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SCHOOL DISTRICT

Ops/Finance Working Group

October 28, 2014

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Recap: objectives

Determine a method to assess and allocate an operator fee for ASD authorizer and LEA services

Set principles for the ASD and operators around the overall fee level and accountability

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A few considerations / definitions

We identified 2 ways to allocate costs

- Allocate costs to activities and activity costs to operators based on estimates of actual use that drive cost for the ASD – e.g., per IEP, per hearing, etc.
- "Flat" fee – lump sum costs assessed per pupil or per school

We identified 4 types of costs

- "Startup" costs – incurred in year 0 or 1 of a new school (e.g., school matching process)
- Costs that do not vary significantly across schools / operators[1]

"Authorizer" costs

- Costs that do vary according to school / operator usage[2]
  - These are primarily in finance and student services

"LEA" costs

- Overhead costs – internal costs of operating the ASD as an organization (e.g., HR, accounting) that could be spread proportionally across activities

Cost allocation is not the only important objective – we also want to set principles around the overall fee level, cost transparency, and the process for evaluating and adjusting the fee going forward

1. Or even if they do, are so small as not to be worth tracking, or are too unpredictable
2. Independent of consideration of any "optional" services, even "required" services can vary in usage

Potential operator fee options

Option 1:
Flat fee model

1a: Full ASD costs allocated per pupil or per school

1b: Startup costs extracted and assessed as a year 0 fee per school; remaining costs assessed per pupil or per school

Option 2:
Hybrid driver-based model

2a: Costs that are both <u>meaningful</u> and <u>vary by operator</u> allocated by drivers; remaining costs assessed per pupil or per school

2b: Same as 2a, but with year 0 startup fee described in 1b

Subgroup recommendation

Option 2b: Driver-based allocation where appropriate and applicable with separate year 0 startup fee; most ASD costs assessed via flat fee

- Initial analysis suggests differences in fee based on usage could be meaningful (~4.7 ADM worth of BEP or almost 1 FTE)
- Can only pursue this <u>if</u> meaningful and valid cost drivers can be identified

Scaling the fee overall (I)

ASD needs to be able to adjust to circumstances and do its work

- Operators are responsible for helping to fund that

But total ASD operating cost needs to be predictable and stable

- Operators are on a somewhat "fixed income" and cannot see the fee grow as much as it has in the past 14 months
  - $2.5M in summer of 2013 (per Bridgespan) to $4M+ now, per ASD
- If the need and scale generate a number beyond operator capacity, the remainder needs to be covered by state or private funding

ASD should find economies of scale – and pass those savings on to operators

- ASD should retain some managerial flexibility to reallocate funds internally
- But if ASD reduces activities, or can do the same activities cheaper per-pupil by reaching scale, those savings should be passed on to operators by reducing the fee

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Scaling the fee overall (II)

ASD costs in operator fee	Assumed enrollment				
	10,000	**12,500**	**15,000**	**17,500**	**20,000**
$2M	2.50%	2.00%	1.67%	1.43%	1.25%
$2.5M	3.13%	2.50%	2.08%	1.79%	1.56%
$3M	3.75%	3.00%	**2.50%**	2.14%	1.88%
$3.5M	4.38%	3.50%	2.92%	2.50%	2.19%
$4M	5.00%	4.00%	3.33%	2.86%	2.50%
$4.5M	5.63%	4.50%	3.75%	3.21%	2.81%

Fee as a % of BEP

- Assumes $4M total go-forward operating cost at scale…
- …with only $3M included in fee…
  - ~$500k charged as year 0 startup fees / app fees; $500k in state or private funds
- …divided over a scale of 15,000 students

→ **2.5% average fee**

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Some considerations

What incentives do we create with this fee? What does a flat fee structure incent? What does charging by cost drivers (e.g., per IEP) incent?

What is the appropriate cost driver and allocation method for “fixed” or “flat fee” costs (per pupil or per school)?

How should the authorizer scale services and costs (i.e., how should the fee change if the ASD passes its target enrollment)?

Should individual operators have a cap on absolute contributions to the fee?

Through what formal mechanisms should operators provide input into the ASD budget and the fee? (These are also accountability mechanisms)

What are the implications of adding an application fee for those seeking authorization to the ASD?

Should the ASD offer optional services?

Should federal funds be included?

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Scaling the fee <u>by operator stage of growth</u>

The "flat" portion of the fee should be scaled or tiered by operator size

- 2.5% seems right on average BUT makes less sense at the two ends
  - Inadequate for the real costs of small operators (100 students x $8K x 2.5% = just $20K)
  - Too much for the largest operators (2,000 student CMO = $400K, far exceeding actual LEA cost)

We rejected the alternative of charging per school

- In reality, a fair amount of ASD's services do vary more by school than by pupil
  - e.g., SPR visits a similar number of classrooms in large vs. small school
- BUT apportioning flat fee by school = *much* higher *implied per-pupil fees* for small schools. This seems worth avoiding, to the extent that small schools are worth incenting by the ASD because of the perceived culture value

Recommend further study of scaled apportionment of flat fee

- ASD should study this by projecting distribution of operator size in the future
- Suggested options:
  - Keep 2.5% but with a minimum & maximum overall contribution
  - Charge a slightly higher or lower % fee with cut points (e.g. 2% over *xx* ADM or 3% under *yy* ADM)

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More about the proposed Year 0 fee structure

Year 0 startup costs are relatively easy to identify and could be allocated 1) to operators who are ultimately matched with a school and/or 2) as part of an increased application fee

- Operators could pay their Year 0 fee all in that year, or over a payment plan
- ASD would add a contingency % to protect it from the small # of schools that don’t match

Benefits of the Year 0 fee:

- If partially rolled into application fee, could discourage lower quality applicants
- Year 0 / startup costs are easier to convert into fundraising asks than ongoing overhead fees
- Lowers the ongoing fee as a % of BEP; creates savings for operators not growing
- Disincents ASD from carrying extra overhead; encourages varying costs based on need for projected growth

Alternative option is lumping these into the flat, scaled portion of the fee

- Would make sense to the extent that growth is “for the good for the LEA” (a reasonable but slippery slope)

Other notes

All aspects of the fee should be fully itemized and transparent, broken out by activity as much as possible

OAC should review the ASD's activities and costs annually and re-evaluate the average fee level every 2-3 years (with ability to recommend changes)

Fee should include contingency so ASD can make in-game adjustments

Fee should have a "lock-in period" and designated windows for adjustment or true-up, for predictability

- e.g., set for year with midyear and EOY adjustment

LEA and operators jointly responsible for limiting scope + fee creep

- LEA must beware the "self-fulfilling prophecy" that operators can or will not do X, after which the ASD holds back more funds and control to do X, which undermines operators' ability or interest to do X
- Operators must take responsibility for their role in the joint enterprise and avoid free-riding, which increases the perceived need for the ASD to do more
- Operators ASD hold each other accountable through feedback on work performance

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Backup: Driver-based cost model scenario

ASD dept.	Cost ($k)	Estimated "variable" component[1]	Avg. variable cost per operator ($k)	Potential variance (in $k and ADM)
Communications	271			
Finance	893	50%	22	+/- 11 (1.4)
Operations	941			
Portfolio	2,128	50%	53	+/- 26 (3.3)
Superintendent	369			
Total	**4,604**		**75**	**+/- 38 (4.7)**

1. Based on analysis of ASD org chart and service list; includes an estimated 10% overhead rate across the ASD for internal operations (HR, accounting, etc.) 2. Assumes 20 operators 3. Assumes a maximum of 50% variance across operators

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Discussion - Allocation

1. Strategic plan connection: work from the actual costs of doing business. So, need to know where the ship is heading and what happens on the ship en route.
2. Which risks can/should be borne by individual operators, and which can't and should be borne by all?
3. Floor and ceiling to be explored.
4. High performing operators – is the reduced support significant enough (e.g., one FTE) to differentiate?

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Recap: Objectives

Determine a method to assess and allocate an operator fee for ASD authorizer and LEA services

Set principles for the ASD and operators around the overall fee level and accountability

Guiding Questions

1) **What mechanisms / information should an ASD operator fee include to promote transparency and comfort?**

2) **What information should operators have to determine whether the ASD is a good steward of their funds?**

3) **What accountability mechanisms are actually realistic (at least in Year 1)?**

Required Basic Information

If the ASD were to charge an operator fee, it should – at a minimum – provide its operators with the following basic information:

A. List of concrete services provided (with timing when possible)

   I. Ex: Portfolio pays to host required SPR led by SchoolWorks

   II. Ex: Finance will submit monthly federal funding reimbursements to the State

   III. Ex: What necessary information will all ASD functions provide to operators and on what dates will this happen?

B. Budget

   I. Next slide

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Required Basic Information – Budget

If the ASD were to charge an operator fee, it should – at a minimum – provide its operators with the following basic information:

B. Budget

I. *At inception of Operator Fee*:

   a. Historical audited financials by function and whole organization
   b. Historical FTE head counts by function, # of ASD schools & ASD enrollment
   c. Organizational Chart
   d. Projected (3-year) financials by function and whole organization
      i. Split between salaries / benefits and operational expenses
   e. Projected (3-yr) head counts by function, # of ASD schools & ASD enrollment

II. *On an ongoing basis*

   a. Year-end budget-to-actual financials by function and whole organization
   b. Projected (3-yr) financials by function and whole organization
      i. Split between salaries / benefits and operational expenses
   c. Organizational chart
   d. Projected (3-yr) head counts by function, # of ASD schools & ASD enrollment

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Information to Determine Good Stewardship

If the ASD were to charge an operator fee, it should adhere to the following guidelines that promote good stewardship of funds:

A. For potential / new operators:

I. Estimate of start-up costs and ongoing operating costs specific to the ASD (e.g., SPED) that will be the responsibility of the operator – This will mitigate any confusion about what a fee would cover and provide for better budging

II. ASD strategic plan – How will operator revenue fund ASD goals?

III. Fee structure visibility – The ASD should commit to calculating and publishing its operator fee 2 years in advance

B. For all operators

I. Fee structure visibility – The ASD should commit to calculating and publishing its operator fee (with a minimal +/- %?) 2 years in advance

II. If/when the ASD implements an operator fee, it should commit to this fee increasing no more than [0.25]% between Years 0-2

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Additional Accountability Questions

If the ASD implements an Operator Fee, operators will be funding a substantial portion of the ASD's budget. Given this situation, should any additional accountability mechanisms exist for operators to hold the ASD accountable?

Discussion - Accountability

1. Two year lock-in for predictability.
2. Two or three year strategic planning and projections.
3. Annual report for ASD to include fee reporting.
4. OAC vetting and recommendation following review.
5. What pressure currently exists to rein in ASD operating budget, and what accountability mechanisms might do the same?