



Jack Wagner, Auditor General Special Report

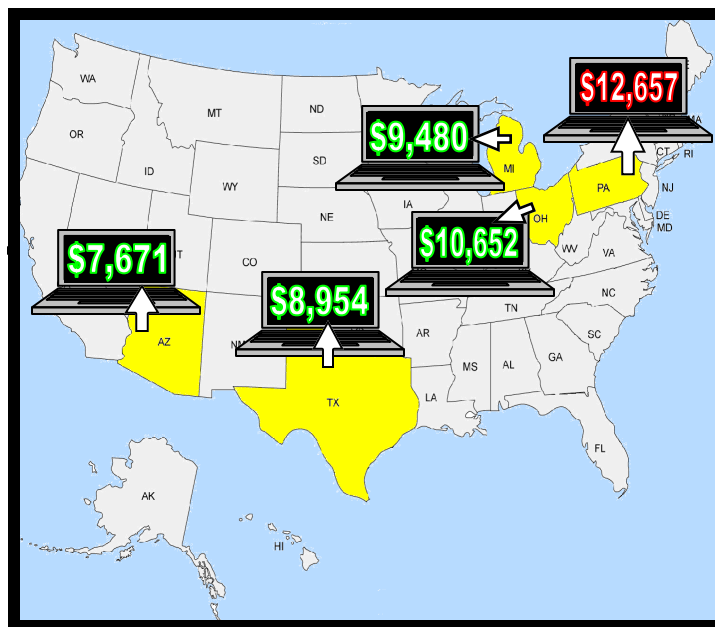
June 20, 2012

Charter and Cyber Charter Education Funding Reform Should Save Taxpayers \$365 Million Annually

Highlights

- Because of a flawed charter school funding formula, PA continues to pay excessive costs to fund charter and cyber charter schools.
- PA spends about \$3,000 more per student to educate a child in a brick-and-mortar charter school and about \$3,500 more per student to educate a child in a cyber charter school compared to the national average, which adds up to \$315 million in annual savings.
- PA could save \$50 million a year by eliminating a loophole, which allows a “double dipping” of retirement benefit payments.
- The PA Department of Education should take a leadership role and set charter and cyber charter school funding rates like those in AZ and MI.

THE BIG FIVE



Pennsylvania spends the most of the list of five states with the largest student enrollment in independently operated charter and cyber charter schools.


Report Conclusions

For the past 15 years, the Commonwealth of Pennsylvania has funded its charter and cyber charter schools using an inefficient statutorily set formula. Specifically, the formula establishes a per student tuition rate based on the cost to educate a student at his/her home district, and not on the actual costs at the charter or cyber charter school. Without a statewide formula, all of Pennsylvania's 500 school districts pay different tuition rates to the same charter or cyber charter school. Moreover, the dollar amounts for these rates vary significantly, particularly for special education tuition. This fact is especially concerning given that there are times when children enrolling in a charter school are reclassified as needing special education services even though they did not previously get those services from their home school district.

Despite the flaws in this funding mechanism, which have been discussed in a variety of reports, including the Department of the Auditor General's October 2010 special report, *The Commonwealth Should Revise Its Charter and Cyber Charter School Funding Mechanisms*, the funding formula remains unchanged. As a result, Pennsylvania's funding model continues to inflict additional costs for taxpayers. For example, taxpayers should only pay the actual cost of educating the student at the charter or cyber charter school, no more and no less.

Given the fact that Pennsylvania's charter and cyber charter school enrollment reached over 100,000 students during the 2011-12 school year, correcting the funding formula must be a priority. New Department of the Auditor General research shows that other states are able to fund their charter and cyber charter schools for less than Pennsylvania. Therefore, the Governor and the General Assembly, with leadership from the Pennsylvania Department of Education (PDE) regarding implementation, should use these other state charter and cyber charter funding methods as a potential model for fixing Pennsylvania's broken funding system. Taking this action will reward taxpayers with significant savings of \$365 million annually. With Pennsylvania continuing to face economic challenges, such a windfall could significantly assist in addressing the Commonwealth's budgetary gaps and shortfalls in educational funding. Continuing to ignore these long-standing and well-documented charter school funding inadequacies only exacerbates the funding problems.

Five Reasons Why the Governor and General Assembly MUST Correct the Charter School Funding Formula NOW!



1. Because taxpayers could save \$365 million annually.
2. Because limited public dollars must be distributed fairly, so that all students receive a quality public education.
3. Because parents and students deserve adequately funded public school options that don't deplete traditional public school services.
4. Because taxpayers cannot be expected to pay more than the actual cost to educate students at charters/cybers.
5. Because the inequities in charter school funding need to be corrected once and for all in the best interest of children and the taxpayers.

Recommendations

To save taxpayers money, while simultaneously maintaining high-quality school choice options, the **Governor and the General Assembly should** develop a more efficient and equitable charter education funding system based on the models used in other states. Specifically, they should:

Develop A Statewide Brick-and-Mortar Rate:

A statewide brick-and-mortar charter school funding rate close to the national average of \$10,000 per student in brick-and-mortar charter schools could save the Commonwealth \$3,000 per student or \$210 million annually.

Develop A Statewide Cyber Charter Rate:

A statewide cyber charter funding rate based on the current national average spending by cyber charter schools of \$6,500 per student could save the Commonwealth \$3,500 per student or \$105 million annually.

Develop A Charter Funding Model That Avoids Double-Dipping: A statewide tuition rate for both brick-and-mortar charter schools and cyber charter schools would eliminate double-dipping of Commonwealth contributions to state programs, such as retirement contributions to the Public School Employees' Retirement System. Eliminating double-dipping could save the Commonwealth \$500 per student or at least \$50 million annually.

Develop Limitations on Private Management

Company Contracts: Pennsylvania law is deficient on placing limits on contracts with and fees paid to private management companies, which can result in excessive profit making with public education dollars. Developing limitations could save the Commonwealth and its taxpayers from paying excessive costs to private companies to run charter and cyber charters.

To ensure that changes to the funding system are effective and that existing charter and cyber charter schools spend their tax money in line with their approved charter, **the Pennsylvania Department of Education (PDE) should:**

Lead The Charge to Correct the Formula:

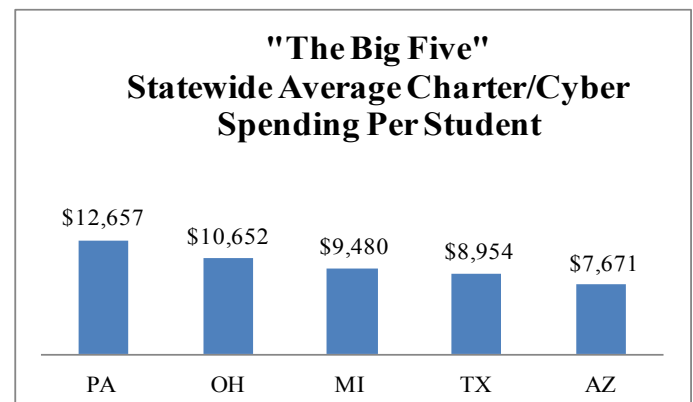
Increased leadership and direction from PDE is essential for any effort to correct the charter school funding system to succeed. Additionally, as the sole authorizer of cyber charter schools, PDE should play a key role in determining a statewide cyber funding rate.

Improve Oversight: PDE should show leadership in the closing of charter and cyber charter schools that are not operating in line with their approved charter or have other documented problems.

Funding Models Where Statewide Funding Rates Cost Less

To identify ways for Pennsylvania to improve its current charter and cyber charter school (hereinafter referred to as "charters/cybers" unless noted otherwise) funding mechanisms, we examined how other states fund their charters/cybers.¹ Specifically, we focused on other states, which like Pennsylvania, have high numbers of independently operating charter schools and then determined how much they spent on average per student. We also analyzed financial reports filed by states with the U.S. Department of Education to determine per student spending at charters and cybers across the U.S.

Of the five states with the most students attending independently operated charters/cybers, Pennsylvania's average spending per student is the highest at \$12,657. Arizona spends the least at \$7,671. According to this data, the U.S. average spending per charter/cyber student is \$10,790, which is nearly \$2,000 lower per student than Pennsylvania.



Source: U.S. Department of Education,
Common Core Data 2008-09 School Year.

¹ Please note that as of May, 2012, nine states do not have a law authorizing charter schools.

Taxpayers Can Save \$210 Million With Statewide Brick-and-Mortar Charter Funding Rate

Our research found that most states fund charter schools primarily with state money paid directly to the charters/cybers based on a **statewide per-student funding rate**. In these funding scenarios, **local funds remain with the district**. Such approaches generally lowered total funding levels, thereby minimizing the financial burden placed upon districts losing students to charters/cybers and reducing additional costs to taxpayers. Currently, Pennsylvania bases its tuition rate on educational costs at the charter student's home school district. Across all states, funding levels appear to dictate spending habits. Therefore, if Pennsylvania adopted a statewide per student funding rate, its taxpayers could see substantial savings. The following examples illustrate these points:

- In Arizona, cyber charters receive slightly less (5%) state funding per student than brick-and-mortar charters, and no local money is included in the funding for either. The exclusion of local funds results in lower total funding levels and reduced spending per student.
- Brick-and-mortar and cyber charters receive the same state funding in Minnesota and Ohio, but local money does not follow the student, which results in lower total funding levels and reduced spending per student.
- In Michigan, brick-and-mortar and cyber charters receive the same funding based on an allowance equal to the state per-pupil funding of the school district in which the charter/cyber is located or the maximum charter rate, whichever is less.
- Based on a national study of state funding strategies, the national average funding rate for brick-and-mortar charter schools is \$10,000 per student.² If Pennsylvania developed a statewide brick-and-mortar charter funding rate based on the national average, taxpayers could save approximately \$210 million per year.

How Pennsylvania Is Different

- ✓ Pennsylvania funds charters/cybers almost exclusively with tuition payments from sending school districts, which includes more local funds, including property taxes, than state funds.
- ✓ Pennsylvania is in the minority of states that require local funds to follow a student to a charter/cyber, particularly one located outside of the student's home district.
- ✓ Brick-and-mortar and cyber charters receive the same funding despite very different cost structures.
- ✓ None of the other state funding models we reviewed included a structure whereby all 500 sending districts pay a different per student rate to the same charter/cyber.
- ✓ Pennsylvania's flawed charter/cyber funding formula produces greater payment differentials with special education tuition rates, which on average are two times higher than non-special education tuition rates.
- ✓ While Pennsylvania has the 2nd highest cyber charter school enrollment,³ it is among the minority of states that do not have a state-led virtual school or virtual learning program for the purpose of providing supplemental online courses to school districts and their students.⁴

² *Costs and Funding for Online Schools*. International Association for K-12 Online Learning. Information presented by Dr. Allison Powell in November, 2011.

³ List of Virtual Charter Schools, March 21, 2012. Center for Education Reform.

⁴ *Costs and Funding Models of a State-led Virtual Learning Program*, February 2011. Pennsylvania Legislative Budget and Finance Committee.

Funding Models Where Separate Statewide Cyber Charter Funding Rates Cost Less

In Georgia and South Carolina, the creation of a statewide authorizer and a fixed state funding rate, including a reduced rate for cyber charters, has reduced overall costs per student while providing an alternative way for charters/cybers to be created in addition to local school districts.

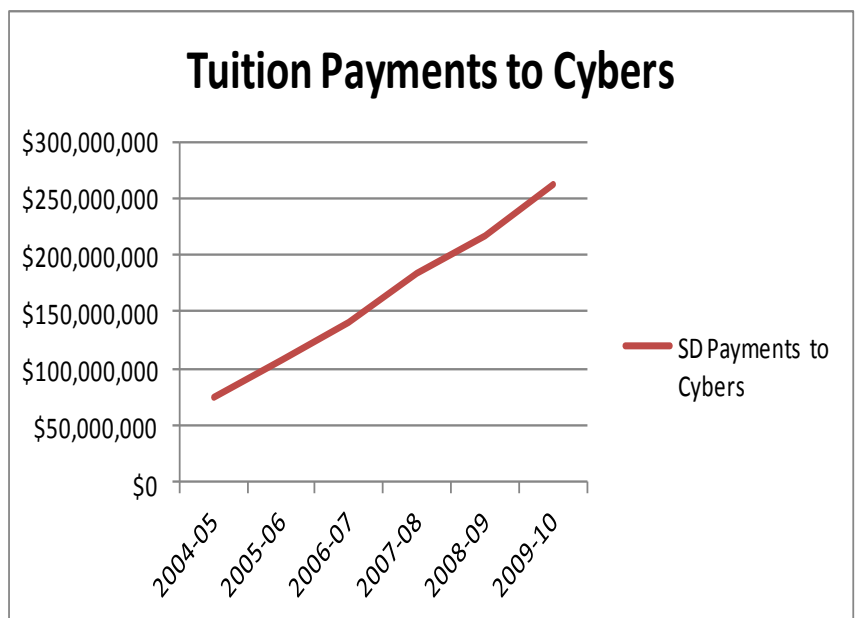
- ✓ In South Carolina, if authorized by the statewide Public Charter School District, brick-and-mortar charters receive a fixed state funding rate of approximately \$5,000 per student, and cyber charters receive a reduced rate of approximately \$3,500 per student.
- ✓ In Georgia, if authorized by the state, the brick-and-mortar per student rate is \$6,332, and the reduced cyber charter rate is \$4,461, which is \$1,871 less.
- ✓ In both South Carolina and Georgia, if authorized by a school district, all levels of funding (local, state, and federal) follow the student to their charter school. However, charter schools can only receive students from the authorizing school district unless otherwise agreed upon, so local money is not being transferred to a charter/cyber located outside of the student's home district.

Taxpayers Can Save \$105 Million With Statewide Cyber Funding Rate

Several states we examined had separate, reduced statewide cyber charter funding rates, such as Arizona, South Carolina and Georgia. According to the International Association for K-12 Online Learning, the national average funding rate for cyber charter schools is \$6,500 per student, with most states funding these schools at \$6,000-\$7,000 per student. These national averages are another indicator that funding levels dictate spending habits. If Pennsylvania developed a statewide cyber charter funding rate based on the national average, taxpayers could save approximately \$105 million per year.

Under Pennsylvania's current funding formula, brick-and-mortar charters and cyber charters receive the same amount of funding, even though research shows significant differences in their cost structure and spending habits. For example, in the 2009-10 school year:

- The average cost per student at brick-and-mortar charters was \$13,411, while the average cost at cyber charters was \$10,145. Therefore, cyber charters spent approximately \$3,000 less per student than their brick-and-mortar counterparts.
- Cyber enrollment has more than doubled over the last five years, which has resulted in school district tuition payments to cybers tripling from \$70 million in 2004-05 to over \$250 million in 2009-10.



Taxpayers Can Save \$50 Million With A Charter Funding Model That Eliminates Double-Dipping

Pennsylvania's current charter and cyber charter school funding model not only creates multiple tuition rates for students attending the same charter school, but also leads to the duplication of state reimbursements. This duplication occurs under the current charter funding formula because it includes certain school district costs for which charters/cybers are also eligible to receive direct state funding. Hence, a charter school could receive two forms of funding related to the same costs. Thus, establishing statewide funding rates for charters/cybers in Pennsylvania would eliminate double-dipping into Commonwealth contributions to state funded programs.

The most egregious example of double-dipping occurs with retirement costs. Specifically, the Commonwealth is currently responsible for paying a portion of the "employer's" share of retirement costs for all public school employees, including charters/cybers. This is the **biggest pot of money** the state currently pays directly to charters/cybers. However, retirement costs at districts are included in the charter school funding formula's calculation of charter/cyber tuition payments, and ultimately, money that follows the student to the charters/cybers.⁵ Thus, charters/cybers are receiving two forms of funding related to the same state program.

- * In 2010-11, school districts paid retirement costs that equate to approximately \$500 per student. If these costs were eliminated from charter/cyber tuition rates, which resulted in the double payment of state funds and inflated charter tuition rates, the Commonwealth could save at least \$50 million annually.



⁵ Pennsylvania Association of School Business Officials. *Legislative Report*. February, 2012.

Taxpayers Can Save By Limiting Management Company Contracts

Generally, a private organization or firm that manages public schools, including district and charter public schools, is referred to as an Education Management Organization (EMO) or a Charter Management Organization (CMO). Contracts detail the services these private companies are to provide. Our research revealed that some states do not allow private companies to manage their charters/cybers and/or contracts are carefully scrutinized by the authorizer or oversight body. This is likely because excessive management company contracts can result in excessive fees, salaries, and inefficient spending. Currently, Pennsylvania law is deficient on placing limits paid and contracts made with management companies which can result in profit making with public education dollars. Moreover, management company fees increase a charter school's administrative costs and result in less money being available to educate the students. In addition, unless specifically provided for in statute, it is difficult for authorizers, oversight bodies, and the taxpayers to see how their money is spent by these private companies.

In Pennsylvania, 42 percent of cybers and 30 percent of brick-and-mortar charters paid management companies in 2010-11. When we reviewed the management company contract at one Pennsylvania charter school where the fees were based on a percentage of the school's total revenue and not on the management services provided, it equated to approximately \$1,300 per student in management fees. Under this fee schedule, the size of the school drives the fees that the management company receives. Moreover, since Pennsylvania's charters and cyber charters are funded by a per-student tuition rate, our funding method has attracted management companies to cyber charters and charters in urban areas with higher student enrollment. Specifically, 100 percent of Pennsylvania's top five charters/cybers having the highest student enrollment used a management company in 2010-11. Overall, the use of management companies in Pennsylvania is largely by cyber charters and brick-and-mortar charters located in Philadelphia and Pittsburgh.

Top 10 States with the Largest Number of Charters/Cybers Run By Management Companies (Mgt.), 2010-11	
EMOs	CMOs
1. Michigan	1. Texas
2. Florida	2. California
3. Ohio	3. Arizona
4. Arizona	4. Ohio
5. California	5. New York
6. New York	6. Illinois
7. Pennsylvania	7. Louisiana
8. Colorado	8. District of Columbia
9. Georgia	9. Pennsylvania
10. Indiana	10. Michigan

Eight States with Charters/Cybers No Mgt. Run Schools, 2010-11
Alaska
Iowa
Maine
Mississippi
New Hampshire
Rhode Island
Virginia
Wyoming

Source: Public Charter School Dashboard, 2010-11. National Alliance for Public Charter Schools.

Pennsylvania Taxpayers Can Save With More Leadership From PDE

Over the last decade, a large part of Pennsylvania's continued failure to revise its broken charter/cyber funding formula is the result of a lack of leadership on the part of the Pennsylvania Department of Education (PDE). PDE allows tax dollars to knowingly be wasted despite funding reports highlighting the funding formula's problems dating back to 2001 and charter/cyber data that PDE has collected for over a decade. For example, there is no evidence to suggest that PDE has followed the recommendations in a 2007 report issued by the PA Task Force on School Cost Reduction, which emphasized the importance of PDE collecting and analyzing data on the cost of cyber education and regularly sharing this information. Instead, PDE still fails to provide current and comprehensive data on charter and cyber charter schools, including financial information, on its website, which would allow parents, taxpayers, and other interested parties to follow public education dollars to the charters/cybers and know how this money is being spent.

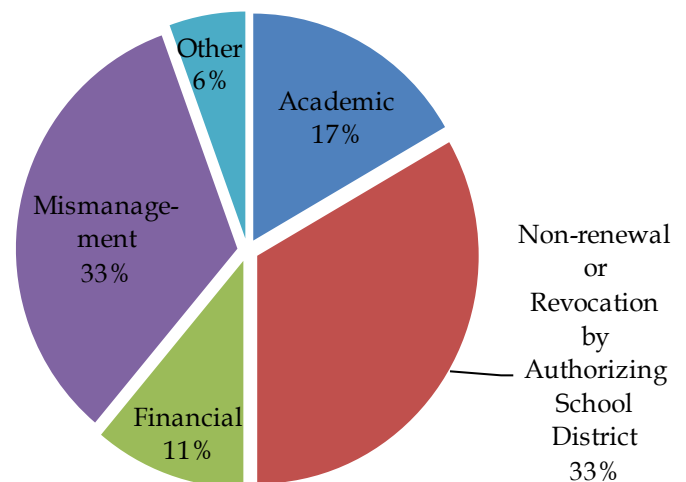
While PDE has provided lawmakers with suggested reforms to the Charter School Law, it has fallen short of offering real solutions to the funding problems, such as dollar amounts of how much cyber charter schools should receive. Without greater leadership from PDE, it will be difficult for the General Assembly to successfully change the charter and cyber charter funding formula.

Pennsylvania Taxpayers Can Save With Better PDE Oversight

PDE and the Charter School Appeals Board headed by the Secretary of Education have failed to take a leadership role in closing charters/cybers that are not operating in a manner consistent with their approved charter or that have documented financial, operational, or legal issues. Consequently, taxpayer dollars continue to be poured into mismanaged charters/cybers without any regard for the fact that it is likely these public funds are not being used appropriately. This approach is not in the best interest of the taxpayers or the students enrolled in these schools, particularly given that one of the benefits of charter schools is that those that perform poorly can be closed. Specifically, the National Association of Charter School Authorizers indicates that a quality authorizer maintains high standards and "closes schools that fail to meet standards and targets set forth in law and by contract."⁶

From 1997 to 2012, only 18 Pennsylvania charters/cybers have closed. The most common reason for closure was mismanagement, which contributed to 9 of 18 charters/cybers closures. By implementing better oversight and plugging this leak in the charter school structure, the Commonwealth could save money and improve the quality of its public educational system in one step.

Why Have Pennsylvania's Charter Schools Closed?



⁶ National Association of Charter School Authorizers. *Principles and Standards for Quality Charter School Authorizing*. 2010 Edition, pg. 7.

Pennsylvania Taxpayers Can Save With Better PDE Oversight (Continued)

According to the National Association of Charter School Authorizers (NACSA), a quality authorizer “oversees charter schools that, over time, meet the performance standards and targets set forth in their charter contracts on a range of measures and metrics.”⁷ In addition, the NACSA also states that a quality authorizer “protects student and public interests by supporting parents and students in being well-informed about the quality of education provided by a charter school.”⁸ These standards are frequently difficult for Pennsylvania’s school districts, the authorizers of brick-and-mortar charter schools, to meet because they have limited authority and limited access to data related to charter school operations. Moreover, while school districts are the authorizers of brick-and-mortar charter schools, they do not make the final decision regarding whether a charter school application should be approved. Rather, decisions made by districts about whether to grant, renew, or revoke a charter can be appealed to the Pennsylvania Charter School Appeals Board headed by the Secretary of Education. As a result, some school districts have been involved in expensive legal battles and exhaustive appeals processes in order to close or not renew a charter school. These scenarios provide yet another example of precious taxpayer dollars being spent on something other than the education of students. By implementing better oversight and plugging this leak in the charter school structure, the Commonwealth could save money and improve the quality of its public educational system in one step.

In addition, identifying charter schools that should be closed because they are not sufficiently meeting the standards set out in their charter would be easier for school districts if more data on their operations were available. For example, PDE has significant amounts of information on charter/cyber finances, student achievement, and access to services (i.e. student wait lists) that it currently does not share with the public or with school districts. Moreover, in its dual role as authorizer of cybers and as the state agency responsible for collecting public school financial data, PDE has fallen short of offering solutions to the funding problems, such as dollar amounts of how much money cybers should receive.

Finally, as the sole authorizer of Pennsylvania’s cyber charter schools, PDE has also not successfully met the standards established by the NACSA. These lapses are detailed in the box below.

PDE Leadership Failures As A Charter Authorizer

- PDE has failed to utilize its increased role as the sole authorizer and oversight body of cyber charters to collect and analyze data on the actual cost of cyber education.
- Since becoming the sole authorizer of cyber charter schools as of July 1, 2002, PDE has never revoked or not renewed the charter of an existing cyber charter school, despite the fact that only 2 of 12 operating cybers met academic standards (AYP) in 2010-11 and the majority have not met these standards for several consecutive years.
- PDE doesn’t share the results of its required on-site cyber charter reviews, annual cyber charter assessments, or comprehensive reviews prior to granting a five-year renewal of a cyber charter on its website or elsewhere in an effort to keep parents and taxpayers informed of these results.

⁷ National Association of Charter School Authorizers. *Principles and Standards for Quality Charter School Authorizing*. 2010 Edition, pg. 7.

⁸ Ibid, pg. 8.

About our methodology: This special follow-up report is a status and informational report based on extensive research and data analysis, including a review of the 2011-12 enacted state budget and information obtained from the Pennsylvania Department of Education. We also considered information from numerous other sources as noted, including national and state charter school research studies. We developed this report as a public service to taxpayers and as a management tool for use by the Commonwealth of Pennsylvania, including the Governor, the General Assembly, and Department of Education, to improve Pennsylvania's current methods for providing financial support to publicly funded charters/cybers. We may also use this report as a planning tool for future reports.

Appendix

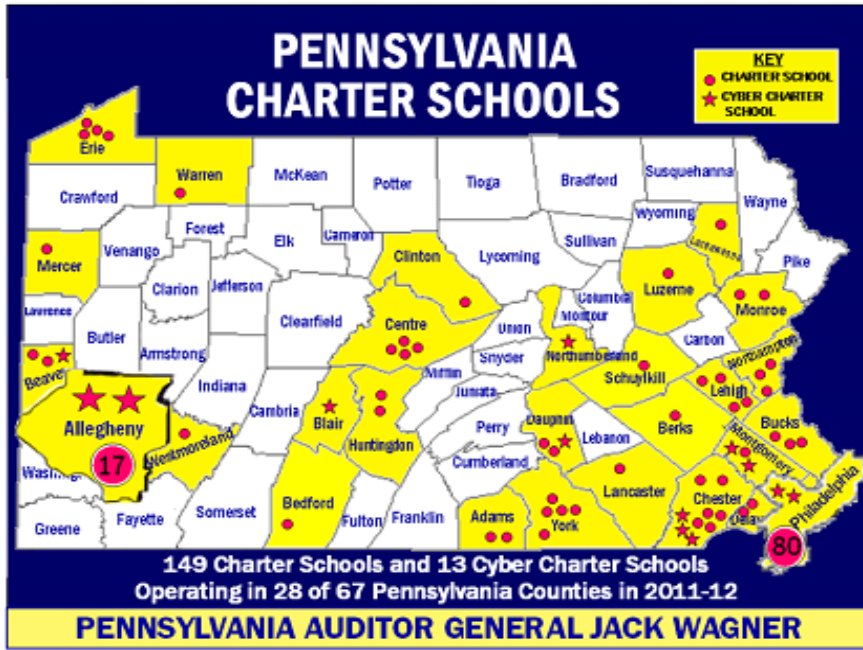
FUNDING FACTS: CHARTERS AND CYBERS

PENNSYLVANIA’S CHARTER SCHOOLS

What Are Charter Schools?: Charter and cyber charter schools (hereinafter “charter schools” unless stated otherwise) are **free public schools**.

How Many Are There? : 149 brick-and-mortar charters and 13 cyber charters operated in 2011-12.

Where Are They?: Charters/cybers were located in 28 of 67 Pennsylvania counties in 2011-12.



STATE AND TAXPAYER DOLLARS AND CHARTER FUNDING IN PENNSYLVANIA

Who Pays For Charter Schools?:

Taxpayers, the Commonwealth, and School Districts.

What Is The Theory Behind The Funding?: Public education dollars should follow the student.

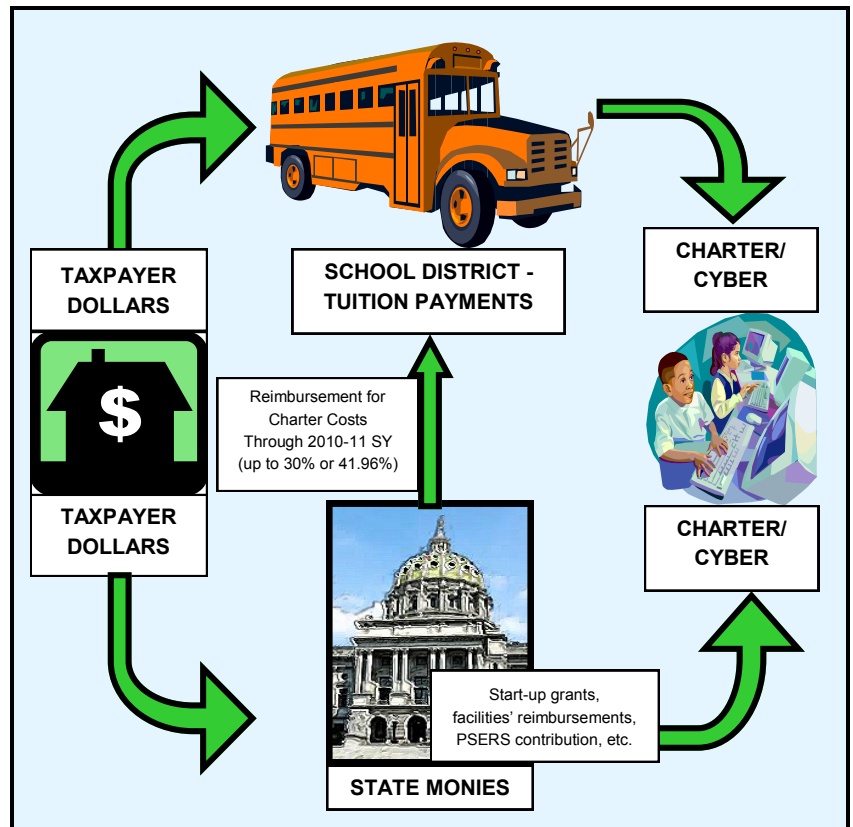
What Funding Methods Are Used?

- 1) Districts pay a per-pupil tuition rate for students attending charter schools.
- 2) The Commonwealth provides both indirect and direct financial support through subsidies paid to support charter education.

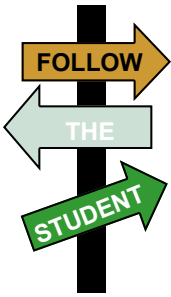
How Are Taxpayers Paying For Charter Schools?: Taxpayer dollars are passed through local school districts in the form of tuition payments for students attending charter schools.

Does Money From Local Property Taxes Go To Charter Schools?: Yes. Local property taxes are included in school district tuition payments made to charter schools.

How Is the Commonwealth Paying For Charter Schools?: 1) **Indirect** state contributions are included in the tuition payments from school districts to charter schools. 2) **Direct** state contributions to charter schools are in the form of subsidies and grants, such as facilities’ reimbursements, start-up grants, and employee benefits. 3) Prior to the 2011-12 school year, the state provided **indirect** financial support to charter school education by reimbursing districts a portion of their charter school tuition payments according to established rates (up to 30%, or 41.96% in some instances), but this reimbursement was eliminated in the Commonwealth’s 2011-12 annual budget.



TUITION PAYMENTS AND CHARTER FUNDING



What Path Does The Funding Take?: Charter school funds pass through the local school district where the student resides.

How Do Charter Schools Receive Their Funding?: Local school districts are responsible for paying the required tuition rate directly to the charter school for their students attending a charter school.

How Is The Tuition Rate Calculated?: A funding formula set by law establishes the per-pupil tuition rate based on each sending school district's costs to educate its students for the prior school year.

Is The Tuition Rate The Same For All Districts?: No. All 500 school districts pay a different charter school tuition rate based on the costs at the districts the students come from per the funding formula required by law. Tuition rates also vary by classification as a non-special or special education student.

Do Cyber Charters Receive The Same Funding?: Yes. Cyber charter schools receive the same per-pupil tuition rate as brick-and-mortar charter schools.

Can A District Refuse To Pay A Charter School?: No. If a district refuses or fails to directly pay a charter school, the Department of Education intervenes and deducts the required charter school tuition payments from the district's state funding.

