AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 2
ON EDUCATION FINANCE

Assembly Member Julia Brownley, Chair

TUESDAY, APRIL 1, 2008
STATE CAPITOL, ROOM 444
9:00 AM

ITEMS TO BE HEARD

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6110 DEPARTMENT OF EDUCATION

ISSUE 1: LAO ALTERNATIVE: CATEGORICAL PROGRAM REDUCTIONS OR ELIMINATIONS (INCLUDING QEIA)

The issue for the Subcommittee to consider is the LAO recommendation to realign program spending for certain categorical programs as well as phase out or eliminate certain programs.

BACKGROUND:

As part of the LAO alternative to the Governor's budget, the LAO recommends the Legislature "technically realign" spending, phase out or eliminate certain categorical programs. The table below lists these programs. The LAO also makes a recommendation to suspend the Quality Education Investment Act (QEIA) which is not listed in this table but will be discussed at the end of this section.

Recommended Categorical Program Reductions for 2008-09

(In Millions)

Program	Amount[a]	Rationale[b]
Physical Education Incentive Grants	$41.80	Poorly structured
Adult education	30	Technical realignment
Economic Impact Aid	25	Technical realignment
Year Round Schools	19	Reduced participation
School safety competitive grants	18.1	Duplicative
Home-to-School Transportation	11	Technical realignment
Targeted Instructional Improvement	10	Technical realignment
High Priority Schools (corrective action)	6	Duplicative
Alternative certification/intern	3	Technical realignment
National Board certification	2	Technical realignment
Paraprofessional teacher training	1.8	Technical realignment
CCC economic development	11	Noncore program
Total K-14 Reductions	**$178.70**	

[a] Reflects reduction from *2007-08 Budget Act* level.
[b] See text for description of various rationales.

Programs Recommended for "Technical Realignment". According to the LAO, the programs identified as candidates for "technical realignment" routinely end the fiscal year with unspent monies. The LAO recommends the Legislature make a one-time correction to realign the budgeted funding level with the anticipated spending level.

- **Adult Education.** Current law provides a 2.5% annual growth adjustment for adult education. According to the LAO, the adult population has been growing below 2.5% since the early 1980s when the rate was established. In the 1990s the adult population grew by an average of 1.2 %; since 2000 the average growth rate has been 1.8%. The projected growth rate for 2008-09 is 1.6%. The LAO recommends a reduction to the program by $30[1] million in order to capture excess growth the program has received over the past four years.

  Concerns have been raised by advocates over the LAO proposal. They disagree with the LAO's characterization of the proposed reduction as a "technical realignment". They argue that the growth rate is not reflective of the need for adult education programs. Districts that do not currently offer an adult education program are not able to due to caps on the program. Also, existing programs are anticipating greater demands as they begin to serve high school students who have not passed the California High School Exit Exam (CAHSEE).

- **Economic Impact Aid (EIA).** This program directs supplemental funds to districts to address the learning needs of economically disadvantaged students and English learners. Funding for the program is distributed namely based on the number of economically disadvantaged students and English learners, along with other factors. Because of a decline in enrollment in 2007-08, the LAO recommends a one-time downward adjustment of $25 million for this program in the budget year. CDE has concerns with this adjustment and believes the money is already accounted for.

- **Home to School Transportation.** The Home-to-School Transportation program provides funding for school districts to purchase and operate school buses for transporting students to and from school. Recent data indicated that almost all school districts (930) participate in the program, transporting a total of approximately 936,000 students (including special education students), or about one in six K-12 students. The formula used to calculate each school district's apportionment is based on the requirement that its current year funding cannot exceed its prior year cost. There is consensus among the LAO, CDE, and DOF that a downward adjustment of $11 million in the budget year is appropriate.

[1] The Governor's budget proposes to provide $722.4 million for this program in 2008-09; which equates to a $31.3 million reduction from the 2007-08 level.

- **Targeted Instructional Improvement.** This program funds the costs of any court-ordered desegregation program and any voluntary desegregation program, and provides instructional improvement for the lowest achieving pupils in the district. According to the LAO, there is a balance of $10 million for this program and therefore a one-time adjustment should be made to bring funding in line with spending. CDE does not believe that there is a balance of funds available and would not support this adjustment.

- **Alternative Certification.** Alternative certification programs provide a route to a teaching credential through intensive preparation programs that enable candidates to work as intern teachers while they complete credential requirements. These programs help school districts recruit talented individuals from a variety of sources to address geographic and subject matter shortage areas. This program does not get an annual COLA. This program has reverted money on an annual basis based on participation in the program. The Commission on Teacher Credentialing (CTC) agrees with the LAO recommendation to make an adjustment to the program.

- **National Board Certification.** The National Board Incentive Award Program, administered by CDE, currently provides 4-year $5,000 grants to teachers that become National Board certified that agree to teach in low-performing schools. National Board Certification has been earned by more than 60,000 teachers and counselors across the nation.

  The LAO proposes a $2 million reduction to the program which would bring total funding for the program to $4 million. LAO's estimate is based on current year estimates however, according to CDE, program funds are expended at the end of the fiscal year so it is not known how much of the current $6 million will go unspent. CDE estimates that at most, $1.8 million will be available at the end of the fiscal year.

- **Paraprofessional teacher training program.** The purpose of this program is to create local career ladders that enable school paraprofessionals – including teachers' assistants, library-media aides, and instructional assistants – to become certificated classroom teachers in K-12 public schools. The Budget Act of 2007 allocated a per capita funding increase of $500 and participants now receive $3,500 annually to support their teacher certification goal. Costs that exceed the annual $3,500 expenditure cap must be paid by the participant. Although there has been an increase in funding provided to program participants, the $3,500 annual financial assistance provided by the state does not meet the tuition and academic needs of these participants. This program also does not get an annual COLA. This program has reverted money on an annual basis based on participation in the program. CTC agrees with the LAO recommendation to make an adjustment to the program.

Programs recommended for phase-out or elimination. The LAO recommends the Legislature phase out or completely eliminate the following programs:

- **Physical Education Incentive Grant Program**. The *2006-07 Budget Act* established the Physical Education Teacher Incentive grant program, which provides $35,000 to 1,141 K-8 schools to hire a teacher specifically to provide physical education instruction to students. Schools were selected randomly but were to be representative of schools statewide, based on the size, type, and geographic location of the school. In 2007-08, the program was continued for the same schools and recipients were provided a 4.5% cost-of-living adjustment. For the budget year the Governor proposes to reduce program funding by 6.9%, which would result in school grant amounts being reduced by the same percentage.

  The LAO recommends elimination of this program because it does not distribute funds based on need, has no built-in accountability measures, and prioritizes physical education above other subject areas. Elimination of the program would yield a savings of $42 million (Proposition 98 GF).

- **Year Round Schools.** The Year Round Schools (YRS) grant program provides funding for schools that operate on a multitrack year round calendar and enroll more students than the state's facility capacity standards. Under a multitrack calendar, students are split into "tracks." Schedules are staggered so one track is on vacation at a time, allowing schools that are over capacity to still adequately provide classroom space for all students. The YRS program provides a dollar amount per pupil that is adjusted depending on the degree to which a school site is above its capacity. The *2007-08 Budget Act* provided $97 million for the YRS program. The Governor proposes to reduce funding to $91 million in the budget year.

  According to the LAO, over the last several years, the YRS program has experienced a decline in the number of participating school districts. In 2004-05, 16 school districts received funds through the program. Only four districts have requested funds in 2007-08. Due to statewide enrollment declines, some schools no longer qualify for the program. In addition, a majority of the schools that currently receive YRS funding are not expected to be on a multitrack calendar by 2012-13. The settlement of the *Williams* lawsuit in 2004 also requires the state to eliminate by 2012 the "Concept 6" calendar, a type of multitrack calendar that reduces the number of days of instruction but increases the length of the school day.

  Because of the expected decline in the program and fiscal challenges facing the state, the LAO recommends reducing the program to $78 million in the budget year, a reduction of $13 million from the proposed level. They further recommend the state reduce the program by $19 million each subsequent year until 2012-13, at which time the LAO recommends sun setting the program.

- **School Safety Competitive Grants.** The School Safety Consolidated Competitive Grant program (SSCCG) awards grants of up to $500,000 for a five-year period for local educational agencies (LEAs) to address school safety and violence prevention issues. This competitive grant is open to LEAs serving grades K-12 for school safety activities involving community collaboration. In 2007-08, the state provided $18 million for this program. This funding level resulted in 31 grants to serve 46 schools. For 2008-09, the Governor has proposed a funding level of $17 million.

  According to the LAO, there is no accountability, reporting, or evaluation requirement for the SSCCG program. Furthermore, in addition to SSCCG, the state funds the School Safety Block Grant program. The LAO argues that the School Safety Block Grant serves the same purpose as SSCCG—providing grants to LEAs to address school safety and violence prevention issues. In 2007-08, the state provided $101 million for the School Safety Block Grant and over 950 LEAs received apportionments—including all 31 of the LEAs receiving SSCCG grants. For 2008-09, the Governor has proposed a funding level of $94 million.

  The LAO recommends that the Legislature eliminate the SSCCG due to lack of accountability and program duplicity. Eliminating this program would save $18 million in Proposition 98 General Fund monies.

- **High Priority Schools Corrective Action**. In 2007-08, $6 million in state funding is budgeted for corrective action and $71 million in federal funding is budgeted for Program Improvement, which has a corrective action component. About $4.5 million in state funding and at least $29 million in federal funding is expected not to be spent in the current year. Moreover, the state has $78 million in new federal funding available for corrective action in 2008-09.

  The LAO recommends the Legislature eliminate state funding for corrective action as little of the budgeted amount is being spent and considerable federal funds are available for the same types of activities.

The LAO recommends suspension of the Quality Education Investment Act (QEIA). QEIA was established pursuant to SB 1133 (Torlakson), Chapter 751, Statutes of 2006. The Legislation appropriates $450 million in 2008-09 ($402million for a class size reduction program for K-12 schools and $48 million for community colleges), most of which is designated for Career Technical Education (CTE). Although little information is available on how much the 488 K-12 schools participating in QEIA are spending in 2007-08, virtually none of the community college CTE funding has been awarded to date. The LAO argues that ramping up such a program in the budget year while at the same time not providing a COLA to existing core programs (such as revenue limits, special education and Economic Impact Aid) would be counterproductive. The LAO therefore recommends the Legislature suspend the program until more ample resources are available. (Suspending by a year also would allow the Legislature to consider possible program improvements, such as better integrating QEIA with other state and federal programs that focus on low-performing schools and districts.)

ISSUE 2: LAO CATEGORICAL BLOCK GRANT PROPOSAL

The issue for the Subcommittee to consider is the LAO proposal to consolidate categorical programs into four block grants.

BACKGROUND:

The LAO has proposed categorical consolidation since the early 1990's. In their 2008-09 Analysis of the Budget Bill, the LAO again proposes the Legislature consolidate several categorical programs in an effort to increase local flexibility. Specifically, the LAO argues that reforming the categorical system would allow schools and districts the latitude to identify and solve local problems; help build local school site collaboration with school staff and the community; focus on outcomes and; increase transparency of funding sources. The LAO also notes that the *Getting Down to Facts* studies, published by Stanford University in 2007, found California's system of categorical programs "extremely troublesome" and in need of reform.

The *2007-08 Budget Act* devotes $14.9 billion in General Fund support for 62 K-12 categorical programs. These programs fund a broad array of program activities. Among the largest are K-3 class-size reduction ($1.8 billion), child development ($1.8 billion), and Economic Impact Aid ($994 million). Many programs, however, are relatively small—30 of the 62 programs received an appropriation of less than $50 million in the current year. Many of these programs also are comprised of several separate subprograms. The child development program, for example, has eight individual subprograms that serve different subgroups of infants and toddlers using different payment mechanisms. Similarly, the special education program is comprised of more than 15 individual subprograms.

The LAO recommends the Legislature streamline the K-12 fiscal system by consolidating a large number of categorical programs into three block grants. In addition, they recommend the Legislature create a new base grant by consolidating base revenue limits with selected add-on and categorical programs. In total, the LAO recommendation includes about 80% of all Proposition 98 K-12 funds. Under the LAO proposal, districts would continue to receive the same amount as in the past in the first year. In the future, grants would be equalized based on the formulas contained in each block grant. Also, the underlying requirements of the programs that are merged into the block grants would be eliminated as part of the reform.

Base Funding Grant. The “base” grant is largest of the LAO proposed grants providing almost $35 billion. The new grant would include existing revenue limit funding and seven other individual funding programs. The LAO also includes class size reduction (CSR) funds in the base grant. Rather than spread the CSR funds across all grades, however, the LAO recommends the Legislature adopt specific *grade-span* base grants that reflect the higher funding levels for K-3 and 9th grade CSR.

LAO Proposed K-12 Base Grant	
Current Program	**2007 - 08 Amounts (in Billions)**
Base revenue limits	$31.4
K-3 Class Size Reduction	1.8
SB 813 incentives	1.4
Meals for Needy Pupils	0.2
9th Grade Class Size Reduction	0.1
Minimum teacher salary	0.1
Unemployment insurance[2]	-
Public Employees' Retirement System (PERS) reduction	-0.2
TOTAL	**$34.8**
[1]Less than $100 million	

Consolidated Special Education Grant. This grant would merge funding from seven existing programs into the existing per pupil funding formula for special education, creating a $3.2 billion state grant for special education. In identifying the programs to consolidate, the LAO focused on programs that distribute funds to most of the SELPAs or support core special education activities. While no additional accountability provisions would be recommended, the LAO does recommend the Legislature require the California Department of Education (CDE) to submit an annual performance report on the progress of special education students using data from Standardized Testing and Reporting (STAR) and California High School Exit Examination (CAHSEE).

LAO Consolidated Special Education Grant	
Current Program	**2007-08 Amounts (in Millions)**
Attendance-based apportionments	$3,021.5
SELPA base funding	88.1
Workability	39.6
Vocational Education	5.3
Small SELPA base funding	2.6
Personnel development	2.5
Low incidence services	1.7
Necessary small SELPA	0.2
TOTAL	**$3,165.5**

Opportunity to Learn (OTL) Grant. This grant would merge 11 different programs aimed at students who need additional services to succeed in school. This new grant would provide $3.1 billion in funds to districts and is split into two parts: an academic support grant that would provide compensatory instructional services to disadvantaged students and a student support grant that would fund other types of services or activities that promote learning in schools. The LAO suggests districts be given flexibility to move money from one grant to the other and also suggest continuing the requirements that districts provide counseling and remedial instruction to students who fail or are likely to fail CAHSEE. Further, the LAO suggests the state monitor district performance under this grant through STAR scoring, graduation rates, and completion of "A through G" courses or an employer-certified vocational certificate. They also recommend the CDE be required to submit an annual performance report on the progress of disadvantaged students using the program data discussed above.

LAO Opportunity to Learn Grant	
Academic Support	
Current Programs	**2007-08 Amounts (in Millions)**
Targeted Instructional Improvement	$1,075.7
Economic Impact Aid	994.3
Supplemental Instruction	420.8
CAHSEE Supplemental Instruction	72.8
English Learner Assistance	63.6
Advanced Placement Fee Waivers	3.1
Subtotal	*($2,630.3)*
Student Support	
Grade 7-12 Counseling	$209.1
School Safety	100.6
Pupil retention	97.5
Community English Tutoring	50.0
AVID (non-98)	9.0
Subtotal	*($457.2)*
TOTAL	**$3,087.5**

Expanded School Improvement Grant. Under this last grant, the LAO proposes to merge the funding currently provided by 16 programs to provide $1.2 billion for the new grant. The new grant is comprised of two parts, one targeted at instructional improvement and the second focused on staff development. Consistent with the purposes of the other grants, this grant would free districts from the specifics of the existing grants but would still require districts to use the funds to improve student achievement through better instructional approaches and training. The LAO proposes distributing funding for the two grants based on average daily attendance and allowing districts to transfer funds between the grants. They would not provide additional accountability as they feel that school accountability under existing state and federal law is sufficient.

LAO School Improvement Grant	
Instructional Improvement	
Current Programs	**2007-08 Amounts (in Millions)**
School & Library Improvement Grant	$465.5
Arts and Music Grant	109.8
Gifted and Talented	51.3
Partnership Academies	23.5
Education Technology	17.7
Specialized Secondary Program	6.2
Civic Education	0.3
Subtotal	*($674.3)*
Staff Development	
Professional Development	$274.7
Teacher Credentialing Block Grant	128.7
Mathematics and Reading Professional Development Program	56.7
Staff Development	32.7
Alternative Certification (Intern)	31.7
Certificated Staff Mentoring	11.7
Paraprofessional Teacher Training	7.9
Teacher Incentives National Board	6.0
Principal Training	5.0
Subtotal	($555.1)
TOTAL	**$1,2229.4**

COMMENTS:

Categorical funding already seen as flexible by some. According to School Services of California, "Despite all the talk about there being 'strings attached' to categorical funding, ironically a categorical dollar is often the most flexible dollar around an educational agency. In the average LEA, almost all unrestricted general fund resources go to support school site staff and district administration. In 2006-07, approximately 92% of the average unified district's unrestricted expenditures were for employee salaries and benefits."

AB 825 Block Grants. In 2004, the Legislature passed AB 825 (Alpert), Chapter 871, Statutes of 2004. While funding was not increased under the block grants, the legislation did add flexibility in spending. Any block grant may be added to by transferring funds from another eligible block grant (up to a 20% augmentation). However, only four of the six block grants can be used for transfers-out (up to 15% may be transferred out if allowed). The funds can be transferred to another AB 825 block grant or to any stand alone categorical program.

Block Grant		Component Programs
Protected	Pupil Retention	Continuation High School High-Risk Youth Tenth Grade Counseling Opportunity Dropout Prevention Early Intervention for School Success At-Risk Youth (LAUSD)
	Teacher Credentialing	Beginning Teacher Support and Assessment
Flexible	School and Library Improvement	School Library Materials School Improvement Program
	Targeted Instructional Improvement	Targeted Instructional Improvement Grant Supplemental Grants (Various)
	Professional Development	Staff Development Buyback Days Teacher as a Priority Intersegmental Programs
	School Safety	School Community Policing Gang-Risk Intervention Safety Plans for New Schools School Community Violence Prevention Conflict Resolution

SOURCE: School Services of California

Assembly Education Committee Working Group on Categorical Reform. In response to the LAO proposal and several pieces of legislation that have been introduced on this topic, the Assembly Education Committee has formed a staff working group on categorical reform. As the Subcommittee reviews the LAO proposal, they may wish to make recommendations to the working group and the Assembly Education Committee as they consider various legislative proposals on categorical reform.

ISSUE 3: LOCAL FUNDING FLEXIBILITY OPTIONS

The issues for the Subcommittee to consider are local flexibility options that have been provided in prior budget years when reductions have been made to education funding.

BACKGROUND:

During the 2003-04 fiscal year, the state was in a similar budget situation, facing a budget shortfall of $38 billion. In 2003, the Legislature made mid-year reductions to K-12 education totaling $2 billion. Under the Budget Act of 2004, the Legislature did not provide growth or COLA to categorical programs, did not provide COLA to revenue limits and reduced revenue limits by $350 million.

In order to help local education agencies (LEAs) mitigate these budget reductions the legislature passed several bills, including SBx1 18 (Chesbro), Chapter 4, Statutes of 2003 and AB 1754 (Committee on Budget), Chapter 227, Statues of 2003, to provide "flexibility" options to LEAs.

Control Section 12.40. This control section in the budget, also known as the "mega-item", currently allows districts to transfer funding between certain categorical programs. Specifically, districts can transfer up to 10% out of an eligible program to be spent on other programs in the mega-item but no more than 15% can be transferred into a program. Below is a table listing the categorical programs eligible in 2006-07 for transfer under this control section.

Control Section 12.40 - Mega-Item Programs	
2006-07 Fiscal Year	
Budget Act Item	**Program**
6110-167-0001	Agricultural Vocational Education Incentive Grants (EC 52460)
6110-150-0001	California American Indian Early Childhood Education Centers (EC 52060)
6110-203-0001	Child Nutrition (EC 41311/49501/49536/49550/49552/49559)
6110-124-0001	Gifted and Talented Education (GATE) (EC 52200)
6119-181-0001	Educational Technology (EC 51870)
6119-122-0001	Specialized Secondary Programs (EC 58800)
6119-193-0001	Staff Development Peer Assistance and Review (EC 44500) Bilingual Teacher Training Program (EC 52180) Reader Services for Blind Teachers (EC 45371/44925)
6119-209-0001	Teacher Dismissal Apportionments (EC 44944)
6119-111-0001	Transportation Home-to-School (EC 41850) Small School District Bus Replacement (EC 42290) Special Education (OH/SH) (EC 41851.5)
6110-224-0001	Year-Round Education Grants (EC 42260/42263)
Note: Funds may be transferred into, but not out of, Economic Impact Aid and Foster Youth Services	

The Governor's budget proposes to change the amounts that can be transferred into and out of each program under this control section. The Governor's budget as written allows districts to transfer up to 60% out of a program and up to 65% into a program. The Department of Finance has stated that this was a technical error and that the proposal is to allow a transfer of up to 50% out of a program and up to 55% into a program. The Administration does not propose to change the number of programs in the control section.

In prior difficult budget years, the Legislature has made changes to the amounts allowed to be transferred to and from programs and has also made adjustments to the programs eligible for transfer under this control section. For the 2002-03 fiscal year, districts were authorized to transfer 20% out of a program and 25% into a program. The Budget act for the following fiscal year lowered the transfer percentages (10% out and 15% in) however, if districts had made use of the higher percentages during the 2002-03 fiscal year, districts could continue to transfer funds using the 2002-03 percentages.

Prior to 2005-06 the most common transfers between programs were from School Improvement Program (now part of the AB 825 School and Library Improvement Block Grant) and Economic Impact Aid (which was removed in 2006-07) to Home to School Transportation. The removal of large funding sources such as EIA and SIP have left little funds to transfer from one program to another.

Lowered Minimum Reserves for Economic Uncertainty. In an attempt to curtail an increasing number of school districts facing fiscal insolvency, current law requires LEAs to set aside a certain percentage of their budget as a reserve for economic uncertainty. The state requires districts to maintain a reserve of between 1% and 5% of their General Fund expenditures. The percentage depends on the size of the district, with smaller districts needing to keep a larger portion of their budget in reserve. This reserve provides a cushion against unanticipated fiscal needs that may arise, and thereby reduces the risk of insolvency and the associated need to borrow and increase district debt, for example, through a state emergency loan.

Meeting the reserve requirement is also a criterion the county superintendent of schools evaluates, along with other fiscal criteria, in determining whether to intervene in district fiscal matters, as required in law (also known as the AB 1200 process). Failing to meet a reserve requirement has no mandated consequence. However, it strengthens the county superintendent’s justification for intervention.

SBx1 18 allowed LEAs, for the 2002-03 fiscal year, to use up to 50% of its reserves for economic uncertainties in order to provide local budgeting flexibility in an effort to mitigate midyear budget reductions. LEAs were only allowed to use the amount of reserves equal to the amount of reductions taken that year with specific legislative intent that these reserves be used to offset reductions to the Peer Assistance and Review (PAR) program, supplemental instruction, remedial programs and one-time funding for instructional materials.

For fiscal years 2003-04 and 2004-05, AB 1754 also allowed school districts to reduce their required reserves by 50%. These funds could be used for any purpose. The bill also required for the 2005-06 fiscal year that the minimum state requirement for this reserve be restored to the original percentage and dollar amounts specified in the criteria and standards.

Based on CDE data from 2002-03 and 2003-04, approximately 40 districts took advantage of this option. It is likely that many districts did not take advantage of this option because of the requirement that reserves be replenished in the following fiscal year.

Many, including FCMAT and CDE, caution against lowering the current reserve requirements. Lowering the reserve requirement will not necessarily allow a district to avoid "qualified or negative" fiscal certifications. The ability of a district to pay its debts remains the same and their county office will likely continue to evaluate that overall ability. Furthermore, lowering the reserve requirement does not provide additional revenue to the district, it simply leaves less money available for unanticipated costs such as federal funding reductions, health benefit cost increases, insurance rate increases, state required mid-year cuts, or any general cost overrun that creates a cash flow problem. Districts should also be cautioned against spending reserve funds, which are one-time funds, for ongoing purposes. It is important to note that the smaller the district, the more critical the discussion becomes when the reserve levels are lowered during a two year period. Larger districts have a greater economy of scale and can better weather the storm - small districts likely can not.

Access to Restricted Ending Balances. Restricted ending balances are one-time funds that a district has not spent at the close of the fiscal year for a particular categorical program. On two occasions the Legislature authorized the use of these restricted balances for purposes other than is required by law.

In response to the mid-year reductions taken in 2003, SBx1 18 allowed districts to use up to 50% of the balances of restricted accounts in its General Fund (excluding restricted reserves committed for capital outlay, bond funds, sinking funds, and federal funds) in order to provide local budgeting flexibility for the 2002–03 fiscal year. Districts were prohibited from using more reserves than the total of the midyear budget reductions and it was intended that these funds be used specifically to offset reductions to the Peer Assistance and Review Program, supplemental instruction and remedial programs, and instructional materials funding. Districts were able to tap into just about every categorical program. As a result, districts curtailed spending on programs such as Economic Impact Aid (EIA) in order to access the balance of these funds for other purposes.

In order to mitigate cuts to school district revenue limits taken during the 2003-04 fiscal year, the Legislature, through AB 1754, again allowed school districts to access restricted ending balances. This time districts were allowed to use 100% of the balances of restricted accounts in its General Fund or cafeteria account. However, they could not use of any redirected categorical reserve funding to directly backfill a district's share of the $350 million reduction to revenue limits and several programs were off limits including: the Public School Accountability Act, EIA, Targeted Instructional Improvement Grants, Class Size Reduction, Instructional materials and Special Education. The Legislature also required districts that chose to use the restricted balances for other purposes to report to the Superintendent of Public Instruction regarding the programs and amounts of the balances used.

Current legislation, pending in the Assembly Education Committee, that addresses this issue includes: AB 1908 Wolk, AB 2056 (De Leon) and AB 2831 (Fuller).

Lower Routine Maintenance Reserve. Under current law, school districts that receive state school bond funds are required to use 3% of their local general funds on facility maintenance. This local match ensures that districts contribute their share to maintain state bond funded facilities.

The Routine Maintenance Reserve is used primarily for two purposes. First, the district is allowed to use 0.5% to make its contribution to Deferred Maintenance. Second, the vast majority of the remaining 2.5% is used to pay classified salaries for district employees who maintain the facilities.

In 2003, AB 1754 lowered the 3% reserve requirement to 2% of the total expenditures by the district from its general fund in the 2003-04 fiscal year. According to School Services of California, when this requirement was lowered, most districts had to lay off classified maintenance workers to achieve the savings. Ironically, just two years later, the flexibility provisions expired and many districts had to cut teaching positions in order to restore classified positions in maintenance so they could once again meet the 3% requirement.

Current legislation, AB 2832 (Fuller), pending in the Assembly Education Committee, would reduce from 3% to 1.5%, the amount a school district is required to maintain in a restricted account for ongoing maintenance.

Lower Deferred Maintenance Reserve. The Deferred Maintenance Program provides state matching funds on a dollar-for-dollar basis to assist districts with major repair or replacement of existing school building components (i.e. roofing, plumbing, heating, air conditioning, electrical systems, wall systems, floor systems.) Districts that choose to participate in the program set aside 0.5% of general fund expenditures and the state provides a match for those dollars. Any year, in which the school district does not set aside this 0.5%, the district is required to report to the Legislature, Superintendent of Public Instruction, the Department of Finance, and the State Allocation Board.

For the 2002-03 and 2003-04 fiscal years, the Legislature waived the local match requirement for participation in the Deferred Maintenance Program. For districts that used their unrestricted general fund to provide this match, the ability to not set aside this money freed up 0.5% from the unrestricted general fund.

Unlike the routine maintenance account, these dollars generally do not go to pay classified staff. Projects eligible for Deferred Maintenance are generally large enough that state law requires that they be bid rather than performed by district staff. Therefore, this option generally does not require layoffs or restoration of positions at a later date. However, fewer dollars going towards maintaining facilities will likely result in a delay of major facility repairs.

Instructional materials. In the 2002-03 budget, a one-time funding reduction was made to money allocated specifically for the purchase of reading/language arts instructional materials that were adopted in January 2002. Essentially, school districts received a lower per pupil allocation for the current year for the purchase of reading/language arts instructional materials. To mitigate this reduction, SBx1 18 allowed districts to postpone adoption of these materials for two years. In addition, AB 1266 (Committee on Budget), Chapter 573, Statutes of 2003 extended the instructional materials flexibility for an additional year through 2004-05.

Circumstances have changed since the last time the Legislature granted this flexibility. The *Williams* settlement of 2004 requires that every California public school provide each student with sufficient textbooks and instructional materials. Furthermore, the State Board of Education recently required districts facing corrective action under federal Title I Program Improvement to fully implement the State Board's standards-aligned curriculum.

COMMENTS:

As the Subcommittee considers options for flexibility it is important to note that in prior years when flexibility has been granted, it has been tied to or triggered by specific reductions to education.

ISSUE 4: COLA: PROPOSED CHANGE TO INDEX

The issue for the Subcommittee to consider is the Governor's proposed change to the COLA index and the LAO alternative COLA proposal.

BACKGROUND:

Each year, the budget provides most Proposition 98 programs with a cost-of-living adjustment (COLA), or an increase in funding to reflect the higher costs schools experience due to inflation. For K-12 education, some programs (including revenue limits, or general purpose funds) are statutorily required to receive this adjustment, whereas others receive the adjustment at the Legislature's discretion. (*see attachment for list of programs receiving a discretionary COLA).*

School districts generally use a portion of this new funding to provide annual increases to employee salaries through "step and column" salary schedules and raises. Depending on local collective bargaining agreements, the rate of the employee adjustment may be more or less than the COLA rate the state is providing. In addition to salary adjustments, COLA funding also goes to address cost increases for local operating expenses including employee benefits, utilities, materials, and supplies.

Both LAO and Administration have concerns with existing COLA index. Both the Administration and the LAO have concerns with the existing index used to calculate the K-12 COLA because it is heavily influenced by cost increases in areas that do not significantly affect schools.

Under current law, the K-12 COLA rate is based on the gross domestic product price deflator for purchases of goods and services by state and local governments (GDPSL). This index, calculated by the federal government, is designed to reflect changes in costs experienced by state and local governments around the country. To reflect the multiple categories in which state and local governments spend money, the GDPSL has several components including employee compensation, services (e.g. utilities), structures/gross investment, nondurable goods, and durable goods. In recent years, costs for structures and nondurable goods have experienced rapid growth due to national and international factors such as the hurricanes of 2005, instability in the Persian Gulf and growing demand for steel on the international market. The recent increases in these two categories have contributed to a higher overall GDPSL and K-12 COLA.

According to the LAO, the cost factors that school districts actually face are somewhat different from those reflected in the GDPSL. Although the GDPSL measures the costs of state and local government agencies, schools typically have different expenditure patterns than many other government entities. For example, a typical school spends about 85% of its annual General Fund budget on employee salaries and benefits. In contrast, employee compensation makes up only around 56% of the GDPSL. Conversely, the overall GDPSL is significantly more affected by cost increases in energy and construction than are typical K-14 General Fund budgets.

Governor's proposal to change COLA index to Consumer Price Index for Wage Earners and Clerical Workers (CA CPI-W). In an effort to better align the COLA with the cost pressures schools actually face, the Governor proposes to change the index used to calculate the K-12 COLA from the GDPSL to a modified version of the CA CPI-W. The proposed change would take effect beginning in the budget year. The proposed change would lower the rate from 5.43 % (GDPSL) to 4.40 % (CA CPI-W).

The United States Consumer Price Index (CPI) measures changes in the prices consumers in urban areas pay for a fixed "market basket" of goods and services. The CPI-W is a subset of the CPI based on the spending patterns of urban consumers who work in clerical or wage occupations. The federal government also produces data reflecting consumer prices in California's two largest urban areas—Los Angeles and San Francisco. State economists use data from the two regions to calculate a state-specific urban price index, known as the CA CPI-W. Many of the state's county public health departments use this index to calculate annual COLAs for their employee salaries. The Governor's proposed change for the K-12 COLA would use an unweighted version of the CA CPI-W.

LAO recommends using the employee compensation component of the GDPSL. The LAO argues that because the CA CPI-W focuses exclusively on consumer costs, it may be influenced by cost increases that have no bearing on schools' operational expenses.

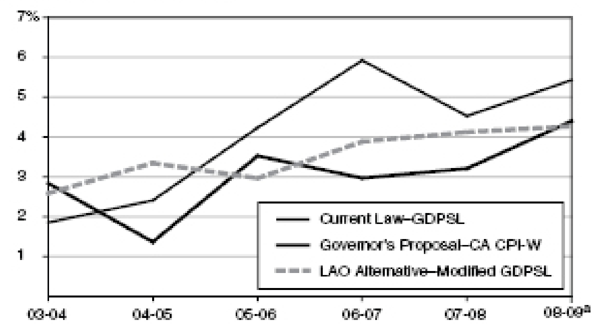
Because the state is providing K-12 COLA funding to schools and colleges—the employers—and not directly to the employees, they believe the GDPSL is a more appropriate inflationary measure than the administration's proposal. However, the overall GDPSL index does not accurately reflect cost increases schools actually face. Therefore, the LAO recommends that instead of using the total GDPSL, the state use the employee compensation component of the index. According to the LAO, this would account for inflationary changes in employer costs for both salaries and benefits and this approach also results in greater simplicity and transparency, making it easier for all parties to understand.

What is the effect of the LAO recommendation? The following figure displays actual growth rates for the GDPSL, the CA CPI-W, and the employee compensation component of the GDPSL from 2003-04 to 2007-08, as well the projected growth rates for 2008-09. As shown, no one index is consistently higher than the others. However, looking back at the GDPSL and its components over the past 20 years, the employee compensation component has grown more quickly than the overall index 75% of the time.

Figure 5

Comparison of K-12 COLA Rates Under Different Indices

2003-04 Through 2008-09



[a]Estimated. Based on revised data.

Costs of Existing COLA Rate Higher Than Alternatives in Recent Years. Over the past four years (2004-05 through 2007-08), the state paid approximately $8.3 billion to fund COLAs for K-14 education. Had the K-12 COLA been calculated over the same time period using either the Governor's proposed index or the LAO alternative, the costs would have been less—$5.4 billion or $6.9 billion, respectively.

Existing COLA Rate Expected to Be High Again in 2008-09. The LAO projects the GDPSL will continue to be higher than the two alternatives in 2008-09. Providing COLAs at the current statutory rate of 5.4% to the K-14 programs that typically get them would cost the state approximately $3 billion in 2008-09. In contrast, estimates are lower for both the Governor's proposed index and the LAO alternative—4.4% and 4.3%, respectively—each resulting in a cost of around $2.4 billion.

COMMENTS:

COLA change and the effect on the budget year and out-years. The LAO contends that this may be the best year for a change to the COLA index since K-14 education programs may not receive a COLA in 2008-09. (Neither the Governor's proposed budget nor the LAO alternative includes COLAs.) However, the change in 2008-09 could have a fiscal effect on future K-12 revenue limits if the Legislature chooses to create a "deficit factor."

When COLA is not provided, the state has the option of providing a deficit factor. This allows the state to keep track of the level of revenue limit funding that would be needed in subsequent years if the earlier reduction had not occurred. As a result, the state achieves short-term savings but revenue limits are not affected into perpetuity. Instead, the state provides more than otherwise required for revenue limits when times are better.

The Governor's budget proposes not to provide a COLA to revenue limits and to create a deficit factor. Based on the current COLA factor (5.4 percent), the size of the deficit factor would be $1.9 billion. By comparison, it would $1.6 billion under the Governor's COLA proposal (4.4 percent) and $1.5 billion under the LAO recommendation (4.3 percent).

ISSUE 5: FISCAL CRISIS MANAGEMENT ASSISTANCE TEAM (FCMAT) ANNUAL PRESENTATION ON DISTRICT FINANCIAL HEALTH

The issue for the Subcommittee to consider is a required presentation by the Fiscal Crisis and Management Assistance Team (FCMAT) on the overall fiscal health of school districts.

BACKGROUND:

The Fiscal Crisis and Management Assistance Team (FCMAT) provides financial and management assistance to school districts that request their assistance, and particularly those with negative or qualified financial certifications. It is housed in Kern County Office of Education.

FCMAT will give a presentation today on the latest report that districts have filed to reflect their financial status. The Education Code requires FCMAT to provide this presentation annually at a budget subcommittee hearing.

School districts required to file financial reports, reviewed by county offices. Under current law, local educational agencies (LEAs) are required to file two reports during a fiscal year (interim reports) on the status of the LEA's financial health. The first interim report is due December 15 for the period ending October 31. The second interim report is due March 17 for the period ending January 31. County superintendents are to report to the Superintendent of Public Instruction and the State Controller the certification for all districts in their county within 75 days after the close of the reporting period.

The interim reports must include a certification of whether or not the LEA is able to meet its financial obligations. The certifications are classified as positive, qualified, or negative, as follows. In addition, the Superintendent of Public Instruction may reclassify any county office of education or appeal of a school district certification.

- A **positive certification** is assigned when the district will meet its financial obligations for the current and two subsequent fiscal years.
- A **qualified certification** is assigned when the district may not meet its financial obligations for the current or two subsequent fiscal years.
- A **negative certification** is assigned when a district will be unable to meet its financial obligations for the remainder of the current year or for the subsequent fiscal year.

Results of First Interim Status report for the current year. The latest report available on CDE's website shows, that for the period ending October 31, 2007, there were seven districts that received a negative certification. (Last year, for the same period, three districts had received a negative certification.) Total budgets for these seven districts totaled more than $355 million. 28 districts received a qualified certification, compared to 19 districts during the same time period last year. Staff notes that these certifications occurred before the release of the Governor's January Budget. FCMAT anticipates the number of districts with qualified or negative certification will grow when the second interim report becomes available. The Subcommittee may wish to request an update as soon as this report is available.

Attachment 1 – Programs receiving discretionary COLA

Item	Program Name	Jan COLA	May COLA	Total COLA
6110-211	*Deferral - Charter School Categorical BG*			
6110-248	School Safety Competitive Grant	698	84	782
6110-104	Supplemental Instruction- Core Academics Grades K-12	3,028	475	3,503
6110-104	*Deferral - Core Academics Grades K-12*	890		890
6110-104	Supplemental Instruction-Low Star Grades 2-6	665	103	768
6110-104	*Deferral - Low Star Grades 2-6*	189		189
6110-167	Agricultural Vocational Education	201	24	225
6110-150	American Indian Early Childhood Education	26	3	29
6110-151	American Indian Education Centers	175	22	197
6110-103	Apprentice Program	484	88	572
6110-103	*Deferral Apprentice Program*	251		251
6110-265	Arts and Music Block Grant	4,242	215	4,457
6110-204	CAHSEE Supplemental Instruction	2,812	341	3,153
6110-267	Certificated Staff Mentoring	452	55	507
6110-201	Child Nutrition Startup Grants	-	-	-
6110-208	Civics Education	-	-	-
6110-107	COE Fiscal Oversight (FCMAT)	451	55	506
6110-240	College Prep: Adv Placement	69	9	78
6110-188	Deferred Maintenance	-	-	-
6110-181	Education Technology	685	82	767
6110-125	English Language Acquisition	2,460	296	2,756
6110-119	Foster Youth Programs	735	88	823
6110-111	Home to School Transportation	22,214	2,952	25,166
6110-111	*Deferral - Home to School Transportation*	2,124		2,124
6110-189	Instructional Materials Program	16,239	1,953	18,192
6110-137	Mathematics and Reading Professional Development	-	-	-
6110-195	National Board Certifications	-	-	-
6110-166	Partnership Academies	-	-	-
6110-260	PE Teacher Incentive Grants	1,616	196	1,812
6110-144	Principal Training	-	-	-
6110-228	School Safety Programs	2,332	468	2,800
6110-228	*Deferral - School Safety*	1,558		1,558
6110-122	Specialized Secondary Program Grant	238	29	267
6110-108	Supplemental School Counseling Program (Middle/HS Counseling)	8,080	980	9,060
6110-209	Teacher Dismissal Apportionment	2	-	2
6110-224	Year Round Schools	3,764	453	4,217
				85,651