

EDUCATION FINANCE COMMITTEE

The Education Finance Committee was assigned three responsibilities. Sections 9 and 6 of 1995 Senate Bill No. 2519 directed a study of the financing of elementary and secondary education and the availability of state support for school construction, a review of formulas used to equalize state aid in the areas of transportation and special education, a review of funding sources that could be alternatives to property taxes, and a review of supplemental payments to high school districts. The Legislative Council also directed the committee to monitor implementation of the special education block grants as provided for by Senate Bill No. 2063 (1995). The committee incorporated this directive in its study of the financing of elementary and secondary education. The Legislative Council chairman instructed the committee to review the report on the performance audit of the Department of Public Instruction.

Committee members were Senators Layton W. Freborg (Chairman), Tony Grindberg, Jerome Kelsh, Rolland W. Redlin, Steven W. Tomac, Terry M. Wanzek, and Jim Yockim and Representatives Ole Aarsvold, James Boehm, Jack Dalrymple, David Drovdal, Tom D. Freier, William E. Gorder, Lyle L. Hanson, Ruth E. Holm, Dennis Johnson, Joe Kroeber, Richard Kunkel, David Monson, Ronald Nichols, Catherine Rydell, and Dennis J. Schimke. Representative Andy Hagle was also a member of the committee until his death in March 1996.

The committee submitted this report to the Legislative Council at the biennial meeting of the Council in November 1996. The Council accepted the report for submission to the 55th Legislative Assembly.

FINANCING OF ELEMENTARY AND SECONDARY EDUCATION STUDY

Background

Initiation of the Foundation Aid Program

A foundation aid program designed to provide financial assistance to local school districts has been in effect in North Dakota since 1959, when the Legislative Assembly enacted a uniform 21-mill county levy and provided a supplemental state appropriation to ensure that school districts would receive 60 percent of the cost of education from nonlocal sources. This initial program was adopted in part because the Legislative Assembly recognized that property valuations, demographics, and educational needs varied from school district to school district. The Legislative Assembly embraced the broad policy objective that some higher cost school districts in the state "must continue to operate regardless of future school district reorganization plans." Taking into account the financial burdens suffered by the low valuation, high per student cost school districts, the Legislative Assembly forged a system of weighted

aid payments that favored schools with lower enrollments and higher costs. This initial program also allocated higher weighting factors to districts that provided high school services.

The 1970s

For the next several years, the foundation aid program remained essentially unchanged. However, federal and state courts were beginning to address issues of spending levels for elementary and secondary education and whether those levels should be dependent upon the wealth of the school district in which a student resides. The Legislative Assembly, in an attempt to preempt the issue in North Dakota, responded by amending the foundation aid program in a way that evidenced a higher level of sophistication. The state more than doubled the per student payments and replaced the flat weighting factor with one that recognized four classes of high schools. Elementary weighting factors were altered as well. Adjustments continued to be made during the mid-1970s. A new category encompassing seventh and eighth grade students was created and fiscal protection for schools experiencing declining enrollments was instituted. This latter provision ensured that no school district could receive less in foundation aid payments for a current year than that district would have received based on its enrollment during the previous school year. For the 1975-77 biennium, the foundation aid appropriation was \$153.4 million. In 1979 the Legislative Assembly appropriated \$208.4 million for the foundation aid program and added an additional appropriation of \$1 million to pay for free public kindergartens.

The 1980s

The next major development affecting education finance occurred with the approval of initiated measure No. 6 at the general election in November 1980. This measure imposed a 6.5 percent oil extraction tax and provided that 45 percent of the funds derived from the tax must be used to make possible state funding of elementary and secondary education at the 70 percent level. To meet this goal, the 1981 Legislative Assembly allocated 60 percent of the oil extraction tax revenues to the school aid program. Initiated measure No. 6 also provided for a tax credit that made the 21-mill levy inapplicable to all but the owners of extremely high value properties. The Legislative Assembly eliminated the 21-mill county levy and increased state aid to compensate for the revenues that would otherwise have been derived from the levy.

During the early 1980s, discussions continued to center around purported funding inequities. Districts spending similar amounts per student and having similarly assessed valuations were not levying similar amounts in property taxes to raise the local portion of education dollars. It was alleged that the system encouraged some districts to levy much smaller amounts than their spending

levels and assessed valuations would seem to justify.

In response, the Legislative Council's Education Finance Committee, during the 1981-82 interim, examined a method of funding education known as the "70-30" concept. This proposal was a significant departure from the existing foundation aid formula in that it took into account the cost of providing an education in each school district. The formula required determination of the adjusted cost of education, and then required the computation of a 30 percent equalization factor to arrive at each district's entitlement. It was contemplated that a local mill levy would be employed to raise the district's local share of the cost of education.

Proponents touted this approach as one that included a comprehensive equalization mechanism and which recognized local variances in the cost of education. Opponents argued it did nothing more than award high spending districts and penalize those that had been operating on restricted budgets. The interim committee did not recommend the concept.

Discussions regarding the many aspects of education finance continued through the 1980s. Legislative Council interim committees explored weighting factors, considered the effects of increasing the equalization factor, and explored the excess mill levy grant concept. During the 1987-88 interim, the Education Finance Committee established specific goals and guidelines to guide its deliberations on matters of education finance. While the interim committees have articulated the need to alter the state's education funding system, they could reach little agreement beyond recommending increases in the level of per student aid.

State Litigation

In 1989 legal action was initiated for the purpose of declaring North Dakota's system of public school finance unconstitutional. The complaint in *Bismarck Public School District No. 1 v. State of North Dakota* charged that disparities in revenue among the school districts had caused corresponding disparities in educational uniformity and opportunity which were directly and unconstitutionally based upon property wealth.

On February 4, 1993, after hearing 35 witnesses and examining over 250 exhibits, the district court issued 593 findings of fact and 32 conclusions of law. The court listed these "constitutionally objectionable" features of the school financing system:

- Disparities in current revenue per pupil are the result of variations in school district taxable wealth.
- The 22-mill equalization factor in the foundation aid formula fails to equalize for variations in district wealth because the equalization factor is below the state average school district tax rate for current revenue and leaves much of the school millage outside the foundation formula.
- The low level of foundation educational

support fails to ensure substantial equality of resources for children in similarly situated school districts.

- The use of cost weightings that are inaccurate unjustifiably benefits districts with large amounts of taxable wealth.
- The flat grant allocation of tuition apportionment ignores the vast differences in taxable wealth among school districts and operates as a minimum guarantee for wealthy districts.
- The transportation aid program exacerbates existing resource disparities by reimbursing some, often wealthy, districts for more than the actual cost of transportation to the district and require other, often poorer, districts to fund a substantial share of transportation costs from other revenue sources.
- The special education funding program exacerbates existing resource disparities by giving higher spending districts an advantage in obtaining state reimbursement of special education costs and requiring school districts to fund a large share of the excess costs of special education programs from the disparate tax basis of school districts.
- The state aid for vocational education exacerbates existing resource disparities.
- The state system for funding school facilities relies on the unequal taxable wealth of school districts.
- The payment of state aid to wealthy districts maintains large ending fund balances.
- The failure of the state to ensure that resource differences among school districts are based on factors relevant to the education of North Dakota children rather than on the unequal taxable wealth of North Dakota school districts.

The district court declared the North Dakota school financing system to be in violation of Article VIII, Sections 1 and 2, and Article I, Sections 21 and 22, of the Constitution of North Dakota. The Superintendent of Public Instruction was directed to prepare and present to the Governor and the Legislative Assembly, during the 1993 session, plans and proposals for the elimination of the wealth-based disparities among North Dakota school districts.

Response to the Litigation

In response to the district court's order, the Superintendent of Public Instruction presented the following recommendations to the 1993 Legislative Assembly:

- Raise the per student payment to \$3,134.
- Fund special education by dividing the 13 disabilities categories into three broad categories and assigning weighting factors to each.
- Fund vocational education by assigning weighting factors to high cost and moderate cost programs.
- Provide transportation reimbursements based

on six categories of density.

- Provide state funding of education at the 70 percent level.
- Establish a uniform county levy of 180 mills.
- Distribute tuition apportionment in the same manner as foundation aid.
- Provide that federal and mineral revenues in lieu of property taxes and districts' excess fund balances be part of a guaranteed foundation aid amount.
- Allow districts the option of levying 25 mills above the 180-mill uniform county levy.
- Require that all land be part of a high school district and that districts having fewer than 150 students become part of a larger administrative unit.
- Provide \$25 million for a revolving school construction fund.

As introduced, House Bill No. 1003 (1993) was the appropriations bill for the Superintendent of Public Instruction. As it progressed through the legislative process, it became the principal 1993 education funding enactment. The bill:

- Set the state support for education at \$1,572 per student for the first year of the 1993-95 biennium and at \$1,636 for the second year.
- Raised the equalization factor from 21 to 23 and then to 24 mills.
- Set weighting factors at 25 percent of the difference between the prior statutory amount and the five-year average cost of education per student, as determined by the Superintendent of Public Instruction, for the first year of the biennium and at 50 percent of the difference for the second year of the biennium.
- Capped state transportation payments at 100 percent for the first year of the 1993-95 biennium and at 90 percent for the second year of the biennium and directed that any savings resulting from imposition of the 90 percent cap during the second year of the biennium be used by the Superintendent of Public Instruction to increase the per student transportation payments available under North Dakota Century Code (NDCC) Section 15-40.1-16.
- Reiterated the existing statutory requirement that school districts admitting nonresident students charge tuition but exempted school districts that admit nonresident students from other districts offering the same grade level services.
- Directed the Legislative Council to conduct another study of education finance and appropriated \$70,000 for purposes associated with the study, including necessary travel and consultant fees.

1993-94 Interim Study

The Legislative Council's interim Education Finance Committee began its efforts during the 1993-94 interim before an appeal of *Bismarck Public School District No. 1* was taken to the North Dakota Supreme Court. The committee was

aware that many of the issues addressed by the trial court had been the subject of interim studies and legislative deliberations for many years. However, the committee also realized that the requisite number of Supreme Court justices (four) might not necessarily agree with the lower court's determination that the state's system of funding education was unconstitutional.

The North Dakota Supreme Court issued its decision on January 24, 1994--*Bismarck Public School Dist. No. 1 v. State of North Dakota*, 511 N.W.2d 247 (N.D. 1994). Only three of the five justices held that the state's education funding system was unconstitutional.

A majority of the Supreme Court indicated that there were three principal areas in need of attention--in lieu of revenues, equalization factors, and transportation payments. The Supreme Court did not, however, mandate specific legislative action. The court indicated the areas of concern and then left it up to the Legislative Assembly to determine how those areas should be addressed. In a dissenting opinion, Chief Justice VandeWalle stated:

[T]he present funding system is fraught with funding inequities which I believe have not yet transgressed the rational-basis standard of review but which appear to me to be on a collision course with even that deferential standard.

The Supreme Court decision was issued midway through the 1993-94 interim. By the time the Education Finance Committee had completed its work, it had considered 35 bill drafts and three resolution drafts. Twenty-seven pieces of legislation were recommended to the Legislative Council for introduction during the 1995 legislative session.

The committee's recommendations included increases in the minimum high school curriculum; establishment of an additional Governor's school; appropriation of funds for elementary summer school programs, professional development programs, professional development centers, and refugee student assistance; placement of all land in a high school district; alteration of the weighting categories; a variable equalization factor; reclassification of special education categories; distribution of tuition apportionment according to average daily membership; an increase in transportation payments from 28 cents to \$1 per day for all students transported by schoolbuses; and an \$80 million increase in the level of foundation aid over that appropriated during the 1993-95 biennium.

Response by the 1995 Legislative Assembly

Although the 1995 Legislative Assembly enacted a variety of bills dealing with education and education finance, the most significant provisions were found in three bills--Senate Bill No. 2059, Senate Bill No. 2063, and Senate Bill No. 2519.

Senate Bill No. 2059 dealt with the funding of

transportation. The bill maintained the per mile payment of 25 cents for small buses and 67 cents for large buses and it added a payment for in-city transportation of 25 cents per mile. The per head payment for in-city students riding schoolbuses or commercial buses was increased from 17.5 cents to 20 cents per one-way trip. The 90 percent cap on payments, which was instituted by the 1993 Legislative Assembly, was left in place.

Senate Bill No. 2063 dealt with the funding of special education. The bill provided that \$10 million must be used to reimburse school districts for excess costs incurred on contracts for students with disabilities, for low-incidence or severely disabled students, and for certain boarding care. The bill also provided that \$400,000 must be used to reimburse school districts for gifted and talented programs approved by the Superintendent of Public Instruction and \$500,000 must be used to reimburse school districts with above-average incidence of moderately or severely disabled students. Any amount remaining in the special education line item must be distributed to each school district in accordance with the number of students in average daily membership. The line item for special education was \$36,850,000. The bill also provided that during the 1995-96 school year, no district or special education unit may receive less than 95 percent of the amount it received during the 1993-94 school year, excluding reimbursements for student contracts, boarding care, and gifted and talented programs. During the 1996-97 school year, no district or special education unit may receive less than 90 percent of that amount.

Senate Bill No. 2519 provided an increase in the per student payment for small but necessary elementary and high schools and increased by 20 percent the weighting factors applied to students attending school out of state. The bill raised the equalization factor from 24 mills to 28 mills for the first year of the biennium and to 32 mills for the second year of the biennium, and provided that thereafter the equalization factor would be tied by a mathematical formula to increases in the level of foundation aid. The equalization factor would not fall below 32 mills nor rise above 25 percent of the statewide average school district general fund mill levy. Weighting factors, which had been set at 50 percent of the difference between the factor stated in statute and the five-year average cost of education per categorical student, were left at 50 percent of the difference for the first year of the biennium and then raised to 65 percent of the difference for the second year. High school districts whose taxable valuation per student and whose cost of education per student are both below the statewide average are entitled to receive a supplemental payment, again based on a mathematical formula. The sum of \$2,225,000 was appropriated for supplemental payments. The payments, however, are effective only through June 30, 1997. Per student payments were set at \$1,757 for the first year of the biennium and at \$1,862 thereafter.

The 1995 Legislative Assembly appropriated \$517,598,833 for foundation aid, transportation aid, supplemental payments, tuition apportionment, and special education. That figure exceeds the 1993-95 appropriation by \$41,561,941.

School Construction - Testimony and Conclusion

Before 1964, there were only five court cases in which the constitutionality of school finance was challenged. The generic profile of school districts, however, was being replaced by a variety of characteristics. Some districts became larger, while others became smaller. Some were left with a declining agricultural tax base, while others were able to take advantage of urban sprawl. The resulting diversity in the ability to access dollars prompted charges of inequity and an onslaught of court cases across the nation. The court cases addressed issues of equity and adequacy in terms of general operating revenues--dollars necessary to pay teachers and to purchase supplies and equipment. The committee was told that future court cases are expected to extend their focus to issues of equity and adequacy in terms of capital construction.

North Dakota, like similarly situated states, has experienced the development of new programs, increased demand for teacher inservice activities, increased demand for technological updating, declining student numbers in the rural areas, and a reluctance on the part of taxpayers to accept additional taxes on state and local levels. School districts have responded by prioritizing their financial requirements. Because facility maintenance and construction do not have the same actual or perceived significance as instructional needs do, the result, the committee was told, has been a deterioration of the state's school buildings and facilities.

The Superintendent of Public Instruction commissioned a study of the state's school facilities. The resulting report indicated that 40 percent of the state's 21 million plus square feet of school buildings is located in the eight largest school districts. Over 50 percent of the state's 21 million plus square feet of school buildings is more than 30 years old. The report indicated that even though a facility might be structurally sound, it probably suffers from educational obsolescence in that it was not designed to appropriately accommodate many of the educational programs or instructional activities we now have.

The report stressed that school buildings, like any other physical plants, deteriorate if timely maintenance and renovation efforts are not undertaken. In the case of North Dakota schools, needed maintenance and renovation includes paving parking lots; lighting sites; repairing or replacing windows, doors, exterior walls, and roofs; making classrooms, washrooms, drinking fountains, and elevators handicapped accessible; updating teaching and noninstructional areas; and repairing or replacing heating, plumbing, and electrical services and systems. The estimated cost

of doing such work is \$421,367,366. Testimony indicated that these costs traditionally increase by five percent a year.

It was suggested to the committee that some long-term responses might include:

- Developing a state role in which school facilities are funded in the same proportion that the foundation aid received by a district bears to the total amount of foundation aid appropriated by the state.
- Guaranteeing a level of valuation perhaps equal to the statewide average valuation.
- Implementing a system of grants to support multidistrict construction and renovation efforts.

The committee makes no recommendation relating to school construction.

Transportation - Testimony and Committee Considerations

The state has played a role in the funding of school district transportation services since 1972. Rates are set by the Legislative Assembly and payments are made by the Superintendent of Public Instruction, taking into account factors such as miles traveled, number of students, vehicles used, and one-way and return trips. In past years, some school districts received transportation reimbursements in excess of their transportation expenditures. In 1993 the Legislative Assembly limited transportation payments to 90 percent of a district's current transportation operating cost plus the eight-year average cost of transportation equipment.

Districts affected by the cap complained that reported transportation costs were not uniform among the districts. Superintendents from smaller districts said they spend considerable time on busing--time that is not reflected in the cost calculations. Other districts charge costs to other users of transportation services on an ability-to-pay basis. For example, an extracurricular program not having a budget for transportation may be subsidized by the regular transportation program in one district and not reported at all in another. Recognizing these inconsistencies, the Legislative Assembly, in 1995, directed the Superintendent of Public Instruction to develop and require that school districts use a uniform cost accounting system for the transportation reimbursement program.

The document *Guidelines for Student Transportation Costs* was issued in April 1996 and presented to the committee. The guidelines address contracted services, bus drivers, fuel, family transportation, repairs, maintenance, insurance, equipment costs, the district superintendent's allocation, business office and school board costs, and time allocation.

The committee was told that the Superintendent of Public Instruction believes that the 1995 formula, together with the uniform cost accounting system now in place, must be given time to work and must be adequately assessed before legislative changes are made. The

Superintendent of Public Instruction does not intend, therefore, to seek any changes in the transportation funding formula.

The committee, however, did consider a bill draft relating to contracted transportation services. According to testimony presented to the committee, if a school district switches from contracting for transportation services to providing its own transportation services, there is a problem in determining actual costs for reimbursement purposes. The bill draft provided that in such a situation a school district may use the higher of its own transportation operating expenditures or the statewide average cost of transportation during that first year. The committee determined that contracted costs include capital expenditures and therefore it is reasonable that school districts switching from contracting for services to providing their own services be given a factor they can use when applying for transportation reimbursements. This is not a widespread problem, but very significant to the affected school districts. Approximately 20 percent of all school districts contract for transportation services.

Special Education Funding and the Monitoring of Special Education Block Grants - Testimony and Conclusion

The 1995-97 appropriation for special education was \$36.8 million--an increase of \$3.35 million over the previous biennium. With that increase, the Legislative Assembly also revised the parameters within which the Superintendent of Public Instruction could distribute the funds. In the past, the Superintendent of Public Instruction distributed special education appropriations in accordance with language found in NDCC Section 15-59-06.2:

If allowable costs for special education and related services for a child with disabilities in a special education program, as determined by the Superintendent of Public Instruction, exceed the reimbursement provided by the state, the school district is liable to pay for each such student an amount over the state reimbursement up to a maximum each school year of two and one-half times the state average per-pupil elementary or high school cost, depending on whether the enrollment would be in a grade or high school department. The two and one-half times amount includes the amount the school district is required to pay in section 15-59-06. The state is liable for one hundred percent of the remainder of the cost of education and related services for each such student with disabilities.

Under that method of distribution, the amount appropriated for special education was first devoted to the excess costs and then any remaining dollars were devoted to noncontract costs such as teacher-student units and new program initiatives. The reimbursement of costs in excess of the two

and one-half times amount were guaranteed. Other reimbursements were not.

The guaranteed amount was generally associated with costs for student contracts, i.e., the costs for students placed in a school district for reasons other than education. This tends to occur as a result of placements by other state agencies such as the Division of Juvenile Services or foster care entities. It also applies to costs incurred by students placed in private care facilities inside or outside the state for purposes of education. The problem was that the cost of student contracts continued to rise at an exponential rate. During the 1990-91 school year, 14.4 percent of a \$12 million annual allotment for special education was used for student contract reimbursements. During the 1995-96 school year, the cost of student contracts was \$5.7 million. The committee was told that without changes there was no reason to expect that this growth rate would have slowed down.

In an attempt to curb this growing cost, and perhaps force districts to consider alternative placements for the contract students, the 1995 Legislative Assembly reverted from guaranteeing the excess amount of student contracts to capping the amount allocated for student contracts at \$10 million, and, in effect, guaranteeing the personnel side of special education reimbursement. Personnel reimbursement had been tied to a complex formula involving student-teacher units, but the new reimbursement system is based on average daily membership. In addition, the Superintendent of Public Instruction clearly defined the components of a student contract, including how costs are calculated and what qualifies as an excess cost. Before this effort, each school district and special education unit engaged in somewhat different forms of calculations, resulting in inequitable reimbursements. As a result of these changes, some school districts, which had been advantaged by the former reimbursement system, received fewer dollars. However, the majority of the school districts received two-thirds of their special education dollars through a mechanism that equalizes the special education dollars in the same fashion as foundation aid dollars.

School districts receive \$109 for each student in average daily membership and have available to them certain safety features that were built into the revised distribution method, including a set-aside of \$500,000 for above-average incidences of moderately or severely disabled students. During the 1995-96 school year, districts and special education units were guaranteed a special education funding level of no less than 95 percent of the amount they received for the 1993-94 school year, excluding reimbursements for student contracts, boarding care, and gifted and talented programs. For the 1996-97 school year, the guarantee was lowered to 90 percent of the amount received for the 1993-94 school year, excluding reimbursements for student contracts, boarding care, and gifted and talented programs.

Because Section 1 of Senate Bill No. 2063 (1995) provided that \$10 million must be used to reimburse school districts for excess costs incurred on student contracts, the committee questioned what would happen if school districts and special education units, working under the new reimbursement system, claimed or were allowed to claim an amount less than the \$10 million. Testimony offered to the committee indicated that if any portion of the \$10 million set aside for student contracts was not so distributed, it would be prorated on a per student basis.

The committee determined that this new reimbursement mechanism, also referred to as a block grant distribution, had been thoroughly studied during the 1993-94 interim and implemented on that committee's recommendation by the 1995 Legislative Assembly. Even though there is continuing controversy about the distribution of special education appropriations, the committee determined that the controversy stems less from the actual method of distribution than from the fact that the special education needs of North Dakota students exceed the funds available to accommodate those needs.

The committee makes no recommendation relating to special education funding and the monitoring of special education block grants.

Supplemental Payments to High School Districts - Testimony and Conclusion

In Senate Bill No. 2519, the Legislative Assembly appropriated \$2,225,000 for supplemental payments to high school districts whose taxable valuation per student and whose cost of education per student are both below the statewide average. The payments, however, are effective only through June 30, 1997. Future payments were conditioned upon a review of the provision by an interim committee and a favorable recommendation for continuation.

Districts receiving supplemental payments during the 1995-97 biennium include:

Belfield	\$ 27,111
Beulah	\$ 45,792
Bismarck	\$322,620
Bottineau	\$ 16,321
Center	\$ 6,609
Devils Lake	\$126,582
Dickinson	\$251,629
Edinburg	\$ 3,673
Flasher	\$ 5,419
Grafton	\$ 48,045
Grand Forks	\$190,414
Granville	\$ 33
Hankinson	\$ 4,182
Hazen	\$100,704
Jamestown	\$126,826
Larimore	\$ 2,091
Lisbon	\$ 1,448
Mandan	\$ 92,379
Milnor	\$ 2,011
Minnewaukan	\$ 7,779
Minot	\$147,789

Montefiore	\$ 6,372
Mt. Pleasant	\$ 762
Newport	\$ 49
New Salem	\$ 5,027
Park River	\$ 4,861
Rugby	\$ 269
Sawyer	\$ 1,675
Sheyenne	\$ 3,055
Southern	\$ 1,104
South Heart	\$ 23,079
Stanley	\$ 5,674
Surrey	\$ 21,449
Thompson	\$ 12,212
Underwood	\$ 3,661
United	\$ 5,901
Valley City	\$ 62,868
Velva	\$ 13,180
Wahpeton	\$ 40,628
Washburn	\$ 40,118
West Fargo	\$ 47,450
White Shield	\$ 28,119
Williston	\$362,874

Testimony indicated that the supplemental funding provision was included in the 1995 education funding package so that the effects of the implemented equity provisions would be found more palatable by those districts negatively impacted.

With respect to whether the supplemental payment provision should be maintained, it was suggested that rather than creating a formula and adding a supplemental payment provision because the foundation aid formula is deemed to be inequitable, inadequate, or both, an attempt should be made to arrive at a funding package that is equitable and adequate when standing on its own. The committee discussed whether income should be included as a factor in determining eligibility for supplemental payments. The committee determined that because income taxes are not levied locally, they should not be equalized locally.

The committee considered a bill draft that would have removed the sunset provision on the section of law providing for supplemental payments to certain high school districts. Some committee members were concerned that, at this point, they did not know the specifics of the foundation aid package and that it was therefore premature to assume a supplemental payment provision would be necessary. It was also stated that while districts falling within the parameters of the statutory eligibility criteria clearly needed the additional funding provided by the supplemental payment mechanism, there were also districts falling just outside the eligibility parameters and those districts were in equal need of additional money. Others argued that even if the concept of the supplemental payment is not perfect, it should be considered during the legislative session as a part of the overall funding package.

While the committee, by motion, articulated its support for the concept of supplemental payments and the use of such payments, if necessary, to ensure a greater level of adequacy and equity in

the 1997-99 foundation aid package, the committee makes no recommendation relating to supplemental payments to high school districts.

Property Tax Relief - Testimony and Conclusion

The school districts of this state receive revenues from two primary sources--the state general fund and local property taxes. Property taxes traditionally have been favored as a significant component of school funding because of the stability of that funding source. Unlike income taxes, energy taxes, or sales taxes, property taxes are not greatly affected by economic fluctuations. The ability to pay property taxes and the reliance of the education sector on property taxes, however, have brought the issue of property tax relief to the forefront.

Proposal by the Superintendent of Public Instruction

The Superintendent of Public Instruction presented to the committee a proposal that would have placed a two percent tax on North Dakota taxable income, thereby raising \$100 million a year. The local source of the income tax revenue would be identified and \$3 of every \$4 raised by the tax would be returned to the local districts so that property taxes could be lowered and the remaining funds would be left with the state for redistribution through the foundation aid formula. The school district mill levy cap would be reduced from 185 mills to 110 mills in the process. Proponents of this concept indicated it would greatly reduce dependence on local property taxes; it would replace property taxes with equalized dollars; it would allow school districts flexibility to meet their individual needs in that they could still levy up to 110 mills, or if they were unlimited taxing districts, they could levy any amount deemed necessary locally; and it would provide options to the Legislative Assembly in that decisions could be made to provide less property tax relief, but use the income tax assessment for additional education revenues.

The proponents cited these advantages of the proposal:

- Issues regarding the regressivity of a sales tax increase would be avoided.
- Income taxes, unlike sales taxes, can for the most part be attributed to a specific district.
- Cities levying sales taxes would not be as opposed to an income tax hike as they would to a sales tax increase.
- The state is ranked higher nationally with respect to its sales tax rates than its income tax rates.

Approximately 46 percent of all school district revenues come from property taxes and 42 percent of all school district revenues come from state sources. The two percent income tax proposal was advanced as potentially reducing the local share to 26 percent and raising the state share to 62 percent of the cost of education (assuming that \$25 million of new money is included as a result of

the rise in income taxation). Per student payments would be increased to \$2,560.

The committee, however, was concerned that a subsequent reduction in local property taxes would not be applicable to those districts having unlimited taxing authority. The committee also was concerned that there is no guarantee future Legislative Assemblies would be inclined to filter the new dollars generated by the increased income taxes to education funding. It was stated that the end result could in fact be an increase in income taxes with no perceivable long-term reduction in property taxes. Moreover, concern was expressed that if in the future the Legislative Assembly found itself needing to raise revenue for a purpose other than education, it would be unlikely that the electorate would support a further increase in the state's income tax rates.

The committee took no action on the proposal by the Superintendent of Public Instruction.

Proposal by the North Dakota Stockmen's Association

Representatives of the North Dakota Stockmen's Association presented to the committee a proposal that would have increased the personal income tax rate from 14 percent to 22 percent of federal liability and increased the taxes on all corporate income over \$50,000 from 10.5 percent to 15.5 percent, thereby raising approximately \$100 million annually. The proposal included a provision whereby 20 percent of the amount raised would be considered new money for education and 80 percent of the amount raised would be returned in the form of property tax relief. School districts would have their mill levies lowered by the property tax replacement funding and then be allowed to increase their mill levies by only two percent each year.

The committee determined that this proposal would shift the burden of taxation from those who own property to those who are generating income. The committee was concerned about capping school district mill rates and even considered a proposal whereby the cap would be instituted only if the 1997-99 appropriation for foundation aid exceeded the 1995-97 appropriation for the same purpose by \$40 million. The proposal to implement a conditional mill levy cap was not favored because of the theory that \$20 million in new funding during each year of the biennium would alleviate the districts' need to generate more local revenue. However, the committee also found that while the proposal addressed property tax issues related to school districts, nothing in the proposal limited other local taxing entities from raising their levies.

The committee determined that a proposal such as this, if enacted, would provide a readily available avenue for future tax increases for education or other purposes. The committee also determined that the proposal did not require property tax reductions by school districts having unlimited taxing authority.

The second part of the proposal offered by representatives of the North Dakota Stockmen's

Association involved the equalization factor. During the 1995 legislative session, the equalization factor was set at 32 mills for the 1996-97 school year and thereafter would be raised according to a mathematical formula based on the amount of foundation aid actually appropriated. The equalization factor cannot fall below 32 mills nor rise above 25 percent of the state average school district general fund mill levy. The association's proposal reduced the equalization factor to 16 mills and factored in .21 of one percent times the total adjusted gross income of school district residents.

Proponents of the proposal indicated that .21 percent of income approximates 16 mills and, as a result, the proposal substituted an income value for property value. Opponents questioned how income would be identified and how it would be attributed to a particular school district, especially if an individual lives in a bedroom community, and earns income in a neighboring city located in another school district, or if an individual lives in one school district and farms in another school district. Even though income tax forms require identification of a school district, opponents contended penalties for misidentifying or not identifying school districts would have to be considered.

The committee determined that while there were legitimate concerns regarding implementation of the concept, inclusion of income in the financing formula precipitates additional equity discussions that should be shared with all members of the Legislative Assembly.

Other Property Tax Relief Measures

As discussions ensued regarding the merits of the proposals offered by the Superintendent of Public Instruction and by representatives of the North Dakota Stockmen's Association, the committee considered two bill drafts that were variations of the prior proposals and a third bill draft that related to the state average school district general fund mill levy.

The first bill draft would have raised personal and corporate income taxes to provide for a combined annual increase of \$80 million, all of which would be dedicated to property tax relief. The combined biennial tax increase would set personal income tax rates at 20.4 percent of federal liability and corporate rates at 14.5 percent.

Proponents of the bill draft hailed it as being truly neutral in that it did not raise additional taxes for education, but merely shifted the tax burden from the present system favoring property taxes to one placing greater reliance on income taxes. Opponents argued that a mere replacement of tax dollars through a shift in revenue sources does not address the continued need for additional education funding. Opponents also argued that the bill draft contained the same concerns articulated with respect to the proposal by the North Dakota Stockmen's Association. Specifically, the bill draft imposed a cap on school districts that do not have unlimited taxing authority but relied

on the good faith of school districts with unlimited mill levy authority to maintain reduced property tax levels.

The second bill draft would have provided for an increased short-form income tax rate, changed the basis of the tax from tax liability to taxable income for the purpose of raising approximately \$100 million during each year of the biennium, and provided that 80 percent of the amount raised be returned in the form of property tax relief. The bill draft would have used the federal rate tables, as they are adopted by the federal government each year and would have established a rate of 22 percent of whatever the federal rate is for income in that bracket. Although the rates would generate the same revenue, they would look lower because they would apply to taxable income.

Proponents stated that the reference to taxable income would in fact make the tax increase appear more palatable both to North Dakota taxpayers and to citizens in other states seeking to move to the state or invest in the state. Opponents argued that the bill draft might be thought of as being deceptive. Even though the rates look lower, the fact that they are being applied to taxable income rather than being a percentage of federal liability does not change the reality of an income tax increase of \$100 million per year.

The committee considered a bill draft that would have provided that the calculation of the state average school district general fund mill levy could not include school districts having unlimited taxing authority. Proponents testified that the state average school district general fund mill levy is 209.4 mills. If the school districts with unlimited taxing authority are eliminated from the calculation, the state average school district general fund mill levy drops to 170.98. This bill draft would have reduced the equalization factor for school districts and consequently allowed some school districts to obtain increases in state aid.

Opponents suggested that if the top six taxing districts are removed from the calculation, perhaps the six lowest taxing districts should also be removed. That would, however, present a skewed figure in that the top six taxing districts have a huge valuation while the bottom six districts have very little valuation. The committee determined that this bill draft would result in less local effort and consequently amount to a move away from equity.

Committee Recommendations

The committee recommends Senate Bill No. 2031 to provide that if a school district has contracted for transportation services and then proceeds to provide its own transportation services, the school district may use the higher of its own transportation operating expenditures or the statewide average cost of transportation during the first year for which it seeks transportation reimbursement from the Superintendent of Public Instruction. The committee determined that it was important to statutorily establish a base cost so that districts switching from contracted services to

their own services can obtain reimbursement during the first year in which they provide their own services.

The committee recommends House Bill No. 1050 that reduces the equalization factor to 16 mills and requires that .21 of one percent times the total adjusted gross income of school district residents be factored into the calculation of the equalization factor. The committee determined that while property ownership is not necessarily an accurate measure of wealth, income is an accurate measure.

Miscellaneous Matters - Testimony and Committee Recommendation

Computer Programming Error

During the 1993-95 biennium, a computer programming error resulted in a miscalculation in the number of students attending alternative high schools in Bismarck, Devils Lake, Fargo, Grand Forks, Jamestown, and Minot. The error was not discovered until after the close of the 1993-95 biennium. Using current biennial appropriations, adjustments were made to the 1995-97 payments. Because the Superintendent of Public Instruction could not use current appropriations to correct errors applicable to the previous biennium's payments, the question of addressing the loss suffered by these school districts during the 1993-95 biennium came before the committee. The unadjusted amount of the error is \$426,000.

The committee considered a bill draft that used funds remaining in the foundation aid - transportation line item at the end of the 1995-97 biennium to first reimburse the six school districts for the losses they suffered during the 1993-95 biennium. Upon completion of that distribution, the Superintendent of Public Instruction would distribute any remaining funds to all school districts as a separate and contingent per student payment on a weighted basis. Previous appropriations to the Superintendent of Public Instruction for the foundation aid program traditionally included language allowing for the separate and contingent distribution of any funds remaining in the line item at the end of the biennium. The committee was told that such authorizing language was omitted from the 1995 appropriation because if a statute sets forth a specific dollar appropriation, and those dollars are available and distributed, any funds remaining should be returned to the state general fund. The Superintendent of Public Instruction estimated that there will be approximately \$2.5 million in excess funds at the end of the 1995-97 biennium.

While the committee was concerned with how an error of this magnitude could have occurred, the members were in agreement that the six affected school districts should not bear the financial burden of the error and should be reimbursed out of any excess funds remaining in the foundation aid - transportation line item at the end of the biennium. There was not, however, a consensus that the tradition of distributing a separate and contingent per student payment at the end of the

biennium should be maintained, if legislatively authorized payment amounts are met. Doing so was labeled a poor accounting practice, even though it may have become an expectation on the part of school boards when determining district budgets.

The committee determined that the concept of reimbursement for the six school districts having alternative high school students and the concept of maintaining separate and contingent per student payments should be viewed independently and therefore recommends separate bills.

The committee recommends House Bill No. 1051 to use funds from any amount remaining in the foundation aid - transportation line item at the end of the 1995-97 biennium to reimburse the six school districts in Bismarck, Devils Lake, Fargo, Grand Forks, Jamestown, and Minot for the losses they suffered during the 1993-95 biennium as a result of a computer programming error that miscalculated the number of students those districts had in their alternative high schools.

The committee recommends House Bill No. 1052 to authorize the Superintendent of Public Instruction to distribute any funds remaining in the foundation aid - transportation line item at the end of the 1995-97 biennium to all eligible school districts as a separate and contingent weighted per student payment.

REVIEW OF THE PERFORMANCE AUDIT OF THE DEPARTMENT OF PUBLIC INSTRUCTION

Background and Testimony

Section 11 of Senate Bill No. 2013 (1995) directed the State Auditor to conduct a performance audit of the Department of Public Instruction. The audit was presented to the Legislative Audit and Fiscal Review Committee. Because many of the issues addressed in the audit pertained to the administration of education programs and issues within the purview of the interim Education Finance and Education Services committees, the Legislative Audit and Fiscal Review Committee requested the Legislative Council chairman to reassign review of the audit to one of those committees. The Legislative Council chairman directed the interim Education Finance Committee to review the audit and to make appropriate recommendations.

Created in 1889, the office of Superintendent of Public Instruction is charged with enforcing state statutes and federal regulations pertaining to the establishment and maintenance of public schools and related programs. The Superintendent of Public Instruction is responsible for the general supervision of the common and secondary schools of this state.

Within the Department of Public Instruction there are eight separate divisions--the Executive Operations Management Council Division; the Instructional Services Support Division; the Operations and School District Support Services Division; the Adaptive Services Support Division;

the Division of Independent Study; the North Dakota State Library; the Vision Services Division; and the North Dakota School for the Deaf.

The performance audit of the department was designed to:

- Assess the effectiveness and efficiency of the school approval and state accreditation programs by evaluating the accomplishment of legislative intent, evaluating the laws and policies, and by evaluating the programs' resources;
- Determine if department personnel meet the Office of Management and Budget's qualifications;
- Determine if the department is in compliance with the supplanting clause of the federal contract for the safe and drug-free schools program; and
- Determine whether a more efficient monitoring process could be used through development of a consolidated team monitoring process.

Audit Recommendations Regarding Approval and Accreditation Programs

The audit recommended that the Superintendent of Public Instruction take appropriate steps to clarify statutory criteria regarding the approval of schools and to ensure that only schools meeting the statutory criteria are designated as "approved" schools. The Superintendent of Public Instruction should develop a coordinated system for the inspection of schools seeking approval or maintenance of the approval standards, should include a visual inspection of the schools' calendars, and should verify that the schools are meeting all statutory health, safety, and fire requirements.

The audit recommended that the Superintendent of Public Instruction should take appropriate steps to ensure that only those schools meeting all accreditation standards are designated as "accredited" schools. The Superintendent of Public Instruction should combine the elementary and secondary education units; should review accreditation on a two-year cycle rather than annually to ensure that more indepth reviews are conducted; should conduct and document onsite monitoring of schools before determining approval and accreditation status; should review the *Accreditation Standards, Criteria, and Procedures for the Classification of Elementary, Middle Level/Junior High, and Secondary Schools* to ensure it reflects procedures being followed; and should follow a formal procedure for the reduction of state aid to schools that do not meet approval or accreditation standards.

The audit recommended that the Superintendent of Public Instruction review NDCC Title 15, as it relates to elementary and secondary education, to ensure that departmental personnel are appropriately implementing or enforcing the statutory provisions, and to seek the amendment or repeal of those sections no longer necessary or appropriate. The audit found that the

Superintendent of Public Instruction has exceptional controls to determine compliance with teacher qualification standards, but has implemented only limited reviews of curriculum requirements, kindergarten plans, and compliance with health, fire, and safety requirements.

Audit Recommendations Regarding Personnel Issues

The audit cited several employees of the Superintendent of Public Instruction who do not meet the Office of Management and Budget's qualifications for the positions they hold. The audit recommended that the Superintendent of Public Instruction reclassify, promote, transfer, and hire individuals for positions only if those individuals meet the minimum qualifications established by the Office of Management and Budget and that the Superintendent of Public Instruction review current personnel to ensure that all are in compliance with the statutory and administrative requirements.

Audit Recommendations Regarding the Safe and Drug-Free Schools Program

The audit found that the department is not in violation of the supplanting clause contained in the grant agreement for the safe and drug-free schools program. The department was found, however, to be in violation of certain state laws as they relate to the procurement and awarding of funds for the chemical abuse and prevention program. The audit recommended that the Superintendent of Public Instruction make an effort to identify additional sources of funding and to secure funding through the appropriation process so that the chemical abuse and prevention program can be administered in accordance with the requirements of NDCC Chapter 15-21.1. If funding cannot be obtained, the Superintendent of Public Instruction should take appropriate steps to amend or repeal the chapter.

Audit Recommendations Regarding the Combined Monitoring Functions

The audit found that the Superintendent of Public Instruction is responsible for administering 12 programs that require monitoring at the elementary, middle, and high school levels to ensure compliance with federal laws and regulations and to evaluate the effectiveness of the programs. Local administrators questioned the need for so many different individuals from the department coming to their schools at different times. They complained about the interruptions this has caused in their schools. The audit recommended that the Superintendent of Public Instruction conduct a comprehensive review of the safe and drug-free schools program, Title I programs relating to the operation of basic programs by local education agencies, Title II programs relating to professional development, Title VI programs relating to innovative education strategies, migrant education, the education of the homeless, and Goals 2000 to determine how the

monitoring functions could be consolidated to provide more efficient and effective services. This should include the development of a master matrix of all entities administering the different programs, the development and implementation of a plan for coordinating efforts as appropriate, the determination of specific expertise needed to monitor and evaluate the different programs, and the development of a cross-training program so that individuals can conduct multiple monitoring functions.

Committee Considerations

The committee was particularly concerned that one of the statutory criteria for the approval of schools--fire safety--was not well-defined. The North Dakota Century Code makes no specific provision for the timely inspection of schools, the correction of noted defects, and the criteria to be employed in determining when a school should be deemed unsafe and subsequently closed. The issue of school fire inspections and school safety was addressed by the 1993-94 interim Education Finance Committee, which recommended House Bill No. 1038. However, the bill encountered difficulty when concerns were raised about revenue sources to assist with potentially costly repairs and when concerns were raised about state versus local responsibility in ensuring a safe environment for North Dakota schoolchildren. The bill failed to pass.

The committee considered a bill draft that required the State Fire Marshal to inspect each public and private elementary and secondary school in the state at least once every three years. An inspection report is to be prepared and deficiencies are to be categorized. With respect to correction schedules, the bill draft provided that if a deficiency is related to a school's design, it is to be remedied when any construction, repair, improvement, renovation, or modernization is undertaken. If the deficiency is related to fire safety, the building principal is to remedy the deficiency within a time period acceptable to the State Fire Marshal or to submit a plan of correction to the State Fire Marshal. If the deficiency is an imminent fire hazard, the State Fire Marshal may require that the principal take immediate remedial action or may recommend to the Superintendent of Public Instruction that some or all of the school be closed until the hazard is eliminated. If a school is closed under these circumstances, the bill draft directed the Superintendent of Public Instruction to work with the school's authorities to make arrangements for the interim education of all affected students.

Unlike House Bill No. 1038 (1995), this bill draft contained no provision for the withholding of financial aid or the imposition of any financial penalty. The committee determined that a financially strapped school district will be in no better position to make needed repairs or corrections if additional funds are withheld.

Proponents of the bill draft indicated that it focused on education--on ensuring that people

understand why certain conditions create serious fire hazards and it relied on reasonableness to correct noted deficiencies. The committee determined that many fire safety issues can be addressed through alternative means. Sometimes, rather than remodeling an entire wing of a school building, installation of early warning systems such as smoke detectors or the installation of a sprinkling system can serve as adequate and cost-effective options.

The committee also was concerned that issues regarding the approval and accreditation of schools were indicative of a larger, more pressing need to review all the provisions of Title 15 that relate to elementary and secondary education. The committee determined that the irrelevant, duplicative, inconsistent, illogically arranged, and unclear sections in the title needed to be examined and addressed. Because of the scope of such a project, the time factor, and the need for legal and educational expertise, the committee determined that the most desirable approach would be to ask that an interim legislative committee be directed to undertake the task.

Recommendations

The committee recommends Senate Bill No. 2032 to require the State Fire Marshal to inspect each public and private elementary and secondary school in the state at least once every three years, to prepare an inspection report, to categorize deficiencies, and to work with school staff to appropriately correct noted deficiencies. The committee determined that through education, reasonableness, and cooperation among state and local fire and school officials, all North Dakota schoolchildren can be assured of a safe educational environment.

The committee recommends Senate Concurrent Resolution No. 4002 to direct the Legislative Council to study those provisions of NDCC Title 15 which relate to elementary and secondary education and to subsequently recommend changes to those portions of the title found to be irrelevant, duplicative, inconsistent, illogically arranged, or unclear in their intent and direction.