

MINUTES

**MONTANA HOUSE OF REPRESENTATIVES
53rd LEGISLATURE - REGULAR SESSION**

SELECT COMMITTEE ON SCHOOL FUNDING

Call to Order: By **CHAIRMAN JOHN COBB**, on January 12, 1993, at
3:15 p.m.

ROLL CALL

Members Present:

Rep. John Cobb, Chairman (R)
Rep. Ray Peck, Vice Chairman (D)
Rep. Bill Boharski (R)
Rep. Russell Fagg (R)
Rep. Mike Kadas (D)
Rep. Angela Russell (D)
Rep. Dick Simpkins (R)
Rep. Dave Wanzenried (D)

Members Excused: None

Members Absent: None

Staff Present: Andrea Merrill, Legislative Council
Eddy McClure, Legislative Council
Dori Nielson, Office of Public Instruction
Evy Hendrickson, Committee Secretary

Please Note: These are summary minutes. Testimony and
discussion are paraphrased and condensed.

Committee Business Summary:

Hearing:
Executive Action:

CHAIRMAN COBB informed the committee they would be hearing an overview of school funding. The chairman then introduced **Eddy McClure, Legislative Council**, who would bring the committee up to date on school funding lawsuits.

Eddy McClure, Legislative Council, said the underfunded suit filed in August 1991 is very similar to the first suit; it represents approximately 40% of the school population and about 65 districts. Basically, these districts claim that, while HB 28 was an improvement to the system, it still violates Article II, the equal protection part of the Montana Constitution, and Article X, section 1, the guarantee of equal educational opportunity. They also raise the claim, also raised in the first suit, that the right to education is fundamental.

In his 1988 decision, District Court Judge Loble said that education was a fundamental right and, if not a fundamental right, at least a right that deserved middle-tier scrutiny. In its decision, the Supreme Court did not rule on the equal protection argument, but went strictly on equal education opportunity. Inadequate funding in the foundation program means there is an excessive reliance on permissive and voted levies.

Ms. McClure said the trial began on January 4, 1993. Prior to that the state filed a motion in December to allow evidence based on test scores such as SAT and ACT, for the purpose of showing that Montana students do well on these scores and, therefore, the state has provided a basic quality education. Judge Sherlock denied the motion on December 18, 1992. The State has appealed this order to the Supreme Court and is awaiting that decision. She indicated she would discuss the order in more detail later in her overview.

Ms. McClure said the second suit, filed on behalf of 160 districts by the Montana Rural Education Association in December 1993, is expected to begin upon conclusion of the underfunded suit. Their complaint is that HB 28 still violates Articles II and X of the Constitution; that education is a fundamental right; that foundation program classifications and funding levels are arbitrarily set; that reliance is still on voted and permissive levies; that caps set in HB 28 adversely affect rural schools; and that GTB eligibility formulas are biased against rural schools.

She then discussed Judge Sherlock's Order of December 18, 1992, saying the order gives a clearer indication of his position; this is important since he will be the judge on the two suits she just reviewed. The order was issued in response to the request that the State be allowed to introduce evidence on test scores. She said the 1988 Loble Decision and Judge Sherlock's Order both indicate the State has relied too much on voted and permissive levies; as the committee studies proposals before it, members need to keep this language in mind.

Questions from Committee Members and Responses:

REP. SIMPKINS said that Judge Sherlock seems to hold to the concept of equalizing per student costs and to the concept that the State could equalize down.

Ms. McClure replied that they are concerned with the disparity in per pupil spending. They are not saying what the disparity range might be, but that districts must be able to access whatever money is available on an equal basis. Not all districts, because of wealth differences, have equal ability to raise the same amount of money. That's what got the state into trouble. The expense is being shifted to the local district for funding.

REP. BOHARSKI said if the judge is going to hold the State to a fundamental right, somewhere along the line it will have to be provided for. He asked whether a determination will have to be made whether the State is meeting its obligations in providing that fundamental right.

Ms. McClure said this is under the "strict scrutiny" test which wasn't true in the first lawsuit. In that suit it was middle-tier scrutiny, and the State did not meet the middle-tier test.

REP. SIMPKINS said it seems that Judge Sherlock is trying to indicate to the legislature that just defining basic education and then funding our share is not a way out. However, it seems it could still be acceptable. The State Board of Public Education definition defines the overall objective; the legislature would have to determine the cost of that overall objective. Ms. McClure said Judge Sherlock doesn't address the Board's definition.

REP. KADAS asked whether it was true that the first thing Judge Sherlock said is that the question of a basic education is not part of this suit. Ms. McClure replied that was correct. REP. KADAS said the second thing the judge asked was whether all funds going to K-12 are meeting some kind of an equity standard. Ms. McClure said the judge used the word "system" and that implies everything.

CHAIRMAN COBB said the next presentation would pertain to the study committee's efforts and would be presented by Andrea Merrill, Legislative Council.

Andrea Merrill, Legislative Council, said the purpose of the last interim study was to study equalization of transportation costs and capital outlay because those two items were left on the table after HB 28. She said they had some very productive meetings where the education community came with solid plans and an agreement was reached. SB 32 reflects, in large part, things the education community wanted. Existing and new debt for facilities would be equalized with guaranteed tax base aid (GTB) (estimated to cost around \$6 million). It offers property-poor districts a chance to receive this state aid up to the statewide average in taxable valuation per student; it changes the debt limits to allow a below average district to try to reach the state average with GTB help. She said there was some consternation that these districts might over-bond themselves, but local voters still have a great deal of statutory and constitutional power to control debt limits. The study committee talked a great deal about the idea of controlling state costs by controlling who builds and what they build, however, state control of building projects was not included in the bill.

Ms. Merrill said transportation turned out to be the problem area that was expected. There is not enough known about transportation costs, or even if it needs to be further

equalized. She said it may be equalized to a degree that would be acceptable. She said there is a task force of education officials and OPI staff still looking at some of these things. The 1990 January Special Session asked the study committee to look at school administrative costs but the discussion didn't include school unification or consolidation.

Questions From Committee Members and Responses:

REP. KADAS asked what the status is of the task force studying transportation issues. He wondered whether that would result in a bill or a definitive answer as to whether the issue has been settled?

Ms. Merrill said he could ask that question of the Office of Public Instruction. OPI officials said that, since the issues had turned out to be quite extensive, they would give their report either to an interim committee or the next regular session of the legislature.

CHAIRMAN COBB said the next presentation would be a report on the implementation of HB 28 by Ms. Merrill.

Ms. Merrill said that a certain level of tax equity has occurred -- through the 95 statewide mills, the guaranteed tax base aid, the local government severance tax provisions, and the general fund caps. But half of the district revenues still come from property tax, and that's not equitably distributed. There is some improvement in per-student spending equity and in the state's share of funding through the increased foundation program schedules and the GTB. In the first year, the state's share was increased to 74%. For 1992, that's dropped down to 72% because there was no foundation program increase by the legislature. She said most of the spending disparities are still in the 2 to 1 range.

Ms. Merrill said another highlight of HB 28 is the cash flow problem to the state equalization aid account. State support was increased in the 1989 special session by \$110 million but only \$80 million was added to the state equalization aid account. There has been an insufficient flow of funding into that account.

Questions From Committee Members and Responses:

REP. BOHARSKI said one of the things that keeps coming up is the caps. He wondered whether the legislature should let people know that one of the reasons equity is not being achieved sooner is the 104% cap. He asked Ms. Merrill if she had any feeling that tightening the restrictions on those caps would help reach equity sooner. He wondered whether that is contributing substantially to the problem.

Ms. Merrill said the inflation rate has been running about 4%, and a question to be answered is whether school budgets should have the ability to grow at the same rate. A great many levies have failed, and there is a lot of local capping going on that doesn't come by way of law from Helena.

CHAIRMAN COBB said that, as the committee goes into actual discussion in the next few weeks, members can address caps and whether they should be handled differently.

CHAIRMAN COBB introduced Dori Nielson, Office of Public Instruction.

Dori Nielson, Office of Public Instruction, gave an overview of special education funding and a study done during the interim on that subject. This committee, chaired by REP. PECK, was composed of a diverse group dedicated to drafting their recommendations into bill form. She asked that Bob Runkel, OPI, give a brief outline of the components in the suggested draft.

Robert Runkel, Director of Special Education, Office of Public Instruction, said the committee which Ms. Nielson referred to was charged with four issues. That charge was to maintain the quality of special education programs, to equalize funding, to make funding more predictable, and to provide greater flexibility in administrators' ability to utilize state funding.

There was a concern about the need for greater flexibility, and an effort was made to address the problem with the current, allowable cost funding system. He said that system has resulted in school programs being driven by that funding mechanism. Mr. Runkel listed some of the points addressed by the committee. They felt it was fundamental to begin the discussion by addressing concerns regarding special education cooperatives. Simply changing the way the money was distributed was not enough without addressing some of the concerns regarding special education cooperatives. One of the points was that all schools need to be included in an established geographic boundary so there was no overlapping membership. There was also a need to encourage participation in co-ops by providing a financial incentive. Finally, there should be no more co-ops than currently exist.

He said the group concluded that funds should be distributed in the form of block grants. Two of the three methods of receiving funds under this system would be through block grants. The first would be instructional block grants which would provide funding for teacher salaries, aides, equipment and supplies; they would be distributed to schools based on ANB, not on numbers of special ed students or any other variable. In order to receive this grant, and in an effort to equalize the amount of local district effort in providing special ed services, the districts would have to provide matching funds of approximately 25% to the local special ed budget.

Mr. Runkel stated the second portion of funding would be in the form of a related services block grant. This would cover costs such as school psychologists, therapists, administrative costs, independent evaluations and others, such as in-service training costs. Districts, or co-ops, would receive this grant in the same way as the instructional services block grant in that it would require a matching contribution from the co-op or the district.

The third portion was a major concern to the committee, Mr. Runkel said. Doing this kind of block grant on the function of ANB causes real life disparities and real costs because of differences in the numbers of kids identified in need of special ed from district to district and differences in salary schedules between districts. This third leg would be a reimbursement system for disproportionate costs of local districts. If the district contribution to the special ed program exceeded a threshold amount, a portion of that would be reimbursed by the state. There was a concern as to how that reimbursement would be handled because sometimes those costs are unpredictable. At present, this is addressed by a system called contingency funds. The commission's recommendation was to abolish contingency funds and provide "advance reimbursement." The district could apply for that reimbursement in the year in which the emergency occurred. The commission also felt a need for inservice training and recommended that OPI encourage districts to use their federal flow-through funds at a level of approximately 5% to help both special ed staff and general staff provide services to handicapped children.

He said that funding shortfalls for any one of those three areas would result in proportionate funding. There would be an effort to equalize the amount of money the state would provide under any of those programs based on available appropriations relative to total costs in any one of those programs.

Questions From Committee Members and Responses:

CHAIRMAN COBB asked Ms. Nielson if there was a bill prepared for some of these recommendations. Ms. Nielson said they were working on the bill to bring all the details together.

REP. KADAS noted that Mr. Runkel had said the state is picking up 60% of the costs and locals 40%. He wondered how the state figures out what the local share of the cost is.

Mr. Runkel responded that the current funding system is based on an allowable cost schedule. Districts submit their budget applications, and OPI reviews the number of children being served, handicapping conditions, contact hours, educational needs of the children in the district, etc. Based on that information, OPI determines the number of staff needed to serve those children. Once that determination is made, they determine the

individual's salary, their benefits, their supply and equipment needs. That becomes the level of approved allowable costs.

REP. KADAS asked how the state decides how much of that amount will be sent to that district. Mr. Runkel replied they prorate the amount based on the available funds relative to the total of approved allowable costs. The funding is not based on a per child basis but on what is approved as their allowable costs.

REP. KADAS asked whether, if it is clear the state is contributing 60%, it is also clear that local districts are putting in 40% or if that maybe is not happening. Mr. Runkel said his best estimate was that they were coming very close to 40%.

Ms. Nielson said she would provide figures on that because it varies greatly from district to district.

REP. PECK told REP. KADAS he could compare it to the transportation situation. They are paying a portion of the schedule but many districts exceed that schedule and have a local obligation in excess of 100%. He said Mr. Runkel has given a statewide average which doesn't apply to all districts and said it would be difficult to give a definitive answer.

REP. KADAS referred to the 25% match in order to get state money in a couple of the categories. He said if a dollar amount match was required, that is clearly not equalized. He asked if the commission discussed whether the amount contributed ought to be equalized either through GTB or millage effort per student, etc.

Ms. Nielson responded that special education dollars and foundation dollars are multiplied by 35% to determine the permissive range, that portion they were able to access with GTB support, if they're eligible.

REP. SIMPKINS asked Mr. Runkel if the percentage of special education students was growing, decreasing, or what the situation is as far as the population in special ed.

Mr. Runkel replied there is a significant growth in the number identified as in need of special ed. In Montana, there are about 17,500 students identified. That grew at a rate of about 19% in a four-year period and is a significant growth over ANB count or general enrollment.

REP. SIMPKINS said the reason for his question was that Superintendent Keenan had made a statement on television that perhaps the state should start looking at students being placed in special ed who maybe should not be in special ed. He asked whether this has been done. He also asked whether the area of special education keeps broadening when perhaps it should just be called remedial work instead of special education.

Mr. Runkel said the answer to his question was yes, and this was a major focus of the commission on special education finance. He said when he talked about the goal being to improve the flexibility in the use of the dollars, the concern was that the state needs to be more flexible in accessing these children in various deliveries other than special education, by providing some help for them without having to place them in special education. The commission also studied the Vermont funding model very closely which paralleled in many ways the recommendations of this commission. Over the past couple of years in Vermont, the actual numbers of children identified as in need of special ed have decreased. He said he understood the reason for the decrease is the availability of help without having to go into an identification process. Help comes in the classroom.

REP. BOHARSKI asked how children are identified and whether there is a federal definition or state definition for a child in need of special education. Mr. Runkel said it is clearly identified in federal regulations.

REP. PECK said he thought the commission had adopted an average salary for personnel that they would accept which took the fluctuation out of the budgeting.

Mr. Runkel said the funding under the new system would be based on enrollment. He said they would simply take the statewide costs for instructional services and divide that by ANB. The current funding method in special ed is an allowable cost schedule; so once OPI determines whether a teacher is needed or not, then the salary, high or low, gets built into that district's budget as the allowable cost. Under the new system, salaries would only be an issue as far as what their statewide average is because that determines how many dollars per child each district would receive.

CHAIRMAN COBB asked Ms. Nielson if she could take the same system and make it statewide for all education, not just special education.

Ms. Nielson said they modeled it back to the foundation schedules; but based on some costs they were familiar with, they could divide it into the instructional and related services costs.

REP. KADAS said that Mr. Runkel had stated that, under the current system, dollars are sent to districts based on the job that has to be done and based on what it costs to get it done in that district. He asked whether, if salaries are higher, the state would send that district more dollars to do the same job as a district where the average salaries are lower. Mr. Runkel said that is the current system.

REP. BOHARSKI asked Mr. Runkel about the 19% growth and whether that was 19% annual growth over four years. Mr. Runkel said that

was not 19% over each of the last four years, but 19% in a four-year period.

REP. BOHARSKI asked if the definition is expanding to encompass more students. Mr. Runkel said that the last reauthorization of the Education of the Handicapped Education Act, which is now called the Individuals With Disabilities Education Act, expanded the numbers of categories identified as special education disabilities. They now include autism and traumatic brain injury. He feels those changes did not dramatically impact the numbers served in Montana in special ed. The majority of growth is occurring in categories such as learning disabilities.

CHAIRMAN COBB said the next discussion would be the definition of a basic quality education. He read a partial list of discussion topics to be included in the meeting with the Board of Public Education (Board). He then introduced Dr. Wayne Buchanan, Executive Secretary to the Board of Public Education.

Dr. Buchanan said the committee had asked him to outline the process by which the Board developed the basic quality education definition. He said in May 1992 Governor Stephens requested that the board undertake the process of developing a definition of the basic system of free quality elementary and secondary schools which is the language in the Montana Constitution. The board voted unanimously to undertake that project.

Meetings began in June 1992, a schedule was established, and over 500 letters were received. Dr. Buchanan gave the committee the chronology of events, and talked about the mailings, work sessions and public hearings held throughout the summer of 1992. On August 25, 1992 the Board adopted, with minor changes, the language submitted by the former chairman of the Board as the basic definition. On October 14, 1992, the Board adopted the final language of the definition which was basically that adopted on August 25.

Questions From Committee Members and Responses: None.

CHAIRMAN COBB said the next overview would be on PL81-874 federal impact aid (874 funds) by Eddy McClure.

Ms. McClure said she started last July trying to deal with what could be done with PL 874, if anything. PL 874 is money given for a federal presence, i.e., Malmstrom Air Force Base and, predominantly in Montana, Indian reservations.

REP. PECK was under the impression that Montana was one of the few states that did not equalize 874 funds but that's not the case. As of 1989, five states have met the equalization test: New Mexico, Wisconsin, Alaska, Kansas and Michigan. Maine and Arizona have been decertified. She said Montana receives approximately \$21 million in 874 funds. To date, Montana does

not meet the three equalization tests: 1) the disparity standard (expenditure disparities per-student can't be greater than 25% in order for the federal government to allow equalizing 874 money into state formulas); 2) the wealth neutrality test (85% of total expenditures has to be wealth neutral) and, 3) discretion for exceptional circumstances (a state could be allowed to equalize if there were extreme situations). She said that dealing with the federal government is frustrating; during the July 1992 Special Session the state had outlined in HB 62 what state officials thought was what Washington wanted. Montana received a 10-page letter from the Department of Education that was vague and confusing.

She said that the U.S. Department of Education said the federal impact aid bill is up for reauthorization in 1993; the Department expects major changes and is proposing major amendments. Their advice to Montana was that it was not wise for any state to do major work on 874 funds because everything could be changing. She said the department told her they are looking at changing the equalization tests and looking at the entire package. She said, therefore, REP. PECK and she decided maybe this was not the time. She said she and REP. BOHARSKI have tried to decipher what they think they can clarify and change, and REP. BOHARSKI does have a bill draft request in to try to address some of the changes that need to be made in HB 62. Again, that will be contingent upon getting approval from the Department of Education. She closed with a comment that the state has approximately \$21 million in this funding; even if Montana was to meet the equalization tests or be allowed to equalize, there are certain amounts of those funds that still could not be touched.

REP. PECK said that he understood all 50 states shared in this money; however, there are only 22 states. He said he was informed by Washington, D.C. it was very questionable that it will be reauthorized because of Congressional budget-cutting.

REP. SIMPKINS asked whether, if one school is out of whack, the state loses the entire state funding; or whether it's based on a per-school or per-district basis.

Ms. McClure referred to page 4, second paragraph of Ms. Keenan's letter where it states, "In the event of a violation of section 5 B(1), the Department is precluded from making impact payments to any local education authority in the affected state."

CHAIRMAN COBB said Andrea Merrill would give a brief overview of the foundation program schedules.

Ms. Merrill gave a brief explanation of the foundation program schedule changes since the creation of the funding model the first year it was in effect, the 1951-52 school year.

REP. SIMPKINS referred to a report that clearly showed that the state has kept up with inflation, whereas increases in local mill

levies have far exceeded inflation rates. This showed that the disparity was really caused by uncontrolled spending on a local level. Ms. Merrill said that was correct for a lot of the years.

CHAIRMAN COBB said at this point the committee would prioritize its duties. Transportation issues may not be able to be addressed now and the committee should not spend its time discussing PL 874 money at this time.

REP. SIMPKINS asked Ms. McClure whether, in relationship to the Montana Constitution which requires the legislature to establish a school system, anyone has ever determined if the state has met that constitutional responsibility.

Ms. McClure said that whether the state has established a system is before the courts now. Obviously, there is some kind of system in place.

REP. KADAS said with the schedule of priorities outlined by CHAIRMAN COBB the committee would be assigned any bills concerning district unification and consolidation which do have an affect on equalization, although not a great deal. He said administrative costs should be included in discussions as that particular issue is connected to schedules. CHAIRMAN COBB said he would like to see them discuss K-12 unification. He asked the committee if consolidation has anything to do with equalization and if so, how do we want to handle that? If the committee doesn't want to discuss that, he would ask the Speaker to assign those bills to the regular House Education Committee.

REP. SIMPKINS said this Select Committee is in an unusual situation because if another committee passes out bills on consolidation and reorganization or works on a different funding mechanism, there could be two different proposals which will need to be merged. He suggested that REP. SONNY HANSON, Chairman of the House Education Committee, be asked to hold funding bills in that committee until this committee has made its decisions.

REP. BOHARSKI said it was the policy of the Speaker to send all bills through this committee and then to the education committee. REP. KADAS said that, once this committee is done with a bill, it will be rereferred to the education committee. REP. BOHARSKI said he wasn't sure if this committee should take up the consolidation bills.

REP. RUSSELL agreed with REP. KADAS about addressing administrative costs. She said the committee has a limited amount of time and should focus on district general fund and foundation program. REP. KADAS didn't believe the committee had to get involved with accreditation standards, just administrative costs.

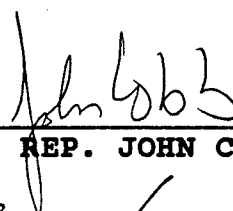
CHAIRMAN COBB replied to a question from REP. BOHARSKI that the committee would discuss state finances and other school funds at

the end of deliberations, if there is time. They will look at distribution of equalization funding which is the schedules, expenditure and taxpayer disparities, spending limitations, guaranteed tax base, administrative costs, and the last would be finance and fund structures.

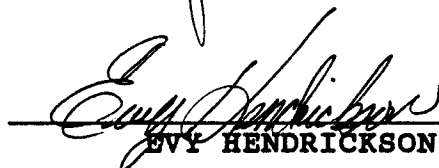
REP. KADAS suggested some ideas on how to begin the process and said he had a major data request from the Legislative Auditor's office, which is almost finished, concerning various school costs by district category. This is a broad overview of what's being spent where, by what size school, and this may be a place to begin.

ADJOURNMENT

Adjournment: 6:45 p.m.



REP. JOHN COBB, Chairman



EVY HENDRICKSON, Secretary

JC/eh/ls

HOUSE OF REPRESENTATIVES

School Funding

SUB-COMMITTEE

ROLL CALL

DATE

1-12-93

NAME	PRESENT	ABSENT	EXCUSED
Rep. John Cobb, Chairman	✓		
Rep. Ray Peck, Vice Chairman	✓		
Rep. Bill Boharski	✓		
Rep. Russell Fagg	✓		
Rep. Mike Kadas	✓		
Rep. Angela Russell	✓		
Rep. Dick Simpkins	✓		
Rep. Dave Wanzonried	✓		

SELECT COMMITTEE ON SCHOOL FUNDING

Date: Tuesday, January 12, 1993

Time: 3:00 p.m.

Room: 312 -2

Staff

Andrea Merrill	444-3593
Eddy McClure	444-3804
Dori Nielsen	444-3656
Evy Hendrickson	444-4828

Agenda

OVERVIEW of Montana School Funding

Current status of school lawsuits - Eddy McClure

Study committee efforts

HB 28 Implementation - Andi Merrill (etc.)

OPI Special Education Commission - Dori Nielson

Definition of basic quality education - Wyane Buchanan

PL81-874 overview and update - Eddy McClure

Foundation program schedules, history and structure -
Andi Merrill and Dori Nielson

Public Input

At the meeting on January 12th we will set and prioritize our agenda for the following weeks.



EXHIBIT 1
DATE 1-12-93

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF ELEMENTARY AND SECONDARY EDUCATION

THE ASSISTANT SECRETARY

RECEIVED

OCT 20 1992

OCT 20 1992

SUPERINTENDENT
OF PUBLIC INSTRUCTION

Ms. Nancy Keenan
State Superintendent
Office of Public Instruction
State Capitol
Helena, Montana 59620

Dear Superintendent Keenan:

This responds to your September 3 letter to Charles Hansen, Director of the Impact Aid Program which we received on September 14. In that letter, you requested an opinion as to whether section 12 of House Bill 62 (hereinafter section 12), enacted in July by the Montana legislature, complies with Federal law for the use of P.L. 81-874 funds. In addition, you posed a number of related specific questions. For the reasons described below, based upon our understanding of the Montana funding program, we conclude that section 12 of House Bill 62, while not invalid on its face or under all circumstances, could under some circumstances result in violations of section 5(d)(1) of the Impact Aid law, P.L. 81-874, 20 U.S.C. § 240 (d)(1). If those circumstances do not arise, there would be no violation of section 5(d)(1). In administering section 5(d)(1), the Department's focus is on the actual application of a law -- i.e., whether a State in fact takes Impact Aid payments into consideration in distributing State aid -- not on the facial validity of State legislation. Therefore, our opinion as to the validity of section 12 is dependent on the effects of the bill as applied.

Section 12 of House Bill 62 directs the trustees of a local educational agency (LEA) at the end of each school fiscal year to designate a portion of the general fund end-of-year fund balance to be earmarked as an operating reserve to be used to pay certain warrants to be issued in the subsequent fiscal year. With certain exceptions, the amount that may be designated as an operating reserve may not exceed the lesser of 10% of the ensuing year's final general fund budget or \$10,000. No minimum operating reserve is required.

Section 12(3) describes what happens to the general fund end-of-year balance that is not designated as operating reserve (the "unreserved fund balance"). It provides that the unreserved fund balance may be used to reduce the permissive levy under Montana Codes Annotated § 20-9-145 or the voted levy under Montana Codes

Annotated § 20-9-353 up to the level of the prior year's excess reserves. Any portion of the unreserved fund balance that is not used under section 12(3) to reduce the permissive and voted levies must be used for property tax relief under Montana Codes Annotated § 20-9-141(1)(b)(iii).

As we understand the Montana funding formula, use of the funds in the unreserved fund balance to reduce the permissive levy has the effect of reducing State aid that would otherwise be paid to LEAs. It is our further understanding that use of these funds to reduce the voted levy or general fund net levy would not result in reduced State aid; and therefore those uses present no section 5(d)(1) problems.

For the reasons explained below, it appears that section 12 could result in funds considered Impact Aid remaining in the unreserved fund balance and that LEAs could have their State aid reduced as a result of the ensuing reduction in the permissive levy. This would conflict with section 5(d)(1) of the Impact Aid law which provides that

no [Impact Aid] payments may be made . . . for any fiscal year to any local educational agency in any State . . . if that State has taken into consideration payments under this title in determining . . . the amount of such aid with respect to any such agency; during that fiscal year or the preceding fiscal year . . . if such State makes [State] aid available to local educational agencies in such a manner as to result in less State aid to any local educational agency which is eligible for payments under this title than such agency would receive if such agency were not so eligible.

20 U.S.C. § 240(d)(1).

Judicial and administrative interpretations of section 5(d)(1) of the Act have held that reducing State aid by ending fund balances that necessarily include Impact Aid funds violates section 5(d)(1). See San Miguel Joint Union School District v. Ross, 173 Cal. Rep. 292, 118 Cal. App. 3d 82 (1981), In the Matter of Fourteen South Dakota School Districts, Docket No. 88-29, p. 5 (October 6, 1988) (both enclosed). Since Impact Aid funds are commingled with a district's general funds, the Impact Aid Program considers that the ending fund balances of a district that is an Impact Aid recipient consist of Impact Aid in the same proportion as Impact Aid is to the district's total revenues.

Your regulations (Mont. Admin. R. 10.22.104 (3)(a)) provide that unreserved fund balances must first be used to reduce the permissive levy upon which guaranteed tax base aid (GTB aid) is paid by the State under Montana Codes Annotated § 20-9-367. GTB aid is paid to school districts whose district mill value per

Page 3 - Ms. Nancy Keenan

"average number belonging" (ANB) is less than the Statewide district mill value per ANB, in essence those with tax bases per student below the Statewide tax base per student. Eligible LEAs receive a certain amount of State aid per mill of the levy. The fact that any funds remaining in the unreserved fund balance would first be used to reduce the permissive levy which in turn reduces GTB State aid for districts eligible for such aid increases the likelihood that violations of section 5(d)(1) could arise. If your regulations provided that unreserved fund balances had to be used to reduce the voted levy or general fund net levy before they are used to reduce the permissive levy, the likelihood of a section 5(d)(1) violation arising would be reduced.

Although Section 12 contains exceptions to the 10% limitation that would allow trustees to include at least some of the ending fund balances that would be considered Impact Aid in the operating reserve, nothing requires them to include those funds in the operating reserve. Therefore, the funding formula as amended by Section 12 would authorize the inclusion of funds considered Impact Aid in the unreserved fund balance and the loss of State aid could result due to the reduction in the permissive levy.

Furthermore, although section 12 contains specific exceptions regarding Impact Aid receipts authorizing trustees to exceed the 10% cap on the operating reserve, even where trustees of Impact Aid LEAs take maximum advantage of these exceptions, funds considered Impact Aid could remain in the unreserved fund balances of some LEAs. In other words, in some circumstances, the exceptions do not authorize the inclusion in the operating reserve of all general fund end-of-year funds considered Impact Aid.

For example, for fiscal year 1993, Section 12(7) provides that "the average of the three previous years' ratio of total district general fund revenue to Public 81-874 money received" may be included in the reserve. (In a recent telephone conversation with an attorney in our Office of General Counsel, Ms. Ferestad of your staff explained that a technical correction has been or will be made to this language; the correct ratio to be averaged is Impact Aid received over total district general fund revenue.) Under some circumstances, use of the three year average ratio of Impact Aid revenues to total revenues does not permit the inclusion of all funds considered Impact Aid in the reserve. If the average ratio is less than the current year ratio, the Department would take the position that funds in the ending balance considered Impact Aid are not covered by the exception.

Under sections 15(3) and (5)(B) of House Bill 62, section 2 of the bill is effective immediately and retroactively unless section 12 becomes effective following an opinion from this

Department that section 12 is lawful. Section 2 is generally similar to section 12 and presents the same issues with regard to section 5(d)(1) of P.L. 81-874. While it does not on its face violate section 5(d)(1) of the Impact Aid law, it could result in such a violation as applied (e.g., an LEA's trustees fail to place funds considered Impact Aid in the operating reserve).

In the event of a violation of section 5(d)(1), the Department is precluded from making Impact Aid payments to any LEA in the affected State. Where payments have already been completed for a year in which a violation of section 5(d)(1) is found, the Department would establish overpayments for the Impact Aid paid to LEAs for that year.

Turning now to the specific questions in your letter, following are our responses to the questions which are in bold print:

1) How do federal laws or regulations restrict the amount of a district's end-of-year fund balance that can be identified as P.L. 81-874 funds and be earmarked as operating reserve or excessive reserve?

The answer to this question has been provided in the foregoing discussion. It should also be noted that Impact Aid regulations that became effective beginning with fiscal year 1987, provide that an Impact Aid applicant can receive payments for children claimed under section 3 of the Act only if "[t]he State provides funds for the education of those children on the same basis as all other public school children in the State, unless permitted otherwise under section 5(d)(2) of the Act." 34 C.F.R. § 222.80(c).

2) May Montana statutes limit the amount of P.L. 81-874 funds that can be identified as operating reserve or excess reserve to include only the current year receipts of P.L. 81-874 funds as stated in House Bill 62, Section 12(5)?

If current year Impact Aid receipts are in fact placed in the operating reserve or excess reserve there would be no section 5(d)(1) violation. However, as explained above, mere authorization to include funds considered Impact Aid in the operating reserve would not prevent a section 5(d)(1) violation if the authority is not exercised and the funds are used to reduce the permissive levy. This response is based upon our understanding that in each fiscal year the unreserved fund balance is depleted for tax reduction such that prior year funds considered Impact Aid would not be in the unreserved fund balance used to reduce the permissive levy.

3) May the State of Montana limit the portion of the fund balance identified as P.L. 81-874 money to the average of the 3 previous years' ratio of P.L. 81-874 money to total district

Page 5 - Ms. Nancy Keenan

general fund revenue received as stated in House Bill 62, Section 12(7)?

As explained on page 3, in certain circumstances this approach could result in violations of section 5(d)(1).

4) Under Montana Codes Annotated, a district's maximum general fund budget may not exceed the greater of 135% of the foundation program amount or 104% of the districts general fund budget amount for the previous school year. An exception to the maximum allowed is when the source of funding for the excess amount is P.L. 81-874 funds. Therefore, P.L. 81-874 recipient districts are allowed to exceed their budget caps. May the state codes require that the P.L. 81-874 recipient districts limit their general fund budgets just as other districts are limited?

Yes, so long as State aid is not reduced as a result.

5) May districts receiving P.L. 81-874 funds place portions of this revenue (even transferring it from the general fund excess reserves) in a fund for capital outlay, to compensate for the lack of tax base to fund building projects?

Yes, however the transfer must be irrevocable or the transferred funds will be considered available for current expenditure under certain needs tests under the Impact Aid law.

6)(a) Federal regulations (Section 5(d)(1) of P.L. 81-874) prohibit the state from reducing the amount of "state aid" paid to school districts based on their receiving Impact Aid. Separate from the "Foundation Program", which is our state aid to school districts, the 1989 legislature implemented a statewide "guaranteed tax base subsidy" program to provide equalized funding at the local level. Under the program, the state makes a payment in-lieu-of-taxes when a district with below-average mill value per student levies a mill in support of the "permissive" part of the budget. In this way, each mill levied in any district in the state in support of the permissive portion of the budget is guaranteed to produce the statewide average mill value per student. Districts with an average to above-average mill value per student are not eligible for the subsidy. Does "state aid" as used in the Federal regulation 5(d)(1) include our guaranteed tax base program, which is designed to provide a payment in-lieu-of-taxes when the taxpayer is charged a mill?

For purposes of section 5(d)(1), "State aid" is defined to mean "any contribution, no repayment for which is expected, which is made by a State to or on behalf of local educational agencies within the State for current expenditures in the provision of free public education." 34 C.F.R. § 222.61(d)(1). Based upon the description of the "guaranteed tax base subsidy" (GTB aid)

EXHIBIT 1
DATE 1-12-93
X

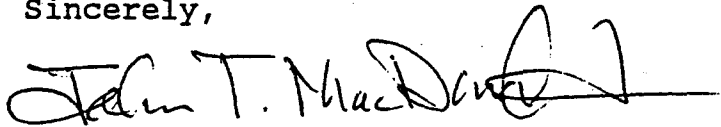
Page 6 - Ms. Nancy Keenan

contained in your question, and our review of the materials you provided, it falls within the regulatory definition.

(b) Would a state law mandating all unreserved fund balance, including any amount therein which may be attributable to P.L. 81-874 received, be used to fund the permissive portion of the budget (i.e., reduce the levies required) be in accordance with Federal regulations for the P.L. 81-874 program?

No, because the reduction in mills under the permissive levy would reduce State aid that would otherwise be paid.

The answers provided above are based on the information and materials you have provided us and our understanding of Montana State law. If we can be of further assistance, please call me or Charles Hansen, Director of the Impact Aid Program at (202) 401-3637.

Sincerely,

John T. MacDonald