



Education Report: **Setting financial performance measures for charter schools**

To:	Hon David Seymour, Associate Minister of Education		
Cc:	Hon Erica Stanford, Minister of Education		
Date:	7 June 2024	Priority:	Medium
Security Level:	In-Confidence	METIS No:	1330264
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Seen by the Communications Team:	No	Round Robin:	No

Purpose of Report

This report seeks your decisions regarding financial performance measures and the related reporting requirements to be included in the Performance Management Framework. These decisions will support the development of template contracts.

Alignment with Government priorities

The Coalition Agreement between the National party and the ACT party committed to reintroducing partnership schools and introducing a policy to allow state schools to become partnership schools. The charter schools Performance Management Framework is a key component of the charter school model.

Summary

1. The Performance Management Framework (the Framework) is intended to enable intervention when charter schools are not performing well, while also supporting high-performing charter schools to grow and share good practice. The Framework covers three key performance management areas: student outcomes (including attendance and achievement), financial performance and standard minimum compliance.
2. This paper provides you with advice on financial performance measures and reporting requirements for charter schools to be included as part of the broader performance management framework. These decisions will inform the development of the Framework and template contracts to be provided as part of the sponsor application process.

Recommended Actions

The Ministry of Education recommends you:

Financial performance measures

- a. **agree** that the following financial performance measures be included in the Performance Management Framework:
- i. Operating surplus Agree / Disagree
 - ii. Working capital ratio Agree / Disagree
 - iii. Debt/equity ratio Agree / Disagree
 - iv. Operating cash Agree / Disagree
 - v. Enrolment variance Agree / Disagree
- b. **agree** that to assure financial probity, contracts may also require:
- i. that charter school sponsors specify the expected use of funds through financial plans and forecasts. Agree / Disagree
 - ii. that charter school sponsors must notify when any source of anticipated funding on which the ongoing viability of the sponsor or schools is dependent will not be available either in the expected amount or time. Agree / Disagree
 - iii. that charter school sponsors must notify when they have failed to pay any debt from borrowed money, or when they reasonably anticipate it will fail to pay this debt in future. Agree / Disagree
 - iv. all contractual obligations be discharged before profit or dividends can be used at the sponsors discretion. Agree / Disagree
 - v. charter school sponsors must apply an appropriate policy for sensitive expenditure. Agree / Disagree
- c. **note** that we will provide you with further advice on setting performance standards for the above measures based on your preferences identified in recommendation a and b above.

Noted

Reporting for financial performance

- d. **note** that charter schools will be legislatively required to provide an annual self-audit on various components of the Performance Management Framework [METIS 1319872 refers].

Noted

- e. **agree** that contracts include provisions for one additional reporting milestone for financial performance measures to enable monitoring of progress trends to further support performance management of charter schools. **Agree / Disagree**
- f. **agree** that, should you agree with recommendation e above, additional reporting against financial performance measures do not need to be externally audited but instead require sponsor certification. **Agree / Disagree**
- g. **note** that we will provide you with further advice on the remaining components of the Framework in due course including setting performance measures and tools, reporting requirements, and finalising the high-level approach for performance targets. **Noted**

Proactive Release

- h. **agree** that the Ministry of Education release this paper **in full** once it has been considered by you as part of the subject-specific release on Charter Schools. **Agree / Disagree**



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7/06/2024



Hon David Seymour
Associate Minister of Education

9/6/24

Background

3. The Performance Management Framework (the Framework) is intended to enable intervention when charter schools are not performing well, while also supporting high-performing charter schools to grow and share good practice. The Framework includes establishment of performance measures and the tools used to track these, setting targets for charter schools to achieve against these measures, and interventions that may be applied if a school does not meet performance targets, including contract termination should a sponsor breach its obligations.
4. You have indicated that the performance measurement for charter schools should include areas like attendance, student achievement, financial probity, and legislative compliance [METIS 1319872 refers].
5. This paper provides you with advice on financial performance measures, assurance requirements and reporting for charter schools to be included as part of the broader Framework. This was initially intended to be provided to you as part of broader advice on the Framework. However, given the Treasury's interest in the financial performance measures and accountability, we are providing you with this advice ahead of other recommendations.
6. You will receive further advice on the remaining components of the Framework in due course. This will include advice on:
 - a. Performance measures and tools related to:
 - i. attendance;
 - ii. student achievement; and
 - iii. standard minimum compliance.
 - b. Ongoing development of a value-added measure and work to utilise detailed data to understand post-school outcomes for charter schools.
 - c. Whether measures of stakeholder voice and experience should be included in the Framework.
 - d. The high-level approach for setting performance targets and reporting requirements for student outcomes measures (attendance and student achievement).
7. The decisions sought will support development of template contracts. This will provide potential sponsors with sufficient knowledge and assurance to engage in these processes and subsequently present robust proposals to the Authorisation Board. All documentation issued via the sponsor application process (and relevant supporting communications) will be clearly caveated, ensuring finalisation of terms is subject to the enactment of the relevant legislation.

Engagement with the Charter Schools | Kura Hourua Establishment Board on financial performance measures

8. We engaged with the Establishment Board on the financial performance measures and requirements in a hui on 22 May 2024. We also engaged separately with Neil Paviour-Smith on this content, given his expertise and as he could not attend the full Board hui. Following engagement with the Board we have included some additional requirements based on their advice. This is outlined in more detail below.
9. The advice in this paper has been informed by past engagements with the Board. However, given the shortened timeline for providing advice on this content, the Board has not seen the final recommendations being provided. We will share this paper with the Board.

Financial performance measures and assurance requirements are crucial for understanding charter schools' financial health

10. You have agreed that charter schools' financial performance will be assessed as part of the Framework. To support effective contract management, we recommend the inclusion of key financial measures that will support contract managers in assessing the financial health of each charter school. We have focused on indicators that are regularly used in the finance sector.

Financial performance measures

11. We have shortlisted the following financial performance measures with a brief rationale for inclusion in Table 1 below. These measures align with those used under the previous Partnership Schools model, and we consider these to still be appropriate for use.

Table 1: Summary of financial performance measures

Financial measure	Description	Rationale for inclusion
Operating surplus	This measures the difference between revenue and expenditure. This would be expressed as a surplus/deficit to total revenue percentage.	This indicates whether the charter school is operating within its means, and its ability to meet immediate expenses.
Working capital ratio	Working capital is defined as: <i>current assets less current liabilities</i> . This calculation does not include any investments with a term of over 12 months or any trust fund investments. A higher working capital ratio indicates a healthier financial position.	This indicates a school's ability to meet their short-term debts as they fall due.
Debt/equity ratio	This measure defined as: <i>Debt / debt plus net tangible assets</i> . A higher debt/equity ratio suggests higher risk.	This indicates the degree to which a charter school is financing its operations with debt rather than its own resources.
Operating cash	This measures all cash generated/reserves held by a charter school.	This measure would indicate a charter school's liquidity and ability to meet any unplanned or unexpected costs should they arise (e.g., emergencies).
Enrolment variance	This tracks the charter school's variance in enrolments over time.	This would indicate whether a school's roll is growing or declining.

12. Following your direction on the above financial measures, we will provide you with further advice on the specific performance targets these will be measured against.

Financial assurance requirements

13. To be consistent with other publicly funded organisations, we seek your agreement to additional financial assurance requirements to be included in contracts for further assurance of schools' financial performance and management. These are:
 - a. a charter school sponsor must specify the expected use of funds through financial plans and forecasts;
 - b. charter schools must discharge all contractual obligations before the sponsor can use any profit at their discretion;
 - c. charter schools must notify when any source of anticipated funding on which the ongoing viability of the sponsor or schools is dependent will not be available either in the expected amount or time;
 - d. a sponsor must notify when they have failed to pay any debt from borrowed money, or when they reasonably anticipate it will fail to pay this debt in future;
 - e. a charter school sponsor must disclose any related parties; and,
 - f. a charter school sponsor must apply an appropriate policy for sensitive expenditure.
14. The requirements in c and d above were included in contracts under the previous model.

Feedback from the Establishment Board

15. The Establishment Board showed general support for the proposed financial performance measures. There was also strong support for some forward-looking requirements for schools' forecasts and budgeting, which we have included above (see paragraph 13a). We have included a requirement for disclosures from related parties following engagement with the Board.
16. The Ministry also proposed that charter schools apply sensitive expenditure policies. Some members of the Board did not support this, noting this may not be a reasonable or useful requirement to impose on charter schools. However, we consider that given charter schools will be publicly funded entities, it is important that additional requirements are applied to ensure all charter schools have appropriate sensitive expenditure policies in place. This will help ensure that expenditure of public funding can withstand public scrutiny and align with guidance provided from the Office of the Auditor General.¹

Links to charter school interventions

17. Charter school contracts will include provisions that allow the Authorisation Board to use a range of possible responses or interventions set out. You have previously agreed to include a suite of potential interventions in the proposed legislation should a charter school breach its requirements within the Framework. These include:
 - a. Requiring ERO to conduct a review of the charter school.
 - b. Issuing a statutory notice.
 - c. Replacement of the Sponsor
 - d. If applicable, the school could be reconverted to a State school.
 - e. Termination of the contract.
18. Alongside these interventions set out in legislation, you have also indicated that other lower-level interventions that currently apply to State schools could also be included in contracts, such as increased reporting or development of remedial plans.

¹ Office of the Auditor General. (2024). *Sensitive expenditure*. Accessed at <https://oag.parliament.nz/good-practice/docs/sensitive-expenditure.pdf>

In addition to annual self-audits, additional reporting on financial performance measures and assurance requirements could strengthen the Framework

19. You have previously agreed that legislation set out a minimum requirement for charter schools to provide an annual self-audit against various components of the Framework [METIS 1319872 refers]. In addition to the annual self-audit, one additional reporting milestone set in contracts for financial performance measures and assurance requirements would help understand important performance trends throughout the year.
20. We recognise the importance of balancing administrative burden for schools with the need for assurance of charter schools' performance. We also acknowledge that you have previously indicated that a preference away from quarterly financial reporting.
21. However, we consider that including one additional reporting milestone per year with lighter requirements (e.g., the second reporting milestone against financial measures does not require external audits, only sponsor certification) would not cause significant additional administrative burden for schools while still providing additional assurance.
22. For financial reporting in particular, biannual reporting mitigates the risk of reporting at a single point-in-time, where schools' financial position at that point may be misleading. Having only one reporting milestone in the year for schools' finances could also create a timing lag for intervention should this be required.
23. Should you agree to the above recommended reporting requirements for charter schools' financial performance and monitoring, then we will include this as part of charter school contracts alongside the legislated self-audit.

Next Steps

24. Following your direction, we will seek Cabinet's agreement to the financial performance measures and assurance requirements via the *Charter schools | kura hōrua: Funding model* Cabinet paper.
25. We will develop further advice on the remaining components of the Framework in due course including setting performance measures and tools, compliance measures, reporting requirements, and finalising the high-level approach for performance targets related to student outcomes measures (attendance and student achievement).