

Local Education Funding Dispute Resolution Process Is Effective and Economical, but Litigation Could Be Eliminated

A presentation to the Joint Legislative
Program Evaluation Oversight Committee

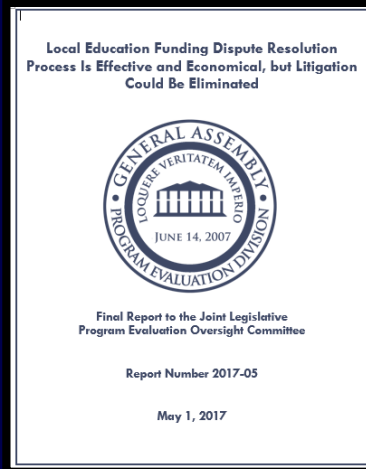
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Sean Hamel, Principal Program Evaluator

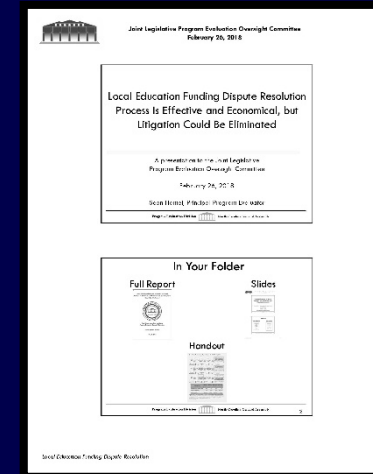


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Slides



Handout

Revised Dispute Resolution Process Replaces Litigation with a Default Funding Mechanism

Dispute Resolution Process

Dispute Resolution Process

Dispute Resolution Process

Dispute Resolution Process

Physical Example	Base Year Fiscal Year 2013-14	Dispute Year 1 Fiscal Year 2014-15	Dispute Year 2 Fiscal Year 2015-16	Dispute Year 3 Fiscal Year 2016-17
Proposed Average Daily Membership (ADM)	1,000	1,013	1,042	1,071
Cost Index Percentage Change	N/A	0.89%	1.89%	1.82% x 2.04%
Local Operational Expenditures per ADM	\$ 100	\$ 100.89	\$ 102.88	\$ 107.21
Total Local Expenditures	\$ 100,000	\$ 102,280	\$ 107,242	\$ 114,781

Notes: SCOE stands for School of Curriculum and Instruction. SCOE stands for school board of education. For the hypothetical example, the Program Evaluation Division used the Bureau of Labor Statistics Employment Cost Index for elementary and secondary school services for calendar years 2013 through 2016 (located at CH2000000000). The cost index is reported quarterly for a calendar year, and annual percent change results for the most recent year available during the year reported. Using dispute resolution process, to calculate the Cost Index Percentage Change for each dispute budget year, the second quarter cost index data from the previous calendar year was compared to the second quarter data for the current year.

Source: Program Evaluation Division.



Our Charge

- Directive: Session Law 2016-116 directed PED to evaluate the process for resolving education funding disputes between local boards of education and boards of county commissioners
- Agency: Association of County Commissioners and School Boards Association
- Team: Sean Hamel and Brent Lucas

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Overview: Findings

1. The dispute resolution process is used infrequently and seldom reaches the litigation phase
2. The process does not favor either party and may serve to improve future budgeting efforts
3. The cost of the process represents a fraction of total county funding for local boards of education, but litigation is costly and time-consuming
4. Opportunities exist to replace litigation with a default funding mechanism
5. Local boards of education maintain relatively large unencumbered fund balances



Overview: Recommendations

The General Assembly should consider:

1. Revising state law for settling local education funding disputes to replace litigation with a default funding mechanism

and

2. Establishing a working group to develop and recommend statutory parameters for fund balances maintained by local boards of education



Background



State Law Assigns Specific Responsibilities for K-12 Funding

N.C. Gen. Stat. § 115C-408

It is “the policy of the State of North Carolina to provide from State revenue sources the instructional expenses for current operations of the public school system as defined in the standard course of study. It is the policy of the State that the facilities requirements for a public education system will be met by county governments.”

In practice, however, funding for operations and capital is shared

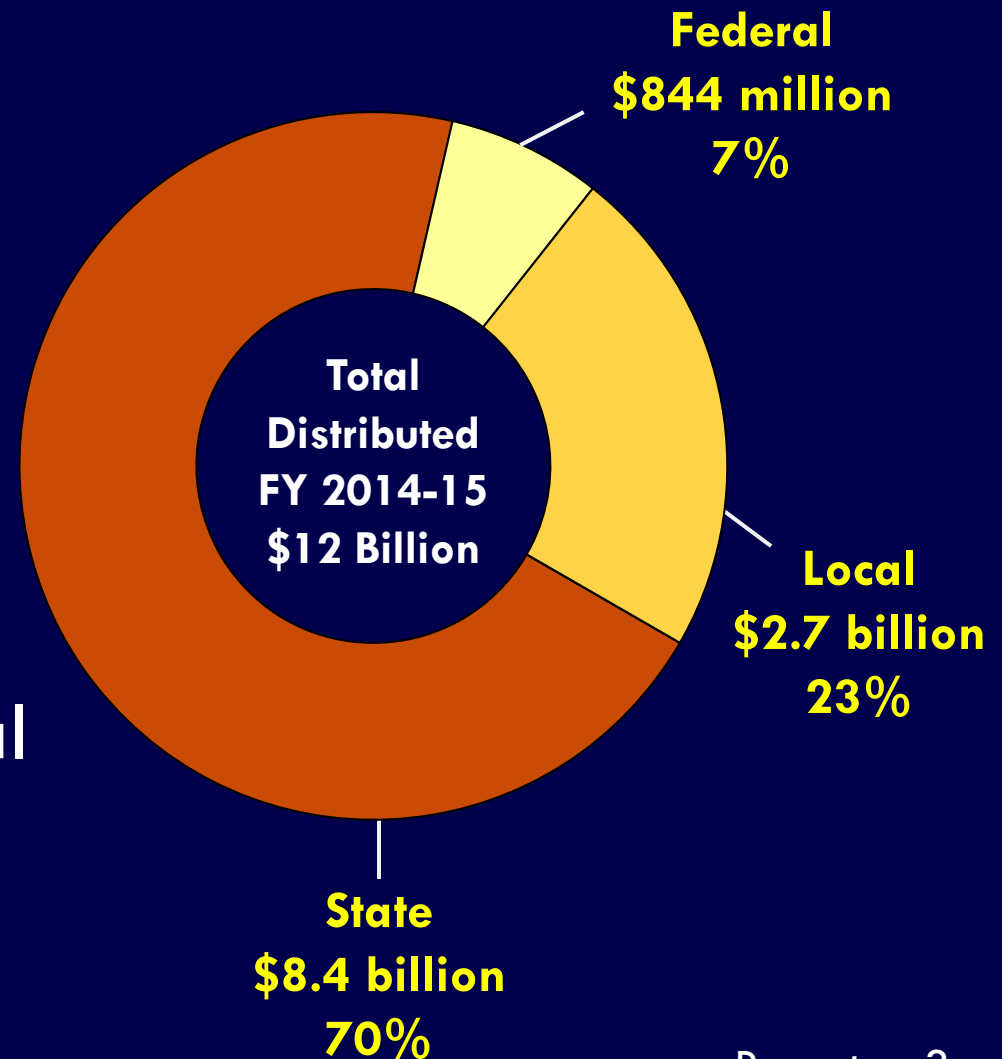
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Operations Funding Fiscal Year 2014–15

Local governments fund more than 20% of operating costs

State and federal funds are distributed through allotments, whereas local funds are appropriated by county commissioners

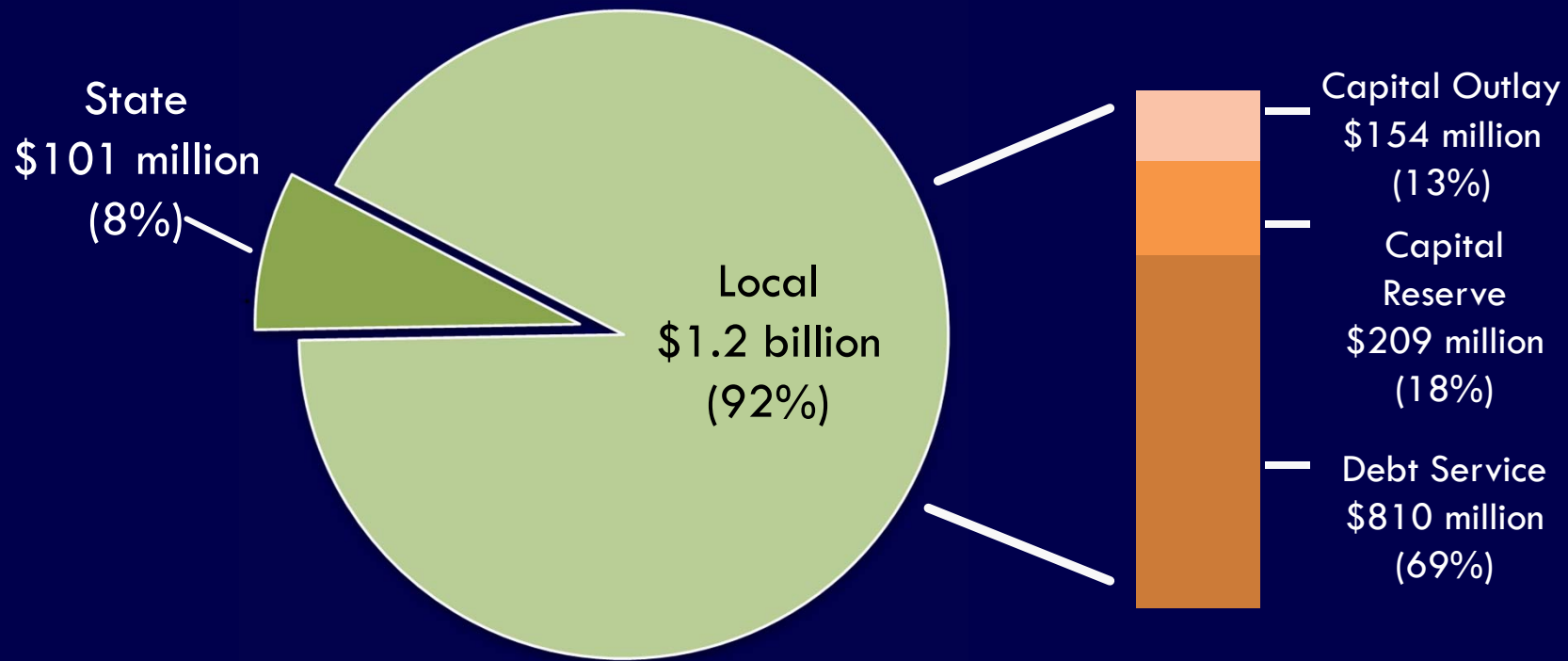


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Capital Funding Fiscal Year 2014–15

Total School Capital
\$1.3 billion



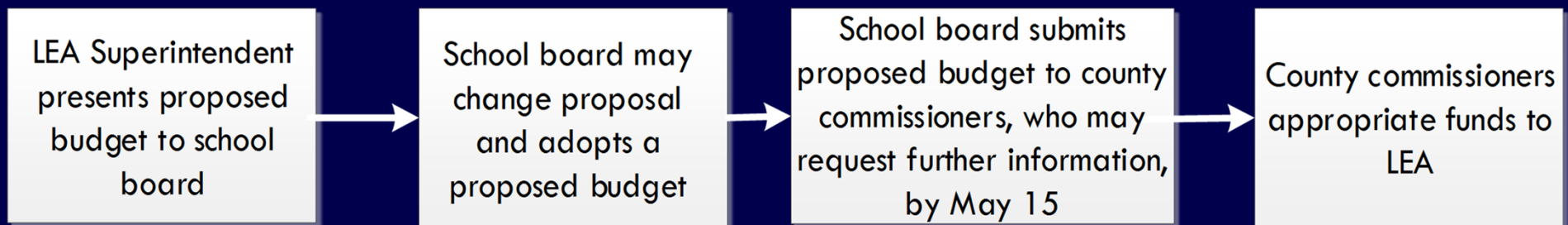
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Local Funding for K-12

- County commissioners are responsible for determining local appropriations for capital and operations
- Local Boards of Education are fiscally dependent on county commissioners

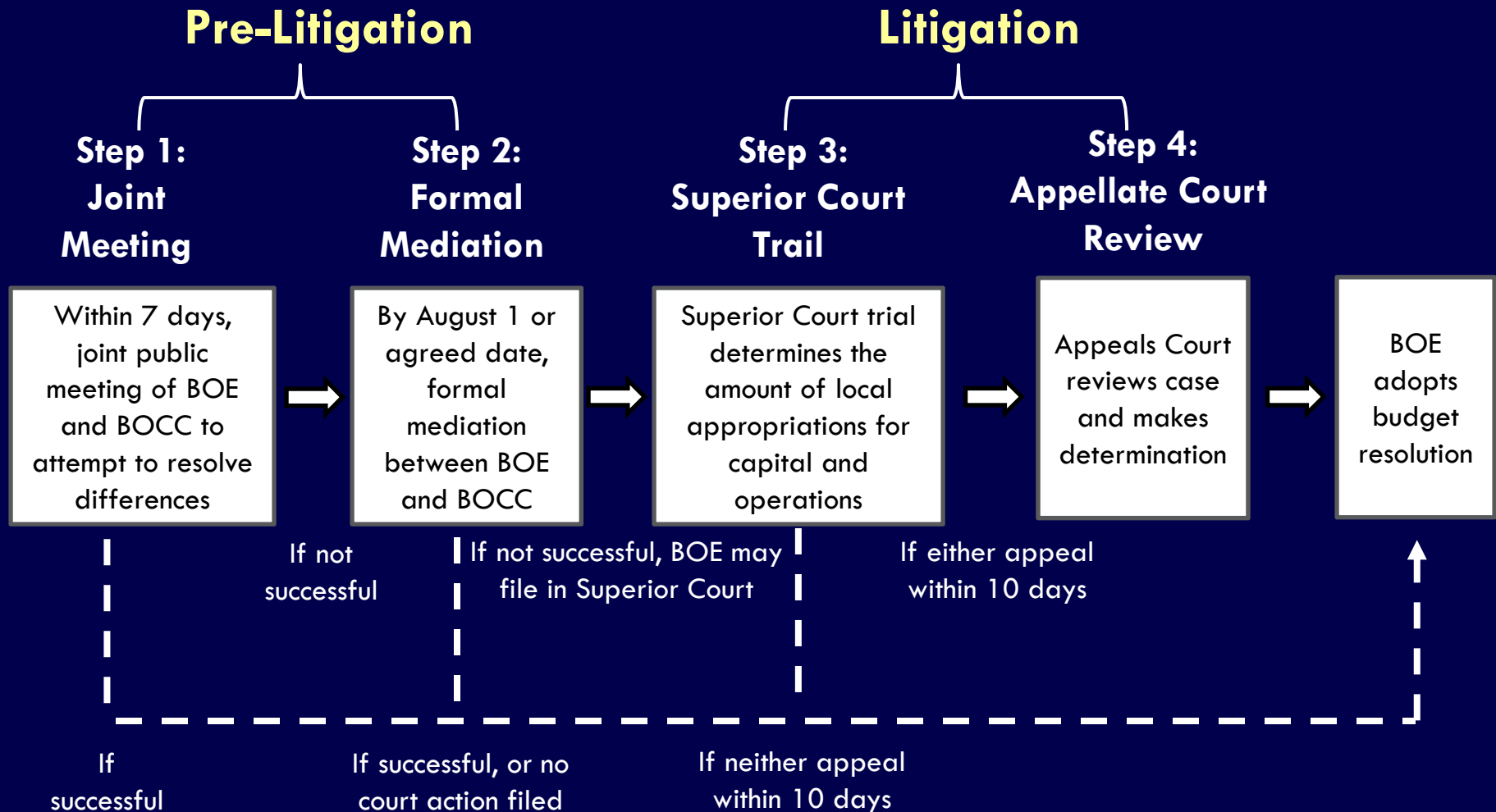
Annual Budgeting Process



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Local Funding Disputes



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Findings



Finding 1

The dispute resolution process is used infrequently and rarely results in litigation between boards of county commissioners and local boards of education

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The Process is Used Infrequently

- Between 1997 and 2015, LEAs passed 2,070 annual budget resolutions
- The dispute resolution process was used 40 times < 2%
- Litigation was required only 4 times

0.19% of local K-12 education budget resolutions result in litigation



Finding 2

Only 4 of the 40 local education funding disputes proceeded to the litigation phase between 1997 and 2015, but these cases proved disproportionately time-consuming and costly compared to disputes resolved in the pre-litigation phase

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Funding Disputes That Require Litigation Are Time Consuming

Dispute Resolution Stage	Statutory Deadline	Estimated Days to Resolution
Pre-Litigation		
Joint Meeting	115c-431(a) requires chairs of the board of county commissioners and local board of education to hold a joint meeting within 7 days of the decision of appropriations.	Average = 57 days
Formal Mediation	115c-431(b) states mediation shall end no later than August 1 unless both parties agree otherwise.	Maximum = 154 days
Litigation		
Superior Court Trial	115c-431(c) states that trial must be set for the first succeeding term of the Superior Court, but state law does not set a deadline for completing this stage.	Average = 638 days
Appellate Court Review	115c-431(d) states that notice of appeals must be filed within 10 days of judgment, but state law does not set a deadline for completing this stage.	Maximum = 1,184 days



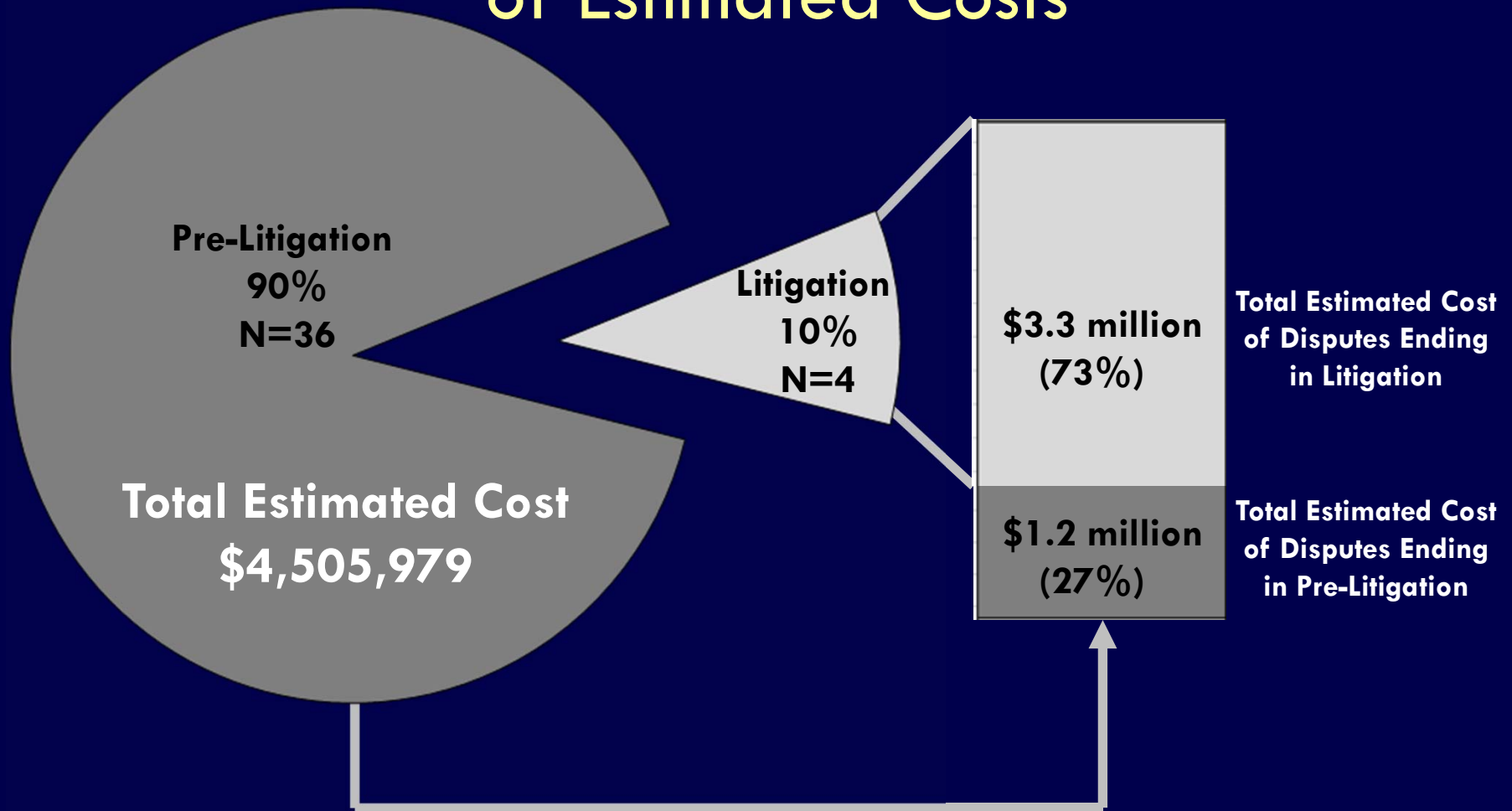
Estimated Cost of Dispute Resolution Process is a Small Fraction of Total Funding

- An estimated \$4.5 million was spent on the local education funding dispute resolution process between 1997 and 2015
 - Costs represent legal fees and mediation fees paid by boards
 - Costs are borne entirely by the county
- Estimated cost represents 0.5% of the total funds eventually appropriated to local boards of education in the disputed years (\$834 million)

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Litigation Phase is Responsible for 73% of Estimated Costs



10% of disputes are responsible for 73% of the cost



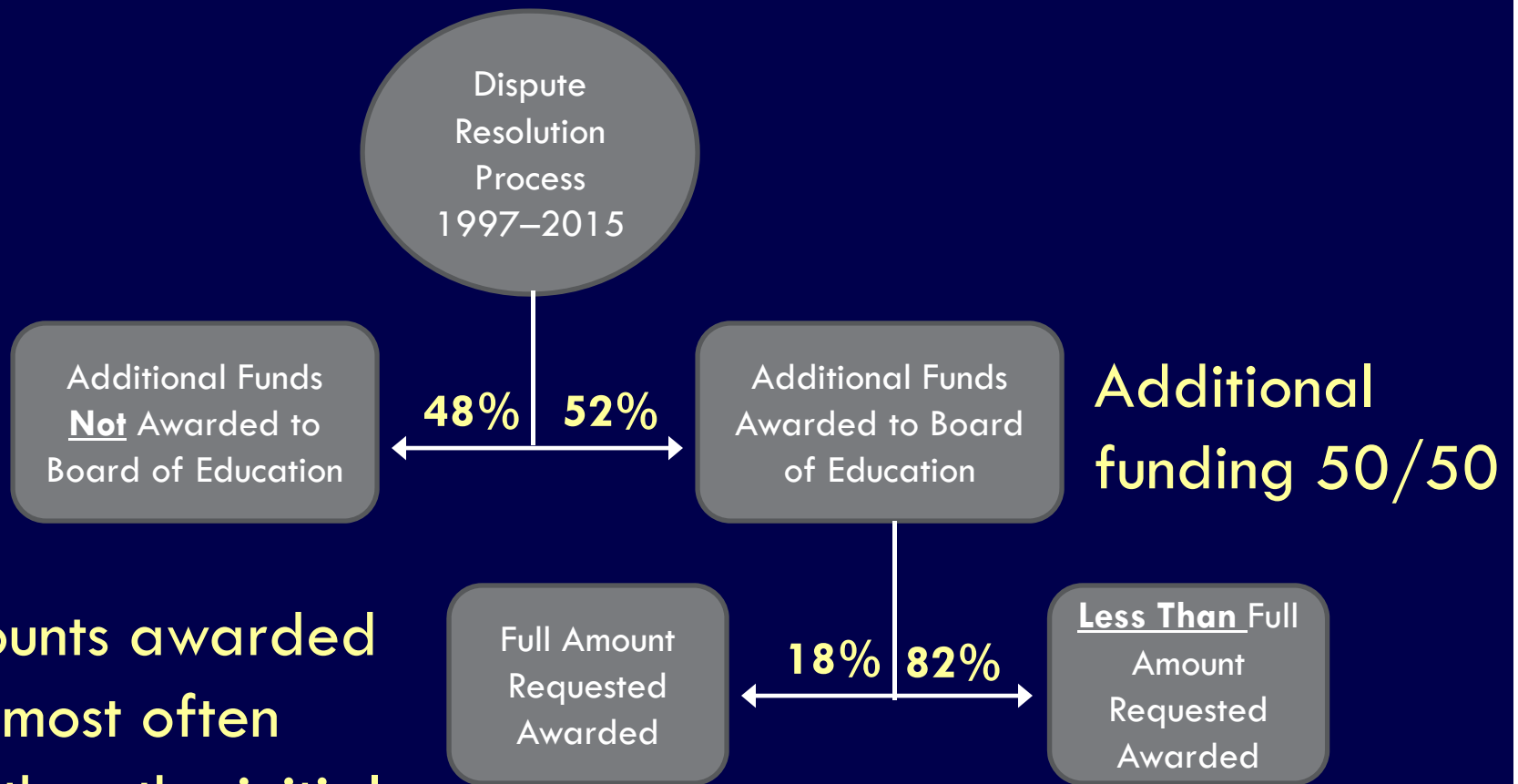
Finding 3

The funding-related outcomes of the dispute resolution process do not favor one party over another, and non-funding-related outcomes of the pre-litigation phase may improve future local education budgeting efforts

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Financial Outcomes: Additional funding vs. no additional funding



Amounts awarded are most often less than the initial amount requested

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Local Funding Dispute Resolution

Non-Financial Outcomes

- Process can result in non-financial outcomes that serve to improve future budgeting
 - Multi-year funding agreements
 - Student-based formulas
 - Bond referendums
- Attributable to the non-litigation phase

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Finding 4

North Carolina and Tennessee are the only states with elected school boards that are fiscally dependent on county commissioners; whereas North Carolina has a dispute resolution process that can involve litigation, Tennessee uses a default funding mechanism to avoid litigation

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Other States

- Charged with looking at how other states like North Carolina resolve local funding disputes
- Criteria
 - ✓ Fiscal Dependence
 - ✓ Board Structure (appointed vs. elected)

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Tennessee Is the Only Other State with Fiscally Dependent Elected School Boards

Method of Selecting School Board Members	Fiscally Dependent Local School Boards	Fiscally Independent Local School Boards	Total
Appointed Boards	1 (ME)	0	1
Elected Boards	2 (NC, TN)	37 (AK, AR, AZ, CA, CO, DE, FL, GA, IA, ID, IL, KS, KY, LA, MI, MN, MO, MT, ND, NE, NH, NM, NV, NY, OH, OK, OR, PA, SC, SD, TX, UT, VT, WA, WI, WV, WY)	39
Hybrid Model	6 (AL, CT, MA, MD, RI, VA)	3 (IN, MS, NJ)	9
Total	9	40	49

Tennessee avoids funding disputes through local funding requirements and default funding formulas



Finding 5

Local boards of education maintain relatively large unencumbered fund balances, which can contribute to funding disagreements and result in local resources being withheld from K-12 public schools

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Fund Balance

- A fund balance is the difference between assets and liabilities and generally represents a reserve of unspent resources
- Not all fund balances can be considered spendable reserves
- Encumbered vs. **Unencumbered**

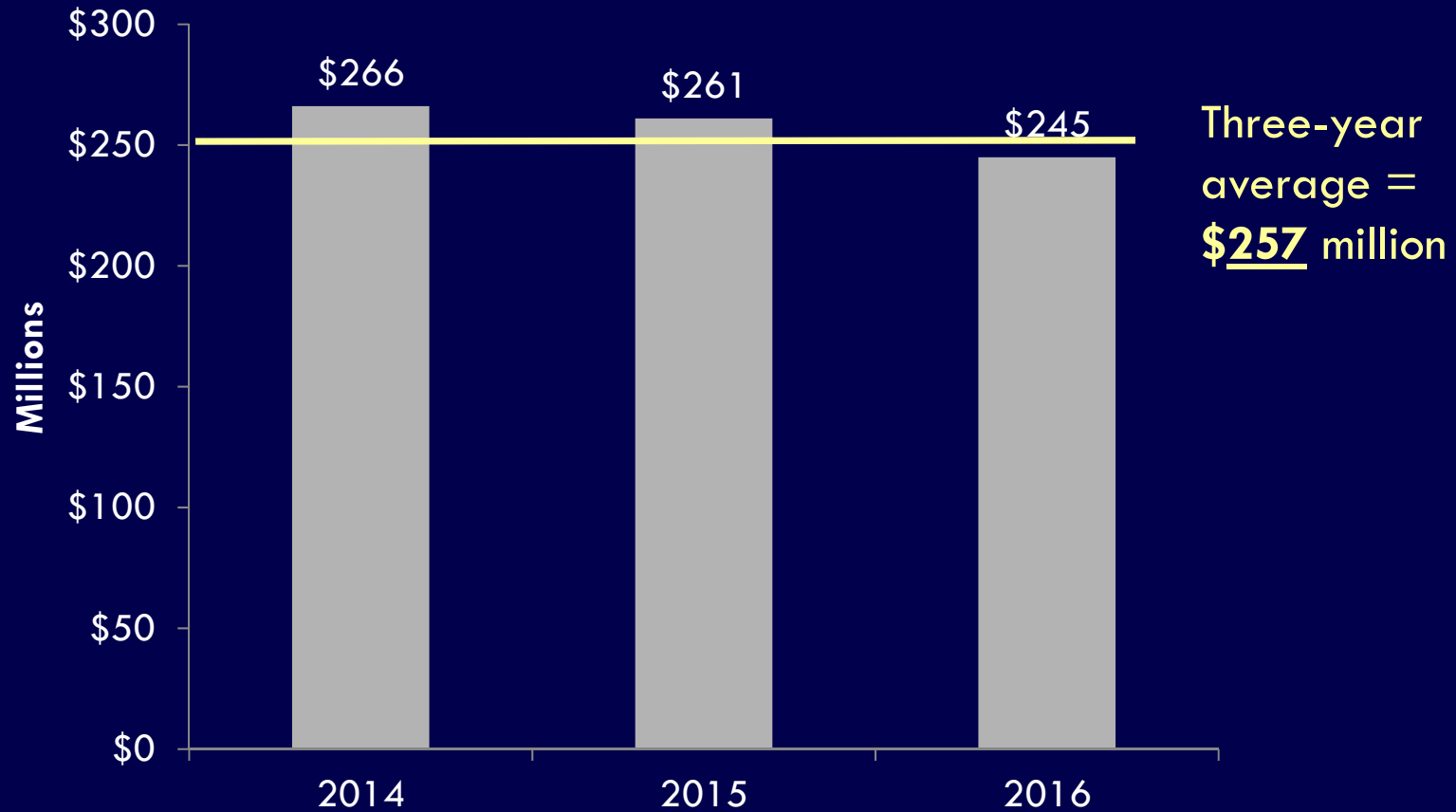


Unassigned Fund Balance

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Unassigned Fund Balances of Local Boards of Education are Relatively Large



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Unencumbered Fund Balance Ratios Vary Widely Across Local Boards of Education

Fiscal Year	Local Boards of Education Unencumbered Fund Balance Ratios		
	Minimum	Mean	Maximum
2013–14	0%	20%	77%
2014–15	0%	21%	82%
2015–16	0%	19%	70%
Three-year average	0%	20%	76%

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Justifications for Fund Balances

Justification for Fund Balances	Operational Need	Rationale Regarding Existence of Operational Need or Not
Meeting cash flow needs	◐	The majority of operational funding comes from state allotments and resources become available as expended. Furthermore, because local school funds are distributed on at least a monthly basis, cash flow needs are limited.
Avoiding challenges of the tax collection cycle	○	Local boards of education are non-tax collection units of government. Furthermore, school revenue from the collection of local taxes is distributed monthly and is not subject to the challenges of the tax collection cycle.
Maintaining reserves for emergencies and other unforeseen events	◐	LEAs are subject to emergencies and other unforeseen events. However, counties are charged with the statutory authority for appropriating local resources, so it is reasonable to assume counties serve as the source of reserves for LEA emergencies.
Increasing investment income	○	Local board of education investment authority is limited to N.C. Gen. Stat. § 115C-443 and capital.
Protecting credit ratings	○	Local boards of education do not have the authority to issue debt.
<p>No Operational Need Exists = ○ Some Operational Need Exists = ◐ Operational Need Exists = ●</p>		



Recommendations



Recommendation 1

Revise state law for settling local education funding disputes to preserve the benefits of the pre-litigation phase while replacing the litigation process with a default funding mechanism

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Recommendation 1

- Preserves state law directing the joint meeting and formal mediation stages of the dispute resolution process before triggering a default funding mechanism
- Default funding mechanism establishes a consecutive three-year framework for settling recurring local education funding disputes
 - Sensitive to changes in Average Daily Membership
 - Adjusted for changes in industry-specific Consumer Price Index

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Recommendation 2

Establish a working group to develop and recommend statutory parameters for fund balances maintained by local boards of education

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Recommendation 2

- Local Government Commission and School of Government should convene a working group including representatives from
 - North Carolina Association of County Commissioners
 - North Carolina School Boards Association
 - North Carolina Association of School Business Officers

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Recommendation 2

- Working group should develop and recommend parameters for local boards of education on
 - minimum and maximum fund balances with a focus on unencumbered funds,
 - uses of fund balances,
 - annual reporting requirements of fund balances,
 - how fund balances should be factored into annual local budgets for education, and
 - the role of boards of county commissioners, if any, in determining the use of fund balances



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