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IMPROVING ARIZONA'S FINANCIAL MANAGEMENT

ATRA's state budget recommendations

The Arizona state budget is in the fifth year of a structural deficit where ongoing spending exceeds ongoing revenue. Despite widespread recognition of the state's budget problem, the Legislature and Governor increased spending 13.2% for fiscal year (FY) 2005. Two-year spending for the 46th Legislature climbed $1.3 billion, or 22.3%.

Much of what drives state government expenditures involves formulas. Some formulas are as simple as multiplying an established dollar amount by the number of people served, or eligible to be served, by a particular program. In most cases, however, spending formulas are considerably more arcane and complex. Undoubtedly, formulas can be useful tools in the budget-making process, providing benchmarks to determine annual funding levels.

As with other tools, however, it is unwise to allow these state funding formulas to run on automatic, performing the appropriator's work unchecked. In too many cases, formulas contain hold harmless provisions, or merge with other formulas, or become obsolete altogether, resulting in spending that lacks accountability or that is replete with redundancies. These same flawed spending formulas are sometimes referred to as "statutory" or "non-discretionary" or are grouped unnecessarily with voter-mandated spending.

ATRA has pointed out that budget shortfalls provide a good opportunity for legislators to simplify, repair, and regain control of these formulas and, to a considerable extent, the appropriations process. The 47th Legislature should make every effort to avoid the kind of recent budget decisions that have relied on deficit financing and budget gimmickry.

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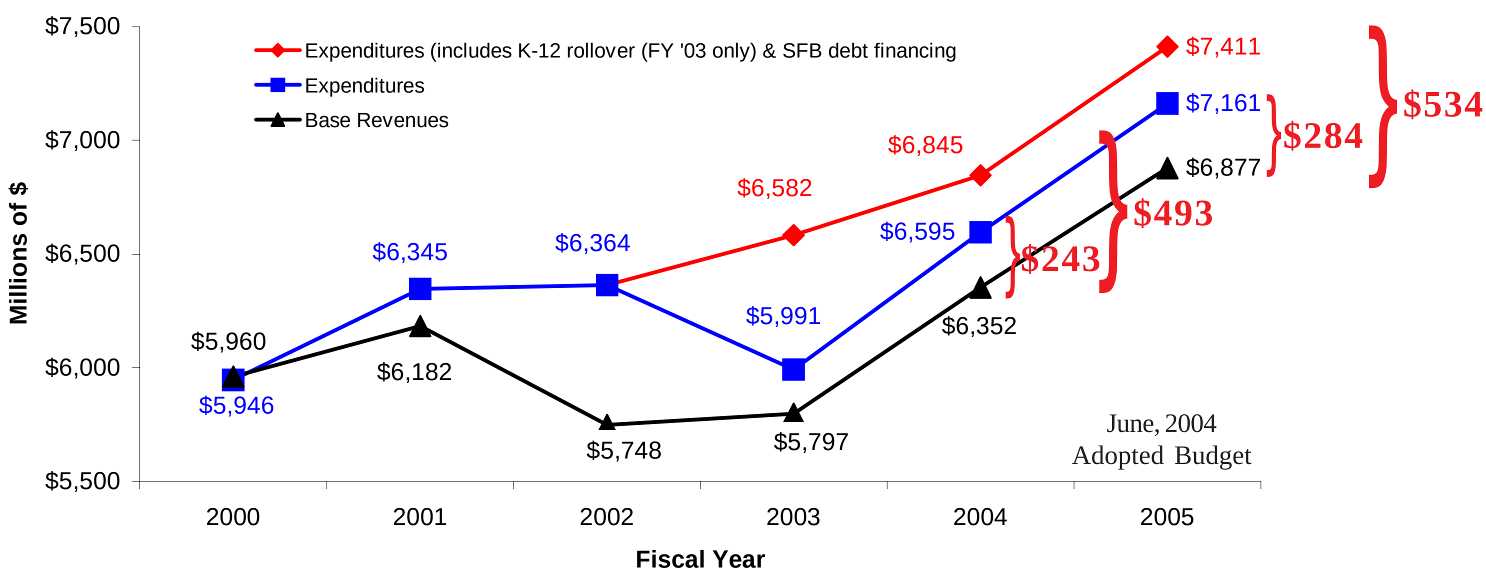
ARIZONA'S ONGOING STRUCTURAL DEFICIT

Comparison of General Fund Revenues & Expenditures

Excludes beginning balance, one-time revenues & expenditures, & Prop 301



Data source: JLBC

	2000	2001	2002	2003	2004	2005
Beg. Balance: (in millions)	255	203	13	1	18	243

IMPROVING ARIZONA'S FINANCIAL MANAGEMENT

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The following are several specific recommendations to reform such problematic formulas in K-12 and higher education that are the result of either **flawed policies** or simply **sloppy budgeting**. ATRA encourages the Legislature to apply similar scrutiny to other statutory formulas such as those in corrections, health care, and retirement funding.

Reform agency authority to transfer line item funds between budgets: State agencies have the authority, subject to approval from the Department of Administration, to transfer funds between line items of their budgets in order to balance revenues with expenditures within a budget. A recent use of this transfer authority has exposed a lack of oversight and accountability by the Legislature in this policy. The Superintendent of Public Instruction has announced his intention to use $10 million in excess "additional state aid" revenue from the state general fund (see above) to fund a new tutoring program. This transfer authority was not intended to allow agency heads to circumvent the appropriations process to use "found money" to create new programs. The Legislature should reform this policy to maintain the integrity of the appropriations process.

Manage the general fund exposure to additional state aid costs: "Additional state aid" is money that the state pays to school districts in recognition of what residential property taxpayers would pay were it not for the 35% homeowner's rebate and the one-percent constitutional cap on primary taxes. Despite efforts to contain property tax growth through the state's adherence to the truth-in-taxation laws (TNT), growth in local school district property taxes for desegregation/OCR, excess utilities, career ladder, and transportation will result in increased exposure to the state general fund. For FY 2005, the Legislature appropriated $296,669,700 in additional state aid. The state should minimize its exposure to homeowner rebate and one-percent cap costs by capping local school district levies that are outside the school district equalization system.

Don't exaggerate your obligation to adjust for inflation: Enacted by Prop. 301 in 2000, §15-901.01 requires the Legislature to "increase the base level ***or*** other components of the revenue control limit by two per cent" [emphasis added]. Some have argued that (for the purposes of this statute only, apparently), *or* means *and*. Therefore, goes the argument, the Legislature is required to apply the 2% factor to both the base level *and* other components of the revenue control limit (RCL). During the 1990s, mandatory inflation adjustments were purposefully removed from statute because of the detrimental impact they can have on the appropriations process in lean years. If there are sufficient funds to adjust formulas for inflation, then there is no reason for the Legislature not to make such adjustments. Increases in funding to hold government harmless for the impact of inflation when the state is facing a deficit of this magnitude is a certain recipe for tax increases. Citizens and taxpayers are not held harmless for the impact of inflation. If the Legislature wants to adjust the base level by 2%, it should make that decision because it desires to do so and it has the revenue to do so — not because it is a legal requirement. Further, if such an adjustment is made to the base level, no such adjustment should be made to "other components" such as the transportation support level (TSL).

Phase out career ladder: Despite the fact that Prop. 301 helped set a policy direction toward performance pay for all school districts in the state, 28 school districts currently have the legal authority to participate in a "career ladder" program. The number of participating districts was capped as of FY 1994 because of concerns raised about the cost and effectiveness of the program. According to the Joint Legislative Budget Committee (JLBC), $24,389,800 was levied in local property taxes for career ladder in FY 2004, while $36,350,400 was appropriated from the general fund. Property tax levies on residential property for career ladder also exposes the state general fund to additional state aid costs. Because it is available to only 28 districts, career ladder contributes greatly to inequities in Arizona's school district spending and taxation.

Cap the transportation revenue control limit: State law provides two K-12 formulas for transportation — the transportation support level (TSL) and the transportation revenue control limit (TRCL). The TSL formula involves the average daily route miles per eligible student transported. Additional factors in the formula reflect academic, vocational, and athletic trips, as well as students with disabilities. The formula can result in changes as variables in the transportation calculation of the district change. Meanwhile, the TRCL calculation can change in only one direction — up. To calculate the TRCL, the previous year's TRCL is adjusted by growth, if any, in the TSL. In other words, if the TSL formula results in more funding, the TRCL grows by the same amount. If there was no growth in the TSL, or even if it declined, the TRCL is held harmless. In 1980, the year the current system was adopted, the TSL and the TRCL were

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STATE BUDGET RECOMMENDATIONS

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approximately equal. Over the last two decades, as the actual transportation needs of districts have changed, this "hold harmless" funding mechanism has resulted in the TRCL outpacing the TSL by approximately $49 million in FY 2004. That's $49 million in transportation funding for students who are not there. The state's equalization formula (with only a handful of exceptions) recognizes only the TSL. School district budgets, however, use the TRCL. What this means is that the $49 million to transport ghosts is falling mostly to local property taxpayers. The cost to the state general fund is approximately $13 million through additional state aid in recognition of the homeowner rebate and the one-percent cap.

Move from the "prior year plus growth" to current year funding: School district funding is based on the prior-year's 100th day student count plus current year growth. The system therefore holds districts harmless for reductions in enrollment from the prior year, even though state taxpayers may be funding those very same students at another district or charter school.

Ensure districts properly withdraw students: Numerous cases have emerged where students are being counted in two districts because one of the districts failed to complete withdrawal paperwork. The Legislature needs to continue to develop checks on student counts and ensure that state dollars in the system follow the child.

Eliminate or reduce rapid decline funding: School districts that experience declining enrollment for more than one year (they are held harmless automatically for the first year) may be eligible for additional "rapid decline" funding. ATRA supports the Legislature's effort to fund rapid decline at 50%, which was vetoed by the Governor in FY 2004 but survived in FY 2005.

Eliminate student count adjustments for the "concerted refusal by students to attend classes": Districts are allowed to adjust their student counts in certain circumstances, such as widespread illness or adverse weather conditions. Surprisingly, this list also allows an adjustment for "concerted refusal by students to attend classes for three consecutive days or more." Again, sometimes these students are actually attending another district or charter school.

Reform joint technological education districts (JTEDs) to increase efficiency and avoid redundancies: A recent report from the Arizona Auditor General confirms numerous concerns and observations that ATRA has communicated to the Legislature for years. JTEDs were originally conceived as opportunities to increase efficiency by centralizing the investment in vocational training facilities and technology. Growth in so called "satellite" JTED courses conducted in high schools and community colleges goes counter to the original purpose for JTEDs and has resulted in inefficient and redundant funding. Reforms should be targeted toward increasing efficiency and avoiding redundancy.

Revisit building renewal and new construction formulas: Several adjustments to Students FIRST formulas should be made. ATRA supports the Legislature's effort to reform the building renewal formula. Similar scrutiny should be applied to the new construction formula, especially in regards to population growth estimates used to determine when districts qualify for new schools.

Eliminate invisible square footage for new construction qualification calculations: School district square footage that is built with local option dollars (class B bonds or overrides) is invisible to the state, while students within the walls of that square footage are not invisible in the "pupil per sq. foot" calculation to determine if a school qualifies for new construction.

Eliminate automatic 5% additional funding for statutorily-defined "rural" districts: Students FIRST statutes require the School Facilities Board (SFB) to add 5% to new construction and building renewal formulas for "rural areas." Rural is defined as a district outside a 35-mile radius from the boundary of a municipality with a population of more than 50,000. The formula generates some interesting results. Globe is rural; Miami is urban. Skull Valley is rural; Kirkland is urban.

Allocate university appropriations in accordance with enrollment growth: For primarily political reasons, general fund appropriations to the universities have strayed considerably over the years from the growth formula guidelines . The result is that there now exists a sizeable per-student funding inequity between Arizona's three public universities. The Legislature should begin immediately to close this funding gap by appropriating whatever dollars are available for the universities proportionate to where enrollment growth is occurring.

Eliminate the community college hold harmless formula: Operating state aid for colleges increases through student growth, but never decreases for declining student counts. For example, say a hypothetical district started with 1,000 full time student equivalents (FTSE). In the following year, that district's student count declined resulting in 800 FTSE. The funding formula holds the district at the 1,000-FTSE funding level. If that district gains those 200 FTSE in the year after that, those FTSE are counted as growth and added to the base. In effect, then, the formula generates 1,200 FTSE worth of funding for only 1,000 FTSE. Community college funding should be reformed so that student-based funding follows the students.

Reduce or eliminate redundant funding through dual and concurrent enrollment: Community colleges, high schools and joint technological education districts often enter into agreements that can result in two or more entities counting the same students for the same seat time for funding purposes. Funding should go only to the entity providing the services or should be distributed proportionately.

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RECOMMENDATIONS TO IMPROVE ARIZONA'S FINANCIAL MANAGEMENT

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Eliminate the community college "equalization assistance" formula: Four of Arizona's eight "rural" community college districts qualify for equalization assistance from the state general fund. The key driver in this formula is the average net assessed value (NAV) for the eight districts. The further a district is from the average, the more money it gets from the state. Valuation growth in Coconino and Yavapai counties has been driving a wedge into the formula resulting in greater exposure for the state general fund. The formula for FY 2005 resulted in an estimated $15.5 million cost to the general fund. The equalization assistance formula was designed to provide money to Eastern Arizona College when the system was established. If the formula were eliminated, the state could support Eastern through direct appropriation.

Eliminate state aid to community colleges for recreational classes: The state's taxpayers have an interest in providing funding to community colleges for academic and technological training. However, taxpayers can and should question what it is the state is paying for when credit is awarded for a course and thus are funded at the state level. Courses like *Single Again*, *Coping with Stress*, *Humor and Play*, and *Creative Grandparenting* have appeared in community college catalogs. Other courses that have been offered in Arizona community colleges might lead one to question whether they are truly at a college level: *Approaching Math Positively*, *Notetaking*, *Testing Tips*, and *How to Study* are all offered for college credit and therefore generate state funding.

Stop adding to the problem: Every year, the Legislature is asked to codify in statute a host of formulas that further erode the Legislature's flexibility to deal with spending demands and priorities. Worse, in order to side-step the difficulty of funding new programs, the costs are often phased in, leaving to future legislatures the real burden for funding them.