budget advisory

CSBA

October 2009

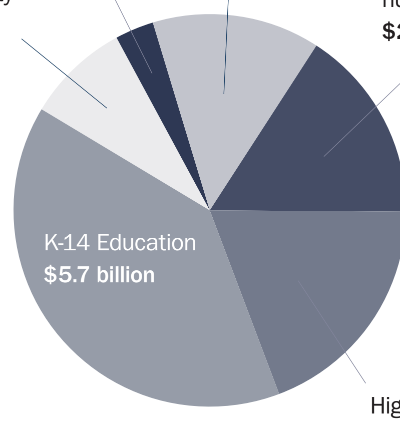
Revisions to the 2008 and 2009 state budgets

Additional considerations for boards

This advisory on the revisions to the 2008-09 and 2009-10 state budgets provides governance teams with tools and strategies to implement the changes made to the budget in July, an overview of issues to consider for the use of federal funds, and a preview of what's ahead in the coming months. The advisory includes:

- Brief overview of the architecture of the July budget
- Detailed information on the education components in the budget, including:
  - Maintenance factor
  - Additional flexibility
- Information on federal stimulus funds
- Where we go from here

$15.3 billion in cuts



Introduction

Nearly a month into the 2009-10 fiscal year (and four months after the original Budget Act was adopted), the Legislature approved a revision to the budget that addressed the state's $24 billion deficit. The final budget adopted $24.1 billion in "solutions," including:

- $15.3 billion in program reductions and cuts (see chart for more details)
- $4 billion in revenue accelerations and fees
- $0.5 billion in fund shifts
- $2.1 billion in borrowing (mostly from local government under Proposition 1A)
- $1.2 billion in other one-time savings

Total general fund spending in 2009-10 will be just over $84 billion, which is down from $91.7 billion in 2008-09 and nearly $103 billion in 2007-08. That represents a reduction of nearly $18.9 billion (18.3 percent) in just two years.

Education budget

While Proposition 98's minimum education funding guarantee was not suspended, lawmakers exploited an accounting maneuver to make a $1.6 billion cut in July from Proposition 98 in the fiscal year that ended June 30, which in turn reduced the funding base for 2009-10.

The total cut to Proposition 98 in 2008-09 and 2009-10 is $5.7 billion—on top of the cuts already made in September and February. These cuts included $1.6 billion in 2008-09 school funding that was appropriated but never actually sent to districts and county offices; $2.4 billion from 2009-10 general purpose spending for local educational agencies; and an additional $1.7 billion in revenues that are deferred from 2009-10 to 2010-11.

Actions taken by the legislature and governor over the last 12 months have resulted in $12.5 billion in funding reductions to schools and an additional $4.5 billion in deferrals that are meant to further reduce the Proposition 98 base. The $12.5 billion reduction includes $7.5 billion in programmatic cuts, meaning direct reductions to district and county office revenue limits and categorical programs, and an additional $5 billion for the loss of a cost-of-living adjustment but does not include any of the deferrals. That is an astounding reduction in the loss of school district purchasing power equating to $2,100 per student!

Deficit factor

As has occurred in the past, when the state has faced a fiscal crisis a "deficit factor" has been applied to school district and county office revenue limits. When a deficit factor is applied, schools do not receive the full amount for each student that they are entitled to under the law. Rather, that amount is reduced by a percentage (deficit factor) specified in law. This year, the deficit factor is 18.355 percent for school districts and 18.621 percent for county offices. This means that for every dollar school districts and county offices should receive for their revenue limits they will receive less than 82 cents. The loss of funding reflects two years without a funded COLA in addition to the cuts to revenue limits that were approved in February and July. It does not reflect the 20 percent cut to categorical programs, the loss of the COLA to those categoricals or the apportionment deferrals.

- The advantage of a deficit factor is that it must be restored, and this is typically the first priority on any new dollars for schools. Schools will not receive the money lost in those years when a deficit factor was in place.

- Board members should be aware that this reduction in funding will be in place for at least the next few years, and could continue to grow should a COLA not be provided next year or there are further cuts to revenue limits.

Maintenance factor

The 2009-10 budget package also included the acknowledgement of an $11.2 billon maintenance factor for 2008-09 that would restore funding to schools in future years and be built into the Proposition 98 base. The inclusion of this payment is in response to the assertion earlier this year by the Schwarzenegger Administration that such funding wasn't owed to schools. This was the key issue in a subsequent lawsuit that CSBA's Education Legal Alliance joined along with the California Federation of Teachers, Service Employees Union International and Association of California School Administrators.

The maintenance factor restoration will be made when the state's economic condition improves according to existing constitutional provisions.

- Given the economic climate in the state and the loss of increased tax revenues in 2011, it is unlikely that schools will see this funding any time soon and therefore should not factor it into short-term planning.

- When the maintenance factor restoration is made it will likely be used to pay off the state's credit card to schools including eliminating the revenue limit deficit and payments owed for mandates.

Deferrals and apportionments

An additional deferral of $1.7 billion from 2009-10 into 2010-11 was approved in order to further reduce the Proposition 98 base in 2009-10 and help manage the state's cash flow. This means the payments that local educational agencies were expecting to receive beginning in April and May 2010 will be deferred to August 2010. This brings the total amount of K-12 inter-year deferrals to $5.7 billion.

Further, a change to the apportionment schedule was also adopted that provides for 5 percent of all funding owed to schools to be disbursed in July and August and 9 percent disbursed in each of the remaining 10 months. This significantly alters how payments go out to schools. However, the funding districts receive each month will continue to vary greatly because of the inter-and intra-year deferrals.

- The combined effect of the significant increase in deferrals approved in the last several months and the change in the apportionment schedule will likely pose greater cash flow challenges for districts.

- Districts should be working on cash projections now in order to be better prepared should they face a shortage of cash.

AB 1200 reserve

The reserve requirement for economic uncertainty under AB 1200 was lowered to one-third of the usual requirement. It is important to note that this applies only to 2009-10, and in 2010-11 school districts must demonstrate progress toward returning to the required reserve level. In 2011-12, that level must be fully restored.

- While this is intended to help districts, the lowering of the reserve provides only limited relief and must begin to be restored in 2010-11 and fully restored by 2011-12.

- Districts should be cautious in budgeting a lower reserve since doing so will provide one-time funding only.

- Districts that lower their reserve should also be mindful of the cash flow challenges that the increased deferrals and the change in the payment schedule will have on their ability to meet monthly financial obligations. Having a higher reserve will help ensure that the cash is available during months when state apportionments are lower.

Shorter school year

The July budget also provided districts with the ability to reduce the school year by up to five days. Such a reduction in the school year cannot be enacted unilaterally and must be negotiated with employees. Beyond contract issues, the proposal raises other legal issues. In 1992, the California Supreme Court held that a district's closure of schools violated students' fundamental right to basic equality in public education. This case concerned the closure of the Richmond Unified School District (now West Contra Costa Unified School District) six weeks early because of a lack of funds. It is possible that despite this new legislative authority, similar equity issues could be raised if one school district offers 175 days of instruction and a neighboring district offers 180 days.

- Districts seeking to reduce instruction should proceed cautiously and consult with their legal counsel, as well as their bargaining units.

- Districts should also be sure to include parents in any conversations about shortening the school year.

- Districts may also want to consider furloughs for employees on non-instructional days in order to further reduce the impact on students.

Unallocated categorical programs

The budget included taking back $1.6 billion for categorical programs in 2008-09 that reportedly had not yet been sent out to education entities. This affected approximately 50 categorical programs, including many that are in the budget's Tier 3 level that gives LEAs flexibility, such as grade 7-12 counseling, professional development, and block grants for arts and music and school safety. Other programs that had "unallocated" balances "recaptured," such as special education, child development and after-school funding, are outside of the flexibility pool of programs.

Because cuts that focus solely on categorical programs impacts each district differently, the Legislature devised a scheme to "recapture" the categorical funds in 2008-09 but make the actual cuts to revenue limits in 2009-10.
The scheme involves (1) withholding the payment for these programs in order to reduce the Proposition 98 base by $1.6 billion, then (2) providing the funding back to the same programs in 2009-10 and finally (3) withholding a one-time per-student amount of $252.83 from district and county office of education revenue limits in 2009-10. By reducing the Proposition 98 guarantee, this maneuver allowed the Legislature to avoid having to suspend Proposition 98 in 2009-10.

- Depending on how the QEIA (see below) cuts are backfilled, districts may need to reopen how they accounted for the recapture in 2008-09.

Quality Education Investment Act

To further reduce state general fund spending, $450 million to fund the Quality Education Investment Act was eliminated in 2009-10. QEIA was created as a result of the CTA v. Schwarzenegger lawsuit over the level of funding owed to schools in 2004-05. Funding for the program comes entirely from the state's general fund, and is outside of Proposition 98. Because of the elimination of this year's general fund support, the program was extended by one year, to 2014-15, to ensure the full amount owed under the settlement will be paid by the state.

While state funding for the program was eliminated for 2009-10, the program itself was not suspended and instead, is funded with Proposition 98 dollars. This was accomplished by redirecting funds from the revenue limits of QEIA districts. Then, the budget trailer bill included a provision authorizing QEIA districts to apply to the CDE to receive Federal Title I and school improvement grants to backfill the revenue limit reduction. This provided the false assurance that the cut to QEIA-district revenue limits could be backfilled by federal dollars. In fact, it appears that may not be possible, due to specific rules tied to these federal dollars and the lack of sufficient funding from those sources.

The Legislature attempted to address this issue in the final days of the regular session by approving SB 84 (Steinberg and Bass), which was vetoed by the Governor who cited his plan to use federal ARRA State Fiscal Stabilization Funds to backfill the cut. ABx3 56 (Evans) has been approved by the Legislature and provides yet another complex shell game to restore the pending cuts to the revenue limits of QEIA districts and uses a combination of SFSF,Title I set aside dollars, if available, and reversion account dollars to indirectly pay for QEIA. The Governor is expected to sign the bill.

There is SFSF money available now due to the severity of the cuts approved in July. The Governor applied to accelerate payment of some of the remaining money available to California instead of waiting for the second round, which likely will include additional requirements and prerequisites in order to access those funds. The $355 million now available is not new SFSF dollars and is money that all districts were expecting to receive. Should any portion of the SFSF dollars be redirected to backfill QEIA it will amount to a further cut to education.

There is some positive news for QEIA districts. It is likely that the revenue limits for QEIA districts will not be cut, as was required by the July budget package. This is important, because some districts with QEIA schools were being required by their county offices of education to reduce their budgets by the amount of the expected revenue limit cut

- Because the backfill hasn't been approved there is much uncertainty as to which funds will be used and how that will impact all districts, not just those with QEIA schools.

- For all districts the use of SFSF funds by the state to backfill QEIA cuts amounts to an additional cut to education, since that money had previously been intended for all schools.

Instructional materials

The suspension of the requirement to purchase instructional materials within 24 months of adoption by the State Board of Education was increased from two years to four years (until 2012-13) to coincide with the flexibility previously provided for categorical programs in February. Therefore, districts are not required to purchase the textbooks adopted by the State Board of Education for mathematics in 2007 or for reading-language arts in 2008 by the start of the 2010-11 school year. Further, the State Board is prohibited from adopting any new instructional materials during that same time that would result in a shift in the adoption cycle. State Board adoptions begin again after July 1, 2013. Funding provided for instructional materials through the Instructional Materials Block Grant remains fully flexible and may be used for any educational purposes.

This change to the adoption cycle does not change the requirements related to sufficiency. Districts are still required to have "sufficient" instructional materials and to hold a public hearing on the "sufficiency" of materials pursuant to Education Code § 60119. However, between 2008-09 and 2012-13, the definition of "sufficiency" has been modified to include those textbooks or instructional materials that are standards-aligned and that were adopted prior to July 1, 2008 by the State Board for grades K-8, or that were adopted by local boards by that date for grades 9-12. This definition of "sufficiency" also applies to Williams inspections conducted by a county office of education.

Sufficiency for Williams' purposes means that all students must have "identical" textbooks and instructional materials; therefore all students in the school districts who are enrolled in the same course must have instructional materials from the same adoption cycle. If a district was piloting materials or phasing in new materials prior to relief on the purchasing timeline, they must continue to do so until all students in the same grade level or class have the same materials from the same adoption cycle. However, this does not mean that the materials for all subjects in the same grade level must be from the same adoption. For example, all third graders in the district can have reading materials from the most recent adoption in 2008, but the mathematics materials may be from the earlier adoption cycle in 2002.

- Sufficiency hearings must still be held within eight weeks of the start of school and districts must be mindful that all students in the same course must have the same materials.

- CSBA has updated its sample sufficiency resolution and it is available at: www.csba.org

- Districts that adopted the sufficiency resolution prior to the recent revisions to the resolution do not need to adopt the revised resolution this year for Williams or audit purposes.

- Districts may utilize funding set-aside for instructional materials for any educational purpose.

Flexibility for districts in Corrective Action or Program Improvement

The revised budget also included a provision specifying that a school, district, county office or charter school that has been identified for Program Improvement under the federal No Child Left Behind Act, or that has received federal corrective action sanctions from the State Board of Education, cannot be prohibited from using the flexibility provided for categorical programs in Tier 3. Further, the budget trailer bill said the California Department of Education and State Board cannot identify which funds are used to implement the sanctions and corrective actions, thus giving districts greater determination over which funds are used.

- The State Board of Education appears to be contemplating the legislative language and what leeway they still have to require districts in corrective action to adopt new instructional materials within 24 months of State Board approval. More will be known after the Board's November meeting.

Suspension of the CAHSEE for special education students

The Legislature and Governor also exempted special education students from the requirement to pass the California High School Exit Exam (CAHSEE) in order to receive a high school diploma, until such time that the State Board of Education makes a determination that alternative means to demonstrate the same level of academic achievement required for passage of the exam are not feasible – or that the alternative means are implemented. Existing law, enacted in 2008, requires the State Board to adopt regulations regarding these alternative means by October 1, 2010, for those sections of the exam that they find it feasible to do so, although it does not require the alternative means to take effect immediately. The State Board is expected to take up this issue at its November meeting.

The language approved in the budget specified that the CAHSEE exemption applies to students with an Individualized Education Program (IEP) or Section 504 plan that indicates the student is scheduled to receive a high school diploma, and that the pupil has satisfied or will satisfy all other graduation requirements to receive a diploma after July 1, 2009. It also specified that an IEP or 504 plan cannot be adopted by a district for the sole purpose of exempting a student from the requirement to pass the CAHSEE.

Because of some ambiguities in the language there are some outstanding issues; further clarification will be provided as soon as possible.

- Students eligible for the exemption are still required to take the exam in 10th grade as part of the 10th grade census for state compliance with No Child Left Behind.

- Should the State Board adopt alternatives means effective in the 2010-11 school year or find that none are available in November, it is possible this exemption may only be in place for 2009-10.

- This “exemption” does not affect the law regarding “waivers” of the CAHSEE whereby a student with disabilities who has taken the exam with modifications and has achieved a certain score may request that the local governing board waive the requirement to pass CAHSEE in order to receive a diploma.

Federal funding

All told, K-12 schools can expect to receive over $7.7 billion from the American Reinvestment and Recovery Act (ARRA) through a variety of grants and allocations. Most of this money has already been allocated to schools. This includes one half of the $1.2 billion provided for Title 1, with the remaining money expected to go out to schools sometime this fall. The funding for special education has in part gone out to special education local plan areas (SELPAs). The state is expecting to receive $2.35 billion to be allocated to SELPAs as they demonstrate proof of expenditure. An initial 20 percent was allocated in June followed by a payment in July, and the remaining to be sent out in October and January.

The Title I monies will flow in the same manner in which they are currently allocated to districts and county offices and may be used for the purposes outlined in Title I. This includes staff development opportunities for teachers and principals, using longitudinal data systems to improve achievement, strengthening and expanding early education opportunities and establishing and expanding extended learning opportunities for Title I eligible students.

For the IDEA funds there is some flexibility to utilize up to half of the funding to offset local contributions relating to local maintenance of effort requirements. While this does provide some relief, it is likely to be one-time in nature as costs are likely to continue to rise and districts will have to absorb those costs when their ARRA funding has run out. It is also important to note that districts must use these freed up local funds for activities that are allowed under NCLB, which is fairly broad and says for services for children at risk of school failure without additional support.

The first two-thirds, $2.56 billion, of the State Fiscal Stabilization Funds were sent out to schools in June and the remaining apportionment was expected this fall. However, the landscape has changed for any additional SFSF money based on two issues. The first is that in August the Governor revised the state's application to receive 90 percent of the SFSF in the first round, increasing the amount for K-12 by $355 million in the first round. The second issue is related to the plan to utilize those dollars to indirectly fund QEIA for this year as described in the section on QEIA.

The funding that was already sent out to districts was used to backfill the cuts to categoricals and revenue limits. This was meant to fully restore the cuts and bring funding for schools back to the September 2008 level. However, this restoration proved to be temporary and was offset by further cuts in July.

Following the use of at least some of the $355 million to indirectly backfill the QEIA, there may be an estimated $324 million available in the last round of SFSF, representing the last 10 percent of the funding available. However, it is still not known what requirements or prerequisites that the U.S. Department of Education may impose upon the state and school districts for the receipt of these funds.

- Due to the likelihood that SFSF will be used at least partially to backfill QEIA and the unknown requirements that will be placed on the use of the final round of funding, districts should not budget based on receiving any more SFSF funding.

- Districts need to be sure to maintain records and comply with reporting requirements and requests.

- School boards should request periodic updates from their superintendent regarding the use of the funds, how they have improved student achievement and how the district budget will be adjusted when these funds are gone.

Where we go from here

The upside is that by most reports the worst economic conditions appear to be behind us. This does not mean that there won't be further cuts, because the state is still facing a deficit of over $8 billion for next year due to the inability of the Legislature and Governor to reach agreement on a number of issues this summer, such as cuts to corrections, the use of one-time solutions and schemes in the July budget and revenues falling short of expectations.

This means additional economic challenges for the state and schools:

- The growth in the economy will likely be very slow over the next couple of years;

- Many schools will continue to see declining enrollment on the immediate horizon followed by slow growth; and

- The tax increases approved in February will end in 2011.

It is not clear if these circumstances will require a budget revision late this fall or in January when the Governor releases his budget proposal for 2010-11. The likely need to adjust the current budget in the coming months may increase the possibility of early budget for 2010-11. It is also important to be prepared for the next few fiscal years, when deficits are anticipated to be in the $15 billion to $20 billion range, because of the expiration of the temporary tax increases and corporate tax breaks approved in September 2008 will be fully implemented.