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HOW WILL PROPOSITION 223 - THE 95/5 INITIATIVE - AFFECT SPENDING BY CALIFORNIA'S SCHOOLS?

INTRODUCTION

The California Educational Efficiency ("95/5") Initiative, sponsored by Children's Rights 2000, is an initiative statute that would limit the share of funds California schools can use for administrative purposes. In general, the measure seeks to direct school funds, to the extent possible, to classroom and school-site expenditures. The measure attempts to accomplish this goal by limiting the amount school districts spend on administrative expenses to no more than five percent of all funds received from state, federal, and local sources. In addition, the measure requires school districts to link proposed expenditures in the budget with pupil performance objectives, requires periodic management audits, defines reporting requirements, and imposes sanctions on districts that fail to comply with any of the mandates contained in the initiative. The initiative is patterned after legislation, supported by the measure's proponents, which failed passage in the legislature.

WHAT DOES THE EDUCATIONAL EFFICIENCY INITIATIVE DO?

If approved by the voters in June, the Educational Efficiency Initiative establishes a set of spending guidelines and imposes reporting requirements on California schools. Provisions of the measure include:

95/5 Ratio. Beginning in fiscal year (FY) 1999-2000, school districts are prohibited from spending more than five percent of the revenues they receive from state, federal, and local sources on administrative activities. Administrative costs are defined as the sum of expenditures for 1) general administration, 2) instructional resources supervision, and 3) supervision of instruction as defined in the initiative. The remaining 95 percent of funds received must be used for direct services to pupils, school site employees, or school facilities. Districts that fail to comply with the 95/5 spending formula are subject to financial penalties (see below).

Linking Expenditures to Pupil Performance. School districts must annually indicate how projected budget expenditures will meet performance outcome objectives designed to improve pupil achievement.

Organizational Management Audit. School districts are required to undergo an independent organizational management audit every five years beginning in FY 2004-05. The audit is intended to

determine the extent to which the district has complied with the expenditure requirements and the effect expenditures have had on pupil achievement.

Reporting Requirements. For FY 1996-97 through 1999-2000, the initiative requires school districts to report annual expenditures for district administration, instructional administration, special projects administration, centralized data processing, and maintenance and operations administration as currently defined by the California Department of Education (CDE). Beginning in FY 2000-01, school districts must report the sum and percentage of total expenditures under the administrative categories (general administration, supervision of instruction and instructional resources supervision) defined in the initiative.

Sanctions. School districts failing to comply with the initiative's mandates are subject to fines of \$25 per unit of Average Daily Attendance (ADA) or five percent of the basic revenue limit times the total ADA, whichever is greater.¹

HOW ARE ADMINISTRATIVE AND DIRECT-SERVICE COSTS DEFINED?

Administrative Expenses

Proposition 223 makes a number of significant changes in the types of expenditures that would be considered administrative. The initiative defines administrative activities as those falling under one of the following three categories. Activities in these categories are subject to the five percent limit on administrative spending.

1. *General administration* includes costs related to:
 - **The governing board:** actions of school boards and the election of board members, property tax assessment and collections, and employee relations;
 - **Executive responsibilities of the school district:** expenses related to county offices of education, community relations, and state and federal relations;
 - **Central data processing:** in-house services provided from a mainframe computer and the cost of centralized services provided by outside agencies;
 - **Central support:** planning, research development, and evaluation services; public information; purchasing, warehousing, and distribution; and printing, publishing, and duplicating; and
 - **Fiscal services:** budgeting, receiving and disbursing funds, accounting, payroll, and managing funds and property.
2. *Instructional resources supervision* involves the overall management and maintenance of:
 - **Resources used to instruct pupils and**
 - **Activities and materials used by pupils to enhance learning.**
3. *Supervision of instruction* includes the cost of assisting staff with:
 - **Curriculum development:** developing curriculum and techniques to stimulate and motivate pupils;
 - **Instructional research:** program evaluation and instruction based on research;

¹ ADA is the average number of students present each day of the school year. Revenue limits place a ceiling on the amount of general purpose money school districts can spend per pupil, and vary from district to district. On average, five percent of the base revenue limit amount is approximately \$175 per unit of ADA.

- **Instructional staff development:** coordination of services which guide teachers in the use of instructional materials, administering sabbaticals, and providing the environment for in-service training; and
- **Instructional supervision:** directing, managing, and supervising instructional services.

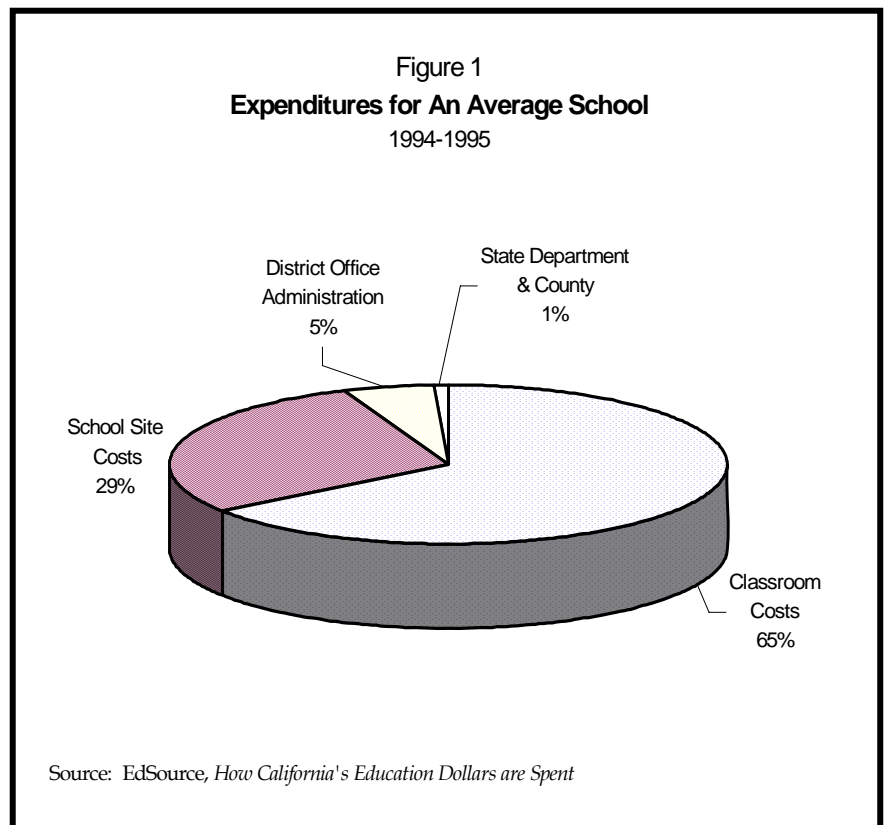
Classroom and School-Site Expenses

Proposition 223 defines activities that directly benefit pupils as those falling under one of the following three categories. Expenditures in these categories count toward the 95 percent spending requirement for direct services.

1. **Direct services to pupils:** all professional services provided directly to pupils by certified or licensed individuals, including teachers, nurses, counselors and librarians. Immediate services where pupils are the direct beneficiaries, such as transportation, cafeteria services, safety and security protection services, and the services of a school supervisor or principal.
2. **Direct services to school-site employees:** expenditures for actual training or professional development activities, police services, school site based support and management services provided to school supervisors or principals, and the services of school supervisors or principals.
3. **Direct services to school facilities:** the labor and material costs of cleaning, maintaining, and improving school facilities. Services provided to school facilities do not include overhead or management costs, whether based on a school site or at central district offices.

HOW ARE CALIFORNIA'S EDUCATION DOLLARS CURRENTLY BEING SPENT?

In order to determine the share of current school spending devoted to "administration," it is first necessary to define what constitutes an administrative activity. Recent analyses suggest that, overall, between five and eight percent of school dollars support administrative activities, although the percentage varies widely among individual districts. In 1994-95, five percent of school funds were used for district administrative expenses, while 94 percent went directly for classroom and school-site expenses.² The remaining one percent of total expenditures went to the State Department of



² EdSource, *How California's Education Dollars Are Spent* (Palo Alto, CA: January 1997). This analysis excludes amounts spent on child care, adult education, and capital outlay and is based on 1994-95 data as reported by the State Department of Education.

Education and county offices of education (Figure 1). Between 1988-89 and 1994-95, spending on district administration dropped by over 7 percent, while overall spending per student fell by 3 percent in inflation adjusted dollars.³ In response to Proposition 223, CDE recently calculated 1995-96 cost ratios for all districts. Using the definitions outlined the initiative, this analysis found that 7.7 percent of total school district funds were

spent on administrative costs statewide.⁴ The CDE also calculated administrative cost ratios for individual districts and estimated penalties that would be imposed on districts that spend more than five percent of their revenues on administration (Table 1).

The discrepancy between the two analyses results from differences in the treatment of various costs. One of the major differences between CDE's definition of administrative costs and that of the 95/5 initiative is the treatment of instructional support expenditures. The CDE treats instructional support as a school site expense. Proposition 223, however, considers many instructional support activities as administrative, including curriculum development, instructional research, instructional staff development, and instructional supervision. Approximately 4.4 percent of total expenditures are spent on

| <u>Districts Exceeding the 5% Administrative Spending Limit</u> | | | | |
|--|----------------------------------|------------|-------------------------------|--|
| County | District | ADA | Percent Administrative | Administrative Spending In Excess of 5% |
| Alameda | Hayward Unified | 19,852 | 8.6% | \$3,598,608 |
| Alpine | Alpine County Unified | 168 | 18.5% | \$222,689 |
| Butte | Manzanita Elementary | 244 | 10.0% | \$51,090 |
| Contra Costa | Canyon Elementary | 68 | 23.5% | \$53,735 |
| Contra Costa | Mt Diablo Unified | 34,580 | 5.5% | \$886,149 |
| Fresno | Fresno Unified | 75,442 | 7.5% | \$10,563,147 |
| Fresno | West Fresno Elementary | 870 | 21.1% | \$683,208 |
| Humboldt | Northern Humboldt High | 1,847 | 6.4% | \$119,429 |
| Kern | Linns Valley-Poso Flat | 104 | 26.2% | \$99,767 |
| Los Angeles | Compton Unified | 27,720 | 18.9% | \$19,897,021 |
| Los Angeles | Los Angeles Unified | 624,382 | 7.4% | \$93,176,365 |
| Madera | Minarets Jt Union High | 29 | 25.6% | \$297,833 |
| Orange | Capistrano Unified | 34,896 | 7.4% | \$3,686,172 |
| Sacramento | Sacramento City Unified | 48,909 | 8.8% | \$10,430,843 |
| San Benito | North County Jt Union Elementary | 618 | 14.3% | \$272,078 |
| San Diego | Grossmont Union High | 20,623 | 9.2% | \$5,070,642 |
| San Francisco | San Francisco Unified | 59,906 | 8.4% | \$13,367,542 |
| San Diego | Poway Unified | 29,768 | 6.9% | \$2,639,055 |
| Santa Clara | Alum Rock Union Elem | 15,783 | 8.3% | \$2,613,062 |
| Stanislaus | Modesto City Schools | 29,935 | 8.7% | \$5,728,909 |
| <u>Districts Below the 5% Administrative Spending Limit</u> | | | | |
| County | District | ADA | Percent Administrative | |
| Contra Costa | Antioch Unified | 15,191 | 4.7% | |
| Glenn | Capay Jt Union Elem | 169 | 4.6% | |
| Kern | Fruitvale Elementary | 2,098 | 4.1% | |
| Kern | Rosedale Elementary | 3,197 | 4.4% | |
| Los Angeles | Castaic Union | 1,804 | 3.8% | |
| Monterey | King City Jt Union High | 1,511 | 4.0% | |
| Nevada | Nevada Jt Union High | 4,081 | 4.6% | |
| Placer | Roseville Jt Union High | 4,807 | 3.2% | |
| Riverside | Temecula Valley Unified | 12,069 | 4.9% | |
| San Joaquin | Tracy Jt Union High | 2,991 | 4.8% | |

Source: California Department of Education, *Analysis of the Educational Efficiency Initiative*

³ EdSource, *How California's Education Dollars Are Spent* (Palo Alto, CA: January 1997).

⁴ California Department of Education, *Analysis of the Educational Efficiency Initiative* (Sacramento, CA: August 1997).

instructional support activities.⁵

The CDE argues that Proposition 223's use of only the general fund to calculate administrative expenditures, while using all funds to calculate total expenditures for the preliminary administrative cost ratio, creates inconsistencies. Because administrative costs paid out of Adult Education, Child Development, Cafeteria, or Building Funds are not subtracted from total expenditures, the preliminary calculations underestimate the final administrative cost ratio. The actual share of total expenditures accounted for by administrative activities could be as much as two percent higher when all administrative costs are taken into consideration in the permanent calculation.⁶

Based on the current definitions of administrative costs, statewide school spending complies with the 95/5 target established by the initiative. However, complying with the five percent limit under the more restrictive definitions of administrative costs contained in the initiative will significantly impact the future spending patterns of a majority of California's school districts.

WHAT DISTRICT CHARACTERISTICS IMPACT ADMINISTRATIVE SPENDING?

In order to assess the potential impact of Proposition 223, the California Budget Project (CBP) analyzed the relationship between administrative expenditures and a number of characteristics of California school districts. This analysis used statistical techniques to explore how this measure affects school districts based on size, the diversity of student populations, and average class size drawing on data from CDE's California Basic Educational Data System (CBEDS) for 1995-96.⁷ Estimates of district administrative costs were taken from the CDE's preliminary calculations of the Educational Efficiency Initiative's administrative cost ratio, which also uses 1995-96 data.⁸ CBP found that:

- **Small districts, on average, spend more on administration than large districts.** Total pupil enrollment is inversely related to the share of school revenues spent for administration. Based on CBP's research, this is particularly true if the Los Angeles Unified School District (LAUSD) is excluded from the analysis. Statistically speaking, the inverse relationship between size and administrative spending is significant albeit to a lesser degree if LAUSD is included in the analysis. Administration accounts for approximately 7.4 percent LAUSD spending.
- **Districts with smaller classes spend a greater share of their resources on administration.** Smaller classes require more teachers, classrooms, facilities, and materials. This, in turn, increases the cost of personnel, accounting, risk management, and maintenance services relative to total enrollment. Similarly, smaller classes increase the demand for curriculum development and assessment, teacher training, staff development, and evaluation activities. Therefore, the share of spending on direct service activities, such as transportation, cafeteria services, security, principals, nurses, physicians, psychologists, counselors, audiologists, librarians, and other support services personnel would be lower. This finding suggests that placing an arbitrary limit on administrative spending for every school district may conflict with the state's current class size reduction initiative. Complying with Proposition 223's requirements may discourage school districts from expanding efforts to reduce

⁵ EdSource, *How California's Education Dollars Are Spent* (Palo Alto, CA: January 1997).

⁶ California Department of Education, *Analysis of the Educational Efficiency Initiative* (Sacramento, CA: August 1997).

⁷ All results reported are statistically significant with $p \leq .005$ based on CBP analyses using data from the California Department of Education, Demographic Data Files <http://www.cde.ca.gov/ftpbranch/retdiv/demo/newcbeds/main.htm>, 1995-1996.

⁸ California Department of Education, *Educational Efficiency Initiative: Preliminary Calculations*, <http://www.cde.ca.gov/ftpbranch/sbsdiv/counties.htm> (Sacramento, CA: August 1997).

class size as they struggle to find teachers and make room for more classrooms, while reducing administrative costs.

- **Districts with a larger share of minority and Limited English Proficient (LEP) students spend more on administration.** CBP's analysis found a direct relationship between the percentage of a district's total enrollment accounted for by minority or LEP students and administrative spending. This trend most likely results from a need for specialized programs such as bilingual education or desegregation. Because minority students disproportionately come from low income families, other categorical programs, such as those funded through Economic Impact Aid, which target low income pupils, are also more prevalent in districts with a large minority enrollment. Such programs' funding is usually tied to specific evaluation and reporting requirements that involve administrative costs as defined by Proposition 223, and thus, an increase in administrative spending for those districts.

San Francisco Unified School District's desegregation program offers an insight into the possible predicament created by an administrative spending limit. Under the district's program, the number of minority students in each school cannot exceed 41 percent. Desegregation activities include coordinating student placement, transportation services, professional development, and school improvements; and facilitating parent/community relations. In addition, the district maintains a database for evaluating the program's academic impact on its pupils. All of these activities are not only necessary for successful desegregation, but are also mandated by a court order. Under the definitions contained in Proposition 223, however, most of the costs would be counted as administrative spending.

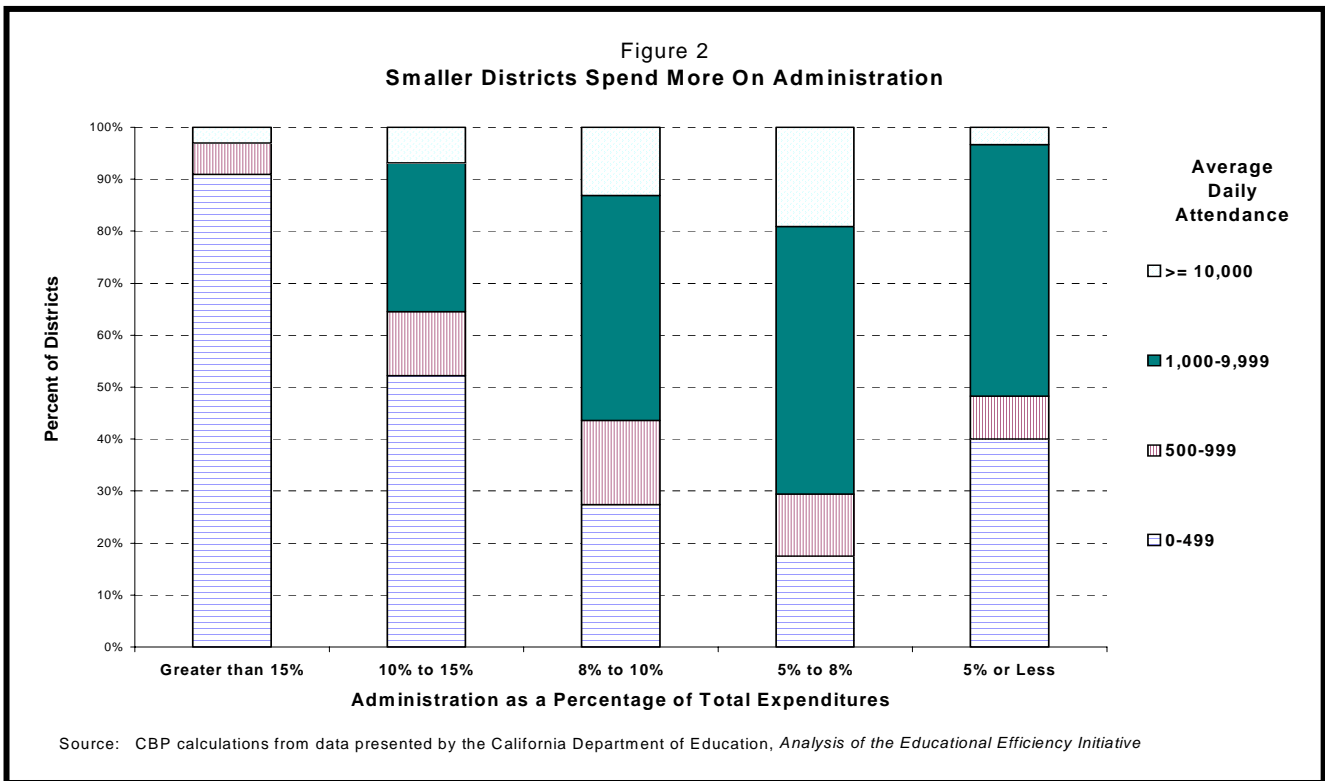
HOW DOES SIZE AFFECT A DISTRICT'S ABILITY TO COMPLY WITH THE INITIATIVE?

Size offers an example of how districts might adapt the operations to fit within the specifications of the Educational Efficiency Initiative.

Large School Districts (districts with high ADA) have the resources and personnel to reorganize activities and personnel more easily than smaller districts. A larger budget and more employees allow positions to be shifted from a central location to local sites or for duties to be organized to include more direct services in order to comply with the initiative's demands. The larger a school district, the less likely it will face penalties for noncompliance.

Organizational restructuring by large districts may, in effect, result in the same activities being performed but in a different location and under a different title. Furthermore, if a duty is currently being performed at a central location on behalf of several schools, requiring the duty to be performed at individual school sites may prove to be less efficient despite *administrative* savings.

Small School Districts will be disproportionately affected by the initiative. As in any business, there are certain overhead and administrative costs that cannot be reduced no matter how small the operation. Some data processing or accounting functions, for example, are equally time consuming for a district of 500 or 10,000 students. Thus, it is understandable that smaller school districts typically spend a greater share of their resources on administrative operations than do larger districts (Figure 2). For example, small districts may employ a single person to perform one or several essential administrative functions and have no feasible means of reducing certain costs. Applying a uniform five percent limit on administrative expenditures ignores the inherent economic differences that exist between districts of



varying sizes. Therefore, smaller school districts could face unavoidable sanctions should the initiative become law.

WHAT WILL BE THE FISCAL IMPACT ON CALIFORNIA'S SCHOOLS?

If Proposition 223 is approved by the voters, school districts will have three options to comply with the measure's requirements:

- Reduce administrative spending and shift resources to direct pupil services;
- Move administrative functions out of central offices and to school sites in an attempt to avoid classification of certain costs as "administrative;"
- Pay the penalties imposed on districts for noncompliance.

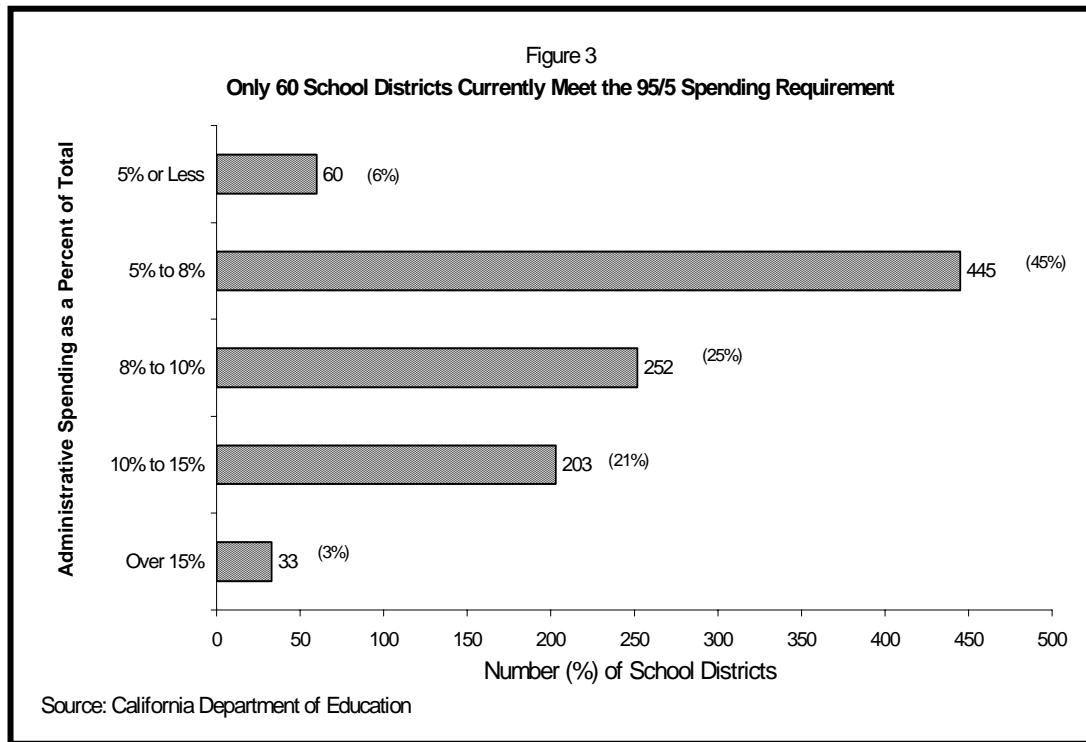
The official analysis of Proposition 223 prepared by the state's Legislative Analyst and the Director of Finance estimates that school districts will be required to shift between \$500 million and \$700 million currently spent on administrative activities to direct services to pupils, school site employees, and school facilities, as defined in the initiative.⁹ This analysis assumes that school districts will reorganize and restructure so as to fully avoid the financial penalties imposed on districts that fail to comply with the requirements of the initiative.

The Department of Education, on the other hand, estimates that school districts would face \$890 million in penalties if the initiative were in place today. Only 60 districts currently meet the 95/5 spending requirement, while 933 districts exceed the five percent administrative spending limit (Figure 3).

⁹ Attorney General of California, *Schools. Spending Limits on Administration. Initiative Statute* (Sacramento, CA: January 25, 1996).

If Proposition 223 becomes law, school districts will likely attempt to avoid penalties by moving services provided by district offices to school sites and/or eliminating certain district office services and contracting those services through school sites. It is also possible that some of the administrative burden will shift to teachers, principals, and support staff at school sites. Smaller districts may even consider consolidation as a way to reduce administrative spending.

Any penalties imposed will be collected by the State Board of Education, but the initiative does not



specify how these funds will be utilized. The money will likely be redistributed back to districts. Since there would be a conflict of interest in redistributing funds back to districts that were in noncompliance, school districts that do adhere to the 95/5 ratio requirement may not only avoid fines, but could be rewarded with additional funds as well. Another

possibility may be that the funds collected will be returned to noncomplying districts once they meet the measure's requirements.

School districts will also incur additional costs associated with the independent audit mandated by the initiative. These costs will count toward the five percent spending limit. In addition, there are administrative costs connected with the reporting and performance budgeting requirements. School districts are required to determine how expenditures affect pupil performance and also determine and record which costs are administrative in order to calculate the ratio and ensure compliance with the measure.

ARGUMENTS IN FAVOR AND IN OPPOSITION

In Favor. Proponents argue that excessive inefficiency exists within California school districts. They claim that funds that should go directly to meet the instructional and classroom needs of the children are used to fund an unnecessary and extensive administration system. The Educational Efficiency Act, they claim, will guarantee that funding will go to schools and classrooms first. Proponents also argue that the measure will give the community greater decision making authority over their schools and will make school districts more accountable to the people of California.

In Opposition. Opponents argue that the measure will unfairly burden small districts, which will have greater difficulty reducing or redirecting administrative activities to meet the initiative's requirements. Opponents also claim that the initiative fails to clearly distinguish between administrative and direct-service costs, leaving room for individual interpretation, manipulation, and confusion when determining which costs are administrative and which are not. As a result, calculating the initiative's administrative cost ratio will be costly and time-consuming. In addition, such ambiguity will require clarification through legislation and, potentially, court action in order to ensure the measure is applied uniformly across all districts. Furthermore, the prescriptive nature of the measure, voice opponents, will diminish local control and accountability over school budgeting decisions by forcing local school boards to forego consideration of many factors affecting the district and making adherence to the requirements of the measure their principal obligation. Finally, opponents argue that the measure will not guarantee educational efficiency. Instead, it will force school districts to redirect administrative activities to school sites and recategorize the activities to conform to the 95/5 ratio requirement.

CONCLUSION

The permanence of measures approved by the voters -- any substantive change must be approved by a subsequent ballot measure -- makes a careful consideration of the issues extremely important. When evaluating Proposition 223, voters should carefully weigh several key policy considerations:

- Can school districts comply with the administrative spending cap without compromising essential administrative operations?
- Will the initiative impose undue burdens on certain types of districts (i.e., small districts or districts with large number Limited English Proficiency students)?
- Will districts truly shift spending from administration to the classroom or simply restructure so as to shift expenditures from one category to another?
- Will the mandated shift in expenditures from administration to direct pupil services result in improved educational outcomes for California's children?

The California Budget Project (CBP) is a nonpartisan, nonprofit organization whose goal is to promote a better understanding of state fiscal issues in order to promote a healthy public sector based on a fair and equitable tax system. CBP neither supports nor opposes Proposition 223. Support for the California Budget Project comes from foundation grants and individual donations and subscriptions.
