

**LEGISLATIVE EDUCATION STUDY COMMITTEE
BILL ANALYSIS**

Bill Number: *HB 449

52nd Legislature, 1st Session, 2015

Tracking Number: .199346.2

Short Title: Charter School Fiscal Reporting

Sponsor(s): Representative W. Ken Martinez

Analyst: Ian Kleats

Date: February 27, 2015

Bill Summary:

Effective immediately upon signing by the Governor, HB 449 enacts a new section of the *Charter Schools Act* to require each charter school to submit annual fiscal performance reports to the Public Education Department (PED) and the charter school's chartering authority.

Among its other provisions, HB 449 requires that:

- each charter school submit an annual fiscal performance report to PED and the charter school's chartering authority for the preceding school year no later than August 1 of each year (see "Fiscal Issues," below);
- at a minimum, the annual fiscal performance report include in disaggregated form:
 - certain revenues from state, local, federal, and other sources; and
 - certain expenditures, including for debt service, capital outlay, and salaries and other expenses for certain specific activities;
- copies of the charter school's lease, rental agreement, or deed be included in the annual fiscal performance report (see "Technical Issues," below);
- PED develop a template for the annual fiscal performance report; and
- the annual fiscal performance report be made publicly available.

*HB 449 contains an emergency clause (see "Technical Issues," below).

Fiscal Impact:

HB 449 does not contain an appropriation.

Fiscal Issues:

According to current statute and regulation, charter schools are required to submit annual audits to the Office of the State Auditor (OSA) for review by November 15 each year as component units of either a local school district or the PED. Some of the information required in the fiscal performance report might not be available until the annual audit is completed. Requiring that the fiscal performance report be due prior to the finalization of the annual audit may necessitate additional expenditure by charter schools for accounting services, and the data in the fiscal performance report might not reflect final audited amounts.

Technical Issues:

On page 2, line 21, HB 449 includes “school lunch money” as an item to be included on the annual fiscal performance report. It is unclear what specifically that term might include, such as revenue from federal grants and student lunch fees, or expenditures on a school lunch program. The sponsor may wish to consider an amendment offering clarification of this item.

On page 4, lines 2-4, HB 449 requires that a copy of the charter school’s lease, rental agreement, or deed be included in the annual fiscal performance report. Charter schools may have leases, rental agreements, or deeds for multiple facilities, potentially used for either administrative or instructional purposes. Additionally, these documents or arrangements referenced might exist for real property other than facilities, such as vehicles or other goods. The sponsor may wish to consider an amendment that:

- requires copies of any and all leases, rental agreements, or deeds entered into by the charter school to be included in the report; and/or
- specifies the characteristics of property for which a copy of the lease, rental agreement, or deed shall be required.

It is unclear why the provisions of HB 449 include a declaration of an emergency. In the absence of an emergency declaration and without an effective date, HB 449 would become effective on June 19, 2015 if enacted, which would appear to still afford PED requisite time to create an annual fiscal performance report template, and charter schools would not have the necessary data to complete the report until after the close of the fiscal year anyway.

Substantive Issues:

The *Charter Schools Act* already requires that, in addition to other items, performance provisions of each charter contract contain indicators, measures, and metrics for financial performance and sustainability. Under current law, the form of those indicators, measures, or metrics is open to negotiation between the charter school and its chartering authority. Fiscal performance reports, as proposed in HB 449, could provide guidance to charter schools and chartering authorities on appropriate financial indicators, measures, and metrics to be included in these performance frameworks.

The bill analysis from the OSA raises the following issues:

- Potential for inconsistent information. The bill requires charter schools to submit to PED detailed financial information by August 1st of each year. This is months before the deadline for audits (October 30 for component units of school districts, November 1 for charter schools that are not component units, November 15 for component units of PED). The result of this dual requirement is that schools could produce inconsistent financial information, with the audit information being more accurate because of the audit process.
- Duplication of Efforts. Charter schools would duplicate efforts in the production of this report. Some of the disclosures that the bill requires are part of an audit, but the auditor would not rely on the report. Some of this information may also be included in year-end reporting to PED.

- Shortage of Resources. Charter schools already struggle with timely and accurate financial reporting. Adding another report to their workload may decrease the quality of all financial reporting.

Background:

2014 LESC Charter Schools Subcommittee

During the 2014 interim, the Legislative Education Study Committee (LESC) convened the LESC Charter Schools Subcommittee, comprising five senators and six representatives from the full committee. The LESC Charter Schools Subcommittee met each month from June to November and considered various issues related to charter school administration and finance, including charter school financial audits.

In response to a specific subcommittee request, the Chief of Staff, OSA, testified that, pursuant to several statutory, regulatory, and administrative provisions, all charter schools are subject to an annual audit. In addition, the audit rule requires that an independent public accountant evaluate whether a charter school is to be presented as a component unit – that is, a separate, financially accountable legal entity – of its chartering authority. Moreover, the Governmental Accounting Standards Board (GASB) requires that this determination be made on a case-by-case basis, using criteria related to financial accountability and fiscal dependency. GASB standards require that a financial audit cover the entire “financial reporting entity,” which includes the “primary government” (such as a school district) and organizations for which the primary government is financially accountable (such as a charter school). This testimony further explained that component units must be included with the audited financial statements of their authorizers.

In response to this testimony, subcommittee members expressed concern over the lack of uniformity regarding component unit status, discussed the responsibility and authority of the authorizers, and considered separating charter school audits from those of their authorizers.

Later in the interim, in response to another subcommittee request, the OSA surveyed several other states to find examples of charter school oversight and component unit reporting.¹ In brief, this survey revealed considerable variety in the practices among other states, depending upon such factors as the type of charter school, the statutory provisions for oversight, and the elements of the charter school contract. The OSA further advised the subcommittee to regard such factors as the availability of funding and other resources and provisions for oversight of charter school compliance when considering whether to require stand-alone audit reports for charter schools.

In related testimony, LESC staff summarized the risk review by the OSA of the Southwest Secondary Learning Center (SSLC) and the Southwest Aeronautics, Mathematics and Science Academy (SAMS), two state-chartered charter schools in Albuquerque. Among other points, as detailed in a letter from the OSA in August 2014, this examination noted:

- apparent violations of the *Procurement Code*;
- conflicts of interest arising from the schools’ head administrator co-owning the company, Southwest Educational Consultants, LLC, that leased both the aircraft and a building to the schools;

¹ The OSA posed a number of questions to the following states: Arizona, Hawaii, Michigan, Missouri, Nevada, Ohio, Oklahoma, Oregon, and Utah.

- lack of internal controls for the flight programs, including the inability to verify whether costs charged by contractors were reasonable and necessary;
- questionable governance arrangements in which the head administrator influenced the appointment of members of the governing council, who evaluate the head administrator; and
- improper or undocumented reimbursements for travel.

In response to these issues, subcommittee members considered certain policies, such as:

- ensuring that a charter authorizer has access to annual and special audit reports;
- providing the Public Education Commission with staff to conduct random internal audits of state-chartered charter schools;
- amending the *Charter Schools Act* to require public disclosure of conflicts of interest as required in the *Procurement Code*; and
- explicitly allowing financial sanctions against charter schools for unsatisfactory performance reviews.

Finally, during the 2015 legislative session, the LESC has endorsed SB 257, which amends the *Audit Act* to:

- include charter schools in the definition of agency;
- allow a component unit of a primary government entity to be audited separately from the primary government entity, at the component unit's discretion; and
- require the component unit to be included in the primary government's audit.

Committee Referrals:

HEC/HWMC

Related Bills:

CS/SB 8 *Charter School Education Tech Equipment*
 SB 148a *Charter School Responsibilities*
 SB 236 *Charter School Lease Approval*
 SB 257a *Charter Schools & Public Audit Changes*
 SB 273a *Charter School Governance*
 SB 418a *Charter School Governing Body Elections*
 *SB 429 *Charter School Fiscal Performance Reports (Identical)*
 CS/CS/HB 19 *Charter School Educational Tech Equipment*
 HB 74 *Public Education Commission as Independent*
 HB 166 *Charter School Transportation Agreements*
 HB 253a *Charter School Facility 4 Year Plans*
 HB 352 *Charter School Capital Outlay Assistance*