

NEIL ABERCROMBIE
GOVERNOR



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CHAIRPERSON

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STATE PUBLIC CHARTER SCHOOL COMMISSION
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RECOMMENDATION SUBMITTAL

DATE: June 12, 2014
TO: Catherine Payne, Chairperson
FROM: Tom Hutton, Executive Director
AGENDA ITEM: Action on Financial Insolvency of Hālau Lōkahi Charter School

I. DESCRIPTION

Recommendation that the Commission: (1) strongly urge the Governing Board of Hālau Lōkahi Charter School (“Halau Lokahi”) to voluntarily surrender its Charter Contract and close the school due to financial insolvency; and (2) adopt a contingency plan should Halau Lokahi’s Governing Board fail to take this action.

II. AUTHORITY

Hawaii Revised Statutes §302D-12(c) provides that, “The governing board shall be the independent governing body of its charter school and shall have oversight over and be responsible for the financial, organizational, and academic viability of the charter school, implementation of the charter, and the independent authority to determine the organization and management of the school, the curriculum, virtual education, and compliance with applicable federal and state laws.”

Pursuant to Section 13.4 of the 2013-2014 Charter Contract, entitled Dissolution, the School may voluntarily surrenders the Contract due to lack of funds, in which case it shall cooperate with the Commission in scheduling cessation of operations and in ensuring the orderly closure of the School.

§302D-5(b)(2) provides that “[a]n authorizer shall: Be responsible for and ensure the compliance of a public charter school it authorizes with all applicable state and federal laws, including reporting requirements.”

III. BACKGROUND

Because the Commission will be meeting in executive session with legal counsel, Commission staff will give an oral update and presentation, and in this submittal will just present an overview of the basic facts and timeline with one recommended motion.

Halau Lokahi forecasted student enrollment at the beginning of the 2013-14 school year at 237. However, the official enrollment count by October was 183, a reduction of 54 students, or 23%. At the time, staff contacted the school to inquire as to the reasons for the enrollment reduction and what the anticipated impact would be on the school's operations as a result of the decreased funding. Staff was told that the School annually has financial challenges but seems to manage to weather through them and anticipated doing so here as well.

On May 16, 2014, Commission staff received an email from Ms. Laara Allbrett, Halau Lokahi's Director, inquiring about the disbursement of the third quarter FICA reimbursement that was due to the schools. Upon being informed that the request had been submitted to the Department of Accounting and General Services, Ms. Allbrett asked if the Commission would be able to advance the funds to Halau Lokahi.

Leila Shar, the Commission's Financial Performance Manager, informed Ms. Allbrett that the Commission would not be able to advance the funds and at that point invited the Governing Board Treasurer, Mr. Jon Nouchi, and whatever school staff he deemed necessary, to meet with Commission staff as soon as possible about the school's financial situation. Staff received no response.

The following week, the Commission staff was contacted by Halau Lokahi employees and the Hawaii State Teacher Association, and individuals Commissioners were approached by school staff, indicating that employees had been only partially paid on the May 20, 2014 pay day. On May 28, 2014, staff notified Governing Board Chair June Nagasawa and Governing Board Treasurer Nouchi that the School was required to meet with Commission staff to discuss the school's financial situation no later than June 10, 2014. In addition, the School was directed to produce a list of financial documents, including bank reconciliations, outstanding payables, and outstanding receivables be provided.

Also on May 28, 2014, the staff notified Halau Lokahi that the Commission was revoking its offer of the new Charter Contract, pending further investigation of the financial situation. This action was acknowledged and protested in a letter from the school to the Commission dated June 1, 2014.

On May 30, 2014, staff issued Halau Lokahi a Notice of Deficiency pursuant to the Intervention Protocol based on the information that the School did not appear to be meeting its payroll obligations, which violates federal and state laws and thus the Charter Contract as well.

After numerous follow-ups by Commission staff, members of the school's Governing Board and school staff agreed to meet with Commission staff on June 4, 2014. Mr. Jon Nouchi was in attendance, along with Ms. Leo Akana (Vice Chair and teacher), Ms. Allbrett and four other school staff members. The school's financial consultant, Eloy Villalba participated via phone.

At this meeting, it was confirmed that all of the school's staff were paid only 60% of their net pay on the May 20, 2014 payday and all employee withholdings for fringe benefits and taxes were paid.

However, the school stated that it would not be able to make payroll for the June 5, 2014 pay day and that the school's cash balance was effectively zero.

Since the requested financial documents were not provided at the meeting, Commission staff tried to get a verbal estimate of the magnitude of Halau Lokahi's shortfall. At the meeting, the school indicated that it had not paid rent since February, 2014 and that there were other outstanding payables of approximately \$20,000 yet to be paid. Assuming payroll for the months of May and June would be due, it was estimated the school's total obligations through the end of the fiscal year would be \$300,000.

At the end of the meeting, Halau Lokahi asked if it could submit an action plan, and it was agreed that the school should submit a plan to address the shortfall for the balance of this year and through July as well as a plan to ensure the school would be sustained through the 2014-15 school year. The plans were to be submitted by Monday, June 9, 2014.

Staff did not receive anything from the school on Monday, June 9, 2014. On Tuesday, June 10, 2014, Mr. Nouchi provided a schedule of outstanding obligations totaling \$417,000 and potential sources of funds totaling \$88,000, which included a \$50,000 bridge loan that the school was applying for. The shortfall between the \$88,000 and \$417,000 was seemingly addressed with a notation that, "OHA has assured additional financial assistance. Total amount still being determined. The remaining shortfall, if any, would be funded by 1st allocation of SY 2014-15 Per Pupil funding." Mr. Nouchi's schedule is appended as **Exhibit A**.

On the advice of the Department of the Attorney General, Commission staff on Monday, June 9, 2014, notified the Governing Board that it had engaged in a *de facto* layoff of its employees and that, in fairness to the school's employees, the school should immediately issue proper notices to all of its employees and their respective labor unions that the layoff had occurred. The school sent a notice to its employees on the following day, stating that it had received a letter from the Executive Director of the Commission and quoting from the letter stating that the school had engaged in a *de facto* layoff of its employees.

On June 10, 2014, the administration of the School provided a written response contesting the Notice of Deficiency for failing to make payroll. The response states that, "The only breach is on the part of the state of Hawai'i that has failed to provide that which is stated in the Hawai'i Constitution, Articles IV and X regarding Hawaiian education. There is clear evidence that Halau Lokahi is providing that which is mandated in the constitution with NO support as promised at the time of chartering."

IV. DECISION MAKING STATEMENT

Based on its current financial situation as of this writing, Halau Lokahi is insolvent and unable to meet its financial obligations. Although a plan to address the school's obligations through the end of the fiscal year was requested, the information provided by the school does not satisfactorily address how the shortfall would be overcome, nor does it provide any plan for keeping the school open through the 2014-15 school year. The information provided is more of a list of outstanding obligations and potential sources of funds. The plan did not address possible changes to operations that would reduce the cost structure of the school, for example, staff reductions or reductions in rented space.

A few of the requested financial documents were provided to the Commission staff on Tuesday, June 10, 2014. Bank statements, payroll registers, and equipment and facility leases were provided. However, outstanding payable, aged accounts payable, accounts receivable, and bank reconciliation information, which was also requested, was not provided.

Based on the estimated shortfall, monthly expenses, and expected receivables provided by the school, staff has prepared an analysis of whether the school would be sustainable for the next school year under low, medium, and high student enrollment scenarios (see **Exhibits B and C**). Base on the need to pay the projected outstanding obligations from the current fiscal year from out of funds for the coming fiscal year, the school's funding will run out in January 2015 at the highest enrollment level of 230 students, which is the school's May 15 projection, and in November 2014 at the lowest enrollment level of 180 students, which is the school's current approximate enrollment. As of Wednesday, June 11, 2014, Halau Lokahi's enrollment for coming school year as reflected in the Department of Education's electronic Student Information System (eSIS) stood at 169.

Based on the information the school has provided as of this date, staff does not anticipate any scenario under which the school will have enough funds to complete the 2014-15 school year. At any rate, it is important to point out that the time for the Governing Board to be developing, adopting, and implementing contingency plans was not now, when students and staff members have limited and dwindling options for the coming school year, but months and months ago. Consequently, to protect the students, staff, the State, and the public, Commission staff recommends that the Commission strongly urge the Governing Board of Halau Lokahi to close the school voluntarily due to financial insolvency.

In addition, the staff recommends that the Commission adopt a contingency plan, to be determined after consultation with legal counsel, to be implemented should the Governing Board fail to close Halau Lokahi voluntarily.

V. RECOMMENDATION

“Moved that the Commission strongly urges the Governing Board of Halau Lokahi voluntarily to surrender its Charter Contract and take action to close the school as soon as possible due to financial insolvency.”

and

“Moved, that _____.”

Exhibit A
Financial Projections Under Student Enrollment Scenarios

Leila,

Below is a calculation of Halau Lokahi's current expenses and obligations for the current fiscal year. This details our current plan to close out the current fiscal year and thereby prepare for the next school year.

SHORT-TERM OUTLOOK

Expenses for the rest of FY2014:

- \$191,000 facilities from February to June
- \$161,000 payroll for pay period ending 5/15 (partial), 5/31, 6/15 and 6/30
- \$65,000 estimated miscellaneous vendor payables

Halau Lokahi will use the following sources of funding to assist with payments:

- \$18,000 3rd quarter FICA/Medicare reimbursement
- \$18,000 (approx.) 4th quarter FICA/Medicare reimbursement
- \$20,000 remaining allocation of SY13-14 OHA funds
- \$50,000 bridge loan from Pacific Rim Bank. Application and approval still pending
- \$34,782 (approx.) SY14-15 Title I funds
- OHA has assured additional financial assistance. Total amount still being determined

Remaining shortfall, if any, will be funded by 1st allocation of SY2014-15 Per Pupil funding.

OBLIGATIONS:

Vendors have already been notified of possible delays in payment.

School management has communicated to staff on timeline and possibility of future payroll distributions.

If you would like to discuss any point further, please notify myself, Laara, and Eloy via email.

Exhibits B and C
Projections based on Projected Student Enrollment

Exhibit B

***** FIRST ALLOCATION ON JULY 18, 2014 *****

Estimated Enrollment		180	200	230
Per Pupil	6,200	1,116,000	1,240,000	1,426,000
Impact Aid	200	<u>36,000</u>	<u>40,000</u>	<u>46,000</u>
Assumption (per pupil @ 60% + 100% Impact Aid)		705,600	784,000	901,600
Other funds available				
3rd quarter FICA reimbursement - B & F	18,000			
Remaining OHA allocation for SY 13-14	<u>20,000</u>			
		38,000	38,000	38,000
Less est expenses in arrears as of 6/30/14				
Facilities 02/14-6/14	191,000			
Payroll (5/15/14 partial, 5/31/14, 6/15/14 & 6/30/14)	161,000			
Miscellaneous vendor payables	<u>65,000</u>	<u>(417,000)</u>	<u>(417,000)</u>	<u>(417,000)</u>
Est net available for SY 14-15		326,600	405,000	522,600
Estimated Rent	38,000			
Estimated Payroll - loaded	86,000			
Estimated Other (util, etc)	<u>10,000</u>			
Estimated Total Monthly Expense:	134,000			

2.44 3.02 3.90
Estimated Number of Months That Funds Will Cover

Exhibit C

***** FIRST ALLOCATION JULY 18, 2104 AND SECOND ALLOCATION ON NOVEMBER 20, 2014 *****

Estimated Enrollment		180	200	230
Per Pupil	6,200	1,116,000	1,240,000	1,426,000
Impact Aid	200	<u>36,000</u>	<u>40,000</u>	<u>46,000</u>
Assumption (per pupil @ 90% + 100% Impact Aid)		1,040,400	1,156,000	1,329,400
Other funds available				
3rd quarter FICA reimbursement - B & F	18,000			
Remaining OHA allocation for SY 13-14	<u>20,000</u>			
		38,000	38,000	38,000
Less est expenses in arrears as of 6/30/14				
Facilities 02/14-6/14	191,000			
Payroll (5/15/14 partial, 5/31/14, 6/15/14 & 6/30/14)	161,000			
Miscellaneous vendor payables	<u>65,000</u>	<u>(417,000)</u>	<u>(417,000)</u>	<u>(417,000)</u>
Est net available for SY 14-15		661,400	777,000	950,400
Estimated Rent	38,000			
Estimated Payroll - loaded	86,000			
Estimated Other (util, etc)	<u>10,000</u>			
Estimated Total Monthly Expense:	134,000			

4.94 5.80 7.09
Estimated Number of Months That Funds Will Cover