

# California's New School Funding Flexibility

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## Summary

Spurred by a deep recession and large budget shortfalls, the California Legislature in 2009 enacted what was arguably the largest change to California's school finance system in decades—relaxing spending restrictions on more than 40 categorical programs through 2012–13, extended later to 2014–15. Categorical funding, which gives school districts money in addition to the general funds they already receive from the state, had been limited to specific, narrow purposes: buying textbooks or providing summer school, for example. Under the 2009 changes, districts could begin spending these funds for any educational purpose.

When the law expires, the legislature will be faced with a decision: whether to return to the previous, tightly restricted categorical fund system or transition to a permanent version of the flexibility now in use.

Because they were part of legislative negotiations over the state budget, not education policy, the decisions made in 2009 were far from optimal for K–12 schools. A more systematic and less political reconsideration of categorical flexibility could result in a more equitable and transparent distribution of funds, while also reserving targeted aid for students who need supplemental services. In addition, under the 2009 provisions, districts could spend categorical funds on any educational purpose. Both state policymakers and local district officials have expressed concern about the impact of completely flexible funds on the collective bargaining process; specifically, that those funds would be used inappropriately to increase teacher salaries and benefits rather than to provide additional services or materials for students.

This report offers three recommendations to improve current flexibility provisions that the legislature could consider should it pursue categorical flexibility beyond the program's sunset date:

- Distribute these less-restricted categorical funds more equally.
- Apply clear criteria for flexibility and consider alternative configurations.
- Consider some restrictions on flex item funds.

These recommendations would create a more equitable and transparent source of revenue. This would provide local school districts with increased flexibility in meeting student needs, and would be consistent with several recent major school finance reform proposals, as well as Governor Brown's campaign plan for K–12 education.

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Technical appendices to this paper are available on the PPIC website:  
[http://www.ppic.org/content/pubs/other/511MWR\\_appendix.pdf](http://www.ppic.org/content/pubs/other/511MWR_appendix.pdf)

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## Abbreviations

|         |   |
|---------|---|
| ADA     | Average daily attendance                          |
| CAHSEE  | California high school exit examination           |
| CalSAFE | California School Age Families Education          |
| CDE     | California Department of Education                |
| CTE     | Career-technical education                        |
| DOF     | California Department of Finance                  |
| EIA     | Economic impact aid                               |
| EL      | English learner                                   |
| K–3 CSR | Kindergarten through grade 3 class size reduction |
| LAO     | Legislative Analyst’s Office                      |
| LEA     | Local education agency                            |
| ROCP    | Regional occupational center or program           |
| TCBG    | Teacher credentialing block grant                 |
| TIIBG   | Targeted instructional improvement block grant    |

# Introduction

School districts in California are funded in two ways: with unrestricted general purpose funds that may be spent for any educational purpose, and restricted funds—called categorical—earmarked for special programs and purposes.<sup>1</sup> Unrestricted funding comes to school districts in the form of *revenue limits*—a per pupil entitlement amount that comes from local property taxes and the state. Other unrestricted funds include part of state lottery revenues and some other local revenues, such as parcel taxes and donations. Together, unrestricted funding sources account for approximately 70 percent of all California school district revenues (Figure 1), approximately \$5,700 per pupil in 2009–10.

Most restricted—categorical—funding is delivered through and is intended for myriad specific programs, including special education, pupil transportation, and professional development for teachers. Weston, Sonstelie, and Rose (2009) catalogued more than 60 state categorical revenues in existence in 2005–06. School districts also receive restricted funds from the federal government through programs such as Title I and the National School Lunch Program. Restricted funding constitutes 30 percent of school district revenues (Figure 1), approximately \$2,600 per pupil in 2009–10.

## California's complex school finance system

California's current school finance system is largely a product of two 1970s-era events that shifted the bulk of school funding from the local to the state level. Previously, school districts set their own property tax rates, and this local revenue constituted the majority of school district funds. Afterward, the burden of financing California's schools shifted largely to the state.

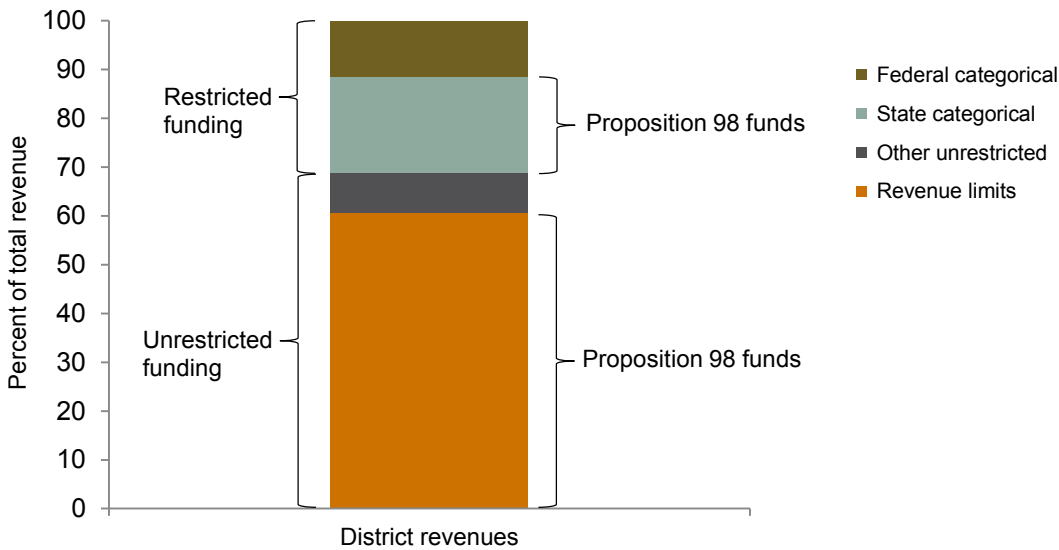
First, the 1971 California Supreme Court decision known as *Serrano v. Priest* found the state's school finance system to be unconstitutional and required the state to equalize general purpose funding across all school districts. Then in 1978, Proposition 13 reduced the amount of local property tax revenue available to cities, counties, and schools.

The state now determines its K–12 contribution through a series of complex formulas governed by Proposition 98, a voter-approved initiative that dictates the minimum amount that the state must spend. K–12 education and community colleges receive at least 40 percent of the state's General Fund revenues under Proposition 98. Proposition 98 funds both general purpose funds and most categorical programs.

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<sup>1</sup> There is some subjectivity in the definition of categorical revenue. For the purposes of this report, the terms restricted and categorical are used interchangeably and include any state funding allocated beyond revenue limit funding. This includes programs with restrictions on expenditures, applications, or requirements to obtain funds, including incentive funding such as K–3 Class Size Reduction.

**FIGURE 1**  
**School district funding by type, 2009–10**



SOURCE: Education Data Partnership statewide totals and averages for school districts, 2009–10.

NOTE: Does not reflect flexibility provisions granted by the 2009 Budget Act; state categorical includes \$4.5 billion flex item. Unrestricted incentive categoricals, such as K–3 Class Size Reduction, are counted as state categorical funds. See [Technical Appendix B](#) for more information about which revenues were used to create these categories. Some state categorical programs are funded through non-Proposition 98 state aid, such as the state lottery and 2009–10 pupil transportation funding.

The largest portion of unrestricted funding, revenue limits, is intended to provide for the basic education of an average student (LAO 1993b). Revenue limits pays for teacher salaries and benefits and other items and services required to keep a school in operation such as janitorial services, administration, desks, and electricity. Conceptually, this base funding is awarded to every district on an equal per pupil basis. Some districts have special costs, such as rural schools that typically have extensive transportation costs to ensure that students can get to school. Another example is schools with many English learners, who may require additional instruction or special materials to assist them in becoming proficient in English. Revenue limit funding may be insufficient to cover those additional costs—costs above the basic education of a typical student. This is a major reason why federal and state categorical (restricted) programs were created: to cover (sometimes only partially) the gap between the base funding and the true cost of educating some groups of students and districts.

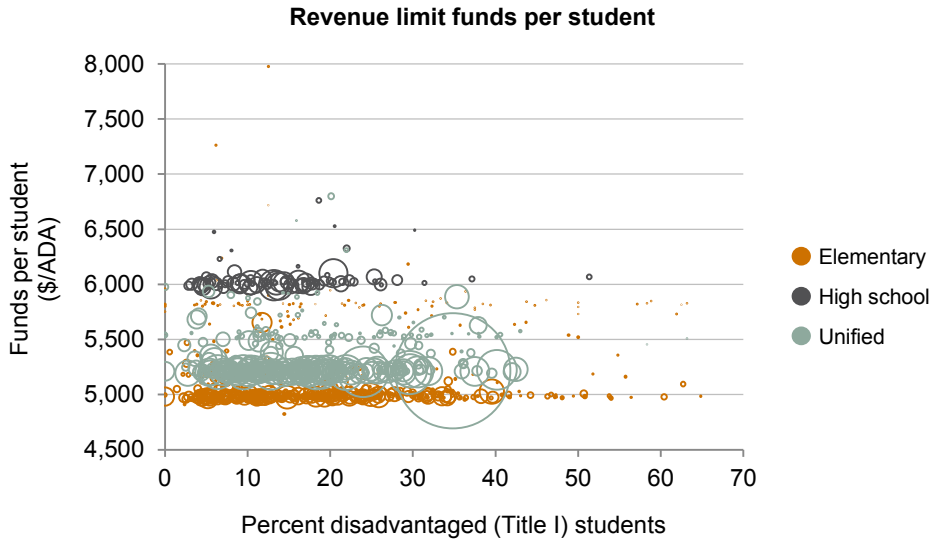
In practice, California school finance follows this framework. Revenue limits funding is relatively equally distributed across school districts, in keeping with the *Serrano* decision (see text box). Any differences in funding are explained by the type of school district (elementary, high school, or unified): the average base revenue limit in 2009–10 for elementary districts was approximately \$5,200 per pupil, for unified districts \$5,300 per pupil, and for high school districts \$6,100 per pupil. Under the *Serrano* equalization rules, districts were categorized by their type and size (small and large) and equalization occurred within each category. This means that the vast majority of students within each district type have roughly the same base revenue limit funding (90 percent of all unified district students are within an \$80 per pupil band). Very small districts, however, have higher revenue limits than other districts of the same type.

These configurations are illustrated further in Figure 2a, which shows funding per student against the percentage of students identified as disadvantaged under the federal Title I program. Each bubble represents a California school district. The bubble color reflects its type and the bubble size reflects the number of students in the district; the largest bubble is the Los Angeles Unified School District, which serves approximately 10 percent



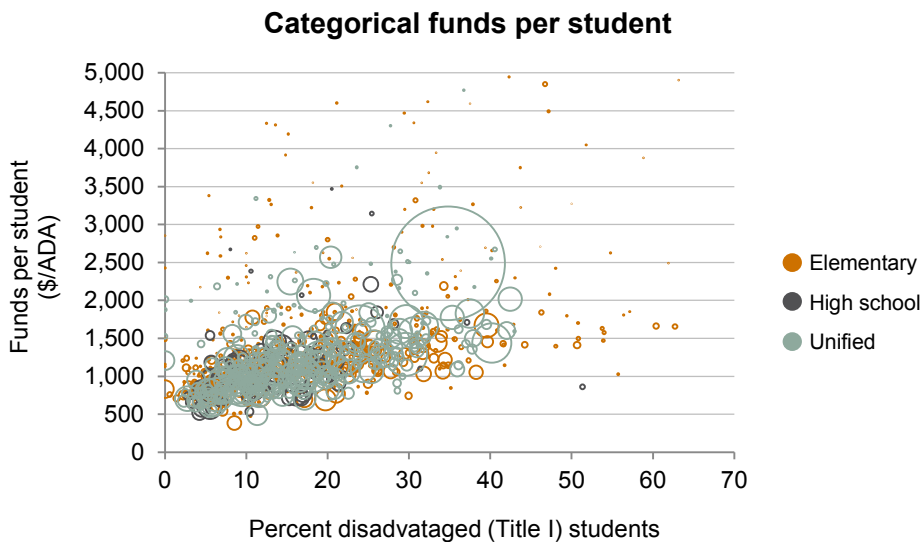
of California’s students. As the percentage of disadvantaged students grows, the revenue limit funding per pupil stays constant at the mean level of funding for each type of district; any variation is explained by district type and size.

**FIGURE 2**  
Per pupil funding by student disadvantage, 2009–10



SOURCES: 2009 Principal Apportionment Summary, Economic Impact Aid Funding Results, and CBEDS enrollment, CDE.

NOTES: Size of circle corresponds to the number of students in the district. Base revenue limit reflects 18.355% reduction in 2009–10. Includes 944 of 961 districts. Reasons for exclusion include missing enrollment counts (7 districts) or Title I counts larger than enrollment (5 districts).



SOURCES: 2009 Principal Apportionment Summary, Funding Results (various programs), and CBEDS enrollment, CDE; Deferred Maintenance Program funding, Office of Public School Construction.

NOTES: Includes 918 of 961 districts. Reasons for exclusion include missing enrollment counts, Title I counts larger than enrollment, and categorical funding greater than \$5,000 per ADA (33 districts). Districts with more than \$5,000 per ADA in total categorical funding are predominantly elementary districts with fewer than 101 ADA. Excludes child care, facilities, mandates, school nutrition, and special education funding.

Figure 2b shows that categorical funds are not equally distributed across school districts; districts with many disadvantaged students tend to receive more categorical revenue per pupil than those with few or no disadvantaged students, but there are wide variations in funding even among schools with similar shares of disadvantaged students. For example, in districts that have between 10 and 20 percent Title I students, the amount of categorical funding per pupil clearly varies: most districts receive between \$500 and \$1,500 per pupil. Within that range are districts of all types, with funding at both ends of the spectrum. However, like revenue limits, districts with much higher than average funding within a band of poverty tend to be very small. In addition, categorical funds do not vary across districts of different types, in sharp contrast to the revenue limit funding of 2a, where the level of funding on the vertical axis is clear and discrete for each district type. This relationship between categorical funding and student disadvantage results from the unique history and politics of categorical programs in California.

## Background

The 1917 federal Smith-Hughes Vocational Act created one of the first categorical programs, with many more created in the 1960s and 1970s as a response to the additional costs faced by school districts to educate students disadvantaged in some way.<sup>2</sup> The state provided additional funds, whose use was restricted to these additional services and programs, to improve educational outcomes. These complemented changes at the federal level that recognized new rights and offered federal funding for these special needs students.<sup>3</sup> Other categorical programs addressed the additional costs facing small and geographically isolated school districts that lacked economies of scale.<sup>4</sup>

Many of those early categorical programs were designed to improve the outcomes of at-risk students—special education, disadvantaged, and English learner students. Following the publication of *A Nation at Risk* in 1983,<sup>5</sup> attention shifted toward the academic improvement of all students and the state’s approach to categoricals shifted as well: funding was supplied to districts that voluntarily met certain criteria and thus the funding became an incentive that districts sought. In general, the criteria targeted education reforms such as longer school days and school years, higher teacher salaries, and smaller class sizes.<sup>6</sup> This shift toward incentives occurred because incentives were generally viewed as more effective and less costly than mandates for such things as pupil health screenings and criminal background checks for staff, in which the state reimbursed districts for the costs of meeting state requirements (Picus 1991, LAO 2002).<sup>7</sup> At present, the largest incentive program is K–3 class size reduction (K–3 CSR), in which districts received \$1,071 per K–3 student in 2009–2010 as long as class sizes did not exceed an average of 20.44 students.<sup>8</sup>

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<sup>2</sup> California’s history of categorical revenues is simplified for this report. See Kirst, Goertz, and Odden (2007), LAO (1993b), Little Hoover Commission (1997), Mockler (1987), Picus (1991), and Timar (1994) for more comprehensive and detailed descriptions.

<sup>3</sup> Education for All Handicapped Children Act of 1975, Title I of the Elementary and Secondary Education Act of 1965, and the Bilingual Education Act of 1968.

<sup>4</sup> SB 813 (Chapter 498, Statutes of 1983) revised the Necessary Small School formula and provided additional funds to small school districts for bus replacement, for example.

<sup>5</sup> A report by the National Commission on Excellence in Education that summarized the literature on American academic achievement relative to the rest of the world. It concluded that the United States was failing to produce a competitive workforce and offered some recommendations to reform education. The report is archived at <http://www2.ed.gov/pubs/NatAtRisk/index.html>.

<sup>6</sup> The first major package of incentives-based categoricals was SB 813 (Chapter 498, Statutes of 1983) which responded to *A Nation At Risk*, and proposed lengthening the school day and year, adopting more rigorous achievement standards, and strengthening teaching. See LAO (1984).

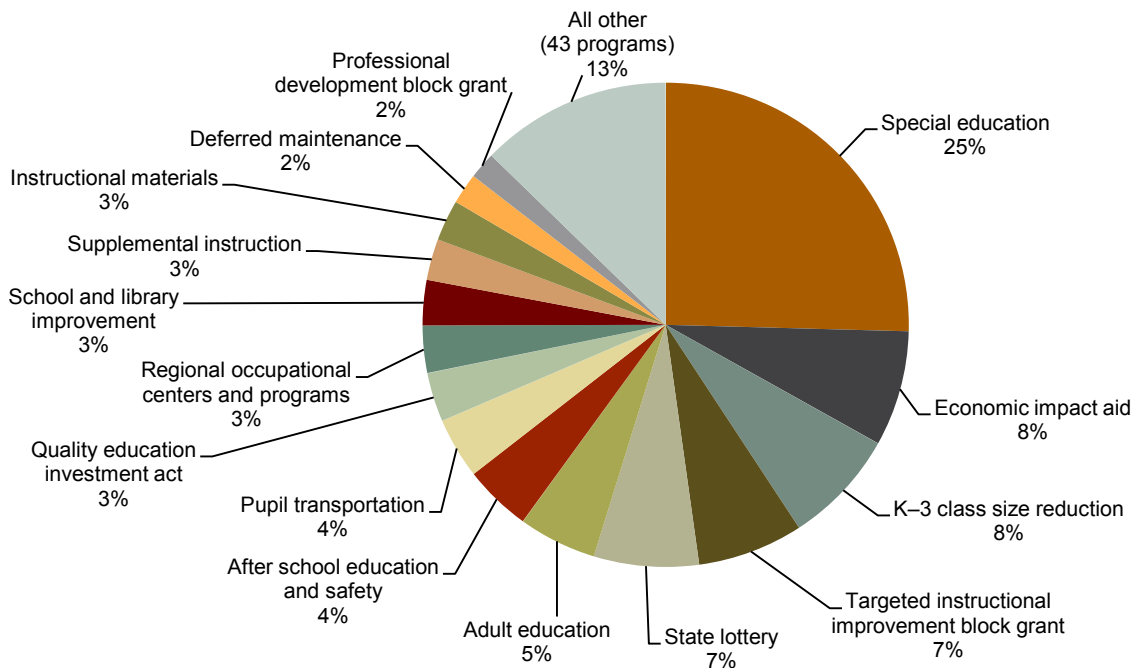
<sup>7</sup> The LAO estimates that the state owes districts \$3.4 billion in backlogged mandate claims (LAO 2010d, 2011b).

<sup>8</sup> The 2009 Budget Act relaxed penalties so that districts could increase class sizes up to 25 students and retain 80 percent of K–3 CSR funds for 20 students. Districts with class sizes between 25 students and the statutory maximum size of 32 students (grades 1–3; maximum is 33 in kindergarten) retain 70 percent of K–3 CSR funds for 20 students.

Politics has also affected decisions about categorical programs. Many local labor agreements require that districts provide salary increases when general purpose (revenue limits) funding increases.<sup>9</sup> Timar (1994) and Kirst (2007) contend that because categorical revenues cannot fund salary increases, Governors George Deukmejian and Pete Wilson and legislators in the 1980s and 1990s viewed them as a way to keep money off the bargaining table; general purpose funding increases automatically trigger salary increases or salary renegotiations in many districts' employment contracts. Timar (1994, 2002) also points to examples of categorical programs or revenues as political leverage in budget negotiations.<sup>10</sup> Further, the creation of categorical programs can give legislators a way to demonstrate a tangible increase in K–12 funding or respond to constituents' needs. This has resulted in the creation of many narrowly focused categorical programs such as those for textbooks, professional development and school safety, as well as auxiliary services such as foster youth programs and oral health assessments.

The overall result has been a proliferation of categoricals, at least 60, as noted above. However, most funding goes to only a few programs; almost 90 percent of all categorical funding is allocated through 15 programs, whereas more than 30 programs each provide less than \$50 million statewide (about 0.1 percent of Proposition 98 funding) (Figure 3). The share of state aid spent on categorical programs compared to revenue limits has grown quite dramatically; Timar (2006) calculates that the categorical share of state funding increased 165 percent between 1980 and 2000, compared to an inflation-adjusted 8 percent *decline* in revenue limits funding.

**FIGURE 3**  
Share of categorical revenues, by program, 2010–11



SOURCES: Legislative Analyst's Office (2011) and California State Controller's Office.

NOTE: Lottery funding is 2009–10 total.

<sup>9</sup> LAO (1997 and 2008).

<sup>10</sup> See Timar (1994) p. 146 and (2002) p. 58, for example.

This program proliferation has led to increased concern about their usefulness—although there are many legitimate reasons for restricting some kinds of funding. First, approximately 40 percent of the state’s general fund goes to K–12 education, so it is rational that the state would want to exert some control over those revenues.<sup>11</sup> Because of its large investment in K–12 education, the state also has a fundamental interest in the achievement of its students and may prioritize specific types of spending to improve student outcomes. Categorical programs ensure that districts pursue those state priorities. Second, categorical programs can correct adverse incentives. A commonly cited example is special education. Districts typically face higher-than-average costs per student to provide supplemental services and programs for students with learning or other disabilities. Without additional, dedicated revenues the result could be fewer services and programs than needed. To correct this, categorical special education revenues offset some of those higher costs and may only be spent on special education students.

Notwithstanding these benefits, there have been several attempts over the last 30 years to provide more flexibility over categorical revenues or to reduce the number of categorical programs. These efforts are described in detail in [Technical Appendix A](#); three main concerns motivated these efforts, concerns echoed by district superintendents, the LAO, and researchers now.

First, not every program will work in every district in a state as large and diverse as California. Categorical restrictions prohibit local administrators from shifting funds to meet local needs, thus fragmenting services (LAO 1999b). As Kirst (2007) explains, some districts may have surpluses in lower-priority categorical accounts while running lean in basic district operational accounts.

Second, some categorical programs can themselves create fiscal disincentives. For example, Economic Impact Aid funds additional services and materials for economically disadvantaged students and for English learners. Funding is allocated based on the number of these students in a district. Districts that are successful with English learners lose these funds when these students become proficient in English—potentially providing a fiscal incentive to reduce the pace of English proficiency or to reclassify English learners as English proficient.

A third major concern driving earlier reform efforts was and is the administrative burden of categorical programs. As long ago as 1997, the Little Hoover Commission found that the categorical administrative burden could redirect district staff time away from instruction. Each program has its own application procedures, compliance restrictions, and paperwork requirements. Although the state has attempted to streamline some of this burden through efforts such as the Consolidated Application, districts must still maintain approved, detailed school site and district plans.<sup>12</sup>

These issues have been the focus of a large body of research.<sup>13</sup> Some critics propose consolidating categoricals into large thematic revenue streams with the goal of a simpler, more streamlined, and more flexible allocation of categorical revenues.<sup>14</sup> As a candidate, Governor Jerry Brown (2010) proposed a similar restructuring.

In 2009, categorical regulations received new attention in that year’s budget negotiation. Large cuts to schools were proposed to help balance the state budget. To give local administrators more flexibility to absorb these

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<sup>11</sup> See the DOF website for historical distributions of general fund revenues across state programs: [www.dof.ca.gov/budgeting/budget\\_faqs/information/documents/CHART-C.pdf](http://www.dof.ca.gov/budgeting/budget_faqs/information/documents/CHART-C.pdf).

<sup>12</sup> See [www.cde.ca.gov/fg/aa/co/](http://www.cde.ca.gov/fg/aa/co/) for more information on the Consolidated Application and [www.cde.ca.gov/nclb/st/le/](http://www.cde.ca.gov/nclb/st/le/) for information about related required accountability plans.

<sup>13</sup> Bersin, Kirst, and Liu (2008); Governor’s Committee on Education Excellence (2007); Kirst, Goertz, and Odden (2007); LAO (1993b, 2004b, 2006, 2008); Loeb, Bryk, and Hanushek (2007); Mockler (1987), Picus (1991), Timar (1994, 2006)

<sup>14</sup> For examples, see Bersin, Kirst, and Liu (2008), Governor’s Committee on Education Excellence (2007), and LAO (2008).

large revenue cuts, the legislature granted spending flexibility to approximately 40 programs comprising 30 percent of all categorical revenues in 2009–10.<sup>15</sup> The programs included in this measure were given the collective name of the *flex item*. In creating the flex item, the legislature suspended all restrictions on the use of funding, reclassifying these categorical programs as general purpose programs through 2012–13, and later to 2014–15.

These actions were not driven by a specific educational reform effort, but by the need to help local districts absorb large budget cuts. Nonetheless, the creation of the flex item—and its long sunset date—now offer the legislature the opportunity to reevaluate California’s school finance system. The legislature could in 2015 revert to the categorical system that existed previously, or it could use the flex item as a case study of categorical deregulation and reconsider the categorical system, perhaps adding additional, and permanent, flexibility. This report focuses on the latter option as the best one for the state’s education system.

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<sup>15</sup> The LAO (2011) found that the flex item had increased to 40 percent of categorical funds in 2010–11. Their calculation excluded child care and lottery funding. Additionally, funding for K–3 CSR decreased by approximately 50 percent between 2009–10 and 2010–11 as districts increased class sizes.

# The Flex Item

The legislature, under pressure from a sagging economy that had reduced revenues, approved the creation of the new categorical flexibility items in February 2009. The overarching theme was that in exchange for large cuts (almost 20 percent from 2007–08 levels), local districts would be given substantial flexibility. Legislative committees heard alternative budget cut and flexibility proposals from the LAO, but largely settled on the provisions in Governor Schwarzenegger’s original budget proposal.

The state’s categorical programs were divided into three levels:

- Tier I programs remained intact: there were no 2008–09 midyear or 2009–10 reductions to their allocation, no programmatic changes, and no flexibility granted.<sup>16</sup>
- Tier II programs received funding reductions but the requirements of the programs remained unchanged.
- Tier III program allocations were reduced and the programs became flexible, allowing districts to make programmatic changes. This represented 40 categorical programs representing about 30 percent of all categorical funds.<sup>17</sup> Districts would be allowed to spend Tier III funds on any educational purpose as long as the school board publicly discussed those purposes at a regularly scheduled board meeting.<sup>18</sup> Although the underlying statutes for programs affected by the flexibility provision remained in place, districts using it would be considered to be compliant with all state categorical program requirements even if they no longer operated a particular program.

Flex item programs vary in their purpose, scope, and beneficiaries (Table 1). The majority fund support services and programs for K–12 students or their teachers at schools. Non-local education agencies such as the Center for Civic Education—a nonprofit that provides civic education materials to participating districts—and American Indian Education Centers, operated by tribal governments—also receive categorical funds. Other programs support statewide administrative activities operated from county offices of education, such as education technology or non-K–12 programs such as adult education.

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<sup>16</sup> Although K–3 Class Size Reduction (K–3 CSR) is considered Tier I, the penalty structure was temporarily changed. Prior to the 2009 Budget Act, districts lost all K–3 CSR funds if they exceeded average class sizes of 20.44 ADA. The exact calculation of K–3 funding for class sizes exceeding 20.44 students is complex, but through June 30, 2014, districts are eligible for 70 percent of K–3 CSR funds even if class sizes exceed 25 students. Smaller class sizes that are nevertheless over the former maximum incur smaller penalties.

<sup>17</sup> SBX3 4 (Chapter 12, Statutes of 2009). See [www.cde.ca.gov/fg/fr/eb/yr09budgetacts.asp](http://www.cde.ca.gov/fg/fr/eb/yr09budgetacts.asp) or Education Code 42605 for more information. The exact number of programs is subject to some debate. Expenditure flexibility was granted to 38 items in the 2009 Budget Act. Many items have several schedules, each of which is sometimes considered a separate program. All categorical programs in the flex item were cut by 15 percent, or \$944 million, in 2008–2009, and reduced by another 4.9 percent, or \$267 million, in 2009–2010. See [Technical Appendix B](#).

<sup>18</sup> As stated in an April 17, 2009 letter from CDE to school districts, “[t]here is some ambiguity in SBX3 4 with regard to the public hearing requirement.” See SBX3 4 for statutory language and <http://www.cde.ca.gov/fg/ac/co/documents/sbx34budgetflex.doc> CDE interpretation and district guidance.

**TABLE 1**  
Categorical programs classified by tier and function

| Program   | 2009–10<br>funding level<br>(thousands) | Program  | 2009–10<br>funding level<br>(thousands) |
|---|---|--|---|
| <b>Tier III: Administrative</b>                       |   |  |   |
| Education technology                                  | 14,074                                  | Williams monitoring                                    | 8,016                                   |
| <b>Tier III: Adult</b>                                |   |  |   |
| Adult education                                       | 634,752                                 | Community-based English tutoring                       | 40,079                                  |
| <b>Tier III: General</b>                              |   |  |   |
| Arts and music block grant                            | 87,979                                  | Instructional materials block grant                    | 333,729                                 |
| Charter school categorical block grant                | 186,326                                 | Oral health assessments                                | 3,527                                   |
| Deferred maintenance                                  | 250,806                                 | School safety block grant                              | 79,942                                  |
| Grades 7–12 counseling                                | 167,076                                 | School and library improvement block grant             | 370,044                                 |
| Grade 9 class size reduction                          | 78,944                                  |  |   |
| <b>Tier III: Specialized</b>                          |   |  |   |
| Advanced placement test fee reimbursement             | 1,425                                   | Gifted and talented education (GATE)                   | 44,231                                  |
| American Indian early childhood education             | 531                                     | International baccalaureate                            | 1,017                                   |
| American Indian education centers                     | 3,639                                   | Pupil retention block grant                            | 76,684                                  |
| California Association of Student Councils            | 26                                      | Regional occupational centers and programs (ROCP)      | 384,676                                 |
| CAHSEE intensive services                             | 58,317                                  | School safety competitive grant                        | 14,350                                  |
| CalSAFE   | 46,425                                  | Specialized secondary programs                         | 4,893                                   |
| Center for Civic Education                            | 200                                     | Supplemental instruction programs                      | 336,285                                 |
| Community day school additional funding               | 41,681                                  | Targeted instructional improvement block grant (TIIBG) | 855,230                                 |
| <b>Tier III: Teacher and Professional Development</b> |   |  |   |
| Administrator training                                | 3,928                                   | Peer assistance and review                             | 23,926                                  |
| Alternative certification                             | 26,188                                  | PE teacher incentives                                  | 33,516                                  |
| Bilingual teacher training                            | 1,708                                   | Professional development block grant                   | 218,406                                 |
| Certificated staff mentoring                          | 8,583                                   | Reader services for legally blind teachers             | 321                                     |
| Math and reading professional development             | 45,472                                  | Teacher credentialing block grant                      | 106,164                                 |
| National board certification incentives               | 2,405                                   | Teacher dismissal                                      | 38                                      |
| <b>Tier II</b>  |   |  |   |
| Adults in correctional facilities                     | 14,966                                  | FCMAT  | 9,168                                   |
| Agricultural vocational incentives                    | 4,135                                   | Foster Youth   | 15,097                                  |
| Apprenticeship  | 15,693                                  | K–12 internet access                                   | 8,340                                   |
| California partnership academies                      | 18,829                                  | Student assessments                                    | 69,108                                  |
| Charter school facility grants                        | 45,466                                  | Year-round schools                                     | 46,558                                  |
| English learner assistance programs                   | 50,558                                  |  |   |
| <b>Tier I</b>   |   |  |   |
| After school education and safety (Prop 49)           | 546,941                                 | K–3 class size reduction                               | 1,824,589                               |
| Child nutrition                                       | 134,044                                 | Pupil transportation                                   | 618,714                                 |
| Child care  | 1,928,645                               | Quality Education Investment Act (QEIA)                | 450,000                                 |
| Economic Impact Aid                                   | 945,779                                 | Special education                                      | 3,121,060                               |

SOURCES: SBX3 4 (Chapter 12, Statutes of 2009), LAO (2010), CDE 2009–2010 funding profiles and results.

NOTES: Classification of programs is subjective, particularly over “general programs” and “specialized programs.” Programs that support non-districts, a small group of districts, or a specific group of students were generally deemed “specialized.” See Weston, Sonstelle, and Rose (2009) for a description of each categorical program, its 2005–2006 and 2007–2008 appropriation, and mean per pupil funding by district characteristics such as type and size, proportion of students eligible for free and reduced price meals, proportion of English learners, and population density.

According to most observers, no clear rationale was applied to determining if a program should become flexible or not—the mix of programs included in the flex item was determined by budgetary expediency and politics rather than by a systematic review of categorical programs or recommendations from research on categorical programs.<sup>19</sup> Thus, similar programs were treated differently and were placed in different tiers. For example, the largest career-technical education (CTE) program, regional occupational centers and programs (ROCP), was moved to Tier III, while two smaller CTE programs, apprenticeship and agricultural vocational incentives, were not.

### Other ongoing flexibility provisions

The 2009 budget enacted other, non-categorical flexibility provisions. Most sunset June 30, 2015, except where noted:

- **Education mandates:** Suspends six education mandates relating to supplemental instruction for retained students, pupil residency verification, chemical removal, scoliosis screening, and school bus safety instruction through 2012–13.
- **Instructional materials:** Delays purchasing requirements for instructional materials.
- **K–3 CSR:** Reduces the penalty for class sizes exceeding 20 students in grades K–3 through 2013–14.
- **Length of school year:** Allows districts to reduce the school year to 175 days without loss of incentive funding.
- **Maintenance:** Reduces the required contributions into routine maintenance accounts from 3 percent to 1 percent of general fund expenditures. Eliminates the local match requirement for the deferred maintenance program.
- **Reserves:** Reduces districts’ required reserve for economic uncertainties through 2012–13.
- **Sale of surplus property:** Proceeds from the sale of surplus property originally purchased through local funds may be spent on any one-time general purpose until January 1, 2014.

SOURCE: Chapters 2, 12, Statutes of 2009; Chapter 724, Statutes of 2010, Chapter 7, Statutes of 2011

For each flex item program, a district’s funding level is determined by its proportion of statewide funds in a base year. If a district received 5 percent of statewide funding for a program in the base year, it will continue to receive 5 percent of the funding appropriated in each year through 2014–15. For most programs, the base year is 2008–09. For programs where funding is determined by student attendance, such as adult education and supplemental instruction, the base year is 2007–08. Except for new schools not in existence in the base year (primarily charter schools), districts without funding in a particular program in the base year are ineligible for funding in that program through 2014–15.<sup>20</sup>

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<sup>19</sup> Some cases, such as the After School Education and Safety (ASES) program, are obvious: ASES was created by 2002’s Proposition 49 and any changes would require voter approval.

<sup>20</sup> Some funding is set aside for new schools that are ineligible for the flex item because they were not in existence in the base year. See Education Code 42606 and [www.cde.ca.gov/fg/aa/ca/nscategfund.asp](http://www.cde.ca.gov/fg/aa/ca/nscategfund.asp).

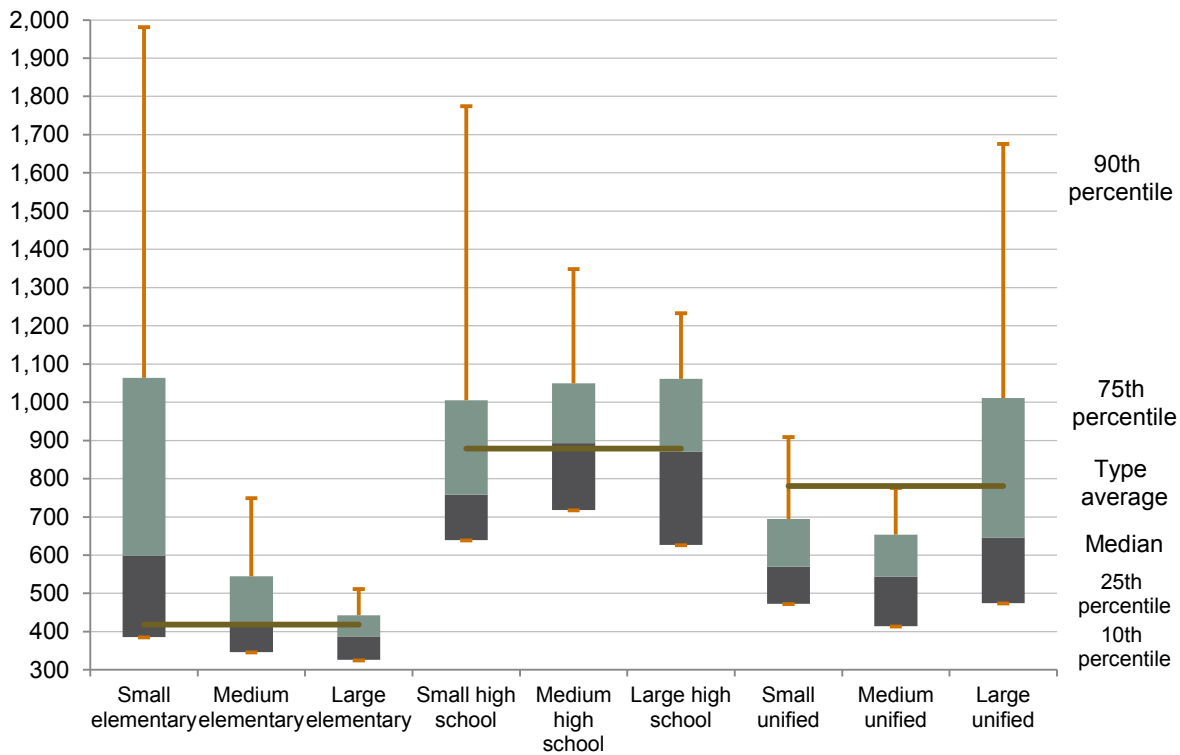


The mix of programs included in the flex item and each program’s prior allocation formula largely determine the distribution of flex item funds across California’s school districts.

## Distribution of Flex Item Funds

Flex item funds per student vary across districts. The statewide average is \$719 per pupil, but this differs according to district type: high school districts receive more than twice as much per pupil (\$879) on average than do elementary districts (\$418). But there is also significant variation among districts of the same type and size, as illustrated in Figure 4. The interquartile range, a measure of variation (the difference between the 75th percentile and the 25th percentile of funding represented by rectangles in the figure) is \$448 per pupil statewide. The interquartile range is particularly large for small elementary (\$678 per pupil) and large unified districts (\$537 per pupil). Large elementary districts have the lowest level of flex item funding and the least variation.

**FIGURE 4**  
Flex item funds per ADA by district type and size, 2009–10



SOURCES: 2009 Principal Apportionment Summary and Funding Results (various programs), CDE; Deferred Maintenance Program funding, Office of Public School Construction.

NOTES: Districts with flex item funds per pupil above the 90<sup>th</sup> percentile or below the 10<sup>th</sup> percentile (outliers) are not shown: the minimum flex item funding per student is \$178 and the maximum \$12,150. The bottom half of a rectangle represents the difference between the median funding level and the 25<sup>th</sup> percentile of funding. The upper half represents the difference between the 75<sup>th</sup> percentile of funding and the median funding level. The endpoints of the vertical bars represent the 10<sup>th</sup> and 90<sup>th</sup> percentile of flex item funds per ADA. Percentiles are weighted by the number of students in a district. Within each group, students are assigned the flex item of their district and ranked according to this rate. The 75<sup>th</sup> percentile is the flex item of the student in the 75<sup>th</sup> percentile of this ranking. The mean flex item funding for each district type is represented by the horizontal lines.

These differences in flex item funds per pupil are not surprising: they are based on the funds the district received in each of the categorical programs prior to the flexibility provisions, which were not equally distributed because many categorical programs did not fund all districts uniformly. The most notable example is the Targeted Instructional Improvement Block Grant (TIIBG). TIIBG was part of a 2004 categorical consolidation and merged two programs: targeted instructional improvement that provided funds for desegregation and supplemental grants designed to equalize categorical funds. Districts with prior desegregation court orders and programs received much more funding than districts with categorical equalization funding. Following the 2004 block grant consolidation, a district’s TIIBG funding was based on its proportional share of funding prior to the consolidation. Today, approximately 82 percent of TIIBG funds are apportioned to 67 districts based on the prior desegregation programs; 516 districts receive the remaining 18 percent, explaining the large differences in per pupil TIIBG funding reported in Table 2.<sup>21</sup>

In addition, flex item funds vary because some districts were ineligible for the previous categorical programs. Elementary districts, which do not serve high school students, are ineligible for Grade 9 class size reduction, ROCP, and adult education funds (Table 2). These three revenue sources account for more than 80 percent of the average \$461 per pupil difference between elementary and high school per pupil funds.<sup>22</sup> The mix of programs included in the flex item largely dictates the degree of variation of funds across districts of different types.

**TABLE 2**  
Flex item funds per ADA by selected categorical programs, 2009–2010

| Program  | Elementary districts with funding (N) | Mean funding (\$/ADA) | High school districts with funding (N) | Mean funding (\$/ADA) | Unified districts with funding (N) | Mean funding (\$/ADA) |
|--|---------------------------------------|-----------------------|--|-----------------------|------------------------------------|-----------------------|
| Adult education                                | 0                                     | 0                     | 71                                     | 238                   | 243                                | 140                   |
| American Indian early childhood education      | 2                                     | 207                   | 0                                      | 0                     | 6                                  | 24                    |
| Grade 9 class size reduction                   | 0                                     | 0                     | 64                                     | 58                    | 182                                | 21                    |
| Regional occupation centers and programs       | 0                                     | 0                     | 29                                     | 210                   | 93                                 | 92                    |
| School safety competitive grant                | 5                                     | 71                    | 3                                      | 20                    | 13                                 | 7                     |
| Targeted instructional improvement block grant | 281                                   | 76                    | 52                                     | 61                    | 207                                | 229                   |
| All other flex item programs                   | 544                                   | 358                   | 83                                     | 450                   | 334                                | 401                   |
| <b>Flex item</b>                               | <b>544</b>                            | <b>418</b>            | <b>83</b>                              | <b>879</b>            | <b>334</b>                         | <b>781</b>            |

SOURCES: 2009 Principal Apportionment Summary and Funding Results (various programs), CDE; Deferred Maintenance Program funding, Office of Public School Construction.

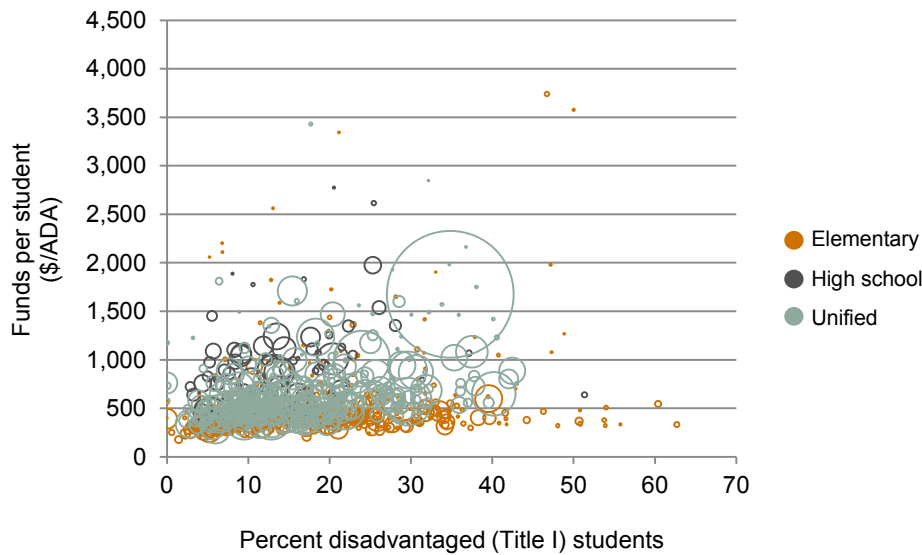
NOTE: Means are student-weighted. Columns show the mean funding per student in the program (for districts receiving the program). The flex item row shows the mean funding for all districts by type.

<sup>21</sup> Proportions and district counts are approximate and based on 2004 funding results for targeted instructional improvement and supplemental grants provided by CDE.

<sup>22</sup> The mean flex item funding per pupil is \$879 for high school districts and \$418 for elementary districts. Once ROCP, adult education, and ninth-grade class size reduction funds are removed, the average for high schools is \$503, a decline of \$377 per pupil. The average difference in flex item funds per pupil between the two district types drops to \$85.

The mix of programs included in the flex item also affects the relationship between flex item funds per pupil and student disadvantage. Although Economic Impact Aid, the categorical program whose funding is based on a count of disadvantaged pupils, is excluded from the flex item, districts with higher percentages of Title I students nevertheless tend to receive more flex item funds per pupil (Figure 5). This relationship between flex item funds and student disadvantage is not as strong as the relationship depicted in Figure 2 for all categorical programs. [Technical Appendix C](#) lists each flex item program and its correlation with student disadvantage.

**FIGURE 5**  
Flex item funds per pupil by percent Title I students



SOURCES: 2009 Principal Apportionment Summary, 2009 Economic Impact Aid calculation results, 2009 Funding Results (various programs), 2009 CBEDS enrollment, CDE; Deferred Maintenance Program funding, Office of Public School Construction.

NOTE: Includes 848 of 961 districts. Reasons for exclusion include missing enrollment counts. Title I counts larger than enrollment, districts with fewer than 101 ADA (113 districts), and districts with categorical funding greater than \$15,000 per ADA (30 districts). Districts with more than \$5,000 per ADA in total categorical funding are predominantly elementary districts with fewer than 101 ADA.

# Improving or Extending California's Categorical Flexibility

Previous PPIC reports have focused on ways to improve California's overly complex and inequitable school finance system and have evaluated school finance reform proposals that would consolidate almost all categorical programs into a few flexible block grants. In *Pathways for School Finance Reform in California* (2010), we offered five principles to guide an improved school finance system. These same principles could guide any discussions about categorical flexibility within a reform context:

- **Meet resource needs.** Schools should have the resources necessary for their students to meet state academic standards, and the cost of those resources may vary from school to school for a variety of reasons.
- **Structure incentives properly.** The formulas allocating revenue to schools should not give schools incentives to deviate from actions that are in the best interest of students and taxpayers.
- **Allocate funds transparently.** The formulas for allocating revenue to schools should be clear and relatively simple.
- **Treat similar districts equitably.** When the state has chosen the factors that determine the revenue a school district receives, school districts with the same values for those factors should receive the same revenue.
- **Balance state and local authority.** Restrictions on the use of funds must properly balance the state objectives with the realities that schools differ widely across the state and that school administrators have unique knowledge about local conditions.

In its current form, the flex item addresses the last principle, but because it was created as a general budget solution, it did not address other underlying weaknesses of education funding and so does not address the other principles.

We recommend three ways of improving the flex item as it currently exists.

- Consolidating flexible programs into one funding stream and setting per pupil funding rates would produce a more equitable and transparent flex item.
- Applying clear criteria to determine whether a program is flexible would make the flex item more transparent and could allow the state to focus categorical resources on cost differences across districts.
- Reinstating some restrictions on flexible funds could help avoid adverse incentives while still balancing state and local authority.

## Recommendation One: Consolidate Funding and Set Per Pupil Funding Rates

One benefit of categorical consolidation is a lower CDE administrative burden, which could be achieved by consolidating flexible program funds into a single revenue stream and amending the relevant code sections.<sup>23</sup> Additionally, the LAO (2010c) estimated that the state could save \$5.2 million by eliminating 70 staff positions at CDE needed to monitor and administer flex item programs.<sup>24</sup>

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<sup>23</sup> Little Hoover Commission (1997); LAO (1993b).

<sup>24</sup> According to a *California Watch* article (9/1/10), former State Superintendent of Public Instruction Jack O'Connell disputed the LAO estimate in a letter to the budget conference committee. See <http://californiawatch.org/watchblog/whitman-overstates-excess-jobs-california-department-education-4231>.

In addition, we recommend the state set per pupil funding rates. Currently, if a district received 5 percent of all international baccalaureate funds available in 2008–09, it will continue to receive 5 percent of all future such appropriations through 2014–15. The state has used this approach in previous categorical reforms, most notably in the 2004 block grant consolidations, but this proportional method poses several challenges and should be reconsidered. The first challenge is equity. One way to address this is to create a per pupil funding rate calculated by dividing each district’s total flex item funds by a pupil count, and then equalizing those funding rates over time. If the flex item continues and the funds within it retain their general purpose designation, then there is no longer a compelling rationale for differences in per pupil funding across districts—districts are no longer required to provide these services and the main requirement of *Serrano* is the equalization of general purpose revenues. As Figure 2 showed, base revenue limits are relatively equally distributed, particularly within each district type. And as the previous section showed, there is currently considerable variation in flex item funds per pupil; the difference between the 75th and 25th percentile of funding statewide is almost \$450 per student.

A per pupil funding rate is more equitable than proportional funding because it can better account for changes in student enrollment. Under the current proportional-allocation method, if the total appropriation remains constant, districts with declining enrollments receive more funds per pupil over time while districts with growing enrollments receive less. Since many of the flex item programs were based on some pupil count, it is both logical and equitable to apportion funds in proportion to the number of students in a district. Additionally, the main source of general purpose funds—revenue limits—is allocated on a per pupil rate.

Current flex item provisions also restrict funding to schools and districts that received funding in the base year. Since flex item funds no longer support prior programs and are instead designated general purpose funds, it is no longer rational to prevent or exclude any schools or districts from receiving this funding. Equalizing funding rates addresses this inequality.

Significant efforts have already been made to equalize schools’ main source of general purpose funds, revenue limits. Revenue limits were created in 1973 by calculating each district’s per pupil expenditures in 1972–73. Through various equalization policies, differences in base rates among districts of the same type have diminished and in 2009–10, the statewide interquartile range in base revenue limits was \$22 per pupil (Table 3). The large variation in flex item funds, even among districts of the same type, produces in turn large variation in total general purpose funds per pupil (revenue limits and flex item funds). The statewide interquartile range increases from \$22 per pupil in base revenue limits to \$696 per pupil in total general purpose revenues. Without attention to this issue, this inequality will continue until the flex item sunsets and may possibly persist in any future categorical consolidations.

**TABLE 3**  
General purpose funds per ADA by district type, 2009–10

| District type | Number of districts | Mean base revenue limit (\$/ADA) | Interquartile range (\$/ADA) | Mean flex item (\$/ADA) | Interquartile range (\$/ADA) | Mean total general purpose (\$/ADA) | Interquartile range (\$/ADA) |
|---------------|---------------------|----------------------------------|------------------------------|-------------------------|------------------------------|-------------------------------------|------------------------------|
| Elementary    | 544                 | 5,008                            | 21                           | 418                     | 120                          | 5,426                               | 117                          |
| High school   | 83                  | 6,017                            | 30                           | 879                     | 434                          | 6,896                               | 462                          |
| Unified       | 334                 | 5,239                            | 11                           | 781                     | 440                          | 6,020                               | 533                          |
| All districts | 961                 | 5,270                            | 22                           | 719                     | 447                          | 5,989                               | 696                          |

SOURCES: 2009 Principal Apportionment Summary and Funding Results (various programs), CDE; Deferred Maintenance Program funding, Office of Public School Construction.

NOTE: All means are student-weighted. Base revenue limit shown is reduced by the 2009–10 18.355% deficit factor. The interquartile range is the difference between the funding level of the student at the 75<sup>th</sup> percentile and the 25<sup>th</sup> percentile.

However, given the slow speed of the economic recovery, additional funds that would be required for equalization are unlikely to appear in the near future.<sup>25</sup> The legislature could look to past equalization policies for ways to equalize rates over time, primarily by providing occasional one-time aid designed to increase the rates of districts at the low end of the distribution. This could become an ongoing increase as the new rates are applied in subsequent years.<sup>26</sup>

Alternatively, flex item equalization could occur slowly over time using expected increases in K–12 funding, similar to the LAO’s 1997 and 2009 proposals. We simulated this type of equalization in Rose, Sonstelie, and Weston (2010) and found that demographic and economic trends could result in a 30 percent increase in real per pupil spending by 2030. If 30 percent of that expected increase (9 percent over current levels) was used each year to slowly equalize flex item funds per pupil, all districts would receive \$1,540 per pupil in 2030 and the flex item would be fully equalized.<sup>27</sup>

## **Recommendation Two: Apply Clear Criteria for Flexibility and Consider Alternative Configurations**

As Table 1 showed, the flex item encompasses much, from state administrative activities to specialized programs for struggling students. However, there are many similar categorical programs excluded from the flex item: funds to reduce ninth grade class sizes are included, for example, but K–3 class size reduction is excluded. In its current form, the flex item lacks clear criteria for which programs are included and excluded. Correcting this would make the flex item more transparent, and if the state transitions from the flex item to some continued form of categorical flexibility, such clear criteria could help guide that process.

If the flex item remains a source of general purpose funds and is allocated to districts on an equal per pupil basis, then any programs that remain flexible should be equally distributed across all schools to support general instruction. Currently, the flex item includes programs that target special costs or needs, such as adult education. Responsibility for adult education rests with school districts in some parts of the state while in others community college districts are responsible. In school districts responsible for adult education, the program imposes extra costs and the state provides funding to offset these costs. Under the new flexibility provisions, school districts with adult education funds have a new source of unrestricted revenue not enjoyed by other districts yet no longer have to provide adult education.

Additionally, the legislature may want to reconsider whether regional programs should be granted flexibility. The flex item currently includes ROCPs and the teacher credentialing block grant (TCBG). These two programs support consortia of school districts, county offices of education, and charter schools, but funding flows only to a small group of administrative districts and county offices of education. These administrative units now have a new source of general purpose funds but without a requirement to actually provide the regional service. Regional funds also include programs that support administrative activities and programs operated by nonprofits or non-local education agencies. These two criteria, removing targeted and regional programs, would likely result in a much smaller flex item, both in funding and number of programs.

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<sup>25</sup> Additional revenues would be necessary if the state held districts harmless, meaning that no district would receive less flex item funds per pupil than it does today. This approach requires that funding rates be leveled up, instead of redistributing funding from high flex item districts to districts with lower flex item rates. It is very unlikely that districts would not be held harmless in any equalization policy.

<sup>26</sup> See Weston (2010) for a description of revenue limit equalization policies and Rose, Sonstelie, and Weston (2010) for special education and Economic Impact Aid equalization policies.

<sup>27</sup> See Rose, Sonstelie, and Weston (2010), pp. 30-31.

However, there are programs currently excluded from the flex item that would meet the criteria and could reasonably be added. One is K–3 CSR, which supports general instruction with a goal of improving student achievement. The state has temporarily relaxed the penalties on districts that exceed the maximum class sizes of 20 students, in effect making the program, or at least the 70 percent of funds districts receive, flexible—even for classes as large as 32 students.

Table 4 shows alternate configurations, some advocated by various groups since the flex item’s inception, and the results of these proposals, and based on the two criteria offered above. The first column shows the current distribution of flex item funds. The next column series shows the distribution of the flex item if additional programs, proposed by the LAO (2010) are added to it, and the following series the distribution of the flex item if some current flex item programs are removed. The first number in each cell is the new mean funding level for a particular district type and size category. The second number, in parentheses, is the interquartile range, the difference between the 75<sup>th</sup> percentile of funding and the 25<sup>th</sup> percentile of funding—a measure of variation.

The effects of the three additional LAO items are represented in the cells of the first three columns of the table; the fourth column represents the cumulative effect. The result is a more equal distribution of flex item funds across districts. In the current flex item, high school districts have much larger flex item funds per pupil than elementary districts. The inclusion of these three programs would raise flex item funding per pupil in all districts, but most significantly in elementary districts. However, within district types, there would be more variation in flex item funds per pupil, as shown in the larger interquartile ranges. For the state as a whole, this variation would be less pronounced because the statewide interquartile range would increase by less than \$30 per pupil.

The next column series represents results from programs being removed from the flex item.<sup>28</sup> The first two columns remove regional programs and special costs and are derived from the criteria described earlier. The next column represents the state assembly’s 2010 budget proposal that removes CalSAFE, a program that supports pregnant minors, and supplemental instruction for students who have failed the California high school exit exam (CAHSEE).<sup>29</sup> Finally, the LAO in 1997 recommended removing the Deferred Maintenance program (DMP) from an older categorical flexibility policy that allowed some funding transfers.<sup>30</sup>

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<sup>28</sup> These alternatives are presented not as recommendations but as illustrations of the type of analysis that can help the state develop a long-range plan.

<sup>29</sup> See [www.lao.ca.gov/handouts/Conf\\_Comm/2010/K12\\_Categorical\\_Flexibility\\_061410.pdf](http://www.lao.ca.gov/handouts/Conf_Comm/2010/K12_Categorical_Flexibility_061410.pdf).

<sup>30</sup> See Technical Appendix A.

**TABLE 4**  
**Alternative flex item compositions by district type and size, 2009–2010**

| District type and size |                        | Current flex item | Add K–3 CSR | Add HTS     | Add ASES  | Add All     | Subtract ROCP and TCBG | Subtract adult | Subtract CalSAFE and CAHSEE | Subtract DMP | Subtract All | Add and Subtract All |
|------------------------|------------------------|-------------------|-------------|-------------|-----------|-------------|------------------------|----------------|-----------------------------|--------------|--------------|----------------------|
| Elementary             | Small (0–250 students) | 943 (678)         | 1,270 (636) | 1,243 (962) | 973 (696) | 1,598 (989) | 943 (678)              | 943 (678)      | 940 (671)                   | 625 (320)    | 621 (320)    | 1,276 (573)          |
|                        | Medium (251–1,500)     | 520 (198)         | 894 (198)   | 692 (334)   | 570 (281) | 1,117 (372) | 513 (198)              | 520 (198)      | 520 (198)                   | 441 (161)    | 435 (161)    | 1,032 (322)          |
|                        | Large (1,501+)         | 396 (117)         | 714 (157)   | 450 (137)   | 474 (209) | 847 (244)   | 389 (111)              | 396 (117)      | 396 (117)                   | 358 (110)    | 351 (105)    | 802 (245)            |
|                        | <b>All elementary</b>  | 418 (120)         | 742 (150)   | 489 (160)   | 493 (222) | 888 (269)   | 411 (112)              | 418 (120)      | 418 (120)                   | 371 (113)    | 364 (113)    | 834 (272)            |
| High school            | Small (0–1,500)        | 928 (366)         | 928 (366)   | 1,114 (404) | 928 (366) | 1,114 (404) | 844 (401)              | 847 (244)      | 890 (342)                   | 770 (389)    | 567 (201)    | 753 (329)            |
|                        | Medium (1,501–6,000)   | 912 (332)         | 912 (332)   | 990 (403)   | 912 (332) | 990 (403)   | 827 (326)              | 634 (216)      | 867 (307)                   | 857 (326)    | 458 (140)    | 536 (228)            |
|                        | Large (6,001+)         | 871 (434)         | 871 (435)   | 917 (475)   | 873 (434) | 918 (475)   | 758 (303)              | 642 (234)      | 828 (430)                   | 831 (432)    | 446 (121)    | 493 (140)            |
|                        | <b>All high school</b> | 879 (434)         | 879 (434)   | 935 (467)   | 880 (434) | 936 (467)   | 772 (328)              | 648 (256)      | 836 (427)                   | 834 (432)    | 452 (125)    | 509 (143)            |
| Unified                | Small (0–3,000)        | 642 (222)         | 860 (230)   | 870 (392)   | 676 (270) | 1,122 (407) | 619 (203)              | 604 (234)      | 633 (224)                   | 564 (190)    | 495 (141)    | 976 (285)            |
|                        | Medium (3,001–10,000)  | 573 (239)         | 788 (242)   | 655 (272)   | 622 (286) | 920 (292)   | 525 (179)              | 483 (156)      | 559 (231)                   | 533 (239)    | 382 (99)     | 729 (192)            |
|                        | Large (10,001+)        | 825 (537)         | 1,047 (566) | 903 (581)   | 902 (534) | 1,203 (615) | 773 (546)              | 683 (336)      | 809 (539)                   | 785 (538)    | 576 (324)    | 954 (599)            |
|                        | <b>All unified</b>     | 781 (440)         | 1,002 (486) | 866 (477)   | 852 (513) | 1,158 (560) | 731 (402)              | 651 (280)      | 766 (445)                   | 739 (435)    | 545 (189)    | 922 (477)            |
| <b>All districts</b>   |                        | 719 (447)         | 938 (407)   | 798 (460)   | 784 (463) | 1,083 (471) | 672 (380)              | 604 (229)      | 704 (433)                   | 676 (443)    | 500 (149)    | 873 (341)            |

NOTES: Student-weighted means appear first in each cell. Student-weighted interquartile ranges are in parentheses in each cell. K–3 CSR is grades K–3 class size reduction; HTS is home-to-school transportation; ASES is Proposition 49’s After School Education and Safety; TIIBG is the targeted instruction improvement block grant; ROCP is regional occupation center or program; TCBG is the teacher credentialing block grant; Adult is adult education; CalSAFE is California School Age Families Education; DMP is deferred maintenance. *Add All* is the cumulative effect of adding K–3 CSR, HTS, and ASES to the flex item. *Subtract All* is the cumulative effect of removing ROCP, TCBG, Adult, CalSAFE, and DMP from the flex item. *Add and Subtract All* is the cumulative effect of adding the three programs and removing the six programs from the flex item.



Several general trends emerge from Table 4. First, removing adult education and regional programs would result in a more equal distribution of funds by reducing the amount received by high school and unified districts that provide these programs. The same equalized distribution is less apparent when CalSAFE, CAHSEE supplemental instruction, and DMP are removed from the flex item—because the former are relatively small (less than \$100 million statewide) and because DMP is already fairly equally distributed across districts. The cumulative effect of removing these six programs is a more equal distribution of funds across districts of different types (as is the case where three programs are added to the flex item). The average difference between elementary and high school districts drops to \$88 per pupil compared to the current average difference of \$461 per pupil. Removing these programs would also result in less variation among districts of the same type, and less variation statewide, as demonstrated by the smaller interquartile ranges. Smaller differences across districts and smaller interquartile ranges would lower the cost of equalizing rates.

Adding specified programs to the flex item and removing specified programs would each result in more equally distributed funding. However, if these actions are taken together the result is less clear. Such a distribution, shown in the final column of Table 4, is almost the reverse of the distribution of the current flex item: elementary districts have much higher average funding levels than high school districts, and unified districts are somewhere in the middle. There is no clear pattern in the variation within district type and size categories—in some cases the variation decreases, such as in small elementary districts, and in others it increases, such as in large elementary districts. Consistent with findings in the previous section, the mix of programs made flexible or made less so largely dictates the extent of variation across school districts.

## Reconfigurations in the Context of School Finance Reform

As previous sections have demonstrated, categorical reform has been the subject of much debate. Over the last few years, several reform proposals have emerged from multiple sources.<sup>31</sup> Although the specifics differ, they share the idea of replacing the maze of categorical programs with three simpler, consolidated, and flexible programs: a base program providing for the general needs of school districts, a special education program, and a targeted program providing additional funds for supplemental services to English learners, disadvantaged, and at-risk students. The LAO's 2008 proposal includes an additional program for instructional improvement.

Reform proposals consolidate many of the current flex item programs into a base program.<sup>32</sup> Using clear criteria to categorize individual programs, the legislature could reconfigure the flex item to align with these consolidation proposals. A majority of the current flex item programs would continue to support general purpose activities while the remainder would form a second flexible fund for supplemental programs and services for disadvantaged or at-risk students. For example, each of the categorical reform proposals consolidates the pupil retention block grant into a targeted program for disadvantaged and at-risk students.

These proposals allow the state to continue to direct spending on disadvantaged students and English learners while providing districts with the flexibility to determine the best way to meet their needs. Under the flex item now, pupil retention block grant funds can be spent for any educational purpose. The LAO (2010b) found that more than half of districts shifted funds away from this program in 2009–10, and that

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<sup>31</sup> See Bersin, Kirst, and Liu (2008), Governor's Committee on Education Excellence (2007), and LAO (2008).

<sup>32</sup> In the LAO proposal (2008), these programs are in the instructional improvement program.

almost 70 percent of districts made programmatic changes to pupil retention efforts. The following year over 70 percent of districts shifted funds away from this program, and almost 20 percent of districts discontinued it altogether (LAO 2011). The specific programmatic changes from 2009–10 are unclear, but the LAO survey found that most districts shifted funds from enrichment and student support programs, like the pupil retention block grant, to direct classroom instruction. If support for disadvantaged and struggling students is a priority, the state could consider restoring some restrictions on current flex item programs designed for these students while still providing flexibility by removing them from the flex item and consolidating them into a larger targeted program.

Table 5 presents the distribution of current flex item funds under such a proposed reconfiguration. Programs that support general education activities or professional development for teachers would remain in a general purpose flex item. Programs currently in the flex item that support specialized programs for disadvantaged or at-risk students would be consolidated into a targeted flex item. The remaining programs would be grouped into the other flex item category.<sup>33</sup>

**TABLE 5**  
Distribution of flex item funds under categorical reform proposals, by district type

| District type | General purpose flex item program funds (\$/ADA) |                     | Targeted flex item program funds (\$/ADA) |                     | Other flex item program funds (\$/ADA) |                     |
|---------------|--|---------------------|---|---------------------|--|---------------------|
|               | Mean   | Interquartile range | Mean                                      | Interquartile range | Mean                                   | Interquartile range |
| Elementary    | 292  | 54                  | 111                                       | 66                  | 15                                     | 18                  |
| High school   | 301  | 91                  | 236                                       | 94                  | 343                                    | 310                 |
| Unified       | 295  | 56                  | 299                                       | 157                 | 187                                    | 288                 |
| All districts | 295  | 62                  | 256                                       | 141                 | 168                                    | 284                 |

SOURCES: 2009 Principal Apportionment Summary and Funding Results (various programs), CDE; Deferred Maintenance Program funding, Office of Public School Construction.

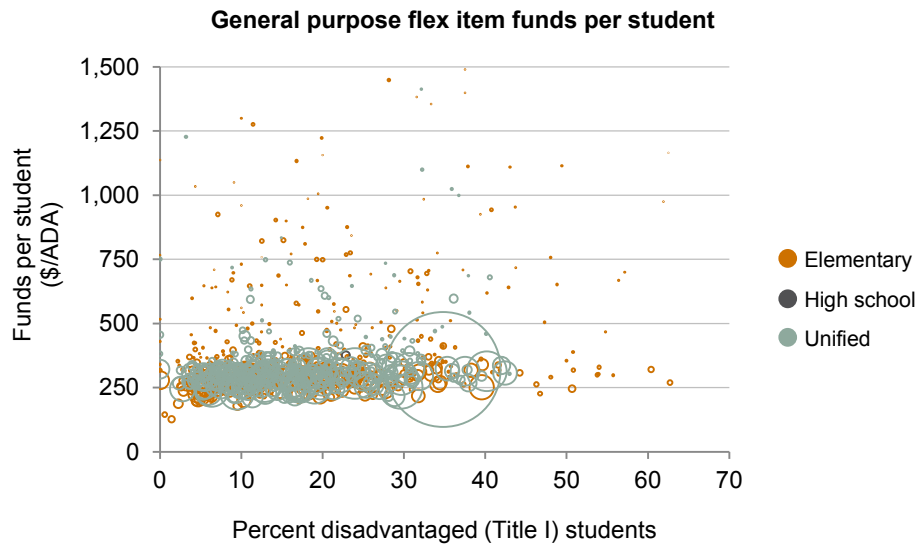
NOTES: *General purpose* includes all general support and teacher and professional development programs from Table 1, except the teacher credentialing block grant (TCBG), a regional program, and programs that do not support school districts or for which data was unavailable. *Targeted* includes all specialized programs from Table 1, except regional occupation centers and programs (ROCP), a regional program, and programs that do not support school districts or for which data was unavailable. *Other* includes adult programs from Table 1, TCBG, and ROCP. Administration programs in Table 1 do not fund school districts. Means and interquartile ranges are student-weighted.

The distribution of flex item funds is more equitable under such a system. There would be less variation in general flex item funds per pupil statewide, as represented by the interquartile range of \$62 per pupil (Table 5). The mean general and targeted flex item funds per student are much closer than the current flex item across and within the different types of districts. For example, the average high school district’s general and targeted flex item funds per pupil are \$301 and \$236, respectively, compared to \$292 and \$111 in elementary districts. These differences are much smaller than the average \$479 per pupil difference in current flex item funds per pupil between these two district types. The more equal distribution of funds is largely explained by removing funds for adult education and the two regional programs from the flex item, represented by the other flex item fund column. These programs are unevenly distributed now and generally flow to medium and large high school and unified districts.

<sup>33</sup> The categorical reform proposals consolidate programs based on the purposes and students served by the categorical programs, a process that can be subjective and differ among the proposals. Flex item programs categories used throughout this paper appear in Table 1.

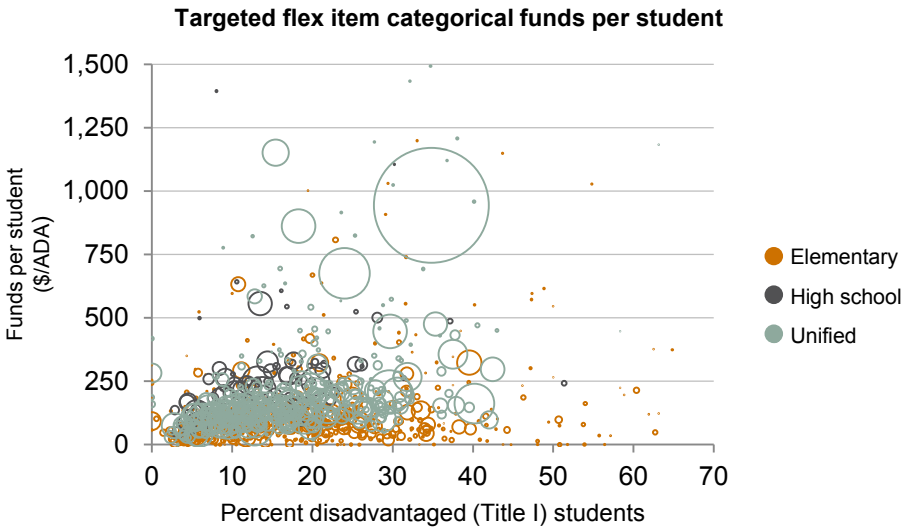
Such a configuration would also affect the distribution of funds by student disadvantage (Figure 6). Currently, there is a small positive relationship between flex item funds per pupil and the percent of Title I students, as demonstrated in Figure 5. Many of the flex item programs classified as general purpose are allocated on a statewide per pupil rate to almost all districts, which explains why, in Figure 6a, the general purpose flex item funds per pupil value remains relatively flat as the percent of Title I students increases. On the other hand, targeted flex item funds per pupil appear to increase as the percent of Title I students increases. There is no clear relationship for the other flex item programs, which may be attributed to the fact that relatively few districts receive these funds.

**FIGURE 6**  
**Distribution of flex item funds under categorical reform proposal, by student disadvantage**



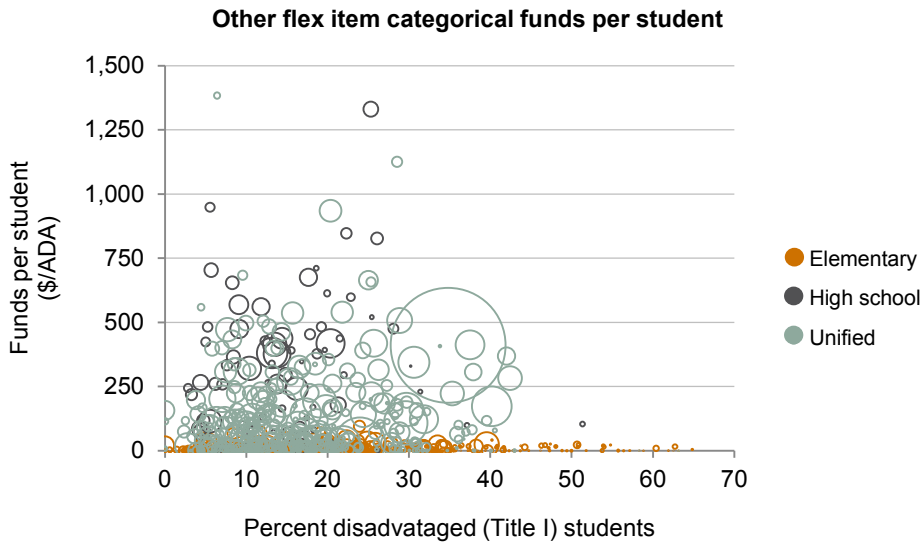
SOURCES: 2009 Principal Apportionment Summary and Funding Results (various programs), CDE; Deferred Maintenance Program funding, Office of Public School Construction.

NOTES: Includes all general support and teacher and professional development programs from Table 1 except the teacher credentialing block grant (TCBG), a regional program, and programs that do not support school districts or for which data are unavailable. Excludes 49 districts with more than \$1,500 per ADA in general purpose flex item programs; these districts are predominantly small elementary districts with fewer than 251 ADA.



SOURCES: 2009 Principal Apportionment Summary and Funding Results (various programs), CDE; Deferred Maintenance Program funding, Office of Public School Construction.

NOTES: Includes all specialized programs from Table 1, except regional occupation centers and programs (ROCP), a regional program, and programs that do not support school districts or for which data was unavailable. Excludes six districts with more than \$1,500 per ADA in targeted flex item programs; these districts are predominantly small elementary districts with fewer than 251 ADA.



SOURCES: 2009 Principal Apportionment Summary and Funding Results (various programs), CDE; Deferred Maintenance Program funding, Office of Public School Construction.

NOTES: Includes adult programs from Table 1, TCBG, and ROCP. Administration programs in Table 1 do not fund school districts.

### **Recommendation Three: Consider Some Restrictions on Flexible Funds**

Loosening restrictions for some programs is not advocating that there should be no restrictions. If the legislature set per pupil rates that could be equalized over time, one option would be to simply fold some or all flexible funds into revenue limit funding, a logical option if the funds support general purposes.

However, the state has placed restrictions on flexible funding for many reasons. One has been to ensure that the funds do not support general salary increases. As noted earlier, salary increases or salary renegotiations

in many districts' employment contracts are triggered when general purpose funding increases. This concern is not solely held at the state level. In their survey of 49 school district superintendents, Sonstelie, Rose, and Reinhard (2006) found that superintendents prefer some flexible restricted funds to unrestricted funding because they fear that unrestricted funds would go entirely to unjustified increases in employee compensation.

Preventing local administrators from increasing salaries may not be a good state policy, but funds in the flex item were restricted from such uses prior to the 2009 Budget Act. The legislature could consider turning the flex item into a block grant that would provide comparable flexibility while mitigating concerns over collective bargaining.

## Evaluate Flexibility

Moreover, the flex item is not the first time the state has provided additional flexibility over categorical revenues. Five major efforts are described in more detail in [Technical Appendix A](#), but, generally, these previous policies offered little additional flexibility and were deemed unsuccessful in evaluations by the LAO and the state auditor. One important takeaway was the lack of substantive evaluation in those earlier efforts. Evaluation, if any, consisted of district surveys or analysis of the program's implementation rather than the effect of flexibility on desired outcomes. Evaluation of the flex item is similarly limited to district surveys because the flexibility legislation changed the procedures for reporting categorical revenues and expenditures.<sup>34</sup>

School districts are required to report expenditures of funds using the Standardized Account Code Structure (SACS). Prior to the flexibility provisions, many categorical programs were assigned specific individual revenue and expenditure codes. Following the flexibility provisions, revenue codes for the flexed categorical programs were terminated. This meant that the state and researchers can no longer track how districts spend specific categorical revenues in any systematic way. It is possible to track general changes in expenditures, but nearly impossible to determine how individual program expenditures change, other than by total dollars spent on the program. Reinstating SACS reporting procedures for the duration of the flex item would enable the state to better understand how districts have prioritized funding and individual programs. It would also enable better evaluation of specific programs. For example, if 70 percent of districts report shifting funds away from supplemental instruction programs designed to help students pass the high school exit exam (LAO 2011), did the exam passage rate in fact change in those districts?<sup>35</sup> If the state extended flexibility to pupil transportation, would districts see a decline in student attendance rates? These types of evaluations—marking a shift from compliance-based to outcomes-based—would better inform state decisions over whether flexibility can be granted to particular categorical programs. Currently, there is little evidence that categorical programs achieve their intended purposes and outcomes. According to the LAO (2011), “This is in part because programs are so rarely evaluated.” Until the state implements substantive evaluations, it will be difficult to determine whether districts, when given increased local control over revenues, will serve what the state believes are the best interest of students.

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<sup>34</sup> This is not to denigrate survey data or the surveys; they provide representative information about how districts choose to spend flexible revenues and how the flexibility affects district decision making. To date, the LAO (2010b, 2011) has released the results from two statewide district surveys on the flex item. A group of researchers affiliated with the Policy Analysis for California Education (PACE) network plan to release a case study of the flex item's implementation in 10 districts and results from their own statewide survey.

<sup>35</sup> There are two programs aimed at helping students pass the CAHSEE after having failed on the first attempt. A supplemental instruction (summer school) program, and the CAHSEE intensive services program. The LAO found in their 2011 survey that 75 percent of districts shifted funds away from supplemental instruction and 63 percent of districts shifted funds from the CAHSEE supplemental instruction.

# Conclusion

Under the California Constitution, the responsibility for K–12 education rests with the state. For most of its history, K–12 education was financed and controlled at the local level, and the state provided limited supplemental aid. *Serrano* and other court decisions and Proposition 13 shifted the responsibility of funding local schools to the state. The state gradually assumed more control over funding decisions through categorical programs. But the state has long struggled with its categorical funding system. Following many years of growth in the number of categorical programs reforms were instituted that were designed to increase local authority over funds or to reduce the number of categorical programs.<sup>36</sup> Although not explicitly designated as categorical reform, the 2009 flexibility provisions provide unprecedented flexibility over approximately 30 percent of categorical revenues and 10 percent of all K–12 revenues.

However, these provisions are set to expire on June 30, 2015, giving the state an opportunity to evaluate the flex item and determine whether to continue some form of increased local authority over education revenues. Favorable reactions to categorical flexibility from school districts may make it less likely that the state will return to the categorical system that existed prior to the flexibility provisions. Districts report positive experiences with the flex item and a majority desire even greater flexibility over programs currently excluded from the flex item (LAO 2010b, 2011).

Despite this, the flexibility provisions in their current form pose many challenges. The flex item was hastily created as a response to severe education budget cuts. The legislature now has the opportunity to deliberate and consider any extension of the flex item in the context of broad, structural school finance reform. We recommend three ways to produce categorical flexibility better aligned with reform principles: consolidate funding and set per-pupil funding rates; create clear criteria to determine whether a program is flexible; and consider making programs flexible through block grants.

As the LAO (2011) points out, “Even if the current flexibility structure were made permanent, the K–12 finance system would still have inherent flaws.” This report and its recommendations attempt to address the current categorical flexibility provisions in light of these flaws and to aid a transition to a more rational, equitable, and transparent, but still flexible, school finance system.

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<sup>36</sup> Detailed descriptions of five major efforts are included in Technical Appendix A.

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