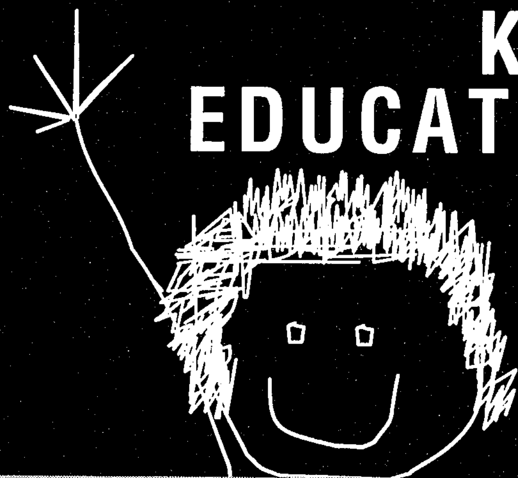
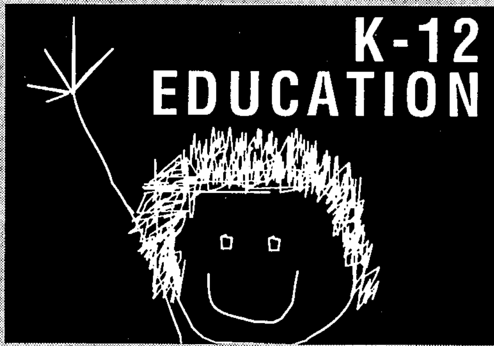
K-12 EDUCATION





MAJOR ISSUES

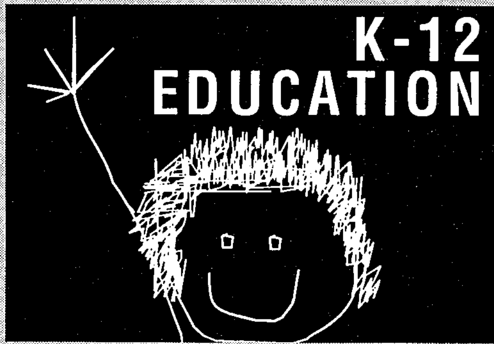
▌*Proposition 98: Budget Maintains K-12 Per-Pupil Funding.* The budget funds Proposition 98 at a Test 3 level of $23.5 billion ($13.1 billion General Fund). Significant Proposition 98 proposals include (1) a shift of $2.6 billion in local property tax revenues to school and community college districts from other local government entities, (2) a $540 million loan in excess of the guarantee to maintain K-12 per-pupil spending at the 1992-93 level, (3) a $266 million unallocated reduction in community college spending, and (4) deferral of a $121 million community college loan repayment. (See page 17.)

▌*New $540 Million Loan Proposed for K-12 Schools.* The budget proposes to borrow $540 million from future Proposition 98 funding to provide the same level of overall (general-purpose plus categorical) per-pupil funding as provided in 1992-93. We recommend that the Legislature take action to minimize budget-year borrowing, in order to increase the state's ability to fund K-12 program needs in 1994-95 and to increase the probability that sufficient discretionary funds will be available so that the state can provide cost-of-living adjustments and program augmentations beginning in 1995-96. (See page 24.)

▌*Budget Reduces Per-Pupil General-Purpose Spending.* Proposed 1993-94 funding for school district general purposes is $260 million less than necessary to fund per-pupil spending at the level supported by the 1992 Budget Act and related legislation. We recommend that the Legislature reallocate funds among

Proposition 98 programs in order to increase per-pupil general-purpose funding to the level currently funded for 1992-93. (See page 21.)

Categorical Program Reform: Budget Proposal Falls Short. The budget proposes to fund most categorical programs under a single block grant. Our analysis indicates that this approach does not meet the principles of sound categorical program reform. We make an alternative proposal to consolidate 19 existing categorical programs into three new programs—a School Improvement Block Grant, a School Incentives Award Program, and a High School Dropout Prevention Block Grant. (See pages 42 and 44.)



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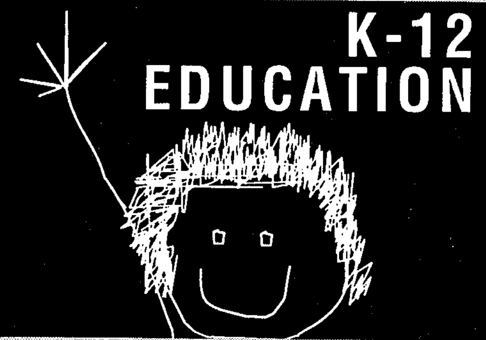


OVERVIEW

The K-12 education budget reflects a substantial General Fund reduction of $2.6 billion due to a proposal to shift $2.2 billion in local property tax revenues to schools from other local government entities.

The budget proposes expenditures of $28.3 billion from all sources for K-12 education in 1993-94, including $13.7 billion from the General Fund. This is $70 million, or 0.2 percent, less than estimated expenditures from all sources in the current year. This reduction is the net result of a $2.6 billion General Fund reduction (16 percent), a $2.2 billion increase in the local property tax revenues that would result from a proposed shift of property tax revenues to schools from other local government entities, and a $233 million increase in other local revenues.

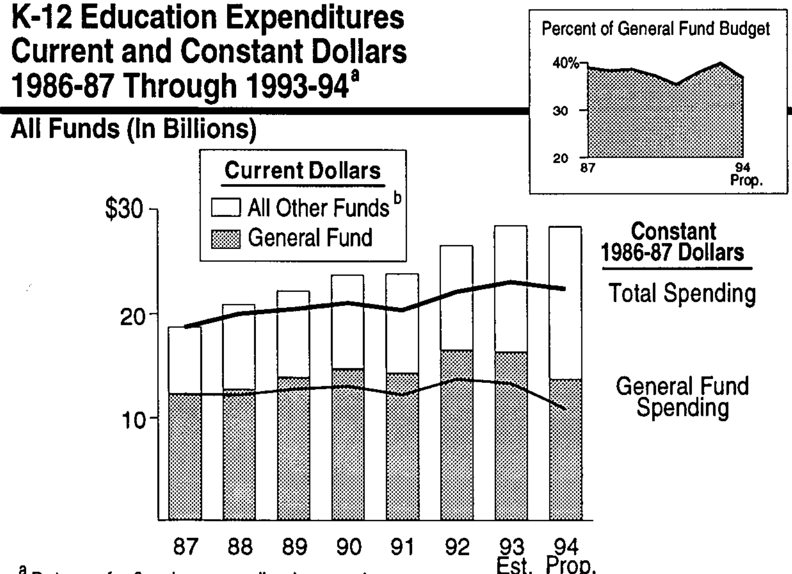
Figure 1 shows that K-12 education expenditures from all sources have increased by $9.6 billion since 1986-87, representing an average annual increase of 6 percent. When these figures are adjusted for inflation, spending increased by an average of 2.6 percent annually. The share of General Fund spending allocated to K-12 education has declined from 39 percent to 37 percent over the period. This decline is associated with increases in the share of local property taxes allocated to schools in the current year and proposed for 1993-94.

Figure 1 shows the amount of K-12 education funding from state, local, and federal sources as reflected in the Governor's Budget. This is not an accurate picture of the actual funding available, for two major reasons. First, there are funding shifts and loans that change the actual amounts available in a given fiscal year. In our discussion of

Proposition 98 (later in this Overview), we provide a detailed description of these funding shifts and loans and discuss year-to-year changes in the amounts actually available for spending for Proposition 98 programs. In 1993-94, Proposition 98 funding accounts for $21.7 billion, or 76 percent, of the $28.3 billion in K-12 spending from all sources.

Figure 1

K-12 Education Expenditures Current and Constant Dollars 1986-87 Through 1993-94[a]



[a] Data are for fiscal years ending in year shown.
[b] Includes state special funds and federal funds from Schedule 9, lottery funds, local property tax revenues, and other local revenues.

Second, our analysis indicates that the Department of Finance has overstated the amount available to schools from local sources other than property taxes in 1990-91 through 1993-94. (These revenues are not included in Proposition 98 calculations.) Later in the K-12 budget issues section, we provide a ten-year perspective on total monies actually available from all sources for spending on K-12 programs.

Spending by Major Programs

Figure 2 shows funding from all sources since 1991-92 for K-12 programs. The budget proposes local assistance expenditures of $26.6 billion for the State Department of Education (SDE) from state, federal, and local sources. This is a reduction of $298 million, or 1.1 percent, from estimated 1992-93 expenditures.

Figure 2

K-12 Education Expenditures 1991-92 Through 1993-94

(Dollars in Millions)

	1991-92	1992-93	1993-94	Percent Change From 1992-93
State Department of Education (SDE) local assistance	$25,360.0	$26,867.5	$26,569.3	-1.1%
Retirement program contributions (State Teachers' Retirement System)	441.8	629.3	708.0	12.5
Debt service	377.1	486.9	561.6	15.3
State-mandated local costs	117.5	193.2	196.8	1.9
SDE state operations	148.8	144.8	144.0	-0.6
State Library	49.8	48.0	48.2	0.4
Commission on Teacher Credentialing	13.2	12.4	14.7	18.5
School Facilities Aid Program	9.1	-34.0	30.3	—
Secretary for Child Development and Education	1.4	1.7	7.0	311.8
Summer School for the Arts	0.6	0.6	0.6	—
Council on Vocational Education	0.3	0.2	0.2	—
Occupational Information Coordinating Committee	0.3	0.5	0.3	-40.0
Totals	**$26,519.7**	**$28,351.1**	**$28,281.0**	**-0.2%**
General Fund	*$16,415.9*	*$16,221.5*	*$13,651.7*	*-15.8%*
Local property tax revenues	*5,311.7*	*6,726.3*	*9,014.9*	*34.0*
Other local revenues	*2,421.0*	*2,633.0*	*2,866.0*	*8.8*
Federal funds	*1,921.5*	*2,176.7*	*2,154.8*	*-1.0*
Lottery funds	*398.6*	*557.7*	*557.7*	—
Special funds	*51.2*	*35.9*	*35.9*	—

The budget also proposes General Fund increases of $79 million, or 13 percent, in contributions to the State Teachers' Retirement System and $75 million, or 15 percent, for debt service payments on school construction bonds. The sharp increase in support for the Secretary of Child Development and Education reflects a proposal for $5 million to implement the Volunteer Mentor Program authorized by Ch 901/92 (SB 1114, Leonard). These funds support a program to match children with academic mentors.

MAJOR BUDGET CHANGES

Figure 3 displays the major budget changes resulting in the net reduction of $2.6 billion in General Fund spending. The table shows that the major changes fall into four categories: (1) funding changes, (2) statutory growth adjustments, (3) other cost and revenue changes, and (4) program proposals.

Figure 3

K-12 Education
Proposed Major Changes for 1993-94
General Fund

Funding Changes

−

- $2.2 billion to account for proposed property tax shift
- $1.1 billion to eliminate funds to repay 1991-92 loan
- $375 million reduction in apportionments to account for proposed new loan (the administration has expressed its intent to use the remaining $165 million of the proposed $540 million loan to augment General Fund support of school district revenue limits)

Statutory Growth Adjustments

+

- $281.4 million for school districts ($221.4 million for enrollment growth and $60 million for increased unemployment insurance costs)
- $111.3 million for enrollment growth in categorical programs
- $14.7 million for enrollment growth in county offices of education

Other Cost and Revenue Changes

+

- $78.7 million to pay State Teachers' Retirement System costs
- $74.7 million for additional debt service payments on general obligation bonds
- $11 million for special education adjustments

−

- $16.6 million to delete Long Beach desegregation impound

Continued

Program Proposals

- $314.8 million to restore current-year reversion from apportionments
- $133.8 million to increase 1993-94 apportionments base
- $20 million one-time augmentation for child care facilities
- $25 million to expand the preschool program
- $23.3 million to expand the Healthy Start Program
- $22.1 million net increase in deferred maintenance
- $19 million one-time child development carry-over funding
- $15.2 million to fund the Adults in Correctional Facilities Program and opportunity programs on a current-year basis
- $11.7 million to expand the California Assessment Program
- $11.6 million to provide full-year funding for school restructuring grants

PROPOSITION 98

The thrust of the Governor's proposal is to keep K-12 funding levels constant on a per-pupil basis while (1) keeping Proposition 98 appropriations at the minimum guarantee level and (2) freeing up additional funds for the non-Proposition 98 portion of the budget.

In the current year, the budget proposes to provide a total of $24.1 billion for Proposition 98 programs in schools and community colleges, a reduction of $460 million below the amount provided in the 1992 Budget Act. These figures include Proposition 98 funding as adjusted for various funding factors necessary to accurately display what schools and community colleges will actually receive during the fiscal year. The reduction reflects a substantial decline in estimated growth in students and would be implemented primarily through reversions of funds already appropriated for the current year.

In 1993-94 the budget proposes to provide a total of $24.2 billion for Proposition 98 programs, an increase of $40 million above current-year proposed funding. The change consists of increases of $334 million for schools and $3 million for other agencies, offset by a $297 million reduction in community college funding. Major proposals include (1) a shift of $2.6 billion in property tax revenues from local governments to schools and community colleges, (2) an unallocated reduction of

$266 million in community college funding, and (3) a new loan of $540 million for K-12 schools.

Overview of Proposition 98

Proposition 98, the "Classroom Instructional Accountability and Improvement Act of 1988," establishes a constitutionally guaranteed minimum level of funding for K-12 schools and community colleges in 1988-89 and thereafter. Proposition 98 was amended by Proposition 111 of 1989 and implemented by various legislative statutes.

Minimum Funding Guarantee

The core of Proposition 98 is the minimum funding guarantee, which is determined based on one of three so-called "tests." Proposition 98 guarantees K-14 education a level of funding based on the *greater* of:

- ***Test 1—Percentage of General Fund Revenues.*** This is defined as the 1986-87 percentage of General Fund tax revenues provided K-14 education—about 38 percent.

- ***Test 2—Maintenance of Prior-Year Service Levels.*** This is defined as the prior-year level of total funding for K-14 education from state and local sources, adjusted for enrollment growth and for growth in per capita personal income.

In low-revenue years, defined as years in which General Fund revenue growth per capita is more than one-half percentage point *below* growth in per capita personal income, the minimum funding guarantee is based on:

- ***Test 3—Adjustment Based on Available Revenues.*** This is defined as the prior-year total level of funding for K-14 education from state and local sources, adjusted for enrollment growth and for growth in General Fund revenues per capita, *plus* one-half percent of the prior-year level. However, the increase in per-pupil funding must be at least equal to the increase in per capita expenditures for all other General Fund supported programs (provided that the total amount of Proposition 98 funding does not exceed the Test 2 level). This per-pupil funding floor (the so-called "equal pain, equal gain," or Test 3b provision) was intended to ensure that K-14 education is treated no worse, in years of low revenue growth, than are other segments of the state budget.

Suspension

Proposition 98 provides that the minimum funding guarantee may be suspended for one year, through urgency legislation, in a bill other than the Budget Bill. The Legislature may suspend the minimum funding guarantee for any reason that meets the general criterion for urgency legislation specified in the California Constitution ("necessary for the immediate preservation of the public peace, health, or safety"). Once the minimum funding guarantee is suspended, which requires a two-thirds vote of each house, the Legislature may appropriate any level of funding for K-14 education.

Restoration

In years following a suspension or use of Test 3, the state may have to make specified minimum payments toward restoring K-14 education funding to the level that would have been required had funding not been reduced.

In practice, the process of suspension and restoration works as follows:

- ***Creation of a "Maintenance Factor."*** In any year in which funding for the minimum guarantee is reduced below the level that would otherwise have been required by either Test 1 or Test 2, a "maintenance factor" is created in an amount equal to the underfunding.
- ***Computation of Guarantee.*** In the following year, the minimum funding guarantee is computed using Test 1, 2, or 3 (as appropriate), with the prior year's *actual* (reduced) level of funding as the new "base."
- ***Computation of Adjusted Maintenance Factor.*** The amount of the maintenance factor is increased annually, using the adjustment factors specified in Test 2 (enrollment growth and growth in per capita personal income).
- ***Minimum Restoration Payment.*** In any year in which General Fund revenue growth per capita exceeds per capita personal income growth, the state must make a minimum payment towards restoring the maintenance factor, equal to one-half of the difference in these growth rates, times total General Fund tax proceeds. The restoration payment serves to reduce the amount of any maintenance factor outstanding.

The restoration payments serve to restore K-14 education funding to pre-reduction levels (as adjusted for enrollment growth and inflation). Amounts that the state saves due to suspension or use of Test 3 do not have to be repaid.

Proposition 98 Funding Versus "Cash" Available for Programs

In practice, the amount of Proposition 98 funding from state and local sources in any fiscal year now differs from the amounts actually available for programs in that fiscal year. There are several reasons for the differences:

- ***Shifts Between Fiscal Years.*** The Legislature has counted funds originally appropriated in one fiscal year—and allocated to districts in that year—against the Proposition 98 funding guarantee in a different year.
- ***Loans From Future Appropriations.*** Loans of $973 million in the current year and a proposed loan of $540 million in 1993-94 support Proposition 98 programs but do not count as Proposition 98 funding. They will count as Proposition 98 funding when they are repaid in some future year.
- ***Other Adjustments.*** Various other funding sources (such as community college fees) are not counted as appropriations for purposes of Proposition 98 but are available to fund programs.

In determining the impact of the budget on schools and community colleges—for example, in calculating the amount of funding per student—it is the amount actually available that matters, not the Proposition 98 appropriations recorded on the state's books. Accordingly, our tables generally show (1) Proposition 98 funding as it appears on the state books (that is, "budgetary" basis) and (2) adjusted cash totals reflecting actual funds available ("cash" basis).

Budget Action in 1992-93

The "recapture" of $1.1 billion from 1991-92 assumed in the 1992 Budget Act is being challenged.

The thrust of the 1992-93 budget solution was to provide schools the same amount of "cash" funding per average daily attendance (ADA) as had been provided in the previous year, while keeping Proposition 98 funding at the minimum level required. To do this, the budget solution included "recapture" of $1.1 billion in funds that had been appropriated in 1991-92, and loans to schools and community colleges totaling $973 million.

At the close of the 1991-92 fiscal year, the Department of Finance calculated—based on revised estimates of General Fund tax revenue and ADA—that the General Fund appropriation required under Proposition 98 was $1.1 billion less than the amount appropriated for Proposition 98 in 1991-92. As part of the budget solution for 1992-93, the education trailer bill (Ch 703/92, SB 766) "recaptured" these funds by characterizing the overappropriation as a loan to schools in 1991-92, to be repaid from the amount appropriated to schools in 1992-93.

This approach was designed to (1) achieve a General Fund savings of $1.1 billion in 1991-92 and (2) reduce the base on which the 1992-93 Proposition 98 guarantee was calculated. Consequently, the 1992-93 guarantee was revised downward by $835 million, and the state realized a total General Fund savings of $1.9 billion over the two fiscal years.

A technical error in the drafting of Chapter 703, however, renders the State Controller unable to execute the recapture provisions of the statute. In the following discussion, we assume, as does the administration, that Chapter 703 will be amended to rectify the drafting error. If this does not occur, the minimum General Fund guarantee for 1992-93 would exceed the guarantee amount discussed below by about $1.1 billion. Therefore, both the 1992-93 and 1993-94 General Fund appropriations proposed in the Governor's Budget would require suspension of the guarantee.

In addition, the constitutionality of several provisions of Chapter 703 has been challenged in court and has not yet been decided. Specifically, the provisions challenged include (1) the recapture mechanism, (2) the treatment of $973 million in current-year support for K-14 programs as a loan from future Proposition 98 funding, and (3) a "poison pill" provision that would hold the state harmless, from a fiscal standpoint, in the event of a successful legal challenge to the measure.

Estimated K-12 ADA Growth Slows Dramatically

Figure 4 shows the Department of Finance (DOF) estimate of Proposition 98 ADA growth in 1992-93 and 1993-94. Proposition 98 ADA includes all school district ADA in primary and secondary programs, less summer school ADA and ADA generated by secondary students over age 21. It also includes ADA generated by county office of education programs. As mandated in legislation related to adult education, ADA for the purposes of calculating Proposition 98 beginning in 1993-94 will exclude K-12 students concurrently enrolled in adult education programs.

Figure 4

Proposition 98
Estimated Average Daily Attendance
In California Public Schools
1991-92 Through 1993-94

	Actual 1991-92	Estimated 1992-93	Percent Change 1991-92 to 1992-93	Proposed 1993-94	Percent Change 1992-93 to 1993-94
Current definition	5,018,183	5,100,243	1.64%	—	—
New definition[a]	—	5,060,608	—	5,140,638	1.58%

[a] Excludes K-12 pupils concurrently enrolled in adult education programs.

The current-year growth estimate, 1.64 percent, is less than half of the 3.8 percent level of growth projected by the DOF in calculating the Proposition 98 guarantee for purposes of the 1992 Budget Act. The 3.8 percent level of growth was calculated primarily on the basis of past-year enrollment trends and appeared reasonable in light of those trends. For instance, Proposition 98 ADA had increased at an average annual rate of 3.5 percent between 1988-89 and 1990-91. The lower estimate is based on recent DOF surveys of large urban and suburban school districts. Based on nearly complete reporting of October 1992 enrollment by school districts, the recent DOF estimate appears reasonable.

The DOF and the Department of Education speculate that this sharp reduction in enrollment growth is related to California's current economic hardships. The lingering recession has made California a less attractive destination for job-seekers from elsewhere, while increasing the rate at which current residents of the state leave to seek opportunities elsewhere in the United States. These two trends add up to slower-than-anticipated state population growth, and slower-than-anticipated growth in K-12 ADA.

These ADA estimates will be updated in the May revision, based on an ADA actually documented through December 1992.

Proposed Revisions Affecting 1992-93

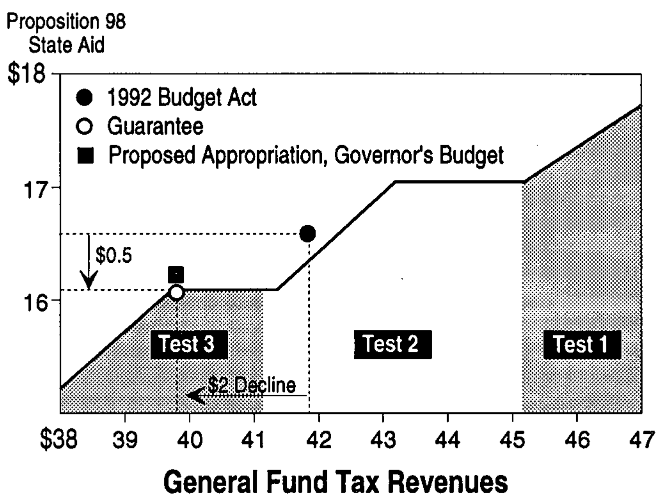
Budget reductions proposed for the current year totaling $460 million (cash basis) are consistent with a policy of maintaining K-12 spending at a constant level per ADA.

The DOF estimates that the minimum Proposition 98 funding requirement for the current year is $23.8 billion, $725 million below the amount provided in the 1992 Budget Act. This change is the net result of (1) a 106,000 reduction in estimated K-12 ADA and (2) a $2 billion reduction in estimated General Fund tax revenues. As Figure 5 shows, the General Fund portion of the minimum funding requirement is $16.1 billion, or $526 million less than the amount provided in the 1992 Budget Act. The General Fund reduction is less than the reduction for all Proposition 98 funds due to a $199 million reduction in estimated Proposition 98 local property tax revenues. As indicated in Figure 5, the guarantee for 1992-93 is determined under Test 3.

Figure 5

Proposition 98 General Fund Guarantee: 1992-93

(In Billions)



As the Proposition 98 minimum funding requirement has declined due to enrollment changes, the amount needed to provide a constant amount per ADA has declined as well. On this basis, the budget proposes to reduce 1992-93 Proposition 98 funding from state and local sources by $637 million. With this reduction, the Proposition 98 funding level would exceed the minimum amount required by $88 million (see Figure 5). Due to a variety of cash adjustments (totaling $177 million), there would be a net reduction of $460 million in cash available for Proposition 98 programs.

Figure 6 shows the proposed funding levels compared to the 1992 Budget Act funding levels. It shows that the net effect of the proposals is to provide $4,187 per ADA, the same level as provided in 1991-92. (As a result of various technical adjustments, the actual amount available per pupil on a cash basis in 1991-92 was $4,187, instead of $4,185 as estimated for purposes of the 1992 Budget Act.)

Figure 6

Proposition 98 Programs "Cash" Funding 1992-93 and 1993-94

(Dollars in Millions)

	1992-93			1993-94	
	Budget Act	Proposed	Change	Proposed	Change From 1992-93 Proposed
Proposition 98 funding sources (budgetary basis)					
State appropriations	$16,620	$16,182	-$438	$13,138	-$3,044
Local property taxes	7,902	7,703	-199	10,357	2,654
Subtotals	**($24,522)**	**($23,885)**	**(-$637)**	**($23,495)**	**(-$390)**
Funding adjustments					
1991-92 loan repayment	-1,083	-1,083	—	—	1,083
1992-93 loans	973	973	—	—	-973
1993-94 loans	—	—	—	540	540
Community college fees	132	126	-6	139	13
Prior-year settle-up	—	122	122	—	-122
IDDA/EPDA offset	50	111	61	—	-111
Adjusted cash totals	**$24,594**	**$24,134**	**-$460**	**$24,174**	**$40**
K-12 schools	**$21,784**	**$21,354**	**-$430**	**$21,688**	**$334**
Amount per ADA					
Current definition	4,185	4,187	2	—	—
New definition	—	4,220	—	4,220[a]	—
Community colleges	**$2,736**	**$2,706**	**-$30**	**$2,409**	**-$297**
Other agencies	**$74**	**$74**	**—**	**$77**	**$3**

[a] Actual amount is $4,219. Difference apparently results from rounding in Department of Finance calculation of the loan amount. The Department of Finance advises that the intent is to provide $4,220.

Proposal for 1993-94

To maintain current-year per-ADA funding levels for K-12 programs while minimizing General Fund obligations, the budget proposes (1) a shift of $2.6 billion in property tax revenues from local governments to schools and community colleges, (2) an unallocated reduction of $266 million in community college spending, and (3) a new loan of $540 million for K-12 schools.

The budget proposes to fund Proposition 98 in 1993-94 at the minimum level based on the assumptions listed below. The amount is $23.5 billion, a reduction of $390 million below proposed funding in 1992-93. The reduction comes about primarily because a projected reduction in per capita General Fund revenues (3.23 percent) more than offsets an estimated increase in enrollment (1.58 percent).

The budget proposes General Fund Proposition 98 appropriations of $13.1 billion, a reduction of $3 billion compared to current-year proposed levels. The reduction is due primarily to a proposal to shift $2.6 billion in property tax revenues from local governments to schools and community colleges.

Figure 7 (see next page) shows how the General Fund Proposition 98 guarantee for 1993-94 varies with different levels of General Fund revenue. The figure is based on assumptions that the Legislature (1) fixes the recapture language of Ch 703/92 (SB 766), (2) adopts the 1992-93 budget actions proposed by the administration, (3) adopts the proposed 1993-94 property tax shift (and related proposed changes in Test 1 and Test 3b), and (4) does not implement a provision stating legislative intent that 1993-94 funding exceed the Proposition 98 minimum funding level by $100 million. Given these assumptions, the budget's General Fund revenue projection results in a guarantee determined by Test 3.

In order to maintain 1992-93 per-ADA funding levels for K-12 programs in 1993-94, the budget contains the following additional proposals:

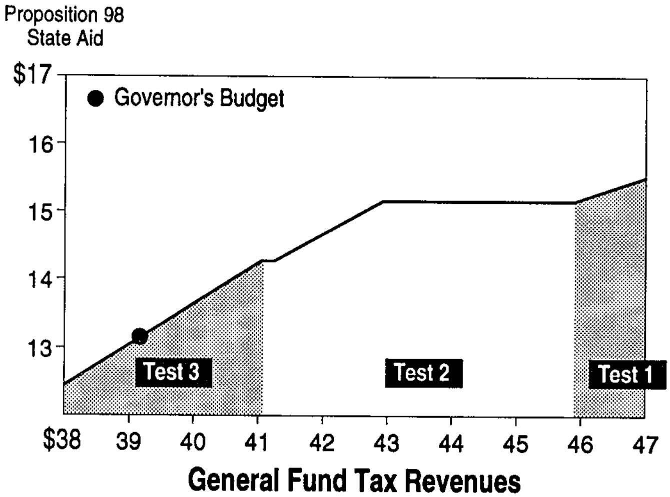
- An unallocated reduction of $266 million in community college funding. The budget indicates that the administration will support legislation to authorize the Board of Governors to impose fees of up to $30 per unit (current fees are $10 per unit) to raise funds to offset all or a portion of this funding reduction.
- A new loan of $540 million for K-12 schools. This would be in addition to the loans provided in the current year to K-12 schools ($732 million) and the community colleges ($241 million). The

budget proposes deferral of a $120.5 million loan repayment by the community colleges scheduled in current law. (K-12 schools do not have to make repayments in 1993-94 under current law.) The budget does not specify a repayment schedule for the new loan.

Figure 7

Proposition 98 General Fund Guarantee: 1993-94 [a]

(In Billions)



[a] Based on assumptions in Governor's Budget.

As shown in Figure 6, the effect of the proposals is to fund K-12 schools at the same per-ADA amount as was provided in 1992-93. Due to changes in the method of calculating ADA (mandated in legislation related to adult education), however, the 1992-93 base per-ADA funding amount is $4,220, rather than $4,187.

Budget Assumes Legislation to Modify Test 1 and Test 3b Formulas

To obtain the level of savings assumed in the budget for the property tax proposal, the budget assumes passage of legislation to modify Test 1 and Test 3b formulas.

Test 3b. Under current law and DOF assumptions about General Fund tax revenues, the maximum amount of state savings possible from the proposed 1993-94 property tax shift is $1.5 billion. This is because Test 3b, the "equal pain, equal gain" provision described above, provides that growth in per-pupil spending for Proposition 98 programs cannot lag behind growth in per capita General Fund spending for other programs.

To achieve the level of General Fund savings contemplated in the budget, Test 3b must be redefined to adjust for the property tax shift. The DOF advises that the proposed property tax shift legislation will include such a provision.

Test 1. Under existing law, Test 1 provides about 38 percent of General Fund tax revenues to schools. This is the percentage of General Fund tax revenues that was allocated to K-14 education in 1986-87, adjusted by Chapter 703 to account for the $1.4 billion 1992-93 property tax shift. The DOF advises that the administration will propose legislation to adjust similarly the Test 1 percentage for the proposed $2.6 billion 1993-94 property tax shift. While the proposed change has no budget-year effect, it is necessary to ensure that future Test 1 calculations of Proposition 98 General Fund obligations are consistent with the proposed increase in the Proposition 98 local funds base.

Property Tax Revenue Estimates May Decline

Lower-than-anticipated Proposition 98 local revenues from property tax shifts constitute a General Fund threat of about $200 million in 1992-93, and of at least $200 million in 1993-94.

The budget assumes that the current-year property tax shifts will result in a General Fund savings of $1.4 billion. The budget proposes to shift $2.6 billion in additional property taxes in 1993-94, thereby resulting in a General Fund savings of $2.6 billion.

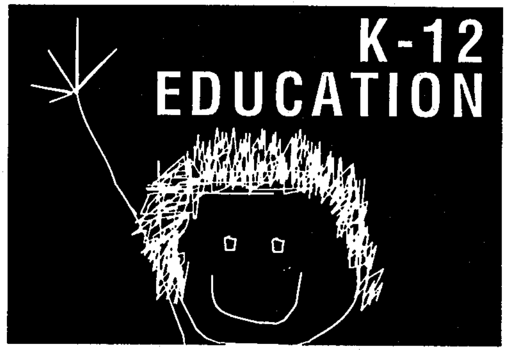
We have identified two problems with these savings estimates. First, current-year legislation affecting property tax shifts from special districts may result in about $200 million less savings than originally estimated in both the current year and 1993-94. (This reduction would be in addition to the $199 million reduction we discuss above, which is not attributable to shifts.) This is due to a provision specifying that the amount of funds shifted from any special district shall not exceed 10 percent of its total annual revenues. We note, moreover, that elements of the current-year shift have been challenged in court.

Second, it is possible that counties may be unable to shift all of the proposed 1993-94 monies to schools to reduce the amount of state General Fund aid provided under Proposition 98. It appears likely that, because of the magnitude of the 1993-94 shift, more than enough local property taxes will be shifted to make all school districts "excess-tax" districts in some counties. In most school districts, state aid makes up the difference between local property tax revenues and the district revenue limit. In excess-tax districts, the amount of local property tax revenue equals or exceeds the revenue limit, and state aid is capped at $120 per ADA ("basic aid").

County allocation of property tax shift revenues offsets state aid only to the point at which all school districts in the county become excess-tax districts. Any additional property tax revenues allocated to districts would increase district revenues without further reducing the amount of state aid. In addition, allocating any additional revenues to these districts would create an issue of equity between these districts and districts elsewhere in the state that remained funded only at their revenue limit. The additional revenues could not be transferred to school districts in other counties because of constitutional prohibitions against shifting property tax revenues between counties.

Insufficient information is available at this time about the current-year revenue status of school districts to enable a specific estimate of how many counties would find themselves in this situation, or of the resulting reduction in projected General Fund savings. Data that will become available between now and the May revision may be sufficient to provide a rough estimate.

We provide a more detailed analysis of these and other local property tax issues in Part IV of *The 1993-94 Budget: Perspectives and Issues*. For budget planning purposes, however, the Legislature should anticipate a threat of at least $400 million in the next 18 months as a result of this issue.



BUDGET ISSUES

K-12 BUDGET PRIORITIES

We recommend the Legislature (1) reallocate funds within Proposition 98 to increase per-pupil spending for general purposes to the level supported by the 1992-93 budget and (2) reduce K-12 spending to the extent possible in order to minimize the need for a loan in 1993-94.

In this group of sections, we discuss findings that (1) general-purpose funding is $260 million short of the amount needed to fund per-pupil spending at the level supported by the 1992-93 budget and (2) the Legislature should minimize the size of the proposed 1993-94 loan by reducing spending to the extent possible. We identify $560 million in reductions that can be used to increase general-purpose funding and reduce the loan.

Budget Reduces Per-Pupil Funding for School District General Purposes

Proposed 1993-94 funding for school district general purposes is $260 million less than necessary to fund per-pupil spending at the level supported by the 1992 Budget Act and trailer legislation.

General-purpose funding is the largest single source of funds for school districts. These funds can be used by districts at their discretion with few restrictions. In contrast, districts must spend categorical program funds for the specific purposes of the state programs under which they are awarded. The budget proposes total Proposition 98 funding of $4,220 per ADA to support general-purpose spending and categorical programs in 1993-94. (This is comparable to the current-year level of $4,187 per ADA, after adjustment for a change in the definition of Proposition 98 ADA.) Proposed general-purpose spending is about three-fourths of this total amount.

Most general-purpose funding is provided through the revenue limit system. In this system, school districts receive funding based on a specific per-ADA amount known as a revenue limit. Revenue limits are funded by a combination of local property taxes and state aid. State funding makes up the difference between each district's property tax revenues and its revenue limit.

In crafting the 1992 Budget Act, the Legislature reduced funding for categorical programs in order to increase per-pupil spending for general purposes. The Legislature also provided a $732 million loan and made other funding adjustments to maintain total Proposition 98 funding for K-12 education at the same level per pupil as provided in 1991-92.

Budget Reduces Per-Pupil General-Purpose Spending in the Current Year

Figure 8 displays general-purpose funding for 1992-93 and 1993-94, adjusted to include supplemental grant funding, which the budget assumes will be rolled into revenue limits in 1993-94. The figure shows that the budget proposes to reduce 1992-93 general-purpose funding for school districts by $417 million, or 2.5 percent, compared to the 1992 Budget Act. A revised estimate of 1992-93 K-12 average daily attendance (ADA) growth accounts for most of this reduction. K-12 ADA is currently estimated to be 2 percent less than assumed in the 1992 Budget Act. Figure 8 also shows, however, that the budget proposes to spend less per ADA. The budget proposal is about $16 per ADA, or $81 million, short of funding the level of per-pupil spending supported by the 1992 Budget Act and trailer legislation.

This shortfall in per-ADA general-purpose funding essentially is an artifact of the way in which the Department of Finance proposes to implement the current-year reduction. The reduction related to the ADA drop is applied only to general-purpose funding, not to all K-12 programs. The Legislature may wish, instead, to apply the reduction equally across all programs.

Figure 8

General-Purpose Funding for School Districts 1992-93 and 1993-94

(Funding in Millions)

	1992-93			1993-94	
	1992 Budget Act	1992-93 Proposed	Percent Change	1993-94 Proposed	Percent Change From 1992-93 Proposed
Revenue limits	$15,645,199	$15,171,125	-3.0%	$15,581,633[b]	2.7%
State appropriations	(9,219,935)	(8,905,162)	(-3.4)	(7,159,652)	(-19.6)
Local and other revenues	(6,425,264)	(6,265,963)	(-2.5)	(8,421,981)	(34.4)
Loans	732,000	732,000	—	540,000	-26.2
IDDA/EPDA	40,000	96,817	—	—	-100.0
Subtotals	$16,417,199	$15,999,942	-2.5%	$16,121,633	0.8%
Supplemental grant roll-in[a]	181,309	181,309	—	—	—
Totals, adjusted	**$16,598,508**	**$16,181,251**	**-2.5%**	**$16,121,633**	**-0.4%**
K-12 ADA (district apportionments)	5,171,935	5,067,335	-2.0%	5,105,500[b]	0.8%
General-purpose spending per ADA	$3,209	$3,193	-0.5%	$3,158	-1.1%

[a] Adjusts 1992-93 spending for comparability with 1993-94 spending. The budget-year amounts include a $181.3 million increase to reflect roll-in of supplemental grants to revenue limits.

[b] Pursuant to existing law, concurrent enrollment ADA and associated funding are pulled out of apportionments and added to Adult Education.

Budget Reduces Per-Pupil General-Purpose Spending in 1993-94

Figure 8 shows that the budget proposes to reduce general-purpose funding for school districts by $60 million, or 0.4 percent, as compared to the current-year proposal. This reduction is the net effect of ADA growth of 0.8 percent and a reduction of 1.1 percent in spending per ADA. (ADA growth of 0.8 percent is the net effect of estimated K-12 ADA growth and legislation that changes the way pupils concurrently enrolled in K-12 and adult education programs are counted for funding purposes). As a result of the reduction in spending per ADA, the budget proposal for 1993-94 is $260 million short of funding the per-pupil level supported by the 1992 Budget Act and trailer legislation. It is $179 million short of funding the level of spending per ADA proposed for the current year.

Categorical Program Augmentations Funded at Expense of General Education

Despite the proposed reduction of per-pupil funding for general education in the current and budget years, the budget maintains funding for *all* K-12 programs in both years at the same level of per-pupil funding provided in 1991-92. As a result, categorical funding per ADA *increases* in both years. In 1993-94 the budget proposes to fund enrollment growth for categorical programs and also funds a number of categorical program augmentations and initiatives.

In separate sections, we present recommendations for reducing proposed categorical program spending. The Legislature could use funds freed up by these reductions to augment the level of per-pupil funding for general education programs.

Borrowing From Future Proposition 98 Funds Should Be Minimized

We recommend the Legislature minimize to the extent possible the amount of borrowing against future Proposition 98 funds in developing the 1993-94 K-14 budget. A smaller loan would (1) substantially increase the state's ability to meet baseline K-14 spending needs in 1993-94 and 1994-95 in the event that the economy recovers more slowly than currently anticipated and (2) increase the likelihood that school districts will receive COLAs and program augmentations beginning in 1995-96.

The Governor's Budget proposes to borrow $540 million in 1993-94 from Proposition 98 appropriations in future years. The budget proposes this loan in order to fund 1993-94 K-12 education at $4,220 per pupil, which is the same level of per-pupil funding as provided in 1992-93. The loan amount is in *excess* of the budget year's Proposition 98 guarantee. Because the $973 million loan of Proposition 98 funds approved for the current budget will not be repaid during the budget year, this proposed loan would increase to $1.5 billion the total claim on future Proposition 98 funding.

In this section, we discuss the desirability of borrowing in excess of the Proposition 98 guarantee in order to provide additional funds to schools and community colleges. Without the loan, the Legislature would have to reduce K-12 and/or community college spending compared to the amount proposed. Eliminating the loan entirely from the K-12 budget, for example, would result in a $4,113 per-pupil funding level, a reduction of $107 per student from the level proposed for 1993-94.

One of the key K-12 issues the Legislature has faced in recent years is the stability of school funding. In order to examine the impact of the loan proposal, we compared the Proposition 98 funding requirement in 1994-95 and 1995-96 (based on the DOF General Fund revenue forecast) with the amount of funds needed to pay for ongoing K-14 expenses, assuming a constant $4,220 per-pupil spending level in K-12 programs. Based on this analysis, we conclude that Proposition 98 funding would be sufficient to fully support baseline expenditures in both 1994-95 and 1995-96. In 1994-95 there would be no additional funding for loan repayments or for discretionary purposes, such as a cost-of-living adjustment (COLA) or program augmentations. In 1995-96, rapid growth in the Proposition 98 funding requirement would permit both a loan repayment and a COLA.

What Happens With a Slower Economic Recovery?

It is possible that the California economy will take longer than predicted by the DOF to recover from the current recession. In this event, the slower growth in General Fund revenues will further depress the Proposition 98 funding requirement in both 1993-94 and 1994-95. As a result, the state would have to increase borrowing in 1993-94 and borrow additional funds in 1994-95 to maintain a constant $4,220 per-pupil spending level. Specifically:

- ***Borrowing in 1993-94 would have to increase more than $600 million, reaching a total of $1.2 billion in 1993-94, to keep per-pupil funding constant.*** This assumes that 1993-94 General Fund revenues are 2.5 percent below the DOF's forecast because of a slower recovery.
- ***The state would need to borrow an additional $340 million in 1994-95 in order to maintain a $4,220 per-pupil spending level.*** This is based on a 1 percent reduction in General Fund revenues below the DOF forecasted level.

Under this slower growth scenario, maintaining the current $4,220 per-pupil spending level through 1994-95 would increase total borrowing by $1 billion over the level proposed in the Governor's Budget. By the end of 1994-95, there would be outstanding loans totaling almost $2.5 billion. Repaying these loans would significantly reduce the amount that would be available to K-14 programs for many years to come. Specifically, schools would be faced with just the opposite situation they face now. As a result of current loans, schools are supporting *today's* students with *future* dollars. When repayments come due, schools will be using *current* dollars to pay for the support already provided *previous* students rather than providing additional support to current students. For example, as a result of the loan repayments, there may not be sufficient funds to provide a COLA or support program augmentations in 1995-96.

Minimize the 1993-94 Loan

These large potential loans demonstrate the significant risk to K-14 programs and the state of making an additional loan in the budget year. Even relatively small reductions in General Fund revenues below the forecasted level can reduce the Proposition 98 funding requirement substantially, resulting in the need for a larger loan in 1993-94 and a new loan in 1994-95 to maintain per-pupil spending.

Due to this risk—and assuming that the Legislature concludes that it cannot afford to allocate additional General Fund resources for Proposition 98 programs—we believe that the Legislature should minimize the size of the 1993-94 loan and make associated reductions in baseline spending. This would give the Legislature more options to deal with future K-14 budgets and increase the likelihood that additional loans will be unnecessary and that school districts will receive COLAs and program augmentations beginning in 1995-96.

For example, we examined what would happen if the Legislature entirely eliminated the $540 million loan and reduced associated expenditures from the 1993-94 budget. By doing this, the Legislature would have reduced K-14 baseline spending levels in 1993-94 and into the future. In this scenario, the baseline programs could be supported even with a reduced Proposition 98 funding requirement resulting from a decline in General Fund revenues. As a result, no additional loan would be necessary in 1994-95. While schools would receive less funding in 1993-94 and 1994-95, they would have a higher probability that an expanding economy would enable the state to fully fund baseline spending and yield discretionary funds that could support program augmentations or COLAs in 1995-96.

Options for Maintaining General-Purpose Funding and Minimizing the 1993-94 Loan

We recommend that the funds freed up as a result of our recommendations in sections that follow be redirected to eliminate the reduction in per-pupil general-purpose funding and reduce the size of the proposed loan.

In our review of the proposed K-12 budget, we identified two serious deficiencies. First, and most important, the budget contains a $260 million shortfall in the amount needed to continue the 1992-93 level of general-purpose funding for K-12 school districts. Second, borrowing $540 million to fund the K-12 baseline budget could jeopardize the state's ability to fund future spending needs and reduce the likelihood that schools would receive COLAs and program augmentations beginning in 1995-96.

To fully correct these problems, the state would need a total of $800 million in some combination of spending reductions or increased Proposition 98 resources. The Legislature's options boil down to four approaches:

- ***Further Reduce Appropriations for Community Colleges.*** The budget proposes an unallocated reduction of $266 million for the community colleges in 1993-94. However, if fees are increased to the level recommended in the budget, the colleges would experience almost no funding reduction.
- ***Reduce K-12 Spending on Lower-Priority Activities.*** This means the budget would no longer be based on $4,220 per student. Instead, the Legislature could hold general-purpose funding constant and make selective reductions in categorical programs.
- ***Shift General Fund Resources From the Non-Proposition 98 Part of the Budget to K-14 Programs.*** The deficit in the non-Proposition 98 side of the 1993-94 budget makes this approach difficult to implement.
- ***Increase State or Local Tax Revenues.*** For example, extending the half-cent sales tax would increase General Fund tax revenues by $1.5 billion, which would raise the Proposition 98 guarantee by $900 million in 1993-94.

The last two options would increase total Proposition 98 expenditures. As such, the Legislature may want to consider them as alternatives to the proposed loan. Because the policy implications of these options are felt outside the K-14 budget, we do not consider them further in this section.

Below, we make a number of recommendations for reducing K-12 spending on lower-priority activities. We recommend that funds freed up as a result of these recommendations be redirected to eliminate the reduction in per-pupil general-purpose funding and reduce the size of the proposed loan.

Most Augmentations Should Be Rejected

We recommend the Legislature delete $60.3 million in proposed program augmentations and redirect those funds to maintain per-pupil general-purpose funding and reduce the size of the Proposition 98 loan.

The Governor's Budget proposes $107.1 million in new Proposition 98 funds for augmentations to ten separate programs. Program augmentations funded with past-year Proposition 98 monies are discussed separately in a later section.

Our review indicates that all these proposals have merit—each would attempt to improve the quality or level of services to K-12 students. Some of the proposals, such as expansions in the preschool and Healthy Start programs, may have long-term benefits, including increased student achievement. However, the administration's proposal to fund such expansions by *decreasing* general-purpose allocations and paying for current programs with *future* dollars has long-term consequences for students as well. For the current year, the Legislature's policy was to redirect categorical augmentations so as to maintain general-purpose funding levels. We believe this approach makes sense and better serves the majority of California students. For this reason, we recommend the Legislature eliminate $60.3 million of the proposed program increases and redirect the monies to fully fund general purposes and to reduce the size of the Proposition 98 loan. We recommend the Legislature approve the remaining amount, $46.8 million, because these funds generally are needed to continue existing program levels or fulfill a previous state commitment.

Below we describe the program augmentations and indicate the portions of each augmentation that we recommend be approved and deleted:

- $25 million to expand the preschool program beginning January 1994. We recommend that this augmentation be deleted.

- $23.3 million for the Healthy Start Program, bringing its total funding to $38 million. Of this amount, $4.3 is needed to fully fund existing programs, and $19 million would permit additional schools to participate in the program. We recommend that the $4.3 million amount be approved and $19 million be deleted.

- $22 million to replace one-time funds available in the current year for child development. We recommend approval of $19.2 million of the $22 million to restore the correct base level of funding to child development programs so that the same number of children could be served. Without the increase, the program would experience a funding reduction. We recommend deletion of the remaining $2.8 million of the $22 million because this can be funded with available carry-over funds that are proposed to be spent in the budget but for which there is no spending plan.

- $11.7 million to continue development and implementation of the new California Assessment Program. These additional funds would bring total program funding in the budget year to $23.5 million. We recommend approval of the full amount. If no increase is granted, further development and implementation of the new testing program cannot go forward.

- $11.6 million to provide full-year support for school restructuring grants. Additional funds would increase total program support in 1993-94 to $24.6 million. We recommend approval of the full amount proposed. Half-year grants were provided in 1992-93. School restructuring projects are based on the expectation that full funding will be appropriated in 1993-94.

- $5 million to increase support for the existing Subject Matter Projects. Funds are proposed to establish four new sites and expand the level of services that could be provided at the 77 existing sites. The proposed augmentation would increase total support for Subject Matter Projects to $16.3 million in 1993-94. We recommend deletion of the full amount.

- $3 million to support the start-up of breakfast programs in almost 300 schools across the state. We recommend deletion of the full amount.

- $2 million to support programs for creating alternate routes to obtaining a teacher credential other than a university teacher training program. The Commission on Teacher Credentialing would administer this program. We recommend deletion of the full amount.

- $2 million for intersegmental programs that help increase college attendance of underrepresented minority groups. We recommend deletion of the full amount.
- $1.5 million to provide additional funds to the Bilingual Teacher Training Program. The program supplies language instruction and courses in methods and strategies for teaching limited-English-proficient students during the school year and summer months. Current-year funding for the program is $1 million. We recommend deletion of the full amount.

We recommend additional reductions of $1.8 million in the community college budget and $10 million in the Department of Mental Health budget for the same reasons. Please see our analysis of the higher education and health and social services budgets for additional information on these recommendations.

Prior-Year Funds Should Be Redirected

We recommend the Legislature eliminate $57.3 million in K-12 appropriations that are proposed to be funded with Proposition 98 monies that are available from past K-12 budgets, and redirect those funds to restore general-purpose funding and to reduce the amount of the Proposition 98 loan.

The Governor's Budget proposes to spend $140.1 million in prior-year Proposition 98 funds for a number of activities in the budget year. These funds do not count towards the Proposition 98 minimum funding guarantee for 1993-94. Instead, these funds were originally appropriated to satisfy the Proposition 98 guarantee in past years.

According to the Department of Finance (DOF), the monies are available from a variety of sources, including carry-over funds, unspent balances from previous budgets, unclaimed mandate funds, and other sources. Most of the funds that are proposed for expenditure in 1993-94, however, come from three sources:

- $71.3 million is available as a result of additional federal matching funds the state expects to receive through State Department of Education child development programs. According to the DOF, retroactive claims for federal funds will free up $25.4 million of Proposition 98 funds in 1990-91 and $45.9 million in 1991-92.

- $69.9 million in unspent Proposition 98 funds is available from funds originally appropriated in 1988-89 through 1990-91. These funds are deposited in the Proposition 98 Reversion Account.
- $19 million is available from unspent child care ("carry-over") funds appropriated in various years.

The spending proposals for 1993-94 include:

- $44.6 million for deferred maintenance in K-12 districts.
- $41.3 million for deferred maintenance and instructional equipment at community colleges. (For additional information on this proposal, please see our analysis of the community colleges budget.)
- $20 million for child care facilities.
- $19 million for child development programs, primarily to backfill base funding for centers adversely affected by new federal regulations.
- $15.2 million to repay prior-year K-12 costs under the Opportunity Program and the Adults in Correctional Facilities Program. Funding for the 1993-94 costs of these programs is included in the mega-item.

Our review indicates that the $19 million in child development funding should be approved because the vast majority of the funds are for baseline purposes. (For additional information on how the child development funds would be used, please see our discussion in a later section.)

Our review also indicates that the proposed appropriation for deferred maintenance should be funded at a level of $22.5 million to continue the existing level of support. This is the funding level provided in the current year through the mega-item. (The budget proposes to eliminate funding for this purpose in the mega-item.) We discuss deferred maintenance issues in detail in our capital outlay section of this *Analysis*.

The remaining proposals involving prior-year funds, like the augmentations proposed in the budget, have merit. However, we believe all available funds should be used to support baseline spending requirements. For this reason, we recommend the Legislature eliminate the remaining expenditures from prior-year Proposition 98 funds and instead reappropriate those funds for use either in restoring the existing level of per-pupil revenue limits or for reducing the amount of the Proposition 98 loan.

The net effect of approving the child development proposal, maintaining deferred maintenance funding, and eliminating other funding proposals, is to free up $98.6 million ($57.3 million in the K-12 budget and $41.3 million in the community college budget) for other purposes.

Technical Errors

In our review of spending from prior-year funds, we identified three technical problems that affect the General Fund balance for the budget as a whole. First, $53.2 million of expenditures are not reflected in the budget: $38.8 million in reimbursements for state mandates and $14.4 million in local assistance funds (primarily apportionments).

Second, the budget also does not reflect $20 million in available past-year Proposition 98 funds that the DOF proposes to revert to the General Fund in order to eliminate the overappropriation of Proposition 98 funds the DOF calculates occurred in 1990-91. This $20 million would become available for use in the non-Proposition 98 portion of the budget. The reversion, however, is not included in the budget.

Third, the budget shows spending from child care carry-over funds of $19 million in 1993-94. However, it shows only $12.9 million of savings in prior years. The difference—$6.1 million—should be reflected as savings as well.

The net effect of these errors is that the General Fund balance is overstated by $27.1 million.

Growth Allocations to Categorical Programs Are Not Appropriate at This Time

We recommend that the Legislature delete most proposed funding increases for categorical program growth, thereby making $114.7 million available for higher-priority purposes.

The Governor's Budget proposes $114.7 million for growth in adult education, child development, nutrition, and categorical programs included in the mega-item. Specifically, the 1993-94 budget proposes:

- $50 million to meet the costs of growth in special education. Based on the statutory formula, the proposed increase would provide a 2 percent increase to special education programs.
- $33.5 million for a 1.55 percent growth allocation for mega-item programs other than special education. These funds would not

be distributed based on statutory growth formulas but would be allocated equally across all affected programs.

- $16.7 million for child development growth. Of this amount, $13.3 million is provided for a 3.2 percent growth allocation in 1993-94, and $3.4 million is proposed to be transferred from the mega-item for 1992-93 growth that was appropriated in the 1992 Budget Act.
- $10.3 million for a 2.5 percent statutory increase for adult education programs.
- $4.2 million for an 8 percent increase for child nutrition programs.

In normal years, we would recommend that program growth receive a high priority for funding, second only to providing growth to base revenue limits. As we have discussed above, this is not a normal year—the K-12 budget is $800 million short of having sufficient funds to maintain per-pupil revenue limits and avoid additional borrowing. By not providing growth to categorical programs, the Legislature would have $114.7 million to use to reduce the gap between revenues and expenditures. For this reason, we recommend the Legislature eliminate all program growth in categorical programs for a savings of $114.7 million.

For the same reason, we recommend a reduction of $1.8 million in categorical program growth in the community college budget. Please see our analysis of the community colleges for additional information on this recommendation.

Legislature Should Consider Categorical Program Reductions

We recommend reducing or eliminating funding for seven K-12 categorical programs in 1993-94 (for a savings of $270 million) in order to restore general-purpose funding or further reduce spending and minimize the size of the K-12 loan.

If all of the recommendations discussed above were adopted, the Legislature could fully support 1993-94 general-purpose funding at the current-year level, but would still be well short of the amount needed to avoid significant borrowing from future Proposition 98 revenues to finance baseline expenditures. For this reason, we reviewed the proposed K-12 categorical program allocations and identified

$270 million in savings that could be achieved by reducing or suspending specific programs, either temporarily or permanently.

We focused on the major programs that could be reduced or suspended with a minimal effect on district operations and the quality of school programs. No reductions are suggested to programs for students with special needs (such as special and compensatory education). Clearly, these reductions would not be painless; staff reductions and other service cuts would result. We have tried, however, to identify those reductions which would have the smallest impact on student achievement.

Reduce School Improvement Programs

In our recommendations on categorical programs (see next issue), we propose the creation of a School Improvement Block Grant. The block grant would combine 13 existing categorical programs into one grant that would be available to school sites for school-wide improvement activities. In total, the block grant accounts for $540 million in categorical funds appropriated in the 1992 Budget Act. This grant could be reduced by half ($270 million) and still provide a moderate level of resources for school improvement during the budget year.

Even if the Legislature does not create the School Improvement Block Grant, our review indicates that the activities of the programs that would be merged into the block grant are relatively lower-priority and could be reduced or suspended for 1993-94 in order to reduce the Proposition 98 loan. The major programs that could be eliminated or reduced (for a savings of $270 million) are:

- ***Instructional materials*** could be suspended, for a savings of $131.2 million. Suspending book purchases for one year would not result in great harm to most instructional programs.
- ***The existing School Improvement Program (SIP)*** could be reduced by 30 percent, for a savings of $95 million. SIP funds pay for a range of improvement services including classroom aides, computers, and staff development. These activities could be reduced for one year without a critical loss of services.
- ***Class size reduction*** funds could be suspended in order to save $30.3 million. These funds reduce the size of English, history, science, and other core courses. Suspending this program would result in larger class sizes.
- ***Education technology*** grants could be suspended for a savings of $13.6 million. These funds support computer purchases and

software development. A one-year suspension would not create a critical problem for most districts.

By making these reductions in the 1993-94 budget, the Legislature would reduce the baseline level of K-12 spending and improve the chances of funding K-14 programs during 1994-95 without an additional loan. If the budget picture improves substantially in 1994-95, the Legislature could restore the reductions to school improvement programs or use funds for other discretionary purposes. Most importantly, the Legislature would have options other than a third year of borrowing against future revenues. For this reason, we recommend the Legislature reduce or eliminate funding for four existing categorical programs and redirect those funds to restore general-purpose funding or reduce the amount of the Proposition 98 loan.

CATEGORICAL PROGRAMS AND THE MEGA-ITEM

1992-93 Budget Action

As part of the 1992 Budget Act, the Legislature created what is known as the "mega-item." The item appropriated $4.5 billion from the General Fund for the support of 37 categorical programs, which previously had received separate appropriations. Funding for these programs is 2.2 percent lower than the amounts appropriated in 1991-92.

Budget Act language in the mega-item specified a procedure for determining allocations to individual programs within the mega-item. This procedure is based on 1991-92 funding for each program, as adjusted, with reductions applied proportionally across all programs. The language permits local education agencies (LEAs) to reallocate up to 5 percent of a program's funds to any other program within the mega-item for which the LEA receives funding. The reallocation, however, cannot increase any program's funding above the amount received in 1991-92.

The Legislature scheduled appropriations for new programs and program augmentations in separate items. In addition, one program, special education, received a separate allocation ($93 million) to pay for growth. Other categorical programs did not receive any growth funding.

Implementation of the Mega-Item by the State Department of Education (SDE). The SDE first allocated mega-item funds to programs using the procedure established in the mega-item. In several instances, SDE made administrative judgments to resolve conflicts in the language. Figure 9 shows allocation of funds to programs as determined by the SDE. The figure also shows the separate appropriations for categorical programs and the total amounts available for each program in 1992-93.

Language in the mega-item does not specifically identify how the SDE should distribute funds for any individual program to districts. Budget Act language, however, does require the SDE to follow policies expressed in statute. Consequently, funds for some programs, such as child development, were distributed through a contract process and were not allocated to districts. (These funds could not be reallocated under the 5 percent flexibility provision because their use was governed by the contract.) In addition, for programs with statutory growth formulas, the SDE reallocated funds among districts to recognize growth in the number of eligible students in each district. In high-growth districts, this reallocation had the effect of offsetting some of the 2.2 percent reduction in appropriations made in the budget. In lower-growth districts, the reallocation further reduced the amount received for categorical programs in 1992-93.

Finally, in an advisory to district and county superintendents, the SDE warned that certain statutory provisions prohibit districts from redirecting funds for certain programs to other programs within the mega-item. Specifically, the SDE pointed to existing law restricting adult education and special education funds for use only within each program. The department concluded that the Budget Act language providing flexibility over 5 percent of each program's allocation would not supersede any statutory prohibitions regarding use of funds. The SDE recommended that each LEA review the legal authority for any proposed reallocation of funds among programs within the mega-item.

Flexibility Generally Was Not Used by Districts. In our conversations with school district officials, it became apparent that few districts used the 5 percent flexibility provided in the mega-item. There were two main reasons for this. First, there was much uncertainty about which programs were protected from the reallocation process by statute. Districts were concerned that reallocating funds could result in an audit exception. Second, there was uncertainty about whether the state would continue to provide this allocation flexibility over the long-run. Districts were often unwilling to make changes in a program's funding level without a greater expectation that the mega-item flexibility would be provided in future years.

Budget Proposes to Continue Mega-Item

The Governor's Budget proposes to continue funding most categorical programs through a mega-item. The budget proposal, which includes an appropriation of $3.7 billion for the mega-item, also would make a number of significant changes to how the mega-item would operate in 1993-94. These changes are as follows:

Proposed budget language would change the mega-item into a block grant. In lieu of the language in the 1992 Budget Act giving LEAs discretion over 5 percent of each program's funding, language in the Budget Bill would permit LEAs to redirect all mega-item funding to any program that is funded within the item. According to the Department of Finance (DOF), this change was intended to give districts more flexibility over funds during these times of tight budgets.

The budget proposes to take four programs out of the mega-item. The budget proposes to withdraw from the item child development, child nutrition, deferred maintenance, and adult education programs. In addition, the budget assumes that all supplemental grant funds will

Figure 9

K-12 Education Categorical Program Funding 1992-93 and 1993-94 General Fund

(Dollars in Thousands)

	1992-93			1993-94		
	Mega-Item	Separate Appropriation	Total	Mega-Item	Separate Appropriation	Total
Regional Occupational Centers/Programs	$244,173	—	$244,173	$244,173	—	$244,173
Class Size Reduction	30,316	—	30,316	30,316	—	30,316
Tenth-Grade Counseling	8,115	—	8,115	8,115	—	8,115
Transportation	336,098	—	336,098	336,098	—	336,098
Court-Ordered Desegregation	420,339	—	420,339	420,339	—	420,339
Voluntary Desegregation	80,631	—	80,631	80,631	$2,380	83,011
School Improvement	321,241	—	321,241	321,241	—	321,241
School Restructuring	—	$13,000	13,000	13,000	11,613	24,613
Student Vocational Organizations	202	—	202	202	—	202
Specialized Secondary Programs	2,214	1,500	3,714	3,714	—	3,714
Opportunity Programs	1,582	—	1,582	1,582[a]	—	1,582
Foster Youth Programs	1,323	—	1,323	1,323	—	1,323
Dropout Prevention	11,822	—	11,822	11,822	—	11,822
Economic Impact Aid	297,850	—	297,850	297,850	—	297,850
Gifted and Talented Education	31,912	—	31,912	31,912	—	31,912
Miller-Unruh Reading Program	21,915	—	21,915	21,915	—	21,915
Intergenerational Programs	127	—	127	127	—	127
Native American Indian Programs	401	—	401	401	—	401
Demonstration in Reading and Mathematics	4,603	—	4,603	4,603	—	4,603
American Indian Centers	1,497	—	1,497	1,497	—	1,497
Adults in Correctional Facilities	7,072	1,001	8,073	8,073[a]	—	8,073
Special Education	1,439,873	93,007	1,532,880	1,483,703[b]	50,000	1,533,703

	1992-93			1993-94		
	Mega-Item	Separate Appropriation	Total	Mega-Item	Separate Appropriation	Total
Early Intervention for School Success	1,584	—	1,584	1,584	—	1,584
Partnership Academies	1,483	1,844	3,327	3,327	—	3,327
Agricultural Vocational Equipment	3,162	—	3,162	3,162	—	3,162
Institute for Computer Technology	419	—	419	419	—	419
Education Technology	13,581	—	13,581	13,581	—	13,581
Instructional Materials, K-8	104,767	—	104,767	104,767	—	104,767
Instructional Materials, 9-12	26,446	—	26,446	26,446	—	26,446
Staff Development	101,185	3,920	105,105	105,105	1,500	106,605
Intersegmental Programs	—	5,880	5,880	5,880	7,000	12,880
Teacher Dismissal	29	—	29	29	—	29
Year-Round Incentives	58,883	—	58,883	58,883	—	58,883
School Law Enforcement	636	—	636	636	—	636
Mega-Item Growth (1.55 percent)	—	—	—	33,523	—	33,523
Adjustment (transfer to child development)	—	—	—	-3,135	—	-3,135
Subtotals, programs funded in the mega-item in 1993-94	($3,575,481)	($120,152)	($3,695,633)	($3,676,844)	($72,493)	($3,749,337)
Healthy Start	—	$14,728	$14,728	—	$38,000	$38,000
California Assessment Program	—	11,760	11,760	—	23,504	23,504
Child Development	$406,966[c]	2,250	409,216	—	450,670[a]	450,670
Child Nutrition	52,451	—	52,451	—	59,647	59,647
Adult Education	286,585	—	286,585	—	422,678	422,678
Deferred Maintenance	22,492	—	22,492	—	—[a]	—
Supplemental Grants[d]	181,309	—	181,309	—	—	—
Totals	$4,525,284[c]	$148,890	$4,674,174	$3,676,844	$1,066,992	$4,748,836

[a] Excludes proposed reappropriations of prior-year funds.

[b] Reflects $71.3 million in additional revenues ($60.4 million in local property taxes and $10.9 million in federal funds).

[c] Includes a $22 million reappropriation.

[d] The proposed budget assumes that Supplemental Grants will be combined with district revenue limits in 1993-94.

be included in district revenue limits rather than added to an LEA's categorical program budget. Under provisions of the 1992 education trailer bill (Ch 703/92—SB 766), districts receiving supplemental grants in 1992-93 have the option of adding supplemental grant funds to revenue limits or categorical program allocations.

The budget proposes to add to the mega-item some programs funded separately in 1992-93. The budget folds into the 1993-94 mega-item funds for the School Restructuring Grant Program, for 1992-93 special education growth, and for various augmentations funded separately in 1992-93. The budget proposes separate appropriations for 1993-94 special education growth and some proposed augmentations.

Proposed Budget Bill language specifies that each LEA shall receive the same amount of program funds in 1993-94 as in 1992-93, plus 1.55 percent growth. The budget includes $33.5 million to fund program growth. Under this language, the SDE would not recalculate program entitlements within each program based on the most recent data. As a result, funds would not be reallocated among LEAs as they were in the current year.

Figure 9 shows the resulting distribution of funds to programs within the mega-item.

Problems With Categorical Programs

Anticipating that categorical reform would be a major issue this session, we are preparing a report that reviews the history, purpose, and success of categorical programs in California. We examine more than 55 of these categorical programs, which account for $5.1 billion in 1992-93.

From our review, we conclude that categorical programs do a relatively good job at allocating resources to specific programs. Program rules ensure that funds are spent on "eligible" students and specific services. We identify, however, a number of problems with the way these programs now operate:

Programs that dictate the details of program design have not been shown to be broadly successful. By mandating a specific model of service delivery, categorical programs can stifle creative local responses to problems—responses that are more likely to address successfully the needs of students.

Despite the extensive data collected from LEAs and the many program evaluations conducted, policy-makers have little information about how well many programs work. Few programs routinely collect good outcome data, which means that educators and policy-makers have little knowledge of the ongoing success of programs. Many evaluations are not evaluations as such, but operational reviews. Moreover, many programs cannot be evaluated because the program is so narrow in its focus that there is no way to measure accurately its impact on the larger educational processes that affect student achievement.

Program funding formulas can reward schools for behavior that is not in the best interests of students. For example, programs that determine district funding allocations based on the number of students eligible for services can create a fiscal incentive for schools to identify students as "in need" of special services. Then, if as a result of the program, a student's performance improves and he/she no longer qualifies as "eligible," the district loses funding. This type of funding structure results in fiscal incentives for LEAs that conflict with the interests of students.

The system of categorical programs promotes fragmentation of services at the school site. This fragmentation manifests itself in schools that focus on program and funding rules and leads to a blurring of responsibility for improving student achievement. Fragmentation of programs also increases the difficulty of integrating categorical services into the regular program. This integration appears to significantly improve student achievement.

Directly funding agencies other than school districts can further fragment services and program authority. Directly funding services through Special Education Local Plan Areas (SELPAs) or Regional Occupational Centers and Programs (ROC/Ps) encourages schools to act as if addressing the problems of special education and job preparedness is not the job of each school and classroom teacher. In the case of ROC/Ps, this problem is compounded by the fact that schools may have very little influence over the types of services provided by ROC/Ps. In addition, these separate organizational structures develop their own constituencies and priorities, which creates resistance to meeting the changing needs of high school students and school districts.

Principles of Categorical Program Reform

Based on our findings regarding the problems with categorical programs, we identify five principles for categorical program reform.

Maximize Local Control Whenever Possible. By increasing local flexibility over program design, schools would have more latitude to use funds to meet the needs of their students. The appropriate level of control (state, district, school site) depends on the nature of each program. Research emphasizing the role of individual schools in reform efforts suggests that, whenever practicable, funds should be made available to schools, rather than districts or other LEAs.

Clearly Identify Program Goals. Goals and outcome measures can powerfully influence the operation of local programs. The Legislature needs to focus on understanding the effectiveness of different approaches to problems through performance measures and leave as much decision-making over the details of those approaches to schools and districts. Not only would this call attention to the impact of different strategies, but it also would highlight the important interactions between the components of school improvement strategies.

Reward Schools for Good Performance. Negative fiscal incentives need to be replaced with positive incentives. For instance, research suggests that creating incentives for integration of special services into the regular classroom could lead to increases in student achievement. Eliminating the classification of "eligible" students for funding purposes will improve program incentives for LEAs.

Consolidate and Simplify Funding Structures. Program fragmentation can be reduced by consolidating programs to the extent possible. Consolidation of programs and funding structures, however, should never proceed beyond the point where there are clear goals and performance measures that describe the intent of the program. Simplifying the school finance system would help schools focus on policy and practice rather than funding.

Foster an Education Policy Environment That Learns From Its Experiences. The Legislature and LEAs need to make a greater effort to learn how services, learning environments, and social conditions affect student achievement, both in the long- and short-term. This means finding outcome measures that supply feedback to administrators and policy-makers about program effectiveness. Evaluation should be used to determine the effect of services and validate the accuracy of performance measures.

Governor's Proposal Falls Short

We recommend the Legislature reject the proposed categorical program mega-item and restore direct appropriations for most categorical programs.

We applied the above principles to the Governor's proposed mega-item and find it has the following problems:

- ***It Does Not Provide Meaningful Local Flexibility.*** Although the budget proposes to give LEAs complete control over *funding* allocations to programs within the mega-item, no relief is provided over state *program mandates.* That is, no matter how much money a district decides to spend on a particular program, it must follow all existing state rules and regulations. Our findings suggest the reverse should occur—that the state has a legitimate role in allocating resources, but more program flexibility should be provided. Protecting funding for specific services is, in some cases, the goal of the program. The Governor's proposal would strip most programs of that protection. Existing programs are designed, in part, to ensure that funds are available locally to support a particular purpose.

- ***Funding Control Is Placed at the Wrong Level.*** The proposal cedes funding control over all programs within the mega-item to school districts or county offices. Yet, our analysis suggests that, for some programs, control is better placed at the school-site level or the state level.

- ***The Proposal Does Not Simplify Programs at the Local Level.*** The mega-item block grant proposal simplifies the state appropriation process but does not simplify the job of LEAs because they must continue to comply with rules associated with each individual program. In fact, it complicates the job of LEAs because, under the proposal, they would be required to determine program funding allocations.

In addition, the Governor's mega-item proposal does not address the remaining principles we identify for categorical program reform: identifying program goals, rewarding good performance, and fostering learning from experience.

Although the Governor's Budget would provide districts flexibility in determining the allocation of mega-item funds among programs, we believe the mega-item proposal goes too far in giving school districts responsibility to allocate funds and not far enough in reducing program mandates, consolidating related programs in order to reduce program fragmentation, and clarifying program goals and outcome measures. For this reason, we recommend the Legislature reject the proposed mega-item and, instead, restore direct appropriations for most existing categorical programs.

Legislature Should Consolidate and Revamp Categorical Programs

We recommend the Legislature consolidate 19 existing programs into three new programs—a School Improvement Block Grant, a School Incentives Award Program, and a High School Dropout Prevention Block Grant.

We believe that substantial improvements can be made to improve categorical programs. Below we make recommendations for three new programs—programs that would be created by consolidating or revamping 19 existing programs. These recommendations follow the design principles discussed above.

A New School Improvement Block Grant. We recommend the Legislature create a school improvement block grant by consolidating 13 separate categorical programs into one grant. Specifically, we recommend merging the following programs into the new block grant: the existing School Improvement Program (SIP), Educational Technology (at least those funds directly granted to schools), Instructional Materials, Class-Size Reduction, Staff Development (at least those funds directly granted to schools), Tenth-Grade Counseling, New Teacher Support, Miller-Unruh Reading, Geography Education, Proficiency in Basic Skills, Teacher Evaluators, Vocational Education Equipment, and Demonstration Programs in Mathematics and Science.

This consolidation would place about $570 million in General Fund support for school improvement activities at the school level. This is $250 million more than is currently made available under the SIP.

The School Improvement Program grant would be available to provide support for school-wide improvement activities—improvements affecting all students at the school. Such a block grant would have the following features:

- ***School and District Plans.*** School improvement plans would be developed by a site council, as in the existing SIP. The plans would include a fairly broad array of school performance data. School site councils would be empowered to take a broader role in reviewing the effectiveness of school programs.
- ***Scope of the Program.*** Block grant funds could be used for virtually any purpose. Because the focus of the program is school improvement, however, the primary use for the funds should be one-time expenditures such as staff development, books, and computers. Consequently, we would encourage limits on the percentage of funds that could be spent on aides, teachers, or

other ongoing expenses so that school councils would maintain the flexibility to redirect funds to new uses as required. Specific program requirements of the 13 existing programs would be deleted.

A School Incentives Award Program. We recommend the Legislature create a new School Incentives Award Program to provide financial awards to schools that perform well. We believe that the almost $70 million now allocated to the Mentor Teacher Program would be better used to create positive incentives—or rewards—for schools that perform well. The use of mentor teacher funds is appropriate from two respects. First, mentor teacher funding is sufficient to provide fairly large awards to schools—large enough to be meaningful to teachers, principal, and parents.

Second, the Mentor Teacher Program is designed to recognize the talents of the state's best teachers. Our suggested incentive program takes that idea one step further: it is designed to recognize the achievements of the state's high-achieving or quickly improving schools. The fund would support awards to school sites that administered very effective programs or showed great progress in improving its program. Awards could be used in any manner, including teacher stipends, as determined by the site council.

Awards would be made to the highest-performing schools and the schools showing the greatest increase in performance over a two-year period in a variety of different performance areas. If 5 percent of the roughly 7,000 schools in the state received an award each year, the $70 million from the Mentor Teacher Program would provide an average of $100,000 per school.

Test scores clearly would be one measurement for purposes of making awards. There are other areas, however, of particular importance to elementary, junior, and senior high schools:

- Elementary schools, for instance, could be rated for attendance and the percentage of students reading at grade level at the end of third and sixth grade.
- Junior high schools could be rated based on dropout rates, percentage of students mastering basic skills by the end of eighth grade, and the percentage of students receiving individual career counseling.
- Senior high schools could be rated based on dropout rates; graduation rates; the percentage of students who go to college, additional training, or find full-time employment; and the wages of those who choose to work upon graduation.

Awards also could be given to schools that do a very effective job at integrating special education, compensatory, and limited-English-proficient students into the classroom.

High School "At-Risk" Block Grant. We recommend the Legislature consolidate five existing programs currently serving students at risk of dropping out of high school into one block grant for that purpose in order to give districts more ways to serve this population. Specifically, we recommend merging the following five programs into the high school "at-risk" block grant:

- Dropout Prevention.
- Continuation Schools (the amount above the district's revenue limit).
- Partnership Academies.
- Concurrent Enrollment (from within each district's 10 percent allowance).
- Economic Impact Aid (compensatory funds going to high schools only).

This consolidation would provide up to $200 million for supplemental services.

These five programs each provide additional services to students at risk of dropping out of high school. Each program uses a different service delivery model. Most districts receive funding from one or two of these programs, which means they are limited in the approach they can take to dropout prevention based on the funding source they receive.

Block grant funds would provide districts with broad latitude over the use of funds, thereby freeing districts to use the service delivery model that best meets the needs of students. The block grant also should permit broad authority to districts to experiment with different ways to prevent dropouts. For instance, some educators believe that potential dropouts can be identified in middle or junior high school years or even during elementary school. Districts should be able to try different approaches using these funds. To provide flexibility at a school-site level, districts could be required to pass funds through to each high school within the district based on each school's need. In this way, each high school would have a pool of funds to support dropout prevention activities.

The success of dropout programs should be measured by a school's ability to prevent dropouts, its ability to help those who have already dropped out to return to school, and to help potential dropouts graduate from high school and go to college or find a job. Therefore, performance data should measure attendance, dropout rates, and the percentage of students completing grade 12 without sufficient course credits to graduate. In addition, schools should be required to report post-graduation data on employment, wages, and the percentage of students attending college or other training programs. These data are essential to increasing the awareness of how school affects a student's post-high school employment opportunities. We believe these data can be obtained at a relatively modest additional cost.

Positions Provide Valuable Services

We recommend that the State Department of Education (SDE) report during budget hearings on other staff reductions that could be made instead of reductions to staff working on program quality reviews.

The budget proposes to delete five consultant positions within the School Improvement Program (SIP) office and redirect the funding associated with those positions to support additional staff in new program areas. According to the Department of Finance (DOF), the SIP has been operating since the 1970s and thus is a mature program. The DOF believes that the program does not need the level of staff support that is generated by five consultant positions.

According to the SDE, however, only one of the consultants actually works on the SIP itself. The remaining staff are responsible for developing and supporting the state and local program quality review (PQR) effort. PQRs are conducted in each school every three years. These reviews, which are conducted by county office and LEA staff, compare a school's curriculum with state model curriculum to identify any content that might be missing in the school's curriculum. As part of the state's role in the PQR process, the SDE staff (1) develop the criteria and guidelines that structure the review process and (2) train program reviewers and school district staff to conduct PQRs.

Our analysis indicates that eliminating these positions would prevent the SDE from implementing some important curriculum improvement activities. One of the findings in our review of categorical programs is that the Legislature needs to create ways that educators can learn from their experiences in order to further improve the effectiveness of services. At the state level, this means improving the quality of program evaluations. At the local level, this means improving the ability of school administrators and faculty to identify problems, develop and implement solutions, and collect data to determine whether those problems were solved.

The PQR staff are currently revising the PQR process in a way that enhances local learning from experience. Specifically, the staff are currently completing a new PQR guide for elementary schools. The new guide will establish a process for school administrators and teachers to use in (1) identifying curriculum problems by examining how well students learn and (2) developing a plan to improve the quality of a school's curriculum. The process will also ensure that the curriculum addresses all aspects of state frameworks and maximizes the use of other state resources in curriculum development. The new guide is expected to be distributed to schools in April, with training to begin in 1993-94. The SDE also is beginning the development of a new high school guide.

We believe the new PQR process will achieve two important goals: improving the problem-solving abilities of administrators and teachers and coordinating quality reviews with the curriculum frameworks. As a result, we view this work as too important to be discontinued at this time. Recognizing, however, the fiscal situation the state finds itself in, we believe there are lower-priority activities that could be redirected in lieu of the SIP staff. For this reason, we recommend that the SDE report during budget hearings on staff reductions that it proposes instead of the SIP cuts.

IMPACT OF CURRENT-YEAR BUDGET ACTIONS

Despite constant year-to-year Proposition 98 funding on a per-pupil basis and a 2 percent per-pupil increase in revenue limit spending, many school districts faced shortfalls in developing their 1992-93 budgets. While all districts we contacted attempted to keep reductions "away from the classroom," several reported class size increases and elimination of some elective subjects. Virtually every district we contacted reported significant reductions in district administrative staff, custodial and maintenance services, instructional support, and pupil support, as well as efforts to minimize increases in employee salary and benefits costs.

The 1992 Budget Act and trailer legislation provided Proposition 98 funding for K-12 education programs (about three-fourths of all funds available to K-12 schools from local, state, and federal sources) of $4,187 per pupil, the same level of per-pupil funding provided in 1991-92, and $76 per pupil more than provided in 1990-91. Given two years of slow or no growth in per-pupil funding, many school districts faced financial difficulties in 1991-92 and the current year. In perhaps the most widely publicized case, the Los Angeles Unified School District made 1992-93 budget reductions of $400 million, 13 percent of its general program budget, including measures to reduce staff salaries by 12 percent.

In order to provide some perspective on these difficulties, and to get a clearer picture of how school districts are managing within current- and prior-year levels of state and local spending for K-12 education, we surveyed school business officials at 16 school districts during October and November 1992. Figure 10 lists these districts. We conducted on-site surveys at 12 district offices, telephone interviews in three cases, and, in one case, reviewed financial summaries submitted in lieu of an interview. Our survey included districts of various types (elementary/high school/unified), sizes, and levels of expenditure per pupil. We asked questions about revenue and expenditure trends since 1990-91, budget reduction and revenue enhancement strategies, collective bargaining, and the budget process. We summarize below the results of our survey.

Current-Year Troubles Rooted in Prior-Year Spending Patterns

All of the districts in our survey implemented spending reductions to balance their 1991-92 and 1992-93 budgets. Most of the school business officials we contacted stressed that it is impossible to

Figure 10

School Districts Surveyed by the Legislative Analyst's Office October-November 1992

District	County
Unified	
Amador	Amador
Fremont	Alameda
Fresno	Fresno
Lodi	San Joaquin
Los Angeles	Los Angeles
Monrovia	Los Angeles
Rowland	Los Angeles
Sacramento City[a]	Sacramento
San Diego	San Diego
High School	
El Dorado Union	El Dorado
Shasta Union	Shasta
Sonora Union	Tuolumne
Elementary	
Buckeye Union	El Dorado
Gold Trail	El Dorado
Redding	Shasta
Riverdale	Fresno

[a] No interview; reviewed budget summary documents only.

understand these recent difficulties without reference to past-year spending commitments and revenue trends. Based on our discussions with them, it appears that the following factors have interacted over at least the past three years to create recent school district budget problems.

General-Purpose Funding Not Fully Adjusted for Inflation. School districts receive the substantial majority of their unrestricted revenue for general education purposes based on a specific per-pupil amount known as a revenue limit. Revenue limits are funded by a combination of local property taxes and state aid. Under current law, revenue limits receive a cost-of-living adjustment (COLA) each year designed to offset the effects of inflation on the cost of basic goods and services. However, revenue limits did not receive a full COLA in 1992-93 or either of the prior two years. Consequently, while total general-purpose funding increased in each of the three years to keep pace with enrollment, school districts' purchasing power with respect to basic goods and services has declined by about 6 percent since 1989-90.

Health Benefit Costs Increase at a Double-Digit Pace. All of the school business officials we contacted considered the rising cost of medical and dental coverage for employees to be a major cause of fiscal strain. Most cited cost increases of 12 to 15 percent annually over the past three years, a rate well above the increases in revenue limit funding during that period.

Salary and Benefit Commitments Exceed Resources. Employee salaries and benefits account for roughly 85 percent of the average school district's annual expenditures. School districts provide salary and benefits packages based on contracts negotiated through collective bargaining with employee representatives. Thus, when revenue growth declined sharply over the past three years, districts with multi-year contractual obligations that were based on a more favorable revenue picture had little hope of offsetting the resulting cost overruns with savings in the nonpersonnel areas of their budgets. They faced the difficult prospect of staff reductions or renegotiation of salary and benefit packages.

The Los Angeles Unified School District (LAUSD), for example, negotiated an agreement with most of its bargaining units to provide an 8 percent COLA for three years, 1988-89 through 1990-91. Revenue limit inflation adjustments in those years, however, ranged from 3 percent to 4.6 percent. Primarily as a result of this disparity, the district's general fund expenditures grew by 30 percent over the three-year period, while its general fund revenues from all sources grew by only 24 percent. As a result, the LAUSD was obliged to close budget gaps of roughly $400 million in 1991-92 and 1992-93. Other large unified districts negotiated salary increases with their employees in the late 1980s that exceeded, though to a lesser extent than the LAUSD rates, the rate of revenue growth that they realized. School districts that negotiated more conservative increases during that period, while by no means immune from fiscal hardship, were able to manage with less severe budget reductions in 1991-92 and 1992-93.

Prior-Year Budget Imbalances Not Fully Addressed. Some school districts, when faced with budget deficits in 1989-90 and 1990-91, addressed them at least in part by one-time revenue and expenditure adjustments. Based on the performance of the California economy through past recessions, policy-makers in these districts believed that the recession would end quickly and that revenues would grow fast enough in subsequent years to fund prior-year shortfalls and ongoing program requirements. One-time adjustment strategies employed by school districts included: spending down general fund reserves, shifting costs to or capturing excess balances from various special purpose funds, debt financing of capital outlay spending previously funded from the general fund, and generally advancing recognition of revenue or delaying recognition of costs.

As we point out in Part II of *The 1993-94 Budget: Perspectives and Issues,* California's economy has remained in the current recession longer than it remained in past recessions, and is projected to recover more slowly. Consequently, state aid to schools is not increasing at the rate anticipated by some district policy-makers early in the recession. Thus, the current economic situation requires school districts that relied in the past on one-time adjustments to now address their accumulated budget problems through ongoing program reductions.

School Districts Pursue a Variety of Strategies to Cope with Shortfalls

Strategies for coping with budget shortfalls followed a fairly consistent pattern among the districts we surveyed. All of the school business officials we interviewed indicated that district policy was to keep budget reductions away from basic instructional programs, insofar as possible. To that end, the districts generally resorted first to reductions in the area of district and school-site administration, and last to reductions in employee compensation and elimination or curtailment of instructional programs. Specifically, the districts acted to:

- Consolidate functions and reduce staff in the areas of district and school- site administration, maintenance, and custodial services.
- Eliminate or reduce instructional support.
- Eliminate or reduce pupil support programs.
- Eliminate athletics and other extracurricular activities, or shift costs to participants and/or community support groups.
- Eliminate or reduce instructional programs.
- Cap or reduce employee compensation.

Based on our survey, we provide below some specific illustrations of these strategies.

Administration, Maintenance, Custodial Services. All of the districts we surveyed made significant budget reductions in these areas during 1991-92, and again in 1992-93. In many cases, cuts in administration involved a major restructuring of district and school-site administrative functions, including elimination and consolidation of whole units in larger districts. Most of the districts had reduced deferred maintenance funding to the minimum required to receive state matching funds. Most also reported programs to hold down utility costs.

Instructional Support. Virtually all of the districts reported reduced spending for staff development, curriculum development, and instructional materials and supplies. Many reduced support for teacher preparation periods. Reductions in library hours and in library staffing were frequently mentioned. Several districts closed resource centers that supplemented their basic curriculum by providing, for example, instruction in computing skills or practice in basic language skills.

Pupil Support. Virtually every district took actions to reduce pupil transportation costs. This is because state aid provided specifically for pupil transportation funds only a fraction of actual transportation costs, leaving a significant share to be supported from revenue limit sources. Cost reduction strategies ranged from improving efficiency through route consolidation and changes in school schedules to assessing transportation fees. Pupil support staff frequently mentioned as the target of reductions were school nurses, language/speech/hearing specialists, social workers, guidance and career counselors, and tutors.

Some district staff indicated that cuts in the area of student support were eroding efforts to provide special support to pupils at risk of dropping out. Other districts, however, indicated that the current fiscal situation had actually focused attention on keeping "at-risk" children in school in order to receive revenue limit funding for them.

Athletics/Extracurricular Activities. Virtually all of the districts surveyed indicated that such activities had been curtailed or that costs had been shifted to participants through fees. In the case of athletics, booster groups were often mentioned as a source of funds for transportation costs and uniforms.

Instructional Programs. While all of the districts we surveyed tried to avoid reductions that would directly affect instructional programs, none could avoid them entirely. Most increased class sizes to some extent over the past three years, and increased the ratio of pupils to classroom aides. All had reduced access to elective programs, or eliminated some programs entirely. The program reductions most frequently mentioned were in the areas of music, dramatic arts, visual arts, foreign languages, and vocational education.

Employee Compensation. Of the districts we surveyed, Los Angeles Unified was the only one to implement a salary reduction. As noted above, the district provided COLAs in past years that were significantly greater than those provided by the others. Most the rest provided no COLA to employees in 1991-92 and 1992-93 but continued to fund salary increases for teachers based on years of service and level of professional preparation. Two provided small COLAs based on collective bargaining agreements that tied COLAs to the level of revenue limit inflation adjustments funded by the state.

Virtually all of the districts we contacted had negotiated cost control measures for employee health and dental benefits. The measures included caps on district contributions to premium payments, increased deductibles and copayments, and shifts from indemnity coverage to health maintenance/preferred provider types of plans. Many of the smaller districts had joined with other districts to provide benefits through a joint powers authority or other risk-pooling mechanism, in order to negotiate more favorable rates with insurers.

Conclusion

All of the districts we surveyed faced budget shortfalls and spending reductions in 1991-92 and 1992-93. These shortfalls resulted from an erosion of the basic purchasing power of district funds, long-run spending commitments that exceeded long-run income, and a final reckoning with prior-year budget problems that had been addressed by one-time budget adjustments. While all districts attempted to keep cuts away from the classroom, none were entirely successful. Spending reductions in the areas of administration, pupil support, instructional support, and extracurricular activities were universal, as were salary and benefit cost-containment efforts.

K-12 EDUCATION FUNDING—TEN-YEAR HISTORY

Per-ADA funding from all sources, in inflation-adjusted dollars, has increased by 6.2 percent since 1984-85, despite reductions in 1990-91, 1991-92, and 1993-94.

Figures 11 through 14 provide a ten-year history of funding for K-12 education programs from all funding sources. This funding history differs from the information provided elsewhere in the *Analysis* because it (1) includes all funding sources, (2) covers a longer time period, and (3) shows funding in the year when it was actually allocated to school districts, rather than the year the funding is shown as an expenditure in the Governor's Budget. This distinction is necessary because monies from Proposition 98 loans and funding shifts between fiscal years are not shown as expenditures by the Governor's Budget in the years they are actually spent by districts. The various funding categories presented in the figures, and other technical factors are detailed in the concluding section.

Figures 11 and 13 show that funding from all sources has increased by a total of 84 percent since 1984-85. The smallest percentage increase has been from the state General Fund. In contrast, the largest

Figure 11

K-12 Education Funding By Funding Source 1984-85 Through 1993-94

(Dollars in Millions)

	State Funds	Local Property Tax Levies	Lottery Funds	Federal Funds	Other Local Sources	Totals
1984-85	$9,940	$3,298	—	$1,095	$918	$15,251
1985-86	10,805	3,596	$556	1,126	1,003	17,085
1986-87	12,174	3,804	411	1,167	979	18,535
1987-88	12,486	4,108	590	1,345	1,592	20,121
1988-89	13,568	4,466	911	1,517	1,767	22,229
1989-90	15,013	4,797	781	1,634	1,943	24,168
1990-91	15,773	5,252	602	1,770	1,770	25,164
1991-92	16,350	5,629	399	2,013	1,770	26,161
1992-93 (proposed)	15,928	7,044	558	2,238	1,770	27,538
1993-94 (proposed)	14,210	9,332	558	2,227	1,770	28,096
Cumulative change						
Amount	$4,269	$6,034	$558	$1,132	$852	$12,845
Percent	43.0%	182.9%	—	103.4%	92.8%	84.2%

change has been in local property tax levies. The current-year shift of $1.2 billion in property tax revenues to schools from other local government entities, and the proposed budget-year shift of an additional $2.2 billion explain over half of this increase.

Figure 12

K-12 Education Funding Per ADA In Current and Constant Dollars 1984-85 Through 1993-94

(ADA in Thousands, Total Funding in Millions)

		Current Dollars		Constant Dollars	
	ADA	Total Funding	Funding Per ADA	Total Funding	Funding Per ADA
1984-85	4,353	$15,251	$3,504	$15,251	$3,504
1985-86	4,470	17,085	3,822	16,455	3,681
1986-87	4,612	18,535	4,019	17,288	3,749
1987-88	4,723	20,121	4,260	18,015	3,814
1988-89	4,872	22,229	4,563	19,099	3,920
1989-90	5,060	24,168	4,777	19,995	3,952
1990-91	5,273	25,164	4,773	20,022	3,798
1991-92	5,438	26,161	4,811	20,406	3,753
1992-93 (proposed)	5,521	27,538	4,988	20,944	3,794
1993-94 (proposed)	5,595	28,096	5,021	20,816	3,720
Cumulative change					
Amount	1,243	$12,845	$1,517	$5,566	$216
Percent	28.6%	84.2%	43.3%	36.5%	6.2%

Funding Adjusted for Inflation and Enrollment Growth

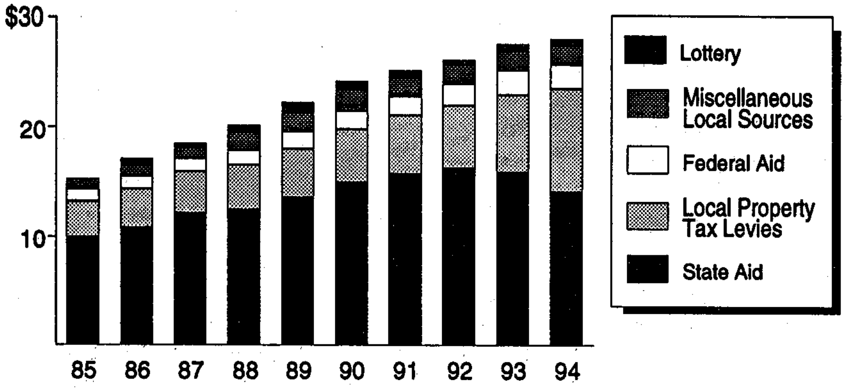
Figures 12 and 14 show total funding on a per-ADA basis, both in current dollars and constant (inflation-adjusted) dollars. They show that per-ADA funding in inflation-adjusted dollars has increased by 6.2 percent during the ten-year period, despite reductions in 1990-91, 1991-92, and 1993-94.

The levels of per-pupil funding presented in these figures for 1991-92 through 1993-94 differ from the $4,220 per-pupil level of Proposition 98 funding discussed elsewhere in this analysis, primarily because the spending figures include funding sources that are not counted under Proposition 98. These funding sources include federal funds, lottery funds, non-Proposition 98 local revenue, and non-Proposition 98 state aid.

Figure 13

K-12 Education Funding By Funding Source 1984-85 Through 1993-94[a]

(In Billions)

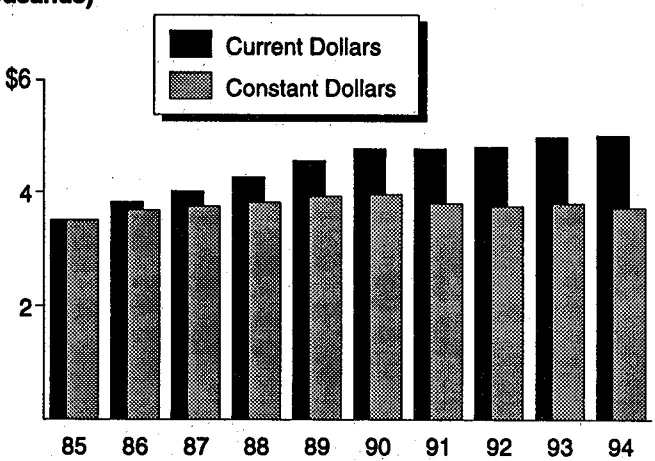


[a] Data are for fiscal years ending in year shown.

Figure 14

K-12 Education Funding Per ADA Current and Constant Dollars 1984-85 Through 1993-94[a]

(In Thousands)



[a] Data are for fiscal years ending in year shown.

Technical Highlights

In order to keep these figures in perspective, it is helpful to understand various technical factors that are highlighted below.

State Aid. This category includes General Fund and special fund monies in Item 6110, contributions to the State Teachers' Retirement Fund, state payments on general obligation bonds and Pooled Money Investment Account loans, and support for other expenditures categorized as K-12 for purposes of Proposition 98 (mandates, deferred maintenance, Office of Criminal Justice Planning, and Department of Mental Health).

Proposition 98 loans and funding shifts between fiscal years are reported in the following manner:

- 1990-91 figures include $1.233 billion loaned from 1991-92.
- 1991-92 figures include $1.083 billion loaned from 1992-93 and exclude $1.233 billion used in 1990-91. Figures for 1992-93 and subsequent years assume correction of a technical error in the legislation that implemented the $1.083 billion shift, and that the shift will therefore occur as intended.
- 1992-93 figures include $732 million loaned from future fiscal years.
- 1993-94 figures include a proposed $540 million loan from future fiscal years.

The 1992-93 estimate is $304 million less than the estimate contained in our status report, *K-12 Education Funding—Ten-Year History* (Legislative Analyst's Office, October 1992). This is primarily because the Governor's Budget proposes a net General Fund reversion of $315 million, based largely on reduced estimates of 1992-93 K-12 enrollment.

Local Property Tax Levies. This category includes Proposition 98 local property taxes, property taxes in excess of revenue limits, and state property tax subventions. These figures assume that schools will receive the full amount of current-year and proposed budget-year property tax shifts. Schools could receive up to $200 million less in the current and budget years, however, due to implementation problems and legal challenges related to a $375 million tax shift from special districts to schools that was implemented in the current year.

Federal Aid. This category includes federal funds in Item 6110, Petroleum Violation Escrow Account funds for the School Bus Demonstration Program, and State Legalization Impact Assistance Grant funds for 1988-89 through 1992-93.

Other Local Income. This category includes revenue from developer fees, sales of property and supplies, cafeteria revenues, interest and lease income, and other income. Our figures for 1990-91 through 1993-94 are significantly lower than figures presented by the Department of Finance (DOF) in the 1993-94 Governor's Budget. Our 1990-91 figure is based on actual local revenues reported by school districts to the State Department of Education. The $176 million decline from 1989-90 occurred primarily for recession-related reasons: revenue from developer fees declined by $171 million from 1989-90, while revenue from other local sources showed no net growth. Based on the continued weakness of the state's economy, and in particular on weakness in the construction sector, we have assumed no funding growth in this category through 1993-94. The DOF, in contrast, assumes annual growth of 10 percent from 1989-90 through 1993-94. Additional data will become available this fall, after the SDE collects data on actual revenues for 1991-92 and surveys school districts concerning 1992-93 local revenues.

Inflation Adjustments. Inflation adjustments are based on the GNP price deflator for state and local government purchases of goods and services.

Sources of Information. Data are from *Financial Transactions of School Districts*, J-41, J-73, J-200, J-400, and J-600 district and county financial reports, and the Governor's Budget (various years).

SPECIAL EDUCATION

Impact of Mega-Item Reductions Not Clear

We withhold recommendation on a $22.1 million augmentation to the special education budget pending additional information on 1992-93 spending that will be available as part of the May revision.

The Governor's Budget includes a total of $1.5 billion in General Fund support for special education in 1993-94. This is an increase of $823,000, or less than 1 percent, above the current-year amount. The budget-year request reflects the following adjustments:

- $60.4 million reduction due to additional local property tax revenues resulting from the proposed shift from cities and counties to school districts.
- $10.9 million reduction due to additional funds from district revenue limits and federal special education funds.
- $22.1 million increase related to revised estimates of current-year expenditures.
- $50 million increase due to growth.

The Governor's Budget includes the same amount for 1992-93 special education costs as the 1992 Budget Act.

Potential Current-Year Shortfall. The 1992 Budget Act made two offsetting changes to the special education budget. First, "base" program funding was reduced (as in all mega-item programs) by 2.2 percent, or $32.4 million. Second, the budget allocated $93 million to support anticipated growth of 3.8 percent (the projected increase in regular ADA) in the number of special education students. The result of the two actions was to *increase* special education funding by $60.6 million.

Special education funds are allocated by "unit," which includes a classroom, teacher, and support services. Each unit serves a certain number of students. Funds are allocated based on units because state law requires special education classes to operate using specific ratios of students to teachers and staff. In allocating special education instructional units in the current year, the SDE did not make a reduction in the number of units to correspond with the base funding reduction. The effect of its action was to allocate more units than could be supported with available funds.

By authorizing the units, the SDE opened the door for LEAs to claim state funds for the unfunded units. To the extent that LEAs actually claim additional funds for those units, special education will have a funding shortfall in 1992-93.

This shortfall may be mitigated to a limited extent because the number of units allocated for growth may exceed the actual number needed. The $93 million allocation for growth was based on 3.8 percent growth in regular K-12 ADA. The current estimate of growth in K-12 ADA, however, is only 1.6 percent. (The effect of this estimated reduction in growth is likely to be limited because the actual growth in the special education student population has typically exceeded the number that can be accommodated in funded units.)

Department of Finance (DOF) Estimate of Shortfall. For purposes of developing the 1993-94 budget, the DOF estimated the current-year shortfall to be $22.1 million. To arrive at the $22.1 million figure, the DOF recalculated funding entitlements based on 1991-92 actual spending and various growth factors for 1992-93. Essentially, the reason for the shortfall is that this methodology has the effect of restoring the reduction imposed on all mega-item programs in the 1992 Budget Act. The DOF methodology assumes that districts will claim all units allocated by the SDE.

Based on statutory requirements, any shortfalls would be covered by reducing special education apportionments across the board. However, in the past, the DOF has requested, and the Legislature has approved, deficiency appropriations to cover special education shortfalls. Thus far, the DOF has not requested a deficiency appropriation to fund this shortfall, and the shortfall is not reflected in the budget document.

Actual Shortfall Uncertain. Because of the uncertainty in LEA response to the mega-item reductions and the lower K-12 growth rate, we are unable to advise the Legislature of the size of the 1992-93 special education shortfall created by the mega-item reduction. Additional information will be available regarding this issue by the May revision.

Budget Proposal Restores Mega-Item Cut. The proposed 1993-94 budget includes an augmentation of $22.1 million related to the 1992-93 shortfall. Because of the uncertainty over 1992-93 special education costs, we believe it is quite possible that some or all of the $22.1 million restoration will not be needed in 1993-94. For this reason, we withhold recommendation on the proposed augmentation, pending better data on actual LEA claims for special education that will be available as part of the May revision.

Although the $22.1 million figure is subject to change, we believe the methodology used by the DOF is essentially sound, because it is based on a realistic picture of LEA claims in 1992-93. We believe that the Legislature should not continue the current situation—where program shortfalls have been generated due to the existence of unfunded units. By allocating unfunded units, the state misrepresents to LEAs the real amount of resources that are available to special education, and opens itself to future claims for funding.

Accordingly, we also suggest that, if the Legislature reduces special education expenditures in the 1993-94 Budget Bill, it direct the SDE to allocate only funded units. By doing this, the state will not create hidden program shortfalls, and LEAs will have clear information on the amount of special education funds that will be available. (We recommend in an earlier section that all growth funding, including growth funding for special education, be deleted to free up funds to restore existing per-pupil general-purpose funding and minimize the size of the Proposition 98 loan.)

Special Education Overbudgeted

We recommend the Legislature reduce by $17 million the appropriation for special education proposed for 1993-94 because of technical errors in the estimating process (reduce Item 6110-230-001).

The budget proposal for special education is based on actual LEA expenditures for 1991-92, as adjusted for growth in the student population during 1992-93 and 1993-94. Our analysis indicates that the proposed special education budget for 1993-94 underestimates by $17 million the amount of revenue limit funds that will be available to support special education programs.

Inconsistent Growth Estimates. The DOF's estimate contains an inconsistency in its assumption about the amount of growth that will take place during the current year. Specifically, the estimate assumes that special education enrollment will increase by 3.8 percent, based on the amount of growth authorized in the 1992 Budget Act. The DOF assumes, however, that revenue limit funds provided to special education students will increase only 1.6 percent. If the number of units used by LEAs during 1992-93 increases by 3.8 percent, revenue limit funds also will increase by 3.8 percent. By using the lower revenue limit growth estimate, the DOF has underestimated revenue limit funding for special education students and, consequently, overestimated state funding needs by $8.2 million.

Revenue Limit Increase Was Not Included. The DOF estimate of 1992-93 revenue limit funds also does not include the 2.1 percent increase in local revenue limits provided in the 1992 Budget Act. By omitting this increase, the DOF projection underestimates the amount of revenue limit funds that will be available to support special education. We calculate that, because of the 2.1 percent increase, $8.8 million in revenue limit funds will be available that is not reflected in the proposed 1993-94 special education budget. Thus, the General Fund request for the program is overstated by that amount.

We recommend that the Legislature delete these funds (total of $17 million) from the special education appropriation. They would be available for other Proposition 98 purposes.

Nonpublic School Program Costs Are Going Through the Roof

We recommend the Legislature enact legislation to increase from 30 percent to 50 percent the local share of nonpublic school (NPS) costs in order to reduce the fiscal incentives for districts and Special Education Local Plan Areas (SELPAs) to place students in nonpublic schools. As part of the legislation, we recommend redirecting funds appropriated for NPS costs in 1993-94 back to local education agencies (LEAs) so that no agency experiences a funding decrease for students placed in NPS settings prior to 1993-94.

School districts, county offices of education, and SELPAs are responsible for arranging instruction for special education students. For the most part, education is provided by these public agencies. Occasionally, a student will have special needs that cannot be met within the public school system. In these cases, students may be referred to attend classes in a nonpublic school or licensed children's institution (LCI).

A nonpublic school is a private school certified by the SDE to serve students with disabilities. Generally, referrals to nonpublic schools are made by LEAs. An LCI is a residential facility under contract with the state to provide nonmedical care to children. LEAs do not refer children to LCIs; such referrals are made by the courts, regional centers for the developmentally disabled, or other public agencies.

Both types of placements are funded under the NPS program. (In this discussion, "NPS program" includes both types of placements, while "NPS" refers solely to nonpublic school placements.) The cost per student under the NPS program can be quite high. In 1991-92, for example, the program served 7,810 students at a total average cost of

$23,850 per student. These costs are high, in part, because they include some residential and mental health costs—for which LEAs are responsible in some situations—as well as education costs.

The budget estimates expenditures of $137 million in 1992-93 for the state share of NPS program costs, an increase of 5.2 percent over 1991-92 expenditures. The budget proposes $143.7 million for 1993-94, an increase of 4.9 percent over estimated 1992-93 expenditures. These costs are in addition to revenue limits and regular special education funding provided for each student with special needs. Based on a 17 percent average annual growth rate for NPS program costs from 1982-83 through 1991-92, however, we believe it is likely this program will incur costs significantly higher than estimated in 1992-93 and budgeted in 1993-94. Existing law requires higher costs to be offset by across-the-board reductions in special education apportionments to districts and county offices. However, in the past, the Department of Finance has requested, and the Legislature has approved, deficiency appropriations to cover increased NPS program costs.

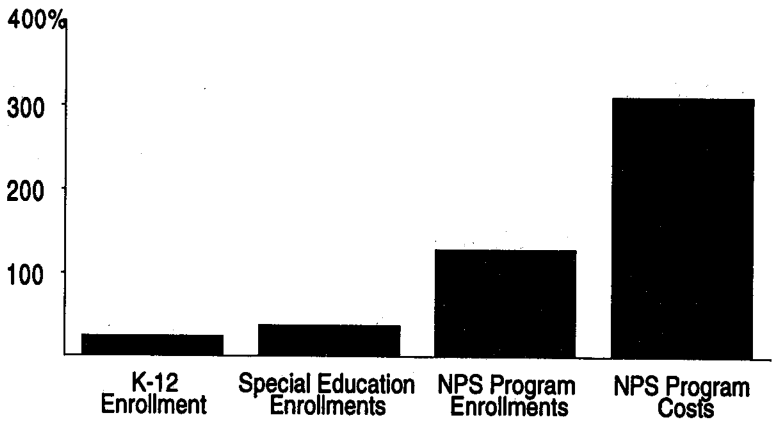
Reimbursement of NPS program costs is handled differently than other special education costs. For regular special education students, LEAs are funded based on the instructional setting (special day class, resource specialist program, or regular classroom) and an LEA-specific funding rate. LEAs also receive revenue limits for some of these students. For NPS program costs, the state pays 70 percent to 100 percent of the amount exceeding the LEA's revenue limit. The percentage reimbursement is determined as follows:

- Costs of placements in LCIs located within the district's boundaries or in nonpublic schools are reimbursed at 70 percent of allowable costs.
- Costs of placements in an LCI outside of the district's boundaries are reimbursed at 100 percent of allowable costs.
- Education costs of children attending school in hospitals or medical facilities—no matter where they are located—are reimbursed at 100 percent.

Figure 15 shows the cumulative growth of NPS costs and enrollments, as well as K-12 and special education enrollments, for 1983-84 through 1991-92. NPS enrollments and costs have escalated far faster than those in special education or the basic educational program. Since 1983-84, NPS costs grew 311 percent, from $31.7 million in 1983-84 to $130.2 million in 1991-92. During that same period, NPS enrollments grew 130 percent, much faster than the 37 percent growth in special education enrollments or 24 percent growth in total K-12 enrollments.

Figure 15

Cumulative Percent Growth of the Nonpublic School (NPS) Program Compared to Growth in Other Programs 1983-84 Through 1991-92



Funding System Creates Incentives for NPS Placements. Our review indicates that the NPS program funding system creates fiscal incentives for school districts to place students with disabilities—especially those who are expensive to serve—in nonpublic schools. First, these placements are not counted toward a district's 10 percent cap on special education funding. Current law limits the number of students for which a district may receive special education funding to 10 percent of its total enrollment. As a result, referring a special education student to a nonpublic school allows districts that are at their 10 percent cap to receive funding for another special education student.

Second, districts may save money by referring a student to a nonpublic school instead of serving the student itself. Depending on the state funding received for special education students by the district, the cost of serving a student within a district, and the cost of a nonpublic school, a district could serve a student at a lower cost to the district by placing a student in a nonpublic school setting. Figure 16 illustrates how this can occur. Assuming "gross service" costs of $15,000 to serve a student, a district with a revenue limit of $3,000 and a special day class rate of $10,000 would save $1,400 by referring the student to a nonpublic school. This is because the district's cost of serving a student in a public school is simply the cost of service ($15,000) less state funding ($10,000), or $5,000, while the district's cost of serving the student in a nonpublic school is the cost of service less the district's revenue limit ($15,000 - $3,000), times 30 percent, or $3,600. Thus, the district saves $1,400 with a referral to a nonpublic school.

Figure 16

School District Costs and Savings in Public and Nonpublic School Settings

	Gross Service Costs		
	$15,000	$24,000	$50,000
Net district costs for public school placement	$5,000	$14,000	$40,000
Net district costs for nonpublic school placement	3,600	6,300	11,100
Savings to district by referral to a nonpublic school	$1,400	$7,700	$38,900

Note: Assumes district revenue limit of $3,000 and district special day class revenue of $10,000. Also assumes service costs are the same whether provided by a public school or a nonpublic school.

The savings grow with the cost of serving the student. If the cost of services totals $50,000, district savings reach $38,900. Thus, as the cost of serving a student increases the incentive for referring the student to a nonpublic school also increases.

State Review of Nonpublic School Placements Is Ineffective in Controlling Costs. Under existing law, the SDE is required to review all referrals to nonpublic schools that exceed $34,370. As part of this review, the department is required to determine whether the placement is appropriate and whether an alternative placement costing less than $34,370 is available. Statute gives the SDE ten days to deny a placement. If the department cannot render a judgment within that time, the placement is automatically approved.

We believe this review process is ineffective in controlling district use of nonpublic schools, for three reasons. First, the process is not designed to control the overall level of placements, but the level of high-cost placements. Thus, the state has no authority to review placements costing less than $34,370, which is substantially *above* the average per-student cost. Second, ten days is often too little time to find any but the most obvious inappropriate placements. After ten days, the SDE has no authority to deny a placement. Third, the state department advises it does not have the staff to do the reviews needed to determine the appropriateness of all high-cost placements. As a consequence, the SDE does only a selective review of placements.

Local Share of Cost Should Increase. We believe that controlling costs for nonpublic schools from the state level would be a difficult and expensive undertaking. For this reason, it makes more sense to change the funding structure to remove fiscal incentives for LEAs to refer students to nonpublic schools.

The SDE is currently administering a multi-year pilot project in nine LEAs to test that idea. In its pilot, the department is permanently redistributing the state share of costs for existing students referred to nonpublic schools to the districts and SELPAs that directed the students to the placement. With these funds, the LEA is not disadvantaged financially if it decides to provide services at a public school rather than an NPS. Rather, it can decide whether the funds should be used to provide services in a public or private school without the fiscal incentive of shifting part of that cost to the state through the NPS program funding system. Presumably, this would—over time—result in savings to the districts from providing these services in a less expensive way.

The SDE does not intend to redistribute funds for students placed in LCIs in this pilot program. These are placements made independently by other public agencies. The department believes that it is appropriate for the state to directly pay these costs because LEAs have virtually no control over placements or resulting costs. While we concur with the department's view, we remain concerned about the local incentives the existing level of reimbursement creates.

Based on our analysis, the department is headed in the right direction. At this point, there are a number of outstanding issues that should be resolved before statewide implementation of its pilot program can go forward.

We believe, however, that there should be immediate changes in the fiscal incentives for districts not involved in the pilot program. Specifically, we recommend implementation of a modest increase in the local share (and redistribution of state NPS funds associated with current placements to LEAs). This would reduce the incentives to place special education students in nonpublic schools without creating significant financial problems for districts. We view this as a first step, however. As we learn more about the effect of the SDE's pilot, the Legislature should further increase the local share in order to reduce the negative incentives. Therefore, we recommend the Legislature adopt legislation to increase the local share of nonpublic school costs from 30 percent to 50 percent. We also recommend that the difference between the LEA's current contribution and its contribution under this proposal be transferred from the NPS program budget to the district's special education allocation. According to our calculations, the amount needed to hold LEAs harmless is $24.4 million.

1992 Budget Actions Shift Costs to Schools—Correction Needed

Recent legislation changed the arrangements for funding residential services for one small group of special education students—severely emotionally disturbed (SED) students placed in for-profit group homes that are certified by the SDE as nonpublic schools. LEAs pay for the *educational* costs of placements under the nonpublic school (NPS) program.

According to the SDE, such placements are made when students are assessed as needing services that are not available through public or nonprofit agencies. Some of these placements are located outside the state. Out-of-state placements typically involve confinement of the student in a "secure" school. According to the department, there are no facilities in the state that are licensed to provide the type of secure care needed by these students.

Prior to January 1993, county foster care programs paid for the *residential* portion of the costs of placement. These costs were shared by the counties and the state Department of Social Services (DSS). If the child was a dependent of the state, the federal government also paid a portion of the residential costs.

Effective January 1993, Ch 722/92 (SB 485) made an important change in the funding of residential services for SED children who are placed in for-profit group homes. Specifically, the act prohibits the DSS from setting reimbursement rates for-profit facilities. This change was made, according to the DSS, in order to maximize federal funding for foster care costs. Under the Foster Care Program, the vast majority of children served by county foster care programs are dependents of the state. Generally, SED children are not dependents of the state.

The effect of this change is to prohibit county foster care programs from paying for the residential costs of any placements in for-profit group homes. The SDE is working with school districts to place as many of the affected students as possible into nonprofit facilities, which would allow county foster care programs to resume paying for the residential costs. For students who cannot be placed into nonprofit facilities, however, LEAs and the state NPS program are required to assume responsibility for paying for the services.

According to the SDE, as of December 1992, 114 SED students were placed in for-profit group homes based on a referral by a school district, court, or other local agency. Of this number, 74 were living in out-of-state facilities and 40 were located in for-profit group homes somewhere in California. Of the 40 in-state placements, 38 were in facilities that have converted or are in the process of converting to nonprofit status. We estimate the residential costs of the students remaining in for-profit group homes to total up to $1.5 million for the first six months of 1993. Without a statutory change or a deficiency appropriation, the additional 1992-93 costs will be supported by making across-the-board reductions in special education apportionments to districts and county offices.

We estimate the potential 1993-94 costs of these placements at about $2.8 million. This assumes that all students attending for-profit in-state group homes will be placed in nonprofit institutions by July 1993. These costs are not recognized in the Governor's Budget as proposed. In our analysis of the DSS budget, we recommend legislation to exempt SED placements from the prohibition on payment by foster care programs of individuals in for-profit group homes. The intent of requiring placement in nonprofit facilities was to maximize federal funds, not shift certain foster care costs to the schools. If such legislation were passed before July 1993, the potential 1993-93 special education shortfall would be eliminated.

CHILD DEVELOPMENT

The State Department of Education (SDE) administers a variety of subsidized child care and development programs that provide services to children from low-income families and those with special needs. The proposed 1993-94 funding level for ongoing child development programs from all fund sources is $494 million. The budget also proposes selected augmentations and one-time expenditures for 1992-93 and 1993-94, as shown in Figure 17.

As Figure 17 indicates, the budget proposes General Fund increases of (1) $22 million in 1993-94 to restore the state preschool base funding level; (2) $25 million to expand state preschool programs, beginning January 1994; and (3) $16.7 million for child development program growth. The budget also proposes $20 million for child care facilities from General Fund monies freed up as a result of receiving retroactive federal reimbursements. Earlier in our analysis, we recommended that all of these proposals, except for the preschool base funding restoration, be rejected because we believe that fully funding K-12 general purposes and minimizing the K-12 loan are higher priorities than categorical program augmentations and growth. We further recommended a reduction of $2.8 million (General Fund) from the proposed preschool base restoration amount, because we identified $2.8 million in unallocated carry-over funds that can be used for this purpose.

Changes Needed in Facilities Program

If the $20 million proposed for child care facilities is approved, we recommend enactment of legislation shifting responsibility for the facilities allocation process to local governments to ensure funds are allocated quickly and meet local priorities.

The budget proposes $20 million in one-time funding to provide portable child care facilities and renovation funds on a competitive grant basis. The funding is part of a total of $71 million in General Fund monies freed up as a result of receiving retroactive federal reimbursements under the Title IV-A "at-risk" program.

As indicated above, we recommend this proposal be rejected because fully funding general purposes and minimizing the K-12 loan have higher priority for available funding.

If, however, the Legislature decides to approve the $20 million proposal for additional child care facilities, we believe that the system for allocating the funds should be restructured. When funds were last

Figure 17

Child Development
Selected Budget Proposals
1992-93 and 1993-94

(In Millions)

	Fund	Estimated 1992-93	Proposed 1993-94
Program proposals			
State preschool base restoration	General	—	$22.0
State preschool expansion, half-year	General	—	25.0
Child development growth	General	—	16.7
Child care facilities	Retroactive reimbursements[a]	—	20.0
Start-up contract transfer costs	Carry-over	—	0.3
San Francisco Children's Council	Carry-over	—	0.2
Southern California Family Center	Carry-over	—	0.1
Services for AFDC children	Reimbursements	—	26.8
Subtotals		(—)	($111.1)
Federal Child Care and Development Block Grant backfills			
45 child care centers	Carry-over	—	12.3
Migrant child care	Carry-over	—	2.3
Migrant child care	Reimbursements	0.8	—
Housing and urban development grants	Carry-over	—	1.0
Housing and urban development grants	Reimbursements	0.1	—
New program start-up costs	Reimbursements	3.6	—
Alternative payment programs	Reimbursements	3.1	—
Subtotals		($7.6)	($15.6)
Unallocated carry-over funds	Carry-over	—	2.8
Unallocated potential reimbursements	Reimbursements	3.9	—
Totals		**$11.5**	**$129.5**
General Fund		—	*$63.7*
Child care carry-over funds		—	*19.0*
Reimbursements (federal Title IV-A, AFDC)		*$11.5*	*26.8*
Retroactive reimbursements[a]		—	*20.0*

[a] These are General Fund monies freed up from prior-year appropriations as a result of receiving retroactive federal Title IV-A "at-risk" reimbursements.

available for child care facilities in the mid-1980s, the state supervised the bidding process for the funds and acquired and managed contracts for the installation of portable facilities. Even though demand for the funds was high, the funds were not completely spent for several years due to various factors, including the high level of state workload involved and staffing problems.

If additional child care facilities funds are provided, we recommend that responsibility for the bidding process and acquisition and installation of portable facilities be shifted to local governments to ensure that funds are allocated in a timely manner and that local facilities priorities are met. We believe the local governments have sufficient expertise to undertake facilities allocations because they have gained experience over the past few years in child care planning due to various new federal requirements. In addition, local governments could acquire portable facilities and contract for installation and renovations, under state guidelines.

Thus, we recommend that the state's role be limited to (1) allocating the funds either to designated county child care facility coordinators or to county offices of education and (2) providing criteria for the further allocation of funds within counties. These criteria should ensure that funds are spent efficiently by requiring a competitive process to distribute the funds. To avoid some previous problems related to the effectiveness of facilities spending, the criteria should also require that facilities funds be allocated only to child care providers that demonstrate they have sufficient expertise and funding to maintain ongoing programs in the new centers.

Recently Implemented Federal Requirements

The budget proposes to fund various child care centers adversely affected by new federal requirements from one-time funds in 1993-94.

The budget proposes $15.6 million in child care carry-over funds (unspent funds from prior years) to solve several funding problems that have recently occurred because of changes in federal rules related to the federal Child Care and Development Block Grant.

The federal Child Care and Development Block Grant has provided child care funds to California since 1991-92. The block grant is divided into two portions—75 percent of the funds must be used primarily for direct services, while 25 percent is for quality improvements and early childhood and school-age child care.

In the current year, the SDE committed funding to various child care programs from the "75 percent" portion of the block grant to many child development centers. This commitment was based on a mutual federal and state understanding of how the 75 percent funds could be spent. In fall 1992, however, the federal government issued final regulations which required that all of the 75 percent block grant funds be made available in the form of vouchers for parents. These new requirements effectively mean that center-based programs cannot be funded from the 75 percent funds. For all but 57 of the centers, the department has been able to meet the federal requirements by switching available funds among programs. These 57 centers include 45 general child care centers, 5 migrant child care centers, and 7 centers built by Housing and Urban Development (HUD) grants.

The federal requirements affect the migrant and HUD programs in the current year, and all 57 centers in the budget year. The budget proposes $900,000 from federal reimbursements in 1992-93 and $15.6 million from carry-over funds in 1993-94 to continue funding these centers. We believe this is a reasonable proposal. The annual cost beginning in 1994-95 will increase to $16.6 million to reflect full-year operation of the HUD centers (these centers are beginning operation in the current year).

The Budget Does Not Propose to Spend Up to $3.9 Million in Additional Child Development Funds

Information will be available in the spring regarding the availability of $3.9 million in additional child development funds.

The budget reflects the expenditure of a total of $11.5 million in federal Title IV-A AFDC reimbursement funds in 1992-93. Supporting information submitted by the Department of Finance, however, shows specific expenditure of only $7.6 million.

At the time of the analysis, it was not clear whether these federal reimbursements would be available as indicated in the budget. More information will be available in the spring. If these funds are available, current state law (Ch 1205/91, AB 2184, Willie Brown) requires that they be spent on expanded services for children from families receiving AFDC.

The budget proposes $26.8 million from this funding source in 1993-94. These funds are proposed to be spent entirely on services for AFDC children.

CALIFORNIA ASSESSMENT PROGRAM

Assessment Work Plan Is Not Clear

We recommend the SDE submit to the budget subcommittees by March 15 a revised work and budget plan for the new California Assessment Program (CAP).

The 1992 Budget Act includes $15.8 million for the development and implementation of the CAP—$11.7 million for local assistance and $4.1 million for SDE support. The program under development has a number of components, including:

- Testing of all students in grades four, five, eight, and ten. The tests will cover core subject areas including reading, writing, mathematics, history, and science. The tests will permit the assessment of individual student progress and classroom, school, and district performance.
- Additional end-of-course tests in core high school subjects, which are intended to improve student achievement and motivation.
- End-of-course tests in a variety of vocational and technical subject areas.
- Development of a Spanish-language version of the fourth-grade test of core subject areas.

The most recently developed budget and administrative plan for the development and implementation of the CAP was developed in 1991-92 and includes projected funding requirements through 1995-96. The plan assumes a 1992-93 budget of $23.9 million. Since the 1992 Budget Act includes only $15.8 million for these purposes, the available plan no longer presents a realistic picture of what can be accomplished in the current or budget years. The SDE advises that a revised plan based on the actual budget is currently under development and will be available in March.

The 1993-94 Governor's Budget proposes $27.5 million for the CAP ($23.5 million for local assistance and $4 million for SDE support), an increase of $11.7 million. This augmentation, however, was based on the department's funding needs as determined in the now-outdated budget and administrative plan for the CAP. Because of the changing plan for 1992-93, the program's plan also will change in 1993-94. To give the Legislature an accurate picture of the program's current work plan and to ensure that the Legislature has an opportunity to review program priorities, we recommend the department submit to the budget committees by March 15, 1993, its revised work and budget plan for the CAP.

Spanish Versions of Tests Are Essential

We recommend the SDE include as part of its revised CAP plan an assessment of the costs and benefits of beginning the development of a Spanish-language version of the CAP tests instead of other developmental activities in 1993-94.

The SDE plans to develop a Spanish version of the fourth-grade CAP tests as part of its overall CAP development program. The department's 1991-92 plan called for development of a Spanish CAP test beginning in 1993-94 but did not specifically identify funding for this purpose. The SDE requested $950,000 from the Department of Finance (DOF) in the budget year for this project. The amount approved by the DOF, however, does not include funding for development of a Spanish CAP test. According to the DOF, the test represents an addition to the original plan that cannot be funded at this time.

The department estimates that Spanish is the primary language of approximately 75 percent of the one million limited-English-proficient (LEP) students in California. Currently, the state has no consistent way to measure the academic progress of LEP students in core subject areas other than English language.

Without a Spanish CAP test, many of these students will not be tested, and parents, districts, and the Legislature will lose valuable insight into the success of programs that meet the needs of LEP students. For this reason, we believe development of a Spanish version of the fourth-grade CAP test in 1993-94 should receive a higher priority than other activities SDE would otherwise pursue. In its existing work plan, for example, the SDE includes $7.2 million in 1993-94 to develop and field-test end-of-course examinations in certain core and technical areas. We believe that these activities have a lower priority than development of the Spanish CAP test.

Without a revised 1993-94 work and budget plan, we are unable to advise the Legislature on the costs and benefits of substituting the Spanish CAP test for other CAP development activities. For these reasons, we recommend that the SDE include as part of its revised administrative and budget plan an assessment of the costs and benefits of funding the development of the Spanish CAP test instead of other activities in 1993-94.

OTHER ISSUES

Year-Round Operating Grants Greatly Exceeding State Cost Avoidance

We recommend that the Legislature reduce funding for year-round school operating grants by $26.3 million, and adopt related Budget Bill language, in order to reflect a more realistic estimate of the statewide average cost avoided through not building school facilities. (Reduce Item 6110-230-001 by $26.3 million.)

The budget proposes $59.8 million in the mega-item for year-round school incentive payments to school districts. This amount includes about $57 million for operating grants to school districts that accommodate, through year-round operations, at least an additional 5 percent of each applicant school's normal schedule capacity. The program is intended to share with such districts between 50 and 90 percent (depending upon the percent of capacity accommodated—5 percent capacity gain yields 50 percent, 25 percent or greater capacity gain yields 90 percent) of the state's avoided costs from not building a new school facility.

The state's avoided cost is calculated based on a statewide average cost of land, construction, and financing. Chapter 1261, Statutes of 1990 (AB 87, O'Connell), specifies that the state's avoided cost per excess pupil accommodated shall be $1,151 in 1990-91 and 1991-92. Chapter 1261 also requires the State Allocation Board (SAB) to recalculate the statewide average cost avoided in 1992, based on 1990-91 and 1991-92 data, and every two years thereafter. For 1992-93 and subsequent years, the "statewide average cost avoided per pupil" is to be specified in the measure that appropriates funds for year-round school operating grants. The amount proposed in the budget assumes average statewide avoided costs of $1,151 per pupil.

In November 1992, staff to the SAB reported that actual statewide cost avoidance per pupil is $930, $620, or $464, depending on whether the useful life of a newly constructed school facility is considered to be 20, 30, or 40 years. These calculations were based on actual school construction costs for 1990-91 and 1991-92, and assumed financing costs based on 20-year bonds paying 6.5 percent interest. The SAB staff concluded that $620 per pupil is the most reasonable estimate of the state's actual avoided cost, recognizing that the state's school facilities lease-purchase program supports major reconstruction or modernization for facilities 30 years of age or older. The SAB passed this information on to the Legislature without recommendation, indicating that the

Legislature should determine what change, if any, to make in the level of avoided cost upon which the grants are based.

Based on these calculations by SAB staff, which appear to be sound, the level of statewide average cost per pupil proposed by the budget significantly overstates actual new school facility costs avoided by the state. We concur with SAB staff in viewing $620 per pupil as a reasonable estimate of the cost of new facilities actually avoided by accommodating additional pupils in existing facilities through year-round operations. Our analysis indicates that if the statewide average costs were reduced to this more appropriate level, $30.7 million would be required for year-round operating grants in 1993-94. This is $26.3 million less than the amount requested in the budget.

Recommendation. In order to provide school districts with an incentive payment that reflects a more realistic estimate of the statewide average cost avoided, we recommend that the Legislature adopt the following Budget Bill language in Item 6110-230-001 to reduce the statewide average cost avoided in the statutory funding formula from $1,151 per excess pupil to $620 per excess pupil:

> For the purposes of Section 42263 (e) of the Education Code, "statewide average avoided cost per pupil" shall be $620.

Consistent with this recommendation, we further recommend that $26.3 million of the $59.8 requested for year-round school incentives be deleted. As we note elsewhere in our analysis, these funds could be used to maintain per-pupil funding for school district general purposes at the level provided in the 1992 Budget Act, or to reduce the amount of the proposed Proposition 98 loan.

Requiring Nominal Fees for Noncredit Students Would Reduce Course Dropouts

We recommend that the Legislature enact legislation establishing a nominal fee of $10 for each adult or vocational education course for adults who have a high school diploma or the equivalent, to ensure that state apportionments are directed at students who are most likely to complete their classes, thereby freeing up $1.6 million for other Proposition 98 purposes. (Reduce Item 6110-156-001 by $1.1 million and reduce Item 6110-230-001 by $500,000.)

In most cases, adults enrolled in state-supported noncredit courses in the community college system or in adult or vocational education through the K-12 system pay no fees. The courses offered by both systems are similar and include basic skills (remedial) education, English as a second language (ESL), short-term vocational education, parenting skills, health and safety education, and classes for older and disabled adults. Other large states tend to charge nominal fees for these types of courses, as long as the adults enrolled have a high school diploma or the equivalent.

Currently, K-12 adult and vocational education programs, including Regional Occupational Centers and Programs (ROC/Ps), have statutory authority to charge fees but are not required to do so. That is, an adult or vocational education program can charge fees and use the revenues generated to serve additional students. Community colleges offering noncredit courses do not have such authority, even though the courses offered are similar to the K-12 courses.

Some ROC/Ps that have instituted fees have found that they tend to reduce the drop rates in courses by as much a half, so that classes are almost as full at the end of the semester as they were at the beginning. Thus, the fee is seen as useful in ensuring that students make up-front commitments to their course selections.

While there are no statewide data regarding the number of students who enroll in community college noncredit or K-12 adult and vocational courses and later drop the courses, it is clear from our site visits that the drop rates in certain courses with no fees may be 10 percent or more. It appears that students are relatively more likely to drop out of some vocational courses and less likely to drop out of ESL courses (where waiting lists are typically quite long).

In the current year, state provides an average apportionment of $1,481 each for 210,000 ADA at adult education classes, and an average of $2,297 each for 107,000 ADA at ROC/Ps. The state also provides an average apportionment of $1,648 each for over 73,000 community college noncredit full-time equivalent students.

Given current fiscal constraints, we believe that these apportionments should be targeted to the extent possible to students who are likely to complete their courses. Thus, we recommend that the Legislature enact legislation requiring a nominal fee of $10 per course for both K-12 adult and vocational education and community college noncredit courses. We recommend that these systems be treated the same, because the courses they offer and the characteristics of the adults they serve are similar.

Based on the practices of other states we contacted, a $10 per course fee seems reasonable. To ensure that students who are working towards a high school diploma or the equivalent are not penalized, we recommend that students who do not have a diploma or the equivalent be exempted from the fee. This is consistent with the practices in other states.

It is difficult to estimate the amount of fee revenues that would be generated from a $10 per course fee. However, assuming only 20 percent of the students already have diplomas or the equivalent, and thus would be subject to the fee, the amount raised in the K-12 system would be roughly $1.6 million ($1.1 million from adult education and $500,000 from ROC/Ps). Accordingly, we recommend reductions of $1.1 million to Item 6110-156-001 and $500,000 to Item 6110-230-001. This would free up these funds for use on other Proposition 98 purposes.

Volunteer Mentor Support Is Premature

We recommend the Legislature (1) delete $5 million from the General Fund (non-Proposition 98) proposed for the Volunteer Mentor Program on the basis that revenues in the budget year are not sufficient to justify establishing a new program and (2) adopt supplemental report language requiring the Office of Child Development (OCD) to submit by January 1, 1994 a plan for the administration of the program. (Eliminate Item 0558-101-001.)

The Governor's Budget proposes $5 million from the General Fund for the Volunteer Mentor Program. Chapter 901, Statutes of 1992 (SB 1114, Leonard), established the Volunteer Mentor Program to be administered by an Office of Academic Volunteer and Mentor Service within the Governor's Office. The program is designed to fund local projects to recruit, screen, train, and place volunteers who want to act as mentors to children.

We have two recommendations concerning the budget proposal. First, given the severe budget dilemma the Legislature faces in 1993-94, we believe that there are higher-priority uses of $5 million in General Fund support than establishing a new program. For this reason, we recommend the Legislature defer establishing this program and delete the funds proposed for the program from the budget. (Eliminate Item 0558-101-001.) We make this recommendation without regard to the merits of the program.

Second, our review of the implementation process required by Chapter 901 indicates that the OCD will need to start implementing the program at the state level in 1993-94 in order to assure that funds can be used in 1994-95. Accordingly, we recommend that the Legislature direct the OCD to begin the implementation process in 1993-94. Below we discuss our findings and recommendation in detail.

Compared to other programs, the developmental process required in Chapter 901 is quite lengthy. Specifically, the act requires the following administrative steps before Volunteer Mentor grants may be awarded:

- The state administering agency must develop a state plan that identifies local planning areas, state guidelines for the operation of local planning councils, state standards for the operation of local projects, and funding formulas for the distribution of funds throughout the state. The administering agency also is required to compile a directory of successful academic mentor programs and organizations.
- County boards of education and supervisors must establish and appoint local planning councils.
- Local planning councils must develop local plans that assess the need for mentors; identify mentoring objectives, service sites, and funding priorities for the local planning area; and provide other relevant information.
- Once the state plan is developed, local councils established, and local plans written, local entities, including school districts, may submit project proposals to the state. The state will decide which proposals to fund, based on its review of how well proposals address local planning priorities and objectives.

The Governor has designated the OCD as the administrative agency for the Volunteer Mentor Program. According to the OCD, implementation of the 1993-94 budget proposal at the state level is unlikely to start before July 1993 because the OCD currently has insufficient staff to develop the state plan and identify local planning areas. With this delay in state-level planning, our review indicates that it will be virtually impossible for the OCD to approve any grants in 1993-94.

With program funding deferred until 1994-95 as we suggest, the program runs the risk of getting into the same situation next year. To avoid this problem, the OCD will need to begin its planning process in 1993-94 in order to begin approving projects in 1994-95. If the office develops the state plan by next winter, the Legislature would have the opportunity in the 1994-95 budget to review the plan and determine the appropriate level of funding for local volunteer mentor grants. Therefore, we recommend the Legislature add supplemental report language to Item 0558-001-001 directing the office to develop the state plan for implementing the Volunteer Mentor Program as required by Chapter 901 by January 1, 1994.

LIST OF FINDINGS AND RECOMMENDATIONS

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K-12 Budget Priorities

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categorical program growth, thereby making $114.7 million available for higher-priority purposes.

12. **Legislature Should Consider Categorical Program Reductions.** Recommend reducing or eliminating funding for seven K-12 categorical programs in 1993-94 (for a savings of $270 million) in order to restore general-purpose funding or further reduce spending and minimize the size of the K-12 loan. 33

Categorical Programs and the Mega-Item

13. **Governor's Proposal Falls Short.** Recommend the Legislature reject the proposed categorical program mega-item and restore direct appropriations for most categorical programs. 42

14. **Legislature Should Consolidate and Revamp Categorical Programs.** Recommend the Legislature consolidate 19 existing programs into three new programs—a School Improvement Block Grant, a School Incentives Award Program, and a High School Dropout Prevention Block Grant. 44

15. **Positions Provide Valuable Services.** Recommend that the State Department of Education (SDE) report during budget hearings on other staff reductions that could be made instead of reductions to staff working on program quality reviews. 47

Impact of Current-Year Budget Actions

16. **1992-93 Budget Shortfalls.** Despite constant year-to-year Proposition 98 funding on a per-pupil basis and a 2 percent per-pupil increase in revenue limit spending, many school districts faced shortfalls in developing their 1992-93 budgets. While all districts we contacted attempted to keep reductions "away from the classroom," several reported class size increases and elimination of some elective subjects. Virtually every district we contacted reported significant reductions in staff support and 49

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services, as well as efforts to minimize increases in employee salary and benefits costs.

K-12 Education Funding—Ten-Year History

17. **Funding From All Sources.** Per-ADA funding in inflation-adjusted dollars has increased by 6.2 percent since 1984-85 despite reductions in 1990-91, 1991-92, and 1993-94. 55

Special Education

18. **Impact of Mega-Item Reductions Not Clear.** Withhold recommendation on a $22.1 million augmentation to the special education budget pending additional information on 1992-93 spending that will be available as part of the May revision. 60

19. **Special Education Overbudgeted. Reduce Item 6110-230-001 by $17 Million.** Recommend the Legislature reduce by $17 million the appropriation for special education proposed for 1993-94 because of technical errors in the estimating process. 62

20. **Nonpublic School Program Costs Are Going Through the Roof.** Recommend the Legislature enact legislation to increase from 30 percent to 50 percent the local share of nonpublic school (NPS) costs in order to reduce the fiscal incentives for districts and Special Education Local Plan Areas (SELPAs) to place students in nonpublic schools. As part of the legislation, we recommend redirecting funds appropriated for NPS costs in 1993-94 back to local education agencies so that no agency experiences a funding decrease for students placed in NPS settings prior to 1993-94. 63

Child Development

21. **Changes Needed in Facilities Program.** If the $20 million proposed for child care facilities is approved, we 70

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recommend enactment of legislation shifting responsibility for the facilities allocation process to local governments to ensure funds are allocated quickly and meet local priorities.

22. **Recently Implemented Federal Requirements.** The budget proposes to fund various child care centers adversely affected by new federal requirements from one-time funds in 1993-94. 72

23. **The Budget Does Not Propose to Spend Up to $3.9 Million in Child Development Funds.** Information will be available in the spring regarding the availability of $3.9 million in additional child development funds. 73

California Assessment Program

24. **Assessment Work Plan Is Not Clear.** Recommend the SDE submit to the budget subcommittees by March 15 a revised work and budget plan for the new California Assessment Program (CAP). 74

25. **Spanish Versions of Tests Are Essential.** Recommend the SDE include as part of its revised CAP plan an assessment of the costs and benefits of beginning the development of a Spanish-language version of the CAP tests instead of other developmental activities in 1993-94. 75

Other Issues

26. **Year-Round Operating Grants Greatly Exceeding State Cost Avoidance. Reduce Item 6110-230-001 by $26.3 Million.** Recommend that the Legislature reduce funding for year-round school operating grants by $26.3 million, and adopt related Budget Bill language, in order to reflect a more realistic estimate of the statewide average cost avoided through not building school facilities. 76

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27. **Requiring Nominal Fees for Noncredit Students Would Reduce Course Dropouts. Reduce Item 6110-156-001 by $1.1 Million and Reduce Item 6110-230-001 by $500,000.** Recommend that the Legislature enact legislation establishing a nominal fee of $10 for each adult or vocational education course for adults who have a high school diploma or the equivalent, to ensure that state apportionments are directed at students who are most likely to complete their classes, thereby freeing up $1.6 million for other Proposition 98 purposes. 77

28. **Volunteer Mentor Support Is Premature. Eliminate Item 0558-101-001.** Recommend the Legislature (a) delete $5 million from the General Fund (non-Proposition 98) proposed for the Volunteer Mentor Program on the basis that revenues in the budget year are not sufficient to justify establishing a new program and (b) adopt supplemental report language requiring the Office of Child Development to submit by January 1, 1994 a plan for the administration of the program. 79