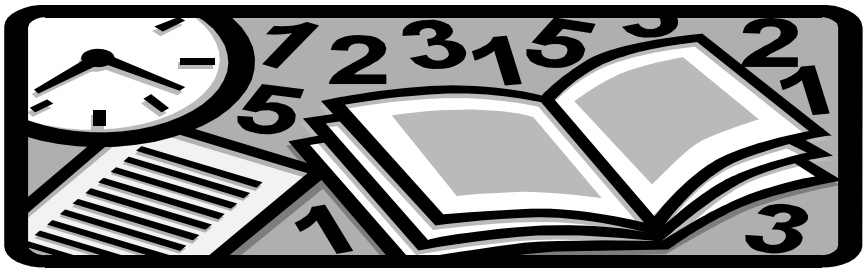
Why Schools Face Financial Crisis:

Mismanagement, Underfunding or Just Bad Luck?



A REPORT FROM THE HEARING OF THE SELECT COMMITTEE ON BRIDGING THE EDUCATION GAP

Assemblywoman Loni Hancock, Chair

July 2003

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Mismanagement, Underfunding or Just Bad Luck?

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Introduction

The charge of the **Select Committee on Bridging the Achievement Gap** is to identify factors contributing to the achievement gap in California schools and to develop legislation to close the gap. Assemblywoman Loni Hancock, Chair of the Committee, observed that the school districts asking for loans from the State in her assembly district were also the districts faced with closing large achievement gaps. Concerned that all students receive adequate resources at school, Assemblywoman Hancock called for a hearing to re-examine why school districts face financial crises. The Select Committee convened "*Why Schools Face Financial Crisis: Mismanagement, Underfunding or Just Bad Luck*?" on Saturday June 21, 2003 at Richmond City Hall.

The State of California's 2003 **budget deficit** ($36 billion out of a $78 billion General Fund) added urgency to the matter, as the State's financial ability to continue to make large loans or takeover school districts is in question. Presently, the California Department of Education has assigned 8 districts a "negative certification," meaning they may not meet their financial obligations this year or next. 56 districts received "qualified certification," meaning they may not meet their financial obligations one of the next three years.

Assemblywoman Hancock stated in her opening remarks, "*We must re-examine the financial supports in place for school districts so that our children do not end up bearing the brunt of a debt that is not theirs*." Assemblyman Gene Mullin, a Member of the Select Committee, also participated in the hearings. A former teacher, Assemblyman Mullin shared his grave concerns about the future of education in California. He stressed the importance of talking with educators and administrators while developing new legislation, noting that "*We learn more when we leave Sacramento."*

This summary reviews the "*Why Schools Face Financial Crisis*" hearing. First, it provides an **overview of how California public schools are currently funded.** At the hearing, this explanation was provided by Erik Skinner, Assistant Secretary for Fiscal Policy to the Secretary for Education.

The second section covers the many **factors that lead schools into financial crisis.** Three local education experts led this portion of the panel: Steve Jubb, Executive Director of the Bay Area Coalition of Equitable Schools; Nicolette Toussaint, Communications Director of the Bay Area School Reform Collaborative; and Dr. Pete Mesa, former Superintendent of the Oakland Unified School District and now Distinguished Visiting Professor at Mills College.

The third section reviews **mechanisms that are currently in place to prevent bankruptcies**, and in the fourth section, leaders in school districts that have been through bankruptcies share their testimony. Assemblywoman Hancock particularly wanted to take the **lessons learned from experience** and asked State Administrator Henry Der, of the Emery Unified School District, and West Contra Costa Unified Board Member George Harris III to share their thoughts.

The report concludes with **recommendations for legislation** from panelists and audience members.

"*Why Schools Face Financial Crisis*" suggested some answers to the question of how current systems can be improved, how the State can better support local school districts, and how Assembly Bill 1200 (the legislation that frames current practice for State loans and takeovers) might be adjusted. With ongoing participation from the panelists and community members, Assemblywoman Loni Hancock, Assemblyman Gene Mullin and their colleagues are developing legislation to address these issues.

A Brief Overview of Education Financing:

How California Funds Our Schools

Annually, California allocates approximately $55 billion to K-12 schools. Funding is provided to over 1,000 school districts and over 8,000 schools. State and Federal dollars are allocated through general-purpose funds and specific funds for over 100 categorical programs. School districts range in size from 5 pupils to over 500,000 pupils.

Funding sources (totaling approximately $55 billion):

1. 52% State General Funds
2. 25% local property tax ($14 billion)
3. 13% Federal funds ($7 billion)
4. Other local sources, lottery, revenues, etc.

Kindergarten through 12th grade education represents the largest single component of the State budget.

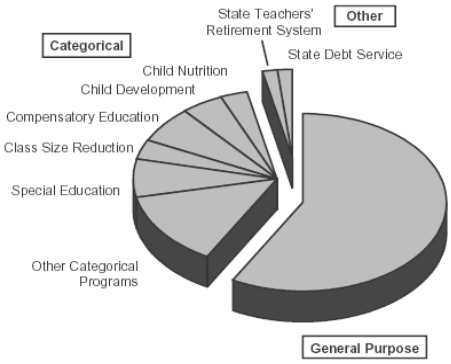
Funding is provided to districts in two forms:

1. Approximately 60% general-purpose revenues through a per-pupil allocation. This funding is discretionary, allowing each district to spend according to its own policy and priorities.
2. Approximately 40% are provided for specific categorical purposes such as teaching English to language learners, textbooks, and maintenance of facilities. Categorical activities have been deemed important enough that the State and Federal government earmark funds for those purposes.

Two-thirds of the education budget goes to classroom expenditures across the State. The largest component of this spending is on teacher salaries (about 50%), as well as instructional aides, textbooks, and supplies. The other one-third is spent on operational support for school sites, such as maintenance of facilities, school site administration, clerical support, pupil support (i.e. bus drivers, nurses, etc.), and instructional support (i.e. reading specialists, etc.). 6% of education funding is spent on administration at the school and State level.

K-12 School Spending 2002-03

(Courtesy of the Legislative Analyst's Office)



Recent trends in school funding:

Reinvestment increased appreciably during the latter part of the 1990s and early 2000s. Total funding increased 20% ($9.3 billion) over the last 5 years, and California schools moved from 48th to 36th in the nation in terms of per-pupil spending. However, California has not reached the median in amount spent per pupil per year with other States. Increased school resources are needed.

In this year's budget, funding for education decreased $180 per pupil.

Proposition 98, our State guarantee for K-14 education (see http://www.edsource.org/pub_edfct_prop98.cfm for more information), is funded by a combination of the State general fund and local property taxes. According to that measurement, school funding increased 30% over the last 5 years.

On a per-pupil basis, there has also been approximately 20% increase in spending to $1,100/ pupil.

The State currently has 3 school districts paying back emergency loans out of over 1000 school districts. "By and large, California schools have been tremendously successful in keeping their fiscal houses in order," Erik Skinner asserted.

L-R: George Harris, Nicolette Toussaint, Erik Skinner, Assemblymember Loni Hancock, Assemblymember Gene Mullin, Henry Der, Dr. Pete Mesa, Steve Jubb

Framing the Issue:
A Student-Centered Perspective

Steve Jubb, Executive Director of the Bay Area Coalition of Equitable Schools (Bay CES), opened the section on factors leading to financial crisis by posing three questions about our current systems.

Jubb believes that urban districts are in fiscal and academic disarray, lack adequate funding, and do not use the little resources they have well. Jubb wondered aloud if State Administrators have been given the tools they need to get the job done. He posed these questions:

1. Who owns the debt? When a district goes bankrupt, who pays?
In the present system, the Superintendent's contract is bought-out, so s/he does not pay the debt. The School Board's authority is suspended and Members lose their stipends, but they do not pay the debt out of their personal accounts. The top administrators in the district are still paid, and often heavily recruited by other districts, so they do not pay either. Even teachers have some mobility.

It is the children who have no power. When their district goes under, they pay by having fewer programs, less access and less opportunity. Jubb asked participants to consider if this is an expression of our values and of what we really want.

2. Who is best positioned to help financially broken districts? What tools do they need?
Jubb observation is that the State's policies are too complex. We have created a system that doesn't work. Jubb noted that the problem is not intent.

Bay CES has found that partnerships between families, communities, businesses and schools help create the conditions for positive change. The fourteen new, small schools Bay CES has helped establish in Oakland in the last two years have shown dramatic results in attendance, grade point averages, school culture and school climate. Jubb contends that these achievements are the result of smaller learning communities where students can be well known by a stable group of caring adults, where people are in closer relationships with one another and take responsibility for what happens in the life of each child.

3. What would our education system look like if it were better?
Having heard a lot about what is wrong in our systems, Jubb hopes to hear more of what the policy infrastructure is that would allow us to take good practice to scale. He paraphrased Peter Senge, a thinker on systems analysis, who said that <u>people, however different, in the same system tend to produce the same results</u>. It is time we stop blaming individuals. We know that the people who work in education are smart, dedicated and work hard – why should they so often produce the same results? Jubb urged everyone to look at the attrition rates of fifth graders through ninth grade, high school graduation, and then at how many are University of California/California State University eligible. "It's an academic holocaust we're facing! Why do we intervene in fiscal crises, but not academic ones?"

Factors that Lead Schools to Face Financial Crises

Nicolette Toussaint, Communications Director of the Bay Area School Reform Collaborative (BASRC), observed that schools do not have the financial and personnel resources to focus on academics when they are in fiscal crises. She noted that national data shows California's per pupil spending has moved from 46th in the nation to 36th. However, when we take the high cost of living in this State into account, California's current spending per student is still closer to 46th. BASRC has identified these factors as contributing to financial crises:

California under-invests in its schools. Inner city and high poverty districts constantly operate on the margin, struggling to find some loaves-and-fishes formula for making good education out of inadequate resources.

California's budget calendar doesn't make sense. School districts adopt their budgets in the spring, several months before the legislature adopts its budget. Often districts' fiscal year has begun before the state has adopted a budget. This means that districts must budget on the basis of guesswork about income levels. When they guess wrong, they're in trouble.

Funding for schools is unstable. Funding for the entire public sector fluctuates with the economy and tax revenues – but school costs are ongoing and consistent. When income tax revenues go up, districts expand programs. But the vast majority of the costs of education are tied up in salaries and it is difficult for districts to renegotiate contracts with teachers and staff to downsize quickly when revenues fall. Until school funding can be tied to a funding stream that is more stable than California's income and sales taxes, school districts will continue to miscalculate and overspend.

Funding streams are inflexible. Sending dollars to districts in rigidly defined categorical "pots" of money makes it difficult for local leaders to manage their budgets. If you need money for a particular purpose – say, providing teachers with literacy coaches to help them in their classrooms learn new ways to teach reading – having resources available in budgets restricted to other purposes does not help.

Districts lack systems, personnel, and infrastructure to do a good job of administration. The persistent tendency to demonize administration as the cause of most of our educational woes has made it close to impossible for school districts to invest in the kind of management infrastructure that the private sector takes for granted. Districts typically lack information management systems, and when they have them, they often fail to invest in maintaining them or training staff to use them well. Given the combination of large budgets, multiple and highly-restricted funding sources, uncertain and fluctuating levels of state funding, most districts struggle to know either how much money they have or how much they are spending.

New leaders over-promise and over-spend. School districts are subject to rapid leadership turnover. New leaders seek to build momentum and political support by promising results, and may take financial chances underwriting their improvement plans. It is easy to fault the leaders, but often the plans are good ones and the expenditures badly needed.

Training for School District Leaders

Dr. Pete Mesa, Distinguished Visiting Professor at Mills College and former Superintendent of Oakland and Milpitas Unified School Districts, elaborated on the challenges school district leaders face. Mesa pointed to the changes in populations and aspirations for our public schools has meant institutions are overwhelmed. Leaders face the impossible task of developing infrastructure to accomplish changing missions. Mesa argued that, "the evolving complexity of leading school systems and the changing nature of the job has made the existing training obsolete. We need to reconceptualize the job and better prepare candidates."

Specifically, Dr. Mesa identifies these four problems in current school leadership:

1. Superintendents and school leaders do not identify variables in budgets.
Administrators need better preparation to understand the revenues/costs of enrollment, preparing staff to implement changes and bringing them to scale.

2. District administrators and school boards do not develop budget guidelines together.
Mesa recommends implementing systems in which every program stands on its own funding. In the event that a program exceeds its budget, staff can come before the Board and Superintendent to request funding, so long as they have a sound plan for recovery.

3. Superintendents tend to compartmentalize different parts of the job without realizing there are no firm boundaries and one must watch the interaction between parts.
Leaders often lack the systemic view recognizing that, "if you poke it here, it pops out there." Districts need an executive who is used to operating large organizations – most administrators are not.

4. Superintendents see what needs to be done and feel morally compelled to do it.
Mesa suggested that the decision to spend more should be a local community decision. Communities should have the option of deciding whether to issue a bond and repay the debt served by the district in cases of school overspending and "bankruptcy".

Current Mechanisms to Prevent Bankruptcies

Assistant Secretary for Fiscal Policy Erik Skinner reviewed the current processes.

The job description of Superintendent and responsibility of the School Board is fundamental in ensuring that schools operate within budget. It is crucial that schools have the appropriate technical expertise.

The current formal processes hinges on County Offices of Education. The framework was introduced in AB 1200 (1991), after the emergency loan to Richmond Unified School District.

The AB 1200/County Office System has 2 elements:

1. A public instruction district submits an annual budget for approval by the County Superintendent. This gives the Superintendent the opportunity to review the budget and determine if it is viable or not. If the budget is disapproved, there is an opportunity for appeal and revision through the Budget Review Committee to the decision of County Superintendent.

2. In December and March, the County Superintendent reviews the district's budget and makes a determination of the fiscal health of the district. At those junctures, the County Superintendent finds either a positive certification, meaning that the budget is likely to meet its obligation for its current and subsequent 2 years; a qualified certification meaning that the budget may not meet obligations within the time period; or a negative certification meaning that the budget will not meet the obligation in the current or subsequent year. The twice-annual interim reviews are the system's best way to try to identify problems early.

In extreme situations a district is unable to meet its fiscal responsibilities and needs an emergency loan from the State.

1. Emergency loans of less than 200% of the district's reserve require a State trustee be appointed by the SPI. The Board retains its authority but the trustee has the ability to block expenditures if the trustee deems them contrary to the fiscal health of the district.
2. Emergency loans equal to 200% of required reserves or over necessitate that the School Board becomes advisory and that the State appointed administrator takes over day to day academic and financial management of the district.

Districts have many formal and informal resources as well to help keep their "fiscal ships afloat." In addition to in-house technical expertise, consultants may come in and provide input and oversight such as the Financial Crisis and Management Assistance Team (FCMAT). FCMAT works on a contract basis helping school districts find ways to optimize their funding, address personnel matters, and improve their information management systems. Erik Skinner suggested that FCMAT, "helps them tighten down the ship and hold things down fiscally so they can achieve all the programmatic good we can expect from our schools."

What Happens in a Bankruptcy:
Personal Testimonies/Lessons Learned

Henry Der, State Administrator of Emery Unified School District reflected that the State's purpose when it takes over a school district is to restore fiscal capacity, integrity, and accountability to support and maintain quality education for students, and then leave the district. "The purpose of a State Administrator is to work yourself out of a job."

Under law, there are three things the State Administrator must achieve.

1. *The State Administrator must develop a multi-year financial recovery plan*. The elements to a simple plan include,
    a) Demonstrating a reduction in expenses,
    b) Identifying any increases in revenues or new revenue funding streams,
    c) Demonstrating the district's ability to repay their loan over a period of time. Using the State as a bank and demonstrating the ability to make annual payments.
    d) Indicating financial stability by working to abolish a negative fund balance, not spending more than received in revenues each year, and putting enough money into reserves to meet times of economic uncertainty.

2. *Development of a management review and recovery plan.* This is necessary to address infrastructure and capacity issues such as personnel administration, business practices, facilities, community relations, information technology support, and other aspects of high performance administration. This requires a hard look at personnel and practices and saying to one and all, "we have to clean up our act, be held accountable so that people in the schools and the public know how our school's are operating."

3. *The State Administrator must rebuild trust and support for our schools*
    If you look at a bankrupt situation before the State Administration steps in, there is tremendous fear, distrust, frustration, mixed feelings, and loss of confidence. It is a terrible emotional, political environment in a local school district.

    The State Administrator has the task of rebuilding confidence in the entire public education enterprise. In this day in age, a local school district cannot support itself without strong support and confidence from the community. City Council, Board of Supervisors, and local elected officials all need to come together and embrace a vision of what will be good for improving the schools.

    Der states, "Community folks assume that the State Administrator has his act together. In truth, I have had the task of pulling in colleagues from the Department of Education, Alameda County Office of Education, and FCMAT. We look at the finances and we each have a role. We all come from different perspectives as to how to pay back our loans and not do it at the expense of the children. This is all political and it takes sacrifice and courage to do what we need to do."

George Harris, Board Member of the West Contra Costa Unified School District Board of Education began by acknowledging the statement made by Henry Der. In particular, Harris concurred with Der's closing points and agreed that it is a necessity to rebuild trust and support for our schools.

Harris asserts, "There is a toll when there is a State takeover. When a State takes over a district it says, 'Hey look, you haven't met your responsibilities, you haven't produced a balanced budget, you haven't found a way to accomplish the goals you locally want to achieve with the revenues that we provide for you.' This is a hard thing to hear."

Harris believes that the State should provide what is necessary for the district to accomplish its education mission – and that has never happened.

This has been a challenging year for the WCCUSD Board. Since January, they have been working to balance their budget, which is projected to be out of balance by $14 million. Of course this is not certain because the State does not have a budget yet. School districts are required to balance their budgets before knowing actual revenues.

Harris states, "It has been a really gut-wrenching 6 months. Our district has had to consider a number of sacrifices. The decisions that we as a School Board are put in the position of making have very little to do with what we believe is best for children. We have a State trustee who can veto our decisions. We have, fortunately over the years, built up reserves for unanticipated expenses. The question is what are we providing for the children now."

"I wish the State had a different approach to dealing with these fiscal issues. I liked what Dr. Mesa said about when the State should step in – I think, at the end of the day, there is a reason why we have a local School Board. We live in the community, respect the community, and depending on the number of votes, we have some level of confidence from the community. So it should be left to the local community if it wants to deficit spend. This is not a free choice – it should have consequences to it. If we decide that we want to deficit spend, there should be tools in order to put that system in place. There is a tool – parcel taxes. This requires a high threshold of a 2/3 vote which means a minority of citizens can decide that we do not want to deficit spend even if the majority feels otherwise. The decision-making process has been taken away from the majority. The ability to deficit spend is not available to us and we have had to suffer through the pretty nonsensical and complicated system of education finance that the State has put together."

Legislative Recommendations from Panelists and Audience Members

(Assemblywoman Loni Hancock has committed to developing possible legislation on the ideas in *italics*.)

- ***Align the budget cycles of the State and school districts.***

- ***Implement financial capacity building training for Superintendents, County Offices of Education and Boards of Education.*** This might be a combination of administrative credential programs changing their requirements and the State offering training to leaders already credentialed.

- ***Require all accountants performing school audits to go through an education specific audit certification process.*** (Firms often assign junior members to the school district contracts.)

- ***Amend AB 1200.***
  There were multiple suggestions, including a floating interest rate for school districts with State loans, allowing districts to sell surplus property to repay loans and/or put a parcel tax to repay the loan before the voters. Regular communication (monthly) between a State Administrator and an advisory school board could also be mandated.

- ***Permit categorical funding more flexibility.***
  School districts could benefit from having the freedom of some block grants – grouping funds into general topic areas with flexible funding between programs.

- ***Redefine fiscal accountability.***

- ***Define "adequate educational funding" and then commit to it at the State level.***

- **Increase overall State funding for schools, or make it more feasible to increase local taxes for education.**

- **County Offices of Education review and report on the soundness of collective bargaining agreements.** The County Office would not have the authority to veto, but would advise school boards before the board signed contracts. (Under the current system, the County often approves the district's budget before the district negotiates teachers' contracts.)

- **De-politicize the County Superintendent positions so those Superintendents can make fiscally sound decisions without political pressure.**

- **Multiyear funding for school districts.**

- **Provide a statewide benefits package.** The State Office of Education could negotiate the salaries and provide health benefits. (At present, some districts provide health coverage for life while others do not provide any post-retirement packages.)

- **Reward excellent management systems that build alliances between business – cities – non-profits – and schools.**

- **Consider use of tax credits for school construction of joint-use facilities: give business community an incentive to invest in our schools as <u>community centers.</u>**

- **California spends $6,000+ per student – legislators should take a field trip to states where $12,000 is spent.**

- **Direct funds to the districts with greatest need.**

- **All districts in all counties should be on the same computer system.**

- **The California Legislature should be able to pass a budget with a simple majority.** This will make funding easier to achieve.

Community members offering public testimony at the hearing.

Resources

The **Fiscal Crisis and Management Assistance Team (FCMAT)** offers services, annual reports, news headlines and articles about California state budget and education issues. They also offer useful links to other organizations and services. Their website is: www.fcmat.org

EdSource is an independent organization providing useful information to clarify complex K-12 education issues. EdSource strives to promote thoughtful decisions about California's public school system and has worked with a coalition to build the Ed Data site (shown below under next resource). Their website address is: www.edsource.org

Article Links:

"School Finance Highlights 2002-03" (Nov 02): www.edsource.org/pub_edfct_SchFin02.cfm
"A Guide To Categorical Aid" (Mar 97): www.edsource.org/pub_edfct_cat_aid.cfm
"A Primer on Proposition 98" (Oct 96): www.edsource.org/pub_edfct_prop98.cfm

The Education Data Partnership's Web Site includes school district financial data and background information on school facilities, testing, and categorical aid in California. Their website address is: www.ed-data.k12.ca.us

The California Department of Education provides access to California School, District and County Offices through this website**:** www.cde.ca.gov

Education Week helps raise the level of awareness and understanding among professionals and the public of important issues in American education. They provide special reports on issues ranging from technology to textbooks. Their website address is: www.edweek.org

Bay Area Coalition of Equitable Schools (BayCES) assists urban schools, school districts, and community groups in the work of creating or redesigning their schools. They provide coaching and organizational support to school, district, and community partners. Their website is: www.bayces.org

Bay Area School Reform Collaboration (BASRC) works with education leaders in both schools and districts to develop, assess, and use the knowledge needed for schools to engage in a systematic and sustainable improvement process. Their website is: www.basrc.org

West Ed is a research, development and service agency that partners with community members, school districts and elected officials to promote excellence, achieve equity and improve learning for youth and adults. Their website is: www.WestEd.org

The California Office of the Secretary of Education is responsible for making policy recommendations to the Governor on education issues. Their website is: www.ose.ca.gov

Assemblywoman Loni Hancock is the Chair of the Select Committee. She also sits on the Assembly Education and Budget Committees. Ms. Hancock represents the 14th Assembly District. Her website is: http://democrats.assembly.ca.gov/members/a14

Acknowledgements

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