

Date: August 26, 2017

Prepared By: Force

Purpose: Review the use of the 2-percent SEG withholding for charter school support.

Witness: Sunalei Stewart, Chief of Staff, Office of the State Auditor

Expected Outcome: Understanding of the background of the discussion surrounding charter school authorizers' use of the 2-percent set-aside for charter school support.

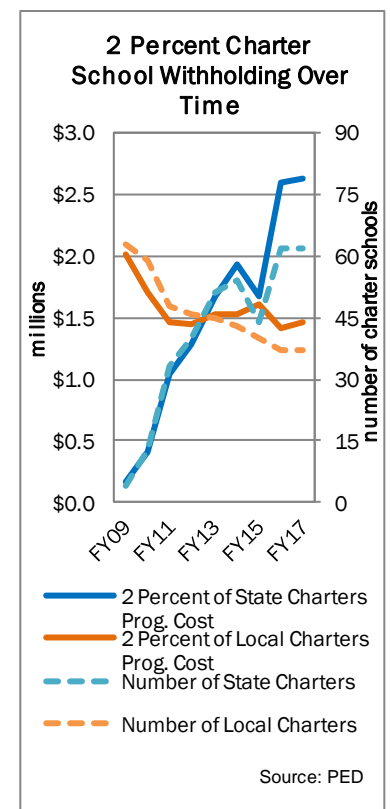
State Auditor Review of Charter School Authorizers' Use of the Charter School 2-Percent SEG Set-Aside

At the Legislative Education Study Committee's (LESC) July 2017 hearing, Sunalei Stewart, Chief of Staff of the Office of the State Auditor (OSA), presented OSA's audit of the Public Education Department (PED) to LESC, noting that state-chartered charter schools were included as a result of their status as PED component units. During the discussion following his presentation, Mr. Stewart noted that the use of the 2-percent withholding is an issue of importance to OSA, and indicated the OSA was unaware of any detailed accounting, at either PED or the district level, of how these funds are being used. Mr. Stewart noted OSA would conduct a sample audit during the recent audit cycle to try to determine the exact use of these funds. Issues of concern included whether PED and local school districts are withholding the correct amounts, how they are using and tracking the withholding, whether the 2-percent withholding is being segregated for purposes of oversight, and whether these funds are being diverted through budget adjustment requests for non-charter-school-related purposes, and what amount of withholding truly reflects the cost of administratively supporting charter schools.

Background

A subject of much concern over the past seven years has been how the 2 percent withheld from charter school-generated program cost is used. Conflicting language in statute raises questions regarding which entity is entitled to state-chartered charter schools' 2-percent withholding, what constitutes "administrative services" or "administrative support," and whether the eligible entity should be required to demonstrate how the 2-percent withholding from a specific charter school is used to support that charter school.

The amount of money that is withheld from charter schools has been steadily growing both because of charter school growth and increases in the unit value. In the 2008-2009 school year, the Public Education Commission (PEC) authorized the first four state-chartered charter schools, which generated close to \$159 thousand in 2-percent withholdings for PED. In the 2016-2017 school year, PED withheld close to \$2.6 million from 62 state-chartered charter schools, while local school districts withheld approximately \$1.4 million for support of 37 locally authorized charter schools.



Statutory Provisions and Conflicts. The distribution and use of the 2 percent of school-generated program costs withheld by authorizers is a matter of law, yet several provisions of the Public School Code create confusion as to how precisely it is to be used. The statutes also confuse which entity is entitled to use those dollars in the instance of state-chartered charter schools, given the bifurcated duties of PED and PEC with respect to the authorization and oversight of state-chartered charter schools. Both the Public School Finance Act and the Charter Schools Act include provisions allowing reduction of a state-chartered charter school’s program costs by 2 percent for administrative services or administrative support. Subsection A of Section 22-8-25 NMSA 1978 of the Public School Finance Act states:

“The difference between the state-chartered charter school’s program cost and the two percent withheld by the [Public Education Department] for administrative services.”

Section 22-8B-13 NMSA 1978 of the Charter Schools Act states,

“The school district or [Charter Schools Division] may withhold and use two percent of the school-generated program cost for its administrative support of a charter school.”

Both of these provisions appear to declare PED as the entity entitled to withhold the 2 percent from state-chartered charter schools. However, in 2011, amendments were made to the Charter Schools Act that required performance contracts between authorizers and charter schools. Due to concerns about the use of the 2-percent withholding, the new provisions required a detailed description of how the chartering authority would use the 2-percent withholding. These provisions create confusion as to which entity – PED or PEC – is entitled to use the 2-percent withholding. Specifically, Paragraph 9 of Subsection B of Section 22-8B-9 NMSA 1978 states:

“The charter contract shall include ... a detailed description of how the chartering authority will use the withheld two percent of the school-generated program cost as provided in Section 22-8B-13 NMSA 1978.”

The performance contracts required by this 2011 amendment to the Charter School Act must include “a detailed description” of how the chartering authority will use the 2-percent withholding. On their website, PED offers a template to guide charter schools in authoring their performance contract. Subsection A of Section 4.02 of the template inserts direct language from statute, stating:

“The amount of funding allocated to the School shall not be less than the ninety-eight percent of the school-generated program costs for its administrative support of the School. The Authorizer shall use the two percent fee for the following purposes...”

In the case of state-chartered charter schools, “the Authorizer” is defined as the PEC. Since the Charter Schools Act describes these performance contracts as a relationship between state-chartered charter schools and the PEC, the contract

does not legally bind PED to disclose how the funds are used, or even use them for their intended purpose. While PED staff indicate this is boilerplate language, it is vague, raising questions about its compliance with the statutory requirement to “include a detailed description” of how the withholding will be used, and about whether salaries, supplies, and travel expenditures, particularly for PED staff in other divisions than the Options for Parents Division, referred to as the “Charter Schools Division” (CSD), constitute true “administrative support.”

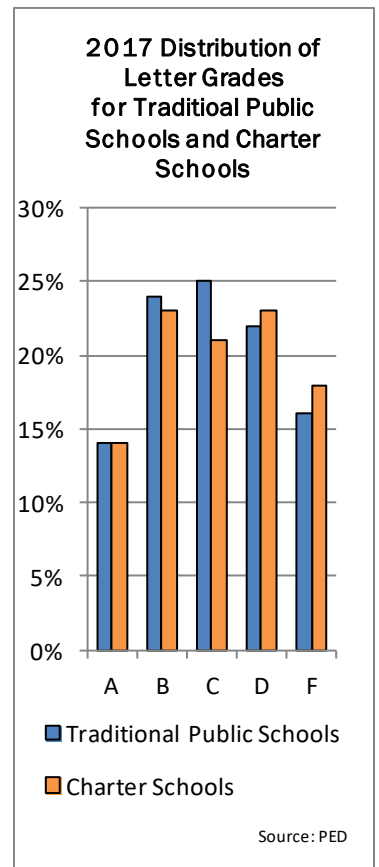
PED Use of the 2-percent Withholding for State-Chartered Charter Schools. This requirement that the withholding be used for “administrative services” or “administrative support” implies the money is withheld from the state-chartered charter schools to serve them. It is unclear if PED is actually using the entire amount to support state-chartered charter schools. For example, in FY13, PED withheld approximately \$1.6 million from state-chartered charter schools, but according to Legislative Finance Committee documents, PED reverted approximately \$294 thousand, or 18 percent of the total withholding, and spent approximately \$370 thousand, or 23 percent on expenses not directly related to charter school oversight. Given recent history of state-chartered charter schools being closed for concerns including academic performance, fiscal mismanagement, and governance issues, PED may want to consider focusing use of the withholding on more targeted support of specific state-chartered charter schools, rather than used as a general source of departmental support for all state-chartered charter schools.

In previous years, PED would include a listing of each specific position budgeted with other state funds (OSF) in its budget submission. PED has two sources of OSF – educator licensure fees and the 2-percent withholding. From FY09 to FY14, it was easy for staff to identify which positions were budgeted with educator licensure fees (generally, licensure bureau staff) and which positions were budgeted with the 2-percent withholding (all other staff). However, with the FY15 budget request submission, positions funded with 2-percent withholding were included with positions funded from general fund revenue (rather than OSF), limiting the transparency of how the department is specifically budgeting positions with the 2-percent withholding. At this time, it is unclear why the 2-percent withholding has not been properly accounted for in PED’s budget request submissions.

According to PED, funding from the 2-percent withholding is used to pay for PEC operations, including eight PED staff, generally CSD, who provide information to the commission, conduct school evaluations and site visits, and provide technical assistance and training to charter schools. However, PED further indicates many of its other departments and divisions also support charter schools with work related to their particular areas that may affect all schools in the state, including state-chartered charter schools. This accounting of the use of the withholding, however, falls short of the detailed description required of authorizers in Section 22-8B-9 NMSA 1978; moreover, as a result of PED withholding the 2 percent, rather than the actual authorizer, PEC is unable to offer a detailed description of the uses to which the 2 percent is applied by the chartering authority, “as provided in Section 22-8B-13.” Further, as PED is not the authorizer of state-chartered charter

A portion of the \$370 thousand not directly spent on charter school support in FY13 was spent on a statewide information technology disaster recovery plan. It is unclear how the rest of those withholdings were spent. While the funds were spent on a project that arguably benefits all schools in the state, it cannot be said that they specifically and directly support charter schools.

In FY17, PED submitted a budget adjustment request, asking that \$63 thousand of the charter 2 percent be transferred from the “other services” category to the “contractual services” category to support PED’s charter summer conference held in June 2017. While this transfer can be more directly linked to charter school support than the FY13 disaster recovery plan, it cannot be directly linked to any charter schools in particular.



schools, they appear to be under no statutory obligation to provide this description, leaving the requirements of Section 22-8B-9 NMSA 1978 unfulfilled with regard to state-chartered charter schools. This lack is emphasized by the section's reference to Section 22-8B-13, which notes that "funding allocated to a charter school" shall be "ninety-eight percent of the school-generated program cost. The school district or division may withhold and use two percent of the school-generated program cost for its administrative support of a charter school." The repeated use of the article "a" in this section suggests that authorizers should be using funds withheld from a particular school for the support of that particular school, yet PED has been unable to demonstrate how these funds are tracked and used in this manner.

History

The use of the 2-percent withholding has been of concern to LESC and the Legislature for some time; of particular interest has been the relationship between PED and PEC, as well as their respective roles with regard to state-chartered charter schools. In November 2012, after one of the PEC's chartering decisions was reversed by the Secretary, which was upheld by the district court, PEC requested its own funding for dedicated staff, including independent legal representation. PEC cannot independently carry out its authorizing duties like local school districts, and they are reliant on PED staff. Further, currently, PEC is advised by representation from the Attorney General's office, but only with respect to conducting Commission business under the Open Meetings Act; any other need for legal representation requires retention of a private attorney, for which PEC has no budget.

Conclusion

While the Legislature has considered granting a portion of the 2-percent withheld by PED for support of state-chartered charter schools to the PEC, to date nothing has been enacted. Further, there have been few attempts to directly and specifically target the use and distribution of, or the party responsible for, the 2-percent withholding in statute. For example, in the recent 2017 Legislative Session, Senate Bill 193 (SB193) proposed to transfer 25 percent of the total withholding to PEC, which in FY17 was approximately \$2.6 million, yielding approximately \$670 thousand for PEC.

Current statute, current practice, and legislative history make the appropriate use of the 2-percent set-aside from the state equalization guarantee difficult to discern. Statute is unclear with regard to the party responsible for the withholding, and current practice yields no detailed accounting of how the funds are utilized. Without greater clarity over how the withholding is to be employed and by whom, this confusion exacerbates the already murky issues surrounding the authorization and oversight of state-chartered charter schools.

In 2010, PEC denied the request of three locally chartered charter schools to become state-chartered charter schools, based on the recommendations of CSD, which noted failure to meet educational standards as one reason for denial. All three schools appealed to the Secretary, who reversed the PEC decisions. After reviewing evidence and hearing the arguments on both sides, the Secretary found PEC's decision was "arbitrary or capricious, not supported by substantial evidence, and made contrary to law..." The Secretary reversed the decision of the PEC, contrary to the recommendations of her own staff. Problematic in the Secretary's decision is the appearance of conflict - the PEC does not have its own staff and must rely on CSD staff, who advise PEC whether to accept or reject a charter school based on their interpretation of statutory provisions and examination of relevant data. The CSD's position as staff to both PEC and the Secretary implies a conflict of interest.