	St. Paul Public Schools	Low enrollment and poor financial management involving overspending.
PEAKS – Pillager <i>Sept. 1998 – June 2001</i>	Central Lakes College	Poor financial management by school founders involving unreasonable lease, misreported enrollment, and special education errors.
Skills for Tomorrow Jr. High <i>Sept. 1998 – June 2001</i>	St. Paul Public Schools	Projected enrollment not sufficient to cover program costs once start-up funding ended.
Martin Hughes <i>Sept. 1998 – Nov. 2001</i>	Mt. Iron/Buhl School District	Poor financial management by management company involving misuse of special education revenue and poor financial records.
Mexica Multicultural <i>Sept. 2000 – Sept. 2002</i>	St. Paul Public Schools	Low enrollment and poor financial management involving overspending.

SOURCE: Office of the Legislative Auditor analysis of Department of Education charter school files.

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**Two funding sources unique to charter schools are lease aid and start-up grants.**

Council.<sup>8</sup> The Advisory Council reviewed the application, met with the applicant and sponsor, and made a recommendation to the Commissioner. The 2003 Legislature, however, removed reviewing charter school applications from the list of Charter School Advisory Council responsibilities.<sup>9</sup> The Commissioner, in any event, has the final say and must approve or disapprove the proposal within 60 days of receipt of the sponsor's affidavit stating its intent to sponsor the school.<sup>10</sup>

Charter schools, like school districts, get most of their revenue through state aid based on a general education funding formula that is linked to student enrollment. In fiscal year 2003, charter schools received basic education aid of \$4,601 per pupil unit.<sup>11</sup> In addition, charter schools receive operating capital revenue, sparsity revenue, training and experience revenue, and equity revenue based on the state average amount per pupil unit and may earn basic skills revenue based on the school's student population of low income students or those with limited English proficiency. Charter schools may also receive special education aid and transportation aid if they provide transportation services. Two types of aid are unique to charter schools. Building lease aid pays for 90 percent of the cost of leasing facilities up to a maximum amount per pupil unit. The 2003 Legislature reduced the maximum building lease aid from \$1,500 to the greater of \$1,200 per pupil unit or the amount per pupil unit that the school received in fiscal year 2003.<sup>12</sup> In addition, new charter schools may receive federal and state start-up funding. Currently, charter schools are eligible for three years of federal funding: \$140,000 for planning the year before the school opens, \$150,000 in the first year of operation, and \$125,000 for the second year of operation. In the past, the state offered start-up funding for the first two years of operation equal to the greater of \$50,000 or \$500 per pupil unit.<sup>13</sup> Due to action by the 2003 Legislature, charter schools opening in fiscal years 2004 and 2005 will not receive state start-up funding.<sup>14</sup> Charter schools may receive grants or gifts, but they may not issue bonds or levy taxes.<sup>15</sup>

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<sup>8</sup> The Charter School Advisory Council was created by the 2001 Legislature. It was charged with encouraging the creation of charter schools, providing leadership and support to sponsors, providing management training to charter school boards, facilitating compliance with auditing and other reporting requirements, and recommending approval or disapproval of charter school applications. Under the original legislation, the Council was scheduled to sunset on June 30, 2003. Among other changes, the 2003 Legislature extended the sunset date to June 30, 2007. *Minn. Stat.* (2002), §124D.10, subd. 2a and *Laws of Minnesota* (1Sp2003), ch. 9, art. 2, sec. 21.

<sup>9</sup> *Laws of Minnesota* (1Sp2003), ch. 9, art. 2, sec. 21.

<sup>10</sup> *Minn. Stat.* (2002), §124D.10, subd. 4(b).

<sup>11</sup> *Minn. Stat.* (2002), §126C.10, subd. 2. Pupil units are based on average daily membership (ADM), which is the sum for all pupils of the number of days of the school year each pupil is enrolled divided by the number of days that school is in session. ADM is converted into pupil units by weighting pupils according to grade level as follows: kindergarten = 0.557; grades 1 through 3 = 1.115; grades 4 through 6 = 1.06; and grades 7 through 12 = 1.3. Pre-kindergarten students with disabilities are weighted based on the number of hours of services they receive. *Minn. Stat.* (2002), §126C.05, subd. 1 and subd. 8. For an in-depth description of K-12 school funding, see Minnesota House of Representatives Research Department, *Minnesota School Finance: A Guide for Legislators* (St. Paul: 2002).

<sup>12</sup> *Minn. Stat.* (2002), §124D.11, subd. 4 and *Laws of Minnesota* (1Sp2003), ch. 9, art. 2, sec. 28.

<sup>13</sup> *Minn. Stat.* (2002), §124D.11, subd. 8.

<sup>14</sup> *Laws of Minnesota* (1Sp2003), ch. 9, art. 2, sec. 51.

<sup>15</sup> *Minn. Stat.* (2002), §§124D.10, subd. 25(b) and 124D.11, subd. 6.

## FINANCIAL ACCOUNTABILITY REQUIREMENTS

For the most part, charter schools are subject to the same financial accountability requirements regarding use of state and federal funds as are school districts.<sup>16</sup> This was not always the case. In 2000 and 2001, several charter schools closed amid allegations of financial mismanagement and conflicts of interest. As a result, the 2001 Legislature amended charter school law to increase charter school accountability.<sup>17</sup> The following requirements now apply to charter schools:

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### Legislative action in 2001 put tighter financial controls on charter schools.

- Charter schools must submit an audit report to MDE by December 31 each year. If the audit report indicates that a material weakness exists in the financial reporting systems of a charter school, the school must submit a written report to MDE explaining how the material weakness will be resolved.<sup>18</sup>
- Charter school boards must keep minutes of meetings and make them available to the public upon request.<sup>19</sup>
- Charter schools must make annual financial reports available to the public upon request.<sup>20</sup>
- Charter schools must adhere to the same requirements that apply to school districts regarding contracts for services and materials.<sup>21</sup>
- Charter schools in statutory operating debt must submit a corrective action plan and limit expenditures accordingly.<sup>22</sup>
- MDE must provide financial management training for charter school board members.<sup>23</sup>
- Charter school board members may not be employed by or serve on a board of a for-profit contractor doing business with the school.<sup>24</sup>

As shown in the list above, charter schools must meet various reporting requirements. Like school districts, charter schools must annually report financial data to MDE using a system of accounts called the Uniform Financial Accounting

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<sup>16</sup> In general, state law and MDE procedures treat charter schools as if each one were a school district consisting of one school. For example, MDE assigns a school district number to each charter school. Whereas regular school districts submit consolidated financial reports for all the schools in the district, charter schools only have to report on a single entity.

<sup>17</sup> *Laws of Minnesota* (1Sp2001), chap. 6, art. 2, sec. 20-28, 66.

<sup>18</sup> *Minn. Stat.* (2002), §124D.10, subd. 6a.

<sup>19</sup> *Ibid.*

<sup>20</sup> *Ibid.*

<sup>21</sup> *Minn. Stat.* (2002), §124D.10, subd. 8(i) and §123B.52, subd. 1.

<sup>22</sup> *Minn. Stat.* (2002), §124D.10, subd. 8(i). We discuss statutory operating debt in Chapter 2.

<sup>23</sup> *Minn. Stat.* (2002), §124D, subd. 4(e).

<sup>24</sup> *Minn. Stat.* (2002), §124D.10, subd. 4a.

and Reporting Standards (UFARS).<sup>25</sup> MDE uses UFARS data to monitor the fiscal health of school districts and charter schools and to track revenues and expenditures. Since school funding is based on the number of students served, charter schools, like school districts, must report regularly on the number of students attending school. Aid payments for the school year are initially based on enrollment projections made in June at the end of the prior school year. In general, MDE reconciles differences between projected and actual enrollment and adjusts aid payments at the end of the school year. The requirements for charter schools in their first three years of operation are different. These charter schools must submit quarterly enrollment reports to MDE, listing each student by grade and showing the student's start and end dates. MDE uses these data to make interim adjustments to aid payments, as needed.<sup>26</sup> Charter schools must also submit an annual report to the school's sponsor and MDE.<sup>27</sup>

## GOVERNANCE AND OVERSIGHT

Charter school oversight begins with charter school boards, but sponsors and MDE also have oversight responsibilities. In this section, we provide background information on their roles. A more detailed discussion of how they implement their responsibilities is in Chapter 2.

Charter schools must be governed by a board of directors elected by the staff employed by the school and the parents of enrolled children. By the end of the third year of operation, a majority of the school's board must be teachers unless MDE waives this requirement.<sup>28</sup> Boards generally set school policies, adopt budgets, and make major decisions. They usually hire directors who are responsible for the day-to-day operation and financial management of their schools.

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### The relationship between each charter school and its sponsor is defined in a contract.

As shown in Table 1.2, six types of organizations may sponsor a charter school.<sup>29</sup> Currently, 39 entities sponsor the 76 charter schools operating in fiscal year 2003. School districts sponsor the majority of charter schools (51 percent). The Minneapolis and St. Paul school districts each sponsor nine charter schools. None of the 16 other school districts that sponsor charter schools sponsor more than two. Colleges and universities sponsor 30 percent of the charter schools, with the University of St. Thomas and Central Lakes Community College each sponsoring three. MDE sponsors seven charter schools, and charitable organizations sponsor five.

The sponsor's authorization for a charter school must be in the form of a contract that, among other things, describes the school's program, including specific

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<sup>25</sup> *Minn. Stat.* (2002), §123B.77.

<sup>26</sup> *Minn. Stat.* (2002), §124D.11, subd. 9(d).

<sup>27</sup> *Minn. Stat.* (2002), §124D.10, subd. 14.

<sup>28</sup> *Minn. Stat.* (2002), §124D.10, subd. 4(c).

<sup>29</sup> The 2003 Legislature added certain chambers of commerce, business associations, or similar nonprofit corporations to the list of eligible sponsors, but these associations may only sponsor a school that has operated for at least three years with another sponsor. *Laws of Minnesota* (1Sp2003), ch. 9, art. 2, sec. 22.

**Table 1.2: Sponsorship of Charter Schools Open in FY2003**

<u>Type of Sponsor</u>	<u>Number of Sponsors</u>	<u>Number of Charter Schools Sponsored</u>	<u>Percentage of Charter Schools</u>
School District	18	39	51%
College or University	15	23	30
Department of Education	1	7	9
Charitable Organization <sup>a</sup>	4	5	7
Intermediate School District <sup>b</sup>	1	2	3
Education District <sup>c</sup>	<u>0</u>	<u>0</u>	<u>0</u>
Total	39	76	100%

<sup>a</sup>Charitable organizations must belong to the Minnesota Council of Nonprofits or the Minnesota Council on Foundations, must be registered with the Attorney General's Office, and must have a year-end fund balance of at least \$2 million.

<sup>b</sup>The state has three intermediate school districts that provide services, particularly in the areas of vocational and special education, to member school districts in the Twin Cities metropolitan area.

<sup>c</sup>Education Districts are agreements among five or more school districts to coordinate programs and services. None of Minnesota's 18 education districts sponsored charter schools in 2003.

SOURCES: *Minn. Stat.* (2002), §124D.10, subd. 3 and 4; §§123A.15–123A.19; §§136D.01–136D.76; and Department of Education data.

**Sponsors and the Department of Education share responsibility for overseeing charter schools' fiscal performance.**

outcomes students are expected to achieve; the school's management and administration; and the requirements and procedures for program and financial audits. Contracts may last up to three years.

The sponsor's oversight responsibilities, as broadly stated in statute, are to monitor and evaluate the fiscal and student performance of the school.<sup>30</sup> Each charter school must report annually to its sponsor with the information the sponsor requires.<sup>31</sup> At the end of the contract term, the sponsor must evaluate the school's performance and decide whether to renew the contract. The sponsor must give the school 60 days notice if the contract is not renewed. The sponsor may also terminate a contract mid-term with 60 days notice. The grounds for either terminating or not renewing a contract are the same:

- failure to meet the requirements for pupil performance contained in the contract;
- failure to meet generally accepted standards of fiscal management;
- violations of law; or
- other good cause shown.<sup>32</sup>

<sup>30</sup> *Minn. Stat.* (2002), §124D.10, subd. 15. A sponsor may annually assess a school up to \$30 per student (\$10,000 maximum) for the first three years of sponsorship and up to \$10 per student (\$3,500 maximum) for subsequent years to pay for monitoring and evaluation.

<sup>31</sup> *Minn. Stat.* (2002), §124D.10, subd. 14.

<sup>32</sup> *Minn. Stat.* (2002), §124D.10, subd. 23(b).

A school may appeal a sponsor's decision to terminate or not renew a contract to MDE. Unless MDE approves a different eligible sponsor for the school, the school must be dissolved.<sup>33</sup>

MDE's other oversight responsibilities for charter schools are similar to those for school districts. For example, MDE must ensure that state academic and testing requirements are met, that teachers are licensed, and that buildings meet health and safety requirements. As the agency responsible for distributing state education aid, MDE must verify the accuracy of enrollment counts. With regard to financial matters, MDE monitors compliance with financial reporting requirements, receives and evaluates financial audits, and provides training and day-to-day technical assistance in financial management.

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<sup>33</sup> MDE may also terminate an existing contract between a charter school and its sponsor if the school has a history of financial mismanagement or repeated violations of the law. *Minn. Stat.* (2002), §124D.10, subd. 23(c).





# Financial Management

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## SUMMARY

*Based on indicators related to year-end fund balances and deficit spending, about one-fourth of charter schools open in fiscal year 2002 were having financial problems. However, roughly the same proportion of charter schools and school districts ended the year in statutory operating debt. Key factors contributing to charter schools' financial problems included deficiencies in financial management policies and poor decisions made by school administrators and boards. The Minnesota Department of Education monitors charter schools' compliance with laws governing the distribution and use of education aid, and in recent years, has initiated several well-received efforts to better assist charter schools. Sponsors are required to monitor and evaluate charter schools' fiscal performance, but many of the sponsors included in our review had a hands-off relationship with their sponsored schools. The state, in general, has not set clear expectations for sponsors regarding the extent and nature of their oversight responsibilities. We recommend that sponsors' obligations regarding financial oversight be clarified and that the Department of Education take additional steps to improve charter schools' capacity to manage the business side of their operations.*

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**A**lthough charter schools are perceived to be largely free from state regulation, that is not the case—particularly regarding financial management. After several high-profile charter school closures and based on broader concerns regarding poor financial management and conflicts of interest, the Legislature amended state law in 2001 to place charter school finances under closer state scrutiny. Now, as discussed in Chapter 1, charter schools must comply with the same financial accounting and reporting requirements that apply to school districts.

This chapter discusses charter schools' financial status in fiscal year 2002 and the effectiveness of financial oversight mechanisms. Specifically, we address the following questions:

- **To what extent have Minnesota charter schools experienced financial difficulties?**
- **What are the underlying causes of any financial problems, and how have charter schools responded?**

- **How effectively have the state and sponsors monitored charter school financial management and helped schools avoid or rectify financial difficulties?**

To assess charter schools' financial status, we analyzed financial and student data reported to the Minnesota Department of Education (MDE) for fiscal years 2000 through 2002.<sup>1</sup> We also developed criteria, based primarily on year-end fund balances and the extent of deficit spending, to identify charter schools in financial difficulty. Applied to fiscal year 2002 financial data, 16 of 68 charter schools met our criteria. Two of the schools have since closed. To understand the circumstances contributing to financial difficulties, efforts to improve their financial status, and the roles sponsors and MDE played in resolving problems, we interviewed school directors, school board chairs, and sponsor representatives for each of the 14 charter schools that remained open in fiscal year 2003. We also reviewed annual reports, financial audit reports, sponsor evaluations, and other documents. In addition, we asked MDE staff and others to identify several charter schools that have demonstrated strong financial management practices, and we interviewed administrators at five selected schools.<sup>2</sup>

To assess the extent to which MDE and sponsors monitor charter schools' financial status and help charter schools with financial management, we relied on interviews with charter school administrators, MDE staff, and sponsor representatives. Our work with sponsors focused on the 11 organizations that sponsored the 14 schools we reviewed in depth. In total, these 11 organizations sponsored about half of the charter schools open in fiscal year 2002. In addition, we reviewed laws; MDE policies, training materials, and staffing data; and various documents related to charter school sponsorship.

## CHARTER SCHOOLS' FINANCIAL STATUS

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**"Statutory operating debt" is a key indicator of a charter school or district's fiscal health.**

There are numerous indicators of fiscal health or lack of health in a school district including the presence of qualified personnel in fiscal management, appropriate financial management policies and practices, and ultimately a set of financial indicators demonstrating fiscal health. Charter schools and school districts are required to report detailed, audited revenue and expenditure data for each fiscal year (ending June 30) to MDE by November 30. As a key indicator of a charter school or school district's fiscal status, MDE measures the end-of-year general fund balance as a percentage of general fund annual expenditures. If the percentage is  $-2.5$  percent or worse, the school is considered to be in statutory

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<sup>1</sup> These are the most recent fiscal years for which reliable data are available. According to MDE, charter school financial data for fiscal years 1999 and earlier are suspect due to errors and inconsistencies in the use of reporting categories.

<sup>2</sup> The five schools are Bluffview Montessori, Math and Science Academy, Schoolcraft, Skills for Tomorrow High School, and Twin Cities Academy.

operating debt (SOD).<sup>3</sup> Charter schools or districts in SOD status are required by law to submit a plan to MDE laying out how the school will get out of debt and achieve a healthier fund balance. MDE must withhold state aid payments from charter schools and districts that do not provide a plan.<sup>4</sup>

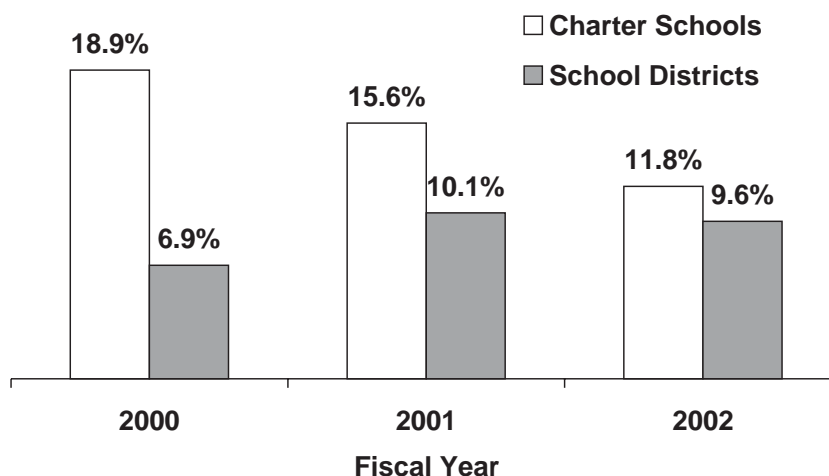
Our analysis of financial data and interviews with charter school officials showed that:

- **Charter schools are vulnerable to financial difficulties, but for fiscal year 2002, roughly the same proportion of charter schools and school districts ended the year in SOD.**

In fiscal year 2002, about 12 percent of charter schools were in SOD status compared to about 10 percent of school districts.<sup>5</sup> As shown in Figure 2.1, the proportion of charter schools in SOD has declined since fiscal year 2000. Several factors may have contributed to this decline. First, seven charter schools closed in fiscal year 2001 due to financial problems. Second, as discussed later in this chapter, MDE initiated an effort to proactively identify and assist charter schools and school districts at risk of being in SOD. MDE’s intervention efforts may have

**The proportion of charter schools in statutory operating debt has declined.**

**Figure 2.1: Percentage of Charter Schools and School Districts in Statutory Operating Debt, FY2000-2002**



NOTES: Data include two charter schools in fiscal year 2002 and one charter school each in fiscal years 2000 and 2001 that closed and were deemed to be in statutory operating debt although the schools failed to report complete financial data. The formula for calculating statutory operating debt changed between fiscal years 2000 and 2001.

SOURCE: Office of the Legislative Auditor analysis of Department of Education data.

<sup>3</sup> The SOD calculation also takes encumbered funds into account, so the percentage is the amount of the unreserved/undesignated general fund balance less encumbrances divided by general fund expenditures.

<sup>4</sup> *Minn. Stat.* (2002), §124D.10, subd. 8(h).

<sup>5</sup> This includes two charter schools, Martin Hughes and Mexica Multicultural, that closed during or shortly after the 2001-2002 school year. According to MDE, both were in substantial debt at the time they closed.

helped some charter schools avoid deeper financial difficulty. And finally, some of the difference between fiscal years 2000 and 2001 may have resulted from a 2001 change in how MDE measures debt.<sup>6</sup>

While there is no firm rule regarding how large a fund balance charter schools should maintain, MDE staff and charter school financial auditors said that a reasonable target is a general fund balance ranging from 10 to 20 percent of general fund expenditures. As shown in Table 2.1, 53 percent of charter schools ended fiscal year 2002 with a general fund balance of 10 percent or more compared to 58 percent of schools districts. More detailed revenue, expenditure, and fund balance data are included in the Appendix.

**Table 2.1: Charter School and School District General Fund Balances as a Percentage of Expenditures, FY2002**

General Fund Balance as a Percentage of Expenditures	Charter Schools		School Districts	
	Number	Percentage	Number	Percentage
-2.5% or lower (Statutory Operating Debt)	8 <sup>a</sup>	12%	33	10%
0 to -2.5%	2	3	12	3
1 to 9%	21	31	98	29
10% or higher	36	53	200	58
No Financial Data Available	1	1	—	—
Total	68	100%	343	100%

NOTE: Fund balance is the unreserved/undesignated general fund balance less general fund encumbrances. The percentage is this net amount divided by general fund expenditures.

<sup>a</sup>Includes two schools that closed in 2002 and were deemed to be in statutory operating debt though they failed to report complete fiscal year financial data.

SOURCE: Office of the Legislative Auditor analysis of Department of Education data.

### Low fund balances place charter schools at risk.

Along with broader financial management problems that may exist, low fund balances place charter schools at financial risk. For example, a low fund balance makes it more difficult to manage cash flow or pay for large, unexpected expenses. Because of this vulnerability, we used a set of criteria broader than SOD status to identify charter schools that ended fiscal year 2002 in financial difficulty. For our review, we categorized a charter school as being in financial difficulty if it (1) had a negative general fund balance at the end of fiscal year 2002, (2) had an annual operating deficit in fiscal year 2002 larger than its

<sup>6</sup> Prior to fiscal year 2001, the SOD calculation included the Food Service and Community Service funds. According to MDE, the statute was changed to more directly exhibit a district or charter's schools financial status because Food Service and Community Service funds cannot be used for K-12 operating expenditures. Similarly, other reserve accounts in the general fund are restricted to specific functions.

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**We identified 16 charter schools in financial difficulty in fiscal year 2002, two of which have closed.**

year-end fund balance and its balance was relatively low,<sup>7</sup> or (3) had not reported final fiscal year 2002 financial data to MDE as of March 2003.

We identified 14 charter schools that were in financial difficulty at the end of fiscal year 2002 and were still operating at the time of our review. As shown in Table 2.2, eight of the schools had negative fund balances at the end of fiscal year 2002, including six schools in SOD. Five schools had positive ending fund balances but had operating deficits larger than their fund balances. One school failed to submit financial data to MDE. As noted earlier, two additional charter schools that had been open in fiscal year 2002 closed because of financial problems, and we did not include these schools in our detailed review. Including the two schools that closed, the 16 charter schools in financial difficulty accounted for about 24 percent of the 68 charter schools that were open in fiscal year 2002.

## Factors Contributing to Financial Difficulty

To better understand the set of circumstances that led to financial problems at each of the 14 schools, we analyzed revenue, spending and student demographic data, interviewed school and sponsor officials, and reviewed financial audit reports, annual reports, and other documents. This analysis showed that:

- **A variety of factors contributed to charter schools' financial problems, notably poor financial planning and insufficient monitoring of actual revenues and spending.**

When comparing the group of charter schools in financial difficulty with the remaining charter schools, we identified some differences in school characteristics, but none of these factors clearly distinguished charter schools in financial difficulty from those that were not. The schools in our financial difficulty group were more likely to be newer—open three or fewer years in fiscal year 2002—and more likely to be located in the Twin Cities metropolitan area. Of the 14 troubled charter schools, nine (64 percent) had been open three or fewer years.<sup>8</sup> In addition, 64 percent of all charter schools open in FY2002 were located in the seven county metropolitan area compared with 86 percent of the charter schools in financial difficulty (12 of the 14).

Charter schools in financial difficulty tended to spend slightly more on administrative expenses than other charter schools. As shown in Table 2.3, charter schools in financial difficulty spent about 19 percent of total expenditures on administrative and support costs, compared to about 15 percent for the

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<sup>7</sup> We included a school if expenditures minus operating revenues (excluding other sources of capital and transfers from other funds) exceeded the year-end fund balance and the fund balance was less than 5 percent of expenditures.

<sup>8</sup> Of the 66 charter schools that were the subject of our broader analysis, 38 schools (58 percent) were in their first, second, or third year of operation in fiscal year 2002. The nine schools in our financial difficulty group accounted for 24 percent of the newer schools. The remaining five schools in our financial difficulty group accounted for 18 percent of the 28 charter schools that had been operating four or more years in fiscal year 2002.

**Table 2.2: Charter Schools in Financial Difficulty, FY2002**

<u>Charter School</u>	<u>Grades Served</u>	<u>Fiscal Year Opened</u>	<u>Location</u>	<u>Sponsor</u>	<u>FY2002 Revenues Less Expenditures<sup>a</sup></u>	<u>FY2002 General Fund Balance as a Percentage of Expenditures<sup>b</sup></u>
Native Arts High School <sup>c</sup>	7-12	2001	Minneapolis	Augsburg College	No data reported	No data reported
Face to Face Academy	9-12	1999	St. Paul	St. Paul Public Schools	\$ -98,226	-17.7%
New Heights School	K-12	1994	Stillwater	Stillwater Public Schools	8,176	-8.1
Studio Academy	10-12	2001	Rochester	College of Visual Arts <sup>d</sup>	15,262	-6.2
Heart of the Earth Center for American Indian Education	K-12	2000	Minneapolis	Minneapolis Public Schools	192,181	-4.4
New Visions School	K-8	1995	Minneapolis	Minneapolis Public Schools	-154,648	-4.2
Minnesota Institute of Technology	K-6	2001	St. Paul	University of St. Thomas	-332,457	-3.0
Crosslake Community School	K-6	2001	Crosslake	Department of Education	-25,439	-2.0
Excell Academy for Higher Learning	K-4	2002	Brooklyn Park	North Central University	-20,783	-1.3
Agricultural and Food Sciences Academy	9-10	2002	Little Canada	Northeast Metro Intermediate School District	-80,118	0.3
High School for Recording Arts	9-12	1999	St. Paul	St. Paul Public Schools	-25,917	0.6
HOPE Community Academy	K-4	2001	St. Paul	University of St. Thomas	-214,599	1.8
North Lakes Academy	6-9	2000	Forest Lake	Department of Education	-163,715	3.0
Odyssey Charter School	K-11	1999	Brooklyn Center	Osseo School District	-59,689	3.1

NOTE: The table excludes two schools (Martin Hughes and Mexica Multicultural) that were open in fiscal year 2002 but later closed due to financial problems.

<sup>a</sup>The revenue amount used in this calculation excludes loans and transfers from other funds.

<sup>b</sup>To calculate the fund balance percentage, we used the Department of Education statutory operating debt calculation formula: unreserved/undesignated general fund balance less general fund encumbrances divided by general fund expenditures.

<sup>c</sup>As of April 2003, Native Arts had not submitted UFARS data or a financial audit report for fiscal year 2002.

<sup>d</sup>At the end of fiscal year 2002, the College of Visual Arts chose not to renew its contract with Studio Academy. Volunteers of America, a nonprofit organization, is the school's current sponsor.

SOURCE: Office of the Legislative Auditor analysis of Department of Education data.

**Table 2.3: Charter School Expenditures Per ADM, FY2002**

	Schools Not in Financial Difficulty (N=52)		Schools in Financial Difficulty (N=13)		All Charter Schools (N=65)	
	Median Expenditures per ADM	Median Percentage of Total Expenditures	Median Expenditures per ADM	Median Percentage of Total Expenditures	Median Expenditures per ADM	Median Percentage of Total Expenditures
<b>Operating Expenditures</b>						
Administration <sup>a</sup>	\$1,491	15.4%	\$ 1,657	19.5%	\$1,516	15.5%
Instruction	3,625	40.8	3,959	38.1	3,638	39.7
Special Education	622	6.9	834	6.7	624	6.9
Food Service	248	2.4	235	2.5	235	2.5
Other Operating <sup>b</sup>	860	9.6	1,175	12.1	905	9.7
Total Operating	\$7,294	79.9%	\$ 8,289	81.0%	\$7,432	80.2%
<b>Nonoperating Expenditures</b>						
Lease	\$1,322	13.7%	\$ 1,459	14.6%	\$1,353	14.4%
Other Nonoperating <sup>c</sup>	607	6.6	274	2.5	534	5.5
Total Nonoperating	\$1,937	20.1%	\$ 1,805	19.0%	\$1,910	19.8%
Total Expenditures	\$9,321	100.0%	\$10,198	100.0%	\$9,367	100.0%

NOTES: Our analysis excluded one charter school that, as of April 2003, had not reported any financial data for fiscal year 2002. Analysis also excludes two charter schools that were open in fiscal year 2002 and subsequently closed. Average daily membership (ADM) is the sum for all pupils of the number of days of the school year each pupil is enrolled divided by the number of days that school is in session. Data presented are medians and will not add to totals.

<sup>a</sup>“Administration” includes expenses for the school board, administration (e.g., principal and office staff), and central office services such as data processing and printing.

<sup>b</sup>“Other Operating” includes, among other things, vocational instruction, instructional and pupil support services, building operations and maintenance, and student transportation.

<sup>c</sup>“Other Nonoperating” includes capital outlay, community service (such as adult education), building improvements, and debt service.

SOURCE: Office of the Legislative Auditor analysis of Department of Education data.

other charter schools.<sup>9</sup> However, schools varied widely. Administrative expenditures for individual schools ranged from 5 percent to 34 percent for all charter schools and from 10 percent to 33 percent for charter schools in financial difficulty.

Statewide, schools in financial difficulty spent \$877 more per student compared to other charter schools. However, some of this discrepancy reflects differences in spending between metro and outstate charter schools. For all charter schools, median expenditures per student for metro-area charter schools were \$1,526 higher than for outstate charter schools (\$10,143 per student for metro charter schools compared to \$8,617 for outstate charter schools). Still, comparing metro charter schools only, median spending per student for the 11 metro schools in our

<sup>9</sup> We had financial data for only 13 of the 14 charter schools in financial difficulty. Also, charter schools did not consistently use the same categories to report expenditures to MDE. As a result, we combined two related UFARS categories (administration and district support) for our analysis of administrative spending.

financial difficulty group (\$10,453 per student) was \$567 higher than spending per student for other metro-area charter schools (\$9,886 per student).

In our view, differences in school characteristics do not clearly explain why some charter schools ended up in financial difficulty while others did not, and differences in spending patterns indicate broader financial management issues. Each of the 14 schools had a unique set of circumstances that led to financial difficulties, but in general, the source of problems lay in the financial management decisions and practices of school administrators and boards. Among the 14 charter schools we reviewed in detail, we identified a number of common factors that contributed to financial difficulties at some or all of the schools.

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**Financial problems often resulted from the decisions and practices of charter school administrators and boards.**

- **Poor financial planning.** According to charter school and sponsor representatives, poor planning and budgeting were at the root of financial difficulties at most of the 14 schools. Financial planning issues included: not having a budget; relying on one-year budgets that lacked out-year projections; overestimating student enrollment; using unrealistic assumptions regarding access to other funding sources, such as grants; and creating budgets that were not sufficiently detailed on the expenditure side. Several schools reported not having board-approved budgets until well into the school year, and one school operated two years in a row with board-approved deficit budgets (the assumption being that fundraising during the year would close the gap). Use of start-up grants also created problems for some new charter schools that relied too much on start-up money to create programs that could not be sustained with the normal aid streams.
- **Insufficient monitoring of actual to budgeted revenues and expenses.** At many of the 14 charter schools, the director and board did not pay sufficient attention to or did not have systems in place to track actual revenues and expenditures to budgeted amounts. In some cases, the school director or board members did not grasp the importance of ongoing financial monitoring; in other cases, the director and board were not able to obtain reliable financial reports from their own accounting systems or from their contractors. For example, at one school that used in-house accounting, the financial manager was not able to produce reliable monthly financial reports. The bookkeeping problem at this school was so severe that the fiscal year 2001 financial audit report was not completed until March 2003 because of insufficient books and records. According to the directors at two other schools that used a management company, the company failed to provide accurate—or during some time periods, any—financial status reports for fiscal years 2001 and 2002. Other school directors said that they and their boards did not act quickly enough to cut costs when it became apparent that revenues and expenditures were out of line.
- **Lack of an independent school board.** Governance issues associated with charter school boards were intertwined with financial planning and monitoring problems at some of the 14 schools. At some schools, the school director or other administrative leader also served as chair of the school board when the financial problems began. This left important budgeting and day-to-day financial management activities in the hands of one person, resulting in loss of accountability. At the time of our review, only one of the 14 schools still had



this governance structure in place. Two other schools are or had been affiliated with a parent nonprofit organization, and decision making was impeded because it was unclear whether the school or the parent nonprofit was the authority. In other cases, the inherent conflicts of interest associated with a teacher-majority board exacerbated financial problems. For example, in at least one school, teachers were slow to react to revenue shortfalls because they were reluctant to cut their own salaries or lay off teachers.

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**Minnesota's school finance system is complex and a challenge for charter schools to navigate.**

- **Misunderstandings regarding state requirements.** Errors navigating the complexities of Minnesota's school financing system contributed to specific funding problems at several of the 14 schools, and understanding the array of state requirements was a general source of frustration. One problem for charter schools is improperly reporting enrollment because of misunderstandings regarding the definition of average daily membership. Other charter schools made errors related to special education and food service funding. In some cases, these errors meant that charter schools did not receive all of the aid to which they were entitled. In other cases, MDE audits revealed that charter schools had received too much aid, and the school did not have sufficient resources to reimburse the state.
- **Insufficient resources to handle unexpected expenses or low enrollment.** Charter schools are often described as operating on a shoestring. Even with a solid business plan, unexpected expenses can have an adverse effect on a small school's finances. For example, one of the schools had been making headway on reducing its debt, when unexpectedly high heating costs in the winter of 2001 set the school back. Another school took out a four-year, \$150,000 bank loan because it had insufficient resources to resolve a cash flow problem when a portion of state aid payments was deferred to the following year. Other charter schools found themselves in financial difficulty when the school opened with enrollment lower than planned or when enrollment dropped substantially from one year to the next and the school did not make spending cuts sufficient to cover the revenue shortfall.

In summary, many of the financial difficulties at the schools we reviewed stemmed from deficiencies in financial planning and day-to-day financial management and from governance structures that did not establish clear accountability. Interviews with administrators at the five schools identified as having strong financial management systems confirmed that charter schools need to directly address these issues to help ensure a school's fiscal health. Administrators at the five fiscally sound schools expressed common themes: develop budgets using conservative enrollment estimates; use multi-year budget projections to understand the implications of financial decisions; treat start-up grants as one-time money; recruit school board members with demonstrated skills in financial management; have qualified financial staff; provide the board with monthly reports that track revenues and expenditures to budgeted amounts; and make immediate adjustments to cut spending when revenues fall below projections.

Nearly all of the charter school administrators, board chairs, and sponsor representatives we interviewed (at the troubled and financially healthy schools) emphasized that a well-functioning board was essential to sound financial

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**A well-functioning school board is essential to sound financial management.**

management. Many, however, said that the statutory requirement to have teachers hold a majority of board seats can undermine this goal. They argued that the teacher-majority structure carries with it inherent conflicts of interest that make financial management more difficult. For example, teachers on the board are both employees of and supervisors of the school director. Some school board chairs also noted that it is quite difficult for some teachers to avoid acting as teacher advocates rather than policy makers. Charter schools may request a waiver from the teacher-majority requirement.<sup>10</sup> According to MDE, six charter schools had waivers as of June 2003. MDE staff noted, however, that a charter school does not have to have a teacher-majority board until its third year of operation, and the agency expects to receive more waiver requests as newer charter schools approach the three-year mark.

## Resolving Financial Problems

During our interviews, we asked school representatives what steps they had taken to resolve their financial difficulties. We also obtained information from the recovery plans the six schools in SOD submitted to MDE. Our review showed that:

- **All of the 14 charter schools are taking steps to improve their financial status.**

These steps focus on increasing revenue, cutting expenses, changing the school's day-to-day financial management, or modifying the budget process or school's governance structure.

Most schools are trying to increase revenue either by increasing enrollment or bringing in new sources of funding. Since most school funding depends on the number of students enrolled, retaining and recruiting students is critical to maintaining or increasing revenue. Several schools developed strategies to more aggressively recruit new students. These included: changing an after-school program to attract more student participation, adding a grade level to stabilize enrollment and to make the school more attractive to students, and adding transportation services to reduce student attrition. Charter schools also sought outside funding by seeking direct private donations and pursuing grants. Other revenue-raising strategies included increasing food prices to offset lunch program losses, selling educational services to other schools, and capturing (through more accurate record keeping and reporting) special education aid to which the school was entitled.

Nearly all schools also took steps to cut short-term or long-term expenditures. Because personnel costs are a major budget item, many of the schools cut spending on administrative and educational staff through layoffs, reducing schedules, and implementing salary freezes or reductions. Several schools achieved personnel cost savings by outsourcing benefit administration, changing

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<sup>10</sup> *Minn. Stat.* (2002), §124D.10, subd. 4(c).



Financially troubled charter schools often instituted tighter controls on spending for classroom supplies.

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**Many of the financially troubled schools cut staff or reduced pay and benefits.**

insurance carriers, or requiring staff and students to perform additional tasks. One school started using teachers to oversee the lunch period (rather than aides) and reduced custodial costs by requiring students to help clean the school. Other cost-saving actions included dropping a money-losing hot lunch program, limiting instructional supplies, buying used textbooks, and increasing use of free community services. Other schools made fundamental changes to their programs to cut costs. In one case, the school spun off grades 10 to 12 by establishing a new charter school that could access additional revenues through start-up funding. Several schools reduced or eliminated use of a year-round calendar option, and another school moved to a smaller location to reduce lease costs.

Most schools changed their day-to-day financial management and monitoring practices. As discussed above, some of the charter schools did not have enough control over their financial records and day-to-day financial activities. They rectified this problem by hiring in-house business managers or changing contracting relationships to allow more control by the school. Some schools added procedures to control spending, such as requiring the use of purchase orders or reducing the use of credit cards. Several schools adopted a policy that managers would frequently review the school's financial situation and recommend changes to the board when assumptions changed or when actual revenues or expenditures did not match up with those budgeted. Administrators cited more frequent enrollment updates as key to keeping on top of the school's finances.

Some schools changed their governance structures or made other changes to improve administrators' and board members' financial management skills. In some cases, this involved creating an independent board membership and identity separate from a parent organization that had originally started the school. Several schools set up board committees that focus on certain tasks such as finance, planning, or management and expanded membership on these committees to other

parents and community members with needed skills. One school uses a management team comprised of the school's principal, finance manager, and two board members to oversee school finances. Some of the charter schools with financial problems also sought additional training for administrators and board members, and most made extensive use of MDE staff expertise through frequent phone calls.

Some troubled charter schools also changed their budget development and review processes. These changes included establishing a timetable and process for developing a budget and reviewing it mid-year, creating budget spreadsheets to model various assumptions, and budgeting over a multi-year period. Relying on more conservative budget assumptions also played a role in improving schools' fiscal positions, for example, by using more conservative enrollment projections or not including grants in revenue estimates until the grant is received. Several have included a reserve category in the budget. One school separated its start-up money from regular education aid, saving some of it for future needs.

## FINANCIAL OVERSIGHT AND ASSISTANCE

Charter school directors and school boards share responsibility for directly managing school finances, while sponsors and MDE each have oversight roles. As discussed in Chapter 1, MDE's obligations focus on proper disbursement of state and federal education aid and proper accounting for the use of those funds. Sponsors are expected to monitor and evaluate the charter schools' fiscal performance, though as we discuss below, the parameters of this responsibility are not clearly defined. Charter schools influence the extent to which MDE and sponsors are able to oversee and assist with financial management by controlling the flow of financial information. Our review focused on how sponsors and MDE have implemented their oversight authority and the extent to which they assisted charter schools in financial difficulty.

### Department of Education

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**The Department of Education oversees proper disbursement and use of education aid.**

MDE uses a variety of tools to help charter schools (and school districts) comply with school financing requirements and, in general, improve their fiscal condition and financial reporting. Among other things, MDE staff provide training and special workshops, report on data and calculations used to determine annual revenues and state aid payments, do enrollment and program audits, monitor and evaluate financial audit reports, and provide day-to-day assistance in response to questions. Overall:

- **MDE has initiated new efforts in recent years to more actively monitor charter school finances and to help charter schools improve financial management.**

The department's new efforts include checking the accuracy of enrollment reports through more frequent reporting and site visits, early intervention with charter

schools showing signs of fiscal problems, and efforts to improve the quality and timeliness of day-to-day assistance.

According to MDE finance and management staff, much of their work with charter schools focuses on new schools. One aspect of this assistance is quarterly monitoring of school enrollment so that state aid entitlements are adjusted to reflect actual enrollment several times during the year rather than in a single year-end adjustment. By law, this quarterly reporting is required for charter schools in the first three years of operation and is designed to alleviate problems associated with excessive over advances of state aid based on inflated enrollment estimates.<sup>11</sup> Because charter schools generally operate on small, tight budgets, most school and MDE officials we interviewed said that the quarterly monitoring was a good management tool, and several suggested that it be extended to all charter schools rather than only those in their first three years of operation. But, enrollment monitoring is not an automated process. MDE staff review revised enrollment estimates for reasonableness and visit each new charter school after the first quarterly report. Because of the effort required to confirm the accuracy of submitted enrollment data, MDE said that extending this monitoring activity to all charter schools would probably require changing the current part-time assignment to full-time. Currently, charter schools that have been operating four or more years are not required to adjust enrollment projections, but may submit revised enrollment data throughout the year. Those that overestimate enrollment and do not make interim adjustments will have to repay the state when actual revenues are calculated based on final reported enrollment.

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**The department initiated an early-intervention effort to help charter schools at risk of financial problems.**

In fiscal year 2001, MDE finance and management staff initiated an early intervention effort to identify charter schools and school districts at risk of falling into SOD. MDE identifies charter schools and school districts for this “watch list” based on the prior year’s financial data and other available information. Indicators include such things as size of a prior year deficit relative to fund balance, deficits in special revenue accounts, or deficit spending several years in a row. According to MDE, staff provide one-on-one assistance to charter schools and districts on the watch list. Staff use schools’ budget and financial data to demonstrate to administrators and school boards that they need to take near-term actions to increase revenues, make appropriate spending cuts, and institute a fiscal policy that does not allow deficit spending. According to MDE and charter school administrators, MDE staff provide a similar level of assistance to charter schools in SOD.

In addition to assisting charter schools on the watch list and in SOD, MDE staff provide ad-hoc technical assistance to charter schools. According to MDE, financial management staff made a concerted effort in the past few years to be more proactive in advising charter schools and more timely in responding to questions regarding financial management. Nearly all charter school officials interviewed during our review gave MDE staff high marks for the quality and

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<sup>11</sup> *Minn. Stat.* (2002), §124D.11, subd. 9(d). In general, a charter school or district receives aid for a fiscal year based on enrollment projections made early in the year. An adjustment payment, either from the school to the state or vice versa, is made at the end of the year if actual enrollment differs from projections. Some charter schools have gotten into financial difficulty when they seriously overestimated enrollment and were not able to repay the state.

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**Charter school administrators and boards are not uniformly taking advantage of training opportunities.**

timeliness of this question-and-answer assistance. At one school, for example, staff called MDE on nearly a daily basis after realizing the extent of their financial troubles.

MDE provides training on a variety of school finance issues, but based on our review, charter school administrators and boards are not uniformly taking advantage of these or other training opportunities. By law, MDE is required to provide financial management training on an ongoing basis to charter school board members, but the workshop MDE offers to meet this requirement is limited.<sup>12</sup> According to MDE, the agency requires interim board members at new charter schools to attend a full-day training workshop for newly approved schools. Instruction regarding the functions of a charter school board is one segment of this training. At their

choice, board members can attend other MDE classes. Among other workshops, MDE offers a two-day Charter School Business Management workshop. We requested from MDE fiscal year 2003 training dates and attendance information for this training. According to the data provided,

MDE held two sessions prior to the start of the 2002 – 2003 school year (one in July and another in August 2002). Attendance rosters showed that 38 charter schools sent at least one representative, though many sent two or three; five attendees representing three schools were listed as being school board members. Based on our interviews, the schools that have sent staff to MDE workshops found them to be helpful.



To help new charter schools stay on budget, MDE monitors quarterly enrollment reports.

Some charter schools reported that administrators and board members were getting financial management training from other sources, including the Minnesota School Boards Association, the Minnesota Association of Charter Schools, and organizations that teach nonprofit management. However, some boards among our financially troubled schools still had not sought training in general board responsibilities or school financial management. While this lack may not be as significant for boards that have members with previous board or management experience, lack of training is a concern for charter school boards whose members are predominantly teachers or others who may lack such experience.

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<sup>12</sup> *Minn. Stat.* (2002), §124D.10, subd. 4(e).

Although MDE receives generally high marks from charter schools for the training and technical assistance it provides, it is unclear whether MDE will be able to sustain this level of assistance in the wake of budget cuts and staff reductions. Prior to the advent of charter schools, MDE worked with about 340 school districts. Because each charter school functions as its own district, growth in the number of charter schools combined with the level of assistance each new school generally needs has created a growing workload for MDE staff. Since fiscal year 2000, MDE has increased by about three full-time equivalent positions the amount of staff time allocated to charter schools, though the number of staff members who work with charter schools full-time, or nearly so, has declined.

In its 2003 reorganization, MDE managers said the department employed a strategy of making part-time charter school assignments to various staff specialists rather than employing as many full-time charter school generalists. Specific to financial management, for example, MDE had a full-time staff member devoted to a range of charter school financial management issues but eliminated this position when the incumbent left early in 2003. According to MDE, the responsibilities included in this position were reassigned to four other staff on a quarter-time basis. Also as part of the reorganization, MDE made three part-time assignments at one-quarter time each for (1) revenue budgeting, (2) enrollment projections and pupil transportation, and (3) financial accounting, expenditure budgeting, and general financial management issues. As of June 2003, MDE has 25 staff members, including support staff and supervisors, in the school finance area who have charter school responsibilities on a part-time basis (with time allocated to charter school responsibilities ranging from 2 to 33 percent) but no staff assigned full-time to charter schools. MDE managers said that one staff member will be designated as a point of contact for charter schools and will refer schools to appropriate specialists as needed.

## Sponsors

As discussed in Chapter 1, charter school law gives sponsors general responsibilities to monitor a school's fiscal status and to evaluate its overall performance. The law also requires charter schools to provide a sponsor with annual financial audits and other annual performance reports if the sponsor requests them. At the start of our review, we assumed that charter school sponsorship was not intended to be a passive activity, particularly for new charter schools or charter schools showing signs of financial difficulty. We evaluated sponsors' oversight from this point of view, assessing the extent to which sponsors sought and received information about charter schools' financial status and the extent to which sponsors helped schools improve their fiscal condition. Our work focused on the 11 organizations that sponsored the 14 schools we reviewed in depth. In total, these 11 organizations sponsored about half of the charter schools open in fiscal year 2002. We found that:

- **The role of charter school sponsors is ill defined, and the scope and nature of sponsors' financial oversight activities varies widely.**

While charter school law provides only a broad statement of a sponsor's role, schools and sponsors can use the charter school contract to spell out specific

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**State law provides only a broad statement of a sponsor's role.**

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**Sponsors generally did not use their contracts to establish detailed financial management expectations.**

terms and conditions of financial oversight, though none of the 14 charter schools chose to do so in detail. MDE provides charter schools with a model contract, but the financial management section, as shown in Table 2.4, is broadly worded and generally restates or refers to statute. Few of the 14 contracts deviated significantly from the model language, clarified specific obligations, or set performance expectations (e.g., timely record-keeping, training requirements, use of a realistic budget, reaching a specific fund balance). The contracts also did not clarify how the sponsor would oversee financial management or the extent to which the sponsor would provide assistance.

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**Table 2.4: Financial Management Provisions in the Department of Education Model Charter School Contract**

**FINANCIAL MANAGEMENT**

The charter school must:

- use UFARS financial accounting principles and methods;
- comply with MARSS requirements for student accounting;
- have all accounting records audited annually by a public accounting firm engaged by the charter school board of directors;
- comply with the same financial audits, audits procedures, and audit requirements of school districts (Minnesota Statutes sections 123B.75 to 123B.83) except when deviations are necessary because of the program of the charter school.
- provide the sponsor with a final copy of the annual audit within fifteen (15) days of its completion and acceptance.

The Department of Education, the State Auditor, or Legislative Auditor may conduct program, financial, and compliance audits.

NOTE: UFARS is the state's financial reporting system, and MARSS is the state's student attendance reporting system.

SOURCE: Department of Children, Families, and Learning, *Model Charter School Contract*; <http://cfl.state.mn.us/charter/modelcontract.pdf>; accessed May 14, 2003.

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Among sponsors included in our review, interactions with charter schools ranged from a hands-off approach that consisted primarily of the schools sending required annual reports to more active efforts during the school year to understand schools' operations and financial status. Most of the 11 sponsors—a mix of school districts and educational institutions—limited their information gathering to use of annual reports and perhaps an annual meeting. Others were more active in seeking information about charter school operations by requiring more frequent financial reports or having a charter school liaison visit the school or attend board meetings. One university, for example, provided written expectations regarding financial reports and has a charter school liaison who visits its three charter



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**Many sponsors had a hands-off relationship with their charter schools.**

schools and attends some board meetings.<sup>13</sup> In 2002, St. Paul Public Schools also hired a charter school liaison in an effort to be a more active sponsor.

The extent to which sponsors assisted charter schools in financial difficulty also varied, and the level of assistance was a point of contention between some of the 14 schools and their sponsors. As discussed above, some sponsors were not actively involved in monitoring charter school finances and, hence, provided little, if any, assistance. Other sponsors were more aware of ongoing problems, and provided some assistance. One sponsor, a university, spoke to the school director and school board chair about strategies for resolving problems with a management company and stressed the importance of obtaining accurate financial data. Another sponsor, a public school district, supplied the names of staff at the district and at MDE who could answer questions related to the school's specific problems (this sponsor's liaison did not have a background in school financial management). The charter schools involved did not always see this assistance in the same light and expected sponsors to do more. In the former case, the charter schools involved wanted the sponsor to intervene with a management company that was not providing adequate financial services. In the latter case, the school was already deeply in debt before the school district became involved, so school officials felt the sponsors' help was inadequate and untimely. Based on their experiences, several of the charter schools interviewed were considering seeking a new sponsor.

Misunderstandings between some of the schools included in our review and their sponsors highlight broad expectation gaps regarding sponsorship. Almost across the board, sponsors, school administrators, and others said that they did not clearly understand the role of the sponsor beyond the few specifics in charter school law. Views on what sponsors are supposed to do ranged from sponsors actively pushing charter schools to better fiscal and academic performance, to providing guidance only during start up, to being ongoing partners in developing academic programs without any oversight responsibility. Still others said that sponsorship had little practical value and should be eliminated as a requirement.

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**The extent to which sponsors should actively assist charter schools was a point of contention between some schools and their sponsors.**

In our view, charter schools in Minnesota require active financial oversight, and by law, sponsors are to play a role. The division of oversight responsibilities between MDE and sponsors, however, is an open question that needs to be resolved in order to hold both parties accountable for adequate oversight. Among the 14 schools, most looked to MDE for practical assistance understanding revenue streams, meeting reporting requirements, and correcting deficiencies in financial management practices. Still, according to MDE and charter school officials, MDE generally got involved with these schools when it noticed a red flag indicating that financial problems already existed. Because their role is not adequately defined, it is not clear how much sponsors should be held accountable for failing to ensure that charter schools had the basic financial management

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<sup>13</sup> In spite of these reporting expectations, two of the three charter schools the university sponsored could not provide the requested financial information. We discuss problems with the timeliness and accuracy of charter schools' financial reports later in the chapter.

capacity required to prevent problems. We discuss charter schools' readiness to manage business operations in more detail below.

## Financial Reporting

MDE counts on financial audit reports and transmittal of detailed financial and enrollment data to monitor schools' financial status and compliance with various laws. As discussed above, sponsors also rely heavily on annual audit reports to oversee a school's fiscal performance. Both parties' ability to detect financial problems was impeded because of late and incomplete financial reporting. We found that:

- **About 30 percent of charter schools missed deadlines for reporting fiscal year 2002 financial information to MDE, though timeliness improved compared to previous years.**

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**Charter schools were more likely than school districts to miss financial reporting deadlines.**

Charter schools are more likely to miss critical financial reporting deadlines than school districts, although timely reporting by charter schools has improved. Of the 66 charter schools included in our analysis, 19 (29 percent) missed MDE's November 30, 2002, deadline for posting summarized audit data in UFARS compared to about 14 percent of school districts. An even higher proportion (50 percent) of the 14 charter schools in financial difficulty missed the deadline. Nineteen charter schools (29 percent) also missed the December 31, 2002, deadline to submit financial audit reports compared to 12 percent of school districts. However, charter schools have improved their timely submission of financial audits. Among 56 charter schools open in fiscal years 2001 and 2002, the percentage of late and missing audits declined from 63 percent for fiscal year 2001 to 29 percent for fiscal year 2002. The 12 schools in our financial difficulty group that were open both years did not show the same improvement, with 50 percent in each year missing the audit report deadline.<sup>14</sup>

While late data and report submissions, in and of themselves, raise a red flag regarding financial management, the missing data make it more difficult for MDE to get a handle on the specifics of a school's situation. In January of each year, for example, MDE prepares a report on charter schools and school districts that ended the prior fiscal year in SOD. This designation relies on a reconciliation of financial audit reports and detailed financial data transmitted electronically. According to MDE, schools that fail to submit required financial data are excluded from the SOD analysis and are not subject to the legal requirements or scrutiny that apply to schools in SOD status. They are not required by law to submit a recovery plan and are not subject to a penalty.

MDE has little power to force charter schools to report financial data on time. If a school is in SOD status, MDE must withhold aid payments if the school does not

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<sup>14</sup> To avoid confusion, our analysis of reporting timeliness excluded the two charter schools that closed, although they were required to submit fiscal year 2002 financial data and an audit report. With the two closed schools included, 31 percent of 68 charter schools missed the November and December deadlines.

submit on time a plan for getting out of debt.<sup>15</sup> MDE does not have similar authority to penalize schools that submit late UFARS data or late financial audit reports. Rather, MDE relies on phone calls and letters urging late charter schools and school districts to comply.

Year-end financial reporting is important, but another indicator of financial management problems at charter schools is the lack of timely, accurate financial data needed to manage finances throughout the year. Among the schools we reviewed, absence of such data not only undermined day-to-day management at the school, but limited the sponsors' ability to understand the school's fiscal status as well. In one case, a sponsor noted, a charter school's financial data was so poor that 21 months elapsed between the time the sponsor reviewed the fiscal year budget and receipt of the financial audit report showing that the school had generated a large deficit. By that time, the sponsor had already reviewed a budget for a second fiscal year that, it turns out, was grossly inaccurate.

## Assessing Charter Schools' Readiness to Open

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**The Department of Education encourages charter schools to take advantage of 12 months of federally-funded planning time.**

MDE and sponsors tended to become more active in overseeing charter schools after schools were already in debt or otherwise struggling. But, the root causes of financial problems are often related to long-standing deficiencies in financial management skills and systems. We found that:

- **Gaps in the charter school approval and planning process allowed some charter schools to open without sufficient capacity to manage school finances.**

Although charter schools go through a planning phase before opening the doors to students, some schools were not ready to operate from a financial management perspective. Among the 14 schools we reviewed, many of the administrators and board chairs said that early mistakes and "lack of readiness" were at the root of current financial problems. MDE staff and sponsor representatives we interviewed agreed.

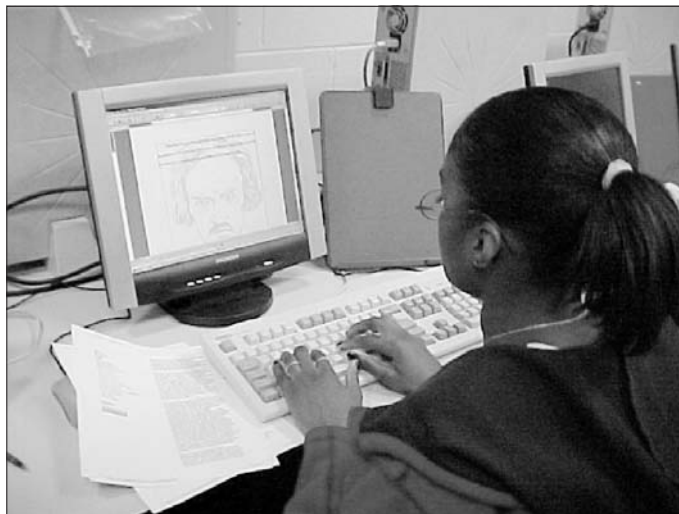
MDE approves charter school applications on the basis of a written proposal. Once a charter school is authorized through a contract with its approved sponsor, it is eligible to apply for federal planning funds to implement its development plan. Some of the 14 schools that we reviewed spent little time in this planning phase. Two schools, for example, were approved late in the spring and opened in the fall of the same year. In response to problems associated with having only a few months between approval and opening, MDE strongly recommends that charter schools apply for authorization by March 1 of one year to open in September of the following year in order to have 12 months of federally-funded planning time.

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<sup>15</sup> *Minn. Stat.* (2002), §124D.10, subd. 8(i) and §123B.81, subd 4.

**The decision to move from the planning stage to enrolling students is largely left up to charter schools.**

Once a charter school is approved, neither MDE nor sponsors have a means to stop a school from opening short of terminating the school's contract. Sponsors have a window of opportunity to withdraw from the sponsoring relationship in the 90-day period between initial approval for the school and the deadline for a signed contract between the school and a sponsor. One of the sponsors we



Ensuring that new charter schools have the capacity to manage business operations before enrolling students should be a high priority.

interviewed declined to sign the initial contract with a charter school when planning for the school was not proceeding as the sponsor wanted it to. (The charter school in question went on to find another sponsor and intends to open in fiscal year 2004.) Otherwise, the decision to move from a planning stage to enrolling students is largely left up to charter schools.

An extended planning period is important, but ensuring that a school acquires staff with the necessary expertise and sets up financial systems and controls is even more so. One of the sponsors we interviewed uses a start-up checklist that, among other things, tracks progress in setting up the business side of school operations. Other interviewees also cited specific tasks that should be completed during a school's planning phase. Although we did not develop a comprehensive list, suggested benchmarks that new charter schools should meet before opening include having:

- a comprehensive, multi-year business plan that includes budget projections and a marketing plan supporting enrollment projections;
- a financial manager (or other administrative staff) on board and trained in all state reporting systems and procedures;
- written financial management policies, including controls over check writing, cash, and access to accounts;
- financial management software installed and tested;
- a schedule for producing financial reports that will be used to monitor cash flow and to track actual revenues and expenditures to budget; and
- board members with financial expertise.

A final check to ensure that charter schools have these people and systems in place could be the responsibility of either the sponsor or MDE, though MDE managers told us that the department's preference is for sponsors to be actively involved in ensuring that charter schools meet these benchmarks with MDE making the final check.

## CONCLUSIONS

Legislative changes in 2001 tightened controls over charter school financial management, but we found that gaps remain. While many of Minnesota's charter schools are financially sound, we identified at least 16 charter schools that had financial problems of varying degrees of severity at the end of fiscal year 2002. Key factors underlying these problems included deficiencies in financial management policies and poor decisions made by school administrators and boards. Many of the charter schools we reviewed in depth were suffering the consequences of early mistakes and not acting decisively enough when problems, such as lower than expected enrollment, arose. In addition, charter schools as a group have a poor track record meeting year-end financial reporting deadlines, which makes it more difficult to detect problems. Although a variety of factors affect the quality of charter school financial management, the experience and technical expertise of charter school administrators and board members is critical. Adequate training for board members, administrators, and business managers is crucial. Systematically assessing whether new charter schools have the capacity to manage the school's business operations before students are enrolled should also be a high priority.

MDE and sponsors both have oversight roles with respect to charter school financial management. MDE monitors charter schools through systems for controlling payment and use of state education aid and has, in recent years, initiated several well-received efforts to better assist charter schools. The value of sponsors' contributions to financial oversight is less clear. Assessing the sufficiency of sponsors' oversight activities was difficult because expectations for their performance in law, contracts, or policy are vague. If one assumes that sponsors are, at least to some extent, responsible for actively ensuring that charter schools have in place sound financial management systems, then many sponsors included in our review failed to meet that expectation. Many had a hands-off relationship with their schools, and if they got more actively involved, it was generally after significant financial problems had already surfaced. Financial oversight based merely on review of annual audit reports may be appropriate for charter schools with a track record of sound financial management, but is not sufficient for new or struggling schools that would benefit from active oversight. Most of the sponsor representatives we interviewed argued that ultimately, it was not a sponsor's responsibility to manage the school's finances, and we agree. But, if sponsors are to serve as financial overseers, we find it appropriate for sponsors to do more than watch from a distance.

## RECOMMENDATIONS

### Strengthen Charter School Financial Management

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#### RECOMMENDATIONS

*To enhance charter school administrators' and board members' capacity to manage school finances, MDE should:*

- *Implement a two-stage approval process that requires new charter schools to demonstrate that they have skilled personnel and financial systems in place before enrolling students;*
- *Modify the model charter school contract to include more detailed requirements regarding budgeting, financial reporting, and training for school administrators and board members;*
- *Enhance training offered to charter school board members to better meet the intent of the law; and*
- *To the extent possible, expand quarterly enrollment monitoring to all charter schools.*

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MDE, in conjunction with the Charter School Advisory Council, is considering options to modify the charter school approval process to include some type of readiness check before a new school opens. Still in the early stages of discussion, the department is considering such issues as how formal the assessment should be and the benchmarks that charter schools should meet before opening. Assuming that MDE identifies requirements for training, budgeting, and financial policies and controls, these benchmarks could serve as a good starting point for modifying the model contract as well. While sponsors and charter schools are not obligated to follow MDE's model, the contracts we reviewed closely mirrored the MDE language. Because we see no reason for this pattern to change and because the language can be modified to reflect a charter school's unique circumstances, we think the model contract is a good vehicle for establishing more specific expectations for financial management and fiscal performance.

As MDE acknowledges, the financial management training that MDE currently offers to fulfill its obligation to provide school board member training is quite brief and is limited to interim board members available at that time. Because charter school boards play a critical role setting financial policy and monitoring fiscal status, training should be more thorough and offered more frequently. To meet its obligation, MDE may be able to facilitate access to board training offered by other organizations.

As discussed earlier in the chapter, charter schools have found that quarterly enrollment monitoring (and any resulting adjustments to aid payments) to be a very useful tool, and administrators that we interviewed suggested that it would equally benefit older charter schools, not just those in the first three years of operation. We qualified our recommendation because of the clear resource constraints associated with it. While we support use of site visits to confirm data reports, MDE may be able limit the cost of implementing this proposal by limiting visits only to new schools and those older schools for which MDE has information indicating a possible problem.

## Improve Oversight

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### RECOMMENDATIONS

*To improve oversight of charter school financial management:*

- *MDE should initiate a process to more clearly define the scope and nature of the sponsor's role regarding charter school financial management and recommend to the Legislature any needed changes to charter school law.*
  - *The Legislature should consider amending charter school law to state that charter school contracts may be terminated for repeated failure to meet deadlines for submitting financial data and financial audit reports.*
  - *The Legislature should consider amending charter school law to remove the requirement that teachers constitute a majority of charter school board members.*
- 

We think there is a clear need to clarify a host of issues related to charter school sponsors, starting with basic questions regarding their purpose and, assuming that sponsors are still found to be necessary, their scope of responsibility and expected outcomes of their actions. We expect the process to distinguish more clearly between MDE and sponsors' obligations and to identify the training and resources needed to implement the sponsorship model. While we recommend that MDE initiate this process, other groups need to be involved, including the Charter School Advisory Council, sponsors, charter schools, and other interested groups.

While the situation has improved over the past several years, late reporting of UFARS financial data and financial audit reports is still a problem that impedes timely oversight of charter schools' financial status. At this time, MDE does not have a clear, effective mechanism to enforce reporting deadlines. Making failure to meet these deadlines grounds for terminating the charter school's contract gives MDE some "teeth."

The requirement that teachers constitute a majority of charter school board members has created governance challenges of sufficient magnitude that more flexibility is in order. Of primary concern are the conflicts of interest inherent in

such a structure with teachers being both supervisors and employees of school directors. In addition, the requirement limits charter schools' abilities to recruit a sufficient number of board members with desired skills and experience and places a particularly difficult burden on teachers at very small charter schools. If the Legislature decides that teachers should continue to be represented on charter school boards, we suggest teacher representation be less than a majority.



## SUMMARY

*Charter schools are not allowed to issue bonds or levy taxes to pay for building space. Instead, the state provides lease aid that reimburses charter schools for a large portion of building lease costs. Charter school administrators view lease aid as essential to charter schools' financial viability. Without it, charter schools would have to rely on general education aid to pay for a school building. Although good comparisons are difficult to make, charter school lease rates appear to be reasonable when compared to rates state government pays to lease office space. In addition, charter schools generally lease less space than the amount called for in Minnesota Department of Education guidelines. Although state law prohibits charter schools from issuing bonds and from acquiring buildings with state funds, 11 charter schools have established affiliated nonprofit building corporations that issued bonds or obtained loans to acquire school buildings. Charter schools then leased the building from the affiliated corporation. We think the time is right for the Legislature to once again weigh the advantages and disadvantages of allowing charter schools to buy buildings.*

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Under state law, charter schools cannot use state funds to acquire land or buildings.<sup>1</sup> They are also prohibited from levying taxes or issuing bonds, methods used by traditional school districts to pay for facilities.<sup>2</sup> As a result, charter schools lease space from a variety of public and private entities. Recognizing that operating capital revenue included in the general education formula was not sufficient to fund appropriate facilities as well as other capital needs, the 1997 Legislature established building lease aid to help charter schools pay for leased space.<sup>3</sup>

This chapter addresses the following question:

- **Is the lease-aid program an effective way to help charter schools obtain school facilities?**

To answer this question, we interviewed Minnesota Department of Education (MDE) staff about the lease aid program, and we analyzed data collected by MDE on lease expenditures and lease aid payments for charter schools operating in

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<sup>1</sup> *Minn. Stat.* (2002), §124D.11, subd. 7.

<sup>2</sup> *Minn. Stat.* (2002), §124D.10, subd. 25(b).

<sup>3</sup> *Laws of Minnesota* (1Sp1997), ch. 4, art. 5, sec. 13.

**Because charter schools may not issue bonds or levy taxes, the state provides lease aid to help pay for facilities.**

fiscal year 2003. To determine the reasonableness of lease expenditures, we compared the rates that charter schools pay for leased space to rates that the State of Minnesota pays for leased office space in the same area. In our interviews with charter school administrators and board chairpersons, we included questions about facilities and lease aid. Finally, we interviewed officials from 14 additional charter schools to learn more about their facilities and leasing arrangements.

## IMPORTANCE OF LEASE AID

If it finds the lease to be appropriate, MDE will reimburse charter schools for 90 percent of the amount they pay to lease building space up to a maximum. For fiscal year 2003, the maximum is \$1,500 per pupil unit.<sup>4</sup> Lease aid may not be used for custodial, maintenance, utility, or any other operating costs. Although not the major source of funding,

- **Lease aid is an important component of charter school financing.**

Total lease aid payments (in constant 2003 dollars) increased from \$1.3 million in fiscal year 1998, the first year charter schools were eligible to apply for lease aid, to \$15.1 million in fiscal year 2003.<sup>5</sup> This increase is due primarily to the increase in the number of charter schools and the number of students attending charter schools. As shown in Figure 3.1, after adjusting for inflation, lease aid has averaged about \$1,100 per pupil unit since fiscal year 2001.<sup>6</sup> The sharp increase in lease aid per student between 1999 and 2000 is the result of a change in the lease aid formula. The 1999 Legislature increased the percentage of lease expenditures eligible for reimbursement from 80 to 90 percent.<sup>7</sup>

As shown in Table 2.3 in Chapter 2, lease expenditures accounted for 14 percent of charter school spending in fiscal year 2002. In total, charter schools collected \$12.1 million in lease aid in 2002, accounting for 12 percent of their revenues. Total lease aid for fiscal year 2003 will be about \$15.1 million, with all but 1 of the 76 charter schools operating receiving lease aid.<sup>8</sup> The amount of lease aid varied widely among schools, ranging from \$11,611 to \$873,547, with the average school receiving \$201,943. Table A.5 in the Appendix provides detailed

<sup>4</sup> *Minn. Stat.* (2002), §124D.11, subd. 4. As discussed in Chapter 1, “Pupil Units” equal average daily membership with students weighted by grade level. Average daily membership (ADM) is the sum for all pupils of the number of days of the school year each pupil is enrolled divided by the number of days that school is in session. Lease aid for fiscal year 2003 was less than expected because the 2002 Legislature required MDE to reduce lease aid for all charter schools by an amount sufficient to make retirement contributions for former employees of charter schools that closed without making the required contributions. *Laws of Minnesota* (2002), ch. 392, art. 6, sec. 4. As a result, MDE reduced total 2003 lease aid by \$282,210; each charter school’s lease aid was reduced by about 1.8 percent.

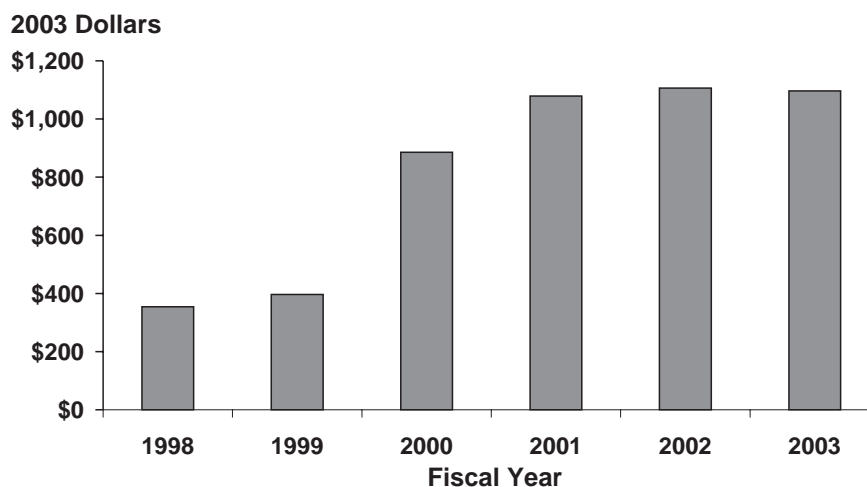
<sup>5</sup> All amounts cited for fiscal year 2003 are preliminary and subject to final enrollment counts. Seventeen percent of 2003 lease aid revenue is deferred until fiscal year 2004.

<sup>6</sup> Our inflation adjustment was based on the Bureau of Labor Statistics’ consumer price index for all urban consumers (CPI-U); <http://data.bls.gov/cgi-bin/surveymost>; accessed May 16, 2003.

<sup>7</sup> The 1999 Legislature also increased the maximum amount allowed from an amount based on the state average debt service revenue plus capital revenue to \$1,500 per pupil unit. *Laws of Minnesota* (1999), ch. 241, art. 5, sec. 12.

<sup>8</sup> Eci’ Nompa Woonspe in Morton owns its building, which it received as a gift, and did not request lease aid.

**Figure 3.1: Average Lease Aid Per Pupil Unit, in Constant Dollars, FY1998-2003**



NOTE: Pupil units are a measure of average student enrollment weighted by grade level. Dollar values were adjusted for inflation using the Bureau of Labor Statistics' consumer price index for all urban consumers (CPI-U).

SOURCE: Office of the Legislative Auditor analysis of Department of Education data.

**In recent years, lease aid has averaged about \$1,100 per pupil unit.**

information about lease expenditures and lease aid for the charter schools operating in 2003.

Our interviews with charter school administrators included several questions about their building leases and lease aid. We found that:

- **Charter school administrators believe that lease aid is essential to charter schools' financial viability.**

All of the charter school administrators we interviewed said that they rely heavily on lease aid as an integral part of their funding. For example, one charter school administrator said: "Lease aid is extremely important to charter schools. [Our school] would not be financially viable without it." Another administrator pointed out the practicality of lease aid when he commented: "This is a good way to help schools. Giving charter schools bonding options in addition to districts would be a public relations nightmare. The public would not understand why there were multiple bonds." Some charter school officials felt compelled to tell us that lease aid is inadequate. According to one administrator: "This is a great system, and we could use more of it. Why is only 90 percent reimbursed? Even that 10 percent takes away from the program."

Because fiscal year 2003 lease aid is capped at \$1,500 per pupil unit, 12 of the 75 charter schools (16 percent) receiving lease aid in 2003 will receive less than 90 percent of their actual lease costs.<sup>9</sup> On average, lease aid will cover about 85 percent of lease expenditures in 2003. The 2003 Legislature reduced the

<sup>9</sup> This calculation is before the 1.8 percent reduction in fiscal year 2003 lease aid (see footnote 4).

maximum lease aid payment for new charter schools to \$1,200 per pupil unit.<sup>10</sup> This could potentially reduce the amount of lease aid for many new charter schools. For example, had the \$1,200 per pupil unit limit been in effect for all charter schools in 2003, 35 (47 percent) would have received lease aid of less than 90 percent of lease expenditures.

## REASONABLENESS OF LEASES

State law lists three criteria that MDE must use to determine whether a charter school's request for lease aid will be approved. The criteria are: (1) the reasonableness of the price based on current market values; (2) the extent to which the lease conforms to state laws and rules; and (3) the appropriateness of the lease in the context of the space needs and financial circumstances of the charter school.<sup>11</sup> In addition, charter school buildings must meet state and local health and safety requirements.<sup>12</sup> Charter schools may not lease property from a related party unless the party is a nonprofit corporation or a cooperative.<sup>13</sup>

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**Due to staff reductions, Department of Education staff no longer make site visits to assess whether lease rates and building space are appropriate.**

When it receives a request for lease aid, MDE reviews the lease to determine the reasonableness of the price and the appropriateness of the space. MDE does not use a formula to determine reasonableness. Rather, it considers each lease as a separate case, sometimes comparing the lease to rates paid by other charter schools in the area and sometimes examining local newspaper advertisements or consulting local realtors to determine if the school's rate is consistent with local rates. For fiscal year 2003, MDE assigned one full-time staff person to lease aid and a range of other financial management issues involving charter schools. In prior years, that person was assisted by a supervisor with general responsibility for school facilities who made site visits to examine the suitability of the facility and the appropriateness of its space.<sup>14</sup> The supervisor's position was eliminated in March 2002, and MDE now requires that charter schools submit pictures of the space, recent building inspection and fire marshal reports, and other documentation with the lease aid application. As discussed in Chapter 2, MDE recently eliminated the full-time position and added lease aid responsibilities to another staff position in fiscal year 2004, with 25 percent of that person's time allocated to lease aid.<sup>15</sup>

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<sup>10</sup> Existing charter schools would get the greater of \$1,200 per pupil unit or the amount of lease aid they received per pupil unit in 2003. *Laws of Minnesota* (1Sp2003), ch. 9, art. 2, sec. 28.

<sup>11</sup> *Minn. Stat.* (2002), §124D.11, subd. 4.

<sup>12</sup> *Minn. Stat.* (2002), §124D.10, subd. 8. MDE requires that charter school buildings be inspected by the State Fire Marshal's Office for compliance with fire safety codes, be inspected for asbestos by an inspector accredited by the Environmental Protection Agency, meet federal and state laws requiring accessibility for people with disabilities, have an emergency evacuation plan, and comply with an MDE checklist of other health and safety requirements.

<sup>13</sup> *Minn. Stat.* (2002), §124D.10, subd. 23a.

<sup>14</sup> According to MDE, the supervisor visited most of the new charter schools that opened between 2000 and 2002 and about half of the established schools that had opened in the 1990s.

<sup>15</sup> A second person will be responsible for calculating lease aid. Ten percent of that person's time will be devoted to lease aid.

State law requires MDE to consult with the Department of Administration before approving a charter school lease with a for-profit or sectarian organization.<sup>16</sup> MDE routinely sends copies of all new charter school leases to the Department of Administration, but as a practical matter, not until after the leases are signed. Administration Department staff review the leases, sometimes noting terms that could be unfavorable to the school, and return them with attached comment sheets to MDE. Since the leases have already been signed, the Department of Administration’s comments have little impact. In general, MDE officials told us that MDE rarely rejects a charter school lease agreement.

To independently assess the reasonableness of charter school lease rates, we compared them to rates that the state pays for leased office space in the Twin Cities metro area and outstate. Table 3.1 presents the results of our analysis. We found that:

- **Charter school lease rates appear to be reasonable when compared to state government leases in the same geographic areas.**

On average, Twin Cities metro-area charter schools paid \$11.48 per square foot in 2003 whereas the state paid an average of \$16.67 per square foot for its metro-area office space. Outstate differences were smaller: \$9.76 per square foot for charter schools versus \$11.36 for state offices.

**Table 3.1: Lease Rates Paid by Charter Schools and the State of Minnesota, March 2003**

	Metropolitan Area		Outstate	
	Average Rate Per Square Foot	<i>N</i>	Average Rate Per Square Foot	<i>N</i>
Charter Schools	\$11.48	47	\$ 9.76	28
State of Minnesota	16.67	141	11.36	285

SOURCE: Office of the Legislative Auditor analysis of data from the departments of Administration and Education.

**Charter school lease rates compare favorably with rates the State of Minnesota pays for office space.**

This comparison has several shortcomings. First, we did not have information on the condition of the state-leased buildings, nor did we have information about the desirability of the location, factors that could influence lease rates. Second, we did not have information about the terms of the state leases, such as whether maintenance and utilities were included. Third, state office buildings may cost more to construct and maintain because they tend to be divided into smaller units (offices or cubicles) than classrooms. Fourth, school buildings may have special requirements, such as space for auditoriums, gyms, cafeterias, and laboratories, which may increase their cost or require remodeling. Some of the charter school lease expenditures included one-time renovation costs that rolled into the lease rate, and others included separate agreements to rent gym space (sometimes from

<sup>16</sup> *Minn. Stat.* (2002), §124D.10, subd. 17.

a nearby health club).<sup>17</sup> Nevertheless, we think this comparison provides a general picture of the reasonableness of lease rates.

As a secondary check on the reasonableness of charter school lease rates, we compared a subset of charter school leases to commercial lease rates for some metro area cities using listings on the Minnesota Commercial Association of Realtors web site.<sup>18</sup> Again, we did not have information about the terms of the lease, the condition of the building, or the desirability of the location. In addition, we restricted our comparison to the metro area because there were too few outstate listings. Our analysis indicated that advertised commercial lease rates in the metro area averaged about \$12 per square foot. This is above the average rate paid by metro charter schools, but below the rates for metro office space that the state is paying (possibly the result of differences between state and commercial office space or perhaps due to recent market trends not reflected in the state's existing leases).

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**Lease rates vary considerably among charter schools.**

Charter schools' fiscal year 2003 lease rates vary considerably, from a low of \$1.95 per square foot to a high of \$21.92. From our discussions with school administrators, we learned that schools lease space from a variety of sources. Some have been able to find space at low rates in older, unused buildings owned by a local school district (which is often the school's sponsor), a church, or an affiliated organization. Others have had to lease from private developers at higher rates. For each school, we compared the rate it paid to the rate the state of Minnesota paid for office space in the same city or county.<sup>19</sup> Only seven charter schools paid rates that were more than 10 percent higher than the rates paid by the state for offices in the same city or county. Four of the seven were in Rice County, where the state was paying an unusually low rate for its office space. The other three had additional costs for gym space or had one-time expenses that MDE determined to be reimbursable (such as remodeling or transporting mobile classrooms). Taking these circumstances into account, none of the charter schools appears to be paying an unreasonable rate for its leased space.

The 14 financially stressed charter schools identified in Chapter 2 paid slightly more for their space (\$11.40 per square foot) than other schools (\$10.70 per square foot). This is primarily because 12 of the 14 charter schools experiencing financial difficulty are in the Twin Cities metro area where lease rates are higher. The 12 metro charter schools in financial difficulty and the 35 other metro charter schools both paid, on average, \$11.48 per square foot for leased space.<sup>20</sup>

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<sup>17</sup> Gym costs are usually included in the expenditures eligible for lease aid, but the gym's square footage (or a pro-rated amount) is generally not counted as part of the building's square footage. As a result, the rates per square foot for schools that rent gym space outside their buildings are overstated.

<sup>18</sup> Minnesota Commercial Association of Realtors, *Minnesota Commercial Property Exchange*; <http://www.mncar.org/index.cfm>; accessed March 6, 2003. The average is based on advertised rates for office space in Minneapolis, St. Paul, Brooklyn Center, Roseville, Stillwater, and North St. Paul. When a range of rates was listed for a building, we used the midpoint.

<sup>19</sup> We used counties when the state did not have leased office space in the same city. Several outstate schools were located in counties with no state offices, but none of these schools were paying rates more than 10 percent above the average rate for all outstate state offices.

<sup>20</sup> We identified only two outstate charter schools as being in financial difficulty. Their average lease payment was \$10.90 per square foot, slightly above the average rate of \$9.67 paid by the 26 other outstate schools.

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**On average, the amount of space charter schools lease is within Department of Education guidelines.**

We also found that:

- **Charter schools lease a reasonable amount of space.**

While not specific to charter schools, MDE has issued square footage guidelines for school building construction. Recognizing that space needs vary according to the programs that the school offers, the guidelines suggest that an average elementary school with less than 500 students needs between 125 and 155 square feet per student; middle schools require 170 to 200; and high schools need 200 to 320 square feet per student.<sup>21</sup> On average, charter schools lease 22,573 square feet of space, or about 150 square feet per student (ADM). This includes classrooms, labs, and offices, and it usually includes auditoriums and cafeterias or lunchrooms. As noted above, it may include gym space.<sup>22</sup> In comparison, MDE data indicate that in 2003, school districts averaged 246 square feet per student.<sup>23</sup> School districts with fewer than 500 students, a group more comparable in size to charter schools, averaged 340 square feet of building space per student. Thus, compared to regular school districts, charter schools use a reasonable amount of space.

Edison Academy in Duluth leased the most space (nearly 114,000 square feet), but it also had the most students (751 ADM). Three schools leased over 300 square feet per student: Hanska Community School, Native Arts High School, and El Colegio Charter School. All of these schools had relatively few students (between 15 and 60) resulting in high costs per student.<sup>24</sup>

## **LEASING FROM AFFILIATED NONPROFIT BUILDING CORPORATIONS**

As noted earlier, state law prohibits charter schools from issuing bonds and from using state funds to acquire buildings. However, we found that:

- **To circumvent the prohibition against using state funds to buy buildings, some charter schools have established affiliated nonprofit building corporations that issue bonds or obtain loans to acquire school buildings.**

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<sup>21</sup> Department of Children, Families, and Learning, *Guide for Planning School Construction Projects in Minnesota* (Roseville, MN: 2003), 66-68. Amounts exclude swimming pools and space intended primarily for community use.

<sup>22</sup> Some schools had arrangements with nearby YMCAs or gym clubs to use their facilities. Typically, the payments for using the gym facilities were included in the lease amount but the square footage was not, thereby overstating the rate paid per square foot for the main school building.

<sup>23</sup> Data furnished by MDE, based on 2003 building square footage and 2002 average daily membership for 349 school districts.

<sup>24</sup> El Colegio leases from an affiliated company, a topic discussed in the next section. It planned for a larger enrollment than the 60 students it has, and the \$1,500 per pupil unit limitation on lease aid means that the school's lease aid is only 57 percent of its lease costs. Hanska Community School has by far the most square feet per student (855). It has only 25 students, and leases a former New Ulm elementary school building that is now owned by a nonprofit corporation. The school paid only \$1.95 per square foot in 2003, so its lease costs are manageable. Native Arts High School has only 15 students and is one of the schools we identified as financially stressed. The school recently moved to a smaller facility.

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**The 11 charter schools that formed affiliated companies to acquire buildings said that they could not find suitable space to lease.**

As of fiscal year 2003, 11 charter schools had affiliated nonprofit building corporations that arranged for bonds or loans to purchase a school building. In turn, the charter schools signed leases with the affiliated nonprofits, and state lease aid provided most of the revenue to repay the bonds or loans. We did not assess the legality of this arrangement. According to MDE, the department consulted with the Attorney General's Office in 1999 regarding this type of lease arrangement. The Attorney General provided some analysis of the practice but did not provide an opinion on its legality. We are not aware of any legal challenges to this practice.

We interviewed officials from the 11 schools that chose this route to acquire facilities. All of the schools that formed affiliated nonprofit companies to acquire a building said they did so because they could not find a suitable building for lease in the area where they wanted to locate the school. Two of the schools were leasing property that the owner decided to sell. Unable to find other available facilities, they each formed affiliated nonprofit companies to buy their buildings. Four schools formed affiliated nonprofit companies to purchase and renovate existing buildings. Four schools constructed new buildings. In one case, the building's owner, a nonprofit corporation, created a new nonprofit corporation affiliated with the school after the building was built.

The most common financing mechanism was one in which a city housing and redevelopment agency issued tax-exempt bonds. Principal and interest on the bonds is covered by the lease payments the school makes to the affiliated nonprofit corporation. Eight schools obtained financing in this manner, and two others used a combination of bonds and bank loans. One school was able to obtain all of its financing through a bank loan.

The average lease rate for the 11 charter schools that established affiliated nonprofit corporations to purchase or construct a facility was \$12.98 per square foot in 2003, compared with an average rate of \$10.47 for the other charter schools. These 11 schools also had more space than other schools (157 versus 147 square feet per student). As a result, the charter schools that established affiliated nonprofit corporations to purchase or construct a facility had lease expenditures in 2003 equal to \$1,964 per student compared to \$1,408 for the other schools. On the other hand, none of these schools met our criteria for being in financial difficulty. Furthermore, if these schools remain successful and repay the bonds, their costs in the long run may be lower when the bonds are paid off.<sup>25</sup> Any long-term savings on the part of schools would result in a reduction in state-funded lease aid.

One issue raised by the use of affiliated building corporations is whether charter schools should be allowed to own their buildings outright. Most of the charter school administrators we interviewed thought that charter schools that demonstrate sound academic performance and financial stability (for example, those that had their contract renewed after three years and had positive fund

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<sup>25</sup> Schools would still have to pay for remodeling and renovation of their building as the need arises. MDE's current practice is to allow lease aid to be used to pay for major remodeling or renovation of a building, but not for routine maintenance.



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**Charter schools' use of affiliated corporations to purchase buildings has introduced a gray area in the state's policy on building ownership.**

balances) should be allowed to own buildings because it is more cost-effective in the long run. Schools would have to pay for their facilities, but they would not have to pay rates that cover property taxes and provide profits to private developers.

Another issue is whether the state would be at risk by allowing charter schools to own buildings. Administrators at the 11 schools maintained that the individuals at risk if the school closes and stops making lease payments are the bond investors and that neither the municipality that issued the bonds nor the State of Minnesota are financially at risk. Bondholders would presumably take possession of the building if the school closed and could sell it to minimize their losses.

A few charter school administrators counseled against lifting the ban on building ownership. One administrator noted that charter school boards are, for the most part, made up of teachers and parents who usually lack financial training. He felt that charter school boards might not be able to successfully undertake all the necessary steps to complete a complicated bond deal that provides the greatest benefit to the school. Another administrator was concerned that charter school buildings could be used as a form of land speculation. A group could, theoretically, form a charter school to acquire a building paid for primarily with state lease aid. If property values increase as they normally do, the school could then sell the building for a profit.

## CONCLUSIONS

Lease aid is essential to charter schools. Without the ability to raise funds through property taxes, charter schools are dependent on lease aid to help pay for their facilities. Charter schools appear to be entering into reasonable lease agreements, in terms of both lease rates and the amount of space leased.

We think it is a good time to reassess the state's policy prohibiting use of state funds to buy charter school buildings. Leasing charter school facilities has both advantages and disadvantages. For example, lease transactions are relatively straightforward and leasing may give a charter school more flexibility as its facility needs change. On the other hand, buying a building can be more cost-effective in the long run and would benefit charter schools that want to locate in an area without suitable lease space available. Charter schools' use of affiliated corporation arrangements has introduced a gray area in the state's policy. While the charter schools in these arrangements are leasing their facilities, they are also indirectly using state funds to acquire buildings. The state also has more experience with charter schools since lease aid was established in 1997. With these issues in mind, we think the time is right for the Legislature to once again weigh the advantages and disadvantages of allowing charter schools to buy buildings.

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## RECOMMENDATIONS

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### RECOMMENDATION

*The Legislature should review and clarify, as needed, the policy on use of state funds to buy charter school buildings.*

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Whether charter schools should be allowed to buy buildings is a policy decision that takes a variety of factors into account, including potential risks for the state and for charter schools. The Legislature has a range of options available, from maintaining the status quo, to explicitly allowing charter schools to create affiliated nonprofit building corporations, to allowing charter schools to finance the purchase of facilities directly.

If the Legislature were to allow direct ownership, it could require charter schools to demonstrate financial stability before they can use state aid to construct or purchase a building. For example, it could limit this option to charter schools that have been through at least one three-year contract renewal or that meet a financial threshold, such as a minimum fund balance.<sup>26</sup> The Legislature could also require that, if a charter school closes, any net proceeds from the building's sale be returned to the state. Alternatively, if the Legislature decides that charter schools should not be allowed to use state funds to acquire buildings, directly or indirectly, it could prohibit the practice of using affiliated nonprofit building corporations. Should the Legislature choose this course, it would also have to decide how to treat the 11 charter schools that currently use this arrangement.

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<sup>26</sup> In theory, the marketplace should place restrictions on which charter schools could finance building projects. Charter schools perceived to be in danger of failing would be less likely to attract investors.

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# Summary of Recommendations

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## **Strengthen Charter School Financial Management (p. 34)**

To enhance charter school administrators' and board members' capacity to manage school finances, MDE should:

- Implement a two-stage approval process that requires new charter schools to demonstrate that they have skilled personnel and financial systems in place before enrolling students;
- Modify the model charter school contract to include more detailed requirements regarding budgeting, financial reporting, and training for school administrators and board members;
- Enhance training offered to charter school board members to better meet the intent of the law; and
- To the extent possible, expand quarterly enrollment monitoring to all charter schools.

## **Improve Oversight (p. 35)**

To improve oversight of charter school financial management:

- MDE should initiate a process to more clearly define the scope and nature of the sponsor's role regarding charter school financial management and recommend to the Legislature any needed changes to charter school law.
- The Legislature should consider amending charter school law to state that charter school contracts may be terminated for repeated failure to meet deadlines for submitting financial data and financial audit reports.
- The Legislature should consider amending charter school law to remove the requirement that teachers constitute a majority of charter school board members.

## **Clarify Lease Aid Policy (p. 46)**

The Legislature should review and clarify, as needed, the policy on use of state funds to buy charter school buildings.



# Detailed Financial and Lease Data

## APPENDIX

**Table A.1: Charter School Revenue, Expenditure, and Fund Balance Data**

Charter School	Fiscal Year 2002 Revenues and Expenditures			General Fund Balances <sup>b</sup>		
	Total Revenues <sup>a</sup>	Total Expenditures	Revenues Less Expenditures	FY2001 General Fund Balance	FY2002 General Fund Balance	FY2002 Statutory Operating Debt Ratio
Academia Cesar Chavez	\$1,983,609	\$1,656,130	\$327,479	\$ -575	\$ 321,360	29.9%
Achieve Language Academy	2,598,906	2,241,262	357,644	443,851	905,733	36.9
Agricultural & Food Sciences	854,468	934,586	-80,118	Not open	2,594	0.3
Aurora	833,702	802,555	31,147	-34,424	15,604	2.3
Avalon	1,367,731	1,244,466	123,265	Not open	123,266	10.3
Bluffview Montessori	1,300,929	1,210,349	90,580	69,252	212,758	20.6
Cedar-Riverside Community	990,645	945,738	44,907	300,161	340,794	74.2
City Academy	1,201,964	1,238,541	-36,577	332,086	295,452	31.8
Community Of Peace	4,501,277	4,190,920	310,357	1,012,338	1,325,503	34.7
Concordia Creative Learning	1,358,412	1,254,532	103,880	2,782	100,553	9.2
Coon Rapids Learning	932,768	1,040,776	-108,008	127,115	60,993	6.0
Covenant Academy	552,402	431,317	121,085	Not open	121,087	34.9
Crosslake Community	453,134	478,573	-25,439	16,337	-9,103	-2.0
Cyber Village Academy	1,449,759	1,512,446	-62,687	99,039	82,184	5.9
ECHO	887,702	823,516	64,186	147,336	173,759	24.1
Eci' Nompa Woonspe'	1,086,349	1,082,945	3,404	205,192	295,606	45.6
Edison - Duluth	6,342,530	6,304,887	37,643	193,972	219,076	4.2
El Colegio	909,804	876,974	32,830	1,317	42,581	5.6
Emily	709,830	695,876	13,954	192,249	214,664	42.4
Excell Academy	857,080	877,863	-20,783	-11,862	-10,712	-1.3
Face To Face Academy	569,220	667,446	-98,226	-12,666	-116,205	-17.7
Family Academy	1,908,546	1,844,386	64,160	-16,241	31,160	1.9
Four Directions	1,335,080	1,309,574	25,506	211,852	263,355	24.8
Friendship Academy	497,408	504,383	-6,975	52,797	52,388	22.4
Great River Education	519,777	479,260	40,517	-16,023	26,559	5.7
Hanska Community	355,391	379,406	-24,015	142,868	118,852	33.7
Harvest Preparatory Academy	4,155,970	3,601,116	554,854	-12,361	27,683	1.0
Heart of the Earth	2,799,975	2,607,794	192,181	-490,838	-103,392	-4.4
Higher Ground Academy	3,441,058	3,186,903	254,155	-111,386	231,439	12.2
HOPE Community Academy	4,479,303	4,693,864	-214,561	260,529	59,137	1.8
Jennings Experiential	1,105,735	1,041,134	64,601	-12,983	104,418	10.2
La Crescent Montessori	521,681	520,623	1,058	76,906	72,923	15.2
Lafayette	586,713	523,426	63,287	41,075	109,511	25.6
Lake Superior	646,550	575,758	70,792	108,397	180,593	33.4
Lakes Area	470,717	391,912	78,805	95,596	174,905	50.7

**Table A.1: Charter School Revenue, Expenditure, and Fund Balance Data (continued)**

Charter School	Fiscal Year 2002 Revenues and Expenditures			General Fund Balances <sup>b</sup>		
	Total Revenues <sup>a</sup>	Total Expenditures	Revenues Less Expenditures	FY2001 General Fund Balance	FY2002 General Fund Balance	FY2002 Statutory Operating Debt Ratio
Math and Science Academy	\$2,009,668	\$1,886,858	\$122,810	\$ 46,168	\$ 172,476	9.3
Metro Deaf	1,575,634	1,720,716	-145,082	573,484	428,388	25.2
MN Business Academy	3,725,205	3,795,498	-70,293	153,385	161,098	4.4
MN Institute of Technology	4,152,581	4,485,038	-332,457	223,454	-111,097	-3.0
MN International	730,223	699,019	31,204	Not open	41,567	6.3
MN New Country	1,050,175	933,006	117,169	160,005	278,610	32.2
MN Transitions	3,838,835	3,407,652	431,183	61,778	485,742	20.1
Native Arts	No data reported			688	No data reported	
Nerstrand	1,166,219	1,118,486	47,733	199,799	247,740	23.6%
New Heights	1,051,055	1,042,879	8,176	-145,359	-77,499	-8.1
New Spirit	3,005,607	2,723,502	282,105	266,901	535,515	33.0
New Visions	4,775,422	4,930,070	-154,648	-51,460	-189,881	-4.2
North Lakes Academy	1,146,932	1,310,647	-163,715	44,965	38,477	3.0
Odyssey	1,732,678	1,792,367	-59,689	110,083	54,112	3.2
PACT	2,313,825	2,344,408	-30,583	260,527	292,088	13.3
Pillager Area	483,659	331,848	151,811	Not open	159,497	68.5
Recording Arts	1,200,070	1,225,987	-25,917	27,013	6,979	0.6
Ridgeway Community	648,115	616,363	31,752	Not open	42,889	7.8
Riverbend Academy	1,468,824	1,346,154	122,670	299,251	421,159	32.2
Riverway Learning Community	763,376	755,265	8,111	16,053	26,835	4.0
Rochester Off Campus	806,580	852,830	-46,250	525,925	479,674	58.4
Schoolcraft Learning Community	1,409,537	1,215,169	194,368	69,057	263,423	25.7
Skills for Tomorrow	1,380,346	1,376,369	3,977	597,109	602,433	44.8
Sojourner Truth Academy	1,731,339	1,817,818	-86,479	509,243	422,765	37.1
St. Paul Family Learning Center	1,506,203	1,515,434	-9,231	126,021	102,413	7.8
Studio Academy	919,058	903,796	15,262	-89,618	-54,611	-6.2
Twin Cities Academy	1,407,103	1,362,231	44,872	252,897	297,768	24.2
Twin Cities International	1,631,239	1,514,326	116,913	Not open	140,318	9.9
Village School of Northfield	547,408	509,105	38,303	105,147	143,447	30.4
World Learner	573,088	572,488	600	61,635	61,999	13.3
Yankton Country	497,202	464,076	33,126	53,216	43,231	9.4

<sup>a</sup> Revenue totals exclude transfers from other funds and loan amounts.

<sup>b</sup> General fund balance is defined as the unreserved/undesignated general fund balance less general fund encumbrances. The percentage used to determine statutory operating debt status is this net amount divided by general fund expenditures.

SOURCE: Office of the Legislative Auditor analysis of Department of Education data.

**Table A.2: Charter School Revenue, Expenditure, and Fund Balance Data Per ADM**

Charter School	FY2002 ADM	Fiscal Year 2002 Revenues and Expenditures Per ADM			General Fund Balances Per ADM <sup>b</sup>		
		Total Revenues Per ADM <sup>a</sup>	Total Expenditures Per ADM	Revenues Less Expenditures Per ADM	FY2001 General Fund Balance	FY2002 General Fund Balance	FY2002 Statutory Operating Debt Ratio
Academia Cesar Chavez	161	\$12,315	\$10,282	\$2,033	Not open	\$1,995	29.9%
Achieve Language Academy	299	8,686	7,491	1,195	\$1,577	3,027	36.9
Agricultural & Food Sciences	46	18,443	20,172	-1,729	Not open	56	0.3
Aurora	91	9,114	8,774	341	-555	171	2.3
Avalon	105	13,051	11,875	1,176	Not open	1,176	10.3
Bluffview Montessori	195	6,655	6,192	463	392	1,088	20.6
Cedar-Riverside Community	108	9,166	8,750	415	2,992	3,153	74.2
City Academy	111	10,847	11,177	-330	2,656	2,666	31.8
Community Of Peace	472	9,538	8,881	658	2,400	2,809	34.7
Concordia Creative Learning	134	10,143	9,367	776	19	751	9.2
Coon Rapids Learning	120	7,759	8,657	-898	1,152	507	6.0
Covenant Academy	20	28,314	22,107	6,206	Not open	6,206	34.9
Crosslake Community	53	8,500	8,977	-477	430	-171	-2.0
Cyber Village Academy	180	8,069	8,417	-349	484	457	5.9
ECHO	113	7,852	7,284	568	1,501	1,537	24.1
Eci' Nompa Woonspe'	44	24,831	24,753	78	5,070	6,757	45.6
Edison - Duluth	737	8,610	8,559	51	245	297	4.2
El Colegio	70	12,911	12,445	466	21	604	5.6
Emily	81	8,789	8,617	173	2,362	2,658	42.4
Excell Academy	81	10,579	10,835	-257	Not open	-132	-1.3
Face To Face Academy	50	11,328	13,283	-1,955	-273	-2,313	-17.7
Family Academy	183	10,438	10,087	351	-144	170	1.9
Four Directions	68	19,741	19,364	377	3,380	3,894	24.8
Friendship Academy	47	10,656	10,805	-149	Not open	1,122	22.4
Great River Education	46	11,251	10,374	877	-454	575	5.7
Hanska Community	30	11,748	12,542	-794	3,218	3,929	33.7
Harvest Preparatory Academy	364	11,409	9,886	1,523	-39	76	1.0
Heart of the Earth	282	9,939	9,257	682	-2,124	-367	-4.4
Higher Ground Academy	347	9,915	9,182	732	-311	667	12.2
HOPE Community Academy	449	9,975	10,453	-478	661	132	1.8
Jennings Experiential	112	9,851	9,275	576	-123	930	10.2
La Crescent Montessori	65	7,976	7,959	16	1,323	1,115	15.2
Lafayette	59	9,897	8,830	1,068	1,045	1,847	25.6
Lake Superior	76	8,460	7,534	926	1,504	2,363	33.4
Lakes Area	30	15,913	13,249	2,664	1,978	5,913	50.7
Math and Science Academy	259	7,767	7,292	475	218	667	9.3

**Table A.2: Charter School Revenue, Expenditure, and Fund Balance Data Per ADM (continued)**

Charter School	FY2002 ADM	Fiscal Year 2002 Revenues and Expenditures Per ADM			General Fund Balances Per ADM <sup>b</sup>		
		Total Revenues Per ADM <sup>a</sup>	Total Expenditures Per ADM	Revenues Less Expenditures Per ADM	FY2001 General Fund Balance	FY2002 General Fund Balance	FY2002 Statutory Operating Debt Ratio
Metro Deaf	56	\$28,359	\$30,970	\$-2,611	\$ 8,193	\$7,710	25.2%
MN Business Academy	340	10,958	11,165	-207	694	474	4.4
MN Institute of Technology	440	9,442	10,198	-756	810	-253	-3.0
MN International	39	18,543	17,751	792	Not open	1,056	6.3
MN New Country	111	9,446	8,392	1,054	1,709	2,506	32.2
MN Transitions	399	9,625	8,544	1,081	217	1,218	20.1
Native Arts	24	No data re-ported			23	No data re-ported	
Nerstrand	151	7,738	7,421	317	1,312	1,644	23.6
New Heights	127	8,266	8,201	64	-1,270	-609	-8.1
New Spirit	231	13,038	11,815	1,224	1,036	2,323	33.0
New Visions	228	20,929	21,607	-678	-239	-832	-4.2
North Lakes Academy	149	7,702	8,801	-1,099	311	258	3.0
Odyssey	213	8,147	8,428	-281	548	254	3.2
PACT	311	7,431	7,530	-98	839	938	13.3
Pillager Area	44	11,063	7,590	3,472	Not open	3,648	68.5
Recording Arts	88	13,606	13,900	-294	183	79	0.6
Ridgeway Community	54	11,942	11,357	585	Not open	790	7.8
Riverbend Academy	138	10,636	9,748	888	2,122	3,050	32.2
Riverway Learning Community	60	12,772	12,636	136	373	449	4.0
Rochester Off Campus	101	7,997	8,456	-459	5,840	4,756	58.4
Schoolcraft Learning Community	159	8,849	7,629	1,220	469	1,654	25.7
Skills for Tomorrow	127	10,893	10,861	31	7,171	4,754	44.8
Sojourner Truth Academy	172	10,059	10,562	-502	2,405	2,456	37.1
St. Paul Family Learning Center	144	10,453	10,517	-64	674	711	7.8
Studio Academy	106	8,652	8,509	144	-924	-514	-6.2
Twin Cities Academy	167	8,430	8,161	269	1,459	1,784	24.2
Twin Cities International	116	14,054	13,047	1,007	Not open	1,209	9.9
Village School of Northfield	63	8,653	8,048	605	1,616	2,268	30.4
World Learner	82	6,964	6,957	7	772	753	13.3
Yankton Country	32	15,665	14,621	1,044	3,130	1,362	9.4

NOTE: Average daily membership (ADM) is the sum for all pupils of the number of days of the school year each pupil is enrolled divided by the number of days that school is in session.

<sup>a</sup>Revenue totals exclude transfers from other funds and loan amounts.

<sup>b</sup>General fund balance is defined as the unreserved/undesignated general fund balance less general fund encumbrances. The percentage used to determine statutory operating debt status is this net amount divided by general fund expenditures.

SOURCE: Office of the Legislative Auditor analysis of Department of Education data.



**Table A.3: Charter School Expenditures by Category, FY2002**

Charter School	Operating Expenditures					Nonoperating Expenditures				
	Administration <sup>a</sup>	Instruction	Special Education	Food Service	Other Operating <sup>b</sup>	Lease	Other Nonoperating <sup>c</sup>	Total Nonoperating	Total Expenditures	
Academia Cesar Chavez	\$350,853 21.2%	\$ 528,335 31.9%	\$ 66,188 4.0%	\$67,470 4.1%	\$290,430 17.5%	\$245,404 14.8%	\$107,450 6.5%	\$352,854 21.3%	\$1,656,130	
Achieve Language Academy	252,076 11.2	1,366,401 61.0	175,201 7.8	102,621 4.6	209,838 9.4	79,971 3.6	55,154 2.5	135,125 6.0	2,241,262	
Agricultural & Food Sciences	282,366 30.2	90,603 9.7	58,716 6.3	0 0.0	241,871 25.9	135,264 14.5	125,766 13.5	261,030 27.9	934,586	
Aurora	189,987 23.7	313,681 39.1	2,348 0.3	70,544 8.8	82,761 10.3	115,780 14.4	27,454 3.4	143,234 17.8	802,555	
Avalon	128,528 10.3	607,203 48.8	59,771 4.8	0 0.0	106,944 8.6	225,290 18.1	116,730 9.4	342,020 27.5	1,244,466	
Bluffview Montessori	176,460 14.6	498,826 41.2	41,135 3.4	40,230 3.3	128,976 10.7	304,351 25.1	20,371 1.7	324,722 26.8	1,210,349	
Cedar-Riverside Community	184,368 19.5	545,858 57.7	35,358 3.7	59,515 6.3	32,848 3.5	67,430 7.1	20,361 2.2	87,791 9.3	945,738	
City Academy	202,029 16.3	777,855 62.8	55,501 4.5	0 0.0	54,764 4.4	120,000 9.7	28,392 2.3	148,392 12.0	1,238,541	
Community Of Peace	498,946 11.9	2,283,509 54.5	257,765 6.2	0 0.0	285,726 6.8	575,292 13.7	289,682 6.9	864,974 20.6	4,190,920	
Concordia Creative Learning	202,642 16.2	380,350 30.3	154,716 12.3	0 0.0	119,028 9.5	180,333 14.4	217,463 17.3	397,796 31.7	1,254,532	
Coon Rapids Learning	160,896 15.5	397,000 38.1	172,193 16.5	0 0.0	129,922 12.5	88,048 8.5	92,717 8.9	180,765 17.4	1,040,776	
Covenant Academy	84,008 19.5	189,897 44.0	62,613 14.5	1,994 0.5	40,463 9.4	35,080 8.1	17,262 4.0	52,342 12.1	431,317	
Crosslake Community	72,905 15.2	154,686 32.3	17,210 3.6	12,026 2.5	133,510 27.9	77,794 16.3	10,442 2.2	88,236 18.4	478,573	
Cyber Village Academy	429,025 28.4	460,940 30.5	61,258 4.1	0 0.0	177,270 11.7	369,299 24.4	14,654 1.0	383,953 25.4	1,512,446	
ECHO	109,201 13.3	387,256 47.0	46,735 5.7	46,393 5.6	87,944 10.7	60,000 7.3	85,987 10.4	145,987 17.7	823,516	
Eci' Nompaa Woonspe'	167,196 15.4	407,357 37.6	33,905 3.1	11,725 1.1	162,975 15.0	3,827 0.4	295,960 27.3	299,787 27.7	1,082,945	
Edison - Duluth	713,857 11.3	2,338,846 37.1	907,336 14.4	259,693 4.1	1,004,442 15.9	983,007 15.6	97,706 1.5	1,080,713 17.1	6,304,887	
El Colegio	134,013 15.3	331,348 37.8	24,234 2.8	12,993 1.5	89,962 10.3	282,957 32.3	1,467 0.2	284,424 32.4	876,974	

**Table A.3: Charter School Expenditures by Category, FY2002  
(continued)**

Charter School	Operating Expenditures					Nonoperating Expenditures			Total Expenditures
	Administration <sup>a</sup>	Instruction	Special Education	Food Service	Other Operating <sup>b</sup>	Lease	Other Nonoperating <sup>c</sup>	Total Nonoperating	
Emily	\$ 81,921 11.8%	\$ 275,387 39.6%	\$ 48,031 6.9%	\$ 40,038 5.8%	\$ 95,116 13.7%	\$ 85,251 12.3%	\$ 70,132 10.1%	\$ 155,383 22.3%	\$ 695,876
Excell Academy	264,152 30.1	348,202 39.7	44,338 5.1	40,473 4.6	52,805 6.0	105,676 12.0	22,217 2.5	127,893 14.6	877,863
Face To Face Academy	222,829 33.4	159,139 23.8	92,814 13.9	9,350 1.4	80,832 12.1	102,400 15.3	82 0.0	102,482 15.4	667,446
Family Academy	320,062 17.4	596,188 32.3	439,711 23.8	49,707 2.7	78,308 4.2	257,665 14.0	102,745 5.6	360,410 19.5	1,844,386
Four Directions	174,044 13.3	536,469 41.0	132,957 10.2	42,791 3.3	149,115 11.4	106,650 8.1	167,548 12.8	274,198 20.9	1,309,574
Friendship Academy	146,526 29.1	233,288 46.3	4,770 0.9	23,275 4.6	27,332 5.4	48,737 9.7	20,455 4.1	69,192 13.7	504,383
Great River Education	94,463 19.7	235,304 49.1	28,840 6.0	0 0.0	7,447 1.6	85,904 17.9	27,302 5.7	113,206 23.6	479,260
Hanska Community	49,808 13.1	97,414 25.7	14,161 3.7	20,486 5.4	135,413 35.7	0 0.0	62,124 16.4	62,124 16.4	379,406
Harvest Preparatory Academy	228,102 6.3	1,410,977 39.2	195,647 5.4	154,583 4.3	691,102 19.2	580,000 16.1	340,705 9.5	920,705 25.6	3,601,116
Heart of the Earth	555,660 21.3	987,415 37.9	72,129 2.8	152,107 5.8	326,421 12.5	381,196 14.6	132,866 5.1	514,062 19.7	2,607,794
Higher Ground Academy	425,517 13.4	1,149,638 36.1	214,842 6.7	122,753 3.9	596,050 18.7	469,806 14.7	208,297 6.5	678,103 21.3	3,186,903
HOPE Community Academy	1,160,582 24.7	1,777,696 37.9	105,068 2.2	261,048 5.6	417,909 8.9	731,789 15.6	239,772 5.1	971,561 20.7	4,693,864
Jennings Experiential	217,581 20.9	300,507 28.9	122,873 11.8	0 0.0	147,489 14.2	196,259 18.9	56,425 5.4	252,684 24.3	1,041,134
La Crescent Montessori	59,266 11.4	219,259 42.1	47,794 9.2	2,161 0.4	38,965 7.5	116,148 22.3	37,030 7.1	153,178 29.4	520,623
Lafayette	65,110 12.4	183,131 35.0	47,159 9.0	18,431 3.5	63,923 12.2	37,091 7.1	108,581 20.7	145,672 27.8	523,426
Lake Superior	112,226 19.5	290,666 50.5	53,922 9.4	0 0.0	28,783 5.0	58,800 10.2	31,361 5.4	90,161 15.7	575,758
Lakes Area	58,008 14.8	182,598 46.6	40,000 10.2	0 0.0	13,506 3.4	76,200 19.4	21,600 5.5	97,800 25.0	391,912
Math & Science Academy	317,844 16.8	799,535 42.4	129,363 6.9	0 0.0	135,752 7.2	453,264 24.0	51,100 2.7	504,364 26.7	1,886,858

**Table A.3: Charter School Expenditures by Category, FY2002  
(continued)**

Charter School	Operating Expenditures					Nonoperating Expenditures					Total Expenditures
	Administration <sup>a</sup>	Instruction	Special Education	Food Service	Other Operating <sup>b</sup>	Lease	Other Nonoperating <sup>c</sup>	Nonoperating	Total Nonoperating	Total	
Metro Deaf	\$245,259 14.3%	\$ 0 0.0%	\$1,171,573 68.1%	\$ 15,593 0.9%	\$ 78,508 4.6%	\$159,727 9.3%	\$ 50,056 2.9%	\$209,783 12.2%	\$1,720,716		
MN Business Academy	658,601 17.4	1,202,229 31.7	168,043 4.4	38,702 1.0	939,923 24.8	749,275 19.7	38,725 1.0	788,000 20.8	3,795,498		
MN Institute of Technology	613,967 13.7	1,789,955 39.9	422,740 9.4	205,560 4.6	659,008 14.7	778,920 17.4	14,888 0.3	793,808 17.7	4,485,038		
MN International	237,272 33.9	252,504 36.1	12,507 1.8	26,774 3.8	73,365 10.5	69,082 9.9	27,515 3.9	96,597 13.8	699,019		
MN New Country	51,287 5.5	527,694 56.6	110,937 11.9	0 0.0	52,966 5.7	139,200 14.9	50,922 5.5	190,122 20.4	933,006		
MN Transitions	550,381 16.2	1,384,430 40.6	271,951 8.0	235,334 6.9	205,164 6.0	507,128 14.9	253,264 7.4	760,392 22.3	3,407,652		
Nerstrand	99,963 8.9	544,061 48.6	78,239 7.0	0 0.0	108,305 9.7	212,400 19.0	75,518 6.8	287,918 25.7	1,118,486		
New Heights	209,264 20.1	397,757 38.1	107,430 10.3	30,543 2.9	84,980 8.1	187,500 18.0	25,405 2.4	212,905 20.4	1,042,879		
New Spirit	369,559 13.6	1,235,088 45.3	127,896 4.7	124,144 4.6	173,061 6.4	420,840 15.5	272,914 10.0	693,754 25.5	2,723,502		
New Visions	799,810 16.2	1,315,965 26.7	1,273,439 25.8	191,462 3.9	769,155 15.6	480,000 9.7	100,239 2.0	580,239 11.8	4,930,070		
North Lakes Academy	180,441 13.8	702,847 53.6	87,373 6.7	0 0.0	64,302 4.9	172,356 13.2	103,328 7.9	275,684 21.0	1,310,647		
Odyssey	184,496 10.3	754,682 42.1	177,329 9.9	40,564 2.3	294,466 16.4	294,066 16.4	46,764 2.6	340,830 19.0	1,792,367		
PACT	367,288 15.7	979,264 41.8	302,367 12.9	18,193 0.8	260,908 11.1	314,435 13.4	101,953 4.3	416,388 17.8	2,344,408		
Pillager Area	56,258 17.0	116,869 35.2	59,873 18.0	0 0.0	36,993 11.1	35,000 10.5	26,855 8.1	61,855 18.6	331,848		
Recording Arts	132,152 10.8	765,491 62.4	96,656 7.9	20,751 1.7	103,607 8.5	102,905 8.4	4,425 0.4	107,330 8.8	1,225,987		
Ridgeway Community	116,831 19.0	225,174 36.5	44,476 7.2	22,599 3.7	125,285 20.3	60,000 9.7	21,998 3.6	81,998 13.3	616,363		
Riverbend Academy	133,317 9.9	670,879 49.8	177,085 13.2	0 0.0	98,938 7.3	248,154 18.4	17,781 1.3	265,935 19.8	1,346,154		

**Table A.3: Charter School Expenditures by Category, FY2002  
(continued)**

Charter School	Operating Expenditures					Nonoperating Expenditures					Total Expenditures
	Administration <sup>a</sup>	Instruction	Special Education	Food Service	Other Operating <sup>b</sup>	Total Operating	Lease	Nonoperating <sup>c</sup>	Other Nonoperating	Total Nonoperating	
Riverway Learning Community	\$112,886	\$233,397	\$ 95,237	\$24,075	\$ 50,168	\$ 515,763	\$123,266	\$116,236	\$116,236	\$239,502	\$ 755,265
Rochester Off Campus	14.9%	30.9%	12.6%	3.2%	6.6%	68.3%	16.3%	15.4%	15.4%	31.7%	852,830
Schoolcraft Learning Community	136,178	430,042	62,579	5,303	49,678	683,780	95,109	73,941	73,941	169,050	852,830
Skills for Tomorrow	16.0	50.4	7.3	0.6	5.8	80.2	11.2	8.7	8.7	19.8	1,215,169
Sojourner Truth Academy	155,453	575,235	73,512	72,459	128,101	1,004,760	155,507	54,902	54,902	210,409	1,215,169
St. Paul Family Learning Center	12.8	47.3	6.0	6.0	10.5	82.7	12.8	4.5	4.5	17.3	1,376,369
Studio Academy	171,104	669,142	133,556	17,070	225,400	1,216,272	135,378	24,719	24,719	160,097	1,376,369
Twin Cities Academy	12.4	48.6	9.7	1.2	16.4	88.4	9.8	1.8	1.8	11.6	1,817,818
Twin Cities International	260,973	936,674	76,057	94,097	150,362	1,518,163	210,000	89,655	89,655	299,655	1,817,818
Village School of Northfield	14.4	51.5	4.2	5.2	8.3	83.5	11.6	4.9	4.9	16.5	1,515,434
World Learner	234,534	510,901	285,048	176,266	110,771	1,317,520	182,346	15,568	15,568	197,914	1,515,434
Yankton Country	15.5	33.7	18.8	11.6	7.3	86.9	12.0	1.0	1.0	13.1	903,796
	175,980	476,023	29,307	0	37,178	718,488	129,820	55,488	55,488	185,308	903,796
	19.5	52.7	3.2	0.0	4.1	79.5	14.4	6.1	6.1	20.5	1,362,231
	230,860	607,296	23,482	59,241	201,822	1,122,701	218,525	21,005	21,005	239,530	1,362,231
	16.9	44.6	1.7	4.3	14.8	82.4	16.0	1.5	1.5	17.6	1,514,326
	378,934	588,323	56,609	79,996	173,061	1,276,923	207,247	30,156	30,156	237,403	1,514,326
	25.0	38.9	3.7	5.3	11.4	84.3	13.7	2.0	2.0	15.7	509,105
	73,844	192,084	52,717	14,382	32,525	365,552	137,572	5,981	5,981	143,553	509,105
	14.5	37.7	10.4	2.8	6.4	71.8	27.0	1.2	1.2	28.2	572,488
	109,191	279,856	68,795	12,180	9,247	479,269	0	93,219	93,219	572,488	
	19.1	48.9	12.0	2.1	1.6	83.7	0.0	16.3	16.3	16.3	464,076
	96,415	152,412	22,276	0	41,248	312,351	38,053	113,672	113,672	151,725	464,076
	20.8	32.8	4.8	0.0	8.9	67.3	8.2	24.5	24.5	32.7	

<sup>a</sup> "Administration" includes expenses for the school board, administration (e.g., principal and office staff), and central office services such as data processing and printing.

<sup>b</sup> "Other Operating" includes, among other things, vocational instruction, instructional and pupil support services, building operations and maintenance, and student transportation.

<sup>c</sup> "Other Nonoperating" includes capital outlay, community service (such as adult education), building improvements, and debt service.

SOURCE: Office of the Legislative Auditor analysis of Department of Education data.

**Table A.4: Charter School Expenditures Per ADM, FY2002**

Charter School	ADM	Operating Expenditures Per ADM							Nonoperating Expenditures Per ADM			
		Administration <sup>a</sup>	Instruction	Special Education	Food Service	Operating <sup>b</sup>	Other Operating <sup>b</sup>	Total Operating	Lease	Nonoperating <sup>c</sup>	Other Nonoperating	Total Nonoperating
Academia Cesar Chavez	161	\$2,178	\$3,280	\$ 411	\$419	\$1,803	\$8,091	\$1,524	\$ 667		\$2,191	\$10,282
Achieve Language Academy	299	843	4,567	586	343	701	7,039	267	184		452	7,491
Agricultural and Food Sciences	46	6,095	1,956	1,267	0	5,221	14,538	2,920	2,715		5,634	20,172
Aurora	91	2,077	3,429	26	771	905	7,208	1,266	300		1,566	8,774
Avalon	105	1,226	5,794	570	0	1,020	8,611	2,150	1,114		3,264	11,875
Bluffview Montessori	195	903	2,552	210	206	660	4,531	1,557	104		1,661	6,192
Cedar-Riverside Community	108	1,706	5,050	327	551	304	7,938	624	188		812	8,750
City Academy	111	1,823	7,020	501	0	494	9,838	1,083	256		1,339	11,177
Community Of Peace	472	1,057	4,839	546	0	605	7,048	1,219	614		1,833	8,881
Concordia Creative Learning	134	1,513	2,840	1,155	0	889	6,397	1,346	1,624		2,970	9,367
Coon Rapids Learning	120	1,338	3,302	1,432	0	1,081	7,154	732	771		1,504	8,657
Covenant Academy	20	4,306	9,733	3,209	102	2,074	19,425	1,798	885		2,683	22,107
Crosslake Community	53	1,368	2,902	323	226	2,504	7,322	1,459	196		1,655	8,977
Cyber Village Academy	180	2,388	2,565	341	0	987	6,281	2,055	82		2,137	8,417
ECHO	113	966	3,425	413	410	778	5,993	531	761		1,291	7,284
Eci' Nompa Woonspe'	44	3,822	9,311	775	268	3,725	17,901	87	6,765		6,852	24,753
Edison - Duluth	737	969	3,175	1,232	353	1,364	7,092	1,334	133		1,467	8,559
El Colegio	70	1,902	4,702	344	184	1,277	8,409	4,015	21		4,036	12,445
Emily	81	1,014	3,410	595	496	1,178	6,693	1,056	868		1,924	8,617
Excell Academy	81	3,260	4,298	547	500	652	9,257	1,304	274		1,579	10,835
Face To Face Academy	50	4,434	3,167	1,847	186	1,609	11,243	2,038	2		2,039	13,283
Family Academy	183	1,751	3,261	2,405	272	428	8,116	1,409	562		1,971	10,087
Four Directions	68	2,573	7,932	1,966	633	2,205	15,309	1,577	2,477		4,054	19,364
Friendship Academy	47	3,139	4,998	102	499	586	9,323	1,044	438		1,482	10,805
Great River Education	46	2,045	5,093	624	0	161	7,923	1,859	591		2,450	10,374
Hanska Community	30	1,647	3,220	468	677	4,476	10,489	0	2,054		2,054	12,542
Harvest Preparatory Academy	364	626	3,874	537	424	1,897	7,359	1,592	935		2,528	9,886
Heart of the Earth	282	1,972	3,505	256	540	1,159	7,432	1,353	472		1,825	9,257

**Table A.4: Charter School Expenditures Per ADM, FY2002 (continued)**

Charter School	ADM	Operating Expenditures Per ADM							Nonoperating Expenditures Per ADM			
		Administration <sup>a</sup>	Instruction	Special Education	Food Service	Operating <sup>b</sup>	Other Operating <sup>b</sup>	Total Operating	Lease	Nonoperating <sup>c</sup>	Other Nonoperating	Total Nonoperating
Higher Ground Academy	347	\$1,226	\$3,312	\$ 619	\$354	\$1,717	\$7,229	\$1,354	\$ 600	\$1,954	\$ 9,182	
HOPE Community Academy	449	2,584	3,959	234	581	931	8,289	1,630	534	2,164	10,453	
Jennings Experiential	112	1,938	2,677	1,095	0	1,314	7,024	1,748	503	2,251	9,275	
La Crescent Montessori	65	906	3,352	731	33	596	5,618	1,776	566	2,342	7,959	
Lafayette	59	1,098	3,089	796	311	1,078	6,372	626	1,832	2,457	8,830	
Lake Superior	76	1,469	3,804	706	0	377	6,354	769	410	1,180	7,534	
Lakes Area	30	1,961	6,173	1,352	0	457	9,943	2,576	730	3,306	13,249	
Math & Science Academy	259	1,228	3,090	500	0	525	5,343	1,752	197	1,949	7,292	
Metro Deaf	56	4,414	0	21,087	281	1,413	27,195	2,875	901	3,776	30,970	
MN Business Academy	340	1,937	3,536	494	114	2,765	8,847	2,204	114	2,318	11,165	
MN Institute of Technology	440	1,396	4,070	961	467	1,498	8,393	1,771	34	1,805	10,198	
MN International	39	6,025	6,412	318	680	1,863	15,298	1,754	699	2,453	17,751	
MN New Country	111	461	4,746	998	0	476	6,682	1,252	458	1,710	8,392	
MN Transitions	399	1,380	3,471	682	590	514	6,638	1,272	635	1,907	8,544	
Nerstrand	151	663	3,610	519	0	719	5,511	1,409	501	1,910	7,421	
New Heights	127	1,646	3,128	845	240	668	6,527	1,475	200	1,674	8,201	
New Spirit	231	1,603	5,358	555	539	751	8,805	1,826	1,184	3,010	11,815	
New Visions	228	3,505	5,767	5,581	839	3,371	19,064	2,104	439	2,543	21,607	
North Lakes Academy	149	1,212	4,720	587	0	432	6,950	1,157	694	1,851	8,801	
Odyssey	213	867	3,548	834	191	1,385	6,825	1,383	220	1,603	8,428	
PACT	311	1,180	3,145	971	58	838	6,192	1,010	327	1,337	7,530	
Pillager Area	44	1,287	2,673	1,369	0	846	6,176	801	614	1,415	7,590	
Recording Arts	88	1,498	8,679	1,096	235	1,175	12,683	1,167	50	1,217	13,900	
Ridgeway Community	54	2,153	4,149	820	416	2,309	9,846	1,106	405	1,511	11,357	
Riverbend Academy	138	965	4,858	1,282	0	716	7,822	1,797	129	1,926	9,748	
Riverway Learning Community	60	1,889	3,905	1,593	403	839	8,629	2,062	1,945	4,007	12,636	
Rochester Off Campus	101	1,350	4,264	620	53	493	6,779	943	733	1,676	8,456	
Schoolcraft Learning Community	159	976	3,611	461	455	804	6,308	976	345	1,321	7,629	

**Table A.4: Charter School Expenditures Per ADM, FY2002 (continued)**

Charter School	ADM	Operating Expenditures Per ADM							Nonoperating Expenditures Per ADM		
		Administration <sup>a</sup>	Instruction	Special Education	Food Service	Other Operating <sup>b</sup>	Total Operating	Lease	Other Nonoperating <sup>c</sup>	Total Nonoperating	Total
Skills for Tomorrow	127	\$1,350	\$5,280	\$1,054	\$ 135	\$1,779	\$9,598	\$1,068	\$ 195	\$1,263	\$10,861
Sojourner Truth Academy	172	1,516	5,442	442	547	874	8,821	1,220	521	1,741	10,562
St. Paul Family Learning Center	144	1,628	3,546	1,978	1,223	769	9,144	1,266	108	1,374	10,517
Studio Academy	106	1,657	4,481	276	0	350	6,764	1,222	522	1,745	8,509
Twin Cities Academy	167	1,383	3,638	141	355	1,209	6,726	1,309	126	1,435	8,161
Twin Cities International	116	3,265	5,069	488	689	1,491	11,001	1,786	260	2,045	13,047
Village School of Northfield	63	1,167	3,036	833	227	514	5,779	2,175	95	2,269	8,048
World Learner	82	1,327	3,401	836	148	112	5,824	0	1,133	1,133	6,957
Yankton Country	32	3,038	4,802	702	0	1,300	9,841	1,199	3,581	4,780	14,621

NOTE: Average daily membership (ADM) is the sum for all pupils of the number of days of the school year each pupil is enrolled divided by the number of days that school is in session.

<sup>a</sup> "Administration" includes expenses for the school board, administration (e.g., principal and office staff), and central office services such as data processing and printing.

<sup>b</sup> "Other Operating" includes, among other things, vocational instruction, instructional and pupil support services, building operations and maintenance, and student transportation.

<sup>c</sup> "Other Nonoperating" includes capital outlay, community service (such as adult education), building improvements, and debt service.

SOURCE: Office of the Legislative Auditor analysis of Department of Education data.

**Table A.5: Charter School Building Leases, FY2003**

Charter School	Lease Amount	Square Feet	Lease Amount Per Square Foot	2003 ADM	Square Feet Per ADM	Lease Amount Per ADM	Lease Aid Approved
Academia Cesar Chavez	\$ 283,535	38,693	\$ 7.33	215	180	\$1,319	\$250,500
Achieve Language Academy	289,340	38,924	7.43	290	134	998	255,628
Agricultural & Food Sciences	266,264	17,751	15.00	155	115	1,718	235,241
Aurora	126,960	7,200	17.63	108	67	1,176	112,167
Avalon	209,703	17,461	12.01	120	146	1,748	185,269
Bluffview Montessori	306,863	25,000	12.27	190	132	1,615	271,109
Cedar-Riverside Community <sup>a</sup>	42,462	10,918	3.89	102	107	416	37,515
Chiron	205,951	21,588	9.54	170	127	1,211	181,955
City Academy	120,000	10,000	12.00	100	100	1,200	106,018
Community Of Peace	1,001,131	77,511	12.92	531	146	1,885	873,547
Concordia Creative Learning	169,579	16,730	10.14	132	127	1,285	149,821
Coon Rapids Learning	208,889	14,530	14.38	183	79	1,141	184,551
Covenant Academy	95,003	9,269	10.25	40	232	2,375	76,569
Crosslake Community	92,306	7,801	11.83	64	122	1,442	81,551
Cyber Village Academy	349,152	22,888	15.25	192	119	1,818	308,471
ECHO	90,000	10,530	8.55	126	84	714	79,514
Edison - Duluth	983,223	113,869	8.63	751	152	1,309	868,664
El Colegio	269,056	20,700	13.00	60	345	4,484	153,138
Emily	57,000	13,250	4.30	73	182	781	50,359
Excell Academy	175,384	15,562	11.27	99	157	1,772	143,022
Face To Face Academy	102,400	10,745	9.53	50	215	2,048	90,469
Family Academy <sup>a</sup>	373,943	22,186	16.85	229	97	1,633	330,374
Four Directions <sup>a</sup>	111,082	10,665	10.42	75	142	1,481	98,139
Friendship Academy	47,807	4,225	11.32	64	66	747	42,237
Great River Education <sup>a</sup>	60,672	5,395	11.25	45	120	1,348	53,603
Hanska Community	41,600	21,375	1.95	25	855	1,664	36,753
Harbor City International <sup>a</sup>	153,612	11,424	13.45	100	114	1,536	135,714
Harvest Preparatory Academy	580,000	72,500	8.00	375	193	1,547	512,422
Heart of the Earth	433,333	38,216	11.34	270	142	1,605	382,844
Higher Ground Academy	540,652	48,000	11.26	367	131	1,473	477,658
HOPE Community Academy	631,806	39,267	16.09	430	91	1,469	558,192
Jennings Experiential	202,167	19,020	10.63	90	211	2,246	172,280
La Crescent Montessori	103,200	10,460	9.87	55	190	1,876	81,693
Lafayette	58,779	17,320	3.39	78	222	754	51,930
Lake Superior	135,181	6,985	19.35	83	84	1,629	119,430
Lakes Area	79,200	6,680	11.86	35	191	2,263	69,972
MN Institute of Technology	756,000	72,000	10.50	393	183	1,924	583,940
Math & Science Academy <sup>a</sup>	453,742	20,700	21.92	275	75	1,650	400,875
Metro Deaf	162,930	15,000	10.86	75	200	2,172	110,848
MN Business Academy	782,496	65,254	11.99	452	144	1,731	691,324
MN International <sup>a</sup>	41,292	3,500	11.80	55	64	751	36,481
MN New Country	173,327	15,000	11.56	97	155	1,787	153,132



**Table A.5: Charter School Building Leases, FY2003 (continued)**

Charter School	Lease Amount	Square Feet	Lease Amount Per Square Foot	2003 ADM	Square Feet Per ADM	Lease Amount Per ADM	Lease Aid Approved
MN Transitions	\$698,900	72,243	\$ 9.67	650	111	\$1,075	\$617,469
Native Arts	73,252	5,000	14.65	15	333	4,883	28,713
Nerstrand	218,772	17,700	12.36	153	116	1,430	193,282
New Century	103,563	15,723	6.59	90	175	1,151	91,496
New Heights	187,500	31,555	5.94	136	232	1,379	165,654
New Spirit	670,000	56,000	11.96	280	200	2,393	436,310
New Visions	389,864	36,000	10.83	238	151	1,638	344,439
North Lakes Academy	172,356	21,520	8.01	161	134	1,071	152,274
North Shore	286,316	33,000	8.68	206	160	1,390	252,956
Odyssey	375,375	34,500	10.88	276	125	1,360	331,639
PACT	379,562	33,850	11.21	320	106	1,186	335,338
Partnership Academy	114,696	13,776	8.33	120	115	956	101,332
Pillager Area <sup>a</sup>	36,250	5,000	7.25	42	119	863	32,026
Prairie Creek	90,000	9,315	9.66	102	91	882	79,514
Recording Arts	122,342	8,913	13.73	124	72	987	108,088
Ridgeway Community	63,000	7,500	8.40	47	160	1,340	55,660
Riverbend Academy	233,364	30,100	7.75	132	228	1,768	206,174
Riverway Learning Community	120,750	11,500	10.50	75	153	1,610	106,681
Rochester Off Campus	113,619	9,004	12.62	103	87	1,103	100,381
Sage Academy	91,616	7,642	11.99	50	153	1,832	80,941
Schoolcraft Learning Community	160,249	17,268	9.28	161	107	995	141,578
Skills for Tomorrow <sup>a</sup>	160,324	11,000	14.57	127	87	1,262	141,644
Sojourner Truth Academy	210,000	25,000	8.40	228	110	921	185,532
St. Paul Family Learning Center	194,937	17,829	10.93	124	144	1,572	172,224
Studio Academy	119,696	12,000	9.97	112	107	1,069	105,750
Trio Wolf Creek	13,143	1,772	7.42	43	41	306	11,611
Twin Cities Academy <sup>a</sup>	218,525	30,673	7.12	180	170	1,214	193,064
Twin Cities International <sup>a</sup>	108,875	10,500	10.37	160	66	680	96,190
Village School of Northfield	129,388	10,078	12.84	56	180	2,310	103,442
Watershed	96,276	7,513	12.81	86	87	1,119	85,059
WISE	264,000	32,700	8.07	124	264	2,129	157,069
World Learner	124,979	8,000	15.62	98	82	1,275	110,417
Yankton Country	30,384	2,683	11.32	38	71	800	26,844
Average	236,519	22,573	10.83	164	150	1,489	201,943

NOTES: Average daily membership (ADM) is the sum for all pupils of the number of days of the school year each pupil is enrolled divided by the number of days that school is in session. 2003 ADM data are subject to change. Eci' Nompa Woonspe' owns its building and did not receive lease aid. It is not included in this table.

<sup>a</sup>Lease amount includes rental of off-premise gym space.

SOURCE: Office of the Legislative Auditor analysis of Department of Education data.



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# Further Reading

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June 16, 2003

Mr. James Nobles  
Office of the Legislative Auditor  
Room 140 Centennial Building  
658 Cedar Street  
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for the Office of the Legislative Auditor's (OLA) report with regard to charter school financial accountability in Minnesota. We appreciate the hard work and recommendations made by OLA staff in the report.

As background, in February 2003 the Minnesota Department of Education (MDE) created the Division of Choice and Innovation. Creation of the division was in response to the growth of school choice options, particularly charter schools, over the past ten years, as well as the recognition that with substantial growth and change comes greater accountability and additional management responsibilities for charter schools and MDE.

We believe the new division, as well as other changes at MDE, will offer the following to charter schools:

- A "one-stop shopping" destination for questions and information. While many staff members throughout MDE are involved with charter school issues, the Division of Choice and Innovation offers charter schools, parents and teachers a first place to call. From there, the staff in the division works with other MDE staff in order to provide charter schools with a streamlined information process.
- More individual attention to charter schools, as their issues are significant given the nature of the issues they face when opening and operating new schools.
- Greater expertise and technical services from MDE employees. Four MDE employees within the Division of Program Finance have been directed to assign 25 percent of their time to work with charter schools on financial issues such as general education, pupil counts, transportation funding, and special education data and payment funding. We

believe this will be of great assistance to charter schools by giving them the technical expertise and information that has been available to school districts.

- Additional financial management training for charter schools, available effective June 2003.

While we believe the changes implemented at MDE represent a good start, we recognize that there is more work to be done. The following represents MDE's responses to recommendations made by OLA.

***Recommendation #1: Implement a two-stage approval process that requires new charter schools to demonstrate that they have skilled personnel and financial systems in place before enrolling students.***

MDE believes it is essential that we increase the amount of cooperative interaction between the Department, the sponsor, and the school during its "planning year," the period of time between when MDE approves the school's sponsor and when the school opens.

As your report notes, MDE is considering options to modify the charter school approval process. At this time, MDE is not prepared to support a two-stage approval process until we have finished assessing the benchmarks that charter schools should obtain before opening its doors to students.

***Recommendation #2: Modify the model charter school contract to include more detailed requirements regarding budgeting, financial reporting, and training for school administrators and board members.***

MDE supports this recommendation and will begin working in collaboration with stakeholders this summer to improve the model charter school contract along the lines recommended by the OLA. However, it is important to recognize the inherent difficulties in creating a "one size fits all" model given the variety of school concepts and of people who develop and staff them. Not every charter school administrator may need the same kind of training (depending on his or her past experience) and not every administrator may need to perform the same functions at each school.

***Recommendation #3: Enhance training offered to charter school board members to better meet the intent of the law.***

MDE has already started to implement enhanced financial management training to charter school board members. The financial management section of the Division of Program Finance is offering various training programs, which are open to board members. In addition to the financial responsibilities charter school board members share, and given the makeup of board members – many who are teachers and administrators - there is a real advantage to these individuals in having a thorough understanding how the charter school business office should function.

The following programs are now being offered at MDE:

- Two-day comprehensive charter school financial workshops offered during the summer.
- One-day school finance accounting programs conducted throughout the year.
- One-day “year-end” financial workshops for charter schools completing their first year of operation (by invitation).
- One-day “year-end” financial workshops for all charter schools that are not in their first year of operation.

Most significantly MDE will now offer, prior to the beginning of this school year, a five-day workshop for new charter schools. This is intended to comply with Minnesota law as well as to meet most basic managerial and accounting needs. A component of this training program is especially designed to meet the needs of school board members. The Minnesota School Board Association has agreed to work with MDE in program design and implementation. It will cover the role of board members, an understanding of the board’s statutory obligations, basic elements of the school finance (such as the responsibility of the board to approve and oversee a budget), how to conduct meetings, hiring staff, and other issues dealing with public relations and board governance.

***Recommendation #4: To the extent possible, expand quarterly enrollment monitoring to all charter schools.***

While MDE supports this recommendation, staffing levels will make it difficult to expand to quarterly enrollment monitoring. However, new charter schools and charter schools that have experienced financial difficulties will be monitored more thoroughly to ensure that financial accountability is in place.

***Recommendation #5: MDE should initiate a process to more clearly define the scope and nature of the sponsor’s role regarding charter school financial management and recommend to the Legislature any needed changes to charter school law.***

MDE supports this recommendation and has already begun scheduling a series of meetings this summer with key stakeholders to develop a plan for increasing the effectiveness of sponsors. The first meeting, which will take place in July, will build on the previous research done in this area by the Center for School Change at the University of Minnesota and other entities.

***Recommendation #6: The Legislature should consider amending charter school law to state that charter school contracts may be terminated [by sponsors] for repeated failure to meet deadlines for submitting financial data and financial audit reports.***

MDE supports this recommendation and will likely include it in its policy recommendations to the Legislature for next year. Although sponsors essentially already have this power under

current law, perhaps stating it explicitly will help to better motivate schools to meet current deadlines for financial reporting. MDE will be working with charter schools to ensure that financial data is submitted in a timely manner.

***Recommendation #7: The Legislature should consider amending charter school law to remove the requirement that teachers constitute a majority of charter school board members.***

MDE supports this recommendation and will include it in its policy recommendations to the Legislature for next year. While having teachers constitute a majority of a charter school board should continue to be permitted, it should not be required.

***Recommendation #8: The Legislature should review and clarify, as needed, the policy on use of state funds to buy charter school buildings.***

MDE supports this recommendation and will work with stakeholders this year to reach agreement on a specific proposal to be presented to the Legislature next year. The OLA's report correctly identifies the key issues to be considered. MDE would support limiting the "building buy" option to more established charter schools that meet certain criteria in such areas as age of the school and financial status. In a situation where the charter school that owns a building closes, MDE would favor requiring the proceeds from the sale of facilities to be returned to the State after paying off any debts owed by the school.

Again, we thank you for your work in creating this report, and welcome the opportunity to address these important issues. Please contact Chas Anderson at 651-582-8207 if you should have any questions or comments.

Sincerely,



Cheri Pierson Yecke, Ph.D.  
Commissioner

C: Chas Anderson, Assistant Commissioner  
Tom Melcher, Director of Program Finance  
Morgan Brown, Director of Choice and Innovation  
Richard Guvernmont, Supervisor, Program Finance



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