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AN EXAMINATION OF THE FINANCIAL HEALTH OF GEORGIA'S START-UP CHARTER SCHOOLS

Charter schools are the most rapidly growing form of school choice in the United States. Since Georgia enacted its charter school law in 1993, approximately 70 charter schools have been authorized throughout the state. Legislation passed in recent years has authorized the creation of entire districts of charter schools, which is expected to increase their numbers to over 100 by the 2009-10 school year.

Charter schools are public schools that have governance and management autonomy from local school districts and the State Board of Education. In exchange for this independence, charter schools must meet performance objectives conditioned in their charters. If performance objectives are not met, charter schools can have their contracts revoked at the end of the charter period (typically five years). Despite the growing popularity of charter schools as an educational alternative to traditional public schools, relatively little is known about their financial positions or management practices compared to student performance objectives that are typically the focus of accountability for charter schools. What evidence exists suggests that they face significant fiscal constraints and challenges.

This brief sheds light on the financial health of start-up charter schools in Georgia during the 2006-07 school year. Financial health, for this brief, is defined as the short-term ability to meet recurring expenses with recurring revenues. A charter school in good financial condition generally maintains an adequate service level during fiscal downturns, forecasts and adjusts well to enrollment changes, and develops resources to expand to full capacity and meet future needs. A charter school in fiscal stress usually struggles to balance its budget, suffers service declines when enrollment decreases, has a difficult time adjusting to state or local funding fluctuations, and has limited resources to expand or meet future needs.

Financial indicators computed for this paper are measures of liquidity, fund balance, step/fixed costs, and budget flexibility. Liquidity measures indicate how well a school can meet its current liabilities with cash and cash-like resources on hand. Step and fixed costs constrain schools from offering optimal instructional services when the importance of such costs cannot be minimized by spreading them across many students. Measures of fund balance include a school's year-to-year operating surplus or deficit and its cumulative reserve of resources across multiple years. Finally, budget flexibility is measured by a school's reliance on federal, state, or local funding, which if too high, will cause financial stress in economic downturns.

This brief also compares financial data from 2006-07 with descriptive statistics from a multi-year analysis of

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charter schools to see if financial indicators over time are consistent with the one year cross-section. This brief is from an interim report of a larger study examining the fiscal health and financial management practices of Georgia's small, but growing charter school population. Besides providing basic financial information on the state's start-up charter schools, this brief explores the role played by factors such as school type, age, and size in financial condition. It concludes with recommendations for programs and policy changes, which may improve the financial health and stability of charter schools in Georgia.

Findings

- *The financial health of Georgia's start-up charter schools in the 2006-07 school year is mixed.* Although a majority of start-up schools had a positive financial position, over 40 percent of schools (11 out of 25) ran an operating deficit or reported negative net assets at the end of their fiscal years. One of these schools closed at the end of the school year. Although eight of the schools running operating deficits had positive net assets to sustain them to the next school year, only two had large enough reserves of cash to meet current liabilities at levels recommended to provide an adequate cash reserve if expenses run higher than expected. Three schools had negative net assets, all of which were in their first two years of operating. It is not unusual for new start-up schools to be in debt as they grow and age, but these schools are struggling to meet expenditure commitments even with access to implementation grants. Two of these schools are in debt to their education management organization for start-up loans and burdensome facilities costs.

- *School age is a key factor in financial condition.* Having enough cash on hand to meet current obligations is difficult for schools operating in their first three years, as evidenced by their low liquidity ratios relative to schools making it past the first charter re-authorization period (year 6 and beyond). New start-ups rely on private foundation and federal grants to survive through the early years of operation as they grow their enrollments. Although public and private implementation grants keep many young schools in the black, they also contribute to a great deal of variability in measures of fund balance for these schools. Schools that survive to year four and beyond may have lower operating surpluses as a share of expenditures, but they often manage to accumulate a consistent (and arguably more predictable) fund balance regardless of enrollment level. This may indicate that as charter school board members and managers become more experienced they are able to develop budgeting and financial management practices more appropriate to their school's operating environment.

- *School size is positively related to charter school financial health, but it is unclear if larger enrollments by themselves help improve a school's financial position or if larger enrollments only improve financial health for more established charter schools.* School age is correlated with school size for Georgia's start-up charters (0.46). As "experiments" in public education for curriculum and governance, it has been considered good practice to slowly grow enrollment over the first several years of operation so that curriculum methodology and management structure can develop. For short-term financial condition, however, low enrollments can put schools at risk of closure because they have less per-pupil revenue to spread over their step/fixed costs. It is difficult to discern if low liquidity and fund balance measures for small schools is a function of size or age or the combination of both. Clearly for some costs like facilities, the number of students in a school is important. Local authorizers who partner with charter schools might consider increasing funding beyond federal implementation grants to aid charter schools' start-up through the first charter renewal term if enrollments are expected to be small. Another option might be to encourage charters to start with more students or ramp up their enrollments more quickly to improve financial stability. More research is needed on the interrelationship between school size and age in charter school financial health.

- *As small, independent organizations, charter schools have few opportunities to realize economies of size.* Start-up charter schools are responsible for managing and staffing non-instructional services on its own. These services range from marketing to payroll to food services. About $1 of every $8 in expenditures for a charter school goes towards management and administration costs alone (food services and facilities excluded). Management and administration expenses typically include salaries of school business staff who manage a school's books, manage student and teacher records (vital for ensuring correct funding from the state), recruit students and teachers, manage information technology services, etc. Charter schools that do not provide these services themselves must contract out for them or find qualified volunteers to do the work. Traditional public schools have a central administrative office to provide these services for many schools. An alternative to providing additional state funding to charter schools to pay for these services on their own is to help them reduce costs through shared services. For example, it may be beneficial to charter schools to buy business services from their authorizing districts as an alternative to using private contractors or an educational management organization. Since local authorizers already have the systems in place to provide these services, it is likely to be a relatively low additional cost to the district to add charter schools. Other services such as transportation and food service are already offered to charters in some districts, so it seems plausible to add-on services like student data management, payroll, and plant maintenance.

In cases where charter schools would prefer to maintain their independence or their local districts are not willing to extend services to charter schools, then cooperative service agreements among charter schools may be an option for reducing costs. Since 75 percent of start-up charter schools are located within the Atlanta metropolitan region, it seems worthwhile to share business services and pool equipment and supplies purchases to reduce unit costs for each school. The Knowledge is Power Program (KIPP) schools in the Atlanta metropolitan region share many of these functions, in addition to development services, social workers, and high school placement coordinators. A similar cooperative for non-KIPP schools could help to reduce the inefficiencies associated with small schools procuring the same goods and services independently. Likewise, when schools are sharing services they are sharing knowledge about best practices. Although it is a challenge to coordinate cooperatives, the cost benefits could be substantial.

- *There is no official guidance or rule for start-up charter schools on which accounting guidelines or presentation to use in preparing their financial statements, nor a required deadline for submitting them to the Georgia Department of Education (GDOE).* A majority of schools use the Financial Accounting Standards Board (FASB) guidelines, but nearly half either report entirely using the Government Accounting Standards Board (GASB) guidelines or use both. Accounting guidelines have implications for how schools account for expenses and revenues and whether their local districts treat them as component units. No uniform practice of reporting financial information makes comparison of charter school finances challenging and closes the door on developing a meaningful financial indicator system to detect financial stress early in a school's operation. Likewise, lack of a statutory requirement for when audited financial statements are due to local authorizers. and GDOE effectively nullifies any attempt to monitor financial health of charter schools. Current law requires start-up charter schools to submit an annual report to GDOE by October 1, which may include audited or unaudited financial statements. A third of schools did not have their financial audits complete by this date for the 2006-07 school year; thus, they answered financial questions in the annual report without having their financial position verified by an independent auditor. An examination of the information provided by these schools in the 2006-07 Annual Report to the State Board of Education published by the Charter Schools Division (CSD) of GDOE reveals that all but two of these schools incorrectly reported their financial positions to the State in their annual reports. Since this document is the only interim fiscal monitoring tool of charter schools outside of the charter renewal review, it is important that schools complete their independent audits in a timely fashion. Audited financial statements for all start-up charter schools should be based on the same accounting guidelines (FASB vs. GASB), and charter schools should face the same required deadline for submission to GDOE. To enforce timely submission of audited financial statements under official rule or law, CSD could withhold federal implementation grants or state facilities funds or, at a minimum, post a list of schools not meeting the October 1 deadline since failure to complete audits on time itself is an indicator of poor financial management within a school.

ABOUT THE AUTHORS

Cynthia S. Searcy is an assistant professor in the Department of Public Management and Policy at the Andrew Young School of Policy Studies at Georgia State University. She specializes in financial management and budgeting, education policy, and health policy related to childhood obesity.

William D. Duncombe is a Professor of Public Administration at the Maxwell School of Citizenship and Public Affairs at Syracuse University. His current research focuses on education finance, public finance and economic development, and elder migration and preferences.

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Publisher(s): Fiscal Research Center of the Andrew Young School of Policy Studies

Author(s): William D. Duncombe; Cynthia S. Searcy

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