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An Examination of the Financial Health of Georgia's Start-Up Charter Schools

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Andrew Young School of Policy Studies
Georgia State University
Atlanta, GA**

**FRC Report No. 197
July 2009**



ANDREW YOUNG SCHOOL
OF POLICY STUDIES

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Executive Summary

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 report sheds light on the financial health of start-up charter schools in Georgia during the 2006-07 school year. Financial health, for this report, 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

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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 report also compares financial data from 2006-07 with descriptive statistics from a multi-year analysis of charter schools to see if financial indicators over time are consistent with the one year cross-section. This paper is 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 report 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

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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

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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

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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*

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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.

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I. Introduction

Charter schools are the most rapidly growing form of school choice in the United States, expanding from 100 schools in 1995 to over 4,100 schools in 2007 (NCES, 2007). 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.

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. What evidence exists suggests that they face significant fiscal constraints and challenges. Besides anecdotal evidence on charter school failure (Labbe, 2006; Gootman, 2006; Jacksonville Business Journal, 2004), there are several reviews of charter school financial management which indicate that a non-trivial number of charter schools have been in a precarious financial position, particularly in their formative years. For example, the Office of Legislative Auditor for the State of Minnesota (2003) found that “about one-fourth of charter schools open in fiscal year 2002 had financial problems, as indicated by negative fund balance or deficit spending...” (p.1). A study of charter school financial management in Florida (Office of the Florida Legislature, 2000) found that close to 30 percent had negative fund balances. Moody’s credit ratings of charter schools are well below those for traditional public schools and more than one-third were below investment grade (Moody’s, 2003). In Georgia, four of eight failed, start-up charter schools had serious financial difficulties before closing or having their charters revoked (GDAA, 2009).

This report sheds light on the financial health of start-up charter schools in Georgia during the 2006-07 school year. It also compares this one-year of financial data with descriptive statistics from a school-year panel to see if financial indicators over time are consistent with the one year cross-section. This paper is an interim report of a larger study examining the fiscal health and financial management

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practices of Georgia's small, but growing charter school population.¹ Besides providing basic financial information on the state's start-up charter schools, this report 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. To the extent that the charter school movement is expanding in Georgia and across the United States, this research provides important lessons for charter schools and authorizers about how to assess and improve their financial health.

¹ Results presented here are cross-sectional for the 2006-07 school year. For schools in operation prior to this year, financial statements were collected to assess trends in financial health over time. These results make up the school-year panel, which is compared to the 2006-07 cross-section at the end of the report. A financial condition indicator system is under development to broaden the indicators of financial health beyond what can be constructed using financial statements. These additional indicators include measures of market position, school governance and management, and school performance. At this time, development of a financial condition indicator system is limited by lack of uniformity in data reporting required of start-up charter schools.

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II. Background

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). Charter schools must accept any student in a grade they serve within their jurisdictions for which they have capacity; however, parents choose to send their children to charter schools rather than their assigned traditional public school.²

The State of Georgia passed legislation authorizing charter schools in 1993. At that time, only local school districts could create a charter school, converting an existing school to charter status. The Georgia legislature amended the Charter School Act in 1998 to permit independent groups and organizations to petition a local school district or the State Board of Education to “start-up” a charter school in its jurisdiction. These schools operate independently from the local district or the State Board of Education, as they have their own governing boards which set school policies and make management and finance decisions for the school. In addition to conversion and start-up charter schools, the Georgia legislature authorized entire school districts to convert to charter status in 2007 and created a new State Commission to grant charters to independent organizations in 2008. These laws and amendments effectively have created five classifications of charter schools in Georgia: 1) Conversion schools; 2) System-wide conversion schools; 3) Start-up schools created and authorized by a local school board; 4) Start-up schools created by an independent organization but authorized by a local school board; and 5) Start-up schools created by an independent organization but authorized by the State Commission. All charter schools must have their charters approved by the State Board of Education, regardless of whether a local school board or the State Commission first authorizes the school.

² Unlike traditional public schools, charter schools decide how many students they will serve in each grade each year as defined in their charters. If the number of students who want to attend a charter school exceeds its designated capacity, a lottery is held prior to the start of the school year to determine which students can enroll.

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As public schools, charters receive federal, state, and local funding via a pass-through from the local district. The state portion of charter school funding follows the Quality Basic Education (QBE) formula used to allocate state appropriations to traditional public schools. The QBE formula allocates funding largely by the number of students enrolled in a school, the characteristics of those students (e.g., grade, special education needs), and the characteristics of teachers (e.g., experience and education). The local and federal share of a charter school's funding is determined by each local school board where the charter school is located, which by law should be "no less favorable" than funding for a traditional public schools in its district. Local funding for charter schools varies district-by-district based on the local tax base and millage rate for public schools. Charters also can apply for several competitive grants to help offset initial start-up costs, including a state funded facilities grant and a federal implementation grant ranging from \$200,000 to \$600,000 for use over a two-year period. Legislation passed in May 2009 requires local school boards to allow charter schools to use excess facilities free of charge, which may make facilities grants less competitive depending on how much surplus space is available in school districts across the state.

This report examines the financial health of start-up charter schools only. Other classifications of charter schools cannot be examined, because they do not report financial information separately from their local districts. As of the 2006-07 school year, 34 independent "start-up" charter schools had opened, but one in five had closed (seven schools). This rate of failure warrants an investigation into how Georgia's start-up charters perform on indicators chosen to assess financial health and if those still in operation can benefit from early detection of fiscal stress. Although financial difficulties can be a symptom of other deficiencies in managing a charter school (e.g., poor student performance, inadequate student recruitment, poor governance), insufficient attention to a school's financial condition can be a direct cause of school failure.

This report presents descriptive statistics from the 2006-07 school year and from a school-year panel of data that considers start-up charters over the years each was in existence to preliminarily explore if one-year trends persist when individual

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schools' financial statements are pooled for all of the years a school has been in operation. Independent start-ups are of interest because most have fixed costs related to facilities, and they do not benefit from the administrative services of their authorizing districts for budgeting, payroll, procurement, and plant operation and maintenance. Start-up charters make up nearly half of all charter schools in Georgia (49 percent) but educate less than one percent of all public school students in the state (0.5 percent). Despite this small market share, start-up charters are expected to grow as the charter movement strengthens and as a result of Georgia amending its charter legislation in 2008 to permit a state commission in addition to local districts to authorize schools.

The start-up charter schools reviewed for this report share characteristics of charter schools across the nation, yet differ on some traits relative to Georgia's public schools (Table 1). Start-up charter schools in Georgia have fewer students on average (300) than traditional public schools (769), with nearly 70 percent having fewer than 300 students. Georgia's average enrollment is similar to the size of charter schools across the nation (271), which reflects the practice of charter schools starting small to add grades as the school grows and/or the choice to serve fewer students per grade or class as a component of curricular programs or school culture. Start-ups serve a higher percentage of minority students (71 percent) than Georgia's traditional public (53 percent) schools and US charter schools (58 percent), reflecting the fact that over 75 percent of start-ups are located in the Atlanta metropolitan region.³ Although start-ups serve a higher share of minorities, they have a slightly lower proportion of students who qualify for free or reduced price lunch (47 percent) compared to Georgia's traditional public schools (50 percent). This is likely a result of Georgia having many rural school districts with high proportions of poor students. Start-up charter schools in Georgia predominantly serve elementary or K-8 grades (50 percent), followed by middle school grades (28 percent), and high school grades (20 percent). Finally, start-up charters in Georgia enroll a similar proportion of

³ In the 2006-07 school year, 25 start-up charter schools were located in the following counties and cities of the Atlanta metropolitan area: Atlanta (8), DeKalb County (6), Fulton County (5), Carroll County (1), Clayton County (1), Cobb County (1), Coweta County (1), Douglas County (1), and Marietta City (1).

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TABLE 1. CHARACTERISTICS OF GEORGIA START-UP CHARTER SCHOOLS COMPARED TO US CHARTER SCHOOLS AND GEORGIA TRADITIONAL PUBLIC SCHOOLS

	US Charter Schools	GA Start-Ups	GA Public Schools
School enrollment (average)	272	299	769
% minority enrollment	58%	71%	53%
% free/reduced lunch	44%	47%	50%
% special education	NA	12%	12%

Sources: Georgia Department of Education, Governor's Office of Student Achievement, 2006-07 School Report Cards. National Center for Education Statistics, Common Core of Data, 2006-07.

special education students (12 percent) as traditional public schools (12 percent), although charter schools typically serve less severe disabilities or must contract out intensive services to their authorizing districts or a private provider.

Student composition has implications for the financial stability of start-up charter schools. Since student count is the basis for the primary source of state and local revenue for start-ups, small enrollments limit the ability to spread fixed costs over the student body and threaten the ability to balance year-to-year operating budgets when enrollment fluctuates. Likewise, to the extent start-up charter schools serve higher proportions of high-need students in urban areas, it may require more resources to meet student performance targets (Duncombe and Yinger, 2005). Schools failing to meet performance goals risk losing students (jeopardizing their revenue stream) and ultimately having their charters revoked. In fact, newspaper accounts reporting on the failure of seven Georgia start-up charter schools in the period up to 2007 cite financial difficulties as the primary or close secondary reason for non-renewal of four of these schools. (Donsky, 2002; Donsky 2003; MacDonald 2004; MacDonald, 2005; Duffy, 2007; Gutierrez, 2007).

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III. Methods

This study draws on the literature for financial condition analysis of public and non-profit organizations to develop a framework for measuring the financial health of charter schools. For example, Ammar et al. (2005) developed a financial condition indicator system (FCIS) for New York school districts, which categorized financial condition into short-run financial condition, long-run financial condition, economic condition, and student performance. While FCIS is more extensive than practical for charter schools, with 50 different indicators, some of the indicators in this system are relevant to charter schools. Moody's (2003), in developing credit ratings for charter schools, considers a broad array of factors such as service area demographics and enrollment trends, financial management policies and planning, charter school renewal risk, and the quality of charter school oversight. In a review of Florida charter schools, the Office of the Florida Legislature (2000) used six indicators to evaluate financial condition, including fund balances, revenue forecasting accuracy, balanced budgets, financial controls, and demand for school services.

The framework employed for this analysis captures the key dimensions of financial health, but uses indicators that were practical to assemble and analyze without significant data requests from charter schools or their authorizers. "Practical," at this time, refers to the availability of audited financial statements and the presentation of financial information contained in them. Financial statements, at a minimum, contain an auditor's opinion as to material weakness in an organization's financial statements, a snapshot of an organization's financial position at the end of its fiscal year (Balance Sheet), a summary of inflows and outflows to the organization over the fiscal year (Statement of Activities), a presentation of how cash was generated and used over the fiscal year (Cash Flow Statement), and notes that explain the significant financial accounting principles used to compile the statements. Some may also include the results of an internal control audit and/or a management discussion and analysis section (under the Governmental Accounting Standards Board guidelines). Although financial statements contain sufficient information to begin an assessment of financial condition, they are intended for an audience external

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to the organization and aggregate data in broad functional categories. Many of the indicators developed by Moody's (2003), Ammar et al. (2005), and the Office of the Florida Legislature (2000) require data that cannot be collected from these broad functional categories or from a single year's financial statement (e.g., revenue forecasting accuracy, demand for services, internal controls). Given this constraint, the findings presented in this report are sufficient for starting to detect fiscal stress, but are inconclusive in determining overall financial health. Trend data and information about each school's financial management practices are a longer range goal of this study, which will require more uniform data reporting from charter schools and/or their authorizers.

The indicators calculated for this paper are for short-run financial condition. The average age of these schools is about four years, and few have long-term liabilities such as mortgages or long-term notes. Since a start-up's charter with the state typically expires after five years (unless renewed), many schools have not invested heavily in buildings or long-term assets other than for equipment. Since charter schools are often started to pilot innovative curriculum and governance models in public education, the focus of management in most schools is to survive through the first renewal period. Thus, a short-term focus on financial position is both realistic and practical given the young age and immediate goals for these schools.

Financial condition is defined as "the ability of a [school] to balance recurring expenditure needs with recurring revenue sources, while providing [educational] services on a continuing basis." (Office of the New York State Comptroller, 2008). 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.

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Financial indicators computed for this paper are measures of liquidity, fund balance, step/fixed costs, and budget flexibility.⁴ 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.

Specific indicators used in this analysis include measures computed using data collected from each school's fiscal year 2007 audited financial statement:

Liquidity

- *Current assets*—a measure of current assets as a percentage of total assets. Schools with a low value for this indicator have few liquid assets on hand to meet future or unexpected liabilities. Schools may report sizeable net assets but have little cash on hand, because their assets are tied up in property or equipment.
- *Current ratio*—a measure of current assets to current liabilities. This indicator measures a school's ability to meet its current obligations.
- *Quick ratio*—a measure of cash assets to current liabilities. This is a more conservative indicator for a school's ability to meet current obligations. It only counts cash, marketable securities, and receivables as monies available to pay a school's bills.

Fund Balance

- *Net assets*—a measure of net assets as a percentage of total expenditures. Schools with a moderate percentage of net assets relative to revenues have sufficient reserves for stable operations and potential growth.

⁴ Debt measures are not computed, because half of Georgia's start-up charter schools are less than 4 years old and do not have debt from mortgages or long-term notes. As these schools age, debt measures will be a component of assessing financial health.

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- *Operating surplus/deficit*—a measure of operating surplus/deficit as a percentage of total expenditures. Negative values indicate a school did not balance its operating budget for the year.

Step/Fixed Costs

- *Management expense*—a measure of general and management expenditures as a percent of total expenditures. Management costs are burdensome for small schools that cannot spread these expenses over many students. A high percentage of management expenses will limit a school's ability to meet instructional needs.
- *Facilities rent*—a measure of annual rent as a percentage of total expenditures. Since charter schools receive little (if any) funding for facilities from their local authorizers or the state, this indicator represents the degree to which schools must find alternative revenue sources or limit spending for other school needs.

Flexibility

- *Government aid*—a measure of federal, state, or local revenue as a percent of total revenues. This percentage indicates a school's reliance on public funding usually distributed on a per pupil basis and its potential instability if government aid decreases.

As with any ratio analysis, what qualifies as “good” performance on an indicator is relative to the service sector and what is standard for that sector. This analysis is exploratory for the charter school sector in that few studies have compiled financial indicators for charter schools. Moody's (2003) provides some guidance as to the performance on ratios for charters in other states, but its report focuses on long-term debt and provides few specific data points for comparison with Georgia's start-up charter schools. Georgia's start-up charter schools have not been rated by Moody's or other ratings agencies, because none have issued bonds or had bonds sponsored by a locality. As predominantly small, young schools, their capital needs

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are not large enough for these debt instruments and facilities are typically leased. Thus, comparisons on financial indicators that may be available through Moody's are not applicable to Georgia's start-up schools. The financial indicators compiled in this report for Georgia's charter schools will contribute to recent efforts in other states aiming to assess the financial health of charter schools across the country.⁵

⁵ To date, no systematic, national report on the financial health of charter schools has been completed, largely because charter school finance laws vary widely from state to state. Existing reports are state-specific and few in number. The Center on Educational Governance at the University of Southern California has compiled three indicators of financial health for charter schools reporting in the State of California's Comprehensive Basic Education Data System since 2003-04. The Massachusetts Department of Elementary and Secondary Education has required its charter schools to submit standardized audited financial statements since 2005-06, but it does not calculate specific financial indicators from these statements.

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IV. Data

The cross-sectional analyses in this report use audited financial statements from 25 Georgia start-up schools that were in operation in the 2006-07 school year.⁶ More recent data from the 2007-08 school year were preferred for this analysis, but at the time of publication five schools required to prepare independent audit reports had not done so or had not submitted them to the Georgia Department of Education's Charter School Division (CSD).⁷ Audited financial statements for 2006-07 were collected from CSD, with the exception of two which were requested via email directly from the school. Data on school characteristics were compiled using the Georgia Department of Education School Report Cards for 2006-07.

Data for the analyses of schools' financial statements, pooled for all of the years each school has been in operation, come from audited financial statements and IRS 990 forms.⁸ Due to the uniformity in reporting definitions, IRS 990 forms were preferred as a data source if both audits and IRS documents were available for the same fiscal year. For the school-years panel, 80 percent of the observations use IRS 990 forms as a data source, and 20 percent come from independently audited financial statements. Audited financial statements are the basis for reporting on IRS 990 forms, however, the later provide more expense detail than a typical audited financial statement (e.g., occupancy, supplies, etc.). For general classifications of assets and liabilities, however, these documents are identical.

⁶Since the Charter School Act was passed in 1998, 34 start-up charter schools have opened. By the 2006-07 school year, five had closed. Of the 29 remaining, three did not prepare financial statements separate from their district authorizers. All three of these schools serve small, specialized populations of at-risk students. By the end of the 2006-07 school year, two more schools had closed, and only one had completed an audited financial statement before closing, which is included in this analysis.

⁷ This fact, itself, is a poor indicator of financial health. Exceptions to this include one school being on a calendar fiscal year and another awaiting its audit from the Office of the State Auditor.

⁸ IRS 990s are informational returns that nonprofits are required to file with the IRS.

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V. Findings

In the course of collecting audited financial statements for this report, the accounting guidelines adopted by each school, their formats, and when the statements were reported provided insight into the ambiguity of financial reporting requirements for start-up charter schools and variation in how charter schools are interpreting them. Table 2 reports whether the school used the Financial Accounting Standards Board (FASB) or the Governmental Accounting Standards Board (GASB) guidelines, the accounting firm that audited their financial statements, and the date of the auditor's opinion letter. Since 15 different accounting firms prepared the statements used in the analysis, it is expected that presentation of financial information will vary; however, it is interesting to find that 19 schools used FASB guidelines (76 percent) and six reported under GASB guidelines (24 percent). Four schools used both—FASB as primary and GASB fund level reporting as supplemental information (not shown).

FASB guidelines apply to private, for-profit and not-for-profit organizations and require accrual accounting methods that recognize revenues when earned and expenses when financial assets are used to provide goods and services. Most charter schools have adopted Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*, as guidance for reporting their financial activities and position. Among directions to classify expenses as program services or support activities, SFAS 117 also requires classification of net assets as permanently restricted, temporarily restricted, or unrestricted. Of the 19 schools using FASB to report, two did not report expenses within function (program services vs. support activities);⁹ four more did not present financial information from the prior year alongside fiscal year 2007. Prior year reporting is not required by SFAS 117 but is standard practice in auditing because it aids detection of changes in financial activities from year to year. As for classification of net assets, Georgia's start-up charter schools infrequently report having permanently restricted or temporarily restricted net assets. Only six schools report having any temporarily restricted assets, typically from designated donations or specific uses of grant money.

⁹ These two financial statements were prepared by the same auditor.

TABLE 2. INFORMATION ABOUT ACCOUNTING FIRM AND GUIDELINES USED FOR 2006-07 FINANCIAL STATEMENTS FOR GEORGIA'S START-UP CHARTER SCHOOLS

Charter School	2006-07 Auditor	FASB	GASB	Date of Auditor's Report
Kennesaw Charter School	Berman, Hopkins, Wright & Laham		X	September 11, 2007
International Community School	Brooks, McGinnis & Co., LLC	X		September 20, 2007
Oglethorpe Charter School	Canady, Richbourg & Co., LLP	X		November 13, 2007
Lewis Academy of Excellence	Carter Davis Group	X		November 10, 2007
Kids Peace School of Georgia	Concannon, Miller & Co., P.C.	X		April 18, 2007
Charter Conservatory For Liberal Arts and Technology	Denmark & Brown, PC	X		September 4, 2007
Baconton Community Charter School	Erwin & Johnson CPAs		X	May 5, 2008
Odyssey Charter School	Erwin & Johnson CPAs	X		December 7, 2007
DeKalb Academy of Technology and the Environment	Erwin & Johnson CPAs	X		March 17, 2008
University Community Academy	Gifford, Hillegass & Ingwersen	X		September 17, 2007
Drew Charter School	Gifford, Hillegass & Ingwersen	X		September 27, 2007
Neighborhood Charter School	Gifford, Hillegass & Ingwersen	X		September 25, 2007
Tech High School	Gifford, Hillegass & Ingwersen	X		September 6, 2007
Atlanta Charter Middle School	Gifford, Hillegass & Ingwersen	X		September 25, 2007
SIA Tech	James Moore & Co.		X	October 8, 2007
Brighten Academy	Mauldin & Jenkins		X	April 28, 2008
DeKalb PATH Academy	McKelvey & Russell LLC	X		September 8, 2007
KIPP West Atlanta Young Scholars Academy	McKelvey & Russell LLC	X		September 26, 2007
Academy of Lithonia	Plante Moran		X	October 3, 2007
Amana Academy	Robins, Eskew, Farmer & Jordon	X		September 18, 2007
Fulton Science Academy	Samuel J. Durden, CPA	X		September 18, 2007
KIPP South Fulton	Samuel J. Durden, CPA	X		September 26, 2007
Hapeville Middle School	Samuel J. Durden, CPA	X		September 10, 2007
T.E.A.C.H. School	Samuel J. Durden, CPA	X		September 28, 2007
Marietta Charter School	Waddell, Smith, Magoon		X	September 19, 2007
<i>Total Number of Schools</i>	<i>25</i>	<i>19</i>	<i>6</i>	<i>Late = 8</i>

Note: Kids Peace School of Georgia submitted financial statements for the 2006 calendar year.

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GASB guidelines apply to public organizations or governmental entities that operate to serve a government. GASB presentation of financial information uses accrual accounting for government-wide statements, but uses a modified accrual system for fund level reporting. GASB primarily differs from FASB in its focus on the availability and use of current resources to provide public services. It is a more conservative reporting of resources available to fund specific services, recognizing revenues only when measurable and available (rather than earned) and expenses when legally liable for them (rather than when used). At the fund level, a charter school's financial position generally will look worse off under GASB than the same financial position reported under FASB. This is due to requirements of modified accrual accounting which do not recognize acquisitions of property and equipment as long-term assets. For example, a school that purchases computers in a school year will report the acquisition as an expense, but not be able to claim them as assets when reporting its fund balance for a fiscal year. GASB remedies this conservative approach by requiring organizations also to prepare government-wide statements of financial position and activities based on accrual methods similar to FASB. Charter schools using GASB, however, only report fund level information for having their financials included as a component unit of their authorizing district.

Neither charter school law nor guidance from the State Department of Education specifies whether charter schools should use FASB or GASB for financial reporting. Some district authorizers require GASB presentation so that the financial information will conform to their financial reporting requirements, which involve incorporating charter schools as component units into their Comprehensive Annual Financial Reports. Atlanta Public Schools (APS), for example, recently began requiring GASB presentation for this reason. Many of APS' charter schools, however, have chosen to use both presentations because FASB guidelines are preferred by foundations and private organizations that provide operating grants to charter schools. Since start-up schools are legally not-for-profit organizations, they must report using accrual methods to the Internal Revenue Service each year for form 990. It also may be more practical and useful for charter schools to use FASB guidelines, under which they are allowed to present property and equipment as assets

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and report expenses, such as inventory, when they are used rather than when they are acquired (based on accrual accounting). Regardless of which presentation is most relevant to the needs of charter schools, it is a challenge to compute financial indicators that are comparable across schools that use different guidelines. In most cases it is possible to reconstruct similar measures to conform to a FASB presentation, but caution should be taken when evaluating indicators using current and net assets later in this report.

In collecting financial statements from GDOE, it also was interesting to learn the non-compliance rate for submitting these documents to the State. As Table 2 reports, eight of the 25 schools (32 percent) did not complete their financial audits by the October 1 deadline as specified in the Georgia Charter Schools Act of 1998.¹⁰ Untimely audits may be an indicator that the school has poor accounting practices and cannot readily compile its financial information to meet the deadline, or management is distracted from or unaware of compliance deadlines. Conversations with auditors compiling financial statements for start-up charter schools suggest that the time of year when audits are due contributes to untimely reporting. The fiscal year for all but one school ends on June 30th, when school staff is on summer break and when management is consumed with other tasks related to the start of a new school year during the months of August and September just prior to the deadline. In addition, some charter school operators claim that they use the same auditor as their authorizer, and the auditor compiles the charter school's statement after the district audit is complete.

Regardless of why audits are not prepared by October 1, it is a reasonable expectation that schools should have their financial statements complete at least by November 15th when IRS 990 forms are due, nearly five months after the close of the fiscal year. Using this criterion, four schools would still have "late" audits. Schools that are regularly reporting activity statements to their boards should have few problems complying with reporting deadlines (Young and Anthony, 2008). In fact,

¹⁰ The Charter Schools Act of 1998 requires start-up charter schools to submit annual reports to their authorizers and the Charter School Division of the State Department of Education by October 1. The law permits charter schools to submit either audited or unaudited financial statements at that time, with the expectation that audited financial statements will be forwarded to both entities when they are complete.

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most charter petitions require language that attests that their board will review financial statements monthly or quarterly. Untimely submission of financial statements may reveal that schools are not complying with good governance practices, in addition to audit reporting. Poor governance in a school is likely to lead to financial difficulties over time, especially when charter schools rely on the financial expertise of their board members to navigate the shallow operating margins most schools face early in operation.

Untimely submission of audited financial statements also prevents GDOE and the State Board of Education from effectively monitoring the financial health of charter schools on an annual basis. Each year, the Charter Schools Division (CSD) of GDOE submits an Annual Report to the State Board of Education reporting on the characteristics and performance of charter schools in Georgia. Each charter school's self-submitted report is printed in the appendix, which includes answers to two questions for financial accountability: "1) Did [the] school have [a] surplus at the end of the 2006-07 school year?" and 2) Did [the] school have a reserve fund? If so, what percentage?" Of the schools that did not have their audited financial statements complete by the due date of the annual reports (eight schools), six incorrectly answered these questions when compared to their financial statements audited after October 1. Four schools incorrectly identified having a surplus, claiming "No" they did not have a surplus when their audited financial statements show positive operating balances. Two schools reported no reserve fund, but had positive net assets; and one school claimed to have a surplus when its audited financials indicate it did not.¹¹ Interestingly, most schools reported a poorer financial position than their audited financial statements reveal. It is not known how much information these schools had about their actual financial position when they answered these questions or whether some schools were acting strategically in their financial reporting. Regardless of intent, incorrect reporting prevents GDOE and the State Board of Education from assessing the financial health of charter schools.

¹¹ One school misidentified its surplus and reserve fund. The schools that reported "no" to a reserve fund have liquidity ratios over 1.0, indicating they have excess cash on hand. It is possible that schools interpret "reserve fund" as a special account set aside for lean operating years. It is not clear how GDOE expects schools to interpret this question.

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Finally, financial statements also provide information on deficiencies in internal controls over financial reporting. Internal control deficiencies exist when a financial system a school has in place to manage its financial recording or reporting does not allow the school's management to prevent or detect misstatements in a timely manner. In fiscal year 2007, four schools had internal control deficiencies reported in their audited financial statements.¹² Two schools were not providing their Boards with periodic financial statements or recording minutes from Board meetings when financial decisions are made. Other deficiencies among these schools included inability to document purchasing card transactions, improper recognition of expenses under GASB, lack of segregation of duties in handling money and managing financial transactions, and overpayment of fees to an educational management company.

Financial Indicators

The financial health of Georgia's start-up schools in the 2006-07 school year is mixed. Although 11 schools (44 percent) ran an operating deficit or had negative net assets, just one school closed at the end of the fiscal year.¹³ (See Appendix for a complete list of indicators by school.) Of the 11 with operating deficits or negative net assets, two appear to be financially sound in the short-term on other key indicators, such as current assets greater than 60 percent of total assets and the current/quick ratios over 2.0. The remaining nine schools in deficit all have current/quick ratios at or under 1.0, indicating that they are not likely to meet their current obligations given their current assets. These nine schools share notable characteristics—enrolling fewer than 250 students or being in the 4th or 5th years of operation.¹⁴

An aim of this analysis is to see if performance on financial indicators varies by school characteristics. Table 3 reports median per pupil spending and medians for measures of liquidity and fund balance by school type, age, and size. The first column

¹² Only one of these four schools also completed its audit "late" after October 1.

¹³ This school's charter was not renewed by the local authorizing district. Reasons for non-renewal included failure to meet AYP, significant management turnover, and enrollment errors that led to inaccurate funding.

¹⁴ One school does not share either of these characteristics. In the 2006-07 school year, it had 328 students and was in its first year of operation under a re-instated charter.

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TABLE 3. LIQUIDITY AND FUND BALANCE INDICATORS BY SCHOOL TYPE, AGE, AND SIZE FOR GEORGIA'S START-UP CHARTER SCHOOLS (2006-07 SCHOOL YEAR)

Characteristic	N	Median Per Pupil Spending ^a	-----Median-----				
			-----Liquidity-----		-----Fund Balance-----		
			Current Assets (% Total Assets)	Current Ratio	Quick Ratio	Net Assets (% Exp.)	Surplus/Deficit (% Exp.)
School Type ^b							
Elementary	7	7,455	54.0%	1.7	1.6	8.1%	0.1%
K-8	6	8,688	59.6%	2.2	2.1	12.3%	2.4%
Middle	7	9,442	68.7%	9.7	9.6	33.4%	5.5%
High School	5	12,206	36.2%	1.1	0.5	21.3%	-3.6%
School Age							
1-3 years	12	8,210	49.4%	1.5	1.0	20.6%	1.1%
4-5 years	9	9,906	58.8%	2.1	2.1	20.2%	0.1%
6 or over	4	7,988	68.0%	14.1	13.0	17.4%	3.0%
School Size							
1~250	10	10,590	44.4%	1.1	0.8	18.0%	-4.2%
251~350	9	9,442	54.5%	2.2	2.2	17.4%	5.5%
over 350	6	7,101	68.7%	11.4	11.0	21.9%	2.4%
<i>All Schools</i>	25	<i>9,067</i>	<i>54.5%</i>	<i>2.2</i>	<i>1.9</i>	<i>17.4%</i>	<i>2.3%</i>

^aPer Pupil spending includes instructional and non-instructional expenses (e.g., administration, facilities).

^bOne of the schools classified as high schools serves 6-12 grades.

Source: Georgia Start-Up Charter Schools, 2006-07 Audited Financial Statements.

reports per pupil spending by each characteristic to compare charter school expenditures with what is known in the education finance literature about spending variation among traditional public schools. Median per pupil spending among all Georgia start-up charter schools, which includes instructional and non-instructional expenses such as facilities, is about \$9,000. This amount varies as expected by school type and size. Elementary schools spend the least amount per pupil (\$7,500) compared to K-8 programs (\$8,700), middle schools (\$9,400), and high schools

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(\$12,200).¹⁵ Likewise, per pupil expenditures varies with school size. Schools with approximately 250 students or less spent \$10,600 per pupil on average compared to \$9,400 per pupil for schools with 250 to 350 students and \$7,100 for schools with more than 350 students. Charter schools have to carry out many of the same administrative functions as traditional public schools, including most school business functions. Small schools have fewer students over which to spread these costs. Studies examining the cost structure of public schools have found significant economies of size, especially for administrative costs (Andrews, Duncombe, and Yinger, 2002). Moody's (2003) has found that "the smallest schools having investment grade characteristics have a minimum enrollment of between 300 and 500 students..." (p.4).

Measures of liquidity and fund balance for financial condition also appear to vary by size, but less so by school type or age. Table 3 reports the median values of these financial indicators. Measures of cash and other liquid assets on hand at the end of the year to meet current liabilities are stronger for larger schools. Current assets as a percentage of total assets have a median of 54.5 percent for all charter schools, but vary from 44.4 percent for the smallest schools to 68.7 percent for the largest ones. Current and quick ratios follow a similar pattern, with the smallest schools averaging \$1 in current assets for every \$1 in current liabilities compared to a much higher ratio of \$11.4 in current assets for every \$1 in current liabilities for schools with enrollments over 350 students. A current ratio of 2.0 or higher is a rough rule of thumb for adequate liquid resources on hand to meet current obligations. Of the ten schools with fewer than 250 students, seven have ratios below this guideline. This trend is also reflected in the schools' measure of operating reserves, although it is not as consistent as the liquidity ratios. Small schools have a median operating deficit of -4.2 percent of total expenditures compared to positive operating balances of 5.5 percent for schools with enrollments between 250-300 students and 2.4 percent for schools with over 350 students. Net assets as a percentage of total expenditures

¹⁵ Typically, high school students are more expensive to educate because their courses require more equipment (e.g., science laboratories) than elementary or middle school students. In Georgia, however, the school funding formula weights high school students less than lower grades; thus, the increase in per pupil spending for high school students in Table 3 is likely a result of larger class sizes.

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indicates that larger schools have accumulated slightly more reserves (21.9 percent) compared to small (18.0 percent) and medium-sized charter schools (17.4 percent). Since larger schools are often older schools due to the practice of adding grades, larger reserves may also be the result of having more time to accumulate assets.

It is expected that school age might be associated with measures of financial condition among start-up charter schools, since young organizations have not had an opportunity to accumulate reserves. Measures of liquidity and net assets show clear patterns of improved financial health as schools age. Schools in operation for three years or less have lower and below recommended current and quick ratios (1.5 and 1.0) compared to schools open for four to five years (2.2 and 2.2) and six or more years (14.1 and 13.0). This indicates that schools, at the median, are accumulating cash or reducing their current liabilities the longer they are open. Older schools also have more liquid assets on hand than younger schools, with current assets over 60 percent of all assets compared to 50 percent for schools aged one to three years. This is likely the result of younger schools having less cash in reserves due to large start-up investments in furniture and equipment, as well as some schools closing within the first charter period (five years).

Year-to-year operating balances, however, do not follow this pattern. Schools in early years of operation have higher percentages of surpluses as a percent of total expenditures (1.1 percent) compared to schools in years four or five of operation (0.1 percent). This is likely the result of new schools having access to implementation grants from the federal government and private foundations during the first years of operation.¹⁶ Schools open in their sixth year or later have the highest median operating balance from the 2006-07 school year (3.0 percent). Although positive operating balances in later years is a good sign of financial health, surpluses are still marginal. Low operating surpluses for older schools may also reflect that start-up schools surviving past their first charter renewal (post year 5) use resources more efficiently, leaving less available as surplus at the end of the year while still ensuring

¹⁶ Federal implementation grants for start-up schools provide \$400,000 over a 24-month period after charter approval from the State Board of Education. The Walton Family Foundation also has a competitive process for \$220,000 of post-authorization grants for aiding the development of quality charter schools in Georgia.

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they can meet current obligations (as evidenced in their liquidity ratios). Small operating balances at the end of the year, however, underscore how vulnerable start-ups may be if enrollment suddenly declines or if state or local revenue decreases significantly.

A final objective of this analysis was to begin to understand the revenue streams and fixed cost burdens faced by start-up charter schools. Table 4 reports medians of the percentage of total revenues accounted for by federal, state, and local funding and the percentages of management and facilities expenses of total expenditures by school characteristics. For government aid, interesting patterns emerge for school age and size. At the median, start-up charter schools derive 94.0 percent of their operating income from federal, state, and local sources. Other major sources of income include individual contributions from fundraising and program income from before/after school care and food services. Schools in their early years of operation receive 89.6 percent of their revenues from government aid versus 99.5 percent for schools open six years or longer. These shares reflect grants from private foundations that are available in Georgia (e.g., the Walton Family Foundation) that are meant to help new schools grow and stabilize. This private start-up assistance from foundations also drives variation in the percentage of government aid by school size. Small schools report 91.3 percent of their revenues from federal, state, or local sources compared to 96.8 percent for schools with more than 350 students. Schools with fewer students in the 2006-07 school year are likely in the process of growing their enrollments as they add grades over the term of their charters. Private foundations interested in expanding the number of charter schools in Georgia provide substantial aid to help schools through these “ramp-up” periods (\$220,000 in the case of the Walton Family Foundation). Since six of the twelve schools in their first three years of operation ran operating deficits in the 2006-07 school year, this funding appears to be essential to being able to keep their doors open. Indeed, schools in years four and five of operation show very little operating surplus (0.1 percent of

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TABLE 4. SHARES OF PUBLIC REVENUE AND STEP/FIXED COSTS BY SCHOOL CHARACTERISTIC FOR GEORGIA START-UP CHARTER SCHOOLS (2006-07 SCHOOL YEAR)

Category	N	-----Median-----		
		-----Flexibility-----	-----Step/Fixed Costs-----	
		Govt. Aid (% Total Rev.)	Management Exp. (% Total Exp.)	Facilities Rent (% Total Exp.)
School Type				
Elementary	7	89.9%	13.5%	9.2%
K-8	6	99.6%	11.7%	14.1%
Middle	7	94.0%	7.6%	7.9%
High School	5	86.0%	14.6%	9.9%
School Age				
1-3 years	12	89.6%	12.1%	13.4%
4-5 years	9	91.4%	8.5%	7.9%
6 or over	4	99.5%	16.3%	7.4%
School Size				
1~250	10	91.3%	13.4%	13.1%
250~350	9	90.2%	10.8%	8.0%
over 350	6	96.8%	13.2%	8.1%
<i>All Schools</i>	25	<i>94.0%</i>	<i>12.5%</i>	<i>9.2%</i>

Note: One of the schools classified as high schools serves 6-12 grades.

Source: Georgia Start-Up Charter Schools, 2006-07 Audited Financial Statements

expenditures) without access to these private funds that typically are used up after the first three years of operating.¹⁷

Moody's (2003) suggests that one of the biggest risks to the financial health of charter schools are the fixed costs of facilities and administration. It reports, "Moody's does not believe that narrow financial margins reflect weak financial management or controls, but are inherent, instead, to the significant start-up costs faced by charter schools." (p.10). In an effort to understand the extent of these costs for Georgia's start-up charter schools, shares of total expenditures were calculated for management/general expenses and facilities. At the median, management and general administrative expenses accounted for 12.5 percent of total expenditures

¹⁷ New charter schools also have access to federal implementation grants (\$400,000 over a 24-month period) that contribute to small operating surpluses of many schools in their first three years of operation.

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followed by 9.2 percent for facilities.¹⁸ If aggregated, these two expenditure categories account for over 20 percent of all spending. Schools contracting with educational management organizations (EMO) (n = 6) report spending 24 percent on management and general expenses alone, with fees accounting for 14 percent of total expenditures (not shown). Further investigation into EMO services may be warranted given these shares of expenditures.¹⁹ Spending for management and general administration varies by school size, but not school type or age. Generally, a fixed-type cost is expected to decline as enrollment increases; but for Georgia's charter schools this trend appears to move in the opposite direction for management expenses. This trend indicates that management expenses are step costs, where having more students does not require additional personnel until a particular threshold (or "step") is reached. Small schools (up to 250 students) report that 13.4 percent of expenditures go towards management and administration compared to 10.8 percent for schools with 250 to 350 students. Management shares then increase in schools with more than 350 students (13.2 percent). It is likely the case that larger schools require one or two more administrators, thus the slight rebound in value of shares. Indeed, supervisory salaries are a classic example of step-cost functions in most organizations (Young and Anthony, 2008).

Shares of expenditures for facilities follow the expected decline for fixed costs as school size increases. Small schools report spending 13.1 percent on facilities compared to 8.1 percent for the largest schools. The pattern in school type suggests that schools with the most grades (K-8) spend a higher share on facilities (14.1 percent) than fewer grades (just 7.9 percent for middle schools). This reflects the need for more individual classrooms for separate grades. Overall, there is substantial variation in the facilities costs charter schools have incurred. See Appendix.) Some schools have few facilities expenses because their authorizing districts give them space; the top 10 percent pay over 19 percent of total expenses for

¹⁸ For most schools it was possible to disaggregate facilities expenses or payment on long-term debt used to acquire facilities from management and general expenditures. In a few cases, however, objects of expenditures were not detailed enough to separate them. Caution should be taken in aggregating the percentages for management and facilities to imply a total share for overhead.

¹⁹ Some EMOs provide more than traditional business services, including student recruitment and licensed curriculum.

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their facilities. These shares omit leasehold improvements that schools often must make to meet occupancy codes for public schools. In most cases, schools with the lowest facilities costs have agreements with their local authorizers to rent existing school space, as opposed to schools with higher shares for facilities which rent commercial space or effectively rent facilities from their EMOs. Legislation passed in May 2009 requires school districts with excess facilities to make them available to charter schools free of charge. For charter schools currently leasing facilities from their districts, this legislation will free up substantial resources (up to 10 percent of current operating expenditures) for other needs.

School-Year Panel

To investigate if the relationships between financial indicators and school characteristics hold when we consider more years of observations, an unbalanced panel was compiled pooling data from financial statements for all years a school has been in operation. For the 25 schools in operation in 2006-07, age ranges from one to eight years. This results in 92 school-year observations.²⁰ Table 5 presents liquidity and fund balance measures for the 92 school-year observations for comparison to Table 3 from just one year of data. Nearly all of the patterns are consistent with the cross-section from the 2006-07 school year, with the notable exception of school size. School type continues to have no clear pattern, while school age seems to be associated with improved financial health. For example, schools in their first three years of operation report a median current ratio of 3.2, compared to 3.9 for schools four to five years old and 14.0 for schools operating for six years or more. Net assets as a percent of expenditures are also slightly lower for young school (19.3 percent) compared to schools six years or older (20.3 percent). Patterns in operating surpluses are similar to the cross-section, suggesting that young schools have larger surpluses (7.3 percent) compared to those in years four and five (0.8 percent), which no longer have access to implementation funds.

²⁰ Four school-year observations do not have a complete set of financial indicators or school characteristics data and are excluded from the panel.

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TABLE 5. LIQUIDITY AND FUND BALANCE INDICATORS BY SCHOOL TYPE, AGE, AND SIZE FOR GEORGIA'S START-UP CHARTER SCHOOLS (SCHOOL-YEAR PANEL)

Characteristic	N	-----Median-----					
		Median Per Pupil Spending ^a	-----Liquidity-----		-----Fund Balance-----		
			Current Assets (% Total Assets)	Current Ratio	Quick Ratio	Net Assets (% Exp.)	Surplus/Deficit (% Exp.)
School Type ^b							
Elementary	22	9,171	56.4%	1.7	1.7	16.4%	3.3%
K-8	26	7,761	61.7%	1.2	1.2	9.4%	3.0%
Middle	32	8,344	70.8%	11.8	11.8	32.3%	9.5%
High School	12	10,403	57.8%	2.4	1.3	25.8%	-1.4%
School Age							
1-3 years	60	8,251	64.9%	3.2	2.3	19.3%	7.3%
4-5 years	23	8,559	60.5%	3.9	3.8	19.5%	0.8%
6 or over	9	6,746	68.6%	14.0	14.0	20.3%	5.5%
School Size							
1~250	45	9,288	66.1%	3.9	3.0	21.8%	7.0%
251~350	24	6,997	65.3%	3.1	3.1	19.3%	4.8%
over 350	23	7,384	60.5%	3.2	3.2	10.9%	2.3%
<i>All Schools</i>	<i>92</i>	<i>8,251</i>	<i>65.4%</i>	<i>3.5</i>	<i>3.1</i>	<i>19.5%</i>	<i>4.4%</i>

Note: ^aPer Pupil spending includes instructional and non-instructional expenses (e.g., administration, facilities).

^bOne of the schools classified as high schools serves 6-12 grades.

Source: Georgia Start-Up Charter Schools, Audited Financial Statements, Various Years

Financial indicators by school size exhibit interesting patterns that deviate from the cross-section, but may be explained by the pooled nature of these data. For example, per pupil expenditures decrease as enrollment increases in a similar pattern to the one year cross-section; however, measures of liquidity and fund balance also decrease. Although differences in current and quick ratios are small (3.9 for small schools versus 3.2 for large schools), variation in measures of fund balance are surprisingly large. For example, schools with 250 students or less report median net assets as a percentage of expenditures of 21.8 percent compared to 10.9 percent for schools with over 350 students. Likewise, surpluses of small schools are a larger share of expenditures (7.0 percent) compared to larger schools (2.3 percent). These

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measures suggest that financial position is stronger for small schools—an unexpected outcome if small schools are burdened with substantial fixed costs.

It is important to keep in mind, however, that these relationships are simple, bivariate comparisons and do not account for school age. Further examination of the relationship between school size and fund balance reveals a great deal of variation in operating surplus/deficits among schools with 250 students or less and in their first three years of operation. This variation decreases substantially as enrollment increases and as schools age (Figure 1). Thus, it appears that the unexpected patterns for liquidity and fund balance in these pooled data are largely driven by the volatility in these measures in a school's early years of operation. In other words, school age may be more important than school size for liquidity and fund balance measures of financial health.²¹

The measures of financial health that assess fixed costs for charter schools follow patterns expected for school size in the pooled data. Table 6 presents the median values of management and facilities costs as a percent of expenditures for comparison to Table 4. Management expenses are larger for charter schools with enrollments over 350 (19.2 percent) compared to the smallest school (10.5 percent). This follows the pattern for management and general expenses in the cross-section from 2006-07 and indicates that larger schools require more administrative personnel. For facilities, Table 6 reports that the pooled data are consistent with the cross-section, in that the share of total expenses accounted for by facilities generally decreases as enrollment increases. Small schools report spending 9.9 percent of total expenditures on facilities compared to 8.2 percent for schools with more than 350 students. Facilities are a classic example of fixed costs, where more students generate higher revenues to cover an expense that does not change until enrollment exceeds the facility's capacity. Finally, reliance on government revenues in the school-year panel matches trends in the cross-section from 2006-07. At the median, Georgia's start-ups get 95.9 percent of their revenues from federal, state, and local

²¹ We expect some of the variation in financial indicators to decrease as schools close due to fiscal stress.

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TABLE 6. SHARES OF PUBLIC REVENUE AND FIXED COSTS BY SCHOOL CHARACTERISTIC FOR GEORGIA START-UP CHARTER SCHOOLS (SCHOOL-YEAR PANEL)

Category	N	-----Median-----		
		----Flexibility---	-----Step/Fixed Costs-----	
		Govt. Aid (% Total Rev.)	Management (% Total Exp.)	Facilities (% Total Exp.)
School Type				
Elementary	22	91.1%	9.6%	9.4%
K-8	26	99.1%	14.2%	8.4%
Middle	32	95.4%	9.3%	7.6%
High School	12	96.3%	17.6%	11.6%
School Age				
1-3 years	60	94.8%	10.8%	9.9%
4-5 years	23	96.3%	11.0%	7.4%
6 or over	9	99.3%	18.8%	7.3%
School Size				
1~250	45	91.1%	10.5%	9.9%
250~350	24	96.2%	10.9%	8.1%
over 350	23	99.0%	19.2%	8.2%
<i>All Schools</i>	<i>92</i>	<i>95.9%</i>	<i>11.5%</i>	<i>9.0%</i>

Note: One of the schools classified as high schools serves 6-12 grades.

Source: Georgia Start-Up Charter Schools, Audited Financial Statements, Various Years.

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VI. Discussion

Because charter schools face a number of fiscal challenges, it is important to regularly monitor their financial condition. Regular financial health assessments can be valuable to charter school administrators and board members in their budget deliberations, to chartering agencies in providing support to charter schools and in considering charter renewal, and to the State Department of Education in its monitoring role as well as for considering charter policy changes. This report provides several preliminary lessons for Georgia's start-up charter schools and their authorizers as they monitor financial health.

- *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 recommended levels (current ratio of 2.0 or higher). 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 EMO 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

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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 schools' operating environments.

- *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 and the State 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 free from the governance of their local districts and the State, leaving each school responsible for managing and staffing non-instructional services on its own.

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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 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

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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 GDOE. A majority of schools use FASB guidelines, but nearly half either report entirely in GASB 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*

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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.

As this study expands to include more dimensions of financial condition (e.g., financial management practices, governance practices, etc.) these observations and recommendations are likely to reveal more complex relationships between school characteristics and financial health. The preliminary results presented here should be interpreted with caution, since the presentation of information in the charter school's financial statements vary by accounting guidelines used to prepare them. These results are a first step towards identifying financial indicators that are appropriate for charter schools and assessing the financial health of Georgia's start-up charter schools. As the number of charter schools continue to increase in the state due to recent changes in authorization practices, it is important that public resources devoted to school choice are properly monitored. Developing quality charter schools extends beyond good performance in the classroom—it must include sound financial health necessary to build a strong charter school community in Georgia.

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APPENDIX. FINANCIAL INDICATORS FOR GEORGIA'S START-UP CHARTER SCHOOLS 2006-07 SCHOOL YEAR

School	Age	Type*	Enrollment	Per Pupil Spending	Current Ratio	Quick Ratio	Current Assets/ Total Assets	Net Assets (% of Exp.)	Operating Surplus/Deficit (% of Exp.)	Management (% of Exp.)	Facilities (% of Exp.)	Govt. Aid (% Total Revenue)
School A	1	1	265	6,919	1.8	1.8	17.3%	8.1%	18.2%	10.8%	13.8%	90.2%
School B	1	2	328	7,074	0.3	0.3	54.5%	-11.3%	10.4%	55.4%	19.6%	99.9%
School C	1	1	180	12,113	1.0	1.0	54.0%	-1.9%	-1.9%	20.3%	34.0%	86.3%
School D	1	4	187	8,112	0.2	0.2	10.0%	21.3%	15.5%	6.5%	9.9%	86.0%
School E	2	3	77	13,034	5.1	5.1	44.7%	59.3%	33.5%	6.7%	16.3%	57.2%
School F	2	2	218	8,308	0.6	0.4	44.0%	6.0%	-4.8%	7.8%	13.5%	99.4%
School G	2	1	287	6,246	2.2	2.2	95.2%	0.7%	4.0%	28.3%	8.9%	89.0%
School H	3	2	252	9,067	2.2	1.9	64.8%	12.9%	-7.0%	10.8%	19.3%	99.0%
School I	3	3	448	6,731	9.7	9.6	68.7%	77.1%	22.2%	6.2%	8.7%	94.5%
School J	3	4	59	19,209	2.3	0.1	100.0%	27.7%	-33.3%	13.3%	13.3%	85.4%
School K	3	1	152	6,291	1.1	0.6	10.6%	26.3%	-20.8%	13.5%	11.8%	96.3%
School L	3	4	206	12,206	1.1	0.9	36.2%	14.7%	-3.5%	14.6%	8.5%	71.4%
School M	4	1	554	7,455	1.2	1.1	60.5%	-0.2%	0.1%	27.8%	9.2%	89.9%
School N	4	3	286	10,953	15.7	15.4	51.5%	57.7%	12.6%	8.5%	0.6%	99.7%
School O	4	3	287	9,906	2.1	2.1	16.3%	17.4%	5.5%	7.6%	7.9%	81.6%
School P	5	4	124	8,600	0.5	0.5	2.5%	24.0%	-3.6%	37.1%	12.9%	98.5%
School Q	5	3	270	9,442	3.9	3.9	81.3%	23.8%	1.5%	20.8%	5.5%	84.5%
School R	5	3	407	8,189	13.0	12.5	70.7%	23.6%	-4.9%	4.1%	13.8%	94.0%
School S	5	1	333	10,979	1.7	1.6	42.9%	14.6%	-1.0%	8.3%	8.0%	86.0%
School T	5	1	308	10,367	4.2	4.2	58.8%	29.7%	11.3%	3.4%	7.3%	91.4%
School U	5	4	88	14,993	1.1	1.1	100.0%	1.0%	-33.4%	20.7%	3.0%	100.0%
School V	7	2	621	5,384	25.2	23.1	52.2%	20.3%	2.3%	1.8%	7.5%	99.0%
School W	7	2	790	10,214	2.3	2.3	68.6%	11.6%	2.5%	29.6%	7.3%	99.8%
School X	7	2	354	9,229	2.9	2.9	67.4%	17.4%	3.4%	12.5%	14.7%	99.8%
School Y	8	3	396	6,746	25.9	25.9	73.9%	33.4%	5.5%	20.1%	3.6%	99.3%
Mean	4	NA	299	9,511	5.1	4.8	53.9%	20.6%	1.4%	15.9%	11.1%	91.1%
Std. Dev.	2	NA	172	3,114	7.3	7.1	27.4%	20.2%	15.0%	12.4%	6.7%	10.3%
Median	4	NA	286	9,067	2.2	1.9	54.5%	17.4%	2.3%	12.5%	9.2%	94.0%

Note: * School type indicators are: 1 = Elementary; 2 = K-8; 3=Middle School; and 4 = High School.

Sources: 2006-07 Independent Audits.

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