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The School District Financial Recovery Law (Act 141) and Basic Education Funding Formulas

Act 141, the School District Financial Recovery Law (“Act 141”) is Pennsylvania’s attempt to help financially distressed school districts¹ get back on a path toward financial stability. The law, passed July 12, 2012, allows the Pennsylvania Department of Education (“PDE”) and the Secretary of Education to declare up to nine school districts at a time in Financial Recovery Status (“FRS”). This would then allow the Secretary to appoint either a Chief Recovery Officer (“CRO”) or a receiver to develop, implement, and administer a financial recovery plan. The CRO and receiver have broad powers under the Act but little accountability.

Proponents of Act 141, including Governor Corbett, say that the school districts in financial distress are at fault for their financial situation. Critics on the other hand point out that Governor Corbett’s drastic funding cuts to education over the past few years helped create the financial difficulties of many of these school districts in the first place. Ultimately, Act 141 does not provide for increased funding to financially distressed school districts, instead only allowing these districts to apply for loans. In addition, those school districts that have already been or may soon be declared in Financial Recovery Status tend to be school districts with higher percentage of students in poverty and students learning English. A fair funding formula that properly accounts for the added costs required to educate these students would drive more money out to these school districts, which could help these school districts avoid further financial hardships. However, Pennsylvania does not currently use an education funding formula that would distribute state education dollars accurately and fairly.

This fact sheet highlights some of the most important provisions of Act 141 and discusses the impact Act 141 has already had on the school districts already identified by Act 141 for having financial difficulties.

Early Warning System: Act 141 gives PDE the authority to monitor the financial status of all school districts under an Early Warning System. PDE will compile financial data from every district and analyze it to determine if any school district should be identified for financial watch status. School districts in financial watch status will be offered technical assistance to correct minor financial problems and to avoid a declaration of FRS. PDE has also established guidelines for the operation of the Early Warning System, which include 3 levels of analysis depending on the financial instability of a school district.

- What This Means: PDE will be requesting varying amounts of financial data from all school districts so as to monitor the financial conditions of the districts. School districts

¹ Please note that Act 141 does not apply to the School District of Philadelphia or any charter schools.

experiencing financial troubles can expect to be closely monitored and may ultimately be declared first in financial watch status and the possibly in FRS.

Declaring a School District in Financial Recovery Status: Under Act 141, the Secretary of Education shall declare a school district in FRS if it receives an advances of its basic education subsidy and either has an average daily membership greater than 7,500, has been declared financially distressed under 24 P.S. § 6-691, or is in active litigation against the Commonwealth seeking financial assistance to allow the district to stay in operation. A school district declared in FRS for the first reason is deemed a Moderate Financial Recovery School District. A school district declared in FRS for either of the latter two reasons is deemed a Severe Financial Recovery School District. Act 141 places responsibility on the Commonwealth to ensure the delivery of effective educational services to all students enrolled in a school district in FRS.

- There are several restrictions to the Secretary’s ability to declare a school district in FRS. First, no more than 9 school districts may be under a declaration of FRS at any time. Second, the Secretary may decline to issue this declaration if a school district had faced an emergency in the previous five years that caused its financial hardship. Finally, a school district will not be declared in FRS if its financial difficulties were caused by the Commonwealth failing to make timely payments that were due to the school district.
 - **What This Means:** Those districts that have received advances of their basic education subsidy are in line for a declaration of FRS. However, although many school districts may be experiencing financial difficulties at this time and may qualify or soon qualify to be declared in FRS, only nine may be declared in FRS at a time. A school district will lose much control and authority if declared in FRS, so it is advisable to do whatever is possible to avoid such a declaration.
- Act 141 also authorizes the State Board of Education to promulgate regulations that would establish criteria for the Secretary to consider in determining whether to declare a school district in FRS, and whether the district shall be a Moderate or Severe Financial Recovery School District. Act 141 lists 15 criteria that should be included in the regulations. Proposed regulations have been approved by the State Board of Education and are pending final changes and approval over the next several months. The proposed regulations include the 15 criteria in Act 141 and add 12 more criteria for the Secretary to consider when determining the status of a school district. However, the restrictions discussed above would still apply.
 - **What This Means:** In addition to the factors discussed above for declaring a school district in FRS, the proposed regulations would give the Secretary an alternative avenue to declare a district in FRS. This alternative avenue includes almost 30 criteria for the Secretary to consider, which gives the Secretary broad latitude in declaring a school district in FRS. Due to the number and breadth of criteria in the proposed regulations, the Secretary could target almost any school district experiencing financial difficulties when deciding whether to declare it in FRS. However, the Secretary would still only be limited to declaring 9 school districts in FRS at a time.

Chief Recovery Officer: The Secretary must appoint a CRO within five days of declaring a school district in FRS. A CRO must have a relevant background in business and finance. The CRO’s main authority and duties are to, with the assistance of PDE, develop, implement and administer a financial recovery plan. The CRO shall meet with the board of school directors and an established advisory committee for the

school district. The CRO shall have full access to all records of the district. Aside from serving at the pleasure of the Secretary, Act 141 does not specify any oversight or accountability for the CRO.

- What This Means: The CRO is an unelected person with a background in business and finance that is appointed to take control over a school district's finances. Although the CRO meets with the board of school directors and an advisory committee, the CRO is only answerable to the Secretary. This gives a CRO broad latitude to develop, implement, and administer a financial recovery plan of his/her choosing.

The Financial Recovery Plan: A school district declared to be in Moderate or Severe FRS must develop a financial recovery plan that will help the school district become financially stable. The plan must include criteria that the school district needs to satisfy before the Secretary may terminate the FRS.

- For Moderate financial recovery school districts, the CRO must develop and submit a plan within 90 days of appointment. The school board must then approve or disapprove the plan within 30 days. If the school board does not approve the plan within 1 year, the Secretary shall petition the court of common pleas for the appointment of a receiver. If the school board approves the plan, the Secretary must approve the plan within 10 days. If the Secretary disapproves, the CRO shall develop a revised plan within 20 days. The process is the same for school districts in Severe FRS, but with accelerated timeframes. Extensions are permissible.
 - What This Means: Once a CRO is appointed, the CRO gathers information to develop a financial recovery plan. The school board and Secretary must approve the plan. If the Secretary disapproves, the CRO must revise the plan to meet the Secretary's approval. However, if the school board disapproves, the Secretary may seek the appointment of a receiver who, as discussed below, will have the power to implement the plan regardless of the school board's protests.
- As part of the financial recovery plan, a school district can request an interest-free loan through the Financial Recovery Transitional Loan Program, which is established by PDE. The Secretary's approval of the financial recovery plan constitutes approval of the loan. Loans must be used to implement provisions of the Plan. A school district may only receive one loan per year.
 - What This Means: Rather than restore some of the Governor's severe education funding cuts from the last few years, Act 141 only allows school districts in FRS to request loans. Act 141 does not provide for direct financial aid to these financially troubled school districts.
- A school district in FRS may exercise certain powers enumerated in Act 141. These powers include the ability to convert an unlimited number of school buildings to charter schools without being subject to the usual procedures for establishing charters; to close or reconstitute a school, including the reassignment, suspension or dismissal of school employees; and to negotiate a new collective bargaining agreement with school employees. However, the school board must comply with all directives of the CRO and may take no action that is inconsistent with the financial recovery plan, not specifically identified in the plan, or not directed by the CRO as necessary to implement the plan.
 - What This Means: A school district in FRS has the authority to turn every one of its

schools into charter schools, close schools, and negotiate new collective bargaining agreements with teachers. However, because a school board must always comply with the CRO and the financial recovery plan, in essence it is the CRO who has these powers. The school district does not even have to comply with the usual procedures for creating charter schools. As discussed above, the Secretary must ultimately approve of any financial recovery plan. Thus, Act 141 gives the CRO and, ostensibly, the Secretary extraordinary power to reshape financially distressed school districts.

- Upon a school district's petition or on his own initiative, the Secretary may terminate a district's FRS when the Secretary has determined that the district has satisfied and is continuing to satisfy certain criteria. After termination of FRS, the school board resumes full control of district management, but the CRO and PDE will oversee the school board for five more years to ensure financial stability. The Secretary shall petition the court of common pleas for the appointment of a receiver if the school board fails to maintain the objectives of the recovery plan.
 - What This Means: Secretary approval is the only way for a school district to terminate its financially distressed status. Even then, PDE will continue to monitor the district and can take back control if it determines the recovery plan is not being followed.

Receivership: A receiver oversees the financial recovery plan of a school district under a receivership. The Secretary will petition the court of common pleas to appoint a receiver when: a board of school directors fails to approve a financial recovery plan, fails to comply with directives issued by the CRO, fails to satisfy its obligations under a financial recovery plan during a transition period, or when a Severe Financial Recovery School District votes to appoint a receiver instead of having a CRO. The qualifications for a receiver are similar to those for a CRO as discussed above, and in fact the CRO may be named the receiver. The court of common pleas shall grant receivership unless the petition is arbitrary, capricious, or wholly irrelevant to restoring the school district to financial stability. The only accountability for the receiver is if the Secretary petitions the court to replace the current receiver.

- The receiver assumes all powers and duties of the CRO and the school board, except for the power to levy and raise taxes, which remains with the school board. Under a receivership, the employees and elected and appointed officials of the school district have a duty to comply with the receiver, and the authority of these individuals to exercise power on behalf of the school district is suspended. A receivership shall expire 3 years after the initial appointment of the receiver unless the Secretary petitions the court to extend the receivership for another 3 years.
 - What This Means: A receiver is appointed by the Secretary and approved by the court. By assuming all the powers and duties of the CRO **and** the school board, the receiver has even more power than the CRO. Unless a Severe Financial Recovery School District votes to appoint a receiver, a receiver is only appointed when the school board does not approve of the CRO's financial recovery plan or does not comply with a CRO's mandates. The practical effect of the school board disagreeing with the CRO is therefore to have the CRO be appointed a receiver, assume the school board's authority, and have the ability to continue with the CRO's financial recovery plan anyway.

Fiscal Impact of Act 141: Act 141 is estimated to cost \$6,000,000 during the 2012-2013 fiscal year. The \$6,000,000 is broken down as follows: (1) \$250,000 to develop and implement an Early Warning System

to compile and analyze information on the financial condition of all school districts; (2) \$250,000 to provide districts in financial watch status with technical assistance; (3) \$500,000 for personnel and administrative costs of PDE; and (4) \$5,000,000 to pay the salaries and necessary expenses of the CROs and receivers, legal fees, accounting costs, costs for other consultants and for financial data software systems for the school districts in FRS. This estimated figure is based on the assumption that only 4 school districts that will be placed in FRS during 2012-2013. Costs in future fiscal years will depend upon the number of school districts in FRS and the amount of money appropriated for the Loan Program.

Act 141 in Practice: Since Act 141 has been passed, 4 school districts have been declared in FRS: Harrisburg School District (“HSD”), York City School District (“YCSD”), Duquesne City School District (“DCSD”), and Chester-Upland School District (“CUSD”). Also, the Reading, Aliquippa, Steelton-Highspire, and Wilkesburg School Districts have been declared in early watch status.

- These 5 school districts have all been experiencing significant financial difficulties for at least several years. Of the 4 school districts declared in FRS, 2 of them, HSD and YCSD, were declared as Moderate Financial Recovery School Districts, and the other 2, DCSD and CUSD, were declared as Severe Financial Recovery School Districts. Each of these school districts now each will be subject to a financial recovery plan put forth by a CRO or a receiver.
- As of this writing, the CROs of HSD and YCSD are still in the process of analyzing finances, making projections, and developing ideas for the recovery plans. The CRO for YCSD is currently considering several options for the plan, including converting the district to all charter schools, creating an internal solution for the financial problems, or even consolidating the school district with neighboring school districts.
- The CROs of both DCSD and CUSD have proposed financial recovery plans. However, in both instances the school boards rejected those plans. This resulted in the Secretary petitioning the court of common pleas to appoint the CROs as receivers in their respective school districts. Both petitions were granted and now DCSD and CUSD are under receivership. The DCSD recovery plan focuses on sending students to nearby districts on a tuition basis via agreement. The CUSD recovery plan includes staffing cuts, at least one school closing, and detailed ways to increase funding while also raising academic standards in order to attract charter school students back to the district.²

Text of Act 141 and approved and proposed regulations: [Act 141](#), [Early Warning System Regulations](#), [Proposed Regulations](#)

CONTACT:

Brett Schaeffer, Education Law Center; bschaeffer@elc-pa.org; 215-238-6970 ext. 334

² The CUSD recovery plan can be found [here](#).