

**SPECIAL REPORT:
THE COMMONWEALTH SHOULD REVISE
ITS CHARTER AND CYBER CHARTER
SCHOOL FUNDING MECHANISMS**



Bureau of School Audits
September, 2010

Impact to Taxpayers

- The charter school funding formula in state law resulted in tuition inequities (over/underpayments) that were unfavorable to both school districts and charter schools.
- School districts paid different tuition rates pursuant to state law for students attending the same charter school, which meant that some districts were partially subsidizing other districts.
- Special education payment differences were significantly larger than those for non-special education; factors significantly impacting this disparity were the funding formula itself and the incorporation of extra state subsidies for each special education student as required by state law.
- Tuition inequities (over/underpayments) were never corrected because state law does not require charter schools to reconcile tuition payments with actual costs at year end like school districts.
- The state law's failure to limit charter school general fund carry-over balances has allowed charter schools to retain \$108 million in unreserved-undesignated reserve funds.
- A disparity in Commonwealth reimbursements to sending school districts occurred because state reimbursement set by state law is based on the flawed charter school funding formula.

Recommendations

- The Governor, the Pennsylvania Department of Education, the State Charter School Appeal Board, and local school districts should place a moratorium on authorizing new charter and cyber charter schools until the flawed charter school funding mechanisms are equitable and reasonable for charter and cyber charter schools, for sending school districts and for Pennsylvania taxpayers.
- The Pennsylvania Department of Education should provide active leadership, and direction in the process of modifying the Commonwealth's existing charter school funding mechanisms, in order to end the current funding disparities and the additional costs to taxpayers.
- This report contains eight recommendations addressing problems with Pennsylvania's charter school funding formula, which has no relationship to the actual cost of charter and cyber charter school education.
- This report also contains four recommendations regarding flaws in the mandatory state reimbursement for charter school costs paid from the Commonwealth's annual budget.

Introduction

The purpose of this report is to provide the public and policymakers with information on the existing inequities in Pennsylvania's current method of funding charter and cyber charter schools, both of which are independent public schools funded by taxpayer dollars. Pennsylvania authorized charter and cyber charter schools in 1997 and 2002 respectively, as alternative public school options to local school districts. This report applies to both brick-and-mortar charter schools, which operate in buildings similar to school districts and must have their charters approved by the local school district board of directors where the charter is to be physically located, and cyber charter schools, which generally use the Internet to provide education to students anywhere in the state and must have their charters approved by the Pennsylvania Department of Education. Brick-and mortar charter schools and cyber charter schools are funded in the same manner. As such, we refer to *charter schools* throughout this report, which include both of these types of entities, unless otherwise noted.

Specifically, this report identifies problems with the funding formula used to provide charter schools with financial support and the process for reimbursing those school districts with students attending charter schools. We based our findings on a review of 18 charter schools throughout Pennsylvania for the 2003-04 through 2005-06 school years¹ and on information from the Pennsylvania Department of Education through the 2009-10 school year.

Overall, we concluded that Pennsylvania's current methods for funding charter schools are inequitable, inefficient, and bear no relationship to the actual cost of educating

the students attending these schools. These disparate charter school funding mechanisms cost Pennsylvania taxpayers approximately \$936 million during the 2008-09 school year. This amount included \$708 million in tuition payments that local school districts paid to charter schools for students who had transferred, plus an additional \$228 million that the state subsequently paid to school districts as a reimbursement for part of their charter school tuition payments. Based on the number of students attending these alternative public schools during the 2008-09 school year, taxpayers paid about \$12,808 per student attending a charter school.

Thus, these unintended consequences of the Commonwealth's efforts to provide school choice have caused hundreds of millions of dollars a year in additional public education spending. Moreover, the disparities brought about by the ineffective charter school funding mechanisms limit the subsidies and grants available in other areas of public education. Based on the severity of these inequities and on the seriousness of the Commonwealth's current fiscal situation, this report calls for a statewide moratorium on creating new charter and cyber charter schools so that the Governor and the General Assembly, with leadership from the Pennsylvania Department of Education and in consultation with the impacted charter schools and school districts, can develop a more reasoned and fair approach to charter school funding in Pennsylvania.

The Governor, the Department of Education, the State Charter School Appeal Board, and the local school districts have the legal authority to suspend authorizing new charter and cyber charter schools. Several states, including Ohio, Delaware and New

Hampshire, have imposed moratoriums at various times to address charter and cyber charter school issues.

In addition to calling for a moratorium, this report includes specific recommendations for revising the Public School Code of 1949's charter school funding formula and Commonwealth reimbursement subsidy so that they do not impair Pennsylvania's 500 school districts or require Pennsylvania taxpayers to pay a premium for charter schools on top of their taxes paid to the local school districts. We also recommend that the Pennsylvania Department of Education provide active leadership and direction over the entire process for modifying the Commonwealth's existing charter school funding mechanisms.

Finally, it is important to note that the financial disparities and inequities noted throughout this report are the result of the flawed funding mechanisms implemented by state law in 1997, and that they are not the result of any misconduct by the charter schools or the school districts.

Given the fact that nationally Pennsylvania has the 7th highest charter school student enrollment, and the 10th largest number of operating charter schools,² charter costs have continued to soar and the disparities have intensified as the state passes more and more money through a broken system that has needed revision for many years. As such, it is imperative that the Governor, the General Assembly and the Pennsylvania Department of Education correct these funding problems as soon as possible.

What problems exist in the Commonwealth's current charter school funding mechanisms? _____

Issue I: Charter School Funding Formula Should Be Revised

Our review of 18 Pennsylvania charter schools, including two cyber charter schools, found that the current statutory funding formula for determining how much money each charter school will receive in tuition payments from its students' districts of residence (hereinafter referred to as "sending school districts") is not reasonable or equitable. This inequality exists because the funding formula is driven by the number of students attending a charter school and by the school districts they come from, not the actual cost of educating those students.³

Moreover, our charter school audits have found a wide variation in the amount of tuition that school districts pay when one of their students decides to attend a charter school, which results in an inequitable distribution of public education money and no assurance that taxpayer dollars are being spent wisely or for their intended purpose.

Under the current funding formula, all 500 school districts within Pennsylvania pay a different tuition rate for their students that leave the district to attend a charter school. Because they pay different tuition rates, some school districts may be subsidizing the education of other districts' charter school students, even though all of the students are attending the same charter school. For example, Propel Charter School – Homestead located in Allegheny County received students from more than ten

sending school districts during the 2008-09 school year, but each paid a different tuition rate. At the high end was Clairton City School District, which paid a charter school tuition rate of \$11,337.43 per non-special education student. Conversely, East Allegheny School District was at the low end of the spectrum and paid only \$7,201.27. These high and low differences are even more considerable with special education tuition rates. Specifically, Duquesne City School District paid a special education tuition rate for charter school students of \$31,653.98, whereas McKeesport Area School District paid \$16,676.18. Consequently, the taxpayers in Clairton City School District are, in effect, partially subsidizing non-special education students from East Allegheny School District, and taxpayers in Duquesne City School District are partly subsidizing special education students from McKeesport Area School District.

Tuition rate differences are even more apparent with cyber charter schools, which typically receive students from multiple sending districts across the state. Pennsylvania Virtual Charter School received students from more than 425 school districts in Pennsylvania during the 2008-09 school year; once again, all paid a different tuition rate for the same cyber charter school education. For example, Grove City Area School District in Mercer County paid \$6,753.21 per non-special education student, and Jenkintown School District in Montgomery County paid \$15,124.72, more than double the tuition rate paid by other districts.

This disparity among tuition rates represents an inefficient use of taxpayers' money for both the charter school and the sending school districts. Instead, charter

schools should receive payments from sending districts based on their actual costs, not on the sending district's per-pupil tuition rate. Furthermore, in contrast to school districts, charter schools are not required to reconcile the resulting tuition payments with the actual costs of educating the students at the end of each school year.

Finally, our review found that cyber charter schools educate students at a lower cost than brick-and-mortar charters, and many charter schools are carrying large unreserved-undesignated fund balances.

Issue II: Commonwealth Reimbursement to Sending School Districts Should Be Revised

Our review also examined the appropriateness and the efficiency of Pennsylvania's mandated reimbursements to sending school districts for up to 30 percent, of their charter school costs. State law also allows some school districts that meet specific criteria, such as having charter school expenses that reach \$1 million, to receive a reimbursement of up to 32.45 or 41.96 percent of their charter school expenses.⁴

This reimbursement, which is appropriated through the state's annual budget, addresses the fact that sending school districts lose money by paying charter school tuition because the sending school districts cannot necessarily reduce their costs when they lose students to a charter school.

Nevertheless, the required state reimbursement is based on the flawed charter school funding formula and, therefore, has no relationship to the actual cost of educating the charter school students. Instead, it is based on what it

would cost to educate those same students if they remained at the district. Therefore, this situation creates the same inequities in the reimbursement calculation that exist in the funding formula, giving rise to the possibility that the state is overpaying for the services provided by charter schools.

Specifically, the reimbursement calculation is based on a state-mandated percentage of the sending school districts' total charter school expenditures, which are determined by the flawed charter school funding formula discussed in Issue I. Our audit found that this issue creates discrepancies in the Commonwealth's reimbursement because there is no way to determine whether the sending districts are receiving the appropriate amount of money. In some cases, the state might be reimbursing a sending school district too much, while in other instances a sending school district may receive too little. Overall, this results in an inefficient use of taxpayer money and places an additional strain on the state's budget. For instance, the Commonwealth reimbursed sending school districts \$228 million in the 2008-09 school year for their charter school costs. When compared to the number of charter school students, this state reimbursement cost Pennsylvania taxpayers approximately \$3,122 per student, above and beyond their contributions to local school districts, mainly through property taxes.

Because charter schools are public schools, the Commonwealth must support them with taxpayer dollars. However, the state should use a funding scheme that does not impair Pennsylvania's 500 school districts or impose additional expenses on taxpayers. Instead, both of these educational bodies (i.e., charter schools and school districts) must work in tandem to effectively educate

the Commonwealth's children without placing an added burden on the Commonwealth's already overextended budget. Therefore, the basis for the current mandated charter school reimbursement should be evaluated to determine its appropriateness and efficiency, and alternative charter school funding methods should be explored.

Why review the Commonwealth's charter school funding mechanisms? _____

The Department of the Auditor General is responsible for conducting audits of all public schools in Pennsylvania, including charter schools. These school audits often yield recommendations to improve performance, accountability, safety, efficiency, and effectiveness.

Due to the continued growth of Pennsylvania's charter schools, ensuring that our funding mechanisms are fair and equitable to all stakeholders, and most importantly to taxpayers, should be of utmost importance. During the 2009-10 school year, 135 charter schools operated in the Commonwealth. This number represents a substantial increase from the six schools that opened when the state began authorizing charter schools in the 1997-98 school year.⁵

As shown in Exhibit 1, student enrollment has also continued to rise. According to the Pennsylvania Department of Education (PDE), 79,167 students attended Pennsylvania charter schools during the 2009-10 school year.⁶ In fact, Pennsylvania has the 7th highest charter school student enrollment, and the 10th largest number of

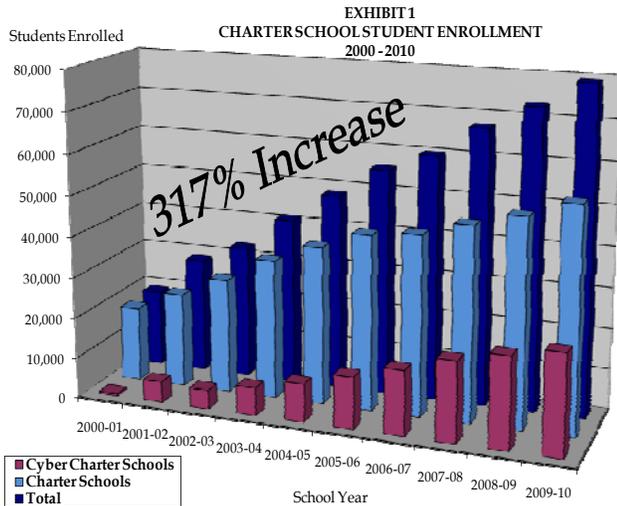
operating charter schools, in the United States.⁷ This expansion will likely put additional stress on the Commonwealth’s current charter school funding mechanisms, as more and more money passes through the system.

How are the Commonwealth’s charter schools currently funded?

Charter schools are free public schools, just like the traditional, local school districts. The Commonwealth bases the funding for charter schools on the principle that public education money should follow the students, regardless of whether they choose to attend traditional public schools or charter schools.

Consequently, Pennsylvania uses a hybrid approach to charter funding. The districts provide some local property tax revenue to charter schools through tuition payments for their students attending charters, and the state provides support by reimbursing districts a portion of their charter school tuition costs. The state also contributes directly to charter schools through other subsidies and grants, such as facilities’ reimbursements and start-up grants. Nevertheless, funding differences and accounting and reporting procedures that do not include specific charter portions make it difficult to precisely follow taxpayer dollars.

Revenue by Source: In Pennsylvania, local revenue is the biggest source of public education funding. However, school districts receive most of their local revenue through property taxes, whereas charter schools depend almost entirely on tuition payments from sending school districts for their local revenue.



Likewise, the state’s current limited financial resources increase its challenges for funding public education and sustaining both traditional and alternative public schools. The General Assembly’s concern for these issues has been demonstrated through several legislative proposals on improving Pennsylvania’s charter school funding system and numerous education committee hearings on these topics. Therefore, the purpose of this report is to provide the public and policymakers with useful information about how to improve the existing charter school funding formula and subsequent Commonwealth reimbursement.

Revenue by Source (2008-09 School Year):

<u>Charter Schools</u>	<u>School Districts</u>
Local: 86.69%*	Local: 56.54%
State: 4.13%	State: 38.66%
Federal: 6.69%	Federal: 3.59%
Other: 2.50%	Other: 1.21 %

*Tuition payments from SDs account for 95% of local revenue.

Pennsylvania’s Funding Formula:

According to the Charter School Law, the sending school district must pay the charter school a per-pupil tuition rate based on its own budgeted costs, minus specified expenditures for the prior school year.⁸ For special education students, the same funding formula applies, plus an additional per-pupil amount based upon the sending district's special education expenditures divided by a state-determined percentage specific to the 1996-97 school year.⁹ The Charter School Law also requires that charter schools bill each sending school district on a monthly basis for students attending the charter school.¹⁰

Typically, charter schools provide educational services to students from multiple school districts throughout the Commonwealth. For example, a charter school may receive students from ten neighboring, but different, sending school districts. Moreover, students from numerous districts across Pennsylvania attend cyber charter schools.

State Reimbursement of Charter Schools:

The Commonwealth also pays a reimbursement to each school district with students attending a charter school. This reimbursement is a mandatory percentage rate set by the Public School Code, as

amended, of total charter school costs incurred by a sending school district.¹¹ Commonwealth reimbursements for charter school costs are funded through an education appropriation in the state’s annual budget.

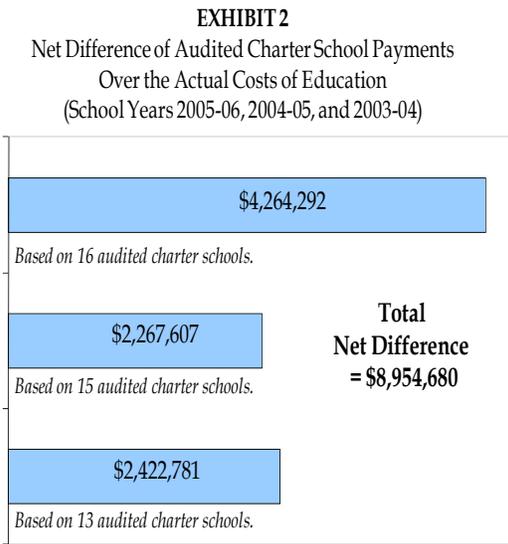
ISSUE I

What are the specific problems with the Commonwealth’s charter school funding formula?—

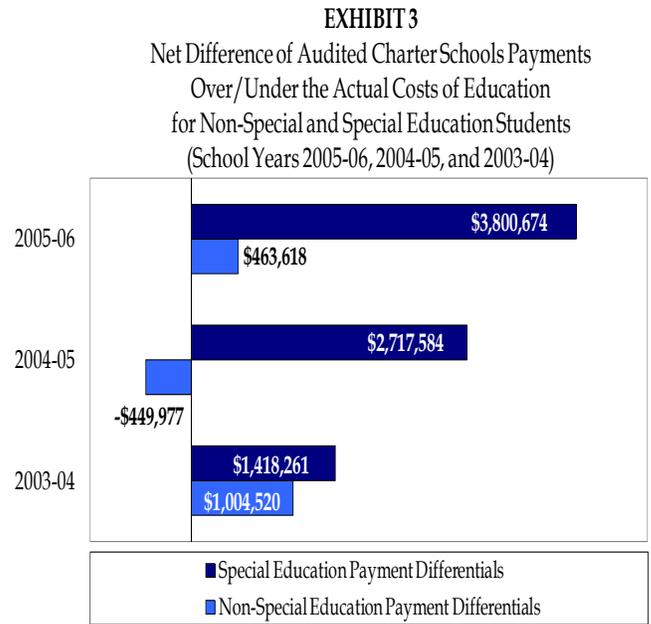
Our review of 18 charter schools, including two cyber charter schools, found a difference between the sending school districts’ charter school tuition payments and the charter schools’ actual education costs. We further found that sending school districts paid different tuition rates for students attending the same charter school, and that special education rates varied considerably more than those for non-special education students. Finally, our review of unaudited information from PDE found that cyber charter schools educate students at a lower cost than brick-and-mortar charters, and many charter schools are carrying large unreserved-undesignated fund balances.

We based our findings on the charter schools’ audited tuition billings and our calculation of total net costs at the charter school. Specifically, we deducted federal, state, and local revenue sources from each charter schools reported costs to determine total net costs at the charter school, which we consider to be consistent with how charter school tuition is calculated under the current state law.

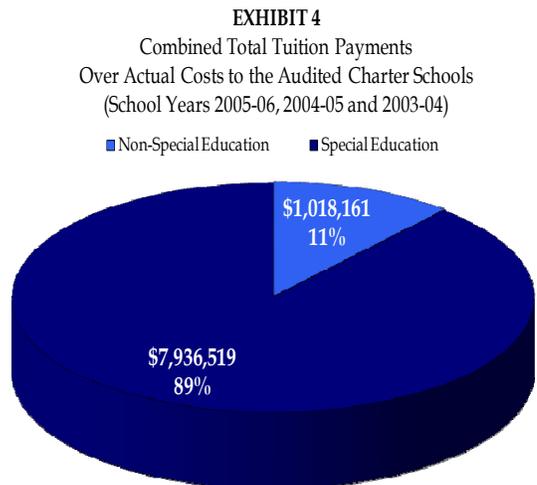
Total Net Difference. As shown in Exhibit 2, our work found that the sending districts paid the 18 audited charter schools a total net amount of \$8,954,680 more than their actual education costs during the three school years reviewed. Specifically, the sending districts made payments over the actual education costs of \$4,264,292, \$2,267,607, and \$2,422,781 during the 2005-06, 2004-05, and 2003-04 school years, respectively.



Non-special vs. Special Education. Exhibit 3 further details the combined total net difference of \$8,954,680 by separating out the non-special and special education tuition payments. This delineation illustrates the audited payments made over and under the charter schools' actual education costs for each category of students.



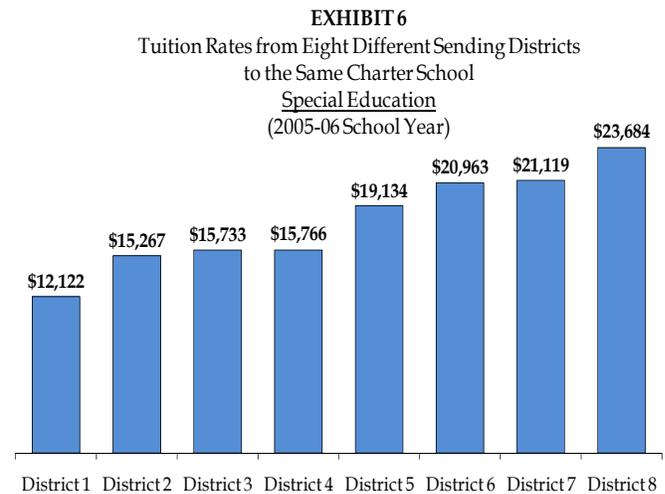
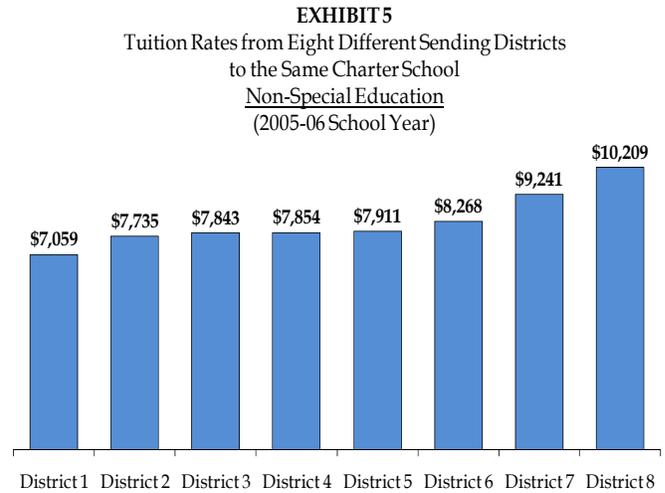
Additionally, Exhibit 4 demonstrates that the total tuition paid for non-special education students over the charter schools' actual education costs for those expenses was \$1,018,161. Likewise, the total tuition paid for special education students over the actual education costs was \$7,936,519. Therefore, 89 percent of the total amount paid over the charter schools' actual education costs for the three-year period was due to special education expenditures.



Consequently, we analyzed these special education payments to try to determine why they accounted for such a large percentage of the overpayments. In our review, we considered factors such as the percentage of enrollment by disability type, the number and percentage of special education students, the number of sending districts, and the range of special education tuition rates from the sending districts. None of these factors alone appeared to significantly contribute to the over/underpayments. However, the special education formula is based on the total special education expenditures at the sending school districts and does not account for differences in the special education populations and resulting expenditures of charter schools and sending districts, nor does it consider the needs of students attending charter schools. As such, we again concluded that the disparity in special education payments was caused by the funding formula itself.

We also reviewed unaudited financial information from PDE in an attempt to analyze statewide special education funds received by charters and the amounts spent on special education programs and services. While we gleaned estimates of the amounts charters spent related to special education, PDE’s lack of accounting and reporting procedures distinguishing between non-special and special education charter school tuition payments hindered a statewide comparison in this area. These limitations on publically available data regarding charter school finances prevent Pennsylvania taxpayers, and the parents of special education students from determining that the charter schools are spending their special education tuition payments for that purpose.

Multiple Tuition Rates. The following exhibits use one audited charter school’s payments to illustrate that sending school districts with students at the same charter school pay different tuition amounts:



Our audit found that this particular charter school received students from eight different sending districts during the 2005-06 school year. As shown in Exhibit 5, the non-special education tuition rates paid by this charter school’s sending school districts ranged from \$7,059 to \$10,209 per student.¹² Exhibit 6 reveals that this gap widens for special education tuition rates, which ranged from \$12,122 to \$23,684 per student.¹³

In addition, our review of unaudited information from PDE found that these variances are not unique to this particular charter school. Instead, PDE’s data reaffirms that school district tuition rates vary significantly statewide.¹⁴

Specifically, as presented in Exhibit 7, PDE’s published tuition rates for the 2009-10 school year demonstrate that non-special education rates ranged from \$6,493 to \$16,249, and special education tuition rates ranged from \$12,333 to \$111,033.

Because the school district tuition rates are the basis for the charter school funding formula, the differences in rates creates stark disparities in the charter school tuition payments.

The difference among tuition rates becomes even more significant as the number of sending school districts increases. For example, cyber charter schools often receive students from many districts across the state. Specifically, one of the cyber charter schools that we audited received both non-special and special education students from 219 sending districts during the 2005-06 school year. Exhibit 8 shows that this cyber charter school had non-special education tuition rates ranging from \$5,103 to \$18,522 per student, and special education tuition rates ranging from \$9,501 to \$45,396 per student. Consequently, sending districts at the top of this scale paid 3.6 times as much for non-special education as those on the bottom, and 4.6 times as much for special education. The median tuition rates were \$7,130 and \$14,291, respectively.

Exhibit 7
School District Tuition Rates
Applicable to Charter/Cyber Charter School Tuition Billings
(2009-10 School Year)

	<u>Non-Special Education</u>		<u>Special Education</u>	
Hazleton Area SD	\$6,493	} 5 Lowest	\$12,333	Crestwood SD
Northwestern SD	\$6,522		\$12,390	Mount Carmel Area SD
Tuscarora SD	\$6,668		\$12,476	Freeport Area SD
Ringgold SD	\$6,748		\$12,528	Dunmore SD
Crestwood SD	\$6,774		\$12,593	Norwin SD
Line Mountain SD	\$8,735	} 5 Middle	\$17,908	Gettysburg Area SD
Iroquois SD	\$8,739		\$17,946	Upper Darby SD
Hamburg Area SD	\$8,752★		\$17,961★	Fort Cherry SD
Chartiers Valley SD	\$8,754		\$17,978	Minersville Area SD
Philipsburg-Osceola Area SD	\$8,755		\$17,999	Mckeesport Area SD
Austin Area SD	\$13,361	} 5 Highest	\$32,952	Cheltenham Township SD
New Hope-Solebury SD	\$14,192		\$33,226	Duquesne City SD
Cheltenham Township SD	\$14,193		\$34,293	Morrisville Borough SD
Lower Merion SD	\$15,974		\$40,221	Lower Merion SD
Jenkintown SD	\$16,249		\$111,033	Bryn Athyn SD

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Information based on "Charter School Selected Expenditures" for the 2009-10 School Year as published by the Pennsylvania Department of Education.

EXHIBIT 8
An Example of a Cyber Charter School's Tuition Rates
(2005-06 School Year)

<u>Non-Special Education</u>		<u>Special Education</u>
\$5,103	} 5 Lowest	\$9,501
\$5,386		\$10,026
\$5,560		\$10,070
\$5,596		\$10,401
\$5,746		\$10,470
\$7,101	} 5 Middle	\$14,251
\$7,122		\$14,273
\$7,130★		\$14,291★
\$7,147		\$14,309
\$7,161		\$14,312
\$11,091	} 5 Highest	\$25,199
\$11,627		\$26,820
\$12,561		\$27,513
\$15,204		\$37,539
\$18,522		\$45,396

★Median

Note: This audited cyber charter school received students from 219 different school districts.

Charter vs. Cyber Charter. Despite their very different facility and cost structures, the Commonwealth currently uses the same funding formula for both charter and cyber charter schools.

An analysis of PDE data for the 2007-08 school year revealed that cyber charter schools had lower per-pupil costs than brick-and-mortar charter schools. Specifically, the median per-pupil rate at a cyber charter school was slightly over \$9,000, compared to the median per-pupil rate of just over \$11,000 at a regular charter school. This \$2,000 per-pupil rate difference is even more significant when combined with the fact that cyber charter schools typically have higher student enrollments than brick-and-mortar charter schools. Consequently, cyber charters could potentially be attaining additional revenue surpluses, while their brick-and-mortar counterparts operate with much smaller margins.

Moreover, the previous discussion of multiple tuition rates applies to this issue because the tuition variance widens as the number of sending districts increases. Because cyber charter schools can enroll students from across the state, a great variation in tuition rates is more common, highlighting the fact that some districts are subsidizing the costs of other districts.

Unreserved-undesignated General Fund Balances. Finally, our review of the unreserved-undesignated general fund balances of charter schools statewide found that they are collectively holding more than \$108 million in this discretionary fund account and most are operating with positive carry-over balances in those areas. “Unreserved-undesignated” represents that portion of the fund balance that can be used

for operating expenditures or that is not segregated for specific or tentative future use.¹⁵ Conversely, an “unreserved-designated” portion of the general fund represents funds that are restricted or have been committed by the local school board for a specific use.

According to unaudited information from PDE for 2008-09, charter schools had a cumulative unreserved-undesignated general fund balance of over \$108 million, which was 13 percent of their cumulative annual expenditures.¹⁶ By comparison, the cumulative unreserved-undesignated general fund balance of school districts was only 7 percent of their total annual expenditures for the same period.¹⁷ This difference may be due in part to state law’s limitations on school districts, preventing them from having a cumulative unreserved-undesignated fund balance of more than 8 to 12 percent of their annual expenditures. The result is that charters and districts are forced to play by different rules and manage their cash reserves accordingly. For instance, Graystone Academy Charter School in Chester County reported a 61 percent unreserved-undesignated general fund balance in 2008-09. It received the bulk of its students from the Coatesville Area School District located in the same county, which reported only a 9 percent unreserved-undesignated general fund balance in 2008-09.

Imposing limits on these fund balances helps ensure that the Commonwealth spends taxpayer funds responsibly and equitably, and that the school districts return excess payments to the Commonwealth. Current state law does not limit charter schools’ fund balances.

Our review of the unreserved-undesignated fund balances for the 127 charter schools included in PDE's annual report for the 2008-09 school year found that 45 percent had a cumulative unreserved-undesignated fund balance exceeding 12 percent of their annual expenditures, the maximum allowable for school districts. In fact, percentages exceeding 12 percent ranged from 13 to 95 percent. In addition, two charter schools and one cyber charter school reported unreserved-undesignated general fund balances exceeding 100 percent of their total annual expenditures. Moreover, 77 percent of charter schools operated with positive undesignated general fund balances, and 31 percent had carry-over balances in those funding areas exceeding \$1 million.¹⁸

Why do these problems exist? —

The significant differences between school district and charter school revenue sources create inherent funding inequalities from the start. In particular, school districts control local property taxes, the largest share of public education revenue, whereas charter schools rely mainly on tuition payments from sending school districts. However, charter schools rely mainly on the tuition payments from the sending school districts. PDE's lack of accounting and reporting procedures for differentiating the local and state portions of public education funding passing through districts in the form of charter school tuition payments makes it difficult, if not impossible, to determine how much money follows each student.

Moreover, the state's complex charter funding formula heightens these innate funding differences. Specifically, the inconsistencies between the sending school

districts' tuition payments and the charter schools' actual education costs occur because the current state formulas for calculating these amounts are based on the budgeted expenditures of the sending school district, not those of the charter school. Likewise, the amount charged per student is not related to the actual cost of educating the student at the charter school. Instead, it reflects the cost of educating the student at the sending district. The same funding formula applies for special education students. However, the charter schools also receive an additional per-pupil amount based upon the sending district's special education expenditures divided by 16 percent of students at the sending district. In addition, both the non-special and special education formulas are based on the prior school year.

Furthermore, the Public School Code makes this problematic funding system even more inequitable by not providing for a reconciliation between the statutorily imposed sending school districts' tuition payments and the charter schools' actual education costs. Consequently, any disparities in charter school payments are not corrected under current state law.

Finally, the state law's failure to limit the charter schools' unreserved-undesignated fund balances allows charter schools to retain excessive payments that could be returned, at least in part, to the school districts that have paid tuition and to the taxpayers.

What impact do the problems have on the Commonwealth?_____

Ultimately, the inequitable charter school funding mechanisms result in an inefficient use of taxpayers' dollars and an inequitable distribution of public education money. Moreover, the flawed formulas create tuition disparities that are unfavorable to both sending school districts and to charter schools.

Impact on Taxpayers. The current charter school funding formula does not assure taxpayers that the state is spending public education dollars responsibly, equitably, or for their intended purpose.

Impact on Sending School Districts. Different sending school districts pay different tuition rates to the same charter school for the same educational service. Additionally, some sending school districts may pay more than the actual cost of education, while others may pay less. These differences lead some school districts to in effect subsidize the education of charter school students from other districts. Furthermore, without a mandatory year-end reconciliation process and a limit on charter school fund balances, these inherent financial inequities are never corrected.

Impact on Charter Schools. Some charter schools may not receive enough money to sufficiently meet their operational needs, while others may receive more than is necessary to adequately pay their expenses. Additionally, sending school districts often withhold or delay making their tuition payments because they believe that the amounts are inequitable. Consequently,

charter schools may struggle because their anticipated revenue is unavailable.

Impact on State Resources. According to PDE, 50 percent of school districts do not make timely charter school tuition payments.¹⁹ When these districts refuse to pay for their students' attendance at a charter school, PDE must intervene and deduct the tuition amount from the sending school districts' state subsidies.

How does charter school funding work elsewhere?_____

Other States. Charter schools have also continued to grow nationally. As of February, 2009, there were more than 4,500 charter schools operating in 40 states and the District of Columbia, enrolling more than 1.4 million students.²⁰ California, Arizona, Florida, Texas, and Ohio lead the country in total numbers of operating charter schools and in charter school student enrollment.²¹

Mechanisms for paying charter schools vary significantly throughout the country. Some states, such as Pennsylvania, Delaware and New Hampshire, have funding formulas based on per-pupil expenditures. Other states, such as Michigan and Minnesota, base funding on per-pupil revenue. Similarly, some states issue charter school funds directly from their departments of education, while other states use school districts to pass through the funds. For example, in California, which has the largest number of charter schools, state funding may go directly to the charter school, rather than through a sending school district. In addition, the state also offers block grants to charter schools and requires a reconciliation to identify overpayments.

When comparing charter school funding in other states, it is also important to consider how these same states fund their traditional school districts and how they define charter schools in their state law. In Florida, school districts are funded using a weighted per pupil system that accounts for *students* served in particular education programs rather than by individual schools or programs. This same funding formula, which is calculated by the Florida Education Finance Program, is also used for charter school funding. However, all charter funds in Florida still pass through the local district. With the exception of Florida's mandated 5 percent administration fee that is withheld by each authorizing district, charter schools and school districts should receive equal funding, with variations that account only for student differences. In 2006, Missouri adopted a new school district funding formula based on state adequacy targets. Missouri's charter school funding formula incorporates the same district formula, minus some specific local funding that charters may be ineligible for. Consequently, charter and district funding are nearly equivalent for similar students. Further, Missouri amended its charter school law to allow charter schools to become their own local educational agency (LEA), which is equivalent to a school district, thereby making LEA charters eligible for the same funding stream categories as school districts.

Therefore, some states managed to reach equity between how and what they paid their charters and school districts not by creating different funding methods for each group, but instead by developing the same mechanisms for both.

Other Areas of Pennsylvania Public Educational Funding. When examining other funding options, Pennsylvania should also look at how tuition payments and billings are handled in other areas of public education. In the non-charter school context, school districts that provide educational services to students from other districts are paid based on the actual cost of educating those students in the receiving district.²² Additionally, at the end of each year, traditional public schools must reconcile their tuition billings to other districts with their actual education costs. For example, when students leave their district of residence to attend a vocational-technical school (vo-tech), the vo-tech performs a year-end reconciliation with the district of residence and resolves any payment differences.

What action should be taken? _____

First, and foremost, we call for a statewide moratorium on authorizing new charter and cyber charter schools until the Governor and General Assembly correct the flawed charter school funding system that bears no connection to the actual cost of educating children. This moratorium requires all authorizers of charter and cyber charter schools, including the Department of Education and local school districts, to suspend the approval of new charter and cyber charter schools. Additionally, the State Charter School Appeal Board should suspend hearing appeals regarding the creation of new charter and cyber charter schools.

We further recommend that PDE provide active leadership and direction, in the process for modifying the Commonwealth's

existing charter school funding mechanisms, in order to correct the current funding disparities.

Specifically, the Governor and the Pennsylvania General Assembly, with leadership from PDE and in consultation with the impacted charter schools and school districts, should review the current formulas for calculating tuition at charter schools and amend the Charter School Law as follows:

1. Establish a funding formula based on the actual cost of educating students, including special education students, at the charter school;
2. Revise the special education funding formula so it is driven by a base amount for each student, with additional "weights" (i.e., percentage increases from the base amount) addressing variable student needs and resources (i.e., special academic needs, disability, English as a Second Language, etc.), to ensure the strong academic performance of all children;
3. Require charter schools to perform reconciliations at the end of each school year to return any overpayments to the sending school districts or collect any underpayments from the sending districts; and
4. Specify a limit on unreserved-undesignated general fund balances consistent with traditional public school limits, and require any excess fund balances to be returned to the paying school districts and to the taxpayers.

We also recommend that:

5. PDE conduct a study of charter school funding in other states with laws authorizing charter schools to identify other potential funding methods and revenue streams;
6. PDE strengthen its accounting and reporting procedures specific to charter school finances so that the public and policy makers can more precisely follow these taxpayer dollars ;
7. PDE increase publically available financial data specific to charter schools in order to provide the public and policy makers with reliable and accessible data to determine whether taxpayer dollars are being spent for their intended purpose; and
8. Sending school districts make timely tuition payments to charter schools to ensure charter schools are receiving public funding in the manner outlined in the Charter School Law and to minimize and/or eliminate the need to expend additional state resources through PDE intervention.

ISSUE 2

What are the specific problems with the Commonwealth's reimbursements to sending school districts? _____

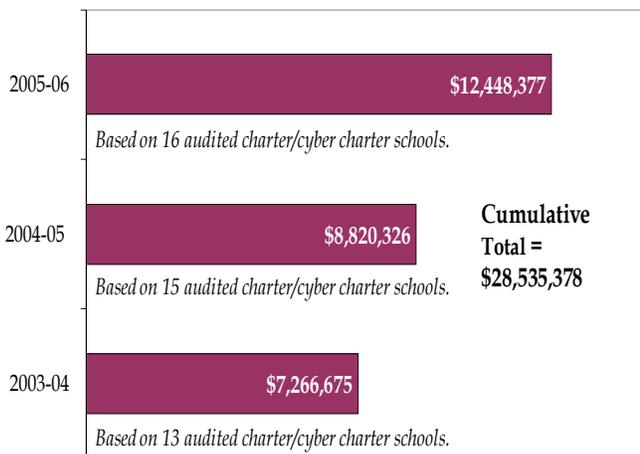
In Pennsylvania, taxpayer dollars are passed through local school districts in the form of tuition payments for students attending charter schools. During the audit period, we also identified discrepancies in the Commonwealth's reimbursements to sending school districts for up to 30 percent,

of their total charter school costs.²³ State law also allows some school districts that meet specific criteria, such as having charter school expenses that reach \$1 million, to receive a reimbursement of up to 32.45 or 41.96 percent of their charter school expenses.

This reimbursement addresses the fact that sending school districts lose money by paying charter school tuition, because they frequently cannot reduce costs when they lose students to a charter school. However, this subsidy is calculated using the flawed funding formula and has no relationship to the actual cost of educating the students at the charter school. Instead, both the funding formula and required state reimbursement are based on what it would cost to educate those same students if they remained at the district.

The Commonwealth, and ultimately the taxpayers, reimbursed the sending school districts for the 18 audited charter schools a total of \$28,535,378 during the 2005-06, 2004-05, and 2003-04 school years, as shown in Exhibit 9.²⁴

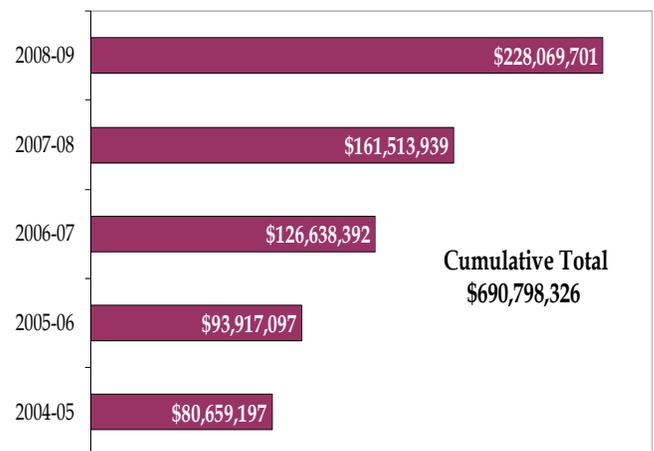
EXHIBIT 9
Commonwealth Reimbursement Totals Paid to Sending School Districts of the Audited Charter/Cyber Charter Schools By School Year



In addition, according to unaudited information from PDE, the Commonwealth,

and ultimately the taxpayers, reimbursed sending school districts a combined total of \$690,798,326 for their tuition payments made to charter schools over a five-year period, as shown in Exhibit 10.²⁵ This amount represents an increase of \$147 million, or 183 percent, in state taxpayer contributions to charter school funding. In 2008-09, state reimbursements for charter school education cost Pennsylvania taxpayers approximately \$3,122 per student, above and beyond their contributions to local school districts, resulting in a total of \$228 million in additional expenses.

EXHIBIT 10
Commonwealth Reimbursement Totals Paid to Sending School Districts of All Charter/Cyber Charter Schools By School Year



As demonstrated in Exhibits 9 and 10, the Commonwealth reimbursement totals paid to sending school districts continue to increase with each school year. This trend is expected to continue, particularly given the fact that the Public School Code has been amended to allow for state reimbursements up to 30 percent or 32.45 percent for the 2006-07 school year, and up to 30 percent or 41.96 percent for the 2007-08 school year, and each school year thereafter.

As previously mentioned, school districts must meet specific criteria regarding charter

school enrollment and expenditures in order to be eligible to receive the maximum reimbursement percentage. While only three sending school districts were eligible to receive the maximum 32.45 percent for the 2006-07 school year, five sending school districts received the maximum 41.96 percent for the 2007-08 and 2008-09 school years. Each of these districts had large numbers of students attending charter schools and charter school costs exceeding \$1 million. Consequently, the state's subsidy dedicated to reimbursing charter school costs has substantially increased over the years to keep pace with the increased state-mandated reimbursement rates and the growth of operating charter schools and charter school students. This trend is particularly true in areas where sending school districts have been eligible to receive the maximum reimbursement rates.

For example, the Philadelphia School District was eligible to receive the maximum reimbursement percentages of 32.45 and 41.96 for the 2006-07 and 2007-08 school years because almost 50 percent of the Commonwealth's charter schools are located in that district. Based on these rates, state reimbursements to the district for those two school years were over \$75 million and \$119 million, respectively. During the 2008-09 school year, the five districts (Carbondale Area School District, Chester Upland School District, Duquesne City School District, Philadelphia School District and York City School District) eligible to receive the maximum 41.96 percent reimbursement rate were paid \$137 million of the total \$228 million distributed among the 499 districts reporting costs for students attending a charter school.

These increased reimbursement amounts also require an increase to the education

appropriation in the Commonwealth's annual budget. In fact, the 2008-09 state budget included an education appropriation of \$226.9 million for reimbursements to sending school districts, an increase of 40 percent from what was appropriated in 2007-08. Consequently, state reimbursements for the 2007-08 school year, payable through the 2008-09 budget, were paid according to the maximum percentage rates of 30 percent or 41.96 percent set by the Public School Code, which represents the first time that the state reimbursement amounts were not reduced to a pro rata share because of insufficient funding. The same amount, \$226.9 million, was also appropriated in the 2009-10 state budget. However, the newly enacted 2010-11 state budget reduced the charter school reimbursement appropriation to \$224 million.

Therefore, the Commonwealth's spending on reimbursements to the sending school districts for their charter school costs have continued to rise. Yet, as previously mentioned, this subsidy is based on the flawed funding formula, which includes tuition payments that are not reconciled against actual costs at year-end. Like the funding formula itself, these state reimbursements have no relationship to the actual cost of charter school education. Consequently, Pennsylvania taxpayers cannot be certain that their money is being distributed appropriately and efficiently. In some cases, the state might be reimbursing a sending school district too much; in other instances, a sending school district may receive too little.

Because charter schools are public schools, the Commonwealth must support them with taxpayer dollars. However, the state

should use a funding scheme that is fair to both school districts and charter schools, and that does not place additional hardship on Pennsylvania taxpayers. Therefore, the basis for the current mandated charter school reimbursement should be evaluated to determine its efficiency and appropriateness, and alternative methods of charter school funding should be explored.

What action should be taken?_____

We recommend that the Governor and the Pennsylvania General Assembly, with leadership from PDE, and in consultation with the impacted charter schools and school districts, take the following actions to correct the disparities in the Commonwealth’s reimbursements to school districts’ for their charter school expenses:

- 9. In order to avoid using questionable factors as a basis for the sending district’s subsidy, analyze the state’s contributions to both charter school and school district funding. Then determine to what extent, if any, funding differences in state subsidies need to be corrected so that both educational bodies receive equitable funding for the education of the Commonwealth’s children;
- 10. Evaluate the basis for the school districts’ state reimbursement for their charter school costs, determine its efficiency and appropriateness in the Commonwealth’s annual budget, and ensure that it does not cost taxpayers an additional premium;
- 11. If the reimbursement is modified, also explore alternative methods of charter school funding that will not impair

Pennsylvania’s 500 school districts or place additional costs on Pennsylvania taxpayers above and beyond their contributions paid to local school districts; and

- 12. If the law is amended to require charter schools to perform a year end reconciliation of tuition payments against actual student costs, as suggested in Recommendation 3 in this report, the need for this state reimbursement subsidy could be substantially reduced or eliminated.

Endnotes:

¹ The charter/cyber schools reviewed were determined by our cyclical audit schedule and the years reviewed were based on audit evidence and payment verification from the Pennsylvania Department of Education, which is not available for audit until 16 months, or more, after the close of a school year.

² The Center for Education Reform, "The Accountability Report 2009: Charter Schools," February, 2009.

³ The charter funding formula is based on each school district's budgeted total expenditure per-pupil for the prior school year.

⁴ See 24 P.S. § 25-2591.1. Please note that this provision is contained in the general funding provisions of the Public School Code of 1949 and not in the Charter School Law.

⁵ Pennsylvania Department of Education, Division of Nonpublic, Private and Charter School Services, Bureau of Community & Student Services. (Information obtained February 11, 2010.)

⁶ Pennsylvania Department of Education, Division of Data Services, "Public School Enrollment Report," August 14, 2010.

⁷ The Center for Education Reform, "The Accountability Report 2009: Charter Schools," February, 2009.

⁸ See 24 P.S. § 17-1725-A.

⁹ See 24 P.S. § 25-2509.5(k).

¹⁰ See 24 P.S. § 17-1725-A(a)(5).

¹¹ See 24 P.S. § 25-2591.1.

¹² Rates according to Form PDE-363 filed by school districts with the Pennsylvania Department of Education.

¹³ Ibid.

¹⁴ Pennsylvania Department of Education, "Charter School Selected Expenditures, School Year 2009-10."

¹⁵ Pennsylvania Department of Education, "Manual of Accounting and Financial Reporting for PA Public Schools - Chart of Accounts," Revised July 1, 2008.

¹⁶ Pennsylvania Department of Education, "Annual Financial Information - General Fund Balance," updated September 12, 2008.

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ "Charter Schools Grow Stronger in Pennsylvania," *Pittsburgh Post-Gazette*, April 28, 2008.

²⁰ The Center for Education Reform, "The Accountability Report 2009: Charter Schools," February, 2009.

²¹ Ibid.

²² See 24 P.S. § 25-2561.

²³ See 24 P.S. § 25-2591.1, most recently amended through Act 45 of 2007, effective July 20, 2007, and again through Act 61 of 2008, retroactively effective July 1, 2008.

²⁴ See Section 2591.1(c.1)(1). Please note that for the audited school years 2005-06, 2004-05, and 2003-04, the mandatory percentage rate was 30 percent or a pro rata share of the funding appropriated for this subsidy in the state's annual budget. Due to insufficient funding available, the pro rata percentage rates during the audit period were 27.50 percent, 25.28 percent, and 27.65 percent respectively.

²⁵ Pennsylvania Department of Education, "Annual Financial Report - State Revenue," updated July 10, 2009.