# AGENDA

**ASSEMBLY BUDGET SUBCOMMITTEE NO. 2**
**ON EDUCATION FINANCE**
Assembly Member Mervyn Dymally, Chair

**TUESDAY, MARCH 14, 2006**
**STATE CAPITOL, ROOM 444**
10:00 AM

## ITEMS TO BE HEARD

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ITEMS TO BE HEARD

6110 DEPARTMENT OF EDUCATION

ISSUE 1: OVERALL PROPOSITION 98 FUNDING

The issues for the subcommittee to consider during this and future hearings are:

- What is the Governor's proposed Proposition 98 funding level for 2006-07, and how does it compare with last year's funding level?

- To what extent does this funding level pay off outstanding debts, like the debt the state owes schools from having suspended the minimum Proposition 98 guarantee in 2004-05? What debt does the state owe for prior years when the state inadvertently underfunded the minimum guarantee (settle-up)?

- How does the proposed funding level for education fare in comparison to the rest of the budget? How will the proposed Proposition 98 over-appropriation in 2006-07 affect the overall budget outlook in future years?

The LAO will present its analysis of the above issues at today's hearing.

BACKGROUND:

**Overall Proposition 98 funding proposed by Governor for K-12 and community colleges**

The Governor's proposed budget provides a total increase of $4.3 billion in Proposition 98 funding for K-12 schools and community colleges over the revised funding level in last year's budget, an 8.67 percent increase over the revised Proposition 98 amount provided in last year's budget for K-12 schools and community colleges. According to the Governor's estimates, this funding level is $1.7 billion more than the amount required to meet the funding requirements for education for fiscal year 2006-07 (see below for more information about over-appropriation.) This total increase is split between K-12 education and community colleges, as follows, and is detailed in Figure 1, below:

- **Increase to K-12 education:** The budget proposes a $3.7 billion increase in Proposition 98 funding for K-12 education. (The composition of this increase is detailed below in Figure 2.)

- **Increase to community colleges:** The budget proposes a $606 million increase in Proposition 98 funding for community colleges. The proposed total Proposition 98 funding level for community colleges is 10.79% of total
Proposition 98 funding. More details on this funding are contained in the section on Higher Education.

<table>
<thead>
<tr>
<th></th>
<th>2005-06 revised</th>
<th>2006-07</th>
<th>Increase over 2005-06 revised amount</th>
<th>Amount</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>K-12 Proposition 98 (Department of Education)</strong></td>
<td>$44,627</td>
<td>$48,356</td>
<td>$3,729</td>
<td>8.36%</td>
<td></td>
</tr>
<tr>
<td>Community colleges</td>
<td>$5,242</td>
<td>$5,848</td>
<td>$606</td>
<td>11.56%</td>
<td></td>
</tr>
<tr>
<td>Other agencies</td>
<td>$117</td>
<td>$113</td>
<td>-$3</td>
<td>-2.72%</td>
<td></td>
</tr>
<tr>
<td><strong>Total Proposition 98</strong></td>
<td><strong>$49,986</strong></td>
<td><strong>$54,318</strong></td>
<td><strong>$4,332</strong></td>
<td>8.67%</td>
<td></td>
</tr>
<tr>
<td>General Fund</td>
<td>$36,311</td>
<td>$40,455</td>
<td>$4,145</td>
<td>11.41%</td>
<td></td>
</tr>
<tr>
<td>Property tax revenues</td>
<td>$13,675</td>
<td>$13,862</td>
<td>$187</td>
<td>1.37%</td>
<td></td>
</tr>
<tr>
<td>K-12 Prop. 98 funding per-pupil(^1)</td>
<td>$7,425</td>
<td>$8,029</td>
<td>$604</td>
<td>8.13%</td>
<td></td>
</tr>
</tbody>
</table>

\(^1\)Per-pupil funding is estimated using K-12 average daily attendance from the LAO of 6,010,454 for 2005-06 and 6,023,040 for 2006-07.

- **Current-year overappropriation.** The administration estimates that the Proposition 98 funding level for the current year (2005-06) is over-appropriated by $265 million, and this additional spending increases the 2006-07 minimum Proposition 98 requirement by a similar amount. This over-appropriation counts towards the maintenance factor (see the bullet below for more information).

- **Budget-year overappropriation.** The Governor's 2006-07 proposed Proposition 98 spending level overappropriates the minimum 2006-07 Proposition 98 guarantee by an estimated $1.7 billion. This does not include the $426 million automatic appropriation required to implement the Proposition 49 after school initiative. The administration considers the $426 million Proposition 49 augmentation as a separate adjustment to the base Proposition 98 funding level, on top of the minimum 2006-07 guarantee that would be calculated absent Proposition 49.

**How the Governor’s budget pays outstanding debts**

There are different ways to talk about the amount the state owes K-14 education. The maintenance factor measure the total amount the state must pay education over time. The amount that education advocates feel the administration owes per their 2004-05 agreement is partially included in the maintenance factor figure. The education "credit card" debt characterized by the LAO is an amount the state must designate within Proposition 98 appropriations.
Outstanding maintenance factor debt. The maintenance factor is the amount the state owes to school districts as a result of the state's suspension of the Proposition 98 minimum guarantee during the 2004-05 budget. The maintenance factor is tracked over time, and Proposition 98 formula contains a mechanism to accelerate K-14 spending in future years to restore the maintenance factor to the ongoing basis. When the state over-appropriates the minimum guarantee, the over-appropriation also counts toward the maintenance factor payments.

- **Amount paid off.** The administration estimates the maintenance factor at approximately $3.7 billion at the beginning of 2006-07 (prior to any payments during 2006-07). The minimum 2006-07 guarantee requires a payment of about $300 million of this balance. The administration then counts its $1.7 billion proposed over-appropriation and the $426 million automatic Proposition 49 payment towards the maintenance factor, for a total repayment of $2.4 billion, leaving $1.3 billion left as outstanding maintenance factor. Under the LAO’s Prop. 98 projections, the Governor’s budget pays off $2.5 billion of the maintenance factor, leaving $1.2 billion. (The LAO assumes that the Proposition 49 appropriations count toward the maintenance factor, but it also recommends repealing Prop. 49.)

- **Proposition 49 and maintenance factor.** There is concern that very little, if any, of the $426 million in Proposition 49 funding can be spent in the 2006-07 fiscal year, and many in the education community believe that the $426 million should not count toward the state’s payment of the maintenance factor owed to schools (see Proposition 49, below). Specifically, if the Proposition 49 appropriations are counted as paying off the maintenance factor, the state will be getting credit for paying a debt to education, yet the education community will not be able to benefit from this repayment, because the repayment will go unspent. If the $426 million is excluded from the administration’s maintenance factor calculation, the Governor’s proposed education budget pays off $2 billion of the estimated $3.7 billion maintenance factor, leaving $1.7 billion left to be paid in future years.

The 2004-05 agreement. During the 2004-05 budget year, education advocates struck an agreement with Governor Schwarzenegger, the intent of which was to ensure a modest funding level for education while also capturing $2 billion in savings to help the state address its fiscal problems. (The Legislature was not a formal party to that agreement.) That agreement allowed for a historic suspension of the state’s minimum spending requirement to education, which is allowed under times of fiscal distress under the provisions of Proposition 98. (Even though the state suspended the Proposition 98

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1 Maintenance factor debt is also created when the state’s budget circumstances do not allow it to provide funding based on the growth in the state’s economy, and the state can only provide funding based on growth in revenues (Test 3). The maintenance factor is equal to the difference between what the state provided and what it would have provided to keep education funding in pace with the growth in the economy.
minimum guarantee for the 2004-05 year, it was still able to provide growth and COLA for education programs, plus additional education funding.) Over the course of the 2004-05 fiscal year, an improving economy resulted in the state receiving significantly more revenues than were projected when the 2004-05 Budget Act was enacted. The increase in General Fund revenues would have increased the amount going to education, had the state not suspended Proposition 98. Specifically, the minimum guarantee increased $1.7 billion above the original $2 billion suspension amount originally estimated, for a total suspension level of $3.7 billion in 2004-05. Education advocates feel the administration should have kept the 2004-05 suspension level at only $2 billion, passing on the additional $1.7 billion. They feel the state owes the difference between what they’ve received up until now, and what they would have received had the state maintained the 2004-05 suspension at $2 billion.

- **Amount paid off.** Since the state suspended its obligation to fund the minimum Proposition 98 spending level during the 2004-05 fiscal year, technically it is not required to pass on the $1.7 billion increase in the suspension amount. For the 2006-07 year, the Governor’s proposed over-appropriation of the minimum funding level would bring 2006-07 spending up to close to where it might be had the state spent an additional $1.7 billion in 2004-05 to maintain the suspension level at $2 billion. However, it does not propose any one-time funding to pay back the amount that education advocates feel they were shortchanged in 2004-05 and 2005-06 (a total of $3.2 billion in one-time funds). This phenomenon is illustrated below.

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Proposition 98 funding: amounts provided and amounts owed per the Governor's 2004 agreement with the education community

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount provided</th>
<th>Amount owed</th>
<th>Total Prop. 98 funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>$42</td>
<td>$44</td>
<td>$44</td>
</tr>
<tr>
<td>2004-05</td>
<td>$44</td>
<td>$46</td>
<td>$48</td>
</tr>
<tr>
<td>2005-06</td>
<td>$46</td>
<td>$48</td>
<td>$50</td>
</tr>
<tr>
<td>2006-07</td>
<td>$48</td>
<td>$50</td>
<td>$52</td>
</tr>
</tbody>
</table>

- Amount of 2004-05 suspension agreed to by education community.
- Amount "owed" to Prop. 98 to keep 2004-05 suspension at $2 billion.
- Total Prop. 98 funding provided (proposed for 2006-07)
**Education credit card.** The LAO tracks obligations the state owes to education as debts owed on the “education credit card.” As noted above, these obligations are not on top of the maintenance factor, but rather **within** total Proposition spending. Recent budgets have included payments on this debt. The Governor’s budget proposes to make payments on the state’s mandate debt and deficit reduction. LAO’s chart below summarizes this debt, as well as the Governor’s proposed payments on it.

<table>
<thead>
<tr>
<th>Status of the Education Credit Card</th>
<th>Under the Governor’s Budget Proposal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferrals</td>
<td></td>
</tr>
<tr>
<td>K-12</td>
<td>$1,097</td>
</tr>
<tr>
<td>Community colleges</td>
<td>200</td>
</tr>
<tr>
<td>Mandates</td>
<td></td>
</tr>
<tr>
<td>K-12</td>
<td>$946</td>
</tr>
<tr>
<td>Community colleges</td>
<td>55</td>
</tr>
<tr>
<td>K-12 revenue limit deficit</td>
<td>883</td>
</tr>
<tr>
<td>Totals</td>
<td>$3,181</td>
</tr>
</tbody>
</table>

**Proposition 98 settle-up funding.** In addition to the above, the state owes K-14 education one-time funds for years in which the state unintentionally underfunded the minimum guarantee in fiscal years 1995-96 through 2003-04. (Because Proposition 98 depends on General Fund revenues, the final calculation on the minimum guarantee often changes after the Legislature approves a budget.) State law requires DOF, CDE, and the California Community Colleges to jointly certify the Proposition 98 funding level nine months after a fiscal year. Once the minimum is certified, the Controller must allocate the funds to meet the certified minimum within 90 days. The state has not certified the Prop. 98 calculations since 1994-95. However, Chapter 216, Statutes of 2004 included language intended to determine finalized Proposition 98 funding levels for fiscal years 1995-96 through 2003-04. CDE and DOF estimate the state owes schools $1.4 billion to meet the minimum guarantee for these years. Chapter 216 also contained an annual appropriation of $150 million to pay off this debt, beginning in 2006-07. The legislation specifies that this funding shall go toward payment of prior-year mandates, unless specified by the Legislature for another purpose. The Governor’s budget assumes the 2006-07 payment goes to pay off mandates.

**How the Governor proposes to spend Proposition 98 increases to K-12**

**Ongoing funds – How the Governor proposes to spend the $3.7 billion increase.** Much of the proposed $3.7 billion increase in Proposition 98 funding goes to a $2.7 billion increase in discretionary funding. The $2.7 billion increase in discretionary funding is made up of $2.3 billion for COLA, $205 million for deficit factor reduction and
$200 million for revenue limit equalization. The increase also includes a $426 million auto-appropriation as a result of the triggering of Proposition 49. The Governor also proposes to spend almost $400 million for a number of new categorical programs. Figure 3 below details how the $3.7 increase in Proposition 98 funding for K-12 is distributed.

**Figure 3: Distribution of $3.7 billion increase in K-12 Proposition 98 funding**

(Amounts in Millions)

<table>
<thead>
<tr>
<th>K-12 Expenditures Above 2005-06 Base Funding Level</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Discretionary funds/ baseline adjustments</strong></td>
</tr>
<tr>
<td>COLA for K-12 programs(^1)</td>
</tr>
<tr>
<td>Growth for K-12 programs</td>
</tr>
<tr>
<td>Deficit Factor Reduction (increase to revenue limits)(^1)</td>
</tr>
<tr>
<td>Equalization (increase to revenue limits)(^1)</td>
</tr>
<tr>
<td><strong>New or expanded categorical programs</strong></td>
</tr>
<tr>
<td>Proposition 49 automatic appropriation</td>
</tr>
<tr>
<td>Physical Fitness Initiatives</td>
</tr>
<tr>
<td>Art, Music Block Grant for Elementary Schools</td>
</tr>
<tr>
<td>Teacher Recruitment Incentives for Low-Performing Schools</td>
</tr>
<tr>
<td>Beginning Teacher Support and Assistance – adds a third year</td>
</tr>
<tr>
<td>Education Technology block grants</td>
</tr>
<tr>
<td>High School Exit Exam Preparation</td>
</tr>
<tr>
<td>Fruits and Vegetables for Breakfast(^2)</td>
</tr>
<tr>
<td><strong>Other</strong></td>
</tr>
<tr>
<td>Mandates (2006-07 costs)</td>
</tr>
<tr>
<td>Various technical adjustments, other changes</td>
</tr>
<tr>
<td><strong>Total Proposition 98 increase above 2005-06 spending level</strong></td>
</tr>
</tbody>
</table>

\(^1\)Part of the overall $2.7 billion increase in discretionary funding.

\(^2\)Last year's funding level of $18.2 million was funded with one-time funds (Proposition 98 Reversion Account funds). The Governor proposes to fund the program this year with ongoing funds.

One-time funds. The Governor's budget includes two types of one-time funding:

- **Settle-up funding.** Per the terms of Chapter 216 of 2004, the budget includes $133 million in settle-up money appropriated for the 2006-07 year – all to pay off prior-year mandate claims. While Chapter 216 appropriated $150 million a year, last year's budget made $16.8 million in early payments on the 2006-07 appropriation, leaving $133 million remaining.

- **Reversion account funding.** The Proposition 98 Reversion Account contains unused Proposition 98 funding from prior-year appropriations. The Governor's budget assumes $213 million in reversion account funding. Figure 4 below summarizes his proposed expenditures for this account. Staff notes that the amount available for expenditure from the Proposition 98 reversion account may
increase slightly relative to the Governor’s proposed amount, due to revised numbers on the amount available. However, under current law, half of all funds in the account must go for the Emergency Repairs Account for schools in deciles 1-3 per the Williams settlement of two years ago.

Figure 4: One-time (Proposition 98 Reversion Account) funds: Governor’s budget proposal

<table>
<thead>
<tr>
<th>Proposed expenditure</th>
<th>Proposed amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>School Facilities Emergency Repair Account (per Williams settlement)</td>
<td>$106,592,000</td>
</tr>
<tr>
<td>CalWORKs Stage 3 childcare</td>
<td>63,721,000</td>
</tr>
<tr>
<td>Attendance accounting – 1998-99 mandate claims</td>
<td>39,000</td>
</tr>
<tr>
<td>Teacher Credentialing Block Grant</td>
<td>9,555,000</td>
</tr>
<tr>
<td>High School Coaches Training</td>
<td>500,000</td>
</tr>
<tr>
<td>Charter School Facility Grant Program</td>
<td>9,000,000</td>
</tr>
<tr>
<td>Charter School Facility Grant Program</td>
<td>1,050,000</td>
</tr>
<tr>
<td>Principal Training Program</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Recruitment of Highly Qualified Teachers – county office of education</td>
<td>3,000,000</td>
</tr>
<tr>
<td>Payment of prior-year mandate claims</td>
<td>18,726,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$213,183,000</strong></td>
</tr>
</tbody>
</table>

COMMENTS:

LAO reco’s on overall funding level – caution against increasing the base. Although the LAO estimates higher General Fund revenues than the Governor’s budget, they maintain that the Governor’s overall proposed spending level presents significant risks, specifically: 1) the persistence of a structural budget gap of several billions of dollars, 2) the presence of other fiscal challenges, such as unfunded liabilities related to retiree health benefits, and 3) uncertainty about the sustainability of General Fund increases.

The LAO recommends that the Legislature over-appropriate the minimum Proposition 98 guarantee, as the Governor does, but at a lower level than that proposed by the Governor. It recommends that the Legislature fund Proposition 98 at the level needed to fully fund base programs in the budget year, and reject all proposals for new programs. It does so, because “while we recognize the desire to use available fund to improve local education programs, we do not believe state finances are sufficiently strong to guarantee that a large infusion of new funding could be sustained in future years.” Their recommendations would lead to a $3.3 billion increase over the current year, instead of the $4.3 billion proposed by the Governor. The chart below summarizes the LAO’s recommendation.
If the Legislature chooses to provide the same level of funding as the Governor, the LAO presents two recommended options:

- **Option 1** – Provide the same level of funding as the Governor proposes, but replace $1 billion in ongoing funds with $1 billion in one-time settle-up funds. The settle-up funds will not count towards the 2006-07 minimum guarantee, and will not increase the Proposition 98 minimum beyond what the LAO believes that the state can sustain in out-years. The LAO recommends that the Legislature dedicate the $1 billion to paying off prior-year mandate claims or other debts on the “education credit card.” The LAO believes these funds can both a) help the state retire its settle-up debt and its credit card debt to help it in the future if General Funds decline, and b) help locals by giving them a large infusion of discretionary funds, to help them address fiscal problems.

- **Option 2** – If the Legislature chooses to provide the same level of ongoing funds as the Governor proposes, the LAO recommends that the Legislature 1) eliminate Proposition 49 appropriations by placing a repeal before the voters 2) commit new K-12 discretionary funds for a fiscal solvency block grant, and 3) approve community college funding for equalization.

**LAO’s Proposition 98 forecast.** As noted above, the LAO estimates higher General Fund revenues than the Governor. These higher revenues lead to a minimum calculation that is $115 million higher than the Governor in 2006-07 and $200 million higher in 2005-06. Because both the LAO and the Governor recommended over-appropriation (but by different amounts), the difference in the minimum calculation does not affect spending obligations at this point. However, the minimum calculation is likely
to change. The LAO asserts that it is difficult to predict General Fund revenues, which leads to uncertainty in the Proposition 98 minimum calculation.

**LAO estimate of impending Test 1 calculation, reco’s regarding re-benching.** The Proposition 98 formula specifies different tests that determine the factors to be used in calculating the minimum. The Test 1 factor requires that Proposition 98 receive a minimum fixed percentage of General Fund revenues. While Test 1 has only been operative in the first year after Proposition 98 was approved by the voters (1988-89), the LAO predicts it may be operative again as early as 2008-09.

- **Need to re-bench.** Test 1 was intended to mirror the proportion of General Fund spending provided to K-14 education in 1986-87. In the past, when the state has changed the composition of K-14 funding, it re-benched the Test 1 General Fund requirement (the proportion of General Fund revenues that must go to schools) to reflect the changes. For example, in 1992-93, the state redirected property tax revenues that had previously gone to local governments to schools, thus lowering the proportion of education funding made up by General Fund. The Legislature correspondingly re-benched the Test 1 factor downward. The LAO believes that the state should similarly re-bench the Test 1 factor upward to reflect a recent shift of property tax away from education and back to local governments, per Proposition 1A. That proposition increased the proportion of education funding made up by General Fund. The total amount of property tax transferred in 2004-05 was $3.9 billion, and this amount increases to $6.8 billion in 2006-07. (These amounts are backfilled with General Fund, holding schools harmless from any funding loss.)

- **LAO and DOF disagreement over re-bench factor.** DOF estimates that the Test 1 factor should be re-benched to 41%, while the LAO believes that it should be re-benched to 41.6%. The difference is due to a technical difference in methodology.
ISSUE 2: GROWTH AND COLA

The issue for the subcommittee to consider is the Governor’s proposal to fully fund growth and COLA on revenue limits and categorical programs.

BACKGROUND:

The Governor’s proposed budget includes approximately $2.4 billion for growth and COLA on revenue limits and categorical programs. It estimates the growth in average daily attendance at 0.21%, and the COLA rate at 5.18%. These amounts are broken down as follows.

- **Growth.** The administration proposes approximately $156 million for statutory enrollment growth for apportionments and categorical programs: $67 million for revenue limit apportionment growth, and approximately $89 million for growth in categorical programs.

- **COLA.** The administration proposes $2.3 billion to pay for a 5.18% cost-of-living adjustment. The cost of providing this COLA rate to revenue limits is $1.7 billion, and the cost for categorical programs is $594 million. This COLA rate is higher than the COLA rate in previous budgets, and will provide a significant source of discretionary funds for school districts, to help allay increasing costs, such as increased benefits costs for existing employees (e.g., escalating health care premiums).

**LAO estimate of COLA.** The COLA rate used for K-12 programs is a national statistic, the gross domestic product deflator for purchase of goods and services by state and local governments. For the budget year (2006-07), the COLA rate will be based on this indicator from the final three quarters of 2005 and the first quarter of 2006. Therefore, the final COLA rate will be known by April. The Governor usually adjusts funding to reflect the final COLA rate in the May Revise. The LAO estimates that the COLA rate for K-12 may be as high as 5.8%. *It estimates that it will cost approximately $270 million more to provide this higher COLA rate for K-12,* and $30 more for community colleges.
The LAO notes that the COLA rate for 2006-07 is so high because of higher-than-usual energy and construction costs last year. It also notes that this year’s COLA rate may be higher than school districts’ actual costs of inflation, because the national statistic used to provide the COLA weighs energy and construction more heavily than districts’ actual costs, and the cost of these factors increased substantially. However, the LAO concludes that it is still fair to provide schools this COLA rate, even though it may overcompensate for districts' costs, because in past years, the COLA rate may have been lower than districts’ actual costs, and may have undercompensated for districts’ actual cost increases.

**COMMENTS:**

**Special education COLA.** Staff notes that the issue of the special education COLA will be discussed at the April 18 hearing, as part of overall special education issues.
ISSUE 3: REVENUE LIMITS: EQUALIZATION AND DEFICIT REDUCTION

The issues for the subcommittee to consider are:

- The Governor's proposal to provide $206 million in revenue limit deficit reduction.
- The Governor's proposal to provide $200 million in revenue limit "equalization."
- The LAO's recommendations on these proposals.

BACKGROUND:

Governor's budget. The Governor's budget includes a total increase of $406 million for permanent upward adjustments to school districts' and county offices of education's revenue limits, which are the rates used to determine the amount of discretionary funds (apportionments) that they receive. These increases take two forms. The first type of increase (deficit reduction) is distributed on an equal percentage basis to each school district and county office. The second type (revenue limit equalization) is distributed unequally, based on districts' distance from a target equalization rate.

- Revenue limit deficit reduction/paying off debt from 2003-04 COLA denial. The Governor proposes $205 million to increase the base revenue limits of school districts and county offices of education. This increase partially restores a COLA to revenue limits that was denied in the 2003-04 fiscal year, due to budget constraints. Last year's budget included $406 million for this purpose, and the 2004-05 budget included an increase of $270 million for this payment. The LAO estimates that if the Governor's proposal is adopted, the remaining debt (deficit factor) would be approximately $100 million. This funding is distributed on an equal percentage basis to each district and county office of education. The Governor also proposes a corresponding increase of $1.1 million to basic aid districts, to eliminate a deduction that was first levied in 2003-04 on basic aid districts to mimic the denial of the revenue limit COLA of the same year (since basic aid districts do not receive apportionments from the state). This increase in discretionary funding corresponds to a portion of the pre-budget deal the Education Coalition made with the Governor two years ago. That deal specified that first priority for any funds above growth and COLA should go toward restoring the cuts that were levied in fiscal year 2003-04.
Revenue limit equalization. The Governor proposes $200 million for adjustments to revenue limits. Unlike deficit reduction, the amount of these permanent adjustments would differ from district to district. While some districts would receive large permanent increases, others would receive smaller or no permanent increases. The differences are based on a formula that takes districts' revenue limits, deducts historic "add-on's," and then measures the distance from the new base and a "target" revenue limit, by size and type of district. The targets are different, depending on districts' size and type. Targets are determined by dividing up districts into groups of small and large elementary, unified and high school districts, and then finding a revenue limit under which 90% of the average daily attendance of districts in that category fall. The formula under which the Governor is proposing to distribute the $200 million is contained in AB 441 (Simitian), Chapter 155 of 2001. To date, the state provided $40 million for equalization under the AB 441 formula, during the 2001-02 budget, and $110 million during the 2004-05 budget.

Controversy over equalization formula. As part of the last appropriation for equalization in the 2004-05 budget, the education trailer bill (Chapter 216, Statutes of 2004) contained language expressing intent that future equalization appropriations use a formula different than that contained in AB 441: "It is the intent of the Legislature and the Governor that the equalization formulas in Sections 42239.44 and 42238.46 of the Education Code not be deemed to be a precedent for the distribution to school districts of additional equalization funding in any fiscal year subsequent to the 2004-05 fiscal year." This language stemmed from controversy over whether the AB 441 formula was really equalizing because of a) the formula's exclusion of revenue limit add-on's, b) the fact that the targets differed substantially by size and type of district, and c) concern that the AB 441 formula only attempts to equalize part of the apportionment equation. The apportionment formula is as follows:

District's average daily attendance X district's revenue limit = District's apportionment.

Not all districts have the same average daily attendance, or the same ability to maximum student attendance, so while the AB 441 formula attempts to equalize one factor in the equation, it does nothing to equalize the other factor.
LAO recommendations regarding revenue limits. The LAO recommends against both of the Governor's proposed augmentations to the revenue limits. On deficit reduction, it recommends that the Legislature redirect the $206 million for deficit reduction for the revenue limit costs of the higher COLA rate it estimates (see issue above). On equalization, it recommends redirecting this funding to a fiscal solvency block grant to address various fiscal health issues that districts are currently facing. If the Legislature chooses to fund equalization, it recommends consolidating revenue limit add-on's into the base revenue limits, and then equalizing. (Under the AB 441 calculation used in the last round of equalization, these add-on's are excluded for purposes of determining how much each district receives in equalization funding.)

Governor's estimate of declining enrollment adjustment and LAO recommendation. The Governor's budget assumes that the declining enrollment adjustment under current law will cost the state approximately $268 million. Under current law, school districts receive their apportionments based on the higher of their current year's average daily attendance or their prior year's average daily attendance. For districts with declining enrollment, this formula holds them harmless for any decline for one year. DOF estimates the cost of this provision to be $268 million. They calculated this amount using last year's cost, and inflating it by growth and COLA. The LAO believes this calculation is too low, since recent years of slow enrollment growth have lead to large year-to-year increases in the cost of the declining enrollment adjustment. The LAO believes that the Legislature should set aside $75 million for the real cost of the adjustment in the budget year. (Since apportionments go out on a continuous appropriation basis, the Legislature does not need to actively appropriate money for the declining enrollment adjustment, but only anticipate its final cost.)

COMMENTS:

Staff notes that since one of the LAO's recommendations relates to district financial health, the subcommittee may wish to hear more of its proposal next week, when the subcommittee is scheduled to hear a presentation next week by FCMAT on the issue of district financial health.
ISSUE 4: MANDATES – ONGOING AND PRIOR-YEAR COSTS

The issues for the subcommittee to consider are:

- The Governor's proposed funding level for prior-year mandate claims and the budget-year cost of claims that districts are expected to make.
- Information on the overall amount that the state owes to school districts for prior-year mandate claims.

BACKGROUND:

Governor's proposal. The Governor's budget proposes a mix of ongoing and one-time funds to address the prior-year and ongoing costs of mandate claims. Specifically, the Governor's budget proposes the following:

- **Paying ongoing costs.** The budget contains $133 million in ongoing Proposition 98 funding to pay for K-12 mandate costs incurred during the 2006-07 year. This is a departure from recent budgets, in which the state deferred the ongoing costs of mandates. The $133 million is expected to fall short of the full 2006-07 cost of mandate claims, and to address this possibility, the administration includes control language instructing the Controller to prorate payments proportionately between the various mandates. The administration also proposes to suspend the following four mandates, consistent with the Legislature's decision to suspend these same mandates in recent budgets: School Crimes Reporting II, School Bus Safety I and II, Law Enforcement Sexual Harassment Training, County Treasury Withdrawals, and Grand Jury Proceedings.

- **Prior-year costs.** The Governor's budget proposes a total of approximately $152 million in one-time funding to pay off prior-year mandate claims for K-12. Because these payments reimburse districts for prior-year costs, they serve as a source of one-time discretionary funds for districts. The $152 million is made up of a combination of:
  - $133 million in settle-up money appropriated for the 2006-07 year in Chapter 216, Statutes of 2004. That bill appropriated $150 million a year; beginning in 2006-07, to pay off amounts the state owes to meet the recalculated minimum Proposition 98 guarantee for prior years. That bill specified that the appropriations be used to pay off prior-year mandate claims for K-12 and community colleges. Last year's budget made $16.8 million in early payments on the 2006-07 $150 million appropriation, leaving $133 million remaining from the Chapter 216, Statutes 2004 appropriation.
  - $18.7 million in Proposition 98 reversion account funding.
Outstanding debt. In its Analysis of the Budget, the LAO estimates that the state owes school districts approximately $1.2 billion for unpaid mandate costs through 2005-06. The administration has a lower estimate of the total debt, based on a report from the Controller's office. That report lists the amount owed to K-12 for mandate claims at $973 million, plus approximately $60 million in interest. This debt has accrued in recent budgets, as the state deferred the ongoing costs of K-14 mandate claims due to budget shortfalls.

COMMENTS:

The LAO Recommends that:

- The Legislature adopt the Governor's proposal to provide ongoing funds to fund the 2006-07 expected mandate claims, because it is a departure from prior years, when the state has not provided ongoing funding for this purpose, accruing a large unpaid debt to school districts. However, the LAO recommends providing $28.2 million more in ongoing funds to fully fund the expected level of claims in 2006-07. They estimate that the Governor proposal to set aside $133 million in ongoing funding for this purpose falls short of the total expected cost of $161.8 million.

- The Legislature amend the budget bill to list the specific mandates funded, the amount allocated per mandate, and the mandates suspended for 2006-07. This is similar to past practice, and provides important information to districts. The Governor's budget bill does not contain a list of specific mandates proposed to be funded, but the administration provides this information on budget support documents found on the Internet.

Decreasing claims? The LAO notes that the total number of school district filing mandate claims has declined in the past few years. It is unclear whether the lack of funding appropriated for this purpose has had anything to do with that decline, and whether providing ongoing funding for this purpose will increase claims, because districts have more assurances that their claims will be funded. In addition, some school districts have complained of mandate audits conducted by the State Controller's Office, and the high rate by which claims have been disallowed.
ISSUE 5: MANDATES – LAO RECOMMENDATIONS REGARDING NEW MANDATES

The issue for the subcommittee to consider is whether to approve funding for new mandates that have recently been approved by the Commission on State Mandate and that has been reviewed by the LAO.

BACKGROUND:

The Governor's budget includes funding for four new mandates recently approved by the Commission on State Mandates. Pursuant to the requirements of Chapter 1124, Statutes of 2002, the LAO has reviewed these mandates. These mandates, along with their costs accrued through 2005-06, and DOF’s future estimates, are summarized in the chart below.

<table>
<thead>
<tr>
<th>Mandate</th>
<th>Requirement</th>
<th>Accrued Costs Through 2005-06</th>
<th>Estimated Cost in 2006-07a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pupil Promotion and Retention</td>
<td>Provide academic instruction to students at risk of failure.</td>
<td>$10.4</td>
<td>$17.3</td>
</tr>
<tr>
<td>Differential Pay and Reemployment</td>
<td>Implement policies for employees who exhaust sick leave.</td>
<td>0.2</td>
<td>—b</td>
</tr>
<tr>
<td>Teacher Incentive Program</td>
<td>Administer state awards for earning national teaching certification.</td>
<td>0.1</td>
<td>—b</td>
</tr>
<tr>
<td>AIDS Prevention Instruction II</td>
<td>Plan and conduct in-service training for teachers.</td>
<td>0.1b</td>
<td>—b</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td></td>
<td><strong>$10.8</strong></td>
<td><strong>$17.3</strong></td>
</tr>
</tbody>
</table>

a  Department of Finance estimate.
b  Less than $50,000.
The LAO notes that the ongoing costs of three of the above mandates will exceed the amount estimated by the Department of Finance (DOF). Specifically, it believes the ongoing costs of the last three mandates listed on the above chart are higher than the $50,000 estimated by DOF, because DOF is basing their estimates on the claims of a few districts, whereas many more districts are expected to eventually file claims for these mandates. It also believes DOF’s estimate of the ongoing costs of the supplemental instruction mandate are too high, because they are based on prior-year claims that were significantly higher than more-recent claims.

COMMENTS:

A note on the process. The process by which a mandate is approved for districts to submit claims is as follows: Districts file test claims with the Commission on State Mandates (Commission), whenever they believe that a new statute creates a reimbursable state mandate. Districts have one year after the passage of a new statutory requirement to file a claim. The Commission then reviews the test claim and makes a determination as to whether the claim is valid. If the Commission makes a positive determination, it then develops parameters and guidelines that outline what activities districts may claim as reimbursable for that mandate. The process of deliberation on a test claim can sometimes take years.
ISSUE 6: MANDATES – LAO RECOMMENDATIONS REGARDING CHANGING PROCESS

The issue for the subcommittee to consider is a proposal by LAO to change the process by which districts may obtain state funding for complying with state mandates.

BACKGROUND:

The LAO recommends providing a mandate block grant, to allow school districts the option of not having to file mandate claims. Under the LAO proposal, school districts would choose between

- Continuing to file mandate claims for individual mandates through the regular process, or
- Receiving funding through a mandate block grant, as adequate reimbursement for all 39 K-12 mandates. If they choose this option, they would be waiving their right to claim for individual mandates, thereby avoiding any "double-dipping" situations.

Other details of the proposed block grant. The proposed mandate block grant would provide approximately $27 per student, using DOF’s estimate of full funding of 2006-07 costs. LAO’s proposal would also maintain $4 million outside the block grant to pay for two PERS mandates. Districts receiving money from the block grant in lieu of submitting claims would be reviewed periodically to ensure they carried out the mandates in question, but would not be subject to financial audits for costs covered by funds from the block grant. Also, the LAO recommends that the block grant be adjusted to accommodate any mandates via the budget process. Specifically, DOF would propose an increase to the block grant to reflect new mandates, and the Legislature could consider whether the proposed adjustment is reasonable as part of the budget deliberation process.

COMMENTS:

Advantages cited by LAO. In general, the LAO believes that categorical programs are a better way for the state to achieve its goals than imposing mandates and requiring districts to claim money for complying. The LAO cites the following advantages of its block grant: avoidance of significant state and local administrative effort in filing and reviewing mandate claims, avoidance of the lengthy and legalistic current process for identifying new mandates, school districts' avoidance of audits by the Controller's office and assurances that small districts would receive some mandate reimbursements (since many small districts fail to make claims for most mandate reimbursements).
Controller's audits. As noted above, some districts have complained about audits of mandate claims by the Controller's office. They claim that the audits disallow a large percentage of claims, largely resulting from the lack of supporting documentation. Districts also claim that the large auditing effort is a recent phenomenon, and that the Controller now demands a higher level of documentation than in prior years, when few audits occurred.
ISSUE 7: MANDATES – UPDATE ON SUBCOMMITTEE’S REQUEST FOR RECONSIDERATION OF THE STAR MANDATE AND LAO RECOMMENDATIONS

The issue for the subcommittee to consider is an update on an issue the subcommittee asked the Commission on State Mandates to review, and a proposal by the LAO to resolve some controversy around the decision.

BACKGROUND:

The Governor’s budget does not assume any funding to pay for 2006-07 mandate claims for the STAR mandate. This reflects the administration’s assertion that much of the state’s testing system is mandated by federal law, and that state funding for the state’s testing system is sufficient to pay for all local costs.

History of STAR mandate. Two years ago, this subcommittee, and the Legislature asked the Commission on State Mandates to reconsider an earlier decision it had made on the STAR mandate. The Commission on State Mandates had made a determination that the state’s testing system (STAR) constituted a state mandate, and adopted broad claiming guidelines. This decision led to initial mandate claims that were high. As part of its 2004-05 Analysis, the LAO questioned the Commission’s decision, noting that many components of the STAR are required by federal law, and federal mandates are not eligible for reimbursement by the state under the state mandate process. The LAO recommended that the Legislature pass trailer bill language asking the Commission on State Mandates to review and reconsider their earlier decision, which the Legislature did.

The Commission’s reconsideration – ongoing costs. The Commission on State Mandates reconsidered their earlier decision on the STAR mandate. Their findings addressed the Legislature’s concerns about it being a federal mandate and greatly reduced the amount that districts could claim in the future. The Commission found that only costs associated with one of the tests that districts have to administer (the norm-referenced portion given in grades three and seven) is a mandate, because it’s not required by federal law. It also found that the California Standards Test, which is administered in most grades, is not a mandate because districts failed to submit a new mandate claim when it was enacted in state law. (Under current law, districts have one year after the enactment of a statute to submit a claim for any mandates they think were created by the statute.)
The Commission's reconsideration – prior-year claims. The Commission did not make any determination regarding districts' prior-year claims through 2004-05, which total $220 million. According to the LAO, DOF has requested that the Controller's office deny prior-year claims related to the California Standards Tests, since the Commission determined that these were not a reimbursable mandate. However, the LAO states that prior-year claims are not sufficiently detailed enough for the Controller to disallow claims related to these tests. On the other hand, if the state were to pay the entire $220 million in claims, it would be paying for activities that are federally required, and therefore not reimbursable.

LAO's recommendation regarding a reasonable reimbursement methodology for past and future costs related to the STAR mandate. The LAO recommends that the Legislature take advantage of a section in the Government Code that allows the state to establish a reasonable reimbursement methodology as a way of developing a payment formula that simplifies the claiming process for STAR. The methodology calculates a per-pupil amount based on prior-year claims and the population in the districts that submitted claims, and provides that per-pupil amount for the proportion of the STAR test that is only required by state law. It accordingly recommends that the state 1) provide $11.2 million in ongoing funding to pay for the budget-year costs of their new reasonable reimbursement methodology, and 2) use the $152 million in one-time funds proposed in the budget for prior-year mandate claims, and redirect $104.5 million of it for prior-year STAR claims using the LAO's reasonable reimbursement methodology.
COMMENTS:

The state spends more than $100 million a year to support the state administrative costs and local costs of administering the various tests of the state’s STAR program: the California High School Exit Exam and the California High School Proficiency Program. Most of this funding goes to apportionments to districts to offset their costs of administration. State funding: $83.8 million  Federal funding: $32 million
ISSUE 8: MANDATES – LAO RECOMMENDATIONS REGARDING TRUANCY MANDATE

The issue for the subcommittee to consider is a proposal by the LAO to eliminate two existing truancy mandates and replace with a categorical program.

BACKGROUND:

The Governor's budget funds the ongoing mandate costs for two existing truancy mandates:

- **The Notification of Truancy mandate**, which requires schools to notify parents of truant students by mail or other reasonable method. DOF estimates 2006-07 claims for this mandate at $9.8 million. Claims are calculated based on a unit cost method in which districts receive $15.40 for each notification made pursuant to this mandate.

- **The Habitual Truant mandate**, which requires schools to make every effort to meet with the parents of habitual truants, who are defined as students who are absent from school five or more times a year. DOF estimates 2006-07 claims for this mandate at $7.2 million.

**LAO recommendation.** The LAO recommends adopted language to delete the above two mandates and replace them with a truancy grant program that districts could use to 1) identify students whose attendance suggests they are at risk of dropping out or falling behind, 2) contact students' parents, and 3) develop a plan to address any barriers' to students' success. The new program would distribute the $16.9 million currently going as mandate reimbursements for the two truancy mandates based on districts' dropout rates.

The LAO identifies the following problems with the current approach of using mandates to address truancy:

- Mandates can create the wrong incentives. Specifically, the unit-cost reimbursement method for the notification of truancy mandate creates an incentive for districts to send notices to parents, and not necessarily communicate with parents in a way that ensures parents' involvement, especially since the reimbursement amount is greater than the cost of sending a notice.

- Implementation is uneven. The LAO cites several cases where the number of notifications sent does not correspond to districts' dropout rates.

- Funds don't go to districts with the biggest truancy/ dropout problems.
COMMENTS:

Staff notes that the state does not currently have any major dropout prevention program.
ISSUE 9: PROPOSITION 49

The Subcommittee will discuss Proposition 49.

BACKGROUND:

As approved by voters in 2002, Proposition 49 requires the state to increase funding for the After School Education and Safety (ASES) program beginning in 2006-07 (based on a complicated trigger calculation). The initiative requires an increase of $426 million from the $122 million currently provided for ASES, for a total funding level of $548 million (there is also roughly $2 million used for California Department of Education (CDE) administration and evaluation costs). These additional funds are provided for the program “on top of” the state’s Proposition 98 minimum funding guarantee (referred to as an “overappropriation”). Proposition 49 also converts after school program funding to a “continuous appropriation” (that is, no annual legislative action is needed to appropriate funds).

LAO RECOMMENDS REPEAL OF PROPOSITION 49:

From the Analysis:

We continue to recommend the Legislature enact legislation placing before the voters a repeal of Proposition 49 because (1) it triggers an autopilot augmentation even though the state is facing a structural budget gap of billions of dollars, (2) the additional spending on after school programs is a lower budget priority than protecting districts’ base education program, and (3) existing state and federal after school funds are going unused.

PROPOSITION 98 MAINTENANCE FACTOR:

LAO believes that Proposition 49 expenditures will count toward the Proposition 98 minimum under Test 1. The LAO forecasts the state transitioning to a Test 1 minimum guarantee starting as early as 2008-09. Under Test 1, K-14 education will receive a specific percentage of General Fund revenues, and Proposition 49 funds will count toward that spending level. Once this transition occurs, Proposition 49 funding would come

The finance mechanism in Proposition 49 requires the state to fund Proposition 49 as an appropriation in excess of the Proposition 98 minimum guarantee. Under the Legislative Analyst’s Office (LAO) and the Department of Finance (DOF) reading of the measure (discussed in detail later in this analysis), these additional funds would restore Proposition 98 “maintenance factor,” that, absent the measure, would be restored to K-
14 education in future years. What may appear to be a technical matter, has a practical effect. It means that, in the near future, the funding for Proposition 49 will likely come at the expense of other K-14 spending priorities, not non-Proposition 98 General Fund priorities. Under the LAO and the administration's interpretation, Proposition 49 funds will count toward the amount that the state owes to schools. The state will benefit by owing less to schools, yet schools will not benefit because the funding will go unspent.

**IMPLEMENTATION CHALLENGES:**

The state faces several significant challenges that must be addressed in order to fully implement the program in the budget year. Without these changes, it is very likely that a significant percentage of the additional funding provided by Proposition 49 will go unspent in the budget year.

**Existing After School Programs Have Significant Unspent Funding Balances.** The State operates after school programs using federal 21st Century funding that mirrors the requirements of the State ASES program. The state program reverts around $30 million out of $122 million each year because of problems with the reimbursement process and budget and contracting delays. Advocates for after school programs suggest that the state's policies of awarding grants and attendance-based reimbursement combined with a low $5 per day reimbursement rate has resulted in the large amount of unspent funding in the program. Although the state made some changes to the 21st Century program last year to improve the ability of contractors to earn their funding, it is likely that the state will again have large unspent balances for both the 21st Century and ASES programs in the current year.

- **Local Match Requirements Are Significant.** ASES requires local programs to provide at least a 50 percent match. While the program allows in-kind expenditures to count towards the local share, it is likely that local districts may not have planned for this program and may not be able to participate in first year or two of the program's implementation. There is some concern that some of the poorer parts of the state may face significant challenges in providing the matching funds and will not be able to participate in the program.

- **California Department of Education (CDE) Is Not Provided sufficient Staff to Implement Program.** Current state administrative staffing seems inadequate to administer the existing scope of the two after school programs. Advocates and contractors for after school programs complain of long delays in receiving payments and often payments are made without supporting documentation so that local districts can't post the funds to the correct program. The handful of staff currently at CDE struggle to meet the work-intensive requirements of the attendance-based reimbursement system.

In order to implement Proposition 49 on July 1, 2006, the CDE will need to begin the application process during the spring of 2006 for an expected 4,000 new applications. The Governor's Budget provides nine positions for the program that would be established in July, but given the normal delays of the state's hiring
process they would not be hired until the fall of 2006. The critical delay in providing resources to CDE means that CDE may lack the capacity to implement the program under the timeframes envisioned by the administration. In addition, the rushed timeframe and lack of personnel could lead to inconsistencies and errors in the awarding of grants for the new ASES programs.

The Governor’s proposed budget only includes half of the administrative staff positions for Proposition 49 requested by CDE. CDE requested an additional nine positions that were not included in the budget. When the new positions contained in the budget are finally hired, they still may have difficulty handling the expected workload associated with implementing Proposition 49. This could further undermine the ability of CDE to implement and administer the program effectively.

• **ASES Program Structure Undermines Implementation.** Recent changes to the federal 21st Century after school program included increasing the reimbursement rate from $5 to $7.50 for each child per day, increasing school, and district caps for the program, and allowing grantees to retain 15 percent of their grant for administration and start-up. These changes are designed to increase the number of children served by each grantee and reduce that amount of unexpended funds for the program. The ASES program also changed last year to allow for 15 percent start-up funding, but it did not adopt the other program changes made to 21st Century. ASES grantees will have difficulty fully utilizing their grants unless the other additional program changes are made to the reimbursement rate and the school-site and district enrollment caps.

Both programs also have cumbersome attendance verification requirements that make the program difficult to operate and administer. The current system requires grantees to verify daily attendance in order to be reimbursed for after school provided. The payment claims for the existing programs result in over 4,000 pages of spreadsheets containing information that must be reviewed to justify payment for after school provided by grantees each quarter. The process of reviewing these claims and processing payments can take over 270 days.

• **Local Programs Will Need Time To Build Capacity.** Proposition 49 more than triples total program funding for after school funding within a short timeframe. The program is currently run through both school sites and non-profit community based organization. In many districts across the state, potential grantees need time to plan new program and secure physical space for their operation. Given the expectations that grantees will apply in the spring of 2006, many districts may not be ready to participate in the first year of the program. As a result, the utilization of the program may be lower in the first year.

• **Proposition 49 Funding Cannot Be Used For Start-Up Costs.** Proposition 49 funding rules are very restrictive and prevent the use of funding for capitol and start up costs necessary to create a new program. For many districts, this lack of start up funding may prevent them from participating in the program.
PENDING LEGISLATION TO CHANGE STATE AFTER SCHOOL:

Two bills have been introduced that change the ASES program to address many of the challenges identified above. Both the administration sponsored SB 1302 (Ashburn) and SB 638 (Torlakson) include program changes suggested by after school advocates to reduce the administrative burden and increase the program flexibility of the program.

The major changes both bills include are:

- Creates a grant-based program that awards grants based upon expected and historic attendance levels. The grant level would assume each student is reimbursed at a $7.50 per day level.
- Provides more flexible grant caps to schools and districts.
- Keeps the local match at $2.50 per child served.
- Grandfathers or prioritizes current federal 21st Century programs into the program.
- Requires outcome measures reporting.

The LAO believes both proposals make substantial changes to the program that would require voter approval on the ballot to fully adopt.

CDE comments that under the new structure in SB 1302 about 4,000 schools will receive grants, an increase of 2,000 grantees. However, this will reduce the overall number of schools that would have been served if Proposition 49 was implemented as currently written.

WHAT HAPPENS TO UNSPENT PROPOSTION 49 FUNDING?

Depending on how the Legislature chooses to implement Proposition 49, the program could result in hundreds of millions of dollars going unspent. As discussed above, the current ASES program reverts about a quarter of its funds annually (these funds are sent to the Proposition 98 Reversion Account). From past experience, as new cohorts were created under either the state or federal after school program, over one-half of the new funds generally went unused in the first year. Since Proposition 49 does not address what should occur with unused after school funds, it will be up to the Legislature to determine how to treat them. The LAO see's three options for ASES funds:
• **Funds Revert to the Proposition 98 Reversion Account.** Under this option, the funds not spent on after school programs would end up in the Reversion Account. Under current law, one-half of these funds would be set aside for emergency facilities repairs under the William’s court settlement. The remainder could be used for one-time activities for any K-14 program (such as reimbursing school districts for past mandated activities).

• **Funds Return to the General Fund.** Under this option, unused funds would return to the General Fund. The main K-12 program that has a continuous appropriation is school revenue limits. For revenue limits, the General Fund appropriation does not occur until the school district “earns” the funding by serving a student. So, no funds for revenue limits are ever reverted to the Proposition 98 Reversion Account; instead, they are effectively not appropriated until the funds are earned. If this logic were applied to Proposition 49, then unearned after school funds would be returned to the General Fund, and would not become part of Proposition 98 until the program fully ramped up.

• **Funds Are Set Aside for Future After School Activities.** Under this option, any unused Proposition 49 funds would stay with the program and be set aside for future one-time spending on after school activities. Such activities could include one-time grants for things like facilities improvements, equipment, and supplies, or professional development for providers.

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**LAO ALTERNATIVE ASES PROGRAM STRUCTURE**

The LAO recommends the Legislature amend the ASES program to transform the program from a school level competitive grant program to a formula-driven district level grant. Because school districts face different challenges depending on the students they serve, we recommend distributing the funds on a weighted per-pupil basis. A weighted pupil formula simply distributes funds based on the number of students in each district. The formula, however, also provides a district a larger grant based on the number of certain types of students—such as low-income, English learner or special education students—attending schools in each district. In addition, the proposal would provide flexibility for small school districts to provide them additional resources in a way that those districts could actually use.
In addition to the two bills proposed in the Senate to change the ASES program, Senator Torlakson has also introduced SCA 24 to delay implementation of Proposition 49 until the Proposition 98 maintenance factor is fully repaid.

The Subcommittee could fully fund the CDE staffing request without impacting the General Fund. CDE did not receive 3 Proposition 49 positions and 6 federally funded 21st Century after school programs.
ISSUE 10: AFTER SCHOOL FUNDING ADMINISTRATIVE DELAYS

Current after school grantees encounter delayed reimbursements from CDE.

BACKGROUND:

Currently several small non-profit organizations provide 21st Century after school programs and many districts and county offices also subcontract with these organizations as part of their after school program model.

The Subcommittee has received complaints that the process for reimbursement of after school expenditure claims can exceed 270 days. For many non-profit entities, this has caused cash-flow problems, as the amounts payable are sizable. At least one provider has had to resort to securing bridge funding from a local bank on account of these delays.

In addition, CDE provides little financial detail regarding the reimbursements when they are sent. Providers can receive several reimbursements for the prior year and their current year advance lumped together into one payment without any accounting detail to help them match the payment to their accounts receivables. In the case of subcontractors, at least one county office took several months to untangle the accounting that linked the check they received from CDE to the contractor’s invoice for the services.

CDE has cited the current structure of the 21st Century and ASES programs as a principle reason for the delays. The current system requires grantees to verify daily attendance in order to be reimbursed for after school provided. The payment claims for the existing programs result in over 4,000 pages of spreadsheets containing information that must be reviewed to justify payment for after school provided by grantees each quarter. CDE has only a handful of staff to handle this workload at the current time, which hampers the ability to respond to the issues raised by the providers.

STAFF COMMENT:

One of the principle challenges to the current administrative system is that the work to verify billing, reimbursement, and attendance all take place during the same time of the year. In addition, CDE is statutorily required to issue new grants under a strict timeline at the beginning of the fiscal year and has to commit most if its resources in this unit towards that activity. This means that the State workload for the program is concentrated into a couple of key months of the year. This ebb-and-flow workload makes it difficult to justify additional full-time staff, but overwhelms the existing staff.

If the changes proposed in either SB 1302 (Ashburn) or SB 638 (Torlakson) are adopted, it will help spread out this workload across the entire year and it will also reduce the number of activities required in the billing of ASES program. However, the
new program will increase the amount of follow up and data expected from grantees of both the ASES and 21st Century programs.

CDE is also developing an automated internet-based claiming system that should reduce the workload and improve the efficiency of the current billing process. This system should be operational in 2007.

Advocates have urged that CDE be given more staff to administer the after school programs.
ISSUE 11: FEDERAL FUNDING – OVERALL TRENDS

This is an informational issue intended to provide the subcommittee with information regarding the recently passed federal education budget and what it means for California. CDE will do a presentation on this topic, similar to previous years. Specifically, CDE will provide information regarding

- Which programs were eliminated?
- Which programs received large decreases?
- Which programs received roughly the same amount of funding as last year?
- Overall trends in funding levels and any information regarding out-year projections of federal funds.

BACKGROUND:

The following information was provided by CDE and compiled by Senate budget staff, and compares the amount of federal funding California received last year to the amount received for 2006-07, for various programs.

<table>
<thead>
<tr>
<th>Budget Item</th>
<th>Program</th>
<th>FFY 2005</th>
<th>FFY 2006</th>
<th>Change</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>610-102</td>
<td>Learn and Serve America</td>
<td>2,636,926</td>
<td>2,690,544</td>
<td>53,618</td>
<td>2.0%</td>
</tr>
<tr>
<td>610-103</td>
<td>Byrd Honors Scholarship</td>
<td>5,139,000</td>
<td>5,125,104</td>
<td>-12,900</td>
<td>-0.2%</td>
</tr>
<tr>
<td>112-0890</td>
<td>Charter Schools</td>
<td>25,107,664</td>
<td>25,125,104</td>
<td>17,440</td>
<td>0.1%</td>
</tr>
<tr>
<td>113-0890</td>
<td>State Assessments</td>
<td>33,952,540</td>
<td>33,952,540</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>119-0890</td>
<td>Title I (Part D) - Neglected and Delinquent</td>
<td>2,867,245</td>
<td>2,804,318</td>
<td>-62,927</td>
<td>-2.2%</td>
</tr>
<tr>
<td>123-0890</td>
<td>Title I - Comprehensive School Reform</td>
<td>27,680,353</td>
<td>0</td>
<td>-27,680,353</td>
<td>-100.0%</td>
</tr>
<tr>
<td>123-0890</td>
<td>Title V – Innovative Programs</td>
<td>24,693,735</td>
<td>12,321,975</td>
<td>-12,371,760</td>
<td>-50.1%</td>
</tr>
<tr>
<td>125-0890</td>
<td>Title II (Part A) – Basic Grants &amp; School</td>
<td>1,776,542,957</td>
<td>1,727,346,107</td>
<td>-49,196,850</td>
<td>-2.8%</td>
</tr>
<tr>
<td>126-0890</td>
<td>Title II (Part B) - Reading First Grants</td>
<td>146,981,710</td>
<td>145,383,383</td>
<td>-1,598,327</td>
<td>-1.1%</td>
</tr>
<tr>
<td>136-0890</td>
<td>Even Start</td>
<td>27,702,424</td>
<td>11,860,068</td>
<td>-15,842,356</td>
<td>-57.2%</td>
</tr>
<tr>
<td>136-0890</td>
<td>Homeless Education</td>
<td>8,606,995</td>
<td>8,309,649</td>
<td>-297,346</td>
<td>-3.5%</td>
</tr>
<tr>
<td>137-0890</td>
<td>Rural/Low-Income School Program</td>
<td>1,718,545</td>
<td>1,701,360</td>
<td>-17,185</td>
<td>-1.0%</td>
</tr>
<tr>
<td>156-0890</td>
<td>Adult Education</td>
<td>81,382,526</td>
<td>80,633,745</td>
<td>-748,781</td>
<td>-0.9%</td>
</tr>
<tr>
<td>161-0890</td>
<td>Special Education-Entitlement Grants &amp; Program Improvement</td>
<td>1,132,572,659</td>
<td>1,130,940,237</td>
<td>-1,632,422</td>
<td>-0.1%</td>
</tr>
<tr>
<td>136-0890</td>
<td>Special Education-Preschool</td>
<td>39,160,720</td>
<td>38,677,085</td>
<td>-483,635</td>
<td>-1.2%</td>
</tr>
<tr>
<td>166-0890</td>
<td>Vocational Education &amp; Tech. Prep.</td>
<td>140,318,604</td>
<td>138,898,803</td>
<td>-1,419,801</td>
<td>-1.0%</td>
</tr>
<tr>
<td>180-0890</td>
<td>Education Technology</td>
<td>65,556,713</td>
<td>35,076,910</td>
<td>-30,479,803</td>
<td>-46.5%</td>
</tr>
<tr>
<td>183-0890</td>
<td>Safe and Drug Free Schools</td>
<td>52,742,911</td>
<td>41,539,958</td>
<td>-11,202,953</td>
<td>-21.2%</td>
</tr>
<tr>
<td>193-0890</td>
<td>Title II (Part A) Math &amp; Science Partnerships</td>
<td>24,513,072</td>
<td>25,055,985</td>
<td>542,913</td>
<td>2.2%</td>
</tr>
<tr>
<td>195-0890</td>
<td>Title II (Part A) – Teacher Quality Grants &amp; State Activities</td>
<td>339,448,010</td>
<td>335,691,360</td>
<td>-3,756,650</td>
<td>-1.1%</td>
</tr>
<tr>
<td>197-0890</td>
<td>21st Century Community Learning</td>
<td>137,174,714</td>
<td>131,320,892</td>
<td>-5,853,822</td>
<td>-4.3%</td>
</tr>
</tbody>
</table>

 Totals: 4,372,940,399 4,219,454,381 -153,486,018 -3.5%
As demonstrated, most programs will receive a 1-2% reduction in the budget year, with the exception of the following programs, which will experience a modest increase: Title III Language Acquisition Grants, Learn and Serve America and Title II Math and Science Partnerships.

**Major decreases or eliminations.** The federal budget eliminates funding for the Comprehensive School Reform program, which currently provides multi-year grants to schools to improve their students' performance (similar to II/USP or HP). The federal cut will mean that a number of grantees will not have federal funding for the final years of their grant. Also, the following programs experience drastic decreases under the federal budget: Title V Innovative Programs, Even Start, Education Technology and Safe and Drug Free Schools.

**Effect on CDE state operations?** CDE's administrative functions are largely funded with federal funds. The federal reductions may negatively affect the funding available to support a number of positions within CDE.

**COMMENTS:**

The subcommittee is scheduled to hear CDE's budget on April 25.