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State of New Mexico
OFFICE OF THE STATE AUDITOR

VIA EMAIL AND U.S. MAIL

August 25, 2017

Christopher Ruskowski
Secretary-designate
Public Education Department
300 Don Gaspar Ave.
Santa Fe, NM 87501

Re: Risk Review – Administrative Support of Charter Schools

Dear Secretary-designate Ruskowski:

In response to long-standing concerns with respect to the transparency and accountability of funding that state and local chartering authorities (“Chartering Authorities”)¹ withhold for administrative support of charter schools, the Office of the State Auditor (“OSA” or “Office”) performed a Risk Review (“Review”) to evaluate compliance with statutory requirements and determine whether the resources were being used for their intended purpose. The results of this Review are included herein.

I. Executive Summary

The Review found that the total dollar amounts being withheld for administrative support of charter schools by the Public Education Department (“PED”) and the school districts tested were consistent with NMSA 1978, Section 22-8B-13 (A) (2006). However, the procedures that Chartering Authorities used to track these monies to ensure the resources were being used for their intended purpose varied greatly. Over a five year period, total withholdings amounted to nearly \$20,000,000 with little ability to tie these funds to specific expenditures.

The widespread inadequacy of tracking appears to be due to three primary factors: (1) problematic guidance in the New Mexico Manual of Procedures for Public School Accounting and Budgeting (“PSAB”) directing districts to budget revenue from the two percent withholding as “Unrestricted Grants;” (2) a general lack of awareness and training at the district level of the legal framework pertaining to the use and accounting of these funds; and (3) failure to include a sufficiently “detailed” description of how the Chartering Authorities will use the two percent in the charter contract, as required by NMSA 1978, Section 22-8B-9(B)(8) (2011).

¹ While the Public Education Commission and local school boards authorize charter schools, PED and school districts provide support on behalf of the authorizers in administering charter contracts and providing oversight.

To address the shortfalls and the associated risks identified in this Review, the OSA calls on PED to revise PSAB budget guidance to reflect the legal restrictions placed on the use of these funds and provide uniform training to districts to strengthen the tracking of administrative support expenditures. Chartering Authorities and charter schools should also review all charter contracts to ensure they include a detailed description of the nature of the administrative support to be provided and take steps to ensure funds are being used for their intended purpose consistent with contracts.

II. Background

a. Concerns Raised

In 2006, as part of a comprehensive set of amendments to the 1999 Charter School Act, the Legislature provided that the PED and school districts “may withhold and use two percent of school-generated program cost for its administrative support of a charter school.” Section 22-8B-13(A).² While charter schools are run directly by their respective governing bodies, and are ultimately accountable for meeting educational standards and fiscal requirements, Chartering Authorities play a critical role in monitoring and supporting these schools. The two percent withholding provision is an important mechanism for PED and districts to help charter schools maintain sound financial practices that safeguard public funds.

Two Percent Withholding by Year (Source: LESC)

Year	# District Charters	District Chartered	# State Charters	State Chartered	# Total Charters	Total
2013	43	\$1,505,491	51	\$1,680,929	94	\$3,186,472
2014	41	\$1,474,783	54	\$1,936,187	95	\$3,411,024
2015	40	\$1,603,614	57	\$2,209,515	97	\$3,813,186
2016	37	\$1,419,197	62	\$2,590,864	99	\$4,010,123
2017	37	\$1,463,755	62	\$2,626,776	99	\$4,090,593
Total		\$7,466,842		\$11,044,273		\$18,511,401

However, since the enactment of the two percent withholding provision, basic but key questions regarding its implementation have gone unanswered. These questions include: Are withholding amounts correct? How specifically is the money being used? How are the funds being tracked and accounted for? Are the funds being used for their intended purpose or being diverted to other uses? What level of withholding adequately reflects the costs of providing administrative support to charter schools?

² The framework for withholding from state-chartered charter schools relies on potentially inconsistent statutory provisions. Section 22-8B-13(A) states that the PED Charter School Division “may” withhold two percent and Section 22-8-25(A) (Definition of State Equalization Guarantee) appears to stipulate that exactly two percent be withheld. Additionally, the provision stipulating how the amount withheld will be used, Section 22-8B-9(8), refers to how the “chartering authority” (PEC not PED) will use the two percent. The actual charter contract language also refers to how the “Authorizer” (PEC) will use the funds but notes that PED provides staff support to PEC in supporting its functions. It may be appropriate for the Legislature to clarify this framework.

In 2011, the Legislature enacted legislation, effective July 1, 2012, to enhance the accountability of charters and Chartering Authorities. This effort included a new requirement in state law that the contract between a chartering authority and a charter school provide a “detailed description of how the chartering authority will use the withheld two percent...” Section 22-8B-9(B)(8). All charter contracts entered into subsequent to the effective date of this act must include this information.

Unfortunately, uncertainties and a general lack of transparency regarding the use of the two percent have remained. In light of the overall increase in the number of charter schools in recent years, it is more important than ever to understand how this provision is being implemented in practice. The objective of this Review is not to answer all of the questions pertaining to this issue, but rather to highlight potential risk areas and provide recommendations to help policymakers, Chartering Authorities and charter schools improve practices in a manner that fosters greater accountability and informed decision-making.

b. *Methodology*

The Office required that the independent public accounting firms (“IPAs”) conducting the Fiscal Year 2016 financial audits for the PED and five school districts across the state to test compliance and gather information with respect to two percent withholding requirements contained in Section 22-8B-13 and Section 22-8B-9(B)(8). Since charter schools are authorized at the state and district levels, both state-chartered and locally-chartered schools were evaluated. District samples were judgmentally selected to obtain diversity with respect to geographic region, district size and the number of charters per district. The school districts encompassed in the Review include: Albuquerque Public Schools; Deming Public Schools; Gallup-McKinley County Public Schools; Santa Fe Public Schools; and Taos Municipal Schools. In forming its conclusions, the Office relied on the workpapers of IPAs as well as source documents.

III. Observations / Risks

a. *Accuracy of Amounts Withheld*

Based on the review of samples from both state-chartered and locally-chartered schools, it appears Chartering Authorities are withholding the correct amount of school-generated program costs from charter schools. This indicates that appropriate financial controls are in place to ensure withholdings are in alignment with the two percent threshold stipulated in Section 22-8B-13(A). Nonetheless, as a matter of general practice, auditors should continue to perform appropriate procedures to confirm the accuracy of withholding calculations.

b. *Administrative Support Detailed in Charter Contracts*

Effective July 1, 2012, all contracts between a chartering authority and a charter school must include a “detailed description” of how the chartering authority “will use” the withheld two percent administrative support of the charter school. Section 22-8B-9(B)(8).³ This requirement applies to both state and locally-chartered schools.

³ In addition to assistance stipulated in a charter contract, some districts and locally-authorized charter schools also enter into memoranda of understanding to provide a broad array of services at a negotiated price.

With regard to state-chartered schools, in general, contracts between the Public Education Commission (“PEC”) and charter schools include boilerplate contract language stating that the Authorizer will use the amount withheld for four primary purposes: (1) PED Charter School Division (“CSD”) salaries and benefits; (2) PEC expenditures, including travel, meals and per diem; (3) resources necessary for oversight, such as supplies, hardware, software and other CSD expenditures; and (4) resources from other PED bureaus working on charter school issues, such as special education, information technology, Title I, school and family support, student nutrition, and budget and finance.

However, not all of the ten state-chartered charter contracts sampled included the required language stating how the chartering authority will specifically use the amount withheld. For example, the current contract between the PEC and the Media Arts Collaborative Charter School has placeholder language “[insert the intended use of the 2%]” in lieu of the boilerplate provision indicated above. The contract does include language that the school “would like to request” that PED provide training for the board and teacher training in common core standards. While it appears that this language reflects a well-intentioned effort by the school to obtain support from PED that is tailored to its needs, it does not comply with the requirement in Section 22-8B-9 that the contract include how the Authorizer will actually use the two percent. The language simply reflects a “request” by the school and not an agreement that PED “will use” the two percent for these purposes.

With regard to locally-chartered schools, the degree of specificity included in the charter contracts varied widely among sampled districts. Furthermore, of the five districts sampled for Fiscal Year 2016, four had at least one noncompliant agreement. On one end of the spectrum, Gallup-McKinley County schools had no written contract in place stipulating how the funds will be used. For its charter school contracts, Albuquerque Public Schools utilizes boilerplate language stipulating broad administrative support categories. Other districts, such as Deming Public Schools, provide a greater level of detail of how the funds will be used. Additionally, as awareness of the contract requirement has risen during the last couple of years, the level of compliance appears to be increasing as charters are renewed with update language.

**“Detailed” Descriptions of How Local Chartering Authorities
Use the Two Percent Withholding (As Stipulated in Charter Contract(s))**

District	Description of Administrative Support to be Provided to Charter School(s)
Albuquerque Public Schools	Charter school division staff salaries and benefits; resources needed to accomplish necessary oversight, such as supplies, hardware, software and other work of the charter school office; expenditures of other departments that spend time on charter schools issues, including special education, technology, Title I and finance*
Deming Public Schools	Payroll services; administrative consultations, including but not limited to, legal issues, building maintenance and construction, staff professional development, document preparation, and administration of district services (transportation, special education, property, food service, technology)**
Gallup-McKinley County Public Schools	No written contract in place addressing two percent usage

Santa Fe Public Schools	PowerSchool software; use of licenses; special education support, including assigned specialist; transportation services; safety and security guidance; teacher training opportunities; testing support; and human resource assistance ***
Taos Municipal Schools	Staff salaries and benefits related to its oversight and technical assistance responsibilities; resources needed to accomplish oversight such as supplies, hardware, software****

* Albuquerque Public Schools utilizes template language detailing the nature of administrative support to be provided in contracts. The categories above reflect recent updates to the template that are included in all new and renewed contracts.

** Deming Public Schools did not have a contract with its charter school in place for FY2016 with the two percent provision but adopted one for FY2017, which was subsequently amended to provide additional details on the administrative support being provided.

*** Santa Fe Public Schools' only charter contract does not specifically list how the two-percent will be used but does discuss areas of general support to be provided by the Chartering Authority under the Organizational Framework.

****Taos Municipal Schools has three charters. The Anansi and Vista Grande charter schools renewed their charter contracts with the above description effective July 1, 2016 and July 1, 2017, respectively. The current charter contract for Taos Charter School lacks the required descriptive language (there is simply a statement that the School "requests" transportation and food service).

It is understandable that Chartering Authorities and charter schools may want to provide the maximum degree of flexibility in charter contracts for the types of administrative support that will be provided. Charter contracts can be for a period of up to five years and it is difficult to anticipate the exact nature of administrative support that may be necessary. However, the requirement to provide a "detailed description" of how the money will be used is also an important mechanism in establishing mutual expectations regarding support that will be provided and maintaining accountability regarding whether these services are actually being delivered. A charter contract serves as both an administrative and performance agreement that establishes each party's rights and obligations. Ambiguity regarding the legal and functional responsibilities under charter contracts increases the risk of disputes and possible litigation. It is important for all Chartering Authorities and charter schools to ensure that charter contracts include appropriately detailed descriptions of the support that will be supplied, whether the contract involves a new school or the renewal of an existing charter.

Additionally, consideration should be given to the actual needs of each charter school and contracts should be tailor support accordingly, especially with regards to state-chartered charter schools and districts with multiple charter schools that rely on boilerplate administrative support language. While there are many commonalities among charter schools with regard to their needs, each may have unique challenges. For example, the nature of the support that may be appropriate for a new school and one with well-established procedures may be somewhat different, and the type of assistance for a school with identified shortcomings (through audits or any other means) may also vary compared to a well-performing one.

Chartering Authorities and governing bodies of charter schools should keep apprised of the support being provided and adjust it as necessary. Routine reporting is a good mechanism for

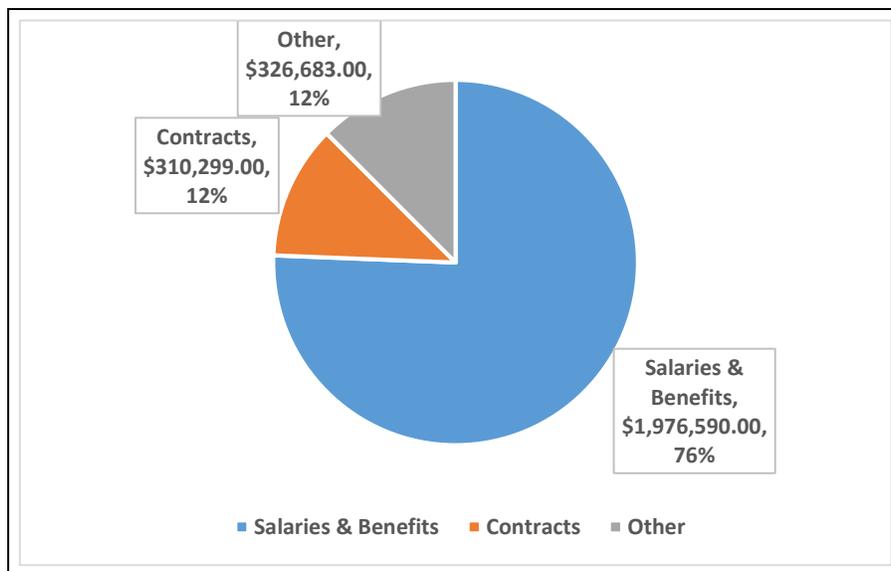
both Chartering Authorities and charter schools to monitor assistance and assess whether any changes to the contract or the level and nature of support are required. PED should also provide guidance and training on best practices regarding the level of detail that is appropriate for charter contracts in describing support to be provided.

c. Tracking of Expenditures

Each year, PED withholds the two percent from each state-chartered charter school. For Fiscal Year 2016, PED budgeted \$2,590,986 for administrative support based on the total amount withheld from the schools with actual expenditures amounting to \$2,613,503. It is our understanding that PED allocates the funds to cover 100 percent of the expenditures of the PED Charter School Division and PEC expenses. In addition, PED allocates 32.5 percent of expenditures of other divisions supporting charter schools toward administrative support. This ratio is based on the total number of districts and charter schools divided by the number of state-chartered charter schools.

Actual expenditures occur under the 200 (Salaries and Benefits), 300 (Contracts), and 400 (Other) budget categories. These costs may include personnel expenses, contracts, overhead costs (equipment rental, tech fees, property insurance, etc.) and PEC member expenses (mileage and pier diem, etc.). Based on sample testing of expenditures, it appears that PED is using the funds being withheld in accordance with the broad categories stipulated in the PEC-charter school contracts. However, since PED is using state-chartered charter school withholdings to cover the costs of the Charter School Division, which also is charged with assisting locally-charter schools, PED may be impermissibly using the withholdings of state-chartered charter schools to fund activities related to all charter schools.

FY16 PED Withholding Expenditures by Budget Category



With regard to districts, the nature of administrative support expenditures varied. However, funds were generally used to cover personnel costs related to charter school support,

partial software costs (such as STARS reporting) and other miscellaneous operational costs. With some exceptions, overall tracking of direct and indirect costs was lacking and there were not clear processes in place to allocate costs based on a set methodology (percentage of time / resources attributable to charter school support).

One factor that significantly limits the tracking of two percent expenditures is the guidance included in the New Mexico Manual of Procedures for Public School Accounting and Budgeting, or PSAB, which directs revenue from the withheld program costs to be budgeted by districts as “Unrestricted Grants” (Supplement 1 – Budget Planning, Preparation and Maintenance, last revised July 2011). As a result, the withheld funds are essentially treated as if they have no restrictions on their use. This guidance is contrary to the plain text of both Sections 22-8B-13(A) and 22-8B-9(B)(8).

First, while Section 22-8B-13(A) refers broadly to “administrative support,” the purpose of these funds is specifically limited to “support of a charter school.” Although actual expenditures may occur within various budget categories, it would be inappropriate to use these funds for expenditures not dedicated to supporting charter schools. Second, in accordance with Section 22-8B-9(B)(8), the use of the funds are further limited by the requirement that Chartering Authorities and charter schools enter into a contract that specifically details how the funds will be used. As such, the two percent withholding by districts would be more properly categorized as restricted revenue that requires tracking of how it is allocated.

PED should work to improve the process for budgeting and tracking of expenditures related to withholdings. This includes revising the PSAB guidance, adjusting the Uniform Chart of Accounts accordingly and providing appropriate training to districts. Currently, of the districts that are attempting to generally track these expenditures, many rely on Excel because there is not an account to post these expenditures to in the Uniform Chart of Accounts. The funds should be accounted for at a level that would enable Chartering Authorities and charter schools to tie the budgeted funds to actual expenditures. Additionally, since administrative costs incurred by PED and districts may be both direct and indirect, the allocation of costs should be based on a sound methodology developed in advance and publicly available.

Failure to strengthen the tracking of these funds significantly increases the risk that these resources will be diverted for other purposes, hampers accountability, and contributes to the inability of policymakers to make informed decisions regarding the sufficiency and effectiveness of the support being provided. Furthermore, to obtain an appropriate level of transparency and accountability, these funds should be tracked as a matter of routine practice and not require auditors to collect the information on an ad hoc basis at the request of the OSA.

d. *Sufficiency of Withholding Amount*

Due to the shortfalls discussed above with respect to the tracking and reporting of expenditures related to administrative support of charter schools, it is difficult to determine whether the two-percent withholding adequately covers the costs associated with administrative support. It is also unclear if the Legislature intended the existing withholding threshold to cover all, or a portion of, the costs incurred. In general, Chartering Authorities indicate that the overall resources being applied to assist charter schools exceeds the amount of funds withheld each year

for administrative support (direct and indirect costs). However, even assuming this is correct, it does not mean that the support being provided is in a manner or at a level that matches the needs of the charter schools. It also does not mean that the overall resources being provided to charter schools are inadequate. As noted in the Legislative Finance Committee's January 18, 2016, report on charter schools, although charter schools serve approximately seven percent of the student population throughout the state they received 46 percent of the funding increases over a seven-year period.

Considering the continued growth in the number of charter schools throughout the state, it is important for Chartering Authorities to fully understand the fiscal and resource implications of authorizing new charters and supporting existing schools. Millions of dollars each year are being utilized by PED and districts across the state for "administrative support" of charter schools, but there has not been any comprehensive evaluation of whether these funds are being allocated in an efficient and effective manner.

State law requires that the PED Charter School Division submit an annual report to the governor, Legislative Finance Committee and Legislative Education Study Committee regarding charter schools which assesses the "sufficiency of funding for charter schools, the efficacy of the state formula for chartering authority funding and any suggested changes to state law or policy necessary to strengthen the state's charter schools." NMSA 1978, Section 22-8B-17-1 (2011). While a report of this nature could highlight important challenges and opportunities involving charter school financing as well as evaluate the current level of administrative support being provided, it is OSA's understanding that PED has not issued any such report since 2014.

Other states vary greatly with respect to withholding ranges and the breakdown of the amount of money retained by an authorizer and/or district. However, best practices dictate that, regardless of the amount withheld and by whom, there should be public transparency and accountability with respect to its use. Many states require reports to be provided directly to charter schools detailing the support provided each year. PED and the Legislature should consider enhancing accountability by requiring Chartering Authorities to report directly to charter schools on how these funds are being used. This could also be implemented by Chartering Authorities on a voluntary basis. PED should also comply with the existing annual reporting requirement under Section 22-8B-17-1 to enable the governor and legislative bodies to make more informed decisions.

IV. Conclusion

Charter schools are primarily responsible for their own operations (Section 22-8B-4(C)). However, Chartering Authorities play an important role in ensuring appropriate oversight and support to help maintain compliance with applicable laws, rules and contract provisions (Section 22-8B-5.3; Section 22-8B-9; Section 22-8B-3). A strong collaborative effort is required to ensure charter schools have the support necessary to succeed in meeting the educational needs of students and to maintain sound financial practices that safeguard public funds. Resources should be sufficient to maintain an appropriate level of oversight and support in a manner that does not drain the resources of Chartering Authorities that are required for other important purposes.

If these resources are not tracked and accounted for at the appropriate level of detail, it is difficult for policymakers to make informed decisions about whether the current withholding level reflects the costs of providing administrative support to charter schools. It also makes it challenging to identify if these resources are being diverted to other uses.

We appreciate your attention to these issues and my office stands ready to assist PED in your efforts to address the matters detailed above. Please do not hesitate to contact the Office should you have any questions.

Sincerely,

A handwritten signature in black ink that reads "Timothy M. Keller". The signature is fluid and cursive, with a long horizontal line extending to the right.

Timothy M. Keller
State Auditor

cc: Members of the Public Education Commission
The Honorable Mimi Stewart, Chair, LESC
The Honorable Stephanie Garcia Richard, Vice-Chair, LESC
The Honorable Patricia Lundstrom, Chair, LFC
The Honorable John Arthur Smith, Vice-Chair, LFC
Rachel Gudgel, Director, LESC
David Abbey, Director, LFC
Paul Aguilar, Deputy Secretary, PED
Kelley Callahan and Greta Roskom, Co-Executive Directors, New Mexico Coalition of
Charter Schools
Joe Guillen, Executive Director, New Mexico School Boards Association
Stan Rounds, Executive Director, New Mexico Superintendents' Association