School Finance 2007–08

A "Status Quo" Budget in a Time of Increased Pressure

BY JULY 1ST OF EVERY YEAR, California's school districts must adopt their annual spending plans based largely on what the state budget provides for them. However, policymakers in Sacramento often do not agree on a state budget by that date, leaving local decision makers to rely on educated guesses. In 2007–08 state leaders were particularly late—55 days after the fiscal year had begun. Some observers say the delay was due more to intraparty politics than substantive policy debates; but regardless of the reasons, the budget was the third-latest in state history.

Few will excuse the tardiness, but crafting a sound budget that satisfies all parties is a difficult task in California given the many constraints that elected officials face. Revenues fluctuate every year. The public tends to frown upon tax increases and yet expects that policymakers will not cut their favored programs. In some cases, the public has established its expectations through ballot initiatives that create spending guarantees for specific priorities.

Given the conflicting pressures on state officials and an uncertain state economy, it is perhaps not surprising that the 2007–08 budget—which calls for spending $102.3 billion from the General Fund—relies on some questionable assumptions and creates difficulties for future budgets. One example is the decision to use one-time monies to fund a few ongoing K–12 education programs. Use of a particular one-time source of funds is already facing legal challenges. Regardless of the outcome of that case, California must face the question of how those programs will be paid for in coming years, especially given that—absent some correction—the state's baseline expenditures for next year are projected to exceed revenues.

In general, however, the education community has much to be thankful for in this year's budget. The spending plan provides a cost-of-living adjustment to general purpose and most earmarked funds for local education agencies. The budget also allows for projected annual changes in student attendance (the basis for much of the revenue that schools receive) and cushions the fiscal impact of the attendance decline that many districts face today. Finally, the budget does not call for major cuts but generally leaves education programs intact. In sum, the education budget provides a level of stability—something that schools cannot always count on each year.

What may concern the education community, however, is that the steady-state allotment for K–12 schools and community colleges (K–14 education) comes at a time of ever-increasing demands. Many K–12 schools are expected to raise students' test scores to meet the requirements of the federal No Child Left Behind Act (NCLB). And community colleges are asked to fulfill an increasingly complex mission, but they will receive few new resources to help them do so. Compounding the challenge are the escalating costs of employee benefits, which comprise a sizable portion of local agency budgets.

Also troubling is a November 2007 report on the state's five-year fiscal outlook by the Legislative Analyst's Office (LAO), which indicates that some of the original assumptions and decisions reflected in the 2007–08 budget may be in jeopardy. The LAO raised the possibility that the state may have to change the education funding level during the fiscal year.

This report focuses on what was known at the time the budget was enacted in late August, with some description of more recent developments. It describes how much money schools were budgeted this year, how those funds are allocated, and some related policy changes. The report first takes an in-depth look at the K–12 segment and then gives a brief overview of the budget for community colleges.

EdSource® is a not-for-profit 501(c)(3) organization established in California in 1977.

Independent and impartial, EdSource strives to advance the common good by developing and widely distributing trustworthy, useful information that clarifies complex K-12 education issues and promotes thoughtful decisions about California's public school system.

K–12 education gets a status quo budget

K–12 education has basically received a status quo budget this year, meaning that policymakers are providing enough funding for a cost-of-living adjustment (COLA), an adjustment based on changes in student attendance, and the maintenance of most programs. Funding per pupil is increasing modestly, mostly because of the COLA. The use of one-time funds for some ongoing programs is driving up the per-pupil amount even more, but policymakers will need to find other sources to sustain the funding for those programs beyond this year.

Ongoing Proposition 98 per-pupil spending is up from last year

Proposition 98, an amendment to the state constitution approved by voters in 1988, determines the annual minimum funding level for the K–12 and community college systems. Proposition 98 dollars are state funds raised primarily through income, sales, corporate, and capital gains taxes, combined with local property tax revenues. They represent about 75% of the funds that K–14 education receives. (The box on page 6 and Figure 3 on page 15 provide details on all sources of funding for the two systems.)

The minimum spending level under Proposition 98 is determined by one of three "tests" or formulas. Several factors influence which test is used to set the minimum guarantee, but the most important are the annual changes in statewide student attendance, per capita personal income, and per capita General Fund revenues. (The General Fund is the state's largest pot of money and is not dedicated to one specific program.)

When the 2007–08 budget was enacted, the state used Test 2 to determine the guarantee. Under Test 2, which is in effect in "normal" years, the guarantee is based on the prior year's K–14 spending level plus adjustments for annual changes in student attendance and per capita personal income. (See the box on page 3.)

In the 2007–08 budget, policymakers provided enough funding to meet the estimated Proposition 98 minimum established by Test 2—$50.8 billion. This amount was not quite enough to cover a cost-of-living adjustment (COLA) for existing programs and keep them all intact. To fully fund the COLA and avoid disruptions to K–12 programs, policymakers tapped into one-time monies to maintain funding levels in certain areas. In the end, the state provided a modest increase in spending per K–12 pupil. (Funding for community colleges is discussed beginning on page 14.)

The exact amount of the increase depends on what is counted as Proposition 98 spending this year. The LAO calculates that the 2006–07 budget provided $8,218 in Proposition 98 dollars per K–12 pupil and that the 2007–08 budget allocates $8,564, an increase of $346. If one-time and special fund monies (such as the Public Transportation Account) are included, however, the 2007–08 amount is $8,659 per pupil, which is a $441 annual increase.

However, two important points must be made about those figures. First, the figures may change, depending on how policymakers react to the LAO's November report. The LAO stated that new revenue projections dictate that the Proposition 98 guarantee in 2007–08 should be governed by Test 3, not Test 2. The guarantee would fall by $400 million or roughly $67 per pupil under Test 3. The LAO is suggesting that the Legislature consider decreasing K–14 spending to the Test 3 minimum because of budget difficulties.

Second, whether Test 2 or Test 3 determines the Proposition 98 guarantee, each year some of these funds are not spent directly on K–12 and community college students. For example, roughly $426 of the per-pupil spending figure will go toward adult education and child care this year.

Local education agencies receive a full cost-of-living adjustment

When providing Proposition 98 funding in this year's budget, policymakers made it a priority to fully fund a cost-of-living adjustment (COLA) for most K–12 programs. Understanding the two major forms of revenue that districts receive makes it easier to understand how the COLA is being distributed.

The general purpose operating money that a school district receives each year is based on a specific amount per pupil. This amount is the district's per-pupil base revenue limit. It is calculated using historical funding levels and a formula set by law. The per-pupil amount is intended to be relatively equal within each of six categories of districts—elementary, unified, and high school, each of which can be large or small. A district's total revenue limit allocation is the product of its per-pupil amount multiplied by its average daily attendance (ADA). The state places few restrictions on how districts can spend revenue limit funds. The portion varies annually, but statewide it usually represents about two-thirds of total district allocations.

The other third comes from categorical programs for which districts receive funds in varying amounts depending on student populations, district characteristics, and the programs districts operate. State law makes it a priority within Proposition 98 spending to provide a COLA for revenue limit funding but not for categoricals.

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EdSource thanks the **Bill & Melinda Gates Foundation**, *the* **William and Flora Hewlett Foundation**, *and the* **James Irvine Foundation** *for their investment in our core work.*

Proposition 98 sets a minimum funding guarantee for education

Proposition 98, passed by voters as an amendment to the California Constitution in 1988, guarantees a minimum level of funding for public schools and community colleges (K–14 education). Voters sought to guarantee a level of funding that would at least keep pace with growth in student population and the personal income of Californians and at best increase the amount schools receive. It was revised in 1990 by Proposition 111.

There are three possible tests used under Proposition 98 to determine the required minimum funding guarantee.

Understanding the Three Tests of Proposition 98

Test 1 Percentage of General Fund Revenues	Requirement:	K–14 education must receive a minimum percentage of General Fund revenues, which is currently about 41%.
	When is it operative?	When it would provide more money than Test 2 or Test 3. It has been used only once, in 1988–89. It may again be triggered in 2010–11, according to the Legislative Analyst's Office (LAO).
Test 2 Adjustment Based on Statewide Personal Income	Requirement:	K–14 education must receive at least the same amount of state aid and local tax dollars (collected locally but the distribution is determined by the state) as received in the prior year, adjusted for changes in average daily attendance (ADA) and growth in per capita personal income.
	When is it operative?	Generally, when General Fund revenues experience normal or strong growth over the prior year. (Specifically, it is used when the percentage growth in statewide per capita personal income is less than or equal to the percentage growth in per capita General Fund revenues plus 0.5%.)
Test 3 Adjustment Based on Available Revenues	Requirement:	K–14 education must receive at least the same amount of state aid and local tax dollars as received in the prior year, adjusted for changes in average daily attendance and per capita General Fund revenues, plus 0.5% of the prior year Proposition 98 spending amount.
	When is it operative?	Generally, when General Fund revenues fall or grow slowly over the prior year. The intent is for K–14 education to bear its fair share of budget changes necessitated by reduced revenue growth. (Specifically, it is used when the percentage growth in statewide per capita personal income is greater than the percentage growth in per capita General Fund revenues plus 0.5%.)
Suspension		Proposition 98 can be suspended for a year with a two-thirds vote of the Legislature and concurrence of the governor. If suspended, policymakers have great discretion as to the level of funding they provide.
Maintenance Factor		If Test 3 is used or if Proposition 98 is suspended, the amount saved (the difference between what Test 2 would provide and what is provided) must be restored over time to the minimum guarantee level, beginning in the next year in which the percentage growth in per capita General Fund revenues exceeds the percentage growth in per capita personal income.

However, policymakers provided a 4.53% COLA for both revenue limits and categoricals in 2007–08. Across all K–12 districts, the COLA is $2.1 billion. Of that amount, $1.5 billion goes toward revenue limit funding. K–12 districts do not receive a percentage increase on their base revenue limits but instead get a flat dollar amount per pupil. The per-pupil amount is determined by multiplying the COLA percentage (4.53%) by the previous year's average base revenue limit for each of the three types of districts (unified, elementary, and high school). According to estimates by School Services of California, unified districts are receiving about $252, elementary districts about $241, and high school districts about $290 per pupil for the revenue limit COLA.

The rest of the cost-of-living adjustment goes toward categorical programs across the state: $150.9 million for Special Education; $69.7 million for child care programs; $58.6 million for class size reduction; and a total of $303 million for other programs.

A decline in statewide average daily attendance has a negative effect on overall Proposition 98 spending

Just as a revenue limit COLA is a priority within Proposition 98, so too is an adjustment for changes in ADA. However, while the COLA represents an increase to state K–12 spending this year, the ADA adjustment is a decrease. This is a bit of an anomaly; since the passage of Proposition 98 until 2005, attendance generally grew each year, which is why the shorthand term for the ADA adjustment is "growth." In 2007–08, "growth" funding is a negative $42 million for revenue limits and a positive $32 million for categorical programs, resulting in an overall "growth" adjustment of negative $11 million. The impact on individual local education agencies varies depending on their local attendance trends and participation in categorical programs. As detailed in the box on page 4, a slight majority of districts have experienced recent declines in enrollment (and thus attendance), but many other districts have been growing.

Declining enrollment is an issue for more than half of the state's school districts

School districts in California have limited control over their enrollment. They can influence whether students will be attracted to good district schools or lost to other districts or private schools. However, these factors generally have a relatively small impact on total enrollment compared to larger demographic and residential patterns in the state. Changes in districts' enrollments have implications for their revenue level because enrollment affects average daily attendance (ADA), which is the basis for the bulk of school funding.

The state's K–12 enrollment began a modest decline in 2005 (less than 0.5% per year), with decreases in the elementary and middle grades outweighing growth in the high school grades, according to Department of Finance (DOF) figures. (Statewide ADA levels, which are the basis for Proposition 98 funding decisions, have followed the same pattern.) The overall enrollment decline is not expected to reverse until 2010, according to demographers in the DOF.

Although statewide enrollment is currently on a slightly downward trend, the experiences in local districts vary. According to School Services of California, 389 districts (39.8% of the total) experienced growth in ADA from 2005–06 to 2006–07 and 75 districts (7.6%) had no change. A total of 513 districts (52.5%) experienced decline. Among the districts that experienced increases, the average growth was 3.6% while declining districts had an average decrease of 4.0%.

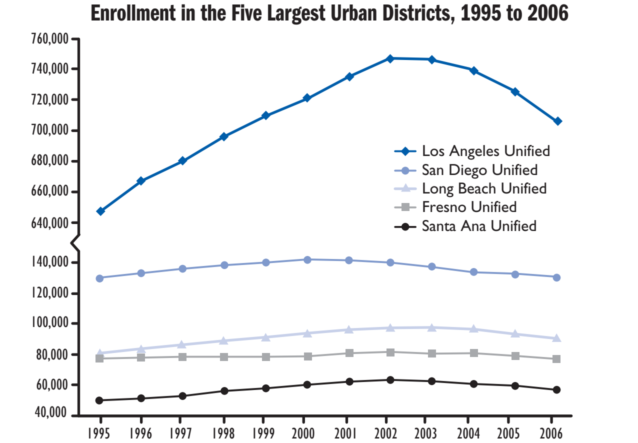
EdSource examined the largest 25 school districts in California (based on their 2005 enrollment) and changes in their enrollment figures from 1995 to 2006. Combined, these school districts represent more than 30% of California student enrollment. Eight experienced continuous or nearly continuous growth over that period. Six of those eight are considered suburban school districts by the National Center for Education Statistics (NCES). Nearly all districts considered urban by NCES have experienced enrollment losses in recent years, including several with dramatic declines. The charts below display enrollment changes for the five largest suburban and urban school districts, providing a glimpse of trends largely common to all 25 districts. (The enrollment figures for the 25 districts include students attending charter schools chartered by those districts.)

Under California's school funding system, declining enrollment puts specific fiscal stresses on school districts while increasing enrollment brings financial advantages. As school districts increase in enrollment, the state provides them with additional funds based on their per-pupil revenue limit. The state funds provided for each new student represent an average amount that would be needed to accommodate the new workload, even though the district may not incur the equivalent increase in costs for that student. For example, a few new students will generate more revenue but may not necessitate the hiring of more staff to serve them.

Conversely, when enrollment declines, school districts may lose more revenue limit funds than are saved on a per-pupil basis. Districts often must accommodate this loss by cutting costs beyond the classroom. A simplified hypothetical example illustrates the point. If a district lost 30 students at a per-pupil revenue limit of $5,000, it would face a loss in unrestricted revenue of $150,000. However, cutting one teacher from the district's payroll would only reduce costs by about $50,000 to $60,000 (assuming the least senior staff would be released first). The savings related to an aide could be $30,000. After making these reductions, the district would still have to find savings of at least $60,000 to mitigate the revenue loss. Reductions in other school or district operations—such as administration, student support services, or maintenance—would be required to keep the district's budget in balance. Because the scale of these operations does not adjust automatically with the loss of each student, incremental implementation of reductions in these areas can be a major challenge. It should also be noted that this example assumes that the 30 students would all be in one school and that categorical funding would not be reduced, neither of which would likely be the case.

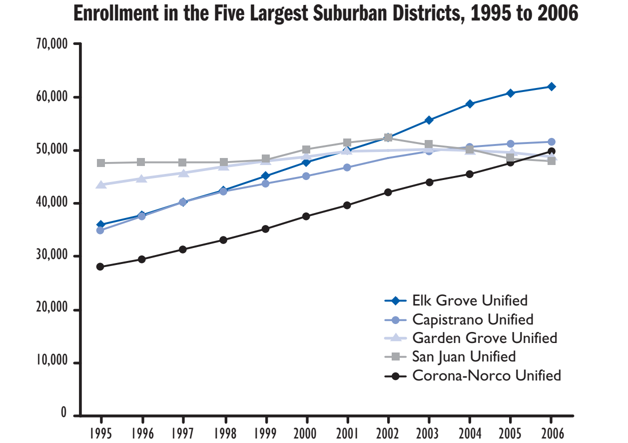
For districts experiencing declining enrollment, the state offers some financial relief by providing revenue limit funding based on the prior year's ADA, at an annual statewide cost of about $500 million. Legislative attempts in recent years to provide an even greater cushion have not been enacted.

Enrollment in the Five Largest Urban Districts, 1995 to 2006



Many of the large California school districts considered urban by the National Center for Education Statistics, including the five largest shown above, have experienced declining enrollment in recent years. Charter school enrollments are included in these totals.

Enrollment in the Five Largest Suburban Districts, 1995 to 2006



Many of the large California districts considered suburban by the National Center for Education Statistics, including three of the five largest shown above, have experienced enrollment increases over the past 10 years.

Ongoing obligations are partly funded with one-time monies

Although K–12 education will feel the fiscal effect of the slight decline in ADA in 2007–08, it will likely experience a larger problem and one of a different sort next year. Policymakers used one-time funds this year for programs that will continue beyond 2007–08, which means that they will need to discover other funding sources to sustain those programs. Given fiscal projections about next year, finding other sources will be difficult. State leaders met this year's Proposition 98 guarantee, but the guarantee did not grow to a level high enough to cover the 4.53% COLA and keep all K–12 programs whole. To keep most programs intact, policymakers used $566.5 million in one-time monies to help pay for some programs and free ongoing funds for various K–12 purposes.

First, state leaders shifted funds out of the School Facilities Emergency Repair Account. California created that account as part of settling the *Williams* lawsuit, which centered on the state's responsibility for providing at least a baseline of education services for all students. Since the facilities account was created in 2004, state budgets have allocated a total of $438 million to it. However, $300 million in the account has not been claimed by eligible schools. Therefore, policymakers felt somewhat safe in transferring $250 million from the repair account into the Reversion Account, which holds funds that were appropriated for Proposition 98 purposes in a prior year but not spent. (The budget specifies that funds will be transferred back to the repair account if needed.)

The state then took that $250 million from the Reversion Account, plus $99 million from the state's non-K–12 Public Transportation Account, and shifted those funds—a total of $349 million—to pay for part of the cost of Home-to-School Transportation. (The Public Transportation Account uses fuel tax revenues for planning and implementing mass transportation projects. Public transportation advocates have mounted a legal challenge to transfers from this account.)

California also shifted an additional $115.5 million from the Reversion Account to fund part of the cost of Deferred Maintenance. Finally, the state used $102 million that had been appropriated—but not spent—in two prior years for the High Priority Schools Grant Program to pay the bulk of the cost of that program this year. This multiyear intervention program directs resources to schools in the bottom 10% of the API rankings.

> **California is using one-time monies to help keep programs whole**
>
> Three programs will rely partly on one-time funds this year:
>
> - $349 million for Home-to-School Transportation. Funds come from the Public Transportation Account ($99 million) and the School Facilities Emergency Repair Account through the Reversion Account ($250 million).
> - $115.5 million for Deferred Maintenance. Funds come from the Reversion Account.
> - $102 million for the High Priority Schools Grant Program (HPSGP). Unspent funds from the program in two prior years are being "reappropriated" to the program this year.

More child care spending is now counted toward the minimum Proposition 98 spending level

State policymakers this year counted more child care spending toward the Proposition 98 guarantee than they have in the recent past. CalWORKs—the state's program for helping unemployed parents obtain financial assistance and employment training and placement—has a three-stage child care system. The stages are determined based on how long individuals have been receiving CalWORKs assistance, whether they have found stable child care, and their income. The California Department of Education (CDE) administers Stages II and III. The state has historically funded Stage II with a varying mix of Proposition 98 funds and federal monies, including funds from the federal Temporary Assistance to Needy Families program (TANF). This year, California increased the Proposition 98 portion by $269 million. This freed the same amount of TANF funds for other social service programs, and the General Fund monies that would normally be spent on those programs were, in turn, released for other purposes. The point of these shifts was to free General Fund monies for other needs.

Some have complained about counting more Stage II child care dollars toward the Proposition 98 minimum this year, asserting that such a move displaces spending on K–14 programs. However, others say that the balance of state/federal contributions toward Stage II child care has shifted back and forth over time and that child care funding helps pay for pre-school programs and after-school programs, which directly support the work of K–12 schools.

Pressure on districts is rising

Although districts can be thankful for a status quo allotment in this year's budget, they are being asked to meet higher expectations. For example, districts must generally spend a growing portion of their budgets on noninstructional costs, such as employee benefits, while state and federal expectations for academic performance are rising rapidly. These rising expectations may create a greater need for programs offering supplemental help, but funds for these support systems are not growing.

The rising cost of employee benefits adds pressure to districts' budgets

A 2005 survey conducted by the Association of School Business Officials International found that the rising cost of employee health insurance benefits is the biggest concern faced by many school business officials. The numbers in California support their concerns because the state's school districts

Revenues for K–12 education come from multiple sources

In addition to Proposition 98 revenues, local education agencies receive lottery funds, local miscellaneous revenues, and federal funding. (See the pie chart.) At the time the budget was enacted, lottery funding was projected to stay flat this year, and federal funding is continuing its recent downward trend.

Lottery funding for education in 2007–08 was projected to remain the same as last year, after several consecutive annual increases. Policymakers assumed the lottery would provide about $900 million to K–12 education, or $143 per pupil, in 2007–08.

Schools must use lottery funds for instructional purposes and not for expenses such as facilities or administration. A portion of districts' lottery revenues must be used specifically for instructional materials, as required by Proposition 20 (approved by voters in 2000). For 2007–08 the estimated per-pupil total will be distributed as $22 for instructional materials and $121 for any other instructional purpose.

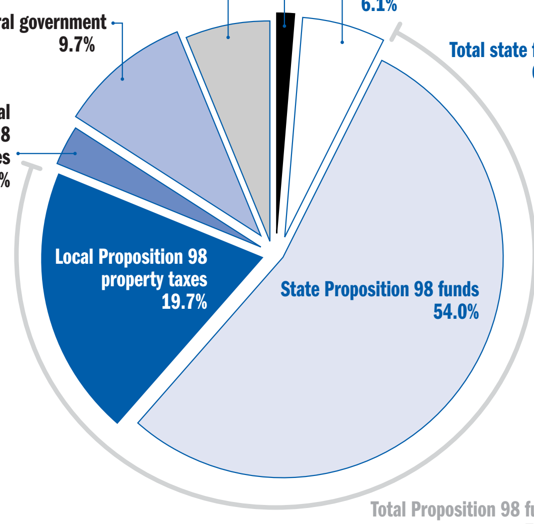
The amount of federal education funding provided to California has been on a downward trajectory, though the decrease in 2007–08 is not as large as it has been in the recent past. The Legislative Analyst's Office (LAO) reports that the reduction totals $419 million this year; however, much of that results from shifting $269 million in federal funds from CalWORKs Stage II child care to other non-K–12 programs, as described earlier in this report.

However, funding for Title I—the first and largest set of programs under the No Child Left Behind Act (NCLB)—has steadily increased until this year. Funding rose from $1.3 billion in 2001–02 (before a big increase to implement NCLB) to a peak of $2.1 billion in 2006–07. This year California's local education agencies will receive slightly less—$2.0 billion. Title I includes several programs, and the funding level for each is adjusted separately. Basic Grant funding to help educate children in poverty decreased by 3% statewide this year, though the impact varies by local education agency. Similarly, Even Start dollars—which promote a variety of literacy programs for low-income families and English learners—have decreased by 19% this year. However, Reading First is up by 7%. This Title I program supports scientifically based reading research and teaching coaches.

Changes in the level of funding that California is receiving this year from other federal programs also vary, as follows:

- Title II – funding for improving teaching quality and instructional technology is going down slightly this year.
- Title III – funding to support English language acquisition is increasing by 11%.
- Title IV – total funding is increasing by 12%. School safety programs remain roughly the same, but more money is going to after-school programs.
- Title V – although the innovative programs portion is funded at the same level as last year, the Comprehensive School Reform Program is discontinued.

(See the accompanying table of major state and federal categorical programs, which provides details on funding levels last year and this year, or go to: **www.edsource.org/pdf/schfin_catable07-08.pdf**)



Total estimated revenues for 2007–08 from all sources are about $68.9 billion, including:

State funds $41.4 billion (60.1%)
mostly from California sales and income taxes, including about $3.8 billion not counted toward the Proposition 98 guarantee. This also includes K–12 education's estimated share ($460.9 million) of a one-time $500 million payment to the California State Teachers' Retirement System due to a recent court order.

Local property taxes $15.6 billion (22.6%)
which are collected locally but their distribution is determined by the state. The total includes $2.0 billion not counted toward the Proposition 98 guarantee and $1.7 billion in local debt service.

Local miscellaneous revenues $4.3 billion (6.2%)
includes such sources as community and foundation contributions, interest income, developer fees, and revenues from local parcel tax elections.

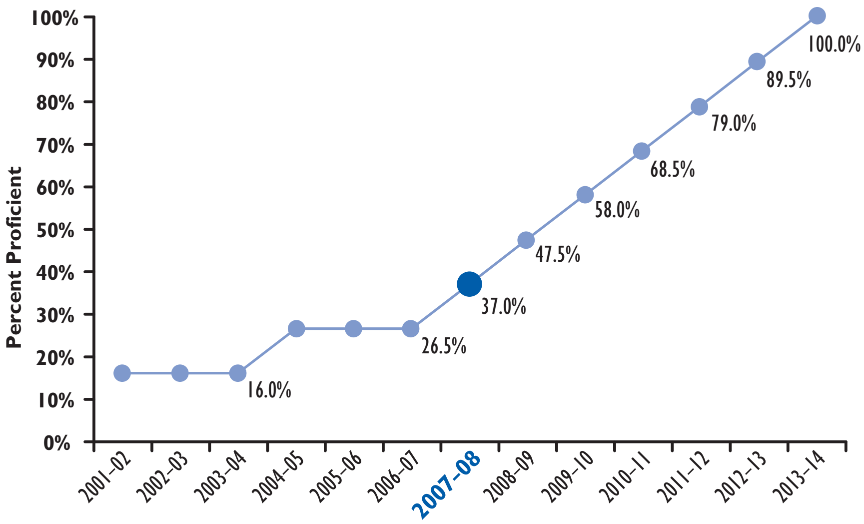
Federal government $6.7 billion (9.7%)
earmarked for special purposes, most notably Child Nutrition, No Child Left Behind (NCLB), and Special Education.

Lottery $0.9 billion (1.3%)
projected at about $121 per student (ADA*) in revenues for any instructional purpose plus $22 per ADA to be used only for instructional materials.

Projected California public school average daily attendance (ADA)*
5.932 million K–12 students (for Proposition 98 purposes) plus about 289,000 students in adult education and 129,000 in regional occupational programs.

*ADA or "average daily attendance" is the total number of days of student attendance divided by the total number of days in the regular school year. A student attending every day would equal one unit of ADA.

Data: California Department Of Education (CDE) And Legislative Analyst's Office (LAO); ADA Figures From California Department Of Finance (DOF) EdSource 12/07 *figure 1* **California's annual measurable objectives for elementary school mathematics under the No Child Left Behind Act begin a steady increase in 2007–08**



This chart shows the percentage of elementary students expected to score proficient or advanced each year on the California Standards Test in math. Middle and high schools have similar requirements. (High schools are assessed based on their students' performance on the California High School Exit Exam.) This year the annual measurable objectives begin a steady climb toward 100%. The objectives for English language arts follow a similar trajectory. These performance expectations apply to all schools, but those receiving Title I Basic Grants can face serious consequences for not meeting the targets.

Data: California Department of Education (CDE) EdSource 12/07

are spending a greater percentage of their operating expenses on health care. According to Ed-Data, in 1995–96 districts spent 17.0% of their operating funds on average for employee benefits, of which the largest share is health benefits. In 2005–06, the average district spent 19.7%.

Many districts cover these costs for retirees as well as current employees, an expense that at the extreme can have serious financial impacts. A 2006 research study by EdSource and School Services of California found that districts that have agreed to provide retiree benefits are more likely to be fiscally unhealthy. In particular, the study found, lifetime health benefits for retirees are correlated with poor district fiscal health.

Federal academic performance requirements increase this year

Under the federal No Child Left Behind Act (NCLB), all students in schools that receive Title I Basic Grant dollars are expected to be proficient in reading and math by 2013–14. Pressure to meet this requirement will increase dramatically this school year despite the 3% decline in Basic Grant funding that California will experience in 2007–08.

Each state sets its own definition of "proficient." In California, it means: (1) elementary and middle school students scoring "proficient" or "advanced" on California Standards Tests in English language arts and math; (2) for high schools, 10th graders scoring about 75% in English and 70% in math on the California High School Exit Exam, which is more than what is required to pass.

To meet NCLB's funding conditions, California has set annual academic performance benchmarks called annual measurable objectives (AMOs) for schools, districts, and the state. An AMO is a target percentage of students who demonstrate proficiency in English or math. AMOs are interim goals toward the ultimate target in 2013–14 when all "numerically significant subgroups" of students based on ethnicity, poverty, disabilities, and status as English learners are expected to achieve these goals.

The AMOs increase significantly in 2007–08, after three consecutive years without increases. From 2004–05 through 2006–07, objectives ranged based on school type from 22.3% to 24.4% for English language arts and from 20.9% to 26.5% for math. However, they will jump by about 10 percentage points this year and in each subsequent year until they reach 100% in 2013–14. (See Figure 1.)

The AMOs are just one factor that determines whether schools and districts have made "adequate yearly progress" (AYP). Schools must also test at least 95% of students in each subgroup, achieve a minimum Academic Performance Index (API) score or show growth in that score, and for high schools, achieve a specified graduation rate or improvement in that rate.

For the roughly 60% of schools and 95% of districts that receive Title I funding, repeatedly failing to make AYP results in escalating sanctions that can end in some type of restructuring. In 2006–07, 39% of Title I–funded schools did not meet all federal AYP criteria. With performance targets rising rapidly, the percentage of Title I schools facing sanctions is likely to increase significantly beginning this year.

A lawsuit settlement results in a greater district obligation to support students struggling to pass the exit exam

This year's state budget appropriates $72.8 million to help schools provide supplemental instruction for students who have not passed the California High School Exit Exam (CAHSEE). This program has been ongoing since 2005–06, but this year the state modified it in response to the settlement of *Valenzuela v. O'Connell,* a lawsuit challenging the legality of the CAHSEE. Assembly Bill (AB) 347, which resulted from the settlement, now entitles students who have not passed the CAHSEE by the end of 12th grade to receive this supplemental instruction for up to two extra years.

The program provides $520 per eligible 12th grade pupil. Students electing to receive supplemental instruction beyond 12th grade must be served with existing funds; no funding is provided specifically for these students unless they are engaged in a regular course of study as a fifth- or sixth-year senior. Only students in a regular course of study would count toward a district's average daily attendance (ADA) and trigger revenue limit funding. It is unknown whether these individuals will be eager to stay for an additional year or two as regular full-time students, however. It seems more likely that a student wishing to pass the CAHSEE after finishing 12th grade would take only the supplemental instruction.

In districts that offer supplemental instruction and participate in the Middle and High School Supplemental Counseling Program that California created last year, counselors must notify 12th grade students who have not passed the CAHSEE about the remedial instruction option. These districts must also identify students at risk of not graduating or passing the CAHSEE and provide them and their parents with a list of coursework and experience necessary for them to pass and transition to further education or employment. If eligible students are not offered the CAHSEE supplemental instruction, AB 347 allows them to make a formal complaint.

According to the CDE, about 7% (roughly 29,000) of the class of 2007 who were required to pass the CAHSEE had not passed the exam as of May 2007. These students—disproportionately English learners, Latinos, and African Americans—would be eligible for the supplemental instruction. Special Education students who did not pass were not included in the state's calculation of overall figures, perhaps because most Special Education students in the class of 2007 were not required to pass the exam.

Whether, and to what extent, the graduation requirement should apply to all Special Education students continues to be the subject of much wrangling between the courts and the Legislature. Some Special Education students in the classes of 2006 and 2007 did not have to pass the exam to receive a diploma due to special legislation, which resulted from the initial settlement of *Chapman v. California.* However, the State Board of Education (SBE) voted unanimously in May to support requiring Special Education students to pass the exam, starting with the class of 2008. They also voted to make changes to the testing accommodations application process (which the state calls a "waiver"). Special Education students who receive waivers may take the CAHSEE under special conditions, but they still must pass the test to receive a diploma. Special Education advocates are planning to challenge this policy in court.

In addition to challenging the CAHSEE in court, Special Education advocates have also sought alternative routes to demonstrating proficiency. A report recently released by the Human Resources Research Organization (HumRRO), the state's CAHSEE evaluator, recommends that California continue to explore such alternatives. The report also notes that in the first year students were required to pass the exit exam, California's high school graduation rate fell by about 4% and more students dropped out. However, the report cautions that these figures are of limited accuracy because California has not yet created a centralized data system.

Federal funding to expand district assistance teams has been postponed, awaiting the results of a pilot project

Local education agencies that receive Title I Basic Grants and repeatedly miss their AYP targets advance in NCLB's intervention program—Program Improvement—to a "corrective action" stage. At this stage, the state intervenes by taking at least one strong measure, such as reducing funds or replacing staff. The CDE has recently identified 98 school districts and one county office of education as entering the corrective action phase.

To help districts avoid such state interventions, CDE started a pilot program in which District Assistance and Intervention Teams (DAITs) from four county offices of education are helping districts at risk of entering corrective action. The DAITs are expected to assist with needs assessment and mentor the district leadership. They help districts prioritize key actions for improvement in seven areas:

- governance;
- alignment of curriculum and assessments to the state's academic content standards;
- fiscal operations;
- parent and community involvement;
- human resources;
- data systems; and
- professional development.

To supplement the state's efforts, the Bill & Melinda Gates Foundation donated $15.5 million in November 2006 to help the state expand from four to 15 teams. Each new team will serve one of the 11 regions that the California County Superintendents Educational Services Association (CCSESA) divides the state into.

CCSESA recently issued a request for proposals for evaluating the pilot program. The evaluation will run through December 2009, with quarterly reports issued beginning in December 2007.

During this year's budget process, the Legislature earmarked $7.1 million in federal funding for districts to contract with DAITs. However, the governor used a line-item veto to delete that funding. He stated that he could not support allowing local education agencies (LEAs) to use those funds for DAITs until the pilot program and evaluation show the teams are effective. He recognized that a growing number of districts are facing sanctions, and he set aside the funding for "implementation of an effective plan that supports LEAs and schools and their attempts to improve the academic performance of their students."

In the meantime, the state is supposed to provide technical assistance to the 99 LEAs identified for corrective action and take at least one of the following actions:

- defer programmatic funds or reduce administrative funds.
- institute new curriculum and professional development for staff.
- replace LEA staff.
- remove individual schools from the jurisdiction of the LEA and arrange for governance.
- appoint a trustee in place of the superintendent and school board.
- abolish or restructure the LEA.

In conjunction with one of the above, the CDE may authorize student transfers to a school that is not in Program Improvement in another LEA, with paid transportation.

figure 2 **California has supplemental hourly programs that are mandatory and voluntary**

Program Description and Targeted Students	Grade Span Served	Enrollment and Reimbursement Caps
Mandatory Programs		
Supplemental instruction for pupils *recommended for retention or retained*	2–9	Uncapped
Supplemental instruction for pupils not *demonstrating sufficient progress toward passing the California High School Exit Exam (CAHSEE)*	7–12	Uncapped
Voluntary Programs		
Supplemental instruction for pupils identified as *at risk of retention* or deficient in math, reading, or written expression based on Standardized Testing and Reporting (STAR) program scores	2–6	5% of grade span (7% if funds allow); maximum of 120 hours per student
Supplemental instruction in *core academic subjects* for all students (commonly called "summer school")	K–12	5% of grade span (10% if funds allow); maximum of 120 hours per student
Supplemental instruction for pupils who *failed one or both parts of CAHSEE.* (This is different from the program described on pages 7–8.)	10–12	Uncapped

Data: California Department of Education (CDE) EdSource 12/07

(See "To Learn More" on page 16 for the specific rules on LEA entry into and requirements of Program Improvement.)

As the state is starting to phase out the High Priority Schools Grant Program, it is beginning to implement the Quality Education Investment Act

The High Priority Schools Grant Program (HPSGP), designed to support schools in the bottom 10% of the API rankings, was funded at $239 million in 2005–06 and $249 million in 2006–07. This year, it is receiving $149 million, with $102 million of that reappropriated from the two prior Budget Acts. The funding is lower this year because many schools have exited the program and the state has stopped selecting new schools to participate.

As HPSGP ends, the state is scheduled to implement the Quality Education Investment Act (QEIA) program beginning this year. The QEIA grew out of a settlement of a lawsuit against the state regarding education funding in 2004–05 and 2005–06. Schools in the bottom 20% of the API rankings were eligible to apply in March 2007 for QEIA funding. In return for the funds, participating schools must meet annual benchmarks for ratios of pupils to teachers and counselors, teacher qualifications and experience, and API growth targets (improvement goals).

In July 2007, 1,260 of the 1,455 eligible schools applied for QEIA, and 488 were selected. Those selected will use 2007–08 to develop plans to meet the program's benchmarks over the next six years. The schools will receive two-thirds of "full funding" for this planning year, which means $333 for each K–3 pupil, $600 for each pupil in grades 4–8, and $667 for each 9th–12th grader. From 2008–09 through 2013–14, these schools will receive $500, $900, and $1,000 per student for their respective grade span.

The LAO's November report asks the state Legislature to consider delaying implementation of the QEIA or modifying the program to reduce its cost. Such changes could yield up to $450 million in savings in each year that it is delayed or modified, according to the LAO. The savings would accrue to the state's current General Fund and not affect Proposition 98 spending in the current or future fiscal years. This occurs because QEIA spending comes out of current General Fund revenues but, for accounting purposes, pertains to 2004–05 and 2005–06 Proposition 98 levels. (For more information on the QEIA, see "To Learn More" on page 16.)

Funding for hourly supplemental instruction may not provide reimbursement for both mandatory and voluntary programs

"Hourly supplemental instruction programs" offer instruction outside the regular school day for students who need extra help. Schools conduct these programs before or after school, on Saturdays, or during summer sessions. Districts receive reimbursement from the state based on an hourly rate, not on average daily attendance. The reimbursement rate in 2007–08 is $4.08 per pupil per hour. (See Figure 2 on the left for a description of the state's hourly programs and the students each one is meant to serve.)

For several years, schools have provided more hours of supplemental instruction than the state has reimbursed. School Services of California expects the gap for all the programs combined to be about $33 million for 2006–07, and a similarly sized difference is expected in 2007–08. The gap is calculated based on both mandatory and voluntary programs. Some observers disagree with that calculation and think that the state is obligated to fully fund only mandatory programs, as it likely has this year.

Of course, many school districts would like to see the state provide enough funding to reimburse them for all hours of service provided regardless of whether the hourly program is mandatory or voluntary. A new group of school districts—Coalition for Hourly Instructional Programs, led by the

Three pending lawsuits concern mandate reimbursement

On Nov. 20, 2007, the California School Boards Association Legal Alliance, along with four local education agencies (LEAs), filed suit to compel the state to pay LEAs for the costs incurred in meeting state mandates. The state had 30 days to respond to the suit, which was filed in Sacramento County.

In addition, some districts have asked the courts to intervene in the mandate reimbursement process, citing financial losses from rejections of repayment claims. In March 2007, the Sacramento Superior Court said the state must compensate local education agencies for the cost of complying with three reporting requirements and other new state regulations. The ruling, which is under appeal, would force the Legislature to undo Assembly Bill 138 (2005). Under this bill, the state can deny reimbursement claims for the School Accountability Report Card, for filing Mandate Reimbursement claims, and for certain Brown Act requirements (which pertain to open meetings of public agencies).

Finally, 11 districts, led by Clovis Unified, have charged that the audits for mandate reimbursement by the State Controller's Office (SCO) are "arbitrary and capricious." The plaintiffs allege that large school districts are more likely to be audited than small ones. School and community college districts are asking the SCO to provide $17.5 million in denied claims from 1997–98 to 2002–03. The case has been set for trial in February 2008.

superintendent of Long Beach Unified School District—will advocate for such funding and related policy changes. The group also plans to provide technical support and compile and distribute information about best practices.

"Reimbursable mandates"–the mandates are alive, but the reimbursements are not

Since the passage of Proposition 4 in 1979 (the Gann Limit), the California Constitution has required the state to repay certain mandated costs to local government agencies, including school districts. In this year's budget, the Legislature mandates that LEAs carry out 38 instructional, fiscal, and safety activities and programs for which they may be reimbursed by the state. However, policymakers appropriated only $38,000 for the entire state to reimburse districts for all costs incurred. This token sum meets the legal minimum but will not come close to matching the $160 million in reimbursement claims the State Controller's Office (SCO) anticipates this year. When claims filed exceed the appropriated funds, as will inevitably occur, the state controller is likely to simply defer repayments to a future time.

When the state postpones those repayments, it will be adding to a backlog of unpaid claims. Through 2005–06, reimbursements had been underfunded for several years, and the 2006–07 budget appropriated more than $900 million for paying LEAs back (with interest). However, there was still a deficiency of $275 million at the end of the 2006–07 fiscal year. This was partly because the state appropriated only $30 million for reimbursement of 2006–07 claims. With or without reimbursement, school districts must perform mandated activities.

Compounding the problem of deferred reimbursements is the amount of time it takes state officials to determine that a new policy is a reimbursable mandate. When a new law is enacted, local governments file "test claims" with the Commission on State Mandates (COSM) to establish that the law creates a mandate. After several analyses, written arguments, and counter-arguments between the COSM and local agencies, it can take five years for the commission to make a final determination on a test claim—and possibly additional years if the decision is challenged in court.

Dissatisfaction with the reimbursement process led to a modest reform in 2007. (See the box on this page about related lawsuits.) Assembly Bill 1222, enacted this fall, established two new options for local government entities to negotiate with the Department of Finance (DOF) on funding amounts. The COSM would first determine whether a new law is a reimbursable mandate and, if so, the claimant and DOF would then negotiate the terms and conditions for filing claims related to the mandate. Alternately, the Legislature would first determine whether a new law is a reimbursable mandate based on negotiations between the claimant and DOF. The intent of the bill is to reduce the time between enactment of a new law and the availability of funding to reimburse local agencies for complying with it. The LAO estimates the duration of claims would be reduced from five years to one year.

The state sends mixed messages about tracking students' progress

California policymakers have indicated that assessing and improving student achievement remains a high priority, but their actions, albeit constrained by limited resources, did not reflect a strong commitment to the issue. Although state leaders decided to continue to require testing of second graders, they opted not to provide substantial funding to help local agencies better track the progress of all students. Looking forward, if an improved statewide data system is eventually implemented, districts will then be held responsible for dropouts and the progress of students in alternative education.

California reaffirms STAR testing for second graders

Testing California's second graders in reading, mathematics, written expression, and spelling has been part of the Standardized Testing and Reporting (STAR) program since it was first administered in 1998.

However, some argue that second-grade testing should be eliminated because it is not required under NCLB, does not yield reliable information, and is upsetting for some of these young students. These advocates say that eliminating such testing could save schools and the state money. Those on the other side of the debate assert that test results are reliable. They favor tracking young children's academic progress to monitor schools' performance and help determine if intervention is needed early in a child's development.

In 2004 the Legislature scheduled the Grade 2 STAR program to end on July 1, 2007, at which time legislators could revisit the policy of testing second graders. Gov. Arnold Schwarzenegger agreed to that legislative "sunset" but expressed concerns about it. During the next three years, the CDE and State Board of Education voiced their support for second-grade testing. In August 2007, the governor signed Senate Bill 80, which reinstated second-grade STAR testing through July 1, 2011.

Additional funding for local implementation of CALPADS did not materialize

For the last few years, California has been developing a data system that will allow individual student testing data to be tracked over time. This project is called the California Pupil Assessment Data System or CALPADS. The legislation that authorized CALPADS—Senate Bill 1453 (2001)—stated that the goal of the system is to enable the state "to assess the long-term value of its educational investments and programs and provide a research basis for improving pupil performance."

Implementation of CALPADS requires some centralized, state-level software and data-warehousing capability and the use of unique student identifiers (akin to Social Security numbers) that have already been created. At the time this report was being prepared, this state-level work was moving forward. Assuming that the DOF approves the CDE's recent project plan changes, a contract with IBM to do this work should begin in January 2008.

However, any statewide system relies on regular data collection and correction at the local level, which requires staff training and time and, therefore, money. California appropriated $9.5 million in one-time funds last year to help school districts get the human and technical resources they need to fully participate in CALPADS. This year the governor proposed in his May Revision that the state spend an additional $65 million in one-time funds for similar purposes. The Fiscal Crisis and Management Assistance Team (FCMAT) would have allocated the funds over two years to school districts based on FCMAT's assessment of each district's training and other pre-implementation needs. However, the May Revision contained an error. When the final budget was crafted, policymakers decided that the demands of existing programs did not allow for expanded funding for local data system implementation.

Future changes to the API are tied to the assessment data system

The governor did, however, sign Senate Bill 219, which makes changes to the Academic Performance Index (API) that will take effect only if local education agencies receive a per-pupil allocation before 2010–11 to implement CALPADS. The two changes to the API would take effect on July 1, 2011. If the data system funding is provided, the bill requires the API to include school and district dropout rates for students who drop out during eighth or ninth grade. It also requires the test scores of students referred to alternative education programs, such as continuation high schools, to be included in their home school's—as well as the alternative school's—API. (The "home school" is the "regular" school in whose attendance boundary the student lives.) Supporters say the changes will offset the incentive that "regular" schools have to either transfer students who are not performing well on state tests to alternative programs or not work hard to keep them from dropping out.

Advocates envision what California's education data system could be

Advocates for an improved data system for California students argue that current data system improvement efforts do not go far enough. Those efforts are primarily the development of CALPADS and CALTIDES (California Longitudinal Teacher Education Data System). CALTIDES will integrate existing databases so the state can track data on educators over time to meet federal NCLB and state reporting requirements and facilitate high-quality program evaluations. CALPADS is described on this page.

Those two data systems, they say, will provide important data about graduation rates, student achievement, teacher qualifications, and credentialing programs. But without linkages to other data, they will fail to reach the full potential of a robust data system. These advocates envision a system that will allow the state to determine which schools or programs are effective at preparing students for college or employment and do cost-benefit analyses for preschool, after-school, and other programs.

The Data Quality Campaign, a national organization that advocates for better data systems, says there are six important questions state data systems should allow states to answer. California currently can answer only two of them. California can identify which schools produce the strongest academic growth and calculate each school's graduation rate (though some question whether the graduation data are accurate).

Arkansas, Delaware, Florida, and Utah can answer those two questions plus the remaining four, which include identifying: (1) what achievement levels in middle school indicate that a student is on track to succeed in rigorous courses in high school; (2) what high school performance indicators are the best predictors of students' success in college or the workplace; (3) what percentage of high school graduates who go on to college take remedial courses, and (4) which teacher preparation programs produce the graduates whose students have the strongest academic growth.

If California develops a robust data system, advocates say, the state will be able to make the policy decisions that allow it to effectively address the needs of all children.

Parts of the budget focus on reducing expenditures and increasing revenues

State policymakers made a few additional decisions of interest to local school districts, based largely on the need to reduce expenditures and increase revenues wherever possible.

Legislators did not allocate any funding for additional equalization aid

Each district's revenue limit funding level is partly determined by its size (large or small) and its type (elementary, unified, or high school). Within each of those district categories, the state generally strives to keep revenue limit funding among districts relatively similar. These efforts have been in response to court decisions and lobbying by districts with below-average revenue limits. Funds provided to bring about greater equity among districts is known as equalization aid. Sporadically since the mid-1980s, California has provided equalization aid, and it achieved a very high level of equity in the mid-1990s. However, in 1998–99, changes in attendance accounting disadvantaged some districts.

When the state stopped allowing districts to count excused absences toward average daily attendance, it provided financial offsets to try to minimize the effect of the policy change. However, the size of the financial offsets varied among districts and decreased the equality in revenue limit funding that the state had achieved. This triggered another state effort toward equalization.

The state provided $110 million in ongoing equalization aid in 2004–05 and $350 million in 2006–07. However, this year's budget provides no additional funding for that purpose. Lawmakers instead included "legislative intent" language that gives priority to equalization during 2008–09, after adjustments for cost-of-living and attendance "growth" funding are provided. ("Growth" funding will be negative in 2008–09 if state demographers are correct in their projection of another statewide decline in enrollment.) School Services of California states that slightly more than $130 million in ongoing money is needed to fully fund equalization in the future.

The state is paying a debt to CalSTRS

The California State Teachers' Retirement System (CalSTRS) manages retirement, disability, and survivor benefits for California's current and former public school teachers and their families. It is the second largest public pension fund in the nation and is funded through three sources: employer, employee, and the state. When the state was facing a $34 billion budget shortfall in 2003, Gov. Gray Davis and the Legislature agreed to withhold a $500 million payment to the system. CalSTRS sued. In August 2007, the Third District Court of Appeals ordered the state to repay the $500 million, with $200 million in interest. The state has paid the $500 million this budget year. Of this amount, $460.9 million is counted as K–12 spending on education. The remainder is considered community colleges' share. (The payment does not count toward the Proposition 98 guarantee.) The Legislature has yet to act on repaying the interest.

The teacher tax credit is completely eliminated

One casualty of this year's budget was the Teacher Retention Tax Credit. Legislators provided this credit as an incentive to keep experienced K–12 teachers in the classroom and to compensate teachers for classroom expenses that might not be reimbursed otherwise. To qualify for the credit, a person had to have a preliminary or professional teaching credential and have completed at least four years of service as a fully credentialed teacher at a public or private school.

The state first adopted the tax credit in 2000, but it has been suspended four times during its short history. More than 200,000 teachers claimed the credit each year it was in effect, which cost the state more than $150 million in tax revenues each year. In eliminating the tax credit, the state is assuming it will increase its revenues by $165 million this year and in the future.

Charters receive bigger categorical block grants and more facilities funding

California's charter school segment continues to grow, and the state will have more than 600 charters serving about 220,000 students in 2007–08. These schools, which operate under a performance agreement with a school district, county office of education, or the State Board of Education are more independent of state regulations than noncharter public schools. Accordingly, the state has set up a funding system for charters that is somewhat independent of—yet derived from—how districts are funded. Charters receive a general purpose block grant that is similar to districts' revenue limit funding in purpose and amount. In addition, charters get categorical program dollars in two ways: through a discretionary block grant composed of a few dozen small programs and by applying directly or through their chartering agency for funds for programs not in the block grant, just as school districts do. Finally, charters can access state bond funds for facilities construction or, if they are serving a low-income area, can get rent or lease assistance through a separate program for charters.

California's charter school funding model is derived from the school district funding system

Charters receive per-pupil general purpose block grants that are similar to revenue limit funding. Four grant amounts are available, depending on the grade levels within a school. The grant amounts are based on the average of what the state pays in revenue limit funding. School Services of California estimates that the per-pupil amounts in 2007–08 will be:

- $5,589 for kindergarten–grade 3;
- $5,673 for grades 4–6;
- $5,835 for grades 7–8; and
- $6,765 for grades 9–12.

Although it may be tempting to compare the Proposition 98 per-pupil amounts described on page 2 to the charter general purpose block grant amounts detailed above, there are two problems with doing so. First, the two sets of figures are not completely separate in that the Proposition 98 per-pupil amounts on page 2 include funds allocated to charters. More importantly, the charter block grants reflect only general purpose funds while the Proposition 98 per-pupil amounts represent funds for categorical programs and services outside of K–12 instruction, in addition to general purpose funding.

The state also gives each charter school a categorical block grant in place of numerous categorical programs for which districts receive funding. In an effort to ensure that charters' categorical funding keeps pace with noncharter funding, the state has scheduled the block grant rate to rise in recent years. The grant has increased from $400 per pupil last year to $500 in 2007–08. The state also formed a work group to determine an appropriate grant amount, and the LAO will likely discuss the issue in its March 2008 analysis of the governor's 2008–09 budget.

Charters cannot apply separately for categorical programs included in the block grant, but they can apply (either themselves or through their chartering agency) for other categorical funds. These include some very large programs, such as K–3 Class Size Reduction, as well as small funding sources, such as grants for student councils. Like noncharters, charter schools also receive Special Education funding and must use a portion of their general purpose funds to cover the cost of educating any Special Education students that they serve.

Charter schools also receive extra general purpose money for each student who is identified as low-income or an English learner. This is in lieu of the Economic Impact Aid (EIA) that school districts receive. Charters are getting about $317 per eligible pupil in 2007–08, and students who are both low-income and English learners are double-funded. Some charter schools also receive federal Title I funds to provide extra support to these students. In addition, they receive the same per-pupil amount that districts get from the state lottery.

Child nutrition continues to weigh on the minds of policymakers

In recent years, California's elected officials have created policies on the nutritional content of foods served in schools, possibly because of reports on the increase of child obesity. Public health advocates released studies showing that 28% of California schoolchildren were overweight in 2004, up from 22% in 2001. This year, in Senate Bill (SB) 80, policymakers required schools to eliminate fried foods and trans fats from school meals as a condition of receiving increased state meal reimbursement funding. School districts will receive $0.22 per meal, up from $0.16 last year.

Between 2001 and 2005, lawmakers passed four major bills related to child nutrition. Two were enacted in 2005 and took effect this past July—SB 965 and SB 12. SB 965 extended beverage nutrition standards to high schools. It requires half of the drinks sold in high schools to be water, milk, soy milk, fruit or vegetable drinks with no sweeteners, or sports drinks with limited sweeteners. Starting in July 2009, all drinks must meet those standards. Legislation enacted in 2003 had set similar standards for elementary and middle schools. SB 12 set nutrition standards for food sold outside of the school meal program, requiring fewer calories and less fat and sugar in snacks and entrees.

Critics of this type of legislation say it does not put adequate attention on students' getting sufficient exercise and hurts school districts financially. (Districts can earn revenues from food vendors who sell certain foods and beverages at school sites.) A national study found that beverage contracts generate an average of $18 per student per year.

In 2001 the state created a pilot program in which schools followed the new nutrition standards. UC-Berkeley's Center for Weight and Health evaluated the pilot program to determine, among other things, the financial effect of nutrition standards on schools. They found schools' food services departments benefited because more students purchased school meals instead of outside food. But they also found that revenues from vending machines and student stores decreased at most schools. One exception was a school that worked with a vendor to develop and sell compliant products.

However, recently food manufacturers have created many compliant products to meet California's new standards. So the fiscal impact of the new standards on outside food sales may be negligible.

The facilities program for charter schools serving disadvantaged students is doubled

Under Senate Bill (SB) 740, enacted in 2001, charter schools located in areas where 70% of pupils qualify for free/reduced-priced meals can be reimbursed for facility rental costs. The bill allows reimbursements up to $750 per pupil but no more than 75% of their total facilities rental and leasing costs. For each of the last two years, the state appropriated $9 million for this program. Legislation enacted this year (SB 20) appropriates $18 million in one-time monies for the program. The funds are coming from the Proposition 98 Reversion Account.

The bill also modifies the process used by the State Board of Education (SBE) to authorize "statewide-benefit" charters, which operate at multiple sites throughout the state. Specifically, this measure:

- requires the petitioner for a statewide charter to submit a copy of the petition to the county superintendent in each county where the charter proposes to operate.
- requires the petitioner to inform the governing board of any district where a charter school is to be located at least 120 days before instruction begins.
- prohibits the SBE from approving a statewide charter unless it makes a finding based on substantial evidence that the proposed charter will provide a statewide benefit. The term "statewide benefit" has not been well defined, but the SBE has a policy regarding the handful of statewide benefit charters it has approved. The policy spells out academic performance requirements, constrains the growth of each charter school, calls for some of each school's sites to be located in areas with schools in Program Improvement, and has other requirements.

Policymakers require a study of charter oversight costs

Under current law, charter-granting agencies are allowed to charge a charter school for the actual costs of oversight—up to 1% of its general purpose entitlement and categorical block grant or up to 3% if the charter school is able to obtain substantially rent-free facilities from the chartering agency.

In 2002 the Bureau of State Audits found little consistency in how various charter-granting agencies oversaw charters. Two years later, the LAO criticized the fee system for not linking oversight fees appropriately with underlying costs. For example, just because a charter school does not get a facility rent-free from the district does not mean that the charter is less expensive to monitor. In addition, other factors may affect oversight costs more than facility arrangements.

In an attempt to address complaints by school districts and county offices of education that they were not being adequately compensated for the cost of overseeing their local charter schools, the state enacted legislation to study the issue. SB 537 requires the California Research Bureau to report to the Legislature by January 2009 about the key elements and actual costs of charter oversight as well as best practices and recommendations for improvement.

Community colleges also get a status quo budget in 2007–08

Each year, the California Community Colleges (CCCs) serve about 1.7 million students on their 110 campuses throughout the state. These students range from high school pupils to the elderly. They have varied backgrounds, skill levels, and goals. The community colleges provide basic skills courses, including elementary math and English. They also offer "enhanced noncredit" classes to help students advance in their career or prepare for college. Finally, they provide credit courses for students pursuing an associate's degree or preparing to transfer to a four-year college or university.

Similar to the state's K–12 schools, the colleges are receiving a funding level in 2007–08 that allows them to maintain most programs and keep pace with inflation. And, like K–12 schools, the budget does not provide enough—only $4 million—to cover the cost of state mandates.

As stated on page 2, the colleges receive the bulk of their funding from a combination of state funds (about $4.2 billion this year) and local property taxes (about $2.1 billion). Virtually all of those dollars count toward the Proposition 98 guarantee. In 2007–08 the colleges are receiving a greater portion of Proposition 98 dollars than they have in recent years. When Proposition 98 was enacted, the CCCs were slated to get 10.93% of the K–14 education budget annually. However, that requirement has been suspended frequently, and the percentage has been as low as 9.2%, according to the LAO. In 2007–08 the colleges will receive 10.8%. That compares with 10.7% and 10.4% the previous two years, according to the LAO.

Funding for the community colleges comes from sources other than state funds and local property taxes, such as miscellaneous local sources, student fees, federal funds, and lottery funds. When all sources of revenue are included, the colleges are receiving about $8.6 billion this year. (See Figure 3 on page 15.)

The colleges' funding will serve a variety of purposes, including the continuation of special initiatives designed to advance nursing and career technical education. The budget also sets aside money to provide additional support for high school students who are transitioning to community college but not prepared for college-level work. The goal is to support these students in obtaining a degree or skill certificate or transferring to a four-year institution. The community college budget allocates the rest of the funding increase for various other purposes, such as:

- $263.3 million increase for a 4.53% COLA.
- $107.5 million increase to fund enrollment growth of roughly 23,000 full-time equivalent students (FTES).
- $5.2 million increase to reduce attrition and increase the graduation rate in Associate Degree Nursing programs.
- $31.5 million to backfill cuts in student fees from $26 per unit to $20 per unit. The cuts began in spring 2007.

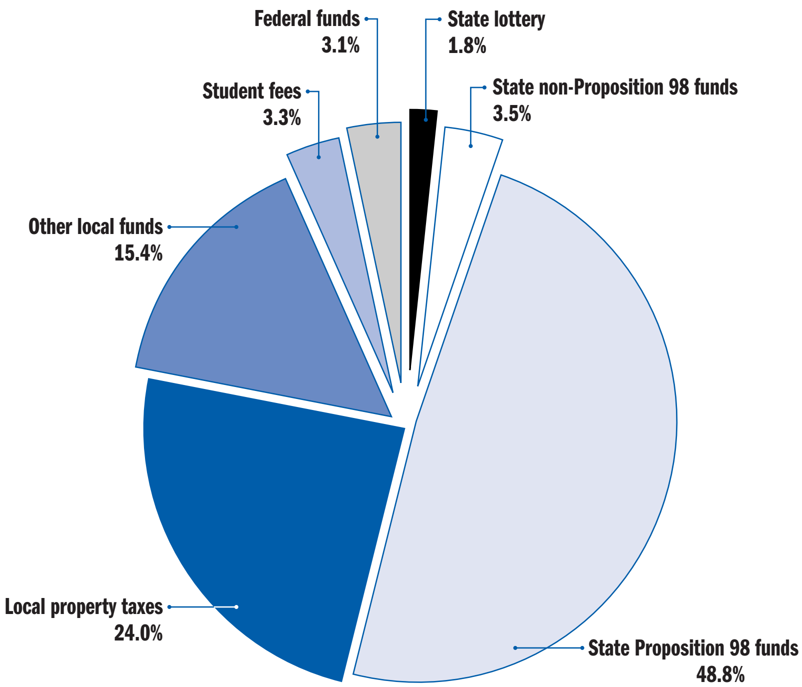
The community colleges' budget also continues to provide $20 million in ongoing funds and $32 million as part of a lawsuit settlement for career technical education. (Described on page 9, it is the same lawsuit that resulted in the QEIA.) In addition, $33.1 million in base funding is being redirected to support better student outcomes (degree/certificate attainment or transfer to a four-year institution as discussed above).

The budget also includes $21.2 million in one-time funds from the Proposition 98 Reversion Account for numerous programs, such as deferred maintenance, instructional materials, nursing programs, and the Cal-PASS program (California Partnership for Achieving Student Success), which collects, analyzes, and shares elementary school through university student data.

Looking ahead: Things could get worse before they get better

When policymakers crafted the 2007–08 state budget, they provided K–14 education with the funding required by Proposition 98 and added some one-time funds to keep most programs whole. The education budget fully funds cost-of-living adjustments to general purpose and categorical programs, but the state could not afford to fully fund all the programs that education agencies would like to use to meet rising expectations. In addition, the state budget as a whole relies on some questionable assumptions and funding shifts.

For example, state leaders used one-time monies to cover some long-term education programs, creating a "hole" in future budgets. In addition, they balanced the budget with the assumption that the state will take in $1 billion from the sale or lease of EdFund, which administers the California Student Aid Commission's activities related to federal student loan programs. However, no organizations have expressed interest in EdFund, and its value has subsequently been estimated to be closer to $500 million. Furthermore, the budget uses $1.3 billion from the Public Transportation Account to backfill reductions in General *figure 3* **California's community colleges receive funding from multiple sources**



Total estimated revenues for community colleges in 2007–08 from all sources is $8.6 billion, including:

State funds $4.5 billion (52.4%) includes $4.2 billion from Proposition 98 sources and $15.6 million in other state funds.

Local property taxes $2.1 billion (24.0%)

Other local funds $1.3 billion (15.5%) includes $337 million in local debt service.

Student fees $284 million (3.3%) based on fees of $20 per unit.

Federal funds $266 million (3.1%)

California State Lottery $155 million (1.8%) about $121 per full-time-equivalent student (FTES) in revenues for any instructional purpose plus $22 per student to be used only for instructional materials.

Data: California Department of Education (CDE) EdSource 12/07

Fund support for various transportation-related programs, and public transportation advocates have begun a legal challenge to that plan. In addition, the state has had to use $500 million of this year's budget reserve to pay back the State Teachers' Retirement System (CalSTRS) for withholding a payment to CalSTRS in 2003 for its program to protect retirees' benefit payments from inflation. Finally and most importantly, revenues for the first few months of the fiscal year have failed to match forecasts. Already the Legislative Analyst's Office is projecting an $8 billion operating shortfall in 2008–09.

Education stakeholders call for long-term policy reforms

Despite the pessimism about the state's financial situation in the short term, a growing number of education stakeholders are hoping that policymakers will nevertheless take up major, longer-range issues related to school finance and governance in 2008. To that end, more than 300 education leaders, researchers, and policymakers gathered in Sacramento in October, at a convening hosted by EdSource, to present diverse policy recommendations related to three goals:

- Building a robust, comprehensive data system to inform continuous improvement of the education system at both the local and state levels;
- Investing more wisely in the skilled educators who run California's schools by re-examining their preparation and credentialing, working conditions, compensation structures, and capacity building; and
- Changing the finance and governance systems to better support student success.

Organizations and individuals throughout the state submitted policy briefs intended to present their perspectives on these issues at the convening. EdSource compiled these briefs for distribution to the Legislature and other government officials. These briefs are also available online. (See "To Learn More" on page 16 for more information.)

Education organizations representing teachers, administrators, school board members, and parents all went on record regarding the importance of improving the state's education data system. The most sweeping recommendations envision a system that meets data needs ranging from instructional improvement by classroom teachers to program evaluation by both local and state leaders, and from public accountability reporting by schools to statewide efficiency studies by university researchers. Children Now and EdTrust West, in particular, spelled out a multipronged strategy in this regard. A second theme related to data was the call for investments in local districts' capacity to report accurately, access, and use data to both inform and evaluate their practice.

Stakeholders had several recommendations regarding personnel and leadership as well. Many briefs called for more and better professional development, such as expanding the Beginning Teacher Support and Assessment (BTSA) program. Others focused on school district administrators and school principals. A number of authors addressed teacher compensation, with some stressing the need for incentives for teachers to work

To Learn More

For the specific rules on entering Program Improvement (PI) and corrective action, see pages 47–50 of the California Department of Education's *2007 Adequate Yearly Progress Information Guide,* which can be found at: **www.cde.ca.gov/ta/ac/ay/index.asp**. For the requirements of local education agencies in PI and corrective action, see pages 72–74 of the *2006 Information Guide,* which can be found on the same page.

For details about the history and program requirements of the Quality Education Investment Act (QEIA), see EdSource's two-page brief on the topic at: **www.edsource.org/pub_brief_qeia207.cfm**. For EdSource's list of state and federal categorical programs, go to: **www.edsource.org/pdf/schfin_catable07-08.pdf**

Briefs for the EdSource policy convening are on the California School Finance website: **www.californiaschoolfinance.org**

To see the analysis of the budget by the Legislative Analyst's Office (LAO), go to: **www.lao.ca.gov**

To view the 2007–08 state budget, go to the California Department of Finance (DOF) website: **www.dof.ca.gov**

in hard-to-staff schools, and some calling for larger compensation reform (though there was great variety in how the concept was framed). A few groups also recommended restructuring the state's approach to teaching credentials. Finally, some organizations focused on working conditions, such as the state of facilities, availability of instructional materials, and staffing levels.

More than half the briefs tackled some aspect of California's complex finance and governance system. Four general issues surfaced:

- How to allocate resources fairly (according to need) to districts, schools, and ultimately to students.
- How to allocate funds efficiently so they produce the highest level of student achievement possible.
- How to make the funding system simple and clear enough so those allocation decisions are transparent and it is possible to measure and report how fair and efficient they are.
- How to determine how much is needed to support the desired level of student achievement.

Several authors called for more local flexibility as well as more funding, though none made a specific recommendation for where California would get the funds for a sizable new investment in K–12 education.

By 2010–11, Proposition 98 mechanisms could increase education's guarantee substantially

Some are hoping that the provisions of Proposition 98 will result in higher per-pupil funds for K–12 schools and community colleges in the near future, thus creating additional resources with which to implement reform ideas. The LAO indicated in November 2007 that the K–14 minimum spending level may be determined by Test 1 of Proposition 98 beginning in 2010–11. If that happens, the minimum funding level would be based on a percentage of the state's General Fund. This would be a significant departure from Test 2 and Test 3, which set a minimum funding level by adjusting prior-year expenditures for changes in student attendance and economic growth.

If Test 1 is triggered, it will be the first time since the initiative's initial year of implementation. It would happen partly because the General Fund revenues have grown significantly and partly because declining student enrollment is not pushing the Test 2 Proposition 98 guarantee upward. Test 1 will only go into effect if it produces a higher total amount than Test 2 or Test 3 would. And if it is triggered, many think it would provide a significant amount of additional money per pupil for education.

According to the LAO, basing education spending on Test 1 beginning in 2010–11 could mean that K–14 education would receive a cumulative total of $7 billion in ongoing funding above baseline expenses (COLA, attendance growth, mandate reimbursement, and natural growth in existing programs) by 2013.

So although 2008–09 is likely to be a tough year for the K–14 education community, it may be an ideal year to plan reforms that could be implemented when funds for education are plentiful in the future.