



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

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

Policymakers have been concerned over the potential misuse of public funds in NCB charter schools 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 could end up in the hands of school administrators in these schools. In October 2001, the California legislature passed Senate Bill 740 (SB 740) to strengthen the oversight of nonclassroom-based schools and implement cutbacks in state funding for schools failing to meet specified spending standards. As of late 2004, the SB 740 funding determination process had been implemented for three consecutive school years.

In April 2003, the California Legislative Analyst’s Office commissioned a team of RAND researchers to perform an evaluation of the SB 740 oversight process and its impact on NCB charter schools. The evaluation addressed five broad questions:

- What does the SB 740 funding determination process entail?

## Abstract

California Senate Bill 740 was passed to strengthen the oversight of nonclassroom-based (NCB) schools and implement funding cutbacks for schools that failed to meet spending standards. Since the bill was passed, NCB schools have increased both instructional spending and spending on certificated staff salaries as a proportion of revenues. The fiscal transparency imposed by the SB 740 funding determination process has prompted schools to increase their attention to resource allocation, but the process has placed a significant administrative burden on NCB schools. SB 740 should be reformed to provide a cost-effective process that oversees quality while better reflecting the nature of NCB instruction.

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

To address these questions, the study team used 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 NCB charter school principals and teachers.

## Findings

**What Does the Process Entail?** SB 740 requires that NCB charter schools meet three main criteria

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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 can 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.

#### **Has the Process Fulfilled the Directives of the Legislation?**

The process was intended to reduce the possible misuse of funds on the part of charter school operators offering nonclassroom-based instruction. The analysis indicated that profits (as measured by revenues over expenditures) for NCB charter schools had turned into losses by the third year of the SB 740 process.

In addition, in an effort to meet thresholds for full funding, NCB 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. Nonclassroom-based schools appear to have made several adaptive responses to SB 740, and the proportion of schools receiving full funding has increased over time.

**What Has Been the Impact of the SB 740 Process on Operations and Instruction?** The analysis indicated that the implementation of the process may 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 profits, 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, to 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 has placed a significant administrative burden on NCB schools. 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 NCB charter schools by the third year of the SB 740 process also raise concerns that the changes these schools are making in order to receive full funding, or the funding cuts themselves, may be placing some schools in fiscal jeopardy.

Furthermore, the instructional spending threshold may have had a harmful impact on finances due to the failure to adequately incorporate the cost of facilities into instructional costs, as evidenced by the strain on facilities reported by principals, teachers, and other stakeholders. 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 funding determinations for the 2004–2005 school year.

**Has the Process Provided Appropriate and Effective Oversight?** The study found 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. The study 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 NCB 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.

The study also found that although the process has increased the proportion of expenditures spent on certificated staff and instructional activities, there was almost no correlation between the growth in these expenditures and the number of certificated teachers or pupil-teacher ratios within the schools. This suggests that the certificated staff requirement may have led to increases in compensation for existing teachers rather than to increases in the number of staff desired by policymakers. In addition, neither the numbers of students supervised or instructed per teacher nor the amount of time teachers spent on average per student were significantly correlated with the percentage of school 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. Principals reported finding it difficult to create and implement a sound fiscal plan as a result of the process.

Thus, while the process has provided oversight, this oversight may be having deleterious effects, and some factors used in the oversight process may place a considerable burden on schools while not adding significantly to public accountability.

**How Can the Process Be Improved?** Improving the process requires reexamining two questionable assumptions underlying SB 740: (a) schools delivering substantial amounts of NCB instruction have—or should have—a lower cost structure; (b) resources needed to deliver this type of instruction can successfully be gauged by a fixed percentage of revenues.

First, instruction in nonclassroom-based schools may be less costly given the different educational technology that they employ. On the other hand, they might serve a population of students who could be more costly to educate. Because NCB charter schools often serve students on the highest and lowest ends of the achievement spectrum, their instructional technologies may require as much or more funding than that 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. More study is needed to determine the appropriate cost of educating students, particularly students of different types. Nonclassroom-based students might be better served by policies that encourage their schools to invest in innovative, high-quality instruction tailored to their needs rather than by policies that result in shrinking the resources available to them.

## Recommendations

- The state should continue to collect financial data from non-classroom-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 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.
- The timing of the SB 740 funding determinations should be changed so that they occur earlier in the school year. Schools need greater certainty regarding funding decisions in order to allocate resources effectively.
- The state should consider moving away from a process that automatically cuts funding as a result of failure to meet a criterion threshold. The state could 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.
- The state should consider the possibility of developing a set of benchmarks for NCB charter schools 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. Student characteristics should be taken into account when assessing a school’s performance against benchmarks.

SB 740 has produced some positive outcomes. It has helped ensure that abuses of the public trust are reduced, has increased the fiscal accountability of NCB schools, and has increased the proportion of revenues devoted to instruction in these schools. However, these positive outcomes have come at a cost. 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. 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. ■

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This research brief describes work done for RAND Education documented in *Nonclassroom-Based Charter Schools in California and the Impact of SB 740* by Cassandra Guarino, Ron Zimmer, Cathy Krop, and Derrick Chau, MG-323-EDU (available at <http://www.rand.org/publications/MG/MG323/>), 2005, 123 pages, \$20, ISBN: 0-8330-3753-6. MG-323 is also available from RAND Distribution Services (phone: 310.451.7002; toll free: 877.584.8642; or email: [order@rand.org](mailto:order@rand.org)). The RAND Corporation is a nonprofit research organization providing objective analysis and effective solutions that address the challenges facing the public and private sectors around the world. RAND's publications do not necessarily reflect the opinions of its research clients and sponsors. **RAND**® is a registered trademark.

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