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An Analysis of K12 (LRN) and Why It Is My Largest Short Position

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The most up-to-date version of this presentation is posted at: www.tilsonfunds.com/K12-Tilson-9-17-13.pdf

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### K12's Stock Is Up 122% From Its 52-Week Low and Is Near Its All-Time High





#### **Conflicting Thoughts on Shorting**



I have two strong feelings about shorting right now:

- It's a horrible business, it's cost me (and my investors) a fortune over the past 4½ years, I
  wish I'd never heard of it, and every bone in my body wants to cover every stock I'm short
  and never short another stock again; and
- 2. In my 15-year career of professional investing, the only other times that have been as target-rich in terms of juicy, obvious shorts are late 1999/early 2000 and late 2007/early 2008 (and we all know how those ended...).

So which feeling am I going to follow? I don't know, but this I know for sure: the only other time I felt like covering every short and becoming a long-only manager was October 2007. At that time, I went through my short book, stock by stock, and said, "OK, am I willing to cover MBIA at \$70? Hell no, not a single share! Allied Capital at \$30? Hell no, not a single share! Farmer Mac at \$30? Hell no, not a single share!" And on it went... I couldn't bring myself to cover a single share of any stock I was short – they were all "trembling-with-greed" shorts.

And that's exactly how I feel today. I look at K12 and the other 10 stocks I'm short – all of which I think are absurdly overvalued and sure to collapse – and feel intensely that covering them now would be the most boneheaded capitulation trade of all time.

That said, unlike in 2007, I don't have the same foreboding feeling that there's a good chance that the world will fall apart in the next year or two (though it's possible), which makes being short that much harder...

#### Overview of K12

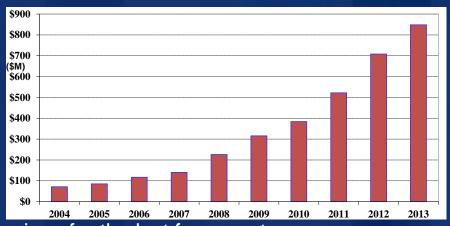


- Founded in 2000, K12 is a for-profit education company that offers "proprietary curriculum, software systems and educational services designed to facilitate individualized learning for students primarily in kindergarten through 12<sup>th</sup> grade"
- It operates in three segments:
  - Managed Public Schools (86% of FY 2013 revenues), primarily managing 54 online (aka, cyber or virtual) charter schools in 33 states and DC
    - This presentation focuses only on this segment
    - Note that my critique is specifically of K12, not all online charter schools, for-profit charter schools or blended learning schools. While I think the online charter school sector has, overall, run amok, there are a small number of good online schools – and a few students at even the worst online schools are doing well.
  - Institutional Sales (9% of revenue): work with districts and schools "to offer their students an array of online education solutions, including full- time virtual and blended programs, semester courses and supplemental solutions"
  - International and Private Pay Schools (5% of revenues): operate three online private schools and manage a foreign brick and mortar private school

#### The Bull Case for K12



- Revenue growth of 32% annually for the past decade:
- Projected revenue and EPS growth of 16% and 32%, respectively, over the next 12 months, fueled by 10 new schools and enrollment cap expansion of 17,000 new seats



- Average revenues per student has risen for the last four quarters
- K12 estimates the market for online schools is as high as \$15 billion annually (vs. nearly \$2 billion today)
- Online schools can be an excellent option for certain students
  - For example, children whose pace is extremely accelerated, entertainers, solo athletes, victims of bullying, children with cancer, seizure disorders, peanut allergies, etc.
- K12 has a well-regarded curriculum and reports very high parental and student satisfaction
- Strong political support, especially among Republicans, for giving parents school choice
- Online learning has enormous buzz (MOOCS, etc.)

#### Summary of Why I'm Short K12's Stock



- K12's aggressive student recruitment has led to dismal academic results by students and sky-high dropout rates, in some cases more than 50% annually
  - I wouldn't be short K12 if it were carefully targeting students who were likely to benefit from its schools – typically those who have a high degree of self-motivation and strong parental commitment
    - ➤ But K12 is instead doing the opposite; numerous former employees say that K12 accepts any student and actually targets at-risk students, who are least likely to succeed in an online school
- There have been so many regulatory issues and accusations of malfeasance that I'm convinced the problems are endemic
  - Enrollment violations, uncertified teachers, illegally siphoning profits from nonprofit entities
- States (and the IRS) are waking up to what K12 is doing and the company is coming under increased scrutiny, which is beginning to impair K12's growth – and I believe this trend will accelerate
- K12's founder, Knowledge Universe, distributed its entire stake to its investors earlier this month
- Yet the stock, trading at nearly 50x trailing earnings, is priced as if K12 will continue to grow at high rates for the foreseeable future and also improve on its persistently low margins and free cash flow

Like subprime lending and for-profit colleges, the business makes sense on a small scale but, fueled by lax regulation and easy government money, the sector, led by K12, has run amok

# Since I Made This Presentation Public, I Am Even More Certain That My Analysis of K12 Is Correct, Thanks to Comments Like These From People I Know



#### A friend of mine told me after reading this presentation:

"I met with Ron Packard years ago and could tell his motivations had little to do with kids, everything to do with manipulating state regulation to protect his interests. I started digging into the results, the business model, the organization, and discovered much of what you lay out in detail in your presentation. As I said, they are terrible and epitomize everything that we should be working against in the ed reform movement."

#### Another told me:

"You're totally right about K12 and, on top of it, they lie all the time. It's naïve to trust anything they say. So I'm not sure if their schools can be fixed, at least under the company's current leadership. There's no such thing as a successful online school in the entire country. To be sure, it works well for some students, but I'd guess only 15% of the ones cyber charters are currently serving."

#### Another emailed me:

"I know the company very well and your presentation rings true. They have a well-deserved terrible reputation."

#### Yet another emailed me:

"I think you are correct about K12 Whitney. I had an inside view of this company early on. They appeared giddy with the fact that they could receive almost the same per-pupil funding levels as brick and mortar schools and use the difference for big salaries and profit (on the public dime). If they are not providing a truly great education it means that, once again, students lose to adult interests."

### I am Not Short K12's Stock Because I Oppose Charter Schools, Online Education, or For-Profit Schools



My parents are educators and my primary philanthropic activities relate to charter schools and school reform:

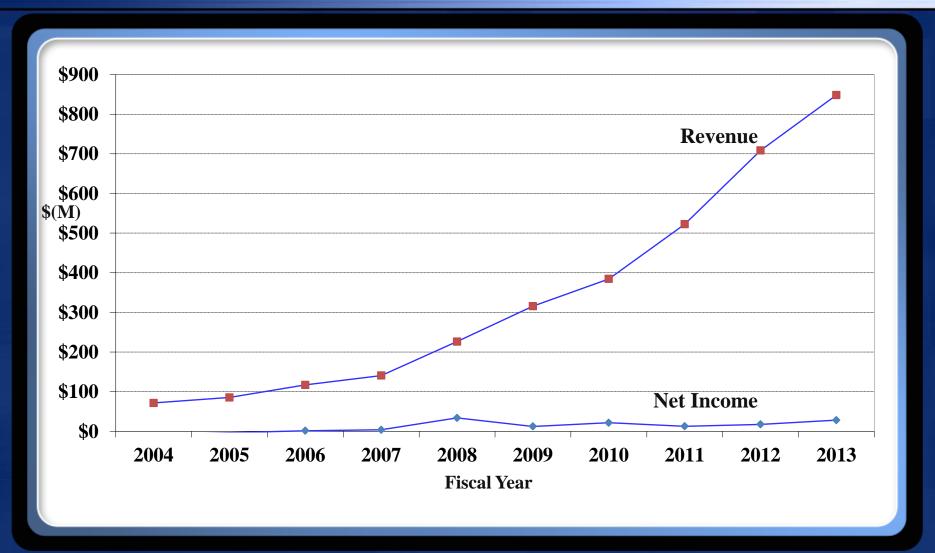
- My parents were both public school teachers in New Haven, CT in the mid-1960s when I was born
- My father has a PhD in Education from Stanford and has spent most of his career doing teacher training and developing/managing educational projects in Third World Countries (as a child I lived for three years each in Tanzania and Nicaragua). He also earned an MBA degree from the University of Colorado at Colorado Springs in 2003 after studying entirely online for five years while living in Ethiopia.
- Upon graduating from Harvard in 1989, I was one of the first people to join Wendy Kopp starting
   Teach for America
- For more than a decade I have served on the board of the KIPP Academy charter school in the South Bronx, which is part of a national network of 141 college prep public charter schools in low-income communities
- I was on the board of the National Alliance for Public Charter Schools from 2010-12
   I am not opposed to all online schools I think such schools can be a great option for some students and families, but an inappropriate and harmful option for others
   I am a champion of high-quality charter schools (including online and/or for-profit ones), but I think that low-quality charter schools give the movement a black eye

To be clear: I am not bearish on K12 because I am short the stock. Rather, I am short the stock because I am bearish on K12



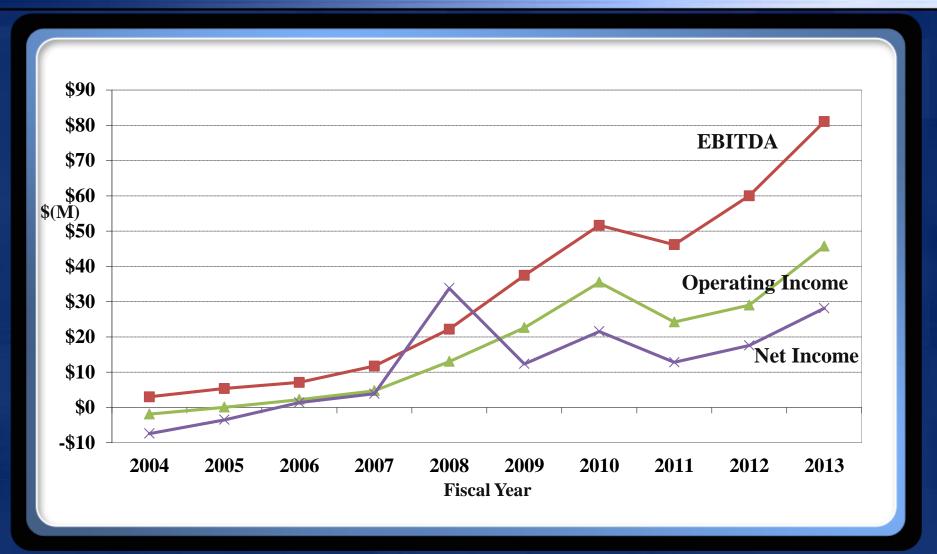
#### K12's Revenue Growth Has Been Impressive Over the Last Decade, but Profits Have Lagged





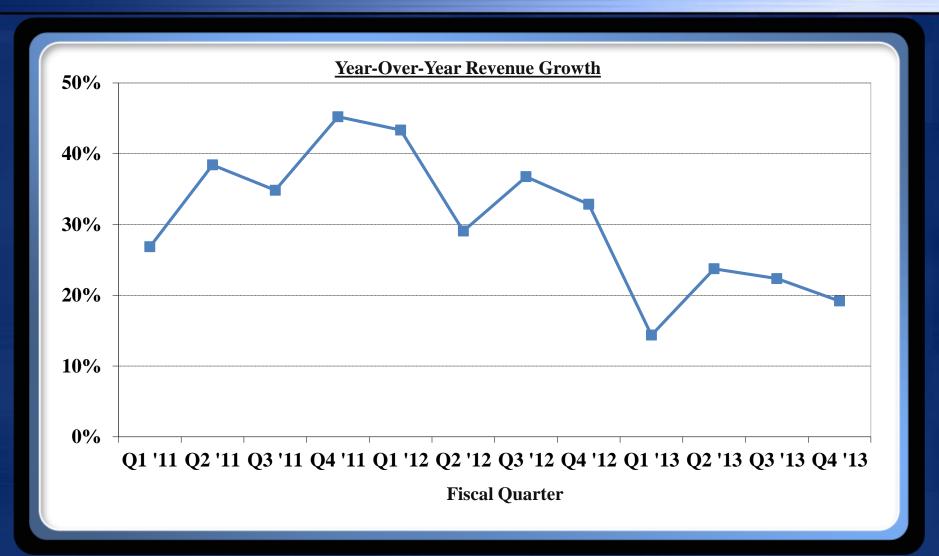
# **Profits Have Improved in the Last Two Years**





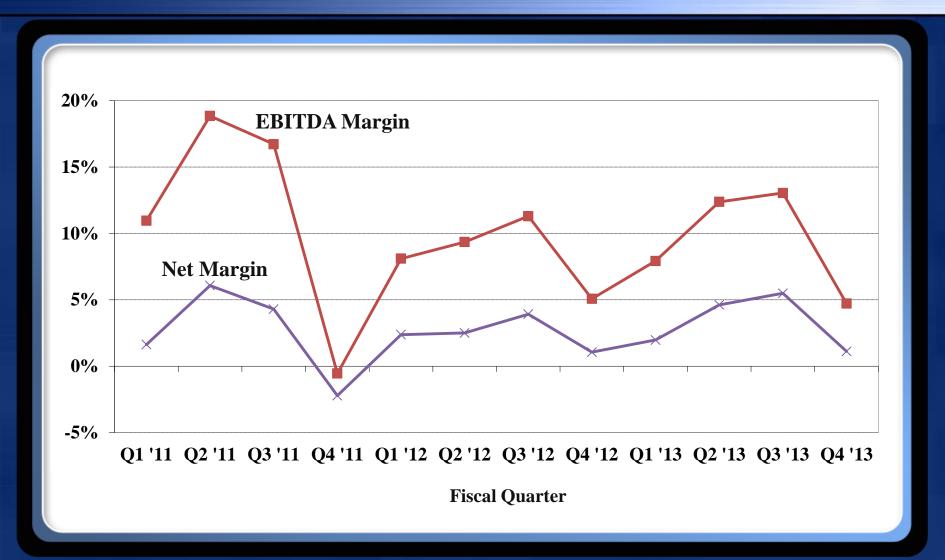
#### K12's Revenue Growth Has Been Slowing Steadily Over the Last Two Years





# Profit Margins Are Low, Erratic and Declined Sharply Last Quarter

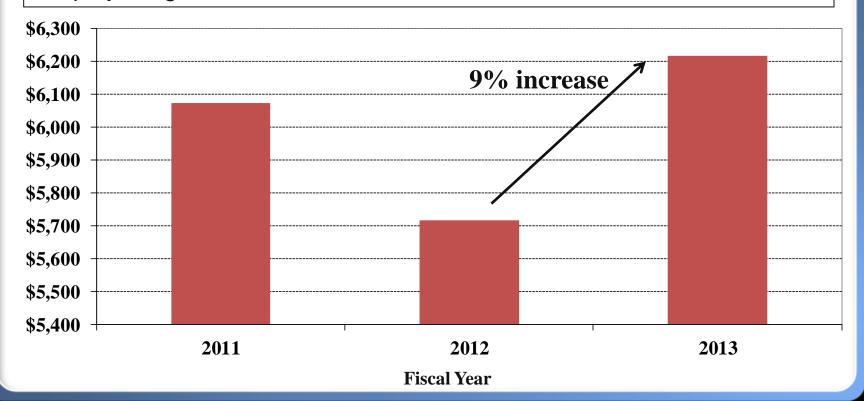




#### A 9% Jump in Revenue Per Student in FY 2013 Boosted Results – But Will Not Be Repeated

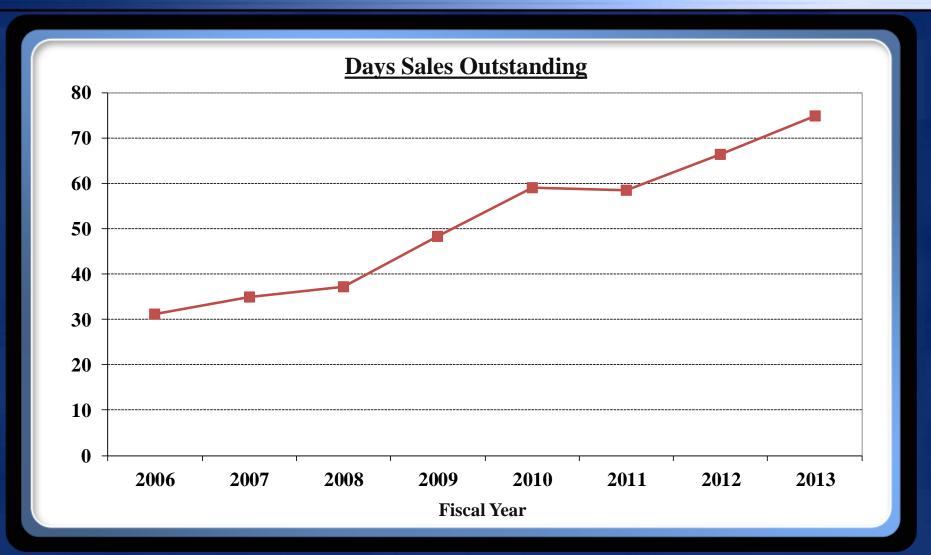


"As we look at 2014, we don't see any change in terms of the level of unfunded students, so the pick up, if you will, that we saw in 2013, we are not projecting for 2014." – CEO Ron Packard, Q4 conference call, 8/29/13



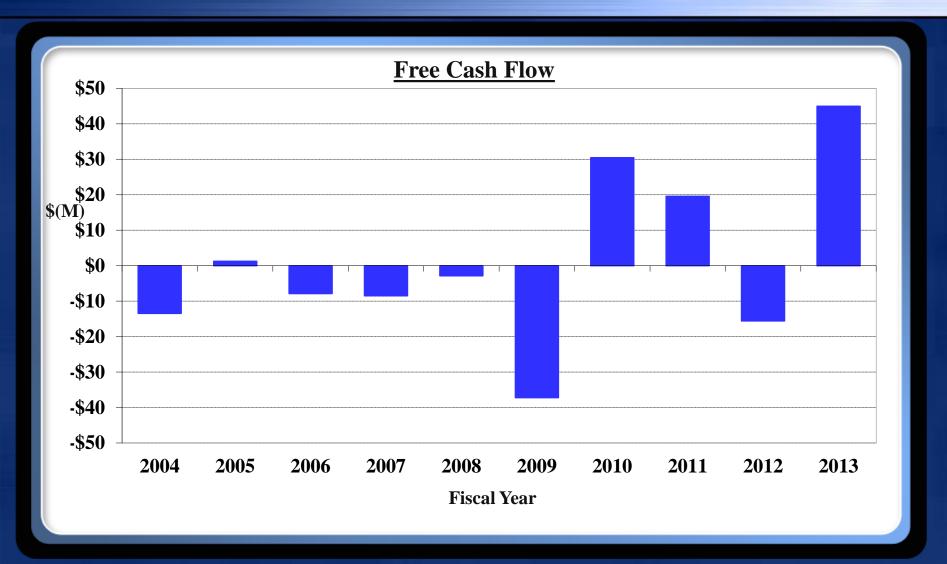
# The Amount of Time It Takes K12 to Get Paid Has Doubled in the Past Five Years, Which Has Impacted Cash Flows





# K12 Has Generated Only \$11 Million of Free Cash Flow Over the Past Decade





## K12 Aggressively Capitalizes Certain Costs – and Does Not Use a Big Four Accounting Firm

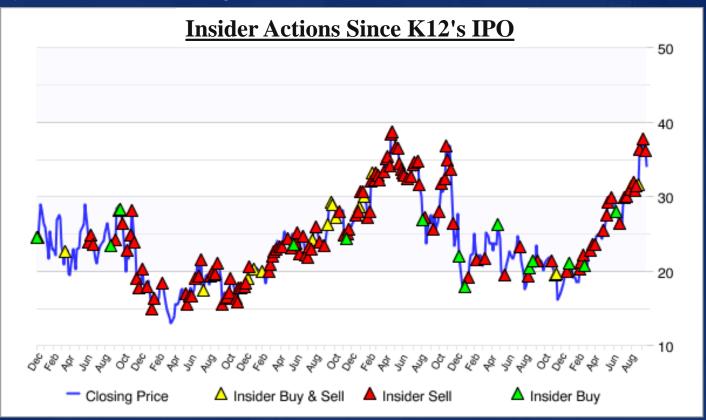


- K12 capitalizes much of its software and curriculum development costs
  - As of FYE 6/30/13, "Capitalized software, net" was valued on K12's balance sheet at \$43.5 million and "Capitalized curriculum development costs, net" was valued at \$64.6 million
- Capitalizing these costs rather than expensing them boosts reported margins and profits
  - EBITDA would have been 21% lower in FY 2013 had these costs been expensed
- While permissible under GAAP accounting, it is uncommon
  - Salesforce.com (not known for conservative accounting, to say the least) does not capitalize any software development expenses
  - Learning Tree International (LTRE), audited by the same BDO office as K12, does not capitalize curriculum expenses
- Perhaps there's a reason K12 chose BDO USA as its auditor, rather than a Big Four accounting firm?
- K12's new CFO (as of June), James Rhyu, has an MBA, not a CFA
- The chair of K12's audit committee, Steven Fink, is a lawyer by training, not a CFA

### There Has Been Steady Insider Selling of K12's Stock Since Its IPO



- The founder of K12, Knowledge Universe, distributed its entire stake to its investors only a few weeks ago
- This charts shows steady insider selling since K12 went public (the only buys are stock option grants):



### K12's Stock Is Richly Valued by Any Metric



- Market cap: \$1.3 billion
- Enterprise value: \$1.16 billion
- Stock price (9/16/13): \$35.15
- P/E (trailing): 48.8x
- P/E (next 12 month consensus estimates): 37.0x
- EV/EBITDA: 14.3x
- Short interest: 13.7% of shares outstanding (down from 27.2% at the beginning of the year) (per CapitalIQ)

# Former Employees and Other Sources Reveal What's Really Going On in K12's Schools



# Comments By a Board Member of a K12 School



Interview with a board member of a nonprofit charter school that's contracted with K12:

Everything you and the disgruntled employees say is right. The company is inherently broken.

K12 simply doesn't know how to manage schools. The systems and business processes inside the company are broken or don't exist. The notion that they have any kind of national model that they're consistently replicating across all of their schools is simply false. And they've been so focused on growth that basic stuff isn't there or doesn't work. The culture of the company is just bad in many ways. You can rarely get them to execute on anything in a timely manner. It's like pulling teeth to get them to respond to anything promptly.

K12's reputation is very poor. It's all about spin and manipulation. Nothing was ever their fault.

I think they're bad actors. There needs to be an inquiry at the state and federal level into these education management companies. That's odd for me to say because I'm a socially conservative moderate Republican. But these guys are worse than what I've seen in the for-profit college space.

I can tell you I wouldn't enroll my kids in Ohio or Agora or anywhere else because I've seen how the company operates. I've been in the belly of the beast.

Knowing what I know now, I'd dump the stock.

### Online Schools Are Only Appropriate For a Small Number of Students



While online schools can be an excellent option for certain students, it's a very small number – typically those who have a high degree of self-motivation and strong parental commitment.

It's sort of obvious if you think about it. Do you think you would have learned more during your K-12 educational experience if you'd sat at home in front of a computer vs. what you did: gone to school and had daily face-to-face interaction with teachers? How many of today's youth – in a world filled with 500 TV channels, texting, video games, etc. – do you think are better off at home rather than being at school?

Lastly, what do you think the answer is for the most at-risk kids, who typically come from poor, single-parent households, in which the parent has little time or ability to be the "parent coach" that's so critical to online education?

Tom Loveless, an education researcher at the Brookings Institution who did paid consulting for K12 in its early years, said: "The enthusiasts for cyber learning have overstated the potential. What they keep forgetting is we're not talking about college students here. We're talking about high schoolers and young kids. The idea that parents go to work and leave their kids in front of a computer—it's absurd."

In summary, online schools are only educationally appropriate for a very small number of students, which means that K12 and its peers need to be highly selective in recruiting students, and warn parents away whose kids are unlikely to succeed at an online school, especially at-risk youth.

So what does K12 do? Exactly the opposite.

# Former Employees Tell Consistent Stories of a Growth-At-Any-Cost Mentality (1)



#### Interview with Jeff Shaw, former Head of School of Ohio Virtual Academy

When I began to recruit students for the inaugural year of the (OHVA) high school, I told parents we have a remarkable curriculum, but it's best suited for students who are hard-working, internally-motivated self-starters, and who have at least one parent in the home during the school day. An online school isn't right for everybody. A failure of a few classes in high school can be devastating. Students can fall behind their graduation cohort group and be at greater risk of dropping out of school altogether.

Our administrative and enrollment team at OHVA was able to tell with a high degree of accuracy which students would do well academically with us. After the first year or so of the OHVA high school program, a decision was made by someone at a higher corporate level to market the high school program to all high school demographics ranging from at-risk to accelerated (Advanced Placement) students.

After the IPO, I got discouraged because the company's priority seemed to shift from academics to growth – it wasn't so much about academic achievement but on delivering the promised enrollment numbers to shareholders. (emphasis added) (continued on next page)

# Former Employees Tell Consistent Stories of a Growth-At-Any-Cost Mentality (2)



#### Interview with Jeff Shaw (continued)

Towards the end of my employment with K12, corporate assumed control of the initial steps in the enrollment process, both at our school and nationally, via call centers that were encouraging enrollment of students who were obviously ill-suited for learning in a virtual environment. It was apparent to those of us operating schools that parents weren't being given the whole story. K12 oversold students' potential to be successful and obligated teachers to do things they wouldn't likely to be able to do.

Eventually, it seemed as though K12's enrollment strategy was to cast a wide net into the sea of school choice and keep whatever they caught regardless if the catch was appropriate for virtual learning or not.

During weekly enrollment calls we were constantly pressured to overlook enrollment paperwork that was critical, consistent with best practice, or even compliant with state guidelines. For example, in order to speed up enrollment conversions, we were pressured by enrollment management to enroll students without a birth certificate or proof of custody. In my opinion, the company was totally crossing the line.

I am shocked that the stock continues to rise. I think it's a house of cards that is going to collapse. It boggles my mind when I read about and hear stories about what's going on in schools managed by K12. (emphasis added)

## K12 and Its Peers Spend Millions to Attract Students



- Online charter schools, using local taxpayer money, "are buying TV, radio, newspaper and Internet ads to attract students, even as brick-and-mortar public schools in the districts they serve face budget crunches."
- "The USA TODAY analysis finds that 10 of the largest for-profit operators have spent an estimated \$94.4 million on ads since 2007. The largest, Virginia-based K12 Inc., has spent about \$21.5 million in just the first eight months of 2012."
- "A look at where K12 is placing the ads suggests that the company is also working to appeal to kids: Among the hundreds of outlets tapped this year, K12 has spent an estimated \$631,600 to advertise on Nickelodeon, \$601,600 on The Cartoon Network and \$671,400 on MeetMe.com, a social networking site popular with teens. It also dropped \$3,000 on VampireFreaks.com, which calls itself "the Web's largest community for dark alternative culture.""
- "Kevin Welner, a University of Colorado professor who tracks virtual schools, estimated that K12 is on pace this year to spend about \$340 per student on advertising, or about 5.2% of its per-pupil public expenditures"
- "K12 spokesman Jeff Kwitowski wouldn't say whether the estimates are accurate or provide actual K12 figures."

#### Other Former Employees Describe K12's High-Pressure, Misleading Sales Tactics That Deceive and Mislead Parents and Students



Former sales employees at K12's call centers described high pressure to make huge enrollment quotas in order to get a commission. Sales employees were provided with a "script" of what to say to prospective students and parents, including purported "statistics" showing that K12 students were years more advanced than brick-and-mortar school students. Sample quotes:

- 1. CW2 described a toxic work environment where sales staff were pressured to meet unrealistic quotas, frequently being forced to make as many as 200 outgoing calls daily to keep up. CW2 confirmed that sales staff were never given any actual data of student performance, but were instead fed statistics from K12's website, and were told to tell parents that students who did the K12 program for 1-2 years performed better than their peers at brick and mortar schools.
- 2. CW4 stated that there was constant pressure to generate sales, describing the Company's sales philosophy as "enroll, enroll, enroll." CW4 stated that enrollment consultants were instructed to refer to the performance of K12 students as "comparable [to] or even better" than the performance of students at traditional schools, and to state that students at K12 schools were "on a better tier" than those at traditional schools.

#### K12 Is Increasingly Targeting At-Risk Students That It Knows Are Likely to Fail (1)



- K12 CEO Ron Packard claims that K12 is serving at-risk students for noble reasons: "It's just K12's culture. We want to help kids. It's just so ingrained all the way through the organization about helping as many kids, doing the right thing for kids." At another time, he said: "We don't want to be recruiting kids who it's not right for. That would be a disaster academically. It would be a disaster for the company economically."
- This is nonsense. Luis Huerta, Associate Professor of Education & Public Policy at Teachers College, Columbia University, who has studied K12 carefully and published reports on virtual schools, told me:

"The virtual providers like K12 are now mostly going after at-risk kids, kids on their last straw – if they didn't sign up, many would be dropouts or go back to juvenile court.

K12's phone banks have figured out a way to target dropouts and special ed kids. <u>They will sign up anyone – as long as that warm body signs in periodically, K12 can draw enrollment money from the district.</u>

It isn't for some noble reason – it's because these kids demand the least amount of education. These aren't kids and parents who will be knocking on K12's doors saying, "Hey, you need to do more for my kid."

K12 and Packard use this as an advertisement, saying they're doing noble things and wondering why they're being criticized. <u>It's almost comical</u>. <u>It's so misleading and conniving</u>." (emphasis added)

#### K12 Is Increasingly Targeting At-Risk Students That It Knows Are Likely to Fail (2)



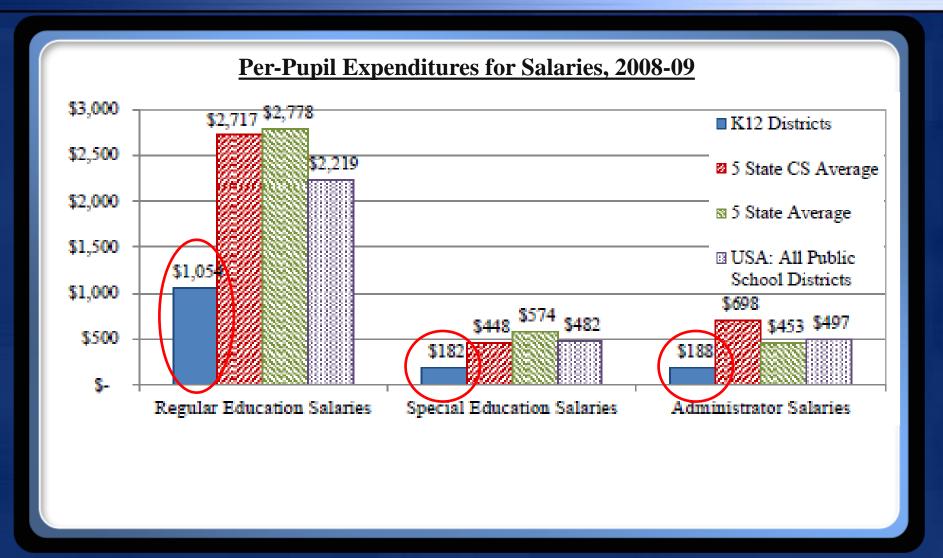
- One person told me that online charters know that "internet advertising leads to lots of students enrolling, but none succeed. Yet online charters are spending big money on this."
- A board member of a K12 school told me: "K12 was enrolling kids over the phone or online, without intentional regard for fit and careful likelihood to succeed. They advertise to the wrong demographic. And, they are enrolling a very large number of new students in August and September after the school year has started which is indicative of why growth hasn't been the right kind of growth."
- A former K12 Market Research Manager described how K12's aggressive marketing kept recruiting children unsuited to K12's program, stated "it was as if you were trying to stop the bleeding but were still inflicting wounds at the same time."
- A former Employment Consultant wrote the following on the web site, Glassdoor:

They push these quotes and "true stories" about all the children they have helped, but the truth is, this product is really only good for about 10% of the market that they target. The only success stories come from homes where there is a large parental support and willingness for the student to learn. K12 markets to low income families who are oftentimes more interested in a free computer and staying out of truancy court than anything else. Not only that, but the curriculum (which is actually very well developed) simply will not work for a low educated family who is having a hard time getting their child to go to a brick and mortar school, let [alone] apply themselves in a home based environment. They push enrollments on families where the adult in the home cannot even read, speak, or write in English, knowing that these students are destined to fail. (emphasis added)

While K12 celebrates how many at-risk students it's serving, I view it as an educational catastrophe in light of the these students' need for intensive, personalized instruction and hence how inappropriate online education is for most of them

### **K12's Online Schools Spend Far Less on Teacher** and Administrator Salaries Than Regular Schools





### Former Employees Tell Consistent Stories of Harried, Overworked, Unsupported Teachers



My interview with a former teacher at K12's Largest School, Agora (PA)

"I taught English at Agora from 2010-12. It was a horrible experience. Every teacher had the same experience I did. It was all of us.

Before I started, I was told there would be a lot of support, a low student-teacher ratio, and that if there were students who didn't show up, they'd take them out and replace them with another. But they took *everybody*. There was no teacher to student ratio.

When I started, I was assigned 300 students, which was very, very overwhelming. I would try to spend the appropriate time to read and grade each of the essays students turned, but I was really struggling with that. I couldn't keep up. I was told to skim over the papers and grade with a rubric.

For each class, I'd have maybe seven out of 30 students in that particular section attend – and even among those seven, just because their name was there showing them present doesn't mean they were at their computers.

A huge portion of my students never showed up or did anything. I have no clue what happened to them, though I have no doubt Agora was charging the state for them. I would tell Agora at the end of the week that I had concerns about certain students, so they'd tell me it was the teachers job to call the families. Once we set up an entire day and called students on the list, but I couldn't reach most of them.

When it came time to give grades, I was told, whatever I had to do, I had to pass every student.

<u>I would not say there was much learning going on</u>. If students were doing the program like they were supposed to, it could work – but the majority of students weren't coming from a family where a parent would help them. (emphasis added)

#### Comments By a Board Member of a K12 School About How K12 Treats Teachers



Interview with a board member of a nonprofit charter school that's contracted with K12:

K12 apparently thinks teachers are a necessary evil and have a factory production line model. In some ways it's become a businessman's approach to education, which I don't inherently mind (as a businessman myself), but they've tried to make teachers become something they are not.

Our teachers report that they are only able to spend 30% of their time actually teaching kids; the rest of their time they're required to do other things. Great teachers love to teach kids. Our teachers are not able to focus 100% of their time doing what they're trained to do.

The assessment culture that K12 has desperately thrown at this doesn't work. Our teachers have to use several different systems and can't get real-time data – it takes many days or even weeks.

What gets measured gets managed. K12 has teacher metrics that have nothing to do with educating kids. It's absurd. Teachers don't respond well to being managed in the same way some might try to manage a sales team.

Across all of K12's virtual academies nationwide, teacher satisfaction is not great.

# Is K12 Defrauding States Via Lax Enrollment Policies?



### Is K12 Defrauding States Via Lax Enrollment Policies?



In most states, K12 must stop charging states for students if they stop signing in after a certain period of time, but there is significant anecdotal evidence that K12 doesn't do this. Instead, it manipulates student counts and underreports student truancy and withdrawals

- A study of 10 online schools in Colorado concluded that "millions of dollars are going to virtual schools for students who no longer attend online classes."
- A former Agora teacher told me:

If students didn't log attendance for 10 days in a row, they were supposed to be withdrawn, but it never happened. When I mentioned it to Agora, they never replied.

The only time I ever saw a student drop off is if a parent were to notify Agora (that their child was withdrawing). It was very rare to see a student drop off. They'd stay on for the whole year.

 Heidi Gardner, a former K12 special ed teacher at Agora, said the turnover in enrollment led to a massive expansion in noninstruction work for teachers:

If you weren't trying to make initial [E-mail or phone] contact with new students then you were trying to keep on top of the 'inactive' [students who had not logged on to Agora's web portal in a few days] or confirm if students who not been in contact with [teachers] for weeks or months were still enrolled. You could add four hours to your work day doing this.

A Bloomberg BusinessWeek article noted:

At least 15 percent of the students enrolled in cyberschools in Pennsylvania's Bangor district end up as virtual truants, Superintendent Patricia Mulroy estimates. As Mulroy puts it: "We pay for them, even though they haven't logged in."

Another teacher wrote on the web site Glassdoor (see Appendix B):

More than half of my job is not about teaching, but about how to trick the state to give K12 more money, so the CEOs will get more pay

Melony Black, a former K12 English teacher at the Colorado Virtual Academy, said:

Three-quarters of my credit recovery kids never logged in, never completed any work, never answered their emails or phone calls, yet they remained on my class rosters. I began wondering about the state-mandated hours for students at the high school level. No one is monitoring this as far as I can see. (emphasis added)

Sources: Troubling questions about online education, EdNewsColorado.org, 10/4/11; my interview, articles, Glassdoor.com.

### Is K12 Defrauding States Via Lax Enrollment Policies? (2)



#### A story in the NY Times reports:

"With retention a problem, <u>some teachers said they were under pressure to pass students with marginal</u> performance and attendance.

Students need simply to log in to be marked present for the day, according to Agora teachers and administrators.

For most students, attendance is recommended but not mandatory at what are called synchronous sessions — when they can interact online with the teacher. A new grading policy states that students who do not turn in work will be given a "50" rather than a zero. Several teachers said assignments were frequently open for unlimited retakes.

Agora records from last year show that failing students were told they could make up their work. "All students with a course average of 40 to 59 percent were called and told all assignments past due could be made up without penalty," according to minutes from a school board meeting. Similar calls were going out to students with averages of 0 to 39 percent.

Theresa Henderson, an Agora teacher until June 2010 and the mother of four of its students, said she was among faculty members who requested a stronger policy to dismiss students who were not doing their work.

Several current and former staff members said that a lax policy had allowed students to remain on the rolls even when they failed to log in for days. Officials of the Elizabeth Forward School District in western Pennsylvania complained that Agora had billed the district for students who were not attending.

One of them was <u>a girl who had missed 55 days but was still on the school's roster</u>, according to Margaret Boucher, assistant business manager at Elizabeth Forward.

The school has cracked down on disengaged students, according to a statement by its director, Sharon Williams, who said a policy adopted last December mandates attendance at online classes for those students who do not log in, repeatedly fail to complete lessons or are failing three courses. She said the school follows state law by removing students who are absent for 10 consecutive days.

Poor attendance and disengaged students have been such a problem that Agora dismissed 600 students last year for nonattendance, 149 of them just before state tests were administered, according to school board minutes."

### Is K12 Defrauding States Via Lax Enrollment Policies? (3)



Audits of K12's enrollment figures revealed significant problems in Michigan and Nevada:

- In Michigan, pupil count auditors described difficulties auditing Michigan Virtual Academy's enrollment in 2010. "While teachers sign a print-out of log-ins, there is no verifiable evidence of student attendance, absences are not recorded, and many parents do not complete or submit their attendance paperwork on count day. For an auditor, this lack of systemic recordkeeping poses a distinct problem."
- Similarly, a 2009-2010 Nevada audit found that "Nevada Virtual Academy was unable to produce and maintain complete enrollment records in a timely manner.
   While we were eventually able to reconcile enrollment and attendance reports, it was noted that the completed Master Register contained multiple inaccuracies regarding the dates and codes for pupil enrollment or withdrawal [and] [t]hese Master Register violations are repeat findings from the previous Pupil Enrollment and Attendance Audit." (emphasis added)

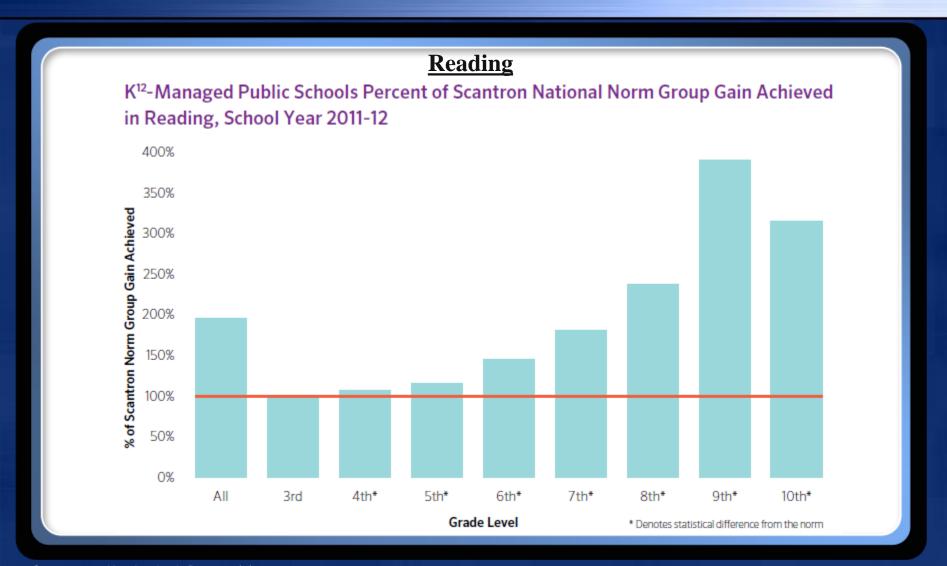
### But Every Company Has Disgruntled Employees, So Let's Look at K12's Academic Results



#### In a Slick, Colorful 132-Page Report, K12 Celebrates Its Strong Academic Results

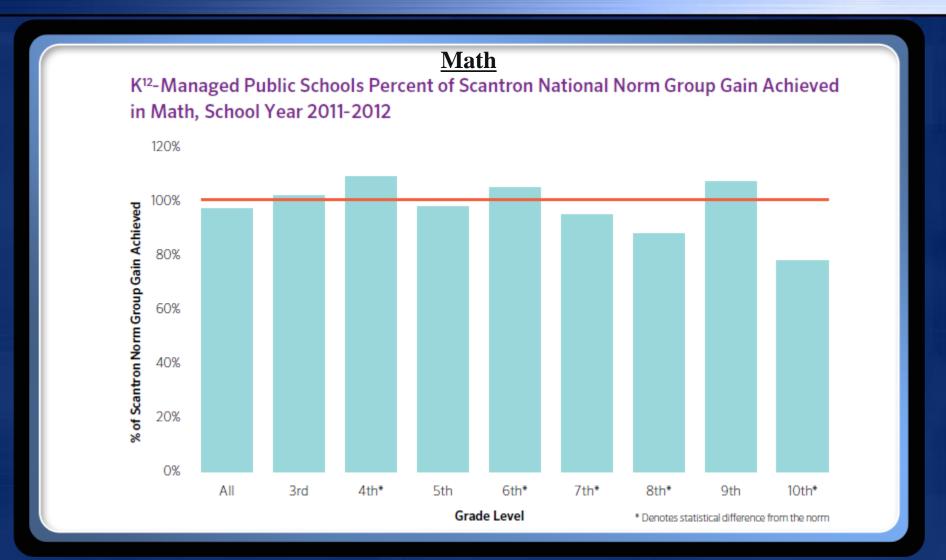


In Reading, Overall Achievement Was 196% of the Norm Group Gain



# In Math, K12 Claims Overall Achievement Was 97% of the Norm Group Gain





# Why K12's Scantron Results Are Virtually Meaningless



- K12 measures its students' academic growth (shown in the charts on the previous two pages) using the Scantron test, which is not a state-adopted exam, but rather simply a diagnostic tool that is used by K12
- K12 has yet to allow independent external evaluators to both validate its data collection efforts and more importantly evaluate its analysis of student achievement data, across all K12 schools
- The Scantron test is given in the home, unsupervised and untimed, making it easy for students to get help from a parent or the internet
- Jeff Shaw, former Head of School of Ohio Virtual Academy, comments:
  - For K12 students, Scantron is given in the home. It is possible for a parent to help Johnny or coach Johnny intentionally or unintentionally. It wasn't unusual for parents to call the school to express concerns that their student had been taking the assessment too long and in tears over the test. Parents were resistant and objected to Scantron testing because it represented one more thing they had to oversee and one more test their student had to take. Also of concern with parents and students was the fact that students were being tested on items they had not yet learned in the K12 curriculum.
- K12's purportedly strong Scantron results stand in stark contrast to K12 students' dismal results on state tests
  - Noting the discrepancy, K12 only says it is "not seeing the same level of success with external gains models that are now being used in some states, and thus, we are actively engaged in research to analyze why our Scantron gains scores do not always correlate to the states' gains scores."

#### K12's Own Data Shows Why Its Scantron Results Can't Be Relied On



- K12 says that "In the fall of 2011, and again in the spring of 2012, approximately 38,700 K12-managed public school students in grades 3–10 took the Scantron Performance Series tests in Math and Reading...Only students who are enrolled for a full academic year and take the fall and spring tests within the designated Scantron Performance Series testing windows are compared with the normed group data"
- As of 9/30/11, K12 had 106,665 students in its Managed Public Schools division and approximately 70% of K12 students are in grades 3-10, so K12 had 75,000 students who were eligible to take the Scantron tests
- Yet only 38,700 (52%) did. Why? There are only two possible answers, both of which skew the data toward the most successful students:
  - 1) Either a large fraction of eligible students didn't take the test, or;
  - A large number of students who were present and took the Scantron test in the fall of 2011 were no longer students in the spring of 2012, indicating high turnover
- In either case, it means the results are virtually meaningless but that hasn't prevented K12 from peddling them to shareholders, politicians, regulators, etc.

### Even K12 Admits That Its Scantron Results Can't Be Relied On



"The Scantron tests are optional for K12 students, and about 30 percent decline to take them. That means the company has been comparing a self-selected group of K12 students to the national norm, which isn't appropriate, [K12 Executive Chairman Nathaniel] Davis said.

The company, he said, needs to find "a more honest assessment" of student progress.

Davis said he pushed teachers to prod more students to take the Scantron last spring in hopes of getting a more valid sample. The company has not released data from those exams."

### University of Arkansas Study of K12's Arkansas Virtual Academy

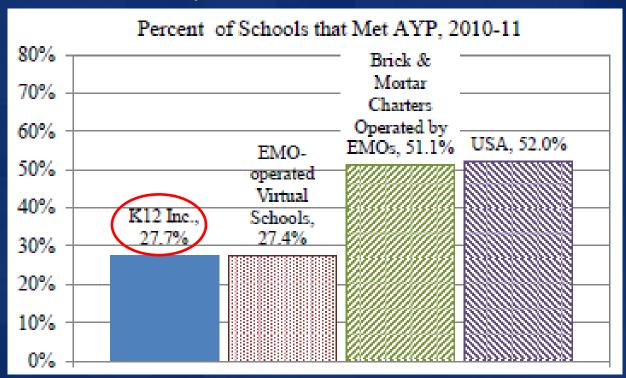


- K12 often cites a University of Arkansas evaluation released in 2012 of the Arkansas Virtual Academy (ARVA), which "found that students attending the online public charter school perform very well compared to nearly identical students in other Arkansas public schools. The study found "very positive trends for ARVA" and highlighted five conclusions:
  - ARVA students outperformed their comparison peers in math.
  - ARVA students outperformed their comparison peers in literacy.
  - The positive trends were apparent in nearly all grade cohorts.
  - Economically disadvantaged students did particularly well at ARVA, outperforming their comparison peers in math and literacy. (Sixty-one percent of ARVA students are identified as economically disadvantaged).
  - There were no statistically significant negative effects for ARVA students in the analyses conducted."
- There are a number of reasons to discount this study, however:
  - It only considered students who had taken tests in both 2009 and 2011 (the first and last years in the sample period). If student attrition at ARVA is anything close to other K12 schools, well under half of students would be there for two full years – reflecting a small subset of students who may, in fact, be doing well at ARVA
  - By state law, ARVA is capped at 500 students so ARVA has likely been more selective in taking only students who are likely to succeed at an online school (exactly what every K12 school should be doing!)
  - ARVA only goes through 8<sup>th</sup> grade (in high school, course failure rates are very high and overall student achievement and withdrawal rates are higher)
- It's also interesting to note that an article about the study is posted on K12's web site, but the actual study has been removed from the site and I cannot find it anywhere on the web

#### Only 28% of Online Schools Run By K12 Made Adequate Yearly Progress in 2010-11



"A study by National Education Policy Center revealed that only 27.7% of K12 schools reported meeting Adequate Yearly Progress (AYP) in 2010-11. This is nearly identical to the overall performance of all private Education Management Organizations that operate full-time virtual schools (27.4%). In the nation as a whole, an estimated 52% of public schools met AYP in 2010-11."



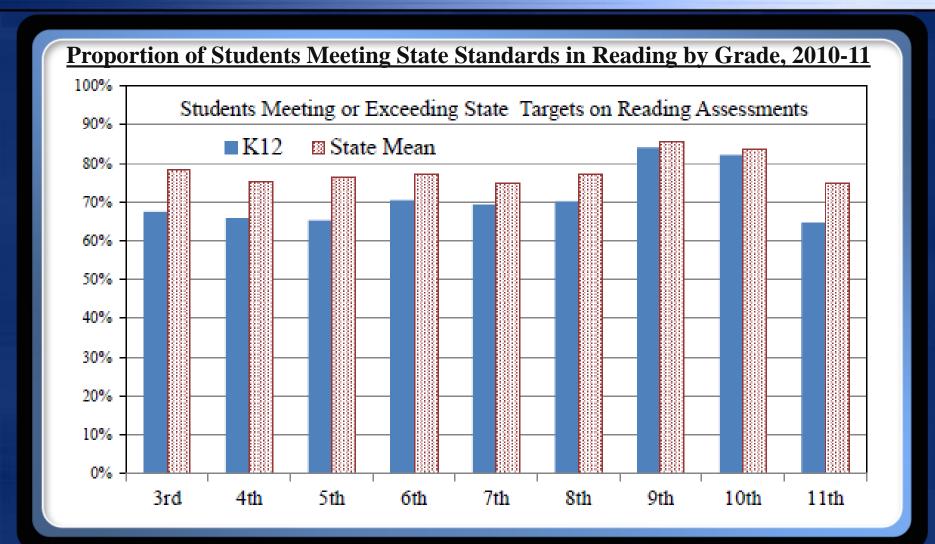
#### K12's Academic Results Are Dismal By Many Other Measures as Well



- 29 of 36 K12 schools (81%) that were assigned school performance ratings by state education authorities failed to earn a rating that indicated satisfactory progress status in 2010-11
- The mean performance on state math and reading assessments of K12operated virtual schools consistently lags behind performance levels of the states from which the schools draw their students.
  - Across grades 3-11, the K12 schools' scores were between two and 11 percentage points below the state average in reading.
  - In math, K12 students score, on average, between 14 and 36 percentage points lower than students in their host states, with the gap increasing dramatically for students in higher grades.

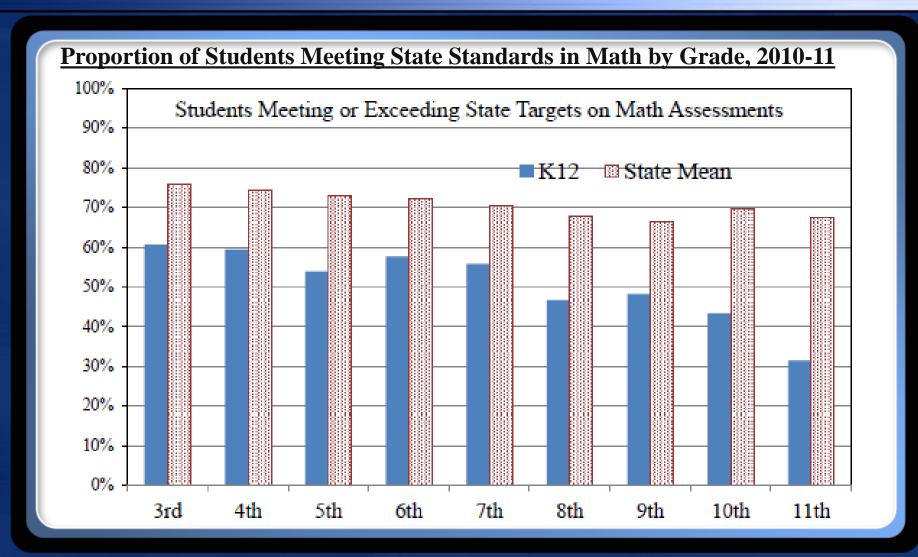
#### K12 Students Trail State Averages At Every Grade Level in Reading





#### K12 Students Trail State Averages At Every Grade Level By Much Wider Margins in Math





#### **Students at K12 Schools Have Low Proficiency Rates in Almost Every State**



K12 vs State Public Schools - Proficiency on Math and Reading Standardized Tests								
		2009-2010		2010-2011				
		M	R	M	R			
AZ	K12 Arizona Virtual Academy <sup>a</sup>	42	74	43	75			
	Arizona State public schools <sup>b</sup>	61.5	76.9	63.6	79.0			
CA	K12 California Virtual Academy @ Los Angeles <sup>c</sup>	24.1	56.3	N/A	N/A			
	California State public schools <sup>d</sup>	35.9	52.3	N/A	N/A			
со	K12 Colorado Virtual Academy <sup>e</sup>	27.9	55.5	38.7	64			
	Colorado State public schools <sup>f</sup>	52.4	68	53.2	67.9			
GA	K12 Georgia Cyber Academy (Odyssey School) <sup>g</sup>	72.3	93.7	66.4	91.4			
	Georgia State public schools h	85	91.4	85.1	92.3			
NV	K12 Nevada Virtual Academy <sup>i</sup> (K-8)	46.7	71	46	59			
	Nevada State public schools <sup>j</sup> (K-8)	66.7	74	69.7	69.3			
ОН	K12 Ohio Virtual Academy <sup>k</sup>	66.7	83.1	67.7	83.4			
ОП	Ohio State public Schools <sup>I</sup>	70.3	76.1	78.9	83.9			
PA	K12 Agora Cyber Charter School <sup>m</sup>	40.5	51.7	38.5	49			
	Pennsylvania State public schools <sup>n</sup>	72.2	70.5	72.9	72.3			
sc	K12 South Carolina Virtual Charter School °	71.7	83.6	55.4	65.5			
	South Carolina State public schools <sup>p</sup>	80.4	83.5	62.3	68.0			
тх	K12 Texas Virtual Academy <sup>q</sup>	60.3	87.5	62.8	85.5			
	Texas State public schools <sup>r</sup>	80.9	89	80.8	88.1			
WA	K12 Washington Virtual Academies <sup>5</sup>	11.5	35.7	38.7	56.3			
	Washington State public schools <sup>t</sup>	50.3	71.4	60.1	72.4			

In Indiana, K12's Hoosier **Academies Virtual School** received a letter grade of "F" from the state for 2011 and 2012. 57% of its students passed both parts of the ISTEP exam in 2011 and 48% did so in 2012, compared with state averages of about 70% for those years.

http://www10.ade.az.gov/ReportCard/SchoolReportCard.aspx?id=79705&Year=2011&ReportLevel=1

http://www.azed.gov/research-evaluation/files/2012/04/2011statereportcard.pdf

http://star.cde.ca.gov/star2010/ViewReport.asp?ps=true&lstCounty=19&lstDistrict=65094-0838&lstSchool=0112706

http://star.cde.ca.gov/star2010/ViewReport.asp?ps=true&lstTestYear=2010&lstTestType=C&lstCounty=&lstDistrict=&lstSchool=&lstGroup=

https://cedar2.cde.state.co.us/documents/UIP2011/0020-1752.pdf

http://www.cde.state.co.us/FedPrograms/dl/danda\_nclbstrptcrd\_0910.pdf

http://archives.gadoe.org/ReportingFW.aspx?PageReq=102&SchoolId=36407&T=1&FY=2011

http://archives.gadoe.org/ReportingFW.aspx?PageReq=102&StateId=ALL&T=1&FY=2011

http://www.nevadareportcard.com/profile/pdf/10-11/18404.E.pdf

http://www.nevadareportcard.com/profile/pdf/10-11/18404.E.pdf [K-8]

http://www.ode.state.oh.us/reportcardfiles/2010-2011/BUILD/142950.pdf

http://www.ode.state.oh.us/reportcardfiles/2010-2011/BUILD/142950.pdf

http://paavp.emetric.net/School/Overview/c15/4/7858

http://ed.sc.gov/data/report-cards/2011/high/c/h4701004.pdf; http://ed.sc.gov/data/report-cards/2010/elem/c/e4701004.pdf

http://reportcard.ospi.k12.wa.us/summary.aspx?groupLevel=District&schoolId=7655&rep&year=2010-11

http://reportcard.ospi.k12.wa.us/summary.aspx?vear=2010-11

## K12's Dismal Academic Results Are Not Due to Serving More At-Risk Students



K12 claims that its dismal academic results are because it serves more atrisk students, but this is questionable for two reasons:

- 1) Though its proportion of at-risk students has indeed risen in recent years, it's from a low base so it's not clear whether K12 is, in fact, serving a higher proportion of such students relative to state averages
- 2) Even growth measures show dismal performance
  - K12 argues (correctly) that "a more accurate method for measuring student performance is the progress a student makes over the course of a school year, also known as a "growth measure"

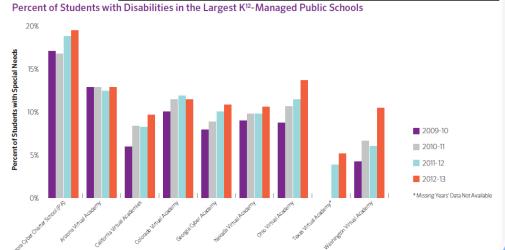
#### K12 Tries to Excuse Its Dismal Academic Results By Highlighting the Number of At-Risk Students It Serves, Which Has Increased in Recent Years





"We estimate that as many as 50% to 70% of new students did not achieve proficiency in math on state exams taken in the year before enrolling in a K12-managed public school, and up to 40% did not achieve proficiency in reading. K12-managed public schools are also being chosen by large numbers of high school students who are not on track for on-time graduation—in one sampling of these schools, approximately 40% to 60% of incoming 10th, 11th, and 12th graders were credit deficient upon enrollment."

In fairness to K12, charter school laws require them to accept all applicants, but K12 is aggressively targeting students it knows are least likely to succeed at an online school. As noted on page 25, I view the number of atrisk students K12 is serving as an educational catastrophe rather than something to be celebrated.

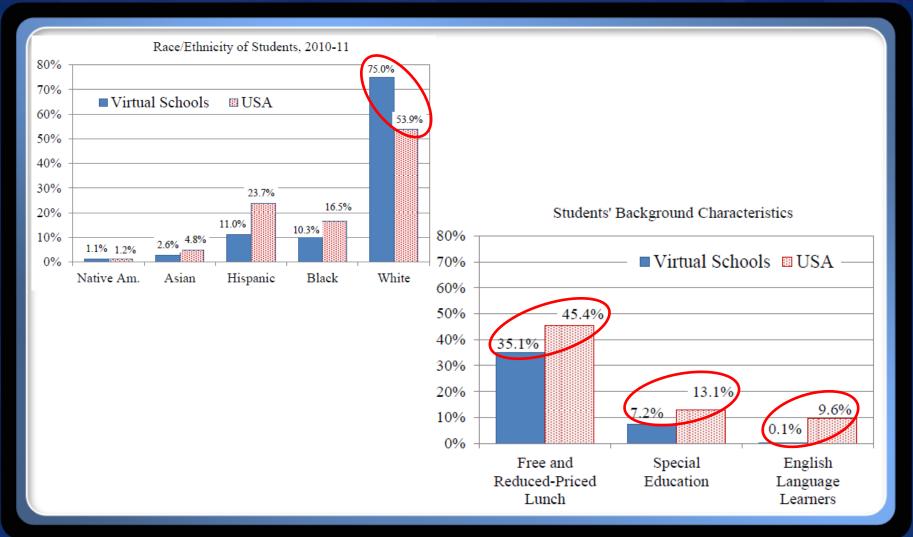


### It's Not Clear, However, That K12's Schools Serve More At-Risk Students



**K12 Had More White Students, Fewer Poor and SPED** 

Students and Almost No ELL Students in 2011

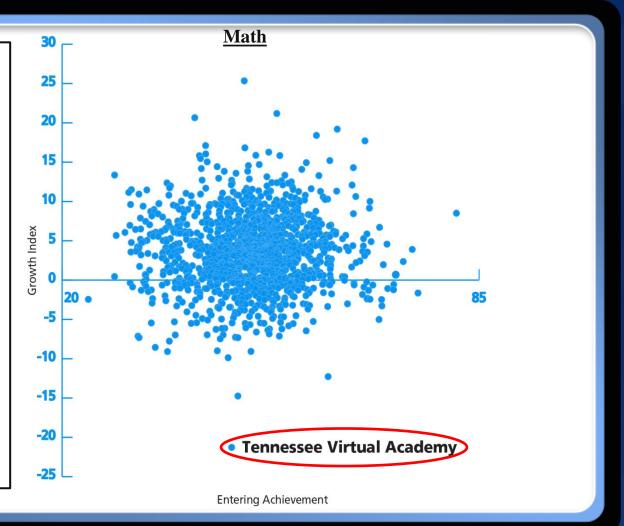


### K12's Academic Growth in Tennessee is By Far the Worst of Any School in the State (1)



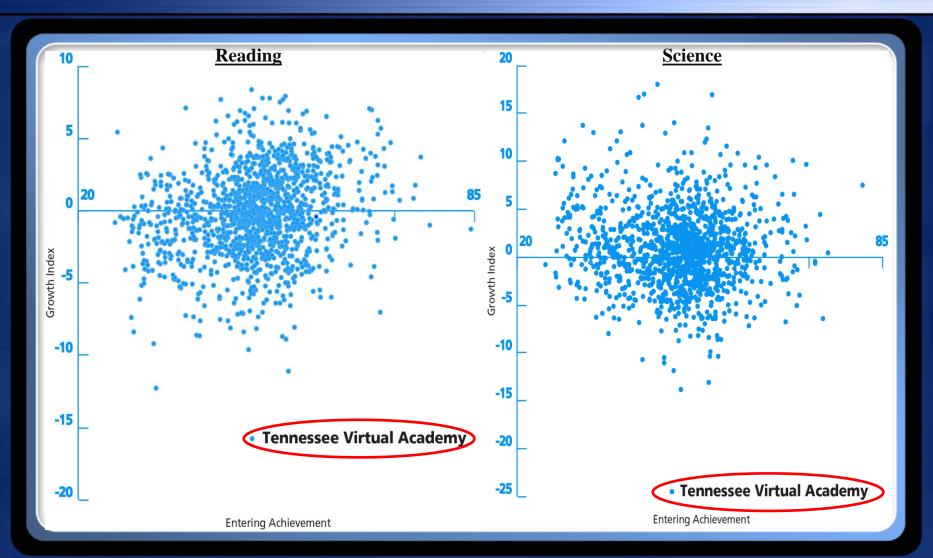
Students are entering only slightly below average, but their Growth Index (i.e., learning) is by far the worst in all three tested subject areas among all 1,300 elementary and middle schools tested in the state.

I think it's safe to say that there's almost no learning at all going on at TVA.



### K12's Academic Growth in Tennessee is By Far the Worst of Any School in the State (2)



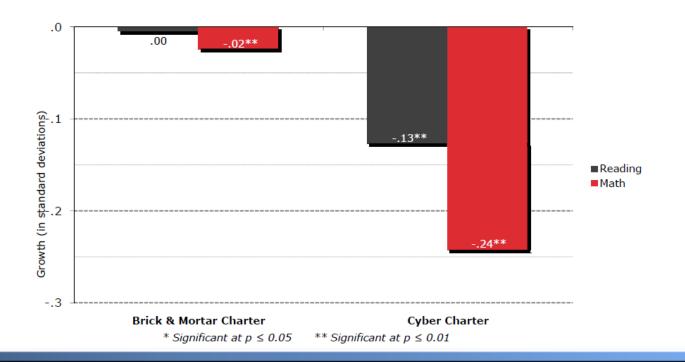


#### Student Growth At Eight of the Largest Online Schools in Pennsylvania Was Dismal



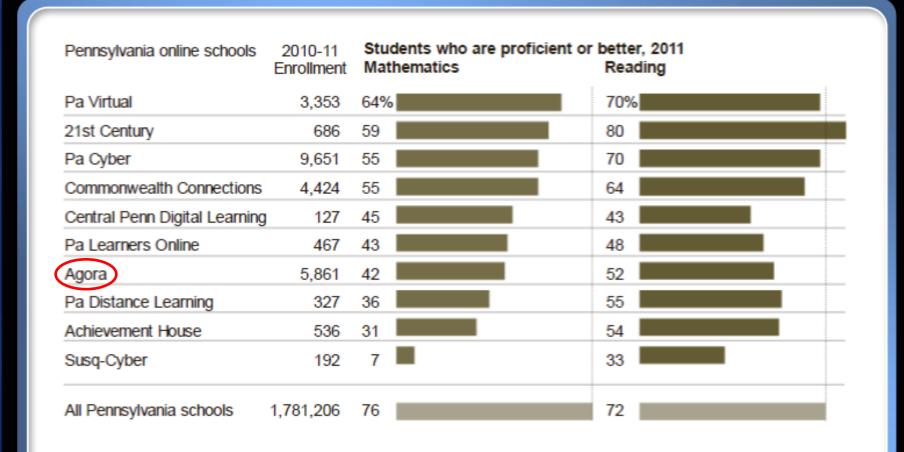
"In both reading and math, all 8 cyber schools perform significantly worse than their traditional public school counterparts."

Figure 3: Average Learning Gains in Pennsylvania Brick & Mortar and Cyber Charter Schools Compared to Gains for VCR Students in Each Charter Schools' Feeder Schools



#### Static Student Performance at K12's Agora School in Pennsylvania Was Dismal As Well





## Conclusions From A Study of Colorado's 10 Largest Online Charter Schools (1)



- Students attending Colorado's full-time online education programs have typically lagged their peers on virtually every academic indicator, from state test scores to student growth measures to high school graduation rates. (emphasis added)
  - Between 2004 and 2011, [K12's] COVA's reading scores dropped six percentage points and math results flatlined. Academic growth indicators put student progress at 29 in math and 36 in reading, far below the state average of 50.
  - Online student scores on statewide achievement tests are consistently 14
    to 26 percentage points below state averages for reading, writing and math
    over the past four years. The gap in reading and writing has remained
    about the same between 2008 and 2011, and the gap in math has risen
    several percentage points.
  - Double-digit gaps in achievement on state exams between online students and their peers in traditional schools persist in nearly every grade and subject – and they're widest among more affluent students.
  - Most online school students do not appear to be at-risk students.

Note: These findings are for 10 online schools, of which K12's Colorado Virtual Academy was the largest with 5,034 students at the time of the study.

# Conclusions From A Study of Colorado's 10 Largest Online Charter Schools (2)



- Half the online students wind up leaving within a year. When they do, they're often further behind academically than when they started.
  - Students who transfer to online programs from brick-and-mortar schools
    posted lower scores on annual state reading exams after entering their
    virtual classrooms...59 percent had scored proficient or above in reading
    while in a brick-and-motor school. But after a year in online school, only 51
    percent achieved that score.
- Students who stayed in online programs long enough to take two years' worth of state reading exams actually saw their test results decline over time.
- Millions of dollars are going to virtual schools for students who no longer attend online classes.
- The churn of students in and out of online schools is putting pressure on brick-and-mortar schools, which then must find money in their budgets to educate students who come from online schools mid-year.

# Conclusions From A Study of Colorado's 10 Largest Online Charter Schools (3)



- Online schools also had among the highest dropout rates and lowest graduation rates in the state over the past two years. In 2010, fewer than one in four online school seniors graduated compared to nearly three of every four high school seniors statewide. (emphasis added)
- The dropout rate in the top 10 largest online programs last year was 12 percent – quadruple the state average of 3 percent.
- Other studies of Colorado online students have found similarly poor results: The state's annual online school report released in June found that "results indicate achievement of online students consistently lags behind those of non-online students, even after controlling for grade levels and various student characteristics," such as poverty, English language ability and special education status.

# Conclusions From A Study of Colorado's 10 Largest Online Charter Schools (4)



- Some online schools appear to be collecting a full year's payment for students and then sending them back to regular schools
  - Many of GOAL's recruited students returned to St. Vrain schools in the middle of the year, behind in school, Haddad said. For many of the returning students, their time in the online program was "wasted," he said. These institutions, what they do is borderline unethical behavior in my mind," said Haddad, who supports online learning as a tool. "It's a money-making proposition and they have no problem sending the kids back after the October count. The sales job they get up front, it's a travesty."
    ...About a dozen of the students came back after Oct. 1, the official state count day to determine per-pupil funding. GOAL got the funding; Florence got the students back. Then the school had to find ways to help them catch up.

## Online Charter Schools in Ohio, Especially K12's, Have Terrible Academic Results



- Ohio's six biggest cyber schools all got Fs on their state progress reports
- "Seventh graders in two of Ohio's big virtual schools learned enough in a year to keep pace with their peers in traditional schools, state data show. But in every other tested grade in every one of Ohio's six largest online schools, students fell woefully behind. The state counts a progress score of -2 as a complete failure for the school. The cyber schools racked up scores as low as -12, -18 and -27."



The scores of K12's school are the worst by far

SOURCE: OHIO DEPARTMENT OF EDUCATION

### Online Charter Schools in Ohio and South Carolina Have Terrible Academic Results

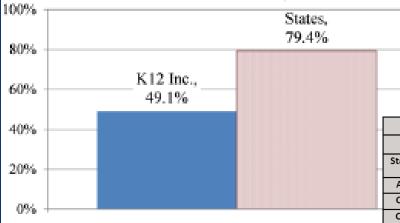


- Another study in 2011 of Ohio's seven statewide online schools found that:
  - "Of Ohio's 7 state-wide E-schools (which account for 90% of all E-school enrollment), six are not even rated "effective" by the Ohio Dept. of Education.
  - 5 of the 7 have graduation rates worse than Cleveland Municipal Schools, which has the lowest graduation rate of all traditional school districts.
  - Far from saving money, E-Schools actually cost the state twice as much per pupil as traditional public schools."
- In South Carolina, all four cyber charter high schools had academic growth ratings of 'below average' or 'at risk,' as did two of the three elementary schools.

#### K12's Graduation Rates Are Extremely Low KASE



 The on-time graduation rate for the K12 schools is 49.1%, compared with a rate of 79.4% for the states in which K12 operates schools:



Here's data for certain states:

		Graduation Rates (%)								
				2009-2010		2010-2011 <sup>a</sup>				
	State	K12 Schools	K12 School	State	K12 School	State				
	AZ	Arizona Virtual Academy <sup>b</sup>	23	76.1	35.2	75.4				
	CA	California Virtual Academy @ Los Angeles <sup>c</sup>	29.2	78.6	34.8	80.5				
	СО	Colorado Virtual Academy	12	72.4	21.6	73.9				
	NV	Nevada Virtual Academy <sup>d</sup>	83.3	71.3	58.3	72.3				
	ОН	Ohio Virtual Academy (OVA) <sup>e</sup>	54.1	83	58.8	84.3				
	PA	Agora Cyber Charter School <sup>f</sup>	68.5	90	66	91				
	SC	South Carolina Virtual Charter School <sup>g</sup>	23.2	72.1	7.4	73.7				
	WA	Washington Virtual Academies <sup>h</sup>	N/A	76.5	22.2	75				
	3 Avinana California Navada Ohia Cauth Carolina and all report providing production data on school and state report and send and many									

<sup>&</sup>lt;sup>a</sup> Arizona, California, Nevada, Ohio, South Carolina and all report previous year graduation data on school and state report cards and more current data are not published. Therefore, for these states, data are reported for the previous year.

http://www.k12.wa.us/DataAdmin/default.aspx

http://www.azed.gov/research-evaluation/graduation-rates/

http://dq.cde.ca.gov/dataquest/CompletionRate/comprate1.asp?cChoice=StGradRate&cYear=2008-09&level=Stateshttp://dq.cde.ca.gov/dataquest/Acnt2011/2010BaseSchDC.aspx?allcds=19-65094-0112706&c=R

d 83.3% based on 12 students; http://www.nevadareportcard.com/profile/pdf/10-11/18404.E.pdf; http://www.nevadareportcard.com/

http://www.ode.state.oh.us/reportcardfiles/2010-2011/BUILD/142950.pdf;

http://ilrc.ode.state.oh.us/PublicDW/asp/Main.aspx?server=mstris2&project=ILRC&evt=3002&uid=guest&pwd=&persist-mode="8" http://paayp.emetric.net/Content/reportcards/RC11S126510020000007858.PDF; http://paayp.emetric.net/;

http://www.education.state.pa.us/portal/server.pt/community/state\_report\_cards/7438

http://ed.sc.gov/data/avp/2011/; http://ed.sc.gov/data/report-cards/2011/high/c/h4701004.pdf

http://www.k12.wa.us/DataAdmin/pubdocs/GradDropout/10-11/GradDropoutStats 2010-11.pdf

# **Even Champions of Online Charter Schools Are Calling for Improvement**



- Susan Patrick, president of the International Association for K-12 Online Learning, an industry trade group, said:
  - "Unless we address these quality issues that have emerged quite profoundly," the poor performance of cyber schools will "put the entire industry of education innovation at risk. We need to have an honest discussion about this."

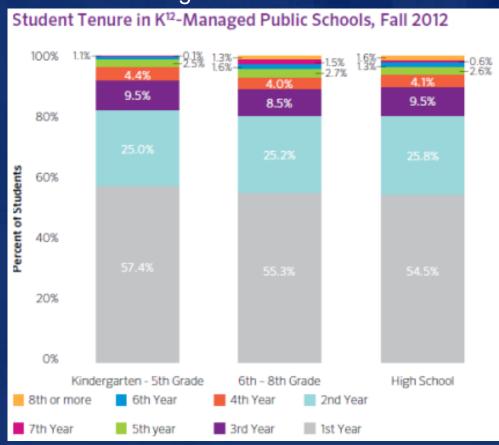
### K12's Sky-High Student Dropout Rate



# K12 Admits to High Student Turnover, But Doesn't Fully Quantify It



- On November 16, 2011, K12's CEO Ron Packard admitted that "[w]e track churn immensely," but that "we haven't chosen to" disclose churn rates to investors. He did, however, reveal that "about 60% of the kids who start with us in September are with us a year later" – meaning a 40% churn rate!
- K12 acknowledges that "online schools experience relatively high departure rates," but that it has "maintained consistent retention rates over the past five years"
- In its 2013 Academic Report, K12 shows the following chart, which shows that in the fall of 2012, 55% of students were in their first year:
  - But this isn't the same as turnover, as K12 is growing rapidly and hence has many new students year



#### In 2010, Student Churn Ranged from 24-51% at Four of K12's Largest Schools



- Journalist Roddy Boyd of The Financial Investigator collected data for the 2010 school year for four of K12's largest schools (see complete data in Appendix A):
  - "Agora [Cyber Charter School in Pennsylvania] grew like a wildfire in the 2010 school year. A total of 7,578 students were signed up through the course of the school year, of whom 4,718 were in place in September. Throughout the year, a total of 2,688 dropped out for a student turnover, or churn rate, of 35.5%.

K12's other virtual academies, Ohio Virtual Academy (OVA), California Virtual Academy (CAVA) and the Colorado Virtual Academy (COVA) show a similar level of churn:

- ➤ OVA enrolled a total of 18,743 students cumulatively throughout the 2010/2011 school year with 9,593 withdrawing by the end of the year, for an astoundingly high churn rate of 51.1%
- CAVA schools signed up a total of 16,934 students in the 2010/2011 school year (11,682 were enrolled in September) and 23.8% pulled out.
- ➤ COVA schools had 6,449 students registered through the 2010/2011 school year of which 4,163 were enrolled as of that August. A total of 2,330 dropped out for a <u>churn of almost 36.1%</u>"

# In Pennsylvania and Colorado, the Dropout Rate Is Roughly 50%



- Columbia Prof. Luis Huerta confirms the high dropout rates at Agora:
  - "We calculated <u>churn rates as high as 57%</u>, where September 2009 enrollment was 4,718 kids and by May 2010, 2,688 kids had dropped out. Yet during the same academic year they enrolled 2,860 new kids, and finished the year with 5,022 kids." [see Appendix A for details]
- In Colorado, "Half the online students wind up leaving within a year."
   (note that this includes all online schools, not just K12's)
  - Of 10,500 students in the largest online programs in fall 2008, more than half or 5,600 left their virtual schools by the fall of 2009. They were more than replaced by 7,400 new recruits by that fall. That new group also experienced high turnover, with more than a third of the students leaving by the end of that school year, the analysis showed. By October 2010, only about a quarter of the students remained in their same online program after two years. (emphasis added)

### Testimony as Part of a Class Action Lawsuit Reveals K12's Student Churn



#### **Employee CW3**

CW3, a former administrator at California Virtual Academy who attended weekly enrollment meetings, confirmed that the turnover rate was high, stating that as soon as students withdrew, more would be brought in to replace them. CW3 referred to California Virtual Academy as a "revolving door."

#### Employee CW5

CW5, a former K12 Market Research Manager from July 2008 to April 2011, confirmed that management internally tracked churn. CW5 was a statistician with a doctorate who was charged, among other things, with studying churn at K12's schools. According to CW5, another factor contributing to churn was the mistaken impression (fed by the Company's marketing team) that K12's program was flexible and not state-regulated – when it became clear that the program was required to meet certain state requirements, the parents withdrew their children. CW5, describing how K12's aggressive marketing kept recruiting children unsuited to K12's program, stated "it was as if you were trying to stop the bleeding but were still inflicting wounds at the same time." (emphasis added)

According to CW5, by 2009 "everybody knew there was an issue with retention," and the Company accordingly created an internal "Retention Task Force," comprised of V.P.- and-above level employees, to focus on retention problems. Defendants, however, did not *publicly* disclose the retention and churn problems until the end of the Class Period.

### K12's Relationship With Nonprofit Charter Holders



#### K12's Relationship With Nonprofit Charter Holders Is Rife With Conflicts and Self-Dealing, Which May Violate IRS and State Regulations



- Of the 42 states (and DC) that permit charter schools, most will only grant charters to nonprofit 501(c)(3) entities, for which the IRS code states: "none of its earnings may inure to any private shareholder and individual"
- This presents a vexing problem for K12, but it gets around this by signing long-term contracts with local nonprofit entities to provide management and other services that, in effect, allow K12 to siphon off all of the profits for itself
  - While this type of arrangement doesn't technically violate IRS regulations nonprofits contact with for-profit businesses all the time – it's critical that the nonprofit be a truly independent entity with an independent board of directors looking out solely for the nonprofit mission of the organization.
- This doesn't appear to be happening with many of the nonprofit charter schools K12 contracts with:
  - K12 employees sometimes serve on the board of the nonprofits and, worse yet, are sometimes involved with their very creation (One person told me that "Many of these nonprofit boards are tiny, clueless, dysfunctional, and have K12 employees on them")
  - The contracts are often awarded to K12 without competitive bidding
  - K12 usually directly or indirectly employs all key people, including the Treasurer a particularly blatant conflict of interest
  - K12 often reviews its own billings and then fails to provide the boards with detailed accounting for its expenditures
  - The contract with K12 typically results in the nonprofit entity reporting minimal "profits" or, often, a loss, which K12 then "forgives"
    - "We take responsibility for any operating deficits incurred at most of the Managed Public Schools we serve" LRN 2013 10-K

Conclusion: Many of these nonprofits are a sham. For all intents and purposes, K12 controls, operates, and profits from the supposedly nonprofit charter schools, in blatant violation of most states' laws and IRS regulations.

#### Newark Prep Charter School Is a Good Example of How K12 Effectively Runs Schools That Are Supposed to Be Nonprofit (1)



"Newark Prep Charter School opened last year with 150 students, a dozen teachers and big ambitions to become among the first schools in the state to offer classes taught online.

It hired K12 Inc., a for-profit online learning giant, to handle the start-up and offer many of the services the high school would provide.

A contract obtained by The Star-Ledger shows the publicly traded company — which operates charter schools for thousands of students in 27 states and made \$30 million in the last school year — selected Newark Prep's principal, drafted its budget and leased it furniture and equipment.

In return, Newark Prep paid the company nearly half a million dollars, or 17 percent of the \$2.8 million it received last school year to educate students, according to financial data provided by the school's board of trustees. This year, as the student body grows, the fees could take up to 40 percent of the school's revenue, according to the contract.

New Jersey law allows for-profit companies to play a big role in public schools.

One thing they can't do is run the place.

But charter school experts and one lawmaker said it's sometime hard to tell if the rules are being followed, and K12's involvement with Newark Prep is one of those instances. (continued on next page)

#### Newark Prep Charter School Is a Good Example of How K12 Effectively Runs Schools That Are Supposed to Be Nonprofit (2)



(continued)

""Technically, on the books, K12 is just a contractor hired by Newark Prep Charter School, but in reality it is running the school, soup to nuts," said Luis Huerta, a Columbia University Teachers College professor who studies the impact of virtual charter schools across the country.

In addition, Assembly Education Committee Chairman Patrick Deignan (D-Middlesex) called the steep fees and the terms of the contract "deeply troubling."

...A letter written on behalf of the seven-member board called the \$489,848 the school paid K12 last school year a "tremendous bargain" because the company allowed the school to postpone payment of other fees it was scheduled to pay last year.

"The board, principal and school business administrator set all policies and run the school," the letter states. "K12 is a vendor. They make suggestions and provide support, but that's all."

But when asked to describe a specific responsibility it handles without any guidance or assistance from K12 Inc., the board could not name one."

(continued on next page)

#### Newark Prep Charter School Is a Good Example of How K12 Effectively Runs Schools That Are Supposed to Be Nonprofit (3)



(continued)

"...Seemingly contradictory clauses in the contract cement K12's authority over important decisions that affect the school's academic success and the company's bottom line, said Huerta, of Columbia.

For example, the contract stipulates that Newark Prep's board must oversee K12 Inc.'s work, but it also requires K12 to implement whatever school policies it deems necessary for the success of its proprietary online curriculum.

The contract, which was drafted by K12., states that Newark Prep Charter School and the company are "independent contractors," pursuant to New Jersey laws and regulations, yet K12 is free to use the school's name "in press releases, on its website, or in other marketing materials."

The document also states in a section titled "exclusivity" that the school cannot consider hiring another curriculum contractor or breaking its agreement with K12 without giving 18 months' notice or getting permission from the company.

If the company expects the school's state aid to decline dramatically, however, it can cancel the contract with 60 days' notice."

#### Ohio Virtual Academy Is Another Good Example of How K12 Effectively Runs Schools That Are Supposed to Be Nonprofit



Jeff Shaw's comments about the Ohio Virtual Academy:

It was rather obvious to me as Head of School that K12 wasn't always interested in reducing the non-profits' expenses if those savings would impact the bottom line for K12.

K12 assumed control of most of the OHVA budget and a majority of any excess funds was soaked up by the end of the year, often to the point where the school would show a loss. In this case, the agreement with K12 required them to issue a credit for management fees so OHVA would show a small surplus for the fiscal year.

The volunteer governing boards assume a limited role in the school's overall governance. The boards tend to put their faith in K12 and count on it to do what is in the school's best interest. A Head of School walks a fine line in order to balance the best interests of both parties. In many cases, the boards know only what K12 wants them to know. It's like the fox guarding the henhouse.

### Comments By a Board Member of a K12 School



Interview with a board member of a nonprofit charter school that's contracted with K12:

Everything you said about the nonprofits not being fully independent, about K12 exercising an inappropriate level of control was certainly true at our school for more than a decade.

One of the problems with the nonprofits K12 contracts with: most have no staff, so they are totally dependent on K12. There's no review of invoices, no independence, no accountability.

K12 received nearly 80 cents of every dollar we received from the state, *excluding* teacher salaries. It's outrageous!

They've forgotten that we're the customer and they're the vendor.

# The IRS Is Scrutinizing the Tax-Exempt Status of Online Schools That Use For-Profit Management Companies Like K12



An alert by the law firm of Lewis Roca Rothberger warns:

Many charter schools are intended to be operated as 501(c)(3) public charities. Historically, the Internal Revenue Service ("IRS") has carefully reviewed other types of charitable organizations operated by management companies to determine whether they qualify as a tax-exempt charities because they are, in fact, operating for the private benefit of the for-profit management company. However, the IRS has not brought a similar focus on this issue to charter schools generally – until now. The IRS is poised to increase its scrutiny of charter school/management company relationships and is now subjecting charter schools to more stringent standards defining such relationships.

Certainly, for those charter schools with management companies that are now seeking or will be seeking tax-exempt status, the level scrutiny of applications for recognition of tax-exempt status will increase.

Charter schools subject to management agreements that are already exempt should be prepared to closely review their management agreements with their counsel to confirm that the management agreement does not violate private inurement and private benefit restrictions applicable to all charitable organizations.

The IRS has thus far refused to disclose the standards and criteria it will employ in reviewing tax exemption applications of charter schools with management companies. It is clear that the IRS's review of charter school management agreements will become more common and burdensome for both existing and new charter schools, and may require amending management agreements – both with respect to their substantive terms and their pricing.

#### **Does K12 Really Save States Money?**



#### It's Not Clear Whether K12 Saves States Money



Though K12 schools only cost "approximately 60% of the national average per-pupil expenditure," it's not clear that they really save states money

- Online schools result in states paying for an unknown number of students who would otherwise be home schooled (at parental expense)
- "Another way K12 maximizes its income is to establish schools in poor districts, which receive larger subsidies in some states."

"The company administers one of K12's newest schools from Union County, Tenn., a mountainous Appalachian enclave where nearly a quarter of the residents live in poverty.

The Tennessee Virtual Academy is technically part of the local school district, which receives more per pupil from the state than most other districts in Tennessee. But of the school's 1,800 pupils, few are actually from Union County.

Out of the state money, the Union County schools will get an administrative fee of about \$400,000. K12 stands to collect almost \$10 million to staff and manage the school. Dozens of other Tennessee counties, however, lost state financing when some of their students elected to go to the virtual school."

#### **Case Study: Virginia (1)**



"The Virginia Virtual Academy, another K12 venture, began enrolling full-time students across the commonwealth in fall 2009, more than a year before state law addressed this new kind of education.

The Virginia school offers a lesson in how K12 relied on political savvy and statehouse connections to build its business.

The Virginia venture was a partnership between the traditional schools of Carroll County — a rural county bordering North Carolina — and K12. Children who enrolled in the Virtual Virginia Academy were counted as Carroll County students no matter where they lived.

That was no accident.

State aid varies by school district and follows a formula based on poverty, among other factors. Affluent Fairfax County receives \$2,716 per pupil from Richmond, whereas relatively poor Carroll County receives \$5,421, according to the state Education Department.

This year, 66 Fairfax students are enrolled in the virtual school. Richmond is paying the virtual school twice as much for those students as it would if they attended neighborhood schools in their own county.

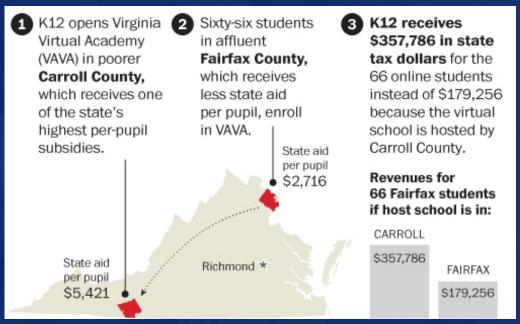
"Clearly, it's not a logical or equitable system," said state Sen. George L. Barker (D-Fairfax). "It's a horrible deal for taxpayers.""

#### **Case Study: Virginia (2)**



"Barker has twice tried to change funding so that subsidies are based on where students live. Twice he was rebuffed by Gov. Robert F. McDonnell (R), a champion of school choice who successfully promoted legislation to authorize full-time virtual schools in 2010.

K12 was the only private company present during talks to craft that legislation. McDonnell has received \$55,000 in campaign contributions from K12 or its executives since 2009, including a \$15,000 payment to his political action committee this month."



### K12 Has Managed to Mostly Fend Off Critics Thanks to Its Well Known Political and Lobbying Prowess



### K12 Spends Large Amounts of Money to Win Political Influence



- An analysis by the National Institute on Money in State Politics concluded that K12 and its employees contributed nearly \$500,000 to state political candidates across the country from 2004 to 2010.
- "K12, for instance, last year contracted with 45 lobbyists in state capitols across the country and donated \$625,000 to politicians of both parties, ballot initiatives and political associations such as the Republican Governors Association, according to records compiled by the National Institute on Money in State Politics and the Center for Responsive Politics."
- One person I spoke with told me that in many states, "the Republican legislatures are bought and paid for" by K12.

### Case Study: Pennsylvania, Which Has 16 Online Schools and 35,000 Students, Most in the Nation



- It would be hard to find better evidence of K12's political influence than in Pennsylvania, home to K12's Agora Cyber Charter School (which accounts for 14% of K12's revenues).
- The Auditor General has released two scathing reports, calling for a 35% funding cut, because:
  - "PA spends about...\$3,500 more per student to educate a child in a cyber charter school compared to the national average, which adds up to \$315 million in annual savings."
- Yet the legislature hasn't acted. Why? Perhaps it's because, as the New York Times reported, in Pennsylvania K12:
  - "Has spent \$681,000 on lobbying since 2007. The company also has friends in high places. Charles Zogby, the state's budget secretary, had been senior vice president of education and policy for K12. In a statement, Mr. Zogby said he still owned a small number of K12 shares, but did not make decisions specifically affecting online schools."
- However, increased scrutiny of PA online schools could result from a federal indictment of the founder and former CEO of Pennsylvania's largest online charter school, who is alleged to have stolen nearly \$1 million in public money and improperly diverted a total of \$8 million to avoid federal income taxes.

#### Case Study: Tennessee



"The Haslam administration introduced a bill that would have let it limit enrollment or shut down any virtual school that failed for two consecutive years. Without taking aim at the Tennessee Virtual Academy specifically, the measure was seen as an attempt to rein in the school.

K12 Inc. fought back. In committee rooms and legislative offices, the school's teachers and some of its parents shared stories of students who had benefited from the program. Behind the scenes, the company's longtime lobbyist, the powerful Nashville firm of McMahan Winstead, worked against the bill.

K12 succeeded in getting the bill amended in March. The most notable change was an extension of how long a virtual school could fail before the state would step in — to three years from two years."

#### Case Study: Ohio (1)



- A 2011 study of Ohio's seven statewide online schools found that:
  - Ohio pays David Brennan nearly \$12 million per year for operating the OHDELA E-school, which graduates just 36% of its students. Another operator, William Lager, rakes in \$64 million per year for operating ECOT, the state's largest E-school, which has a graduation rate of 35%.
  - Together, Misters Brennan and Lager have made nearly \$4 million in political donations since 2001, mostly to Republican candidates and party accounts.
- Dale Butland, Innovation Ohio's Communications Director, said:

"Ohio's E-Schools are an outrageous taxpayer rip-off, a cruel hoax for many students and parents, and a textbook example of the "pay to play" culture that too often permeates state government.

At a time when Ohio's traditional schools are seeing unprecedented state cuts, most Ohioans have no idea how shockingly bad Ohio's E-Schools are and how much state money is being funneled to the for-profit operators who run them.

Gov. Kasich and his legislative allies loudly demand reform and accountability in traditional schools. But when it comes to E-Schools run by their biggest financial donors, they suddenly develop laryngitis. Their silence speaks volumes."

#### Case Study: Ohio (2)



"Among individual donors backing cyber schools, few have been as generous as William Lager, who founded Ohio's largest virtual school, ECOT — and who runs both the company that manages the school and the company that sells the school its online curriculum.

Lager has contributed \$387,000 to Republican politicians and political organizing committees just in the past year and a half, a period in which the state began to calculate academic growth for all students in cyber schools — and found ECOT sorely lacking. On the most recent state report card, ECOT got an F on every measure except one, where it earned a D.

...Republican Gov. John Kasich has made clear that low scores and poor growth rates are unacceptable in Ohio's traditional school districts. He has even proposed stripping funding from urban public schools and turning them over to private groups that promise better results.

But he and other leading lawmakers have shied away from criticizing ECOT, which serves about 14,000 students and received \$88 million in public funds last year. Nor have they taken on other low-performing cyber schools in Ohio, including one run by a management firm owned by another major Republican donor, David Brennan."

(continued)

#### Case Study: Ohio (3)



(continuing)

"Indeed, Ohio's existing cyber schools are in line to get more money per student in the coming school year; the legislature even voted to permit them to tap, for the first time, into funding reserved for vocational and technical education. A state legislative analysis puts the boost at an estimated \$4.5 million extra for ECOT alone, if it maintains its enrollment.

A spokesman for Gov. Kasich, Rob Nichols, said the bounty of donations from Lager and Brennan has not influenced treatment of their schools.

"Obviously not," he said.

Nichols pointed to the governor's effort last year to pass standards for cyber schools; the draft didn't require schools to hit specific academic benchmarks but did urge them "to provide a high quality education." The draft did not pass the legislature.

ECOT Vice President Nick Wilson, meanwhile, said the school rejects as invalid all the F's on its state report card. The school does its own assessments, he said, and is confident its students are learning. "Is it leaps and bounds above where they were? Not necessarily," he said. "But it is progress."

Wilson said he expected "many sympathetic ears" from policy makers as ECOT lobbies to change Ohio's grading formula. Yet he said the anticipated support had nothing to do with Lager's donations. "I don't see that," he said."

#### Case Study: Ohio (4)



"...Former State Representative Stephen Dyer became suspicious when members of the benignly named organization My School, My Choice paraded through his northeastern Ohio district carrying signs attacking him: "Why Won't Rep. Stephen Dyer let parents choose the best education for their kids?" (continued on next page)

The protest was prompted by questions Mr. Dyer had raised over the state's financing formula for charter and online schools. The group describes itself as a coalition of parents, teachers and employees of the schools. But Mr. Dyer said that his wife questioned the people carrying the signs and found out they were paid temp agency workers.

A telephone call to a toll-free number on the Web site for My School, My Choice was returned by Mark Weaver, a Columbus lawyer and political consultant with Republican ties dating back to the Reagan administration.

Mr. Weaver said the group's crowning achievement was a 2009 rally against legislation in Ohio that would limit school choice. "We put 4,500 people on the statehouse lawn," he said. But he declined to answer questions about the group's leadership and financing."

#### Case Study: Massachusetts



"K12's push into New England illustrates its skill. In 2009, the company began exploring the potential for opening a virtual school in Massachusetts in partnership with the rural Greenfield school district.

But Massachusetts education officials halted the plan, saying Greenfield had no legal authority to create a statewide school. So Greenfield and K12 turned to legislators, with the company spending about \$200,000 on Beacon Hill lobbyists.

State Rep. Martha "Marty" Walz, a Boston Democrat, wrote legislation that allowed Greenfield to open the Massachusetts Virtual Academy in 2010. She acknowledged that the language was imperfect and didn't address issues of funding or oversight but said she couldn't wait to craft a comprehensive plan.

"You do what you need to do sometimes to get the ball rolling," said Walz, who accepted at least \$2,600 in campaign contributions from K12, its executives or its lobbyists since 2008, according to the National Institute on Money in State Politics.

That scenario is repeating nationwide as K12 and its allies seek to expand virtual education."

#### Case Study: Idaho



"In Idaho, K12 donated \$44,000 to the re-election of the state's top education official, Tom Luna, who pushed through requirements that students take online classes to graduate, according to an investigation by The Idaho Statesman. Another Idaho paper, The Times-News, found that while state law only allowed taxpayer funds to go to schools operated by nonprofits, the state's largest virtual school diverted 70 percent of the \$9 million it had received from the state to its contractor, K12; a smaller virtual school sent 85 percent of its \$829,000 allocation to its for-profit provider, Connections Education of Baltimore, the country's second-largest online education provider.

"K12 actually gets paid transportation costs in Idaho because they argue that since they bring the school to the children they should be paid the same as (ordinary) schools," says former Republican state Sen. Gary Schroeder of Moscow, who chaired Idaho's education committee for 18 years and sponsored that state's 2004 charter school law. "Virtual charter schools are organized for the most part by money, and the decision-making process in your state will be influenced heavily by education management organizations like K12.""

#### Case Study: Maine



The key findings of an investigative journalism report that won the 2012 George Polk Award for Education Reporting were as follows:

- PULLING THE STRINGS: Maine's digital education agenda is being guided behind the scenes by out-of-state companies that stand to profit on the changes.
- FLORIDA CONNECTION: The LePage administration has relied heavily on former Florida Gov. Jeb Bush's Foundation for Excellence in Education, a conservative think tank, in writing policies to create taxpayer-funded virtual schools in Maine.
- FOLLOW THE MONEY: This foundation and its top officials receive funding from online education companies, which will profit if the initiatives go forward.
- REMOTE CONTROL: The foundation wrote much of the language in Gov. Paul LePage's Feb. 1 executive order on digital learning, which embraces foundation policies.
- BACKSTAGE MEETINGS: The secretive American Legislative Exchange Council -- a corporate-backed political group for state legislators -- developed digital learning legislation that was introduced by Maine lawmakers. Stephen Bowen (pictured) was a private-sector member until he was appointed education commissioner in Maine.

## **K12 Is Encountering Regulatory Problems Across the Country**



# K-12's Terrible Results in Tennessee Has Led to a Political Backlash and Student Enrollment Dropping By 2/3



- "Tennessee Education Commissioner Kevin Huffman declared the Tennessee Virtual Academy's results "unacceptable" and demanded "an immediate turnaround"
- "The school also is free to enroll as many students as it would like this year. But enrollment appears to be slipping. The Department of Education said Friday that the school's current enrollment is 969 students, less than one-third its enrollment last school year."
- "K12 Inc. has asked to open a second school the Tennessee Cyber Academy in neighboring Campbell County. The Department of Education last month turned down the application, citing insufficient information."

#### An Investigation in Florida Revealed K12 Employees Covering Up the Illegal Use of Uncertified Teachers, and Class Sizes of Up to 275 Students



"The state Department of Education's Office of Inspector General, prompted by school officials in Seminole County, is examining whether K12 uses improperly certified teachers, in violation of state law. K12 allegedly asked certified teachers to sign for having taught students they never encountered, according to documents that are part of the investigation.

In a Feb. 15, 2011, email, K12's Samantha Gilormini wrote to certified teachers in Florida: "So if you see your name next to a student that might not be yours it's because you were qualified to teach that subject and we needed to put your name there."

Gilormini sent one K12 teacher in Seminole County a roster of more than 100 students. She only recognized seven names and refused to sign.

"I am happy to sign for the seven Seminole students who are my students, but I cannot sign as the teacher of record for students who I do not know," Capelle wrote. "It is not ethical to submit records to the district that are inaccurate."

According to a subsequent survey conducted by school officials in Seminole County, only 36 percent of parents said their child's teacher was the one K12 had listed. (emphasis added)

Seminole County school officials said the K12 problems uncovered there may exist statewide."

"K12's executive vice president of school services, Chip Hughes, laid out the company's class-size formula in a confidential April 2010 memo.

Under the formula, the more a school district pays, the better the student-teacher ratio.

School districts that pay \$4,000 or more per student receive a 225-to-1 student-teacher ratio in high school classes. Districts paying less than \$3,000 per student have a 275-to-1 ratio."

### In Georgia, K12 Was Caught Using Uncertified Teachers, Contrary to State Law



"The Georgia Department of Education cited the special education program of the K12 administered <u>Georgia Cyber Academy</u> for a host of violations in June; a letter discussing these issues issued last month is <u>here</u>. The letter leaves little doubt that the Department of Education means business: If GCA does not fix a host of problems by the end of October, steps to revoke the school's charter will begin.

The issues read like a laundry list of evergreen complaints <u>made</u> <u>against</u> K12-run schools: High caseloads, high staff-to-student ratios, FTE reporting and questions over <u>compliance</u> with spending <u>IDEA</u> funds.

In K12's defense, the letter notes that progress has been made in improving several areas. Asked for comment about Georgia, K12's spokesman said matters are in hand.

Georgia Cyber Academy (GCA) has been working with a consultant, recommended to GCA by the Georgia Department of Education (DOE), for the last several months on these issues. That consultant recently filed a report to the DOE indicating that the school has taken action to address each issue identified by the DOE. The consultant considers the school to be in substantial compliance and is awaiting final review and acknowledgement by the DOE."

#### K12's Difficulties In Colorado



- State auditors found that the K12-run Colorado Virtual Academy (COVA)
  counted about 120 students for state reimbursement whose enrollment
  could not be verified or who did not meet Colorado residency
  requirements. Some had never logged in.
- The state audit of COVA, which found that the state paid for students who were not attending the school, ordered the reimbursement of more than \$800,000.
- In 2011, COVA received "one of the state's two lowest ratings, requiring the school to submit an improvement plan for state approval and giving it five years to improve or face state sanctions. This rating was revised upward, from the lowest rating of Turnaround, with the state's approval."
- In January 2012, COVA's authorizer nearly closed the school, but instead granted a one-year renewal under the condition that COVA find a new charter authorizer by June 2014 (emphasis added)
  - "The school's 22 percent graduation rate, high student turnover and questions about COVA's management company, K12 Inc., originally led district staff to recommend denying the virtual school's multiyear charter application."

#### K12 Was Denied Online Schools Recently in New Jersey, North Carolina and Maine



Hence, K12 Is Not Opening Schools in Any New States in the Next Year

 In New Jersey, after giving initial approval in January 2011, in June 2013 both K12 online charter schools were blocked:

"The state Department of Education has blocked two virtual charter schools from opening this fall that had sought to enroll New Jersey students from across the state in courses taught online, Education Commissioner Chris Cerf said.

In letters sent to the Newark and Tinton Falls-based schools earlier this week, Cerf cited legal concerns and insufficient evidence that web-based school models help students achieve academic success.

"Uncertainty about the legal foundation for fully virtual charter schools and the department's serious concerns regarding its ability to effectively oversee and monitor such schools precludes the department from granting (final charters)," Cerf wrote in the letters."

- In North Carolina, the state board of education refused to consider the application of K12's North Carolina Virtual Academy in March 2012 and in June 2012 a judge upheld this refusal – in effect, a denial
- In Maine, K12's application to open the Maine Virtual Academy was denied in January

#### I Suspect K12 Is Setting Up Insight Schools Primarily to Escape Scrutiny



- K12 acquired and is now expanding its Insight schools that "tend to focus on academically at- risk students" (most of whom are low-income minorities)
- There is almost nothing about Insight on K12's web site or in its 10K, but CEO Ron Packard said the following on the most recent investor call:

The Insight strategy is moving along nicely, and we're excited to be opening the Insight in Ohio. And we're putting a lot of human brain capital into developing the right model for academically at-risk kids.

And the beautiful thing about the Insight model and the strategy is we want to have schools whose entire culture, from the teachers to administration to the curriculum, is built around taking children who are behind grade level and bring them up to grade level, taking students who are coming to high school credit deficient, who would likely be high school dropouts, and graduating them from high school. So it's a very different culture that you would have than what we traditionally had originally in our virtual academy.

So the idea is absolutely to have one school of each type in every single state we operate in and make sure that students find the right option for them.

- I suspect that what's really going on here is that K12 is engaging in "virtual bussing" of students out of its existing schools primarily to escape the rapidly multiplying government inquiries and punitive measures resulting from its abysmal academic results
- Though Packard claims that Insight schools have "a very different culture," my preliminary inquiries indicate that the schools use a very similar curriculum and often the same teachers and infrastructure
- In other words, it appears to be just a shell game





## States Are Making Many Changes That Will Have Deleterious Consequences for K12



States are responding to the online charter school sector having run amok by adopting one or more of the following changes, none of which are aimed specifically at K12, but all of which have deleterious consequences for the company:

- 1) A full moratorium on any new cyber charters and/or cap limits on existing ones
- 2) Cut funding to cyber charters to levels below that of bricks-and-mortar charters
- Improved accountability systems for all public schools (e.g., every school receives an A-F grade)
- 4) "Default closure provisions" for all charter schools so, for example, if a school is in the bottom 25% of all charters in the state, it automatically won't get its charter renewed. Or, if a school gets an F for two or three consecutive years, it's automatically closed (though there's usually an appeals process). This applies to all charter schools, but would disproportionately affect low-performing online schools like K12's
- 5) Improved practices for charter school authorizers, especially getting rid of rogue authorizers
- 6) Prevent charters from district/authorizer shopping

I actually think the most elegant solution would be to let online charters pick and choose their students, and then tie a meaningful portion of what they are paid to each student's successful completion of a course and demonstrating proficiency/growth. This would incent schools to help students succeed and penalize them for enrolling those unlikely to succeed. (Note that states would have to change their rules to allow this, as most have laws that prevent any charter from being selective.)

The result would be online charters only serving a small fraction of the students they do now – which would be a very good thing.

### How to Ensure That Only Students Who Will Benefit Enroll at Online Schools (1)



Interview with a friend who's been a charter school authorizer for many years

Putting aside K12's performance and recruitment practices, I have actually long argued that virtual schools as a whole should not be part of the charter sector. The reason for this is really quite simple—charter school enrollment structures are not consistent with the pedagogical approach of on-line schools.

Charter schools by definition are open admissions schools that choose students by lottery. In other words, they cannot control the kind or type of student who applies to them and is admitted. This means that even if K12 and others did not actively recruit students who do not have a parent at home who can meaningfully assist them with the on-line curriculum, they would still get many of these students who apply and who are admitted. From my conversations with folks in Colorado, this happens frequently. And yet it is painfully obvious that an on-line curriculum no matter how good is only a good alternative for those children who have parents/guardians able to oversee their educational progress, particularly in the early grades. Moreover, an on-line school really has no plan B with a failing student. It cannot offer a different curriculum, one-on-one tutoring, special time with a reading specialist, etc. in the way that a normal school can. As such, failing students are essentially left to rot.

(continued on next page)

### How to Ensure That Only Students Who Will Benefit Enroll at Online Schools (2)



#### (continued)

This is not to say of course that the on-line approach is not a good one. On-line schools clearly can work with some students, probably with those students who are home-schooled and in which the school itself simply provides a curriculum and assessment structure that is helpful to the parent. But it is limited. There are clearly kids who don't belong in these programs. But as above, as charters, they cannot discriminate and kick out kids who do not belong.

The solution therefore is to make on-line schools contract directly with the state or a district. With that structure, not only can one create a funding mechanism that is specific to the costs of providing such a program, but the state and district can appropriately control enrollment. For instance, it could and probably should limit enrollment to those students who are succeeding in an on-line program; and it should require those students who chronically are not to either dis-enroll or to be provided with additional assistance with more traditional forms of learning. Obviously as well you would want to make a student eligible for such a school where health or other emotional/social issues make these programs the better choice. Yes, there is paternalism in the above and yes there is over-riding of parent choice. But given the evidence that I've seen and that you've compiled, the present system isn't working.

Let's have on-line schools but there is no reason why they should be charters.

### K12 Needs to Not Only Slow Its Growth But Actually Shrink Substantially In Order to Properly Serve Students and States/Taxpayers – Which Is Exactly What Happened to Many For-Profit Colleges in Recent Years



#### Perspectives from Jeff Shaw (OHVA)

<u>I can't see how K12 can get significant increases in student academic growth</u> <u>under their current model</u>. They need to say, "Let's not focus on growth – let's first get the academics right and then look into growing in a controlled fashion so as not to sacrifice student achievement for growth. If student really achieve, the company will grow for the right reasons.

Why would anyone in their right mind sacrifice student achievement for company growth? Those of us at the school level sometimes felt as though Ron Packard was charging ahead full speed to grow, grow, grow and not focusing on long-term sustainability and student achievement.

This kind of thinking hurts students. If you enroll students who clearly are not appropriate for the virtual school setting, you're doing that student a terrible disservice. You have sacrificed a real person for your own economic gain. And I think that's immoral and unethical.

K12's managed schools are public schools. Every student has a right to attend, but as education professionals we have a responsibility to see that students are enrolled in a school most appropriate for their needs. In the end, it's the parents and students who make the ultimate decision regarding what school they attend. Our obligation as professionals is to present them with the realities of virtual schooling and how this school choice option may or may not be the best choice. The profit motive should not guide this process – but at K12 it appeared to. (emphasis added)

### A Case Study of How Shrinking a School Can Lead to Better Outcomes for Students



"One of Colorado's oldest online programs, Branson Online School, is also its highest-performing. But to get there, the school had to cut back.

In 2005, the Branson school district on Colorado's southeastern border with New Mexico ran the state's third-largest online school, enrolling more than 1,000 students. By 2010, the school had dropped back to sixth in size, enrolling 427 students.

Branson assistant superintendent Judith Stokes, who oversees the online school, said the growth and lagging scores – combined with a critical 2006 state audit of online programs – prompted the ranching community's school board to slow down.

"We had grown very, very rapidly at one time, before the audit, and at that point, we pulled back," she said.

Stokes said growth slowed when the school focused on ensuring families understood the online program before enrolling because, "If you're looking for easy, it's not us."

In spring 2011, Branson online students beat the statewide average in proficiency in reading and were six percentage points short in math."

### The Ed Reform Movement Needs to Quickly Regain the Moral High Ground and Cut This Cancer Out of Our Movement



Interview with a friend who runs a high-performing bricks-and-mortar charter school in a state in which K12 has a large presence

The results of the online schools (of which K12's is among the largest) are so terrible that, when CREDO studied the entire charter sector in our state, the online schools dragged down all charter schools' results to such a degree that our state was one of the worst that CREDO had studied.

The scandals and terrible academic results of the online schools are hurting all charter schools because we get lumped in with them.

The statewide charter school organization has a terrible dilemma because the online charters provide much of the funding – and boy can they turn out a lot of parents at rallies! (Not surprising, I guess, given how much money the online charters spend on this and the fact that these are stay-at-home kids so they're easily available to attend rallies.) But the conflicts are so great that we and a few other high-performing charters have hired our own lobbyist.

To persuade us to keep working with them, the online charters actually make the "first they came for us, then they'll come for you" argument. Seriously!

I can understand why, in the short term, it's convenient to work with them, but in the long-term it's going to kill us. I agree with you completely that they're a cancer that we have to cut out of our movement.



### **Conclusions and Catalysts**



- K12 is pursuing a growth-at-any-cost strategy that is harming countless students, likely violating numerous state laws and regulations, and wasting hundreds of millions of dollars of taxpayer money every year.
- What the company is doing is becoming increasingly well-known so states and possibly the IRS – are waking up and thus the company faces increased scrutiny and regulatory risk
- The likely result is that K12 will not only miss its growth projections (analysts project that K12's revenues and profits will grow 16% and 32%, respectively, in the next year), but will actually have to shrink substantially in order to properly serve students (and states/taxpayers)
- Possible short-term catalyst: the company could disappoint when it issues FY 2014 guidance in mid-October and/or when it reports Q1 '14 earnings in early November because:
  - Growth has been slowing
  - Preliminary enrollment data at a few schools are weak
  - Analysts seem to be factoring in rising margins and continued growth in revenue per student, both of which I think are unlikely

Trading at nearly 50x trailing earnings, K12's stock is priced for perfection, yet its future is likely to be far from perfect

## Appendix A: Churn Data for Three K12 Schools



## Churn Data for K12's Agora Cyber Charter School (PA), K12's Largest (14% of Revenue)



AGORA 2010 Month-by-Month withdrawals										
Grade	09/01/09	10/01/09	11/1/2009	12/01/09	01/01/10	2/1/2010	03/01/10	04/01/10	5/1/2010	
K	299	318	353	360	362	359	359	360	352	
1	270	265	290	299	299	299	298	311	294	
2	283	281	294	297	297	297	301	307	296	
3	265	266	266	276	276	276	280	284	273	
4	282	287	313	315	315	301	302	309	299	
5	290	294	305	312	312	324	324	323	315	
6	294	306	318	333	333	335	341	351	340	
7	369	374	407	434	434	416	421	440	422	
8	417	426	479	505	505	511	504	523	501	
9	725	718	860	763	763	855	796	751	698	
10	488	473	605	527	527	649	597	556	515	
11	411	381	482	398	398	504	478	437	398	
12	325	321	426	372	372	401	368	338	319	
TOTAL	4718	4710	5398	5191	5193	5527	5369	5290	5022	
+/-		-8	688	-207	2	334	-158	-79	-268	
Withdrew	451	319	292	228	382	345	271	132	268	
% withdrew	10%	7%	5%	4%	7%	6%	5%	2%	5%	
Added	443	1007	85	230	716	187	192	0	0	

4718 Total Signed Up in Sept
2688 Total Dropped Out During Yr.

57% Churn rate

7578 Total Signed Up All Year

2688 Total Dropped Out During Yr.

35% Churn rate

## Churn Data for K12's California Virtual Academy



CAVA 2011 Month-by-Month withdrawals											
School	August	September	October	November	December	January	February	March	April	May	June
Jamestown	289	316	314	321	316	310	323	310	299	295	294
Kern	537	586	580	599	602	582	605	611	592	583	582
Kings	819	888	871	863	881	876	902	902	871	861	859
Los Angeles	4327	4892	4886	4907	4962	4899	5101	5071	4934	4878	4863
San Diego	2523	2788	2749	2740	2768	2728	2826	2832	2754	2733	2723
San Joaquin	501	554	561	563	571	557	577	588	563	557	557
San Mateo	1043	1184	1186	1197	1219	1228	1254	1258	1223	1210	1206
Sonoma	1044	1155	1151	1131	1144	1147	1189	1181	1150	1134	1130
Sutter	599	680	664	661	679	681	708	703	687	683	682
TOTAL	11,682	13,043	12,962	12,982	13,142	13,008	13,485	13,456	13,073	12,934	12,896
+/-		1,361	-81	20	160	-134	477	-29	-383	-139	-38
Withdrew		510	587	374	264	982	354	405	385	139	38
% withdrew		3.9%	4.5%	2.9%	2.0%	7.5%	2.6%	3.0%	2.9%	1.1%	0.3%
Added		1,871	506	394	424	848	831	376	2	0	0

11,682 Total Signed Up in Sept

4,038 Total Dropped Out During Yr.

35% Churn rate

16,934 Total Signed Up All Year

4,038 Total Dropped Out During Yr.

Churn rate

## Churn Data for K12's Colorado Virtual Academy



COVA 2011 Month-by-Month withdrawals											
Grade	August	September	October	November	December	January	February	March	April	May	
K	236	311	332	333	317	310	295	287	287	284	
1	282	305	321	329	321	314	286	279	273	271	
2	303	344	353	357	339	332	320	311	310	306	
3	315	345	350	355	348	334	304	293	287	284	
4	335	363	369	361	360	357	336	330	327	324	
5	360	406	426	425	422	420	401	387	379	375	
6	360	427	444	464	452	445	423	409	396	393	
7	398	493	541	565	555	538	493	477	467	457	
8	431	508	552	586	598	581	534	518	507	503	
9	319	376	385	354	325	324	274	267	253	251	
10	303	379	433	410	387	384	323	306	292	289	
11	283	332	370	348	316	317	258	248	238	228	
12	238	252	258	236	220	220	190	180	176	161	
TOTAL	4,163	4,841	5,134	5,123	4,960	4,876	4,437	4,292	4,192	4,126	
+/-		678	293	-11	-163	-84	-439	-145	-100	-66	
Withdrew	485	581	232	225	214	324	162	34	42	31	
% withdrew	11.7%	12.0%	4.5%	4.4%	4.3%	6.6%	3.7%	0.8%	1.0%	0.8%	
Added	1,163	874	221	62	130	-115	17	-66	-24	31	

4,163 Total Signed Up in Sept

2,330 Total Dropped Out During Yr.

56% Churn rate

6,449 Total Signed Up All Year

2,330 Total Dropped Out During Yr.

Churn rate

## Appendix B: Detailed Comments By Numerous Employees





# Jeff Shaw Was Initially Very Positive About K12 and Said It Was a Good Fit for Certain Students, But Screening Was Key



#### Additional notes from my interview with Jeff Shaw, Former Head of OHVA

"I was with K12 for 6½ years from 2003-2010. When I joined K12, I was really excited by the school choice and the virtual school option. I loved working for K12. If more public schools operated like K12, then our education system would be better. They did a lot of good things. It was very data oriented, looking at how kids were doing, and they tried great strategies – more sophisticated than other districts I've seen. We had some smart people and the opportunity to strategize together.

I am an educator and I was very sensitive to at-risk students. Bricks-and-mortar schools often tried to coach students to choose a virtual school rather than continue to attend their school. Also, we had students enrolling in order to hold off truancy charges, suspensions, or expulsions from their home schools. These are characteristics of students who are least likely to succeed with us.

An online school isn't right for everybody. I'd have a conversation with families and say things like "If you are considering enrolling your son here because he won't get out of bed in the morning, he won't succeed here either given virtual learning is one of the least restrictive environments of school choice options."

Helping these families understand why the virtual school isn't a good fit and helping them to select a better option is far better for students and gives the virtual academy a fighting chance at reaching NCLB academic goals.

### Testimony as Part of a Class Action Lawsuit Reinforces Shaw's Description of K12's Sales Tactics



Former sales employees at K12's call centers, located in Virginia and Kentucky, described high pressure to make huge enrollment quotas in order to get a commission. Sales employees were provided with a "script" of what to say to prospective students and parents, including purported "statistics" showing that K12 students were years more advanced than brick-and-mortar school students.

#### Employee CW1

CW1 was an enrollment consultant who worked at K12 from April 2010 through September 2011, reporting to K12's Vice President of Enrollment. CW1 stated that salespeople were paid a commission based on the number of students that they enrolled, but explained that the commission structure was not typical – rather than payment based on each student enrolled, K12's salespeople had to hit a target total dollar figure every quarter in order to make any commission. CW1's target was around \$400,000 per quarter. If he didn't meet this target, he received no commission. CW1 said the sales pitch was very vague and included statistical claims that K12 students performed 30% better on standardized tests than students in brick and mortar schools across the country, were 1-2 years more advanced, and that that K12 students had a better chance of going to college. CW1 noted that sales staff had no contact with teachers or schools. CW1 observed that "the goals kept going up and [commission] payments kept getting lower." In 18 months, CW1 sold approximately \$1.5 million worth of contracts but was only paid \$80,000. CW1 repeatedly asked his supervisors for the underlying data for these performance statistics, as he felt it would help him close sales if he were able to better explain the statistics to parents, but was never given anything in response.

Source: Class action lawsuit filed 6/22/12.

## Class Action Lawsuit Testimony on K12's Sales Tactics (2)



#### **Employee CW2**

CW2 worked at K12 from 2003 to 2011. CW2, who worked in customer service and Sales/Enrollment, described a toxic work environment where sales staff were pressured to meet unrealistic quotas, frequently being forced to make as many as 200 outgoing calls daily to keep up. CW2 confirmed that sales staff were never given any actual data of student performance, but were instead fed statistics from K12's website, and were told to tell parents that students who did the K12 program for 1-2 years performed better than their peers at brick and mortar schools.

#### **Employee CW3**

CW3 worked as an administrator at K12's California Virtual Academy ("CAVA") during the Class Period until June 2011...CW3 confirmed that enrollment consultants were paid on commission, with their primary goal to enroll as many students as possible...According to CW3, the weekly enrollment meetings were "all about numbers," and focused on enrollment projections. CW3 stated that a draft enrollment "script," which originated from K12's corporate office, was distributed and discussed at several of the enrollment meetings. CW3 described the script as a "flow chart," which contained responses to potential questions that parents might ask during a sales call.

According to CW3, "enrollment process requirements would change after the school year started." Whereas the "required documents [to] process enrollment" were supposed to include the student's most recent report card, transcripts from prior schools, and a "release of records" enabling K12 to request the student's records from prior schools, the requirements "would change at some point in the year to only require the birth certificate and proof of residence. It seemed to depend on where we were in relationship to [enrollment] projections."

## Class Action Lawsuit Testimony on K12's Sales Tactics (3)



#### **Employee CW4**

CW4 worked for K12 from May 2011 through August 2011 as an Enrollment Consultant for K12's Colorado and Arizona schools, reporting to Bobby Merchant, a Team Leader. CW4's primary responsibility was to contact potential students' parents from a list of "leads" Merchant provided to each sales associate daily. CW4 stated that there was constant pressure to generate sales, describing the Company's sales philosophy as "enroll, enroll, enroll." As added incentive, K12 offered gifts, lunches, and cash bonuses on a weekly basis to the top performing enrollment consultants. CW4 confirmed that a script was given to salespeople for use on their calls. According to CW4, Erica Scott, an Enrollment Manager, provided consultants with a script containing key "verbiage" to use, and various approaches to take with potential customers. Although the script also contained statistics comparing K12 schools to "brick and mortar" schools, such as graduation rates, CW4 was never provided with underlying data supporting the statistics. CW4 stated that enrollment consultants were instructed to refer to the performance of K12 students as "comparable [to] or even better" than the performance of students at traditional schools, and to state that students at K12 schools were "on a better tier" than those at traditional schools.

## Class Action Lawsuit Testimony on K12's Sales Tactics (4)



#### **Employee CW6**

CW6 was the Senior Director for School Development from September 2008 through September 2009, reporting to Peter Stewart, the Vice President for Business Development. According to CW6, when discussing the Company's sales strategy with Peter Stewart ("Stewart"), Stewart informed him that the K12 curriculum wasn't built for "inner-city kids," but instead was geared towards "gifted and talented" students. This struck CW6 as odd because the majority of K12 students were inner-city students. CW6 asked his superiors on more than one occasion to see data that supported the Company's claims concerning the above-average performance of K12 students, but was told that there was no such data.

According to CW6, K12 targeted inner-city and at-risk populations due to their higher potential profit in those areas. CW6 stated that Stewart didn't necessarily agree with this practice, but told CW6 "that's what they had to do." According to CW6, Stewart – who routinely received orders directly from Packard – was acting on Packard's instructions.

### Employee CW7

CW7, a former operations manager at one of K12's virtual schools from October 2008 to June 2010 whose responsibilities included supervising all enrollment activities, confirmed that "habitually truant students drive revenue...and that K12 needs these students or they would have to spend a lot more on instruction." In other words, K12 corporate officials knowingly enrolled students that would be a bad fit for K12 schools and were likely to drop out, resulting in more churn and more instability in enrollments (and, accordingly, revenues), and K12's recruitment of inner-city and at-risk "last resort" students had another benefit – these students used up less of K12's educational and teaching resources while permitting K12 to collect full funding from the states.

Source: Class action lawsuit filed 6/22/12.

## **Excessive Class Sizes and Harried, Overworked, Unsupported Teachers**



## Additional Notes From a Former Teacher at Agora, K12's Largest School



### Additional notes from my interview with a former teacher at Agora

"When it came time to give grades, if a student had a 10%, we were told to give them a minimum of a 35-40% so they could move along to the second marking period, where they were given the opportunity to pass. I was told, whatever I had to do, I had to pass every student.

I was told that if there were students who were not coming to class, but I could reach them by phone, I was supposed to provide them with a modified program so they could pass. I once had students who, at the end of the semester, decided they wanted to pass, so Agora told me to ignore the fact that they'd completed no assignments all semester, give them the end-of-semester test, and if they failed, help them pass.

The majority of students were not at grade level. Some essays were only three sentences – that were not grammatically correct. If I told my supervisor, I was told, "That's your problem, do whatever you have to do." That was their answer for everything.

They wanted us to go out and meet the students – go to their homes. That was a nightmare. Not everyone lived in a safe area. Requesting to have someone come along was hard – no-one was available. So I went to some areas weren't very safe. They said if I was uncomfortable (during a visit), I could walk out the door. There was a mix of students – some were wealthy, but the majority were not. More were at-risk kids; some were suspensions.

We had professional development four times during the year (each two days, one night). It wasn't really useful or well organized. There were times when we were reprimanded because the school hadn't met AYP (Adequate Yearly Progress). It's on the teacher if the school didn't make AYP, but the school has never made AYP. They offered us a 10% bonus if more than half of students passed, but nobody earned it. It was like a greyhound chasing the rabbit."

### **Another Teacher Tells a Similar Story**



#### Melony Black, former K12 English teacher at the Colorado Virtual Academy

(From article published in The Examiner, 9/5/12)

"I started the year with 287 students in my seven high school English classes. I was teaching three sections of lower-level English students who struggled with reading and writing.

I asked how I would manage that many students, especially in a school that advertises itself as providing individual support.

The week before the student-count for COVA, K12's marketing department redoubled its efforts; and scores of new students enrolled. "Class sizes skyrocketed! We were getting emails daily - many of them - listing our new students," Melony said.

Melony explained, "we were told to hold kids accountable to logging in and working on count-day." In short order, she adds, "I had over 577 assignments to grade."

"I was grading essays, journals, response to prompts, resumes and cover letters, threaded discussions... I had research papers to grade," Melony explained. "My philosophy did not mesh with COVA's," Melony said, describing how she typically worked 60-65 hours per week.

COVA's leadership downplayed the workload issue, explaining that they predicted one-third of the students would drop out before second semester started. "What is sad is that these students were supposed to be screened to ensure a good fit for online school", Melony added.

Whatever screening process K12 uses, it was clearly their intent to enroll as many students as possible; with the expectation that significant numbers would drop out mid-year.

"Three-quarters of my credit recovery kids never logged in, never completed any work, never answered their emails or phone calls, yet they remained on my class rosters," she said. "I began wondering about the state-mandated hours for students at the high school level. No one is monitoring this as far as I can see."

### Yet Another Teacher Tells a Similar Story



## Heidi Gardner, former K12 special ed teacher at Agora Cyber Charter School

Heidi Gardner, an Agora special education lead teacher who resigned last year, said the turnover in enrollment led to a massive expansion in non-instruction work for teachers.

"If you weren't trying to make initial [E-mail or phone] contact with new students then you were trying to keep on top of the 'inactive' [students who had not logged on to Agora's web portal in a few days] or confirm if students who not been in contact with [teachers] for weeks or months were still enrolled," Gardner said. "You could add four hours to your work day doing this."

"When it came to the actual instruction, you'd be a secretary, scheduling in 10 minutes here and there for students who often had complex learning challenges. For the harder cases, [teachers] always put in the time and just carved it out of our lives."

### Jeff Shaw Tells a Similar Story of Excessively Large Classes and Overwhelmed Teachers Treated Poorly (1)



### My interview with Jeff Shaw, OHVA

Student:teacher ratios at the OHVA were higher than what you'd find in traditional brick and mortar public schools. When speaking about student:teacher ratios, one usually refers to the total number of students an individual teacher serves as the "teacher of record" for a subject or courses taught per day/week/quarter/semester/year. Since the highest expense for school operations in staffing, K12 is very sensitive about teacher ratios being as tight as possible. An English teacher for example may have 220 students assigned to him/her at any one time. This would constitute a 220:1 student:teacher ratio. Given this high ratio, the teacher's ability to provide constructive and meaningful feedback on frequent and substantive student writing is very challenging. The same difficulties are experienced in math, science, and foreign languages, as well as elective courses where student:teacher ratios are significantly higher.

Hiring decisions were made on a "just-in-time basis." This practice lead to teachers having even larger student:teacher ratios for short-term or even long-term periods. One significant problem with this practice is that new teachers – those not only new to OHVA, but new to virtual teaching – were paired with brand new students who had no experience with virtual teachers or learning. It became a situation where the efficiency of the learning curve was so compromised it was like the blind leading the blind. (continued on next page)

### Jeff Shaw Tells a Similar Story of Excessively Large Classes and Overwhelmed Teachers Treated Poorly (2)



### My interview with Jeff Shaw, OHVA (continued)

The teacher pay was pitiful and an embarrassing topic to discuss with potential new hires. At one point, it was suggested by upper management that we decrease teacher pay 20% and then encourage the teachers to earn (the unknown 20% decrease) back as a bonus based on student test scores and teacher effort. This was a plan I could not endorse and did not implement at OHVA.

K12 seemed to have a greater appreciation for people with an MBA than for educators with a master's degree or higher. In an education company you would think a teacher's value would be considered a priority and they would be compensated appropriately. High school graduates were being paid more than teachers with master's degrees because they functioned in an operational/business capacity rather than an educator. This makes no sense to educators and does nothing to attract high quality teachers and sustain teacher motivation.

## A New York Times Article Highlights Excessively Large Classes (1)



"I know on the elementary level we have anywhere from 70 to 100," Ms. Long said. "I don't know anyone who has 50 students."

Some teachers said they were initially attracted to K12 by the flexibility of working from home, in some cases allowing them to take care of their own children while teaching.

...But many teachers said the job had become less desirable as the company increased enrollment, particularly because pay at many K12 schools starts in the low 30s — low even for online schools. Some class sizes have become unwieldy, they said, requiring 60-hour weeks and compromising instruction.

At Agora, enrollment has reached 8,836, up from 6,323 in May, according to figures released by the school. As of late November, the total number of staff members — 408 — was lower than last year. Some high school teachers said they were managing as many as 270 students, even though they had been told they would have 150. Agora officials said last week that they hired 25 teachers in the past couple of weeks.

Some Agora teachers have been asked to take on extra students at the rate of \$1 per student, per day, according to a newsletter from the Pennsylvania State Education Association." (continued on next page)

## A New York Times Article Highlights Excessively Large Classes (2)



"In interviews, former teachers at Ohio Virtual Academy and Colorado Virtual Academy also complained of bigger class loads, with elementary teachers who once handled 40 to 50 pupils now supervising 75. A teacher with an elementary class that size and a 40-hour workweek could devote little more than 30 minutes a week to each student.

Mary Ravanelli, a former teacher at Ohio Virtual Academy, said she oversaw more than 70 students at a time, answering calls from 8 a.m. to 5 p.m., updating parents on students' progress and attending various school outings. "We'd actually meet our students several times a year," she said.

With teacher salaries and benefits the biggest cost to K12, increasing student-to-teacher ratios is an easy way for the company to increase profits. Ms. Henderson, the former Agora teacher and mother of four students, said the ultimate losers are the children."

## Testimony as Part of a Class Action Lawsuit Reinforces Descriptions of K12's Overextended Teachers



#### **Employee CW8**

CW8 described the student-teacher ratio as "unmanageable," eventually leading to his departure from the Company. CW8 stated that at the beginning of the 2011-2012 school year, he was responsible for approximately 150-180 students, although some of these students ended up withdrawing. Moreover, that ratio was actually the lowest in the Texas Virtual Academy – most teachers were responsible for 200-300 students, and one teacher, Joe Sullivan, was responsible for over 400 students.

CW8 suffered "insane" hours and reached out to Mary Gifford, Regional Vice President, Central Region at K12. CW8 informed Gifford that the "school is unworkable," and that "something needs to be done." Gifford requested that CW8 ask other teachers to participate in a conference call regarding the problems. According to CW8, approximately 20 teachers participated in the call with CW8 and Gifford. When the teachers raised the issue of teacher-student ratios, however, Gifford refused to acknowledge that the numbers being provided by the teachers were accurate, and quickly "shut down" the discussion.





### Comments on the Web Site, Glassdoor (1)



- Some comments are positive, but most are not
  - Many employees, even highly dissatisfied ones, complement K12's "Fantastic people," "tremendously creative environment," and "excellent product"
  - Overall, only 38% of employees recommend this company to a friend, among the lowest of any company I checked (lower than Wal-Mart and United Airlines; the only company I found with a lower rating was Spirit Airlines)
- Sample comments:
  - "This company is driven by profits vs providing a solid education to students.
     They are actively marketing to students who should not be schooled at home.
     Many students make little progress and have no learning coach supervision." current teacher, 5/30/12
  - "You are being treated as dirt due to a lack of teacher unions. I have about 300 students and I am supposed to help all of them pass my class. More than half of my job is not about teaching, but about how to trick the state to give K12 more money, so the CEOs will get more pay. It never trickled down to employees who are doing the dirty work." current teacher, 11/26/12

(continued on next page)

### Comments on the Web Site, Glassdoor (2)



- Sample comments (continued):
  - "The company is too focused on lobbying and threats with lawsuits instead of doing business right. The upper leadership is arrogant and unapproachable. Academic decisions by the educators are overturned by MBA's. It is all business and no academics or concern for children. The negativism and phony press releases are damaging employee morale." – former Product Development employee, 3/19/13
  - "Great place to learn what NOT TO DO in a corporate environment. Probably the most dysfunctional management team ever assembled under one logo." – current employee, 11/8/11
  - "The culture of K12 flows from the CEO, who fosters dissent among senior staff and creates an atmosphere of distrust and stress. Although he has received large salary increases and bonuses, and millions of stock options, he is stingy with his employees. He has no respect for his staff or employees." – current employee, 7/27/11