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# Introduction

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**I**n 1991, Minnesota became the first state to authorize charter schools as an option within its public education system. Charter schools are publicly funded, nonsectarian schools formed by parents, teachers, or community members. Each charter school is governed by a board of directors, the members of which are elected by students' parents and the schools' staff. Within certain legal guidelines, the board governs the school's mission, education program, and administration. Every charter school also must have a sponsor, such as a school district or college, that is supposed to oversee the school's academic and fiscal performance.

While charter schools are often perceived to be largely free from state control, Minnesota's regulation of charter schools has increased in recent years, particularly in the area of financial management. Spurred by several incidences of charter schools closing amid allegations of financial mismanagement and conflicts of interest, the Legislature changed the law in 2001 to make charter schools follow the same financial accountability and audit requirements as school districts. Along with sponsors, Minnesota's Department of Education (MDE)<sup>1</sup> is responsible for overseeing charter schools.

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In April 2002, the Legislative Audit Commission directed the Office of the Legislative Auditor to evaluate charter school financial management. We started our evaluation in February 2003 after completing other projects that the Commission had requested. Legislators were interested in current information on the extent of financial problems at charter schools, the reasons for them, and the sufficiency of oversight provided by MDE and sponsors. Legislators also had questions about the state's program for reimbursing charter school building lease expenses. In addition to providing background information on Minnesota's charter schools, our review addressed the following questions:

- **To what extent have Minnesota charter schools experienced financial difficulties?**
- **What are the underlying causes of any financial problems, and how have charter schools responded?**
- **How effectively have the state and sponsors monitored charter school financial management and helped schools avoid or rectify financial difficulties?**
- **Is the lease-aid program an effective way to help charter schools obtain school facilities?**

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<sup>1</sup> Minnesota's education agency had been named the Department of Children, Families, and Learning. The 2003 Legislature changed the department's name to the Minnesota Department of Education, effective May 2003. We refer to the agency under its new name throughout the text of the report. However, we use the Department of Children, Families, and Learning in footnotes and table notes when we cite source documents published prior to the name change.

To assess charter schools' financial status, we analyzed financial and student data reported to MDE for fiscal years 2000 through 2002. To identify charter schools in financial difficulty, we developed selection criteria, based primarily on the extent of deficit spending and year-end fund balances. Applied to fiscal year 2002 financial data, 16 of 68 charter schools met our criteria. Two of the schools had closed by the time we started our review, so our in-depth work focused on the remaining 14 charter schools.

To understand the circumstances contributing to financial difficulties, efforts to improve their financial status, and the roles sponsors and MDE played in resolving problems, we interviewed school directors, school board chairs, and sponsor representatives for each of the 14 charter schools in the financial difficulty group. We also reviewed annual reports, financial audit reports, sponsor evaluations, and other documents. In addition, we asked MDE staff and others to identify several charter schools that have demonstrated strong financial management practices, and we interviewed administrators at these schools.

To assess the extent to which MDE and sponsors monitor charter schools' financial status and help charter schools resolve financial problems, we relied on interviews with charter school administrators, MDE staff, and sponsor representatives. Our work with sponsors focused on the 11 organizations that sponsored the 14 schools we reviewed in depth. In total, these 11 organizations sponsored about half of the charter schools open in fiscal year 2002. In addition, we reviewed the law; MDE policies, training materials, and staffing data; and various documents related to charter school sponsorship.

To evaluate lease aid, we interviewed MDE staff about the lease aid program and analyzed data collected by MDE on lease terms and lease aid revenue for schools operating in fiscal year 2003. To determine the reasonableness of lease expenditures, we compared charter schools' rates to rates that the State of Minnesota pays for leased office space. We also included questions about facilities and lease aid in our interviews with charter school administrators and board chairpersons. Finally, we interviewed officials from 14 additional charter schools to learn more about their facilities and leases.

We focused our work on charter schools that met our criteria indicating financial difficulty. But because we selected schools based on numerical indicators, we may have missed charter schools with poor financial management practices if their fiscal year 2002 financial data did not meet our criteria. Still, we believe that the issues we identified at the 14 selected schools would likely apply to other troubled charter schools as well. We did not audit or otherwise review charter school financial records in detail.

The report is divided into three chapters. In Chapter 1, we present data on charter school openings and closures, and we describe the process for starting a charter school, financial accountability requirements, and oversight mechanisms. In Chapter 2, we address the extent of charter schools' financial problems, how problems have been addressed, and the sufficiency of MDE and sponsors' oversight and assistance. In Chapter 3, we discuss how charter schools have used state lease aid.