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# Nonclassroom-Based Charter Schools in California and the Impact of SB 740

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## Summary

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Schools that provide nonclassroom-based instruction have represented a rapidly proliferating segment of schools within the charter school movement in California over the past decade. Nonclassroom-based schools differ from traditional schools in that they deliver instruction outside the confines of the classroom setting. Nonclassroom-based instruction encompasses homeschooling and various forms of independent study, including computer-based instruction using software modules and teacher-directed distance learning. Nonclassroom-based schools tend to serve somewhat different students from those found in other schools—that is, students seeking personalized instruction and a pace tailored to their needs.

The potential for the misuse of public funds has been high in nonclassroom-based charter schools, however, due to the nature of the instruction they provide. They use facilities and teachers in a different manner from other types of schools and may have lower cost structures. Therefore, disproportionate amounts of public per-pupil revenues may end up in the hands of school administrators in these schools. In October 2001, the California legislature passed SB 740 to strengthen the oversight of nonclassroom-based schools and implement cutbacks in state funding for schools failing to meet specified spending standards. At this point in time, the SB 740 funding determination process has been implemented for three consecutive school years and has entered its fourth year. Despite evidence of success in combating profiteering, the first three years of implementation have been turbulent. Although funding cuts have been phased in gradually over time, the process has created confusion, and the administrative burden placed on nonclass-

room-based schools has been significant. In addition, concerns have arisen that the process may have resulted in fiscal instability, an inefficient allocation of resources, and a reduction in innovation.

In April 2003, the California LAO commissioned a team of RAND researchers to perform an evaluation of the SB 740 oversight process and its impact on nonclassroom-based charter schools. The evaluation addressed five broad questions:

- What does the SB 740 funding determination process entail?
- Has the process fulfilled the directives of the legislation?
- What has been the impact of the SB 740 funding determination process on operations and instruction in nonclassroom-based schools?
- Does the process provide appropriate and effective oversight?
- How can the SB 740 funding determination process be improved?

We addressed these questions through a research design strategy that included interviews with stakeholders involved in the SB 740 process, analyses of state funding data, and analyses of data from surveys of nonclassroom-based charter school principals and teachers.

## Findings

This evaluation produced the following findings with regard to our research questions.

**What does the process entail?** In Chapter Three we describe the SB 740 funding determination process in detail—both the way it has evolved over time and the way it currently works.

The process entails the collection of financial data from charter schools offering significant amounts of nonclassroom-based instruction and the determination of funding through the use of a fairly straightforward mechanism—the meeting of thresholds. SB 740 requires that nonclassroom-based charter schools meet three main criteria to receive full funding: (1) at least 80 percent of total revenues must be spent on

instruction, (2) at least 50 percent of public revenues must be spent on certificated-staff salaries and benefits, and (3) the pupil-teacher ratio must be equal to or lower than the pupil-teacher ratio in the largest school district in the county or counties in which the school operates. A school that fails to meet these criteria may receive substantial cuts in its funding. Nearly half the nonclassroom-based charter schools in the state have experienced funding cuts as a result of SB 740. While the funding determination process is simple in concept, this process, as we discuss below, might not be meeting the public-accountability needs envisioned.

**Has the process fulfilled the directives of the legislation?** The process has fulfilled many of the explicit directives of the legislation.

The process was intended to reduce the possible profiteering of charter school operators offering nonclassroom-based instruction. Our analysis indicates that profits (as measured by revenues minus expenditures) for nonclassroom-based schools had turned into losses by the third year of the SB 740 process; thus it is reasonable to assume that profiteering has been reduced.

In addition, in an effort to meet thresholds for full funding, nonclassroom-based charters have substantially increased both instructional spending and spending on certificated-staff salaries as a proportion of revenues. Schools have shown only a slight reduction, however, in pupil-teacher ratios. In examining funding determination data provided by the state, we found that nonclassroom-based schools had made several adaptive responses to SB 740 and that the proportion of schools receiving full funding increased over time.

Thus, we conclude that along several fiscal dimensions, the impact of SB 740 has been significant and largely in accordance with the explicit goals of the legislation. Other evidence, however, as described below, indicates that the process could be improved.

**What has been the impact of the process of SB 740 on operations and instruction?** Our analysis cannot determine causality, but indicates that the implementation of the process might be associated with both positive and negative effects on operations and instruction.

On the positive side, in addition to increased spending on instruction and evidence of reduced profiteering, the fiscal transparency

imposed by the SB 740 funding determination process has prompted schools to increase their attention to resource allocation and, in some cases, become self-regulating in their requests for per-pupil funding.

On the negative side, the first three years of implementation of SB 740 have been turbulent. Although funding cuts have been phased in gradually over time, the process has created confusion, and the administrative burden placed on nonclassroom-based schools has been significant. In addition, concerns have arisen that the process may have resulted in fiscal instability, an inefficient allocation of resources, and a reduction in innovation. The losses posted by nonclassroom-based charters by the third year of the SB 740 process also raise concerns that the changes schools are making in order to receive full funding, or the funding cuts themselves, are placing some schools in fiscal jeopardy.

Furthermore, although there is general agreement among stakeholders that instructional spending should consume a large proportion of revenues, the impact of the instructional-spending threshold may not have been entirely positive in past years due to its failure to incorporate the cost of facilities adequately into instructional costs. The strain on facilities reported by principals, teachers, and other stakeholders may have had an adverse impact on instruction. This issue has largely been resolved for future cycles, however, with the recent introduction of a new facilities formula to be applied to instructional spending in the 2004–2005 school year’s funding determinations. Thus, with the resolution of the facilities issue, the relevance of this SB 740 requirement to educational quality is no longer being questioned.

Finally, our analysis of the surveys of nonclassroom-based principals resulted in other interesting findings, which we did not classify as positive or negative but are relevant to this discussion. For instance, a majority of principals reported increases in nonclassroom-based instruction and the percentage of budget invested in technology since the implementation of SB 740 began. These findings suggest that nonclassroom-based approaches to instruction had not been curtailed by SB 740 and that technological innovation had still been possible notwithstanding.

**Has the process provided appropriate and effective oversight?**

We found evidence that some aspects of the SB 740 funding determination process were not appropriate or effective.



The fiscal thresholds were established using assumed spending patterns of public schools generally. The use of these fiscal thresholds assumes that public schools have the correct allocation of instructional and certificated spending. Using financial data submitted by nonclassroom-based charter schools in compliance with SB 740 and state data on school district spending patterns, we compared the proportion of nonclassroom-based and traditional school districts meeting these thresholds and found that almost all traditional public school districts met the instructional-expenditure threshold, but a substantial proportion of school districts did not meet the certificated-staff threshold. In fact, a higher proportion of nonclassroom-based schools met this threshold by the third year than traditional public school districts did when the criteria were established. This finding raises questions about the development of the certificated-staff salary threshold.

We also examined whether SB 740 has increased instructional exposure for students. Although we found that the process has increased the proportion of expenditures spent on certificated staff and instructional activities, we found almost no correlation between the growth in these expenditures and the number of certificated teachers and pupil-teacher ratios within the schools, suggesting that the certificated-staff requirement may have led more to increases in compensation for existing teachers than increases in the number of staff. This hypothesis was supported by data from our survey in which a majority of nonclassroom-based school principals reported that in the three years since SB 740 came into effect, teacher salaries had increased beyond the cost of living. In addition, in our survey of nonclassroom-based teachers, the numbers of students teachers supervised or instructed and the amount of time they spent per student did not correlate significantly with the school-level measure of the percentage of total school public revenues spent on certificated salaries.

Finally, in the survey of nonclassroom-based school principals, principals suggested that the burden of compliance with SB 740 had been high and that this was disproportionately the case for small schools. In addition, principals reported finding it difficult to create and implement a sound fiscal plan as a result of the process.

From the above we conclude that while the process has provided oversight, this oversight might be having deleterious effects, and that some factors used in the oversight process are not adding significantly to the public accountability, while significantly burdening schools. Thus, despite the financial savings to the state and adaptations on the part of nonclassroom-based charter schools to the requirements of SB 740, the success of the legislation as a mechanism for improving education for California students is unclear. In this study, we present evidence that some inefficiencies, unfavorable budgetary trends, and changes in operations may have occurred as a result of SB 740 and that its wide net may have caught many genuinely purposeful schools as well as the few schools in need of correction.

**How can the process be improved?** Our analysis and interviews indicate several ways in which the process could be improved.

Underlying the logic behind SB 740 are two questionable assumptions. One is that schools delivering substantial amounts of nonclassroom-based instruction have—or should have—a lower cost structure, and the other is that the resources needed to deliver this type of instruction can successfully be gauged by fixed percentages of revenues. There are problems with both of these assumptions.

First, instruction in nonclassroom-based schools may be less costly given the different educational technology that they employ. On the other hand, they may serve a population of difficult students who thus may be more costly to educate. Since nonclassroom-based charters often serve students at the highest and lowest ends of the achievement spectrum, it may be the case that their instructional technologies require as much or more funding than those used in traditional classroom settings.

Second, no consensus has been reached at either the state or the national level regarding the appropriate amount of resources needed to ensure an adequate or superior education in traditional classroom settings. It is as yet difficult to assert that a defensible relationship exists between specific allocations of resources and student outcomes. Our analyses showed that nonclassroom-based charter schools were in some cases held to a standard that many conventional public schools did not meet. These findings suggest that the state should step back and gain a more thorough and evidence-based perspective on the types of relation-

ships it would like to promote throughout the system. More study is needed to determine the appropriate cost of educating students, particularly students of different types. It is therefore problematic to assume that a fixed percentage of the funding that flows to classroom-based students may be adequate to educate a nonclassroom-based student. Nonclassroom-based students may be better served by policies that encourage their schools to invest in innovative, high-quality instruction tailored to their needs than by policies that result in shrinking the resources available to them.

SB 740 has sent a strong and important message to nonclassroom-based schools that they must be careful regarding the ways in which they use resources or face strong sanctions. It is appropriate, however, to reshape the regulations to fit a newly acquired understanding of how these schools operate within the context of all public education and to serve the needs of students more effectively.

## Recommendations

Based on our findings, we recommend the following:

1. The state should continue to collect financial data from nonclassroom-based charter schools, but the process should be streamlined, simplified, and clarified to reduce the burden on schools, particularly small schools. The state should establish consistent guidelines for independent audits, and simplified, standardized accounting systems for small schools should be established in the near future to improve the ease and verification of reporting. Cross-referencing of other types of accounting reports and SB 740 forms should be clear, direct, and possibly automated.
2. The timing of the SB 740 funding determinations should be changed to occur earlier in the school year. Schools need greater certainty regarding funding decisions in order to allocate resources effectively.
3. The state should move away from a process that automatically cuts funding as a result of failure to meet a criterion threshold. Non-

classroom-based charter schools should be presumed to deserve full funding unless there are convincing signals that these schools should receive lesser amounts. A more appropriate mechanism would be to gather reasonable data across schools and to use these data in a deliberative, analytic process to determine which schools might need further oversight. In other words, the state should refine the set of indicators used in the SB 740 process to assess fiscal and overall performance and redefine them as signals that warrant investigation and possible audit rather than as criteria for implementing funding cuts.

4. It is beyond the bounds of this report to determine which indicators should be used. The state should consider the possibility of developing a set of benchmarks for nonclassroom-based charters that could be used to identify charters that are well outside the bounds of “normal” operation and might be deemed as needing further investigation. Benchmarks, such as the 80 percent instructional-spending threshold (amended by the new formula to include facilities costs) or a statewide pupil-teacher ratio threshold, should be established with respect to these indicators. The ratio of 50 percent of revenues spent on certificated salaries should not be included as an indicator, however, given that it has not been effective as a means of increasing the numbers or percentages of certificated teachers in nonclassroom-based schools. Student characteristics—such as the proportion and type of students with special needs or the proportion of at-risk students—should be taken into account when assessing a school’s performance against benchmarks. There may be many reasonable causes for deviations from benchmarks. High pupil-teacher ratios, for example, might be acceptable in a school that supplies a high-quality distance-learning program. Low scholastic performance might signal the need for a closer look at instruction in a school, for example, but since this may be due to a student body with large proportions of at-risk students, schools in this situation should be fully supported and encouraged to invest in effective learning strategies rather than sanctioned.

SB 740 has produced some positive outcomes. It has helped curb abuses of the public trust and has increased the fiscal accountability of nonclassroom-based schools. It has increased the proportion of revenues devoted to instruction in these schools. These positive outcomes have come at a cost, however. The administrative burden placed on schools and on the state authorities has been considerable, and the link between some of SB 740's requirements and instructional quality has been weak.

Despite the difficulties that these schools have encountered as a result of the SB 740 process, the demand for nonclassroom-based instruction has remained strong in the state. Given that this type of instruction serves the needs of certain populations of students who may not be as well served in traditional classroom-based settings, it is advisable to reform SB 740 with a cost-effective process that oversees quality while better reflecting the nature of instruction in nonclassroom-based schools.