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FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
CSIS California School Information Services

Fiscal Alert
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Charter Schools and the Anderson Decision

Background

On January 18, 2017, the California Supreme Court denied a review of the Third District of Appeal (Third District) decision in *Anderson Union High School District v. Shasta Secondary Home School* (2016) 4 Cal. App. 5^{th} 262 (Anderson). The Third District's decision became law on that date.

The court held that the geographic restrictions in Education Code Sections 47605(a) and 47605.1(d) apply to nonclassroom-based charter schools that operate resource centers within the county in which they were authorized but outside the boundaries of their sponsoring district (absent other exceptions provided in the Education Code).

In response to this decision, the State Board of Education (SBE) established limited-purpose waivers to existing charter schools "operating noncompliant resource centers to minimize disruption to students and the educational program," and to allow time to establish transition plans.

Waiver conditions are set forth in State Board of Education Policy 17-01 and will, for this purpose, expire June 30, 2018. During the waiver period, each noncompliant charter school's governing board is required to approve a transition plan that details how the charter school's resource center(s) will come into compliance, provide an update to parents and, within 30 days after the SBE approves the waiver, submit the plan to the charter's authorizer and to all school districts where the original charter school resource centers are located.

As charter schools develop and implement their transition plans, a number of questions arise about how best to approach the division of assets and deal with other issues associated with the establishment of new charters in place of resource centers. (This fiscal alert is not intended to address the practice of charter schools "swapping" resource centers with other charters in adjacent counties.)

It is not uncommon for charter schools to close and reopen under a different authorizer, or in some cases under the same authorizer but serving new or expanding grade levels. Charters that close a resource center and are successful in petitioning to open a new charter school in place of that resource center will be faced with all of the normal new charter startup opportunities and challenges.

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Relevant Issues

1. **Division of Assets**

   Charters that are public benefit nonprofit corporations, or that are a component of a charter management organization that is a public benefit nonprofit corporation, may divide the original charter school's assets and reserves and transfer appropriate values to the new charter school assuming there are no limitations or prohibition of such in the existing corporation's bylaws or articles of incorporation. If a resource center is closed and then reopened as a new charter school, the California Education Code provisions on distribution of assets on closure [Section 47605(b)(5)(O)] are not applicable, as the existing charter isn't closing. If the existing charter school doesn't own the resource center, then caution needs to be exercised about an assignment of the lease, which typically requires lessor's consent.

   Capital assets include property, buildings and equipment. Other assets include cash holdings, prepaid expenses, inventory, and accounts receivable. The division of such assets should be based on the governing board's determination and resolution established using any reasonable and measurable methodology determined by the charter/nonprofit governing board.

   For example, distribution methods may be based upon student enrollment, location and use of capital assets, previous commitments and plans, and valuation of assets. The decision making process should be open and clearly documented, and the financial entries should be detailed and easily traceable in the records of each organization involved.

2. **Division of Liabilities**

   The division of liabilities between the original charter school that operated one or more resource centers and multiple new charter schools should follow the same principles as the division of assets.

   Current liabilities include accounts payable, accrued payroll and other tax obligations, accrued CalSTRS and CalPERS obligations, and short-term cash advances. Long-term liabilities include lease agreements, other contracts and agreements, revolving loans, and lines of credit. Obligations created by legal settlements should also be included. Long-term liabilities tied to capital assets usually should be transferred with the asset. The decision making process should be open and clearly documented, and the financial entries should be detailed and easily traceable in the records of each organization involved.

3. **Startup Considerations**

New charter schools are often not eligible for certain appropriations in their first year of operation, or in some cases certain appropriations are delayed until the second operational year. These may include the following:

- One-time discretionary funds, mandated cost funds, and any other new initiative based on prior-year enrollment or average daily attendance (ADA).
- Lottery funding is based on current year annual ADA. However, because initial lottery funding is based on prior year annual ADA, startup charter schools will not receive funding allocations for the first and second year until the second operational year.
- To be considered for federal Every Student Succeeds Act (ESSA) funding, charter schools must submit their Consolidated Application and Reporting System (CARS) by June 30, 2018. Submittals after this date restrict any obligations against grant funds until the SBE approves the new county-district-school (CDS) code and the CARS has been submitted to the CDE.
- Most other federal entitlement program funding is delayed by one year.
- Allocations of special education funding distributed through Special Education Local Plan Areas (SELPAs) to member districts and charter schools vary. If a charter school is a school of the authorizer for special education purposes, the funding allocations for special needs students will depend on the agreement between the authorizer and the charter.
- The Public Charter School Grant Program distributes awards to eligible charter schools based on a reimbursement funding model. Program allocations are distributed quarterly following approval of the Grant Award Notification (GAN). A charter school's first expenditure report will include expenditures from the date of the GAN to the end of the quarter, with funding to follow in approximately 10 weeks.
- Advance state apportionment funding for new (including newly formed) and significantly expanding charter schools is based on the first 20 days of actual attendance. To receive advance funding, these charters must submit their Pupil Estimates for New or Significantly Expanding Charters (PENSEC) in July of the first operational year to receive 20-day Special Advance Apportionment.

4. **Nonprofit Public Benefit Corporation 501(c)(3) Considerations:**

- Although most new charter schools established to replace existing resource centers are likely to be charter schools under a pre-existing nonprofit organization, it is possible that some new charter schools could be organized under a new nonprofit organization.

- If the pre-existing nonprofit organization establishes the new charter school:
    - One federal taxpayer identification number for the nonprofit parent organization is used for all the charter schools within the organization.
    - Charter schools under a single nonprofit are consolidated, meaning the nonprofit organization and all charters are one organization for financial reporting purposes.
    - All charter schools' independent financial audits are consolidated with that of the nonprofit organization.
    - Assets and liabilities of the charter schools belong to the nonprofit corporation.
- Governing board decisions for the nonprofit apply to the charter school(s), including the transfer of any or all assets and liabilities.
- The transfer of assets and liabilities could occur over time rather than all at once. A plan to transfer assets and liabilities in installments may be justified based on the timeline to transfer students to the new charter over time.
- All aspects of the transition should be documented in detail and approved through formal governing board resolution.

5. Other Considerations

- Education Protection Account (EPA) – New charter schools receive the minimum $200 per ADA as a permanent allocation. Although this does not change the total amount of Local Control Funding Formula (LCFF) revenue for most schools, it will have a positive effect on cash flow because it means a school receives more funding monthly through state aid and less funding quarterly through EPA.
- If applicable, LCFF funding protections, including Economic Recovery Target (ERT) and Minimum State Aid (MSA), may be lost.
- After School Education and Safety Program (ASES grant) – Charters can work with the CDE to transfer remaining eligibility to a new CDS code if the transition is within the grant period. The application period for 2018-19 has passed.
- SB 740 – Most charter schools affected by the Anderson decision will not be eligible for SB 740 funding unless the new school is classroom-based. A newly operational classroom-based charter schools may be eligible in its first operational year if it meets the free and reduced-price meal (FRPM) eligibility requirements based on current year data and completes a new funding determination request. To be eligible, new charter schools must submit their 20-Day Attendance Report in October to the California School Finance Authority's SB 740 program. The calculation for eligibility will estimate the school's current year ADA based

on 90% of the school's enrollment reported in the Charter School 20-Day Attendance Report.

- Changes in a nonprofit's name may require reconsideration of its status by the Internal Revenue Service and reissuance of a determination of the nonprofit's eligibility for child nutrition funding through Child Nutrition Information and Payment System (CNIPS). The name of the nonprofit must match the name issued in conjunction with the new CDS code issued by the CDE. This process takes six to eight months to complete, which delays eligibility and payment for students under the federal food programs.
- For special education, each SELPA may have different timelines and processes for notification of a change in services and service levels. As a local education agency, a new charter school must provide each of its students with a free appropriate public education (FAPE), including special education and related services, from the beginning. Each existing special needs student who enrolls in a new charter school must be provided the services outlined in their Individualized Education Program (IEP) until the IEP is modified. If a resource center is closed and a new charter school is established in its place, then the student would disenroll in the original charter school and re-enroll in the new charter school. Such a transition would constitute a change in placement for a special needs student.
- CALPADS – students must be exited in the 2017-18 fiscal year and re-entered into CALPADS at their new school (with the new CDS code) for 2018-19.

This fiscal alert does not constitute legal advice. Charter schools and their authorizing LEAs should seek their own legal advice and consult with their independent auditors. Information and instructions about establishing charter schools can be found at CDE's main charter school page at: https://www.cde.ca.gov/sp/cs/.