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RECOMMENDATIONS TO STRENGTHEN NORTH CAROLINA'S SCHOOL FUNDING SYSTEM

By

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Executive Summary

This report was prepared for the North Carolina General Assembly by Augenblick, Palaich and Associates (APA), a Denver-based consulting firm. APA was selected to do the work described in this report through a competitive bidding process to conduct a study of the state's school finance system. This finance system is based on a number of allotments that are used to allocate state aid to each of the state's 115 school districts. APA conducted all of the work that serves as the basis of this report between March and September 2010.

That work included: 1) Conducting an initial set of interviews with a variety of interested and knowledgeable people, including state policymakers, school district organizations, and public policy groups; 2) Reviewing literature concerning the relationships that exist between education resources and student performance; 3) Reviewing written work that has examined North Carolina's school finance system; 4) Analyzing the equity of the revenues obtained by school districts in 2003-04 and in 2008-09; 5) Analyzing individual allotments based on the revenues they provided to school districts in 2003-04 and in 2008-09; 6) Analyzing the relationships between education resources and student performance in North Carolina in 2003-04 and in 2008-09; 7) Conducting on-site interviews with school district administrators that focused on identifying resources districts believe can impact student performance; and 8) Developing two indices designed to reflect geographic price differences across counties and the attractiveness of counties to teachers.

All of this work focused on the **structure** of the allotment system. By that, we mean that we were asked to examine the approaches used to allocate state aid, including the formulaic procedures, and to determine whether changes in the structures of the allotments would improve the equity and/or efficiency with which state aid is distributed *without being concerned about how much aid is distributed*.

Based on all the work and analyses conducted, APA offers a set of potential modifications to the state allocation system. These suggested modifications are intended to be **fiscally neutral** and are listed *in order of their anticipated ease of implementation*. They should be viewed as being distinct from one another. That is, they could be implemented individually and several of them could be implemented simultaneously but some of them, particularly those toward the end of the list, subsume others that precede them.

In some cases, APA uses parameters to illustrate how a modification might be implemented although such parameters should not be viewed as being precise; if the state is interested in implementing a particular change, further work would need to be done to assure that the cost of implementation would, in fact, remain fiscally neutral.

The potential modifications are listed below:

1. **Combine all allotments that are distributed on the basis of total enrollment** (such as the ones for textbooks, instructional materials, non-instructional support, and technology) – not some subcategory of enrollment based on grade level or need – into a single per student allotment, the revenue from which could be used at the discretion of school districts.
2. **Modify the Special Education Allotment** by setting three different payment rates for students with disabilities that can be organized into three cost categories based on disability severity (such as “mild,” “moderate,” and “severe”) and the expected relative cost of each group.
3. **Modify the Low Wealth County Allotment** by either creating two distinct allotments that would be based on simple formulas (one based on district wealth and another based on district school tax effort) or by creating a single formula that would use a power equalizing procedure that other states have employed to distribute aid.
4. **Modify the At-Risk Student Allotment and the Disadvantaged Student Supplemental Fund Allotment** by combining them and distributing funds based on either: (1) the number of low performing students in each district or (2) a proxy for low performance, such as the number of Title I eligible students (as is done in the At-Risk Allotment) or the number of students eligible for federal lunch support (reduced-price and/or free lunch) but do not use a Census-based count since it does not change annually.
5. **Modify the Small County Allotment** so that it is focused exclusively on size, which is a well-known cost factor that is beyond the control of school districts. We would suggest allocating funds on the basis of district size, not county size, since the size of the district is what creates the cost pressure that state aid should be used to mitigate.
6. **Change the way that Lottery funds are distributed** to support school buildings. Given that the primary responsibility for the construction of school facilities lies with school districts, state aid should be allocated with two objectives in mind: (1) to wealth equalize paying for facilities; and (2) to provide an incentive for school districts to support needed facilities. Current aid is not wealth equalized and our examination suggests that it has not served as an incentive to generate local funds by raising local tax effort.
7. **Modify the Teacher Allotment** to change the way the number of state-paid teachers allotted to each district is calculated. Because the student-based needs of districts vary, we would suggest using a weighted student count, not the ADM count, to recognize those differences (under the assumption that most special student needs, such as participation in special education programs, are addressed through the use of more teaching personnel (to lower class size and/or to extend student engagement)). Our belief is that weights for special education, at-risk students, limited-English proficient (LEP) students, gifted students, and students enrolled in vocational programs should be used. Weights could be created for the three levels of special education discussed above.

8. **Modify the Statewide Teacher Salary Schedule** by adding factors that would make it sensitive to uncontrollable cost pressures that districts face in paying teachers. APA found that two kinds of cost pressures exist in North Carolina: (1) geographic cost differences that reflect differences in prices for consumer goods; and (2) the attractiveness of districts to teachers due to factors such as population density. While some may believe that these cost pressures offset one another, APA found that they do not necessarily do so in every county, with the result that some counties need to pay more than the statewide average salary, or could pay less than the statewide average salary, in order to attract and retain teachers with similar characteristics. In this report, APA produces both geographic cost and teacher attractiveness indices. However, should these kinds of adjustments be of interest, we suggest doing additional work, particularly in order to develop the teacher attractiveness index.
9. **Modify the way the Teacher Allotment salaries are applied.** While many district administrators support the current system of paying individual teacher salaries for eligible positions under the teacher allotment, the approach is cumbersome, requiring significant oversight and tracking of currently employed teachers. An alternative approach would be for the state to pay a total amount to each district to cover the cost of teachers based on multiplying the number of eligible teachers by a statewide average salary adjusted for a variety of district-based factors, such as ones reflecting average education level, average years of experience, geographic cost differences, and teacher attractiveness. Under this approach, each district would receive a lump sum of money, which could be used to pay teachers or, in the name of flexibility, anything the district wants.
10. **Consider modifying the structure of the Statewide Teacher Salary Schedule.** Currently, the statewide teacher salary schedule is based on two teacher characteristics: (1) education level; and (2) years of experience. Almost every school district salary schedule in the nation is based on the same characteristics although they vary in how many credits must be earned before salary is affected and how many years of experience affect salary level. Today, however, many school districts, and a few states, are examining different salary schedule structures. The basic changes being examined include replacing education level with individual professional development plans, de-emphasizing experience, adding multiple roles, levels of leadership and responsibility, and days of work, and adding alternative ways of holding teachers accountable based on student performance, formal evaluation, and individual-based student learning objectives. Our suggestion is that North Carolina consider changing the structure of its teacher salary schedule, which is the primary basis for allocating state aid to school districts.
11. **Create a “foundation” type formula** based on setting a base cost with adjustments for student characteristics and district characteristics but, unlike other states, have no expected local revenue contribution to pay the costs. This would make the school finance system in North Carolina analogous to the systems used in most other states (without the local

contribution). Additional state aid could still be provided for low wealth school districts, to promote particular programs or services of interest to the state, to provide incentives to districts to generate local funds, for transportation, and for capital purposes. This could be accomplished by adding several “tiers” to the foundation program. This final alternative is the most far-reaching because it combines several of the alternatives discussed above.

Overall, APA’s conclusion is that North Carolina has paid a great deal of attention to what other states have been doing in the past several decades to recognize the cost pressures that school districts face in providing education services. The evolution of the state’s allotment system for schools has been to add and remove pieces around the largest, and most basic, component of the entire system – the provision of teachers in every school district. Perhaps the greatest strength of North Carolina’s current system is that, taken together, the allotments address almost all of the cost factors associated with providing education services (although the approaches used to do this could be improved).

Despite its existing strengths, however, the state’s current system could benefit from several potential changes. The modifications suggested above offer North Carolina’s policymakers an opportunity to revisit and renew constructive discussions around key components of the state’s school finance approach, and to further improve upon a system which has continued to evolve over the past 40 years.