



MAGNOLIA PUBLIC SCHOOLS

Board Of Directors

Board Agenda Item #	II B
Date:	September 6, 2016
To:	MPS Finance Committee
From:	Caprice Young, Ed.D., CEO & Superintendent
Staff Lead:	Oswaldo Diaz, Chief Financial Officer
RE:	Approval of Revised CMO Cost Allocation Table and Contingency Reserve for Economic Uncertainties

Proposed Board Recommendation

I move that the Magnolia Public Schools Board approves the revised CMO Indirect Cost Allocation Table and Contingency Reserve for Economic Uncertainties that incorporates a CMO fee capped at a maximum of 14.5% of total consolidated school revenues.

Background

Based on the direction provided by the Finance Committee, senior management has prepared an analysis of the current Magnolia Public Schools Charter Management Organization (CMO) fees and a comparison with other cost allocation methodologies. The purpose of the analysis is to provide the MPS' Board of Directors with the financial impact to each of the schools of various cost allocation methodologies, and a cost effective recommendation for the organization.

CMO Fees and Cost Allocation Methodologies

The two main CMO fee methods are the fixed rate methodology and the indirect cost allocation methodology. Both methods are acceptable and used by CMOs and non-profit organizations that have incurred costs for common or joint objectives and that cannot be readily identified with a particular school.

Based on the conversations and direction provided by the Finance Committee members, Senior Management is presenting the following methodologies for consideration:

1. CMO Fee Rate Based on an Indirect Cost Allocation Methodology driven by ADA and Tier Factor
2. Fixed CMO Fee Methodology
3. CMO Fee Rate Allocation Methodology based on ADA

Option 1.- CMO Fee Rate based on an Indirect Cost Allocation Methodology driven by ADA and Tier Factor

Currently MPS uses the indirect cost allocation methodology driven by ADA and Tier Factor to calculate the CMO fees. The current MPS Home Office Expense Allocation structure was designed to be in accordance with Code of Federal Regulations 2-CFR-230 Cost Principles for Non-Profit Organizations (OMB Circular A-122), and California Education Code § 47600 applicable to approval, operation, and accountability of charter schools.

The Home Office Expense Allocation is a dynamic model that takes into consideration the annual budget of MERF, potential reduction of fees due to limited school reserves, and is based on an attendance tier-model that considers each school's operational thresholds and breakeven costs. As part of the calculation, The CMO Fee



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Rate Based on an Indirect Cost Allocation is based on a redistribution of total expenses and cash reserves, and based on a tier factor driven by Average Daily Attendance (ADA).

Current Fee Structure (includes 5% reserve)						
	FY16-17 Budgeted ADA	CMO Fee - Current Calculation	Indirect Fee	Direct School Specific Charges	Budgeted FY16-17 Net Income (Loss) - Current CMO Fee	CMO Fee as % of Revenue
MSA-1	518	1,010,664	972,192	38,472.26	151,182	14.0%
MSA-2	470	1,007,082	972,192	34,890.11	152,640	18.2%
MSA-3	434	914,224	881,049	33,175.63	343,065	15.9%
MSA-4	181	86,175	72,914	13,260.47	188,978	3.3%
MSA-5	165	84,597	72,914	11,682.75	15,706	3.9%
MSA-6	174	85,400	72,914	12,485.44	293,915	3.7%
MSA-7	291	628,880	607,620	21,260.07	53,688	16.4%
MSA-8	478	1,007,450	972,192	35,258.11	63,471	18.2%
MSA-SA	512	1,005,424	972,192	33,232.62	(550,228)	18.1%
MSA-SD	454	412,955	370,217	42,737.58	186,876	9.6%
Total	3,675	6,242,850	5,966,395	276,455	899,295	14.1%

Option 2 .- Fixed CMO Fee Rate Methodology

Fixed CMO Fee Rate Methodology is calculated by applying the board approved fee structure percentage to the unrestricted income of each school. This fee may be waived or capped in order to mitigate the financial burden of schools that have not reached a minimum threshold of recommended reserves.

In accordance with the independent study commissioned by MPS on February 2015, CMO fees are typically calculated by multiplying a designated fixed fee rate percentage to total unrestricted income. This method is quite common primarily because it is simple to implement and it maintains a constant and stable rate. The CMO fee rate typically ranges between 10% to 20%.

Option 2 - Fixed CMO Fee Rate Methodology (14.6% of revenue)						
	FY16-17 Budgeted ADA	CMO Fee - Current Calculation	Indirect Fee	Direct School Specific Charges	Budgeted FY16-17 Net Income (Loss) - Current CMO Fee	CMO Fee as % of Revenue
MSA-1	518	1,055,446	1,016,974	38,472.26	106,401	14.6%
MSA-2	470	814,460	779,570	34,890.11	345,262	14.6%
MSA-3	434	845,003	811,828	33,175.63	412,286	14.6%
MSA-4	181	334,136	320,876	13,260.47	(58,984)	14.6%
MSA-5	165	285,897	274,214	11,682.75	(185,594)	14.6%
MSA-6	174	297,549	285,063	12,485.44	81,766	14.6%
MSA-7	291	561,800	540,540	21,260.07	120,768	14.6%
MSA-8	478	817,329	782,071	35,258.11	253,591	14.6%
MSA-SA	512	818,275	785,042	33,232.62	(363,078)	14.6%
MSA-SD	454	412,955	370,217	42,737.58	186,876	9.6%
Total	3,675	6,242,850	5,966,395	276,455	899,295	14.1%



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Option 3 - CMO Fee Rate Allocation Methodology based on ADA

CMO Fee Rate Methodology based on ADA is calculated by assigning a percentage to each school based on the school's ADA. The percentage is then applied to the total home office budget in order to determine the allocation to be applied for each school. This fee may be waived or capped in order to mitigate the financial burden of schools that have not reached a minimum threshold of recommended reserves.

Option 3 - CMO Fee Rate Allocation Methodology based on ADA						
	FY16-17 Budgeted ADA	CMO Fee - Current Calculation	Indirect Fee	Direct School Specific Charges	Budgeted FY16-17 Net Income (Loss) - Current CMO Fee	CMO Fee as % of Revenue
MSA-1	518	879,674	841,202	38,472.26	282,172	12.1%
MSA-2	470	797,873	762,983	34,890.11	361,849	14.3%
MSA-3	434	738,165	704,989	33,175.63	519,125	12.7%
MSA-4	181	306,270	293,010	13,260.47	(31,117)	13.3%
MSA-5	165	278,739	267,056	11,682.75	(178,436)	14.2%
MSA-6	174	294,457	281,972	12,485.44	84,858	14.4%
MSA-7	291	494,276	473,016	21,260.07	188,292	12.8%
MSA-8	478	810,710	775,452	35,258.11	260,210	14.5%
MSA-SA	512	863,576	830,343	33,232.62	(408,379)	15.5%
MSA-SD	454	779,110	736,372	42,737.58	(179,279)	19.0%
Total	3,675	6,242,850	5,966,395	276,455	899,295	14.1%

Additional Considerations

Total Home Office expenses excluding direct payroll costs, contingency reserves and grant funded programs amount to \$5,661,973 or 13.42% of total school revenue. The current Home Office CMO indirect cost allocation totaling \$5,966,395 or 14.1% includes both Home Office operational expenses and a five percent (5.0%) contingency reserve for economic uncertainties in addition to operational expenses.

Description	MERF Expenses	CMO % of school revenue
Total Home Office Operational Expenses	5,661,973	13.42%
Total Home Office Direct Payroll Allocation	276,455	0.66%
5% Contingency Reserves	304,421	0.72%
Total Home Office Expenses (Excluding Grant Funded Programs)	<u>6,242,849</u>	<u>14.80%</u>

Home Office fees allocated directly and indirectly to the school sites amount to \$6,242,850 and make up 14.79% of total school revenue, and include direct payroll allocations, indirect cost allocations, and a five percent (5.0%) contingency reserve for economic uncertainty.



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Direct payroll expenses (\$276,455) are charged directly to individual schools for expenses that are not shared across all schools, specifically regional, special education and English Language Learners management. Facilities management is charged directly to capital projects. Both direct payroll expenses and Facilities management are excluded from the CMO fee calculation, and are allocated based on specific needs of each school.

Recommendation

Based on the models presented for Board consideration, Senior Management recommends retaining the current CMO Fee Rate based on an Indirect Cost Allocation Methodology driven by ADA and Tier Factor, and that the CMO fee percentage (excluding directly allocated payroll expenses and facilities capital projects) does not exceed 14.5% of total consolidated school revenues.

The proposed 14.5% CMO fees does not take into consideration organizational growth and will need to be revisited if the organization plans to grow in the future. Funding of future growth will be based on the accessibility of startup grants, availability of MPS schools to provide repayable loans, and/or increase CMO fees.

Budget Implications:

Financial impact as presented in the document.

Name of Staff Originator:

Oswaldo Diaz, Chief Financial Officer

Attachments:

Revised CMO Fee Calculation
CMO comparison analysis

MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION

Request for a revised Indirect Home Office Expense Allocation and Contingency Reserve for Economic Uncertainties Structure

This memorandum, including the information and documents presented in this request, represent the basis for this proposed Home Office Expense Allocation structure revision with an effective date of July 1, 2016. The proposed Indirect Home Office Expense Allocation and Contingency Reserve for Economic Uncertainties Structure (Home Office Expense Allocation) will be implemented and carried out by Magnolia Educational Research Foundation's (MERF). The proposed revised Home Office Expense Allocation is designed to: 1) Be a dynamic Expense Allocation structure model, 2) Adjust for and react to current and future operational Home Office budgetary needs, 3) Adjust for and react to unexpected changes in charter school reserves, 4) Designed to maintain reserves for economic uncertainties at the individual charter school level and as a consolidated organization, and 5) Designed not to exceed a predetermined Board approved Home Office indirect cost allocation percentage.

BACKGROUND

On January 9th, 2015, the Governing Board of MERF approved the current Charter Management Organization (CMO) fee structure. CMO fees pay for the ordinary and necessary administrative and academic support functions required by the charter schools in order to ensure the quality and superior educational needs of the students and programs served.

CURRENT CMO FEE CALCULATION

CMO fees are currently based on an attendance tier-model that considers each school's operational thresholds and breakeven costs. This model was designed to be a self-adjusting dynamic model that takes into consideration the annual budget and forecast of MERF, potential reduction of fees due to limited school reserves, and readjusts the expenses to ensure that no operational losses are incurred by the Home Office on any fiscal year. The current CMO Fee allocation model allows CMO fees to be waived or capped in order to mitigate the financial burden of schools that have reached a minimum threshold of recommended reserves. The current model is not capped and allocates all expenses incurred by the Home Office to the schools.

PROPOSED HOME OFFICE EXPENSE ALLOCATION CALCULATION

The proposed Home Office Expense Allocation structure has been designed to be in accordance with Code of Federal Regulations 2-CFR-230 Cost Principles for Non-Profit Organizations (OMB Circular A-122), and California Education Code § 47600 applicable to approval, operation, and accountability of charter schools. The proposed Home Office Expense Allocation is a dynamic model that takes into consideration the annual budget of MERF, potential reduction of fees due to limited school reserves, and is based on an attendance tier-model that considers each school's operational thresholds and breakeven costs. The proposed model is designated not to exceed a predetermined Board approved Home Office indirect cost allocation percentage of total consolidated school revenues.

HOME OFFICE EXPENSE ALLOCATION CALCULATION METHOD

The Home Office Expense Allocation is based on a redistribution of total expenses and cash reserves, and based on a tier factor driven by Average Daily Attendance (ADA). In order to calculate the Home Office Expense Allocation, the following steps should be followed:

- 1) Calculate the monthly Home Office Expense Allocation base:

Home Office Expense Allocation base = allowable expenses (*) + 5% Reserve – CMO Fees (a)

Notes:

- (*) allowable expenses are expenses that benefit all schools and exclude directly allocated expenses that benefit specific schools.
- (a) Previously approved CMO fees might be required to remain without change for some of the schools, if the charter application and/or charter renewal explicitly states that the rate to be used will be 11%.

- 2) Identify the ADA for all the schools and assign a rate based on the tier rate (table I)

Table I 2016-17 ADA Tier Rate (b)

Average Daily Attendance (in students)	Factor
100 students or less	0.03
101 to 150 students	0.07
151 to 200 students	0.12
201 to 250 students	0.30
251 to 260 students	0.60
261 to 280 students	0.80
281 to 300 students	1.00
301 to 350 students	1.15
351 to 400 students	1.30
401 to 450 students	1.45
451 students and more	1.60

Note: (b) The ADA Tier Rate table will be reviewed and revised as required, in order to be representative of the most current operational thresholds and breakeven points of Magnolia Public Schools.

- 3) Calculate the percentage of redistribution based on Average Daily Attendance:

$$\text{Percentage of Redistribution} = \frac{\text{Tier Rate Factor per School}}{\text{Sum of Tier Rate of all Schools}}$$

- 4) Apply the percentage of redistribution to the Home Office Expense Allocation:

Home Office Expense Allocation= (Percentage of Redistribution) x (Home Office Expense Allocation base)

- 5) Total Home Office expense allocation will not exceed the Board approved CMO fee percentage and will be capped at a maximum amount. Capped Home Office expenditures will be calculated as follows:

Total Capped Home Office Expenditures (d) = (Total School Revenues) x (Board approved CMO Fee Percentage)

Note: (d) Capped Home Office expenditures include total indirect costs and five percent reserves. Capped amount does not include directly allocated expenses.

GLOSSARY

ADA – Average daily attendance for the second principal apportionment (P2) of the previous fiscal year

Unrestricted Income – Unrestricted income from all sources

Allowable Expenses – Costs that have been incurred for common or joint objectives and cannot be readily identified solely to a particular school.

Directly Allocated Expenses – Costs that have been incurred for specific objectives and can be readily identified to a particular school or schools.

ANNEX I

Home Office Expense Allocation Calculation Excel spreadsheet sample (see attached schedule)

Magnolia Educational Research Foundation
Home Office Expense Allocation and Contingency Reserve for Economic Uncertainties

Distribution Calculation

School Names	2016-17 Projected ADA	Tier Factor	Subtract Factor calculated with different fee structure	Adjusted Tier Factor	Percentage of Redistribution based on ADA	Home Office Expense Allocation	Monthly
Magnolia Science Academy	518	1.60		1.60	17%	972,191.51	81,015.96
Magnolia Science Academy 2	470	1.60		1.60	17%	972,191.51	81,015.96
Magnolia Science Academy 3	434	1.45		1.45	16%	881,048.55	73,420.71
Magnolia Science Academy 4	181	0.12		0.12	1%	72,914.36	6,076.20
Magnolia Science Academy 5	165	0.12		0.12	1%	72,914.36	6,076.20
Magnolia Science Academy 6	174	0.12		0.12	1%	72,914.36	6,076.20
Magnolia Science Academy 7	291	1.00		1.00	11%	607,619.69	50,634.97
Magnolia Science Academy Bell	478	1.60		1.60	17%	972,191.51	81,015.96
MSA- San Diego	454	1.60	1.60	-	0%	-	-
PTS- Santa Ana	512	1.60		1.60	17%	972,191.51	81,015.96
TOTAL	10.81	1.60	1.60	9.21	100%	5,596,177.36 (x)	

2016-17 ADA Tier Rate Table

Average Daily Attendance	Factor
100 students or less	0.03
101 to 150 students	0.07
151 to 200 students	0.12
201 to 250 students	0.30
251 to 260 students	0.60
261 to 280 students	0.80
281 to 300 students	1.00
301 to 350 students	1.15
351 to 400 students	1.30
401 to 450 students	1.45
451 students and more	1.60

Total 2016-17 Allowable Expenses (Projected as of June 2016)	6,088,428.00
Add: 5% Reserve for Economic Uncertainties	304,421.40
Subtract: Direct Salary Allocated to Schools	276,455.04
Subtract: Expenses funded with external grants	150,000.00
Subtract: Fees based with different CMO fee structure (11%)	370,217.00
Home Office Expense Allocation Base	5,596,177.36 (x)

School Names	2015-16 Estimate ADA	Allocation %
Magnolia Science Academy	972,192	16.29%
Magnolia Science Academy 2	972,192	16.29%
Magnolia Science Academy 3	881,049	14.77%
Magnolia Science Academy 4	72,914	1.22%
Magnolia Science Academy 5	72,914	1.22%
Magnolia Science Academy 6	72,914	1.22%
Magnolia Science Academy 7	607,620	10.18%
Magnolia Science Academy Bell	972,192	16.29%
MSA- San Diego	370,217	6.21%
PTS- Santa Ana	972,192	16.29%
Total CMO Fees	5,966,395	100.00%

11% in accordance with charter