

School Finance 2004-05

Districts receive an increase despite a state budget squeeze

Another year of financial difficulty for the state of California led to the suspension of the minimum-funding guarantee that has provided some financial protection for schools in recent years. In a negotiation with education leaders, newly elected California Gov. Arnold Schwarzenegger managed to craft the suspension in a way that protected education's interests at the same time it reduced the amount schools were due to receive. Even with the suspension, enough money was available to give school districts additional funds to cover inflation and enrollment growth, plus provide increases for a few specific purposes.

"The deal," as it was often referred to, was the big news for education in a year that saw virtually no new programs or initiatives. At the very end of the legislative session, however, two actions were taken that may affect schools for some time to come. But the extent of their impact is open for debate.

First, the Legislature passed a bill that simplifies the funding system somewhat by consolidating several categorical



What this year's state actions mean for K-12 education

- A funding shift decreases the amount of property taxes districts receive and increases state funding by an identical amount.
- Districts will receive funding to cover additional students plus a cost-of-living increase that applies to both general purpose funds and most categorical programs.
- The state allocated money to partially fund the equalization of revenue limits (general purpose funds).
- Additional amounts were provided for instructional materials and deferred maintenance, some as a result of settling the *Williams v. California* lawsuit.
- Districts hold an I.O.U from the state for billions of dollars that must eventually be restored to them, but that restoration will not even begin for two more years.
- The state has developed a plan for consolidating many categorical programs and giving districts greater flexibility, beginning in 2005-06.
- County offices have new responsibilities for overseeing districts' finances and their allocation of resources to the lowest-performing schools.

programs. This is a step toward the simplification of a school finance system that has been criticized as too complex and at times unfair.

Second, the settlement of the *Williams v. California* lawsuit brought closure to an

issue that has colored school finance discussions in California for four years. The agreement does not make fundamental changes in the way California funds its schools, instead earmarking some money directly to the state's lowest-performing schools and setting up new provisions for oversight by county offices.

This report describes those actions in more detail and provides an overview of the state's budget situation and how education fits into the overall picture. In the process, it provides some detail about how funds will be allocated to schools in 2004-05. Departing a bit from the subject of school finance, it also looks at a few important policy actions that will affect public education in

the coming year and beyond.

Education funding is central to this year's budget resolution

As California's new governor, Schwarzenegger approached budget development in

Education leaders and the governor agree on future priorities for spending

Per “the deal,” the budget report *State Budget Highlights 2004–05*, published by the Department of Finance, says that the administration has agreed that until California’s debt to education is paid off, any funding provided in excess of that needed for programs that existed in the 2003–04 year is to be allocated in the following order:

- 1) Growth and cost-of-living adjustment (COLA);
- 2) Restoring revenue limit (general purpose) reductions made in 2003–04; and
- 3) Reimbursing districts and county offices for the cost of meeting state mandates.

Any additional spending is to be 75% for general purposes, leaving 25% for new state priorities and programs.

The Legislature has not acted to officially commit to or agree with these priorities.

a manner that took advantage of his personal popularity and his status as a Sacramento outsider. His first action, days after his November 2003 inauguration, fulfilled a campaign promise and lowered the state’s vehicle license fee (VLF). The governor’s approach represented a middle ground between the 2003 restoration of the VLF to its 1998 level and its total elimination, which some advocated. His action effectively reduced anticipated state revenues for 2004–05 by \$4.1 billion—a large gap to fill in a state that was already facing a substantial budget deficit.

Two months later, in January 2004, Schwarzenegger presented his first official budget proposal. His spending plan for 2004–05 was predicated on some rather speculative assumptions. The first of those concerned the huge state deficit. To address that, the governor counted on getting voter approval for Proposition 57, a \$15 billion bond on the March 2004 ballot. Voters passed the measure and paved the way for the rest of Schwarzenegger’s plan. Most of the bond proceeds—\$11.3 billion—were used to cover the existing deficits and help balance the 2004–05 budget, with some left over to help in future years.

State leaders suspend Proposition 98 with no backlash from educators

Even with the bond, the state was still facing a deficit in 2004–05 unless officials either raised revenues or cut projected expenditures. And from the start, Schwarzenegger and Republican lawmakers made it clear that they would not support any tax increase. Thus state leaders had to find a way to cut expenditures. The two largest challenges in that regard were the need to protect local governments from the full fiscal impact of the VLF cut and the state’s constitutional funding obligation to K–14 education (kindergarten through community college). The latter reflects voters’ 1988 passage of Proposition 98, which gener-

ally requires lawmakers to increase school funds in step with any annual growth in the state’s per capita personal income or General Fund revenues.

Addressing the needs of local governments meant first undoing a shift of property tax revenues from local government to education that took place in 1992. The 2004–05 state budget moves an estimated \$2.8 billion in property tax revenue back to local governments to mitigate some of the \$4.1 billion revenue loss caused by the reduction in the VLF. The shift leaves local governments with \$1.3 billion less in revenues. In a deal with the governor, they agreed to absorb this cut for two years. In return, the governor promised to put his considerable support behind a proposal to limit future borrowing from local governments and guarantee that the state would pay them back—with interest—if it borrowed from them again. The constitutional change that would create this guarantee is contained in Proposition 1A on the November 2004 ballot.

Shifting property taxes back to local governments did nothing to reduce the state’s funding obligation to K–14 education. It simply transferred the responsibility to the state General Fund, thus increasing from 42% to 47% the proportion of the General Fund that goes to education.

For 2004–05 the Proposition 98 guarantee entitled education to a net increase in funding of about \$3 billion compared to 2003–04. With tax increases off the table, the state could not fund this level of increase for K–14 unless it cut other state and local programs. To provide less than the Proposition 98 guarantee, two-thirds of the state Legislature had to vote to suspend this constitutional provision. In previous years that action seemed to be a huge political risk. Thus, in the years since California’s economy first took a nosedive in 2001, lawmakers had avoided suspen-

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sion through a complicated scheme of deferrals, transfers, and mid-year cuts.

This year Schwarzenegger used his considerable influence to implement a different, less convoluted approach to K–14 funding that made the actual suspension of Proposition 98 palatable to education leaders. The idea was to suspend Proposition 98 while at the same time guaranteeing a net increase in school funds over 2003–04 and promising clear priorities for the future increases in Proposition 98 funding. (See the box on page 2 for a list of those priorities.)

Faced with the very real possibility that the budget situation would eventually necessitate a suspension of Proposition 98 anyway, education leaders agreed to the deal. It meant that they would not rouse their constituents in opposition to the suspension, which state leaders referred to as a “rebasings” of Proposition 98. Education advocates throughout the state stayed silent as lawmakers made their decision. The deal rebased education funding at a level \$2 billion below what the Proposition 98 guarantee amount would otherwise have been. It was a key component in the resolution of this year’s budget.

For fiscal year 2004–05 state officials adopted a balanced budget that included \$768 million in reserves to begin 2005–06, including a \$302 million reserve for Proposition 98 spending. However, the decisions and adjustments that made this possible did not address the “structural imbalance” between the state’s expected revenues and spending in years to come. Assuming the state does not change its policies, the nonpartisan Legislative Analyst’s Office is predicting an annual deficit of at least \$6 billion for the next four fiscal years, from 2005–06 through 2008–09.

The problem is that state spending—along with local spending

previously covered by the VLF—is expected to continue to grow apace because of existing programs that get automatic increases for population growth and cost-of-living adjustments. Education is one of these, along with several health and human services programs. Revenues, on the other hand, are not expected to grow as quickly. In addition, some of this year’s solutions were one-time, such as the bond proceeds from Proposition 57. Others were temporary, such as the \$210 million from suspending the teachers’ tax credit in 2004–05.

The California Budget Project attributes the projection of relatively slow revenue growth to an expected stagnation or slight decline in corporation, sales, and alcohol and tobacco tax receipts as a share of General Fund revenues, combined with a drop in income tax collections from stock market–related capital gains. Further the state has, by most accounts, exhausted its ability to use transfers, deferrals, and loans to mitigate its expenses without an increase in revenues.

Williams v. California settlement redirects funds and adds oversight

Along with the passage of the budget, the other state action that had a potentially big impact on funding for K–12 schools was the settlement of the *Williams v. California* lawsuit. First filed in 2000, the suit asked the courts to decide the nature of the state’s responsibility for providing at least a baseline of educational services for all students. The plaintiffs called on the state to operate an oversight system to prevent and correct disparities in the way districts allocate resources to schools and to assure that basic services are provided at every school. The plaintiffs focused on adequate instructional materials, certificated teachers, and decent facilities.

Proposition 98 protects education funding year to year and over time

When voters approved Proposition 98 as an amendment to the California Constitution in 1988, they guaranteed K–14 education (kindergarten through community college) a minimum amount of state and property tax revenue each year. The calculation of that guaranteed amount is largely based on the health of the state’s economy. From year to year, the Proposition 98 funding guarantee relies on three basic principles:

- In years of “normal” state revenue growth, K–14 education receives at least the same amount as the previous year, adjusted for changes in enrollment and per capita personal income.
- When revenue growth from one year to the next is particularly bad, K–14 education participates in the state’s losses according to specified “fair share” formulas.
- Following a “fair share” reduction that causes the Proposition 98 funding guarantee to lag normal growth, the state is obligated to eventually restore K–14 funding to what it would have been if no reduction had occurred.

As it demonstrated this year, the Legislature also has the option of suspending Proposition 98. A suspension allows the state to fund education at a lower level in the current year, and that level becomes the new Proposition 98 base that gets adjusted going forward. Eventually, however, the state must restore funding to what it would have been if no suspension had occurred. The difference between actual funding and that obligatory amount is called the “maintenance factor.”

This year’s suspension of Proposition 98 adds \$2 billion to an existing maintenance factor. Fair share reductions from prior years had already created a maintenance factor amount of \$1.6 billion, according to Department of Finance estimates. Thus the state has an obligation to eventually restore \$3.6 billion to the Proposition 98 minimum guarantee.

The state is required to begin this restoration effort when General Fund revenues grow faster than personal income. The obligation is to eventually restore the funding level when money is available. But the state does not have to pay back the savings it realized from the suspension in the intervening years, which will amount to about \$2 billion a year.

figure 1 | The state's 2004–05 appropriation of Proposition 98 funds (in thousands)

Source	K-12	Community colleges	Total K-14 education	Other state agencies	Reserve set aside for K-14 but not allocated to schools	Total
State General Fund	\$30,873,601	\$3,035,149	\$33,908,750	\$94,545	\$301,569	\$34,304,864
Local property taxes	\$11,213,733	\$1,771,857	\$12,985,590			\$12,985,590
Total for 2004–05	\$42,087,334	\$4,807,006	\$46,894,340	\$94,545	\$301,569	\$47,290,454

DATA: 2004–05 California State Budget Highlights
CALIFORNIA DEPARTMENT OF FINANCE (DOF)

EDSOURCE 11/04

Former Gov. Gray Davis had contested the suit aggressively based on the argument that the matters at issue were a local responsibility. Schwarzenegger instead took steps to settle the case. In August 2004 the state and the plaintiffs agreed to an out-of-court settlement that provides additional funding for low-performing schools and requires extra oversight of these schools, mainly by county offices of education. The court must still review the settlement and legislation before the case will be officially closed.

After the settlement was announced, the Legislature rapidly passed four bills that detailed how the funds were to be spent and the oversight responsibilities assigned. County offices of education were charged with making sure that school districts provide their lowest-performing schools with appropriate instructional materials, teachers, and facilities.

The funding, which totaled \$188 million in one-time funds in 2004–05, included \$138 million for instructional materials plus another \$50 million to conduct an assessment of facility conditions, supplement county superintendents' capacity to oversee low-performing schools, fund emergency repairs, and cover other costs of imple-

mentation. These funds are in addition to ongoing increases for deferred maintenance and instructional materials. The settlement also commits the state to \$800 million for facilities in future years. These funds will come from the amount already guaranteed by Proposition 98.

For the most part, these resources are to be directed to the state's lowest-performing schools based on their status in Deciles 1–3 on California's Academic Performance Index (API). Specifics of the various bills are described in more detail in the sections of this report that cover instructional materials, facilities, and oversight.

Funding for K-12 schools and community colleges increases modestly

State leaders control about 80% of the funds schools receive. As a result, the state budget represents the single most significant action that determines how much education receives each year.

For 2004–05 the deal between the governor and education leaders means that K–14 education starts this fiscal year with more in total Proposition 98 funding than it received in 2003–04, but \$2.3 billion less than the guarantee would have provided. As Figure I indicates, the \$47.3 billion in funding includes

\$42.1 billion for K–12 education and \$4.8 billion for community colleges, with another \$400 million for other state agencies and to create a reserve. (See “Education holds a large I.O.U.” on page 5.)

Proposition 98 allocation funds enrollment growth and cost-of-living

K–12 education's Proposition 98 funding, which combines local property taxes and state general fund revenues, increases by about \$833 million this year. However, school districts will have substantially more money to spend, including increases for the cost of living, growth in student population, and some specific programs.

This confusing situation is in part a result of the manner in which, between 2001–02 and 2003–04, the state kept year-to-year program funding relatively constant by deferring some of its obligations until future years. In 2004–05 the deferral amount the state owed was about \$1 billion less than it had been in 2003–04, freeing that amount to go to districts for their current program needs. In addition, some funds allocated in 2003–04 were not spent and are available this year. Taken together with other changes, that gives the state about

figure 2 Because of deferrals in past years, the amount budgeted by the state for K–12 education was not the same as the funding available for district programs

Proposition 98 spending	Actual 2001–02	Actual 2002–03	Revised 2003–04	Proposed 2004–05
Per-pupil (ADA) funding according to the state's "ledger"	\$6,608	\$6,597	\$7,009	\$7,007
Per-pupil amount according to districts' "ledgers"	\$6,788	\$6,805	\$6,831	\$7,004

DATA: LEGISLATIVE ANALYST'S OFFICE (LAO)

EDSOURCE 11/04

\$2 billion more that it can provide directly to school districts compared to last year.

For districts, the funding increases include:

- \$509 million to cover student population growth plus \$980 million to pay for a 2.41% cost-of-living adjustment (COLA), both of which apply to districts' general purpose funds (revenue limits) and state categorical programs.
- \$270 million to reduce a deficit in revenue limits left over from prior years.
- \$188 million more for Instructional Materials.
- \$173 million for Deferred Maintenance.
- \$110 million for Revenue Limit Equalization.
- \$120 million to reimburse districts for an increase in unemployment insurance rates from 0.3% to 0.7%.
- \$188 million set aside for the *Williams* settlement (one-time funds).

While these increases will not alleviate all the financial pressure on K–12 schools, they represent an increase over 2003–04 in terms of program funding. Figure 2 shows, based on per-pupil amounts, the difference between the funding the state budgeted and what districts have had available to pay for programs during the last three years compared to 2004–05. The differences reflect the

impact of budget deferrals, showing the fiscal year in which the state actually provided funding versus the fiscal year in which districts had to provide the services and presumably pay for them.

Education holds a large I.O.U.

With its budget decisions in recent years, the state has accrued a substantial debt to K–14 education. There are various reasons for this debt.

As Figure 1 indicates, this year's budget sets aside \$302 million for Proposition 98 spending but does not allocate it to schools. This amount is included in the \$768 million the state expects to have on hand at the end of the fiscal year. Because of the suspension of Proposition 98, the state has no legal obligation to allocate these funds to schools in the current school year. However, depending on the interpretation of the deal that was struck, some say K–12 should receive these funds. The resolution of this will probably depend on the state's general fiscal health and year-end tax receipts.

The state also owes schools what is commonly referred to as "settle up" money. This debt has accrued in years when end-of-year accounting showed that the state did not fully meet its Proposition 98 obligation. At the time the 2004–05 budget was approved, the

"settle up" money totaled \$1.2 billion. In the budget, the state promises to begin paying this back in 2006–07, at a minimum rate of \$150 million annually. If only the minimum is paid each year, the restitution will take until 2013–14.

Also on the books is \$1.5 billion in district claims for reimbursement for meeting state mandates. Some of these claims are under dispute, however, so the eventual total may change.

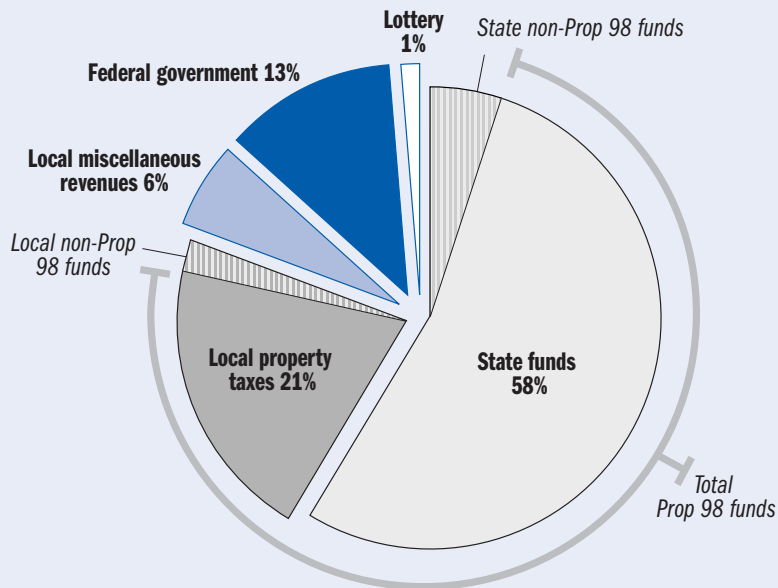
And finally, California's constitution requires the state to eventually restore education funding to the level it would have been without this year's \$2 billion cut from the Proposition 98 guarantee. That restoration process will not start until after the state first restores funding it owes from prior years and other conditions are met. (See the box on Proposition 98 on page 3 for a further explanation.)

An increasing share of K–12 funding comes from sources besides the state

The funds allocated to K–12 education under the Proposition 98 formula represent a large share of the money for schools but certainly not the whole amount. In 2004–05 public education will receive almost \$17 billion more than the state allots through Proposition 98 alone. As Figure 3 on page 6 shows, these funds come from the federal government, the California State Lottery, and "local miscellaneous" sources. There is also \$4.6 billion for K–12 education from state and local property tax sources that is not part of Proposition 98 funding.

In recent years, federal education support has grown steadily in terms of dollars and as a proportion of California's total K–12 budget. All federal dollars are earmarked for specific "categorical" programs, and in 2004–05 they total \$7.6 billion. For more than a decade, up until 2000–01, federal programs provided about 8% of K–12 funding in California. By 2003–04 the contribution represented 13%. This percentage increase comes from

figure 3 | 2004–05 K–12 funding comes from five sources



In 2004–05 the sources of funds for California public schools include:

State funds \$34.1 billion (57.9%)

mostly from California sales and income taxes, including about \$3.2 billion not counted toward the Proposition 98 guarantee.

Local property taxes \$12.6 billion (21.4%)

which state lawmakers allocate to schools. Total includes \$1.4 billion not counted toward the Proposition 98 guarantee.

Local miscellaneous revenues \$3.8 billion (6.4%)

includes community contributions, interest income, developer fees, and revenues from local parcel tax elections.

Federal government \$7.6 billion (12.9%)

earmarked for special purposes, most notably Child Nutrition, No Child Left Behind, and Special Education.

Lottery \$0.8 billion (1.4%)

projected at about \$121 per student (ADA), with \$12 to be used only for instructional materials.

Total estimated revenues for 2004–05 from all sources: \$58.9 billion

Projected California public school average daily attendance (ADA):

- For purposes of Proposition 98: 6.01 million students
- Including adult education and regional occupational programs: 6.38 million students

For an explanation of per-pupil funding calculations and amounts, see the EdSource publication: *What accounts for the difference between education revenues and expenditures?*

the combination of the large growth in federal spending and relatively little growth in state spending during the same time.

In 2004–05 federal funding for several programs continued to grow. The largest funding increases included \$172 million for Child Nutrition, \$140 million for Special Education, and funding for two programs under the Elementary and Secondary Education Act (ESEA), known today as the No Child Left Behind Act (NCLB). The latter includes \$50 million to the state for Title I to support the education of disadvantaged students and \$87 million for Title IV–21st Century Schools, which includes after-school programs.

The local miscellaneous category, taken in the aggregate, represents about 6.4% of school funding and an estimated \$3.8 billion this year. This funding is independent of local property tax revenues. It comes from sources that are controlled locally and that range from local parcel tax proceeds to interest income to donations from parents and community members. As such, it varies widely from one district to another both in terms of the amount per pupil and as a percentage of total funding. For example, in 2002–03 Corona-Norco Unified School District in Riverside County reported just \$23 per pupil in local miscellaneous revenues, while Piedmont City Unified reported \$2,512 per pupil. While there are exceptions, the districts with the highest amounts tend to serve students from the wealthiest neighborhoods.

Community college funding also increases under the Proposition 98 guarantee

Community college funding is connected to K–12 education because of Proposition 98. The \$4.8 billion of Proposition 98 funding allocated to California's community colleges for 2004–05 represents about 69% of the system's total revenues. Another \$1 billion comes from other local sources and an estimated

figure 4 | State and federal education money earmarked for special purposes

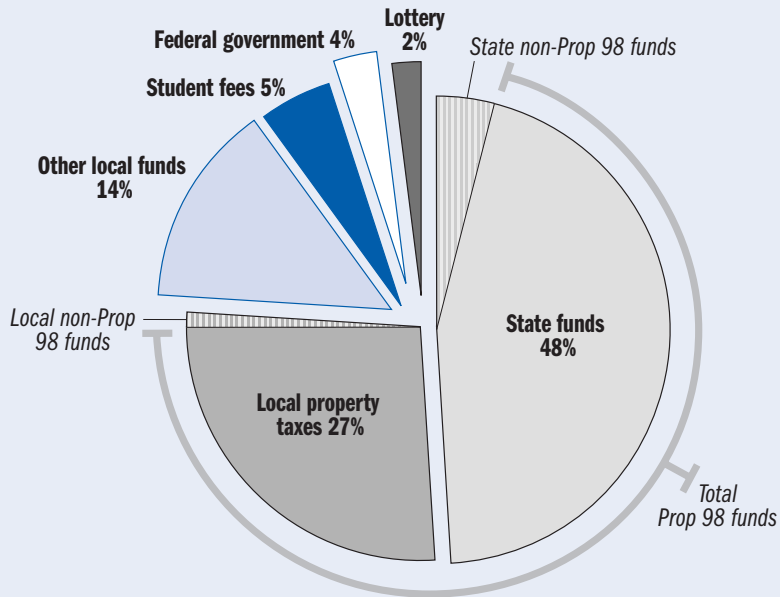
Major state programs (all dollar figures are in millions)	2003-04	2004-05
Special Education	\$2,687	\$2,719
Class Size Reduction (K-3)	1,659	1,652
Child Care and Development (includes after-school programs)	1,281	1,219
Targeted Instructional Improvement Grants	642	664
Adult Education (includes \$14 million for adult education in correctional facilities in 2003-04 and \$15 million in 2004-05)	551	621
Pupil Transportation	474	542
Economic Impact Aid	499	536
School Improvement Program	387	398
Regional Occupational Centers and Programs	370	393
Summer School/Supplemental Instruction	269	364
Instructional Materials	175	363
Deferred Maintenance	77	238
Instructional Time and Staff Development Reform	230	237
High Priority Schools Grant Program	219	193
Supplemental Grants	162	167
Class Size Reduction (9th grade)	110	110
Child Nutrition	85	92
Year-round Education Grant Program	84	84
Beginning Teacher Support and Assessment (BTSA)	86	81
Student Assessment	86	79
Immediate Intervention/Underperforming Schools Programs (II/USP)	99	56
English Language Learners (ELL)	53	55
Charter School Categorical Programs	31	53
Cal SAFE	49	51
Gifted and Talented Education (GATE)	43	44
Community Day Schools	28	41
Professional Development for Math and Reading	32	32
Major federal programs (all dollar figures are in millions)		
ESEA Title I - Extra Support for Students who Live in Poverty	\$1,999	\$2,050
Basic Grants	1,711	1,727
Reading First	145	174
Migrant Education	132	136
Homeless Children Education	7	9
Advanced Placement Fee Waiver	4	4
Child Nutrition	1,445	1,617
Special Education	951	1,091
Child Care and Development Programs	1,045	908
ESEA Title II - Improving Teacher and Administrator Quality	443	435
Part A - Improving Teacher Quality	341	324
Education Technology	88	91
Math and Science Partnership Grants	14	20
ESEA Title IV - 21st Century Schools	129	216
After-school Programs	76	163
Safe and Drug Free Schools and Communities	53	53
ESEA Title III - English Learners and Immigrant Students	133	155
Vocational Education	138	137
ESEA Title V - Innovative Programs	80	113
Innovative Programs	40	40
II/USP and High Priority Schools Grant Program	40	29
Comprehensive School Reform Program	0	44
Adult Education	82	82
ESEA Title VI - Assessment Funding	45	41
Charter Schools	31	38
School Renovation Grants Program	139	0

Note: There are additional state and federal programs funded for less than \$30 million.

DATA: 2003-04 AND 2005-06 BUDGET ACTS

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figure 5 | The state provides the lion's share of community college funding



In 2004–05 the sources of funding for California community colleges include:

State funds \$3.3 billion (48%)

includes \$3 billion from Proposition 98 sources.

Local property taxes \$1.9 billion (27%)

includes \$1.8 billion from Proposition 98 sources.

Other local funds \$1.0 billion (14%)

Student fees \$333 million (5%)

based on fees of \$26 per unit, a 44% increase over 2003–04, and an estimated full-time equivalent student (FTES) count of 1.14 million.

Federal funds \$251 million (4%)

State lottery \$143 million (2%)

projected at about \$121 per student, with \$12 to be used only for instructional materials.

Total funding for 2004–05: \$6.93 billion

DATA: CALIFORNIA DEPARTMENT OF FINANCE (DOF)

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\$333 million from student fees. According to the California Department of Finance, the budget included a total increase of \$608 million, which means total spending will be nearly 10% higher than in 2003–04.

In 2004–05 community colleges will receive slightly more than 10% of the total Proposition 98 funding of \$47 billion. Proposition 98 originally set out approximately 10.9% as the community college

share. However, for the past 12 years the Legislature, in lieu of that set percentage, has calculated the share using the 1989–90 allocation as a starting point.

To help increase funding for community colleges, the Legislature voted to increase student fees for 2004–05. Fees for students were increased from \$18 to \$26 per credit unit. This represents a 44% increase, added to a \$7 per unit fee increase the prior year. Even with this

increase, the fees for community college in California remain the lowest in the nation. With the fee increase, the annual full-time cost in California rises to just \$780 in 2004–05. The national average for the annual full-time cost for community college in 2003–04 was \$2,155.

Opponents of the fee increase argued that while higher fees might be reasonable in the long run, such changes should be moderate and predictable, enabling students and families to plan. As Figure 5 shows, the fees are expected to represent about 5% of total community college revenues in 2004–05.

Funds go to K–12 districts based on established formulas and priorities

The full story of California school finance must take into account not only how much money is available to schools, but also how state leaders choose to distribute it. In general, school districts and county offices are the fiscal agents for schools and receive state funds in two ways. About two-thirds is “revenue limit” funding that districts spend for general purposes. The balance is “categorical aid” earmarked for special purposes. Some of this funding is targeted to particular groups of students, such as those with disabilities; and some pays for specific programs, such as K–3 Class Size Reduction.

This year the state budget provided general purpose and categorical funds in approximately the same proportion as has been the case for the past decade. Lawmakers created no substantive new programs and made very few changes in existing programs.

Revenue limits are augmented in four ways

Nearly all California school districts receive general purpose funding from the state based on a per-pupil amount called a revenue limit. They use this money for the day-to-day operation of schools, including everything from the telephone bill to teacher salaries.

The specific revenue limit amount for each district is calculated annually using formulas set by law and based on historical funding levels. Revenue limit amounts have been set so that within each of six district types—i.e., large and small elementary, unified, and high school districts—districts receive more or less equal base revenue amounts for each student they serve. No adjustments are made for regional differences in the cost of living or based on the characteristics of the students they serve. Districts receive their revenue limit funding according to their average daily attendance (ADA).

For 2004–05 revenue limit funding is augmented in four ways. First, all districts will receive a 2.41% cost-of-living adjustment (COLA). They will also receive their share of \$270 million—another 0.9% approximately—provided to partially repay a revenue limit shortfall in 2003–04.

Second, some districts will receive a portion of the \$110 million set aside for the equalization of revenue limits. The issue of how to make sure similar districts receive similar per-pupil amounts has repeatedly been part of the legislative debate. This year the state provided about one-fourth of the funding needed to bring low-funded districts up to the 90th percentile level, per the provisions of an equalization plan first passed in 2001–02. Lawmakers also stated their intent to once again revise the equalization process and formula during the next legislative session, this time to address concerns that unified districts are disadvantaged under the current approach.

Third, districts with a growing student population will receive their calculated revenue limit amount for each additional student in their district, based on ADA. However, only

about half the districts in the state are seeing enrollment growth. The other half—those with declining enrollments—generally have their total revenues reduced. The state gives districts a one-year grace period on this reduction; they receive revenue limit funding based on their ADA for either the current or previous year, whichever is greater.

Fourth, districts will receive a portion of \$120 million in additional funding to cover the increasing costs of unemployment insurance.

With all four of these variables in play, the increase in revenue limit funding that individual districts receive could vary substantially. On one end of the spectrum would be a district that does not receive equalization and is losing students. On the other end, a district in the most advantageous position this year could receive an extra bump in its per-pupil amount because of equalization and also receive a larger total because of additional students.

Special Education funding formulas continue to evolve

About 10% of students in California receive Special Education services based on physical, mental, learning, and other disabilities. School districts receive extra funds from both the state and federal governments to help pay for the Special Education services they are required to provide. Both state and federal law mandate that students with disabilities receive a “free and appropriate public education” in the “least restrictive setting” possible. Schools must make accommodations for students’ disabilities so they get the most out of their education and participate in regular classrooms as much as possible.

Over the almost 30 years since this has been a requirement, debates and

California's community college system offers a multitude of programs

The equivalent of 1.14 million full-time students attend community college in California at 109 campuses operated by 72 locally governed districts. The system offers academic, occupational, and recreational programs at the lower-division (freshman and sophomore) college level.

Based on agreements with local school districts, some college districts also offer adult education programs that include noncollege-level courses. In addition, many colleges have established various vocational and technical programs suited to regional workforce needs.

Campus sizes vary from 461 full-time students at the Marin Continuing Community College to 30,586 full-time students at Santa Monica Community College.

litigation have repeatedly addressed the share that local districts, the state, and the federal government should each contribute. At the time the federal Special Education laws were passed, Congress stated its intent to provide 40% of the needed funding from federal coffers. That goal has never been reached, and up until about 2001 the funding level had been closer to 10%. Steady increases over four budget cycles have now brought federal funding to about 20% of Special Education costs. Meanwhile, a lawsuit settled in 2001 required the state to also increase its ongoing funding for Special Education by \$100 million, with additional payments of \$25 million each year for a decade.

The formula for deciding how much districts receive does not simply pass all of these increases through to schools. Instead, the state uses a set of general cost calculations to determine

the overall allocation. It first applies the federal funds against that calculated total, and then uses state funds to cover the remainder of the costs. Thus, districts did not receive the full benefit of the federal increases in recent years.

In 2004–05 the state is providing a basic Special Education allocation of at least \$525—with an average of roughly \$600—for every K–12 student (ADA). Districts use those funds to help pay for the extra services they must provide to Special Education students. The state's support for Special Education has grown from \$2.3 billion in 1999–2000 to \$2.7 billion in 2004–05, and federal funds grew from \$453 million to \$1.1 billion.

Effective this school year, districts may get some relief from a Special Education expense that has been particularly problematic. A small percentage of students needing Special Education are placed by county social services and probation agencies, or by regional centers for the developmentally disabled, into group homes, licensed children's institutions, or other residential facilities. In the past, the state provided districts with 100% reimbursement if students were educated in programs run by nonpublic schools or agencies. However, it provided no extra funds at all if districts or county offices wanted to serve these students in publicly operated schools, even if they could do so more affordably and/or effectively. The net result was a fiscal incentive to serve these students in nonpublic schools and no way to control the cost of those schools.

Beginning in 2004–05, a new funding model will no longer directly reimburse the cost of these nonpublic school placements, but rather provide an amount per student (per bed) based on the level of care provided by the residential facility. The amount will vary according to the severity of disability for which a residential facility is licensed and will range from approximately \$500 to \$20,000 per bed. These funds will be the

same whether a student's placement is in a public or nonpublic school. The budget provides almost \$160 million for this purpose, an increase of \$38 million above the amount that would have been provided under the previous funding model.

Legislators build some flexibility into K-3 Class Size Reduction program

One of California's largest categorical programs subsidizes class sizes of 20 for the youngest students. Ever since the state created the K–3 Class Size Reduction (CSR) program in 1996, school district officials have maintained that the extra funding the program provides falls well short of the actual cost. In addition, they have criticized the provision that if any classroom exceeds an enrollment of 20.44 students—based on the average number of students between the start of the school year and April 15—a district loses its entire CSR apportionment for that classroom. With the 2004–05 per student allocation at \$928, the penalty for a single classroom would typically come to \$18,560—a substantial portion of a teacher's salary.

This year the Legislature passed and the governor signed Senate Bill 311, which reduces this penalty if a school modestly exceeds the cap. SB 311 creates a sliding scale for the penalty school districts pay for adding one or two children above the 20-student cap to a classroom for some portion of the year. A 21.95 student average is the new maximum that triggers the full penalty, with interim deductions of 20%, 40%, and 80% for each one-half student above the 20.44 class average. The bill also exempted from penalties Southern California schools that exceeded the cap in the aftermath of the October 2003 fires, assuming they can prove that it was because of the fires.

Many see this measure as a step toward the local flexibility that is needed to accommodate reasonable placements

of students who enter school after the academic year begins. It is unlikely, however, to address the problem of the program costs exceeding the funding.

In recent years, that problem has prompted many districts to consider saving money by either pulling out of or cutting back on the CSR program. Data from the California Department of Education (CDE) indicate that only a small number of districts have actually made that choice. The number of eligible school districts participating in CSR has never reached 100%, but in 2001–02 all but six of the 887 eligible districts participated. Last year, the number of nonparticipating districts increased to 11 out of 895. In addition, a number of districts appear to have cut back on their programs, most notably by eliminating at least some of their small classes in third grade. The number of third grade classes qualifying for the program statewide went down by 7% in 2003–04. Actual allocations to districts also decreased more than \$60 million, from \$1.64 billion to \$1.58 billion. The budget appropriation for CSR in 2004–05, at \$1.65 billion, includes an inflation adjustment but assumes that this reduced level of participation will continue.

Instructional materials funding increases

Along with its adoption of academic standards in the late 1990s, the state provided school districts with nearly \$1 billion in extra funding to buy new textbooks and other instructional materials over four years. At its highest level, the state spent \$606 million on school libraries and instructional materials in 2001–02. That funding was allocated through several separate programs.

In 2002–03 those programs were consolidated into the Instructional Materials Funding Realignment Program (IMFRP). The same year, due to the state's budget crisis, the funding was

reduced to \$103 million. In 2003–04 it was increased to \$175 million. This year IMFRP funding will total \$363 million, or about \$51 per student. The state set aside \$30 million of that total for supplemental materials for English learners. This one-time allocation will give districts up to \$25 per English learner. However, districts are not likely to have the new materials to use in this school year. They have until the end of March 2005 to apply, and actual funding will depend on how many districts apply. The list of state-approved materials for this purpose is not yet available.

Thanks to the settlement of the *Williams v. California* lawsuit (see pages 15 and 18 for more on that settlement), the state's lowest-performing schools will receive extra funding for instructional materials. The budget included an additional \$138 million—or an estimated \$72 per student—that is to pay for extra instructional materials at Decile 1 and 2 schools. (Decile 3 schools were not included in this allocation.)

In addition, county superintendents will now be responsible for determining that low-performing schools (Deciles 1–3) not participating in a state or federal intervention program have sufficient instructional materials. They will do this through inspections at the start of each school year. For this purpose, “sufficient” means that every student has access to materials both in class and to take home.

If county superintendents find that a school does not have sufficient materials, they must report the problem to the district's board and the Superintendent of Public Instruction. If the problem is not remedied in the second month of the school year, the county superintendent must request that the state purchase the necessary materials. The state will deduct the cost of the materials from funds that would otherwise go to the district.

The charter school allocation process differs from traditional public schools

California's approximately 460 charter schools receive their funding based to a large degree on the amount that school districts get. The allocation process for most charter schools is different however.

First, each school receives a set amount per student in a general purpose block grant based on their students' grade levels. In 2004–05 those per-pupil amounts are the following

- \$4,707 for kindergarten–grade 3
- \$4,777 for grades 4–6
- \$4,911 for grades 7–8
- \$5,700 for grades 9–12

These amounts are estimates that are recomputed during the school year as allocations are made to schools. These grants take the place of the revenue limit funding districts receive.

In addition, each charter school receives a categorical block grant from the state. This year a new formula provides the same amount for all grade levels. The actual amount, currently estimated at \$256 per student, will depend on the total statewide average daily attendance (ADA) of charter school students, and so could be adjusted during the year. The state budget act sets the maximum at \$292 per student (ADA).

Charter schools receive this categorical grant in lieu of numerous categorical programs for which districts receive funding. This year's amount includes a substantial increase over 2003–04 because it includes more programs, most notably the Staff Development Buy-out program. Of the 24 largest state categorical programs (those that will receive \$50 million or more in 2004–05), nine are part of the categorical block grant for charters. Schools that receive these funds are not eligible for separate funding for any of these programs. However, they can apply for most of the remaining categorical programs if they qualify.

In addition, charter schools receive extra general purpose money for each student they serve who is identified as low income or an English learner. For 2004–05, this amount is expected to be \$100. This is in lieu of the state Economic Impact Aid that school districts receive. Some charter schools also receive federal Title I funds to provide extra support to the same students. And just like other California public schools, they receive a per-pupil amount from the state lottery.

The budget act this year called for the creation of a working group to develop a “simpler and clearer” method of calculating the funds for charter schools. The Department of Finance and Legislative Analyst's Office convened that group in the fall of 2004.

NCLB adds funds and prompts some new approaches to accountability

With passage of the No Child Left Behind Act (NCLB) in 2001, the federal government embarked on an effort to more directly impact the way school performance is measured and how states hold schools accountable. The changes this year in California's

accountability system were largely driven by federal requirements and expectations.

New district accountability process debuts

The state will use \$66.8 million in federal money to implement a new system for holding school districts accountable under NCLB. Authorized

by Assembly Bill (AB) 2066, the new system creates a number of programs to assist districts in danger of entering or already in the NCLB intervention program, called Program Improvement. This is in addition to the Program Improvement system already in place for individual schools in California.

The process of Program Improvement for districts applies to all that receive Title I funding—95% of school districts in the state. A district enters Program Improvement if in two consecutive years it does not make adequate yearly progress (AYP) and fails to meet the minimum threshold for the districtwide Academic Performance Index (API) for the socioeconomically disadvantaged (SED) subgroup of students. For example, a unified district in which at least 12.8% of any group of students is not proficient in math based on testing in 2003 and 2004—and whose API for SED students was below 560 in the same years—would be designated as being in Program Improvement.

Under this new system, 15 California school districts were identified as being in Program Improvement. They are required to conduct a research-based self-assessment using a format the CDE will provide. They must then contract with an external organization, including but not limited to a county office of education (COE), to verify their findings, provide support, and help them plan for needed changes. Districts will get \$50,000 plus \$10,000 per school to carry out these requirements. Once a plan is in place, districts can apply to the State Board of Education for grants of up to \$2 million to implement recommended changes.

A district that fails to exit Program Improvement over the course of two years will be subject to corrective actions. Among the options for this are replacing personnel, appointing a state-selected trustee, removing schools from a district's

jurisdiction, and even abolishing the district. The state can also require a district to contract with an assistance team. The State Board is to provide further guidance regarding these assistance teams by the end of July 2005.

Much of the emphasis in AB 2066, however, was on providing districts with assistance before they reach Program Improvement. The bill creates two programs for this purpose.

The Prevention of Local Educational Agency Intervention Program (PLEAIP) is for districts at risk of entering Program Improvement within two years. Essentially, it provides the opportunity to implement the same self-assessment and improvement plan as districts already in Program Improvement, with the same type of assistance. If funding is available in the state budget, the district will receive between \$50,000 and \$200,000, depending on its enrollment, to hire the COE or another entity to provide assistance. Districts that choose not to participate in the program must discuss their reasons at a public board meeting.

The Early Warning Program calls on the CDE to warn districts that are in danger of entering Program Improvement within three to four years based on their test score trends. Along with this warning, districts are to receive state-developed, research-based criteria for conducting a voluntary self-assessment, plus encouragement to modify their Title I local plan based on the findings in their self-assessment.

The bill also provides help for districts that are not in Program Improvement but have 10 or more schools—or 55% of their schools—that are. Eligible districts would get up to \$15,000 per school—up to \$1.5 million—for identifying and addressing district-level problems.

STAR reauthorization is not yet complete

Along with many other states, California began to steadily increase its investment

in standardized testing in the late 1990s, prompted by a greater focus on standards and accountability. The federal testing requirements included in NCLB both reinforced the need for that investment and added additional testing and data collection requirements. The total allocated for testing and data reached about \$131 million in 2003–04, with \$86 million from the state and \$45 million in federal funds. For 2004–05 those funding levels will be reduced somewhat, to \$79 million from the state and \$41 million in federal money.

Lawmakers also passed Senate Bill (SB) 1448 this year, which makes a few changes in the state's largest testing system, the Standardized Testing and Reporting (STAR) program. Those changes—part of the scheduled reauthorization of the program—were also in response to federal testing requirements. A second bill, AB 2413, was passed as clean-up legislation but vetoed by the governor.

As the law currently stands under SB 1448, STAR is reauthorized for grades 3–11 until January 2011. However, second-grade testing is only reauthorized through 2007, reflecting a continuing debate among policymakers and educators. The federal regulations do not require testing to begin until third grade, and some say this reflects evidence that standardized testing is not appropriate for younger children. The California Teachers Association (CTA) has been particularly vocal in its opposition to testing second-graders, while both the governor and Superintendent of Public Instruction support it.

In his veto of AB 2413, Schwarzenegger expressed his desire to sign a measure to clean up SB 1448 that would remove “the inconsistencies in the sunset dates for all components of the STAR program.” The governor's veto message also said the clean-up legislation should correct a drafting error in SB 1448 that

required a program of test preparation. He called on legislators to address these issues in a new clean-up bill at the start of the next session.

In order to comply with federal requirements, the CDE must also develop new tests for English learners (ELs). NCLB says that EL students—to the extent practicable—should be tested on state standards in their primary language. So far, California has only administered a primary language test in Spanish; and it was a standardized, nationally normed test rather than one aligned to state standards. The new testing legislation requires the CDE to develop tests that are aligned to state standards and are in the primary languages of the greatest number of EL students enrolled in the public schools. A test in Spanish is a given because about 85% of the state's EL students speak Spanish. Statewide, the other most common languages are Vietnamese, Hmong, Cantonese, Tagalog (Philippines), and Korean. AB 2413 went into greater detail about the creation of these tests and how to decide which languages they should cover.

The STAR reauthorization also supported efforts already underway to use the California Standards Tests (CSTs) as measures of students' college readiness. The CDE and California State University (CSU) system have together developed the Early Assessment Program (EAP) to align CSU's placement expectations with K–12 academic standards. Central to this effort are adaptations of three CSTs that are already part of the STAR tests. Beginning with the spring 2004 tests, EAP added questions to both the Algebra II and Summative High School Mathematics CSTs. It also added both questions and an essay to the 11th grade English language arts CST. High school juniors whose schools chose to participate could take the expanded tests. The results will be used by the CSU to exempt students from placement tests or

let students know that they need additional preparation during their senior year of high school.

Under the new law, the CDE and the State Board are now authorized to assist all public and private colleges and universities in using 11th grade CSTs for academic credit, placement, and admissions. The legislation also includes a mechanism by which students and their parents can give permission to have STAR scores released to colleges.

Funding for state programs to support struggling schools and students is down

When California began its efforts to hold schools accountable for performance in the late 1990s, it included various programs that would support school and student improvement. The state's allocations for these purposes have declined since 2001–02.

Funding for supplemental instruction programs is lower

Programs to provide extra instructional time and support to struggling students were a central component of California's original approach to raising academic standards. Over the course of a few years, the state combined its traditional support of summer school with a multitude of other programs. These were aimed at various student groups—e.g., 7th and 8th grade algebra academies—and funded at an hourly rate.

In 2001–02 the \$435 million allocated for these programs included \$50 million that districts did not use. Reacting to that, the Legislature permanently reduced the appropriation by \$50 million. It also cut back on the percentage of students a district could serve in one program and eliminated two programs altogether. In addition, between 2002–03 and 2003–04, a large portion of the funding for these programs was deferred. For 2004–05 the budget provides \$364 million for supple-

mental instruction programs. Districts are supposed to receive \$3.53 for each hour of supplemental instruction that they provide to a student.

In AB 825, the Legislature calls for 25% of the new Pupil Retention Block Grant to be held in reserve during its first year. (See the section on categorical consolidation on page 15.) That provision of AB 825 will enable the state, if necessary, to backfill the funding for supplemental instruction provided this year should districts apply for more funds than were appropriated.

Intervention programs are funded at a maintenance level

Two intervention programs designed to support school-level improvement also played a central part in California's state-developed accountability system. First the Immediate Intervention/Underperforming Schools Program (II/USP) and then the High Priority Schools Grant Program (HPSG) provided extra funds for schools that entered into a specified planning and improvement process. Those that failed to improve faced the threat of eventual sanctions. The combination of new NCLB requirements and the state's ailing economy have kept these programs at a maintenance level the last few years and to some degree has shifted the focus to the federally crafted Program Improvement approach. The combined state and federal support for the two programs has been reduced from \$358 million in 2003–04 to \$278 million this year, in part because no new cohorts have been added to the II/USP.

However, the *Williams* lawsuit settlement may mean that the HPSG Program will not go away entirely. SB 550 states legislative intent to use funds freed up as schools phase out of both state intervention programs to provide new HPSG Program grants to eligible schools that have not yet participated.

Meanwhile, the federal Comprehensive School Reform Program makes

Mandated cost procedures get overhaul

The California Constitution requires the state to reimburse local governmental agencies, including school districts and county offices of education, for the cost of implementing new programs or higher levels of service that state statutes or executive orders mandate. Open meeting laws and Special Education services beyond federal requirements are two examples.

Among the cuts school districts have absorbed in recent years has been the virtual elimination of state reimbursements for mandated costs, which now constitute an obligation to districts of about \$1.5 billion. This deferral was prompted in part by the budget crisis and in part by skepticism on the part of state officials about the legitimacy of some claims. One source of that skepticism was the often dramatic difference between district cost claims for the same mandated expenses.

The Legislature this year passed two bills—Assembly Bill (AB) 2855 and AB 2856—that together simplify the mandated claim process somewhat and eliminate some specific mandated costs.

AB 2856 addresses the way local governmental agencies, including school districts, seek reimbursement from the state for implementing state mandates and how those cost claims are evaluated. The bill establishes a basic “reasonable reimbursement methodology” to be based, whenever possible, on general allocation formulas, uniform cost allowances, and other approximations of local costs, rather than on the detailed documentation of actual local costs the state currently requires. The methodology would have to yield reimbursements such that the total statewide costs of implementing the mandate were covered and at least half of claimants were fully reimbursed. This means that districts reporting relatively high costs for a given service may not be fully reimbursed as they may have been in the past, but those districts will also not have to go to as much effort to document their costs.

AB 2855 removes a number of mandates on schools as well as exempting some additional mandates from reimbursement. For example, schools will no longer be required to grant the use of campuses as public shelters during emergencies, nor will they have to report to local and state health departments the data they collect as part of student health screenings.

another \$44 million available to support the use of whole school reform models. In addition, federal regulations require the state to set aside \$102 million of its Title I funding this year for school and district improvement activities.

Title I changes create winners and losers

At the center of the federal government’s effort to improve school performance is its Title I program, a set of grants to support schools with high percentages of low-income children. For California, NCLB has meant an increase in Title I funding of more than \$700 million since 2001–02. Nevertheless, issues around the adequacy of Title I funding

persist. In addition, changes in the data and methods used to allocate these federal dollars to districts will benefit some California schools in 2004–05 and hurt others.

A June 2004 brief on Title I funding by the Center for Education Policy (CEP), a national independent nonprofit organization, says that nationwide 55.6% of the districts that receive Title I money will receive less this year. Among California districts, the examples include San Francisco Unified (9.9% reduction) and Oakland Unified (6.7% reduction). An example on the other side of the ledger is Los Angeles Unified, which will receive a 13.3% increase.

Facilities funding has been a bright spot for California schools since 2001

While local schools’ operating budgets have been affected by the state’s economic woes, their ability to address facility needs has improved since 2001. California voters have approved almost \$40 billion in state and local bonds to build and repair schools. The quality of school facilities—and districts’ ability to maintain them properly—will nevertheless receive additional attention in 2004–05, in part because of the *Williams* lawsuit.

State measures increase money available for school facilities

In March 2004 voters passed Proposition 55, a statewide bond measure for \$10 billion to help pay for the construction and renovation of K–12 schools. Two years earlier, Proposition 47 raised \$11.4 billion for the same purpose. Both measures also included facility funds for community colleges and state universities.

The intent is for these two measures to pay for the state’s share of school facility needs projected through 2007. The Office of Public School Construction (OPSC) reports that of the \$11.4 billion that voters approved with Proposition 47, about \$10.3 billion had been allocated as of the end of June 2004, including the full allotment for modernization. Thus, when voters passed Proposition 55 in March 2004, about \$431 million was immediately allocated for modernization projects that had been waiting for funding.

Of the \$10 billion for K–12 school projects, Proposition 55 made available \$5.26 billion to buy land and construct new school buildings, \$2.25 billion for modernization, and up to \$300 million for charter school facilities. Of the remaining funds, \$2.44 billion will go to critically overcrowded schools and \$50 million to joint-use projects. However, the measure permits changes in this

allocation with the approval of the Legislature and the governor.

Along with these state bonds, another major source of facility funding has been local general obligation bonds. Their passage became easier in 2000 when voters approved Proposition 39, which allows passage with a 55% majority vote if districts agree to certain conditions. Those elections continue to succeed, raising a total of \$17 billion between November 2002 and March 2004. In the March 2004 election alone, local voters passed GO bonds totaling \$5.7 billion.

These local elections help districts meet a “matching fund obligation” needed to qualify for state bond proceeds. In most cases, districts must provide 50% of total project costs as a local match for new construction and 40% of total costs for modernization projects.

Williams settlement focuses on the condition of school buildings

The plaintiffs in the *Williams* lawsuit made their case in part because they were able to point to many schools with buildings that were unsafe or unhealthy. They further showed that the students attending those schools were overwhelmingly low-income and either Hispanic or African American. While new facility funding may have addressed many of the original complaints made four years ago, the settlement focused heavily on this issue.

One of the laws to implement the settlement, SB 6, establishes two programs related to facilities. The first, funded at \$25 million in 2004–05, provides grants of \$10 per pupil in eligible schools—those in Deciles 1–3—or a minimum of \$7,500 per school. Districts must use these funds to conduct facility needs assessments at all the eligible schools. The assessment becomes the baseline for the facilities inspection system created under Senate Bill (SB) 550. (See page 18.)

The second program, funded at \$5 million in 2004–05, reimburses dis-

tricts for repairing structures or systems that pose a threat to the health and safety of students or staff in Deciles 1–3 schools. The funding is to supplement, not supplant, existing maintenance funding streams, such as deferred maintenance.

While the current year funding is quite modest, the available amount is expected to increase in the future. Beginning in 2005–06, the annual funding will be at least \$100 million and is to continue until a total of \$800 million has been disbursed. The annual amount could be more, up to half of the state’s Proposition 98 Reversion Account. (The state puts funds that were appropriated for K–14 education but not spent in the Reversion Account. This year the account had \$325 million, which helped fund the 2004–05 budget.)

Another *Williams*-related bill, Assembly Bill (AB) 1550, calls for the eventual elimination of “Concept 6” programs in schools that run multitrack, year-round programs. Concept 6 schools configure their state-required minimum instructional minutes in such a way that students are in school for as few as 163 days, as opposed to the standard 180. The bill puts restrictions on the use of a Concept 6 calendar beginning with the current school year and requires the elimination of such calendars by 2012.

Policy changes are few and far between this year

In contrast to many years in recent memory, this year’s legislative session made few changes in the state’s fundamental education policies. For some that was a disappointment, particularly given continuing hopes for a revamped funding system and the initial optimism regarding the potential influence of a recently developed master plan for education.

Categorical consolidation affects about 18% of the state’s earmarked funds

Much criticism has been directed at California’s complex collection of categorical

programs for school funding. After nearly a decade of rhetoric from many state leaders—during which more programs were created than discontinued—the Legislature this year approved AB 825 to simplify the situation. The significance of this measure is a matter of some debate however. While acknowledging that the bill is an important first step, some believe that much more is needed for meaningful improvement of the state’s complex approach to funding its schools. Others are more enthusiastic, characterizing this measure as a “monumental change.”

Effective in 2005–06, AB 825 consolidates about two dozen categorical programs into six block grants (see Figure 6 on page 17). The block grants will provide funds to be used for the following general purposes: Pupil Retention, Targeted Instructional Improvement, School and Library Improvement, Teacher Credentialing, Professional Development, and School Safety. Each block grant may be spent for any of the purposes authorized in the programs that were consolidated, though some additional conditions apply.

The affected programs represent almost \$2 billion of the state’s total annual categorical spending of about \$11 billion. The allocation process will vary somewhat among the programs with the first three based on prior funding and the teacher programs based on a specified count of teachers eligible to participate. For all of these programs, funding levels will be adjusted annually to reflect changes in cost of living and either student attendance or teacher counts. The school safety grants are to be awarded based on a competitive grant process.

Along with the flexibility districts will have within each block grant, AB 825 authorizes districts to shift up to 15% of funds from four of the block grants to any other categorical program for which a district is eligible. (No transfers from the Pupil Retention or Teacher Credentialing block grants are allowed.) Districts can

only use these transferred funds to increase spending in any categorical program by up to 20%. Prior to transferring funds, a district or county office must discuss doing so at a public meeting.

The legislation also requires the Legislative Analyst's Office to evaluate the effect of the newly created block grants on student achievement by January 2007, after one full school year. The evaluation would also contain recommendations on continuing or eliminating programs that are not part of these block grants. Finally, the bill requires the CDE to annually compile program-by-program and district-by-district information on state and federal categorical programs, as was done by the Bureau of State Audits in a 2003 report.

Master Plan bills will not have the impact advocates had hoped for

From 2000 until 2002, dozens of researchers, educators, and other experts were convened to develop recommendations for the Joint Committee to Develop a Master Plan for Education. After receiving those recommendations, and getting public feedback, the committee presented a Master Plan document to the Legislature late in 2002, out of which came a number of legislative proposals. Among them was AB 2217, which called for the establishment of a Quality Education Commission (QEC) that was to begin its work in July 2003. The job of the QEC is to develop a recommendation for changing California's school finance system based on an "adequacy model." The model is meant to recommend not only an adequate base level of funding for prototype schools, but also ways to make the funding system simpler, more streamlined, and more rational.

When the state provided no money for the QEC, the William and Flora Hewlett Foundation and the Bill & Melinda Gates Foundation stepped forward and offered the necessary funds. The commission is to include 13

members, seven of whom are to be gubernatorial appointments. Before he left office, Davis nominated seven individuals. But the Legislature did not confirm them, and Schwarzenegger has not yet nominated any replacements.

Members of the Master Plan Committee also introduced bills to implement other elements of the Master Plan. These proposals became "two-year bills" and thus part of the legislative debate during the 2004 session. In August, three of the five bills directly affecting K–12 education were amended to implement the *Williams* settlement, including SB 550, which was related to student learning, SB 6, which had focused on public education governance, and AB 1550, which originally dealt with standards for school and university facilities.

The remaining two bills were AB 242 on teacher credentialing and AB 56 on school readiness, which was amended into AB 712. After legislative action significantly reduced the scope of both bills, the governor ultimately vetoed them.

Oversight is a continuing concern and focus of some actions

State officials approved new oversight provisions this year—some prompted by the *Williams* lawsuit—that seek to increase scrutiny of districts, including their management of finances and allocation of resources to school sites.

Some school districts face major financial management challenges

As described above, a variety of factors will influence whether a given school district receives an increase in revenues this year. However, most districts will see their costs increase because personnel costs are likely to go up. On average, about 85% of school district general fund expenditures in California go toward salaries and benefits for employees, with more than 50% of that typically devoted to classroom teachers.

As districts manage their budgets in 2004–05, they will have to contend with three types of increases to their personnel costs. All of these are ongoing expenditures that either reflect prior-year commitments or will obligate districts in the future.

One is the cost of employee benefits, most notably health insurance. Along with most other California employers, school districts face projected cost increases of up to 15% for health insurance, according to School Services of California. If Proposition 72 passes in November 2004, it could also increase the level of health care coverage some districts are required to provide their employees.

The second increase—which varies based on the age and seniority of employees in a district—is a function of district salary schedules. Most districts have agreed to salary schedules that obligate them to provide automatic pay increases to employees based on years of experience and continuing education. As a result, salaries for individuals rise periodically without a district granting a pay raise *per se*, and the total personnel costs generally rise as well. Some districts may take advantage of a state law that allows them to offer early retirement incentives to their most experienced—and thus most expensive—teachers, replacing them with teachers who earn less. While this strategy can reduce payroll costs in the short term, in subsequent years districts usually face faster escalation of costs due to the steeper and more rapid increases typical at the early end of the salary schedule.

The third source of financial pressure will come from employee union demands for a raise. Often collective bargaining demands for salary increases are structured around the cost-of-living adjustment (COLA) the state provides to districts. With cuts last year and just a 2.41% increase in 2004–05, districts are likely to be under pressure to provide employee raises that absorb a large part of their increased funding.

figure 6 | Assembly Bill 825 consolidates existing categorical programs into six block grants

Current programs	New block grants	Estimated 2004–05 funding for separate programs
Supplemental instruction in reading, writing, and math for grades 2–6	Pupil Retention	\$414 million
Supplemental instruction in core subjects for grades K–12		
Supplemental instruction in reading for grades K–4		
Intensive algebra academies for grades 7–8		
Continuation high schools revenue limit adjustment		
High Risk Youth Education and Public Safety Programs		
Tenth grade counseling		
Opportunity schools/classes/programs		
“SB 65” dropout-prevention programs <ul style="list-style-type: none"> ● School-based motivation and maintenance ● Alternative education and work centers ● School-based dropout recovery ● Educational clinics 		
Early intervention for school success and an at-risk youth program in Los Angeles Unified School District		
Targeted Instructional Improvement Grants	Targeted Instructional Improvement Grant (TIIG)	\$832 million
Supplemental Grants		
School library materials	School and Library Improvement	\$391 million
School improvement programs		
School safety grants for grades 8–12	School Safety Consolidation Competitive Grant (SSCCG)	\$19 million
School Community Policing Partnership Act		
Gang Risk Intervention Programs (GRIP)		
School Community Violence Prevention, safety plans for new schools, and conflict resolution		
Beginning Teacher Support and Assessment	Teacher Credentialing	\$81 million
Instructional Time and Staff Development	Professional Development	\$246 million
Intersegmental programs		
Teaching as a Priority		

DATA: ASSEMBLY BILL 825
SENATE BILL 1113

EDSOURCE 11/04

Many districts chose to cut programs last year in order to absorb actual reductions in their revenue limit funding. To the extent that they are forced to use additional funds for these three ongoing areas of personnel expenditure, they will have little ability to restore those programs.

A few districts have not succeeded at this balancing act among program

needs, ongoing costs, and revenue changes. Since the 2000–01 school year, 16 school districts have received a “negative certification” (on their second interim reports). In other words, a county office review of the district’s finances and projections found it unable to meet its financial obligations for either the current or upcoming fiscal year.

This negative certification prompts the county office to disapprove the district’s budget and may trigger a financial review by the Fiscal Crisis Management and Assistance Team (FCMAT). It is not uncommon for a district to receive a negative rating for two or three years in a row. Often the warning signs have been clear in prior years when a district received a qualified certification.

In 2003–04 a total of 35 districts and one county office received this warning (on their second interim report), down from 55 districts and one county office the year before.

New fiscal oversight requirements aim to help districts prevent a crisis

Concerned about the fiscal management challenges school districts face—and about weaknesses in the state’s process for providing districts with emergency loans—the new administration sponsored a bill to address fiscal accountability on several levels.

AB 2756, which was passed as an emergency measure and signed by the governor in June, builds on the provisions for fiscal accountability that were part of AB 1200. That 1991 measure put county offices of education in the position of reviewing district financial statements and certifying the ability of districts to meet their obligations. It also created FCMAT to serve as an advisor to districts when they were facing financial hardships.

The new law makes important and substantial changes in the financial review process and the power that county offices have related to those reviews. It also makes explicit the consequences for districts that accept emergency loans from the state in order to avoid bankruptcy.

By September 2005 the superintendent of public instruction (SPI), the state controller, and the director of the Department of Finance are to update the standards and criteria districts use for budget development and financial management. The new standards are to take effect in 2006–07.

County offices will also be expected to review any report or audit—including district’s routine annual audits—that indicates a district may be having financial problems. The county superintendent would have the option of conditionally approving a district’s budget, thus forcing

a district to undertake some revisions but stopping short of the official steps currently triggered by a disapproval.

The new law gives county offices and the state greater ability to monitor the performance of school district auditors and effectively prohibit the use of firms that fail to meet professional standards. Similarly, the state will now have the ability to oversee the fiscal oversight role of county offices and remove that responsibility if it is not being done effectively.

More visible than the financial management issues was the issuance of \$167 million in emergency loans to Oakland, Vallejo, Emery, and West Fresno school districts between 2001 and 2004. Concerns about these loans and contentious political debates about the consequences—for Oakland in particular—likely helped secure the passage of AB 2756.

The measure adds to the specific consequences that will result from a district receiving an emergency loan from the state. Such a loan already triggers the appointment of a trustee who has veto power over district actions. If the amount of the loan exceeds a specific threshold, the SPI must appoint an administrator who takes control of the district and the local school board loses its decision-making power. With the new law, the superintendent of the district must be dismissed. Specific provisions also address the process for the reinstatement of local control, including a five-year “probationary” period. The measure also limits the cash settlement districts can give superintendents should they be removed for fraud or other illegal fiscal practices.

Settlement adds to oversight responsibilities for county offices

The *Williams* settlement further adds to the oversight responsibilities of county offices. SB 550 calls on county superintendents to ensure that facilities, teachers, and instructional materials meet state-

determined standards. The bill requires county superintendents to publicly report on the condition of local Decile 1–3 schools that are not in a state or federal intervention program.

Current law requires county superintendents to visit their local schools “at reasonable intervals.” This bill is more specific regarding low-performing schools, requiring at least one visit per year within the first four weeks of the school year. Further, it specifies that the superintendent use these visits to determine the sufficiency of instructional materials; the extent of teacher qualifications and vacancies; and the condition of facilities, including the identification of items that pose an urgent threat to health or safety. At least a quarter of the visits are to be unannounced inspections of facilities.

A second bill, AB 300I, further involves county offices of education (COEs) in the effort to make sure that schools in Deciles 1–3 have qualified teachers. The bill requires COEs, as part of their annual review of districts’ teaching assignments, to first review schools in Deciles 1–3 that are not in a state or federal intervention program. COEs are to investigate districts’ efforts to ensure that teachers of classes with 20% or more English learners have state-required training and credentials.

The state allocated \$15 million for COEs to use for these oversight duties. In the future, the physical inspections are to be done to the extent that funding is appropriated, though the intention is to continue to fund this program.

Not all of the provisions for increased oversight out of the *Williams* suit fall on county offices. Greater public visibility regarding the condition of schools is also part of the agreement. To that end, each school’s School Accountability Report Card (SARC) must now include information on teacher misassignments and vacancies, availability of sufficient instructional materials, and maintenance needed

to bring the school into good repair. In addition, the annual school district audits will now examine not only financial records, but also the accuracy of SARCs. As with financial audits, county superintendents are to review audit exceptions and report to the state when the district has corrected or established a plan to correct any problems.

Also in the interest of public visibility, the legislation creates a mechanism for informing parents about the instructional materials, teacher qualifications, and soundness of facilities they should be able to expect at their schools. They are also to be made aware of the complaint procedure when those expectations are not met. Districts can use their existing uniform complaint process for this, modifying it as necessary to accommodate these new areas of focus.

What is on the horizon

When Schwarzenegger took over as California's governor, he promised a review of the performance of all facets of state government. The first milestone in fulfilling that promise was the August publication of the *California Performance Review* (CPR).

California Performance Review may dictate upcoming policy agenda

This 2,500-page document scanned the whole of state government, including the state's K–12 and higher education systems. According to the authors' calculations, the plan could save the state about \$1 billion in 2004–05 and \$32 billion over five years. In a review of the CPR, the Legislative Analyst's Office (LAO) disputes the estimated savings, putting the five-year savings closer to \$10 billion or \$15 billion.

In many areas, including education, the recommendations in the CPR are less about saving money and more about reorganizing state government. The 36 recommendations in education address matters large and small, ranging from

To Learn More

- To find *State Budget Highlights 2004–05*, go to the California Department of Finance website, www.dof.ca.gov, click on "California Budget," and look under 2004–05 Enacted Budget.
- To find the *California Spending Plan 2004–05: The Budget Act and Related Legislation*, go to the website of the Legislative Analyst's Office (LAO) at: www.lao.ca.gov
- For more information on the Early Admission Policy (EAP), a collaborate effort of the State Board of Education (SBE), the California Department of Education (CDE), and the California State University (CSU) system, go to: www.calstate.edu/ar/EAP.shtml
- To read the report by the California Performance Review (CPR) committee, go to: <http://report.cpr.ca.gov>
- For the national, independent, nonprofit Center for Education Policy's study on Title I, go to its website, www.ctredpol.org, and click first on "Index of Topics," then on "Title I," then on *Title I Funds: Who's Gaining, Who's Losing & Why*.
- Go to www.edsource.org, click on Education Issues in the yellow bar, and scroll to School Finance. Also click on Publications in the yellow bar for a number of EdSource reports on school finance and other issues as well as shorter publications that can be downloaded for free.
- Go to www.ed-data.k12.ca.us to find and compare school district financial information.

the State Board's responsibility for cost oversight of textbooks to state governance of K–12 education generally. They also include proposals aimed at kindergarten, high school, community colleges, and the state's universities. Some address the governance of schools, including a proposal to eliminate county offices of education. Perhaps most significant is a proposal to create a centralized department that would oversee both the state's education and workforce-preparation efforts.

The "infrastructure" portion of the CPR includes three proposals related to school facilities. One is a funding reform previously recommended by the LAO and the California Master Plan Working Group on Facilities and Funding.

Skeptics see the CPR as so massive and far-reaching that it is likely to collapse of its own weight. In the case of education, it also includes a variety of recommendations that have been proposed before in the same or similar form, but to no avail. On the other hand, the outcome could be different if those proposals are on the policy agenda of a new governor who has proven himself to be an effective negotiator with a strong popular base.

The first step in the process of evaluating the CPR was a series of public hearings in August and September. The results of those hearings are supposed to help determine what happens next, including presumably the legislative agenda the administration will pursue in the next year or two. While the governor requested the CPR, he has not formally endorsed its specific recommendations.

Concerns about high school performance are taking center stage

As both the state and federal accountability programs have become institutionalized, student performance data have increased concerns about the effectiveness of California's high schools. In particular, they highlight the gaps in achievement among certain student groups. Policymakers, convinced that something needs to change, attempted to turn their concerns into new law this year, but have little to show for it.

By every measure of high school success—completion of college preparatory courses, passage of the high school exit exam, proficient performance on state tests, or simply graduating—English learners, low-income

students, Hispanics, and African Americans lag far behind their counterparts. While there seems to be shared recognition of the problem, state leaders are far from consensus regarding the solutions.

During an initial foray into the debate in the 2004 legislative session, that lack of consensus was clear. Early in the year, Superintendent of Public Instruction Jack O'Connell launched a high school initiative and sponsored two pieces of legislation that focused on the rigor of the high school curriculum. One would have strengthened the state's role in recommending curriculum materials for high schools and the other began with the premise that all high school students should be encouraged to take a course of study that prepares them for college. A third bill would have enhanced the professional development of high school principals. None of these bills was passed by the Legislature.

The fate of these bills likely signals the beginning—not the end—of discussions about high school and about students' transitions to college and work. An October High School Summit sponsored by the CDE is the most visible of several events in the state this year. The inclusion of several related proposals in the CPR indicate that the topic may become an important one for the governor as well.

Further, the issue appears to be a focus outside California. For example, the National Governors Association and the Southern Governors' Association have put high school reform at the top of their agendas.


Will California address the bigger funding questions?

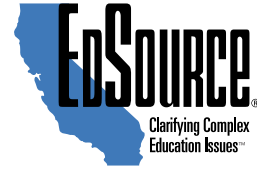
Along with many other areas of California's public sector, schools will have

to tighten their belts to get through the 2004–05 fiscal year. And given the serious, ongoing structural imbalance between revenues and expenditures at the state level, that reality may change very little in the next few years.

Among those people who believe that California needs to invest more in its public education system, few expect that the existing state funding system will eventually provide an adequate amount to schools. As a result, some groups continue to push on the effort to reconfigure the current funding system. Others are putting more energy into changing laws related to generating revenues locally.

For example, a bipartisan group of influential Californians has announced their intent to give greater revenue-raising ability to local communities. Calling themselves Taxpayers for School Improvement, the group is supporting a new initiative effort that would lower the threshold for parcel tax passage from the current two-thirds to 55%. If this effort were to result in a ballot measure, the next regularly scheduled election for which it could qualify would be spring 2006.

Meanwhile, SPI O'Connell has been one voice among many calling on the governor to make his appointments to the Quality Education Commission. Doing so could signal a commitment to look seriously at the school finance system. Absent that commitment, it is likely that lawmakers and education advocates will continue to pursue separate reform agendas—like the categorical consolidation bill this year—that try to address one or another facet of the problem without addressing the whole. 



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