

**AGENDA**  
**ASSEMBLY BUDGET SUBCOMMITTEE NO. 2**  
**ON EDUCATION FINANCE**

**Assemblymember S. Joseph Simitian, Chair**

TUESDAY, APRIL 13, 2004  
 STATE CAPITOL, ROOM 444  
 10:00 A.M.

**REGULAR BUSINESS**

ITEM            DESCRIPTION  
 OUTSTANDING COMMITMENTS

**ITEMS TO BE HEARD**

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## ITEMS TO BE HEARD

### 6110 DEPARTMENT OF EDUCATION

#### ISSUE 1: PROPOSITION 98: PROPOSED SUSPENSION AND GENERAL OVERVIEW

The issue for the Subcommittee to consider is the Governor's proposal to suspend Proposition 98 for the 2004-05 fiscal year. The LAO will also present a brief overview of the Governor's proposed Proposition 98 expenditures, including a description of the major proposed expenditure increases and reductions in K-12 education.

#### BACKGROUND:

**Proposed suspension for 2004-05:** The Governor's budget proposes to suspend Proposition 98, a voter-approved initiative<sup>1</sup> that amended the constitution to require the state to suspend a minimum portion of its General Fund revenues on K-14 education. Proposition 98 dictates the minimum required spending level (the "Proposition 98 minimum") based on K-12 enrollment growth, the growth of the General Fund and the growth of the economy. It generally requires that state education spending keep pace with the growth of the economy, in the long run. Proposition 98 also allows for the annual minimum spending requirement to be suspended if the Legislature approves the suspension with a 2/3 vote of the Legislature and in a bill that is separate from the budget. The Legislature suspended Proposition 98 once before, in 1989, when it approved a temporary tax increase to pay for repairs related to the Loma Prieta earthquake; it suspended Proposition 98 because it would have required a portion of those increased revenues to go to education, and the Legislature wanted to dedicate all of the tax revenue to the earthquake repairs.

The Governor proposes a total Proposition 98 funding level of \$46.7 billion, which is \$2 billion below the Proposition 98 minimum for 2004-05. The Governor proposes to suspend Proposition 98 to allow this \$2 billion in savings.

**Long-term effect of suspension.** The Governor's proposed \$2 billion suspension would result in annual savings of at least \$2 billion not just for 2004-05 but for several years. This is because under the terms of Proposition 98, when the state suspends the minimum funding requirements, it must eventually return to a long-term funding pattern that is based on the original minimum Proposition 98 guarantee. However, over the next few years the LAO estimates that the state will be required to return to this funding level very gradually over a long period of time. Because of this long "payback" period, the state will be expected to enjoy the \$2 billion in savings over many years, until it eventually returns to the long-term funding level.

<sup>1</sup> Approved in 1988

**Proposition 98 minimum may go down in May Revise.** Because this year's Proposition 98 minimum is determined based on certain economic factors, and those factors may change by the May Revise, the LAO estimates that the total Proposition 98 minimum may go down in May Revise. The Governor's budget proposes a \$2 billion suspension regardless of the Proposition 98 minimum. Therefore, according to the existing proposal, if the minimum funding level goes down in the May Revise, the \$2 billion savings will remain the same, and total Proposition 98 proposed expenditures will go down.

**LAO's general overview of Proposition 98 -- Large increases and reductions.** The LAO will present a 5-minute overview of the major increases and reductions in Proposition 98, as proposed by the Governor.

<b>COMMENTS:</b>
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**LAO recommendations on the suspension:** The LAO recommends that the Legislature suspend the Proposition 98 guarantee, because

- It provides substantial savings to the General Fund, thereby avoiding painful cuts in other areas.
- The proposed \$2 billion suspension still provides enough Proposition 98 funding to fund base programs and growth and COLA for K-12 programs.
- Suspension would be necessary anyway if the Legislature were to increase taxes to address the General Fund deficit. This is because the state is currently short of the long-term Proposition 98 funding goal, and certain percentage of any increase in General Fund is required to go to K-14 programs to help bring total funding toward the long-term funding goal.

*However,* the LAO recommends that the Legislature not focus on the total dollar amount of the suspension, but rather spend at the level that it deems appropriate to balance the needs of K-14 education with the rest of the budget.

**The Education Coalition** has indicated that it has an agreement with the administration on a number of principles, including the \$2 billion proposed suspension of Proposition 98. Appendix A contains the issues that both parties have declared they are in agreement on.

**ISSUE 2: PROPOSITION 98: PRIOR YEAR ADJUSTMENTS ("SETTLE UP FUNDS") AND REPAYMENT SCHEDULE.**

The issue for the Subcommittee to consider is how to provide "settle up" funds the state owes schools to meet newly calculated Proposition 98 minimum funding levels for 2002-03 and 2003-04.

**BACKGROUND:**

For the 2002-03 and 2003-04, the Legislature provided the amount of funding for K-14 education to meet the Proposition 98 minimum. However, these minimums were recalculated recently based on updated information, and the recalculated minimums turned out to be higher than the original calculations that the Legislature used. Therefore, the state owes funding to schools to meet the newly calculated Proposition 98 minimum guarantees for 2002-03 and 2003-04 -- commonly known as "settle up" funds. Settle-up funds are one time.

Fiscal year	Amount of "settle up" funds the state owes to meet the <i>newly calculated</i> Proposition 98 minimum for that year
2002-03	\$518 million
2003-04	\$448 million
<b>Two-year total</b>	<b>\$966 million</b>

The Governor proposes to delay re-payment of the \$966 million until 2006-07, and then proposes to repay these funds with one-time payments of \$150 million each year until completely paid off. The Governor also proposes that the funds be provided through continuous appropriation, which is an "automatic pilot" that does not allow the Governor or Legislature to alter the amount provided. The administration indicates that it intends to propose trailer bill language to achieve this re-payment schedule.

The LAO recommends suspending the guarantee for the 2002-03 and 2003-04 fiscal years, to avoid the \$966 million settle-up obligation. Staff notes that the Governor's proposal and the LAO's recommendation regarding these funds do not affect the 2004-05 budget and would only affect future budgets. Also, the \$966 million figure for the total required settle-up amount may also change, given that the final figures for the amount deferred from 2002-03 to 2003-04 may be adjusted.

**COMMENTS:**

**Issues to consider.** The subcommittee may wish to consider the consequences of committing to a future funding schedule that affects several years in the future without

any information about the state's fiscal condition for those out years, and without the ability to alter the payment schedule (since it will be continuously appropriated).

**LAO recommendation regarding prior-year Proposition 98 certification.** The LAO notes that the state hasn't "finalized" or certified the Proposition 98 minimum guarantees for the years 1995-96 through 2001-02 and recommends that the Legislature do so to avoid settle up obligations in the future. Current law requires California Department of Education (CDE), Community Colleges (CC), and the Department of Finance (DOF) to jointly certify the Proposition 98 minimum funding level within 9 months of the end of a fiscal year. However, these parties have ignored statute for a number of years. As a result, any technical changes to factors that make up the minimum guarantee could lead to a change in the minimum for these years, potentially leading to underfunding in any of those years and resulting settle up obligations. The LAO also recommends that the Legislature develop a more definitive certification process.

The Governor's proposal to pay the settle-up funds beginning in 2006-07 is part of the agreement with the Ed Coalition -- see appendix A.

### **ISSUE 3: PROPOSITION 98 DEFERRALS**

The issue for the subcommittee to consider is how to address the growing obligations related to revenue limit and categorical deferrals.

#### **BACKGROUND:**

Three years ago, the Legislature began deferring expenditures from one year to the next, in an effort to reduce expenditures while trying to inflict the least pain to school districts. For example, as part of the 2002 budget, the Legislature deferred \$700 million in expenditures for the Targeted Instructional Improvement Grant from the 2001-02 year, in which we were over-appropriating Proposition 98, to the 2002-03 year, in order to meet the minimum Proposition 98 guarantee for that year. The deferral was intended to not be a cut to school districts, but rather only a slight two-month delay in receiving the funding, given that funding for that program typically was distributed at the end of the fiscal year anyway. The deferral achieved one-time savings in 2002-03.

The Governor's budget proposes to continue a total of \$1.07 billion in revenue limit and categorical program deferrals. This total reflects the net amount of deferrals. The Governor also proposes to utilize \$146 in reversion account funding to pay off two deferrals (the Targeted Instructional Improvement Grant and the School Safety Block Grant (partial)). He also proposes to defer an additional portion of the P-2 apportionment (in which the state provides a lump sum payment for a variety of funding

streams from different programs at the end of the fiscal year) at a total of \$146.2 million. The following table was provided by DOF, and summarizes the deferrals in the Governor's proposed budget.

**Ongoing Deferrals: K-12  
(dollars in thousands)**

Program Name	2003-04	2004-05
Gifted and Talented Education	3,958	3,958
Targeted Instructional Improvement Grant - Court Ordered	95,397	*
Adult Education	40,925	42,720
Supplemental Instruction (Summer School Programs)	83,056	85,447
Community Day Schools	4,451	4,533
Apprentice Program	5,738	5,738
Charter Block Grant	4,635	
Home to School Transportation	50,103	
School Safety Block Grant	82,000	35,687*
P2 Apportionment estimated amount	726,270	747,030
Additional P2 deferral due to categorical reform		146,262
<b>Total Planned K-12 Deferrals</b>	<b>1,096,533</b>	<b>1,071,375</b>

\*The Governor's budget proposes to pay off these deferrals with a total of \$146 million in reversion account funding, as follows: \$48.3 million for the School Safety Block Grant, and \$98.1 million for the Targeted Instructional Improvement Grant - Court Ordered.

**LAO recommendation.** The LAO recommends making repayment of deferrals a funding priority. It groups the above categorical deferrals with other deferrals that the Legislature has enacted in the past, such as deferring payment of claims for state-reimbursable mandates and the revenue limit deficit factor, and argues that these deferrals only add to the amount the state owes to schools and will have to pay at a future date. It recommends that the Legislature gradually begin paying off deferrals and develop a repayment plan to eventually restore all deferred funds. It notes that since school district have already spent the funding to meet the program obligations of the deferred programs, any funding provided to reduce deferrals is effective general purpose in nature at the local level. Payments to eliminate deferrals are one-time, and therefore free up ongoing Proposition 98 funding in the fiscal year following the repayment.

**COMMENTS:**

CDE has raised concerns about utilizing revenue limit apportionments as part of the P-2 apportionment deferral (which includes revenue limit apportionments as well as funding for categorical programs). This is because the amount that will eventually go out as

revenue limit apportionments is difficult to estimate, and makes it difficult to meet a specific deferral target. In 2003-04, the P-2 apportionment deferral increased as a result of the revenue limit apportionment, which led to an underfunding of the Proposition 98 guarantee in 2003-04, resulting in the need to provide Proposition 98 settle up funds to meet the minimum for that year. The subcommittee may wish to consider replacing the revenue limit apportionments with another categorical programs, if it wishes to continue to defer the same amount of the P-2 apportionment.

#### ISSUE 4: REVENUE LIMITS: DEFICIT REDUCTION

The issue for the subcommittee to consider is the Governor's proposal to provide \$270 million for deficit reduction.

#### BACKGROUND:

**Overview of all revenue limit increases.** The Governor's budget proposes an increase of almost \$3 billion, for K-12 revenue limits, which provide discretionary funding to school districts and county offices of education and are the biggest source of Proposition 98 funding to schools. The table below summarizes all of the proposed adjustments to the revenue limits. The proposed increases are a dramatic contrast to last year's budget, in which the state reduced revenue limits by 1.2% and did not provide a COLA. The majority of the proposed increase, \$1.9 billion, reflects the proposed shift of funding from categorical programs into the revenue limit, and as such does not represent a true increase in funding for schools.

#### Proposed adjustments to the K-12 revenue limits

Augmentation / Reduction	Amount
Shift 22 categorical programs into revenue limits	\$1.9 billion
COLA (1.84%)	545 million
Growth (1%)	293 million
Unemployment Insurance	129 million
PERS costs	96 million
Equalization	82 million *
Deficit reduction	270 million*
Revenue limit deferrals/ deficits	- 447 million
<b>Total increases to revenue limits</b>	<b>\$2.9 billion</b>

\* Adjusted amount after the administration and Education Coalition made post-January 10 revisions to their agreement. The revisions added \$240 million to revenue limits compared to the January 10 proposal.

**Deficit reduction.** The Governor's revised January 10 proposal proposes \$270 million to reduce the deficit factor that was applied to revenue limits last year when the state reduced revenue limits by 1.2%. The deficit factor reflects the amount (as a percentage of the revenue limit) that the Legislature agreed that it owes school districts and county

offices as a result of cutting revenue limits and denying COLA's last year. The proposed funding would constitute a real increase in discretionary funding for school districts. DOF estimates that the \$270 million would reduce the deficit factor related to last year's revenue limit cut from the existing level of 1.2% to approximately 0.3%. The state would still owe funding related to the 1.8% deficit factor applied to revenue limits as a result of the lack of COLA's last year.

**COMMENTS:**

The proposed \$270 million in deficit reduction funding is part of the agreement with the Ed Coalition -- see appendix A. As part of that agreement, (should it be adopted by the Legislature), deficit reduction would be the state's highest funding priority for any new funding in future years.

**ISSUE 5: REVENUE LIMITS: NEED FOR SIMPLIFICATION**

The issue for the subcommittee to consider is the LAO's recommendation to simplify the revenue limit formula by merging six add-on's into the base.

**BACKGROUND:**

In its December 2003 report, "The Distribution of K-12 Education General Purpose Funding," the LAO recommends that the existing revenue limit formula is unnecessarily complex and results in funding levels that are not uniform among districts. The existing revenue limit formula contains a number of "add-on's" that have been adopted over the years for different purposes at different amounts per districts. The LAO uses two criteria for determining whether these add on's are general purpose funding and should therefore be rolled into the revenue limit:

- 1) Is the add-on funding free of any state-imposes conditions that accompany the money?
- 2) If the answer to the above question is no, do all districts participate in a program supported by the funds?

The LAO recommends that six add-on's be rolled into the revenue limit: Meals for Need Pupils (which does pay for meals), SB 813 Incentive Programs, Interdistrict Attendance, Continuation Schools, Unemployment Insurance, and the PERS adjustment.

**COMMENTS:**

The LAO will present its proposal at the hearing.

**ISSUE 6: REVENUE LIMITS: EQUALIZATION**

The issue for the subcommittee to consider is the Governor's proposal to provide a \$82.2 million augmentation to equalize revenue limit funding.

**BACKGROUND:**

The Governor proposes a \$82.2 million augmentation as an initial payment to equalize differences in school district revenue limits. This funding would be discretionary for districts and could be used for any purpose. The Governor originally proposed \$110 million for equalization, but reduced the amount as part of the revised agreement with the Education Coalition. SB 1298 (Brulte) contains the Governor's proposed equalization formula. It proposes to bring all districts to the 90<sup>th</sup> percentile of all size and type districts. It is unclear what the total cost of fully equalizing would be under this proposal. However, the full cost would be more than the \$82.2 million proposed for this purpose, resulting in out-year costs.

**COMMENTS:**

**LAO recommendation:** The LAO recommends deleting the proposed equalization funding, due to the state's fiscal situation, and the fact that there are more pressing funding needs. It recommends redirecting the equalization funding to pay off some of the state's deferrals. It argues that this would have two benefits: 1) it would provide districts with discretionary funding and 2) because it would be a one-time expenditure it would free up funds in 2005-06 to support base K-12 programs. It also recommends having the Quality Education Commission identify new equalization targets, and that it re-evaluates the existing definitions of district size as part the development of new equalization targets.

The Quality Education Commission was established in 2002 to estimate how much funding schools need to ensure that different types of students meet state performance standards. It is charged with developing adequate funding levels for elementary, middle and high schools. Given that the commission's work may result in new funding "goals", the LAO argues the state should wait until the Commission completes its work before the state begins equalizing.

The LAO also expresses concerns that because the Governor's proposed formula equalizes based on size and type of district, the formula would result in different increases for different sizes and types of districts. For example, it argues that the formula would provide much bigger increases to small unified districts than large unified districts. It argues that, because the formula is based on the existing (arbitrary) distribution, and not on the actual costs of serving children in each size and type of districts, it results in equalization targets that are arbitrary and may have unintended consequences.

The Governor's proposed augmentation for equalization funding is part of the agreement with the Ed Coalition -- see appendix A.

#### **ISSUE 7: REVENUE LIMITS: PERS OFFSET**

The issue for the subcommittee to consider is the administration's proposed language to remove the 13% PERS offset cap and language that would impose a PERS offset on joint powers authorities.

#### **BACKGROUND:**

**PERS offset cap.** School district and county offices of education make employer contributions to PERS for their classified employees (non-credentialed). Under current law, if districts' PERS contribution rates are below 13.02% (the rate in 1981-82), the state deducts the difference between 13.02% and the rate from districts' revenue limits, thereby saving the state money. (The state adopted this policy to capture any savings that districts might experience as a result of dropping contribution rates.) If districts' PERS contribution rates are above 13.02% the state must pay for local contributions above this level. The current PERS contribution rate is 12.02. The administration proposes, through trailer bill language, to remove the 13% PERS cap on the PERS offset. This would eliminate any obligation by the state to pay districts for local PERS contributions above this level, and result in savings to the state (but a reduction to school districts) if the PERS contribution rate goes above 13% in the future. The administration's proposal has no fiscal effect in the budget year.

**JPA language.** The administration also proposes trailer bill language to impose the PERS offset on joint powers authorities. Under current law, joint powers authorities are not subject to the PERS offset. The administration argues that districts are purposely setting up joint powers authorities and transferring their classified employees to those authorities to avoid the PERS offset. Regional occupational center and programs are often joint powers authorities because they serve more than one school or school district. Advocates for ROC/P's argue that have been joint powers authorities for many years, and did not set themselves up in this fashion to avoid the PERS offset. They argue that they therefore should not be punished for abuses that they did not commit.

#### **ISSUE 8: REVENUE LIMITS: BASIC AID DISTRICTS**

The issue for the subcommittee to consider is the Governor's proposed restoration of last year's \$9.9 million reduction to categorical funds in basic aid districts.

#### **BACKGROUND:**

Last year's budget made two changes to funding for basic aid districts, which receive no or very little state revenue because all or almost all revenue limit funding is from local property taxes. First, it eliminated the \$120 per pupil payment that the state was paying, in compliance with the state constitution requirement that the state pay at least \$120 per pupil, by counting existing categorical funds toward the \$120 per pupil minimum. Second, it reduced categorical funds for basic aid districts by \$9.9 million. This reduction was intended to ensure that basic aid districts experienced the same reductions as non-basic aid districts, who experienced a 1.2% reduction to their revenue limits and were denied COLA's. Since basic aid districts receive no state funds for their revenue limits, the 1.2% revenue limit cut didn't affect them, so the Legislature adopted the categorical cut to ensure that basic aid districts were treated the same as non-basic aid districts.

The Governor's budget proposes to restore the \$9.9 million reduction, arguing that last year's cut was intended to be one-time. It cites last year's trailer bill language that expressed legislative intent to eliminate the revenue limit deficits as soon as possible. Since the \$9.9 million reduction represents the revenue limit deficit for basic aid districts, it proposed to eliminate it this year.

**COMMENTS:**

The LAO recommends eliminating the \$9.9 million, arguing that it treats basic aid districts better than non-basic aid districts, because it restores their "deficit" before non-basic aid deficits are fully restored. (The LAO made its recommendation before the Governor proposed deficit reduction for non-basic aid districts.) It argues that the Legislature can use the savings to meet its other budget priorities or reduce the structural General Fund gap between revenues and expenditures.

**ISSUE 9: INSTRUCTIONAL MATERIALS**

The issues for the subcommittee to consider regarding instructional materials are: 1) What is the appropriate amount of funding to provide to school districts for instructional materials? And 2) Should the existing line item program for instructional materials be eliminated and the funding be rolled into the revenue limit, as proposed by the Governor?

**BACKGROUND:**

The Governor's revised January 10 budget includes no funding that is earmarked for instructional materials. This is a significant departure from prior years, in which the state has provided at least \$175 million to districts specifically to purchase instructional materials. The Governor's January 10 budget originally included a two-fold proposal for funding for instructional materials: 1) the elimination of the existing \$175 million line-item for instructional materials, by rolling this same amount into district revenue limits and 2) a \$188 million augmentation for a new instructional materials categorical program. However, after introducing this proposal, the Governor's office has amended this initial proposal, pursuant to a revised agreement between the administration and the Education Coalition (see appendix A). The revisions include the elimination of the \$188 million augmentation for instructional materials, leaving the \$175 million rolled into district revenue limits, as part of the Governor's overall categorical reform proposal in which he rolls funding for a number of existing categorical programs into the revenue limit. The revisions were part of an effort to fully fund growth and COLA for K-14 programs and fund revenue limit deficit reduction.

***I. What is the appropriate amount of funding that should be provided to school districts for instructional materials?***

**Funding history for IM.** Last year's budget provided \$175 million for instructional materials, a reduction in funding compared to prior years. The table below summarizes the recent history of Proposition 98 funding for instructional materials.

<b>Funding source</b>	<b>2000-01</b>	<b>2001-02</b>	<b>2002-03</b>	<b>2003-04</b>	<b>Proposed 2004-05</b>
Schiff-Bustamante/ Instructional Materials Block Grant	\$250	\$250	\$250	\$175	
K-8 and 9-12 Instructional Materials Funding	\$165	\$173			
One-time funding			\$43		
<b>Total Proposition 98 funds dedicated to instructional materials (does not include lottery funds for instructional materials)</b>	<b>\$415</b>	<b>\$423</b>	<b>\$293</b>	<b>\$175</b>	<b>\$0</b>
Revenue limit					\$175*

\*Available for instructional materials but not required to be spent on instructional materials.

**Instructional materials adoption timeline.** Since the state adopted academic content standards in 1998, the State Board has approved instructional materials that are aligned to these standards. For grades K-8, districts can use state instructional materials money to purchase only those standards-aligned materials approved by the State Board of Education.<sup>2</sup> In 1999, the Board approved instructional materials that happened to be aligned to the state English/ language arts and math standards. At the same time, the Legislature began providing \$250 million a year to purchase these materials. Then, in 2000, the state began adopting comprehensive instructional materials that had been custom-made to meet the state's standards. While some districts purchased materials from the 1999 off-the-shelf approved list, others "banked" their funding each year and waited until the custom-made materials were adopted and purchased those. Yet others purchased materials from the 1999 off-the-shelf list and then purchased customized materials from the subsequent approval. (Districts generally pilot materials before purchasing.) The timeline for the adoption of standards-aligned materials is below:

<sup>2</sup> Currently, the State Board of Education does not approve materials for district purchase for grades 9-12, although the Superintendent of Public Instruction proposes to require approval for materials in these grades as well.

Year of adoption	Standards Area
2000	Science
2001	Mathematics
2002	Reading/ Language Arts
2003	Foreign Language
2004	Health
2005	History-Social Science
2006	Science ; Visual and Performing Arts
2007	Mathematics
2008	Reading/Language Arts
2011	History-Social Science
2012	Science

**Funding need.** It is unclear what districts need to spend per pupil on instructional materials to guarantee that students have adequate access to materials. However, school districts might be expected to make major instructional materials purchase at least every few years, given that 1) districts are required to purchase standards-aligned instructional materials from the ones approved by SBE in the four core curriculum areas (history-social science, math, reading/ language arts and science); 2) the timeline for state adoption of standards-aligned materials allows for a new list of approved materials approximately every year and 3) materials are expected to last several years, after which time districts might be expected to replace them, often with newly designed materials that are more recently approved by the Board for purchase, given that the Board adopts a new list of materials for each subject matter every six years.

According to CDE, per-pupil costs for K-8 Reading/ Language Arts/English Language Development instructional materials vary from \$47 per pupil (the lowest amount for student edition textbooks) to \$348 per pupil (the highest amount for complete programs, including consumable workbooks, teacher's resource materials, assessments and English language Development kits). Reading intervention programs for students in grades 4-8 can cost additional amounts, varying from \$123 per pupil to \$493 per pupil. However, the Governor's proposed \$175 million appropriation for instructional materials would amount to less than \$30 per student for this year to purchase instructional materials.

**LAO recommendation.** The LAO will present their recommendation regarding total funding level at the hearing.

***II. Should the state dedicate resources for instructional materials or roll the funding into the revenue limit?***

**Williams case.** The state is currently facing a lawsuit by the American Civil Liberties Union and other groups on behalf of disadvantaged students attending low-performing schools, *Williams v. State of California*. The case is expected to go to trial in the fall. The suit accuses the state of not ensuring that students have access to basic education needs, including instructional materials for each child. There is no statewide data system to determine whether students have access to instructional materials, however, the ACLU cites a number of studies and surveys of teachers that demonstrate a severe lack of adequate instructional materials, particularly in schools serving economically disadvantaged students. One of the arguments in the case is that the state's high-stakes testing and accountability system (including the high school exit exam) assumes that students are learning the statewide academic content standards, and that standards-aligned instructional materials are the main way in which students have access to those standards. As the case moves forward, the Legislature may have to consider how to ensure that the state meets its obligation to provide adequate instructional materials for each child, and whether dedicating state funding for that purchase achieves that goal.

**LAO recommendation.** The LAO recommends adopting the Governor's proposal to roll instructional materials funding into the revenue limit, according to its own principle for determining which programs should remain as categorical programs and which should be rolled into the revenue limit. That principle is: Is local accountability sufficient to offset district incentives to underinvest in program services? The LAO argues that, because standards-aligned materials are crucial to ensuring that students perform well, district don't have an incentive to underinvest in them, and therefore the funding can be safely rolled into the revenue limit without an effect on districts' spending on instructional materials.

**COMMENTS:**

The Governor's revised instructional materials proposal is part of the agreement with the Ed Coalition -- see appendix A.

**ISSUE 10: GROWTH AND COLA**

The issue for the subcommittee to consider is the Governor's proposal to fully fund growth and COLA for all K-12 programs.

**BACKGROUND:**

In his January 10 proposal, the Governor proposed funding a 1.02% growth rate for revenue limits and some categorical programs, and a 1.84% COLA for revenue limits and some categorical programs. As part of the revised agreement with the Education Coalition, the Governor now proposes to fully fund growth and COLA for revenue limits and *all* categorical programs. The proposed revisions would cost \$15.6 million to fund growth for those categorical programs that were excluded in the January 10 budget and \$17.2 million to fully fund COLA's for categorical programs similarly excluded in the January 10 budget. The table below summarizes the Governor's proposals for growth and COLA. These figures are expected to change in the May Revise, as they normally do each year, due to updated enrollment and COLA figures.

	<b>January 10</b>	<b>Revised</b>
<b><u>Growth</u></b>		
• Revenue limits -- 1.02%	\$280 million	\$280 million
• Categorical programs	\$ 89 million	\$105 million
• Special education	\$ 37 million	\$ 37 million
<b><u>COLA - 1.84%</u></b>		
• Revenue limits	\$555 million	\$555 million
• Categorical programs	\$ 115 million	\$132 million
• Special education	\$ 70 million	\$ 70 million

**COLA expected to increase.** Fully funding growth and COLA for all K-12 programs is part of the Governor's agreement with the Education Coalition. However, the LAO is estimating that the statutory COLA will increase in May Revise to above 2%, resulting in additional Proposition 98 expenditures that could exceed \$100 million.

**Declining Enrollment.** The LAO notes that overall K-12 enrollment growth is slowing, compared to previous years. In particular, a growing number of school districts are facing declining enrollment, which results in a slow decline in discretionary funds, since revenue limit funding (apportionments) is based on average daily attendance. Current law provides a one-year "hold harmless" provision, in which declining enrollment districts are held harmless for declining apportionments for only one year. The Legislature is currently considering legislation to extend this hold harmless provision, to

give districts with declining enrollment additional time to adjust to their declining revenues.

<b>COMMENTS:</b>
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In contrast, last year's K-12 budget provided growth funding for revenue limits and special education only, and did not provide COLA's for any program. In addition, last year's budget contained a 1.2% reduction to revenue limits.

<b>APPENDIX: EDUCATION COALITION AGREEMENT WITH ADMINISTRATION REGARDING MAJOR PROPOSITION 98 ITEMS</b>
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The administration and the Education Coalition have indicated that they are in agreement on several major funding issues, highlighted in the above agenda. The parties initially agreed on variety of issues and funding levels, which were reflected in the Governor's January 10 proposed budget. However, the parties revised the agreement in late January to fully fund COLA's for all programs and provide revenue limit deficit reduction funding. The revisions were intended to be revenue neutral, so the parties agreed to pay for the full COLA and deficit reduction by eliminating funding for instructional materials and deferred maintenance and reducing funding for equalization. These changes, and the final agreement, are reflected in the table and bullets below.

Administration / Education Coalition Agreement -- specified programs  
(Dollars in thousands)

Program	Initial agreement, reflected in Jan 10 proposed budget	Proposed changes	Final agreement, as of 1/20/04
K-12 equalization	\$110,000	-\$27,770	\$82,230
Community college equalization	\$80,000	-\$20,196	\$59,804
Deferred maintenance	\$173,300	-\$173,300	0
Instructional materials	\$188,000	-\$188,000	0
Deficit reduction	0	\$270,089	\$270,089
COLA's**		\$139,177	\$139,177**

\*\*Does not reflect total COLA funding for K-12 programs. Rather, reflects the amount needed to fully fund growth and COLA for K-12 programs and community colleges.

The agreement also contains the following provisions:

- Suspension of the Proposition 98 guarantee, so that funding is \$2 billion below the minimum.
- Growth and COLA for all K-14 programs and services for 2004-05, and a commitment to continue this policy each year thereafter.
- Full payment of all PERS costs as required under current law (\$106 million).
- Pay-back of all 2002-03 and 2003-04 Proposition 98 settle up funds, beginning in 2006-07, with a continuous appropriation of \$150 million per year until all settle up obligations are met.
- Certification of the Proposition 98 minimum funding levels in all previous years since 1994-95. Certification will begin by January 2005 and be completed by June of 2005.
- Establishment of funding priorities for all future years until the \$2 billion suspension is restored. These funding priorities include:
  1. Revenue limit deficit reduction until paid back.
  2. Payment of all approved and legally required mandated costs to K-14 school districts.
  3. 75% of all additional restored funding shall be distributed on a per pupil basis as general aid.
- Establishment of funding priorities for any new monies that may be available in May:
  1. Restore K-12 and community college equalization.
  2. Deferred maintenance and instructional materials.
  3. Remaining priorities:
    - 1) Deficit reduction
    - 2) Legal and Valid Mandates.
    - 3) 75% for discretionary funding and 25% for administration and legislative priorities.