

## COMMENTARY

# School Finance 103

## Accounting for Costs

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*In the debate around Governor Brown's proposed "Local Control Funding Formula" (LCFF), a number of issues have been raised that school finance researchers (and policymakers in other states) have been discussing for years. This 'School Finance' series highlights what we know – and what we don't know – about some of these issues. Much of what is covered in these posts (including additional sources and full citations) can be found in [School Funding Formulas: What Works and What Doesn't? Lessons for California](#), a 2007 report done for the Senate Office of Research.*

In a foundation formula, [base revenue](#) per pupil is typically equal or very similar across districts but the majority of states also distribute additional funding to compensate for differences in the cost of education in different districts. The **cost** of education can be defined as the minimum amount of money that a school district must spend in order to achieve a given educational outcome, such as reading at a grade-appropriate level. Costs generally differ across school districts for reasons that are *outside the control* of local school boards or state governments, such as the number of children with "special needs". In reforming California's system to rationally address differential district needs, the key issues for policymakers are how to incorporate cost factors into the formula, which factors to include, and how large the adjustments should be. In this post, I will focus on the first of these issues and come back to the other two in my next two posts.

### HOW TO INCORPORATE COSTS INTO THE FORMULA?

Brown's LCFF specifically accounts for student poverty, English Learners and grade levels through the use of student weights (technically, Brown's proposal also includes a weight for foster youth but all foster youth also qualify for the low-income weight so there really isn't additional money just for them). There are a few different ways that costs can be incorporated into a foundation formula, or that cost-based funding can be allocated outside the formula. Each has advantages and disadvantages that should be considered as policymakers weigh potential amendments to Brown's LCFF proposal.

### CATEGORICALS

California currently distributes almost all cost-related funding through categorical programs. These are restricted funding streams where the money must be used for the specific purposes designated by the program. California has dozens of categorical programs on the books, although in 2008, districts were given freedom from the restrictions on about 40 of those (often referred to as the 'Tier 3' programs). What distinguishes California's system of categorical funding from other states is not that we *have* categorical programs; many states provide funding through similar programs. The differences are that we have a lot more programs than most states, they cover different types of items, and the allocations often make no sense (like revenue limits, many categorical allocations are based on history or politics, not cost).

## BLOCK GRANTS

One alternative is to consolidate funds in a system more like that used for California's charter schools. Charters typically receive a set amount per pupil as 'general' revenue, and a block grant intended to cover most of the categorical programs that regular districts are eligible for but without the same restrictions. The categorical flexibility introduced in 2008 essentially consolidated the Tier 3 programs into an unrestricted block grant, and the recently-introduced [SB 223 \(Liu\)](#) would extend that block grant through 2019-20. However, under the current system, the allocation amounts for both charter school and Tier 3 block grants are only weakly connected to the characteristics of the students or schools. Thus, they provide more flexibility than do categoricals, but perpetuate inequities and irrationality in the allocations. In other states where block grants are used, the size of the grants are generally tied specifically to student or school characteristics.

## PUPIL WEIGHTS

An alternative that provides both flexibility *and* a specific connection with district needs is to include weighted pupils in the base formula. This is the approach that Brown has proposed, and it is used in numerous states. Pupil weights reflect the idea that certain students are relatively more costly to educate than others. If the foundation amount is, say, \$8000 per pupil, and the add-on weight for English Learner students is 0.5, then districts would receive \$12,000 ( $=8000 \times 1.5$ ) for each EL student. If a student falls into multiple need categories, the weights could be added together; for example, if a student is both low-income (with a weight of, say, 0.8) and an English Learner (with a weight of 0.5), then that student's total add-on weight is 1.3. Some states (e.g., Oregon, Florida) cap the total weight that can be assigned to an individual student. Although the additional funding is allocated based on student characteristics, most states do not put any restrictions on how districts can use these specific funds.

NOTE: The terms 'pupil weights' or 'weighted student formula' are sometimes used to refer to school-based allocation formulas (i.e., the weights are used to allocate funds directly to schools within districts). Although pupil weights can be used in this way, and some individual districts may use weights to allocate money to schools within the district, the terms are also used more broadly than that. Many states have pupil weights in their state formula but no state allocates money directly to non-charter schools, bypassing districts.

*Direct adjustments to the foundation amount:* Some cost factors can be incorporated into the school finance formula by adjusting the foundation amount directly. A good example is Florida, which uses a District Cost Differential in which each district is assigned an index value signifying the relative cost of hiring and retaining teachers. Districts with teacher costs higher than the state average have index values greater than 1; districts with teacher costs lower than the state average have index values less than 1. This index is multiplied by the foundation amount to generate a teacher cost-adjusted foundation level for each district. For example, if the base foundation amount is \$8000 and a district in a high cost-of-living area has a District Cost Differential value of 1.2, then the foundation amount in that district becomes \$9600 ( $=8000 \times 1.2$ ). Note that since teacher salaries comprise the majority, but not the entirety, of a district's budget, this sort of wage adjustment may be applied to only part of the foundation amount. For example, Colorado applies a cost of living index to only 80-90% of the foundation amount (the actual percentage depends on district enrollment).

Direct adjustments to the foundation amount can also be used to account for student need factors, although this is less common. Generally, pupil weights are most straightforward when the additional costs are associated with specific *students* (e.g., special education, ELs, etc.). Adjusting the foundation level directly is most appropriate when the additional costs are associated with specific *district* characteristics (e.g., geographic teacher costs, demographics, etc.).

## WHICH APPROACH IS "BEST"?

Using weighted pupils in the base formula, or directly adjusting the foundation amount, allocates additional funding to districts that have higher costs but does so without the strings generally associated with categorical aid. The only research that addresses whether student outcomes are affected by the way in which special needs are addressed in a school finance formula is [Loeb and Strunk \(2007\)](#). They find that increases in the share of spending coming from categorical aid are associated with lower student performance. In addition, the positive effects of stronger accountability policies are reduced in states with higher shares of categorical aid. This suggests that for California, replacing most categorical aid with pupil weights or adjusted foundation levels would generally be beneficial.

## WHEN ARE CATEGORICALS STILL JUSTIFIED?

Removing the restrictions associated with categoricals has been one of the biggest concerns about Brown's LCFF. Many advocates for specific programs or populations, such as adult education, career tech or foster care, fear that without a state requirement to use funds for these programs, they will disappear from many districts. These concerns certainly make sense, given the experience the last few years under Tier 3 flexibility. As documented by [Stecher, et al \(2012\)](#) and [the LAO](#), many districts used that flexibility to reduce 'non-core' programs, including adult education, arts and music and GATE. Although it could be argued that such reductions would not necessarily have happened in a better fiscal environment (i.e., it's lack of money, not flexibility, that is the root cause), it is reasonable to assume that without specific requirements, some districts will choose not to use their funds for these programs.

From a certain perspective, *that is exactly the point* – giving districts more flexibility means they can choose *their own* priorities, rather than having Sacramento *impose* priorities on them. One of the biggest complaints that school administrators have had about categorical programs is that they know better than legislators what the most effective use of dollars might be in their district, particularly when district needs are so different across the state. If District A believes their students are best served by having smaller classes while District B believes their students are best served by having a strong arts program, most local administrators see making those decisions as their job, not that of Sacramento legislators'.

At the same time, it *is* the job of Sacramento legislators to set overall priorities for the state, and some of those priorities may still best be funded with categorical programs. As mentioned earlier, almost every state has *some* categoricals, and these tend to reflect one of two situations. The first is when funds need to be distributed along a dimension other than per student; common examples include debt service, transportation funding and teacher retirement benefits. The other situation is when the state decides they want to prioritize specific programs outside the base curriculum, such as adult education or GATE. Categoricals then provide additional funding connected to the cost of those services.

## CONTROL AND ACCOUNTABILITY

The debate over categoricals versus weights highlights the fact that decisions about the structure of the state school finance system are also decisions about **governance**. Most would agree that it is the state's role to set over-arching educational goals that districts must then fulfill, such as making sure all students are receiving a high-quality core education that prepares them for work or college. What is less clear is whether other priorities, such as the importance of non-core educational programs, should be set at the state or local level. Should the state say all districts must offer adult education or art or GATE, or should that be a decision left to local officials?

Even if one believes these priorities should all be set at the state level, policymakers have choices about *how* to ensure those priorities are met within districts. What we currently do is enforcement through categorical funding: districts must provide the services or lose the money (regardless of whether the services are effective). An alternative is enforcement through accountability: set standards and then districts must show that they are achieving those standards. This approach is somewhat foreign in California

but it is used regularly in other states.

In general, policymakers must strike a balance between giving districts the flexibility that they need to best serve their students, while ensuring that districts are also using resources in the most effective ways possible to meet whatever priorities the state has set. California has a long history of top-down regulation that conflates funding and enforcement. But many experts would argue that it is the job of the accountability system (not the funding system) to ensure districts are meeting state priorities. That is, rather than impose restrictions on how districts must use their funding, the state's role should be to set strong standards and monitor effectiveness through the accountability system.

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