













Nonfarm payroll employment increased for seven consecutive months through March 2004. The gains were small, on average, and left employment below its level at the end of the 2001 recession. But they, along with declining initial claims for unemployment insurance benefits and declining layoff announcements, point toward better labor markets ahead.

While residential construction grew more slowly in the first quarter, home markets soared. Boosted by favorable weather and low mortgage rates, existing home sales in March reached their second highest level on record and new home sales jumped to a new record.

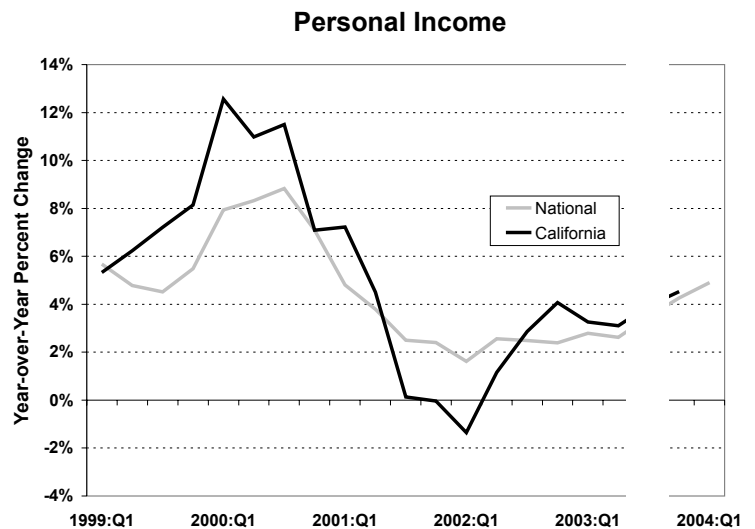
While still very low, inflation appears to be turning up. The Consumer Price Index jumped a higher-than-expected 0.5 percent in March. While surging energy prices were instrumental in the gain, a variety of non-energy prices also played a role—apparel, lodging, and medical care. Also, the Producer Price Index jumped in March in response to rising energy prices, higher food prices, and increasing prices of cars and trucks. In addition, there were large increases in crude and intermediate goods prices. The advance GDP report showed that the price index for gross domestic purchases, which measures prices paid by U.S. residents, increased at a 3.2 percent annualized rate in the first quarter, compared with an increase of 1.3 percent in the fourth quarter of 2003. Excluding food and energy prices, the price increase was 2.3 percent in the first quarter as compared with 1.5 percent in the fourth quarter.

## California

Since the release of the Governor’s Budget, positive signs in the economy have increased and troubling ones have grown fewer. Foremost among the positive signs is a pick-up in state personal income growth. In the second quarter of 2003, personal income was 3.1 percent higher than a year earlier; two quarters later it was 4.5 percent ahead of a year ago (Figure ECON–2). And once again, personal income is increasing more quickly in the state than in the nation.

Wages and salaries tell a similar story of improvement, as do state personal income tax withholdings. The latter look particularly strong, up almost 9 percent through the first four months of 2004. About a percentage point and a half of that gain is due to two extra days of collections in March 2004. Yet even net of that, the gain is quite striking.

FIGURE ECON–2















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Cash receipts associated with the 2003 tax year were higher than expected and this accounts for the upward revision in 2003-04. Through April, total personal income tax revenues, not including VCI collections, were \$285 million above the Governor's Budget forecast. This strength is assumed to be at least due, in part, to the upturn in the stock market that began in mid-2003. In 2002, capital gains were 70 percent below the 2000 peak level. Our estimate assumes the market has bottomed out and will continue on an upward trend. After the initial rebound of 30 percent from the 2002 low, capital gains are projected to grow at a 10-percent annual rate. The year-to-date strength in withholding, which was \$142 million above the Governor's Budget estimate, has been an encouraging sign. Total withholding from January through April was 8.8 percent above the year-ago level. Since withholding is based on current wages, it is a good indicator of current activity and this forecast assumes that the recent strength is real and ongoing.

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### **Sales and Use Tax**

The sales and use tax forecast has been decreased by \$105 million in the current year and \$417 million in the budget year. Through March, sales tax receipts were \$36 million below the 2004-05 Governor's Budget forecast. Taxable sales in the fourth quarter of 2003 were slightly below the January forecast and it appears first quarter 2004 sales are also somewhat below estimate.

Of the \$417 million reduction in 2004-05, \$175 million is due to an increased transfer to the Public Transportation Account (PTA). The PTA estimate has increased because gasoline and diesel fuel prices are higher than estimated in January. However, as previously discussed, \$140 million of this amount will be credited to the Traffic Congestion Relief Fund. The remaining amount is due to more modest expectations of taxable sales growth. For calendar year 2004, taxable sales are expected to grow by 4.1 percent, while 5.2 percent growth is expected for calendar year 2005.

On March 2, 2004, California voters approved Proposition 57, a bond act authorizing issuance of up to \$15 billion of Economic Recovery Bonds to fund the accumulated State budget deficit. To repay these bonds, a new one-quarter cent sales tax will become effective July 1, 2004. This sales tax will automatically cease as soon as the bonds are repaid. Because the local portion of the sales tax will decrease on July 1, 2004, the total base statewide sales tax will remain at 7.25 percent. Revenues from the one-quarter cent sales tax are estimated at \$1.136 billion in 2004-05, and approximately \$1.3 billion annually thereafter.

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### **Corporation Tax**

The corporation tax forecast has been decreased by \$173 million in 2003-04 and increased by \$358 million in 2004-05. The \$173 million reduction in 2003-04 reflects an increase attributable to a more positive corporate profits outlook for 2004, but which was more than offset by weakness in the final payments for the



2003 year. The \$487 million in recent cash collections related to the VCI is accrued to prior years, and so it does not affect the estimated total. The \$358 million increase in 2004-05 reflects a more positive corporate profits outlook and proposals to increase audit activities related to abusive tax shelters. The forecast anticipates continued improvement in corporate profits after three years of flat or negative growth.

FIGURE REV-2

## General Fund Revenue Forecast

### *Reconciliation with Governor's Budget (Dollars in millions)*

Source	Governor's Budget	May Revision*	Change Between Forecasts	
<b>Fiscal 02-03</b>				
Personal Income Tax	\$32,710	\$32,710	\$0	0.0%
Sales & Use Tax	22,415	22,415	0	0.0%
Corporation Tax	6,804	6,804	0	0.0%
Insurance Tax	1,880	1,880	0	0.0%
Other Revenues	4,728	4,728	0	0.0%
Transfers	2,785	2,785	0	0.0%
<b>Total</b>	<b>\$71,322</b>	<b>\$71,322</b>	<b>\$0</b>	<b>0.0%</b>
<b>Fiscal 03-04</b>				
Personal Income Tax	\$35,117	\$36,066	\$949	2.7%
Sales & Use Tax	23,714	23,609	-105	-0.4%
Corporation Tax	7,466	7,293	-173	-2.3%
Insurance Tax	1,985	2,085	100	5.0%
Other Revenues	4,825	4,807	-18	-0.4%
Transfers	1,520	731	-789	-51.9%
<b>Total</b>	<b>\$74,627</b>	<b>\$74,591</b>	<b>-\$36</b>	<b>0.0%</b>
Change from Fiscal 02-03	\$3,305	\$3,269		
% Change from Fiscal 02-03	4.6%	4.6%		
<b>Fiscal 04-05</b>				
Personal Income Tax	\$38,043	\$38,602	\$559	1.5%
Sales & Use Tax	25,022	24,605	-417	-1.7%
Corporation Tax	7,609	7,967	358	4.7%
Insurance Tax	2,078	2,170	92	4.4%
Other Revenues	2,858	2,769	-89	-3.1%
Transfers	797	575	-222	-27.9%
<b>Total</b>	<b>\$76,407</b>	<b>\$76,688</b>	<b>\$281</b>	<b>0.4%</b>
Change from Fiscal 03-04	\$1,780	\$2,097		
% Change from Fiscal 03-04	2.4%	2.8%		

\*These figures exclude the following amounts, which will be prior year adjustments:

- \$1.225 billion from the Voluntary Compliance Initiative
- \$185 million from the tax amnesty proposal
- \$465 million from the Farmer Brothers Company lawsuit

# K–12 EDUCATION

## Proposition 98 Guarantee

<b>2003-04</b>	<b>\$266.8 million</b>
<b>2004-05</b>	<b>\$275.2 million</b>

The 2004-05 Governor's Budget was based upon Test 2, which adjusts the prior guarantee level for growth in attendance and the change in per capita personal income. However, in recognition of the State's fiscal condition, the Administration and the education community agreed to rebase the 2004-05 Proposition 98 funding guarantee by \$2 billion and direct available funding to specific priorities. The May Revision maintains this agreement. Despite the proposed rebasing of the guarantee, approximately \$2.4 billion in additional funding capacity within the Proposition 98 budget is available for 2004-05 compared to the 2003-04 enacted Budget. This results from the natural growth in the guarantee, the release of funds used for one-time prior-year obligations, and other changes such as caseload adjustments in various programs and child care reforms. The amount of maintenance factor owed to schools and community colleges in future years as economic conditions improve remains at \$4 billion.

A slight decline in the K–12 average daily attendance (ADA) growth rate, from 1.02 percent to 0.95 percent, a decrease in the growth in per capita General Fund revenues from 4.4 percent to 4.2 percent, and slightly increased General Fund revenues subject to the State Appropriation Limit results in an increase of \$275.2 million to the 2004-05 guarantee. Additionally, the 2003-04 guarantee is \$266.8 million higher than the level in the Governor's Budget.

As shown in Figure K–12-1, the General Fund contribution to the guarantee increases by \$4.3 billion, while the local revenue contribution (property taxes) is reduced by \$3.9 billion. This large fund shift reflects the recent agreement with California's local governments to eliminate the VIF tax relief payments to local government (keeping taxpayer rates the same) and replacing those revenues with additional property tax allocations, and hold schools harmless by providing additional



General Fund moneys and reallocating local property taxes. Additionally, there is modest growth in the underlying property tax estimate and the portion of school property tax shifted to cities and counties for the deficit bond financing arrangement ('triple flip') is reduced by \$200 million from the Governor's Budget estimate due to timing of the implementation of the shift.

FIGURE K-12-1

**Proposition 98  
January vs. May Revision  
(Dollars in thousands)**

<b>2003-04</b>	<b>January Estimates</b>	<b>May Revision</b>	<b>Change</b>
General Fund	\$30,166,130	\$30,422,562	\$256,432
Local Revenue	15,778,671	15,789,049	\$10,378
<b>Total Guarantee</b>	<b>\$45,944,801</b>	<b>\$46,211,611</b>	<b>\$266,810</b>

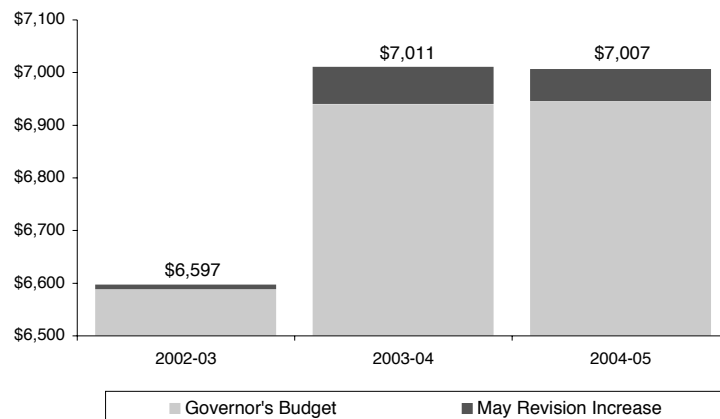
<b>2004-05</b>	<b>January Proposal</b>	<b>May Revision</b>	<b>Change</b>
General Fund	\$29,739,800	\$34,003,307	4,263,507
Local Revenue	16,973,852	12,985,590	-3,988,262
<b>Total Guarantee</b>	<b>\$46,713,652</b>	<b>\$46,988,897</b>	<b>\$275,245</b>
<b>Total Two-Year Funding</b>	<b>\$92,658,453</b>	<b>\$93,200,508</b>	<b>\$542,055</b>

**K-12 Per Pupil Funding**

Funding per pupil under Proposition 98 continues to increase as shown in Figure K-12-2. Increased appropriations for 2003-04 will raise the funding level from \$6,940 to \$7,011 per pupil. Of the 2003-04 amount, \$45 per pupil is proposed to be appropriated for the one-time purpose of reducing deferred appropriations, bringing the funding into the

FIGURE K-12-2

**Proposition 98 K-12 Per Pupil**





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2004-05 fiscal year. Since this does not impact classroom funding, a more comparable 2003-04 figure is \$6,966 per pupil. Per pupil funding of \$7,007 in 2004-05 represents an increase of \$62 from the Governor's Budget level of \$6,945 and an increase of \$41 from the comparable 2003-04 figure and a growth of \$410 per pupil from the 2002-03 level.

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## Implementing the Agreement

The May Revision reflects the further implementation of the Administration's agreements with the K-12 education community. The agreements provide that Proposition 98 funding will be reduced by approximately \$2 billion below the level provided by the Constitutional formula. The Administration has agreed that the priorities for spending any amounts above the levels needed for programs funded in the 2003-04 fiscal year are: (1) growth in enrollment and cost-of-living adjustments (COLAs), (2) restore general purpose revenue limit funding reductions made in the 2003-04 Governor's Budget, (3) pay valid State-mandate claims, and (4) provide additional general purpose funds and funding for State priorities in a 75 percent to 25 percent ratio.

In April, the Governor's Budget proposal was adjusted to shift more funding to restore prior-year reductions in general purpose funding and provide growth and COLA adjustments to additional programs by reducing funding for revenue limit equalization for K-12 and Community Colleges, instructional materials, and deferred maintenance. It was agreed that if the Proposition 98 guarantee calculation provided more funding in May that these reductions would be restored to the extent possible with equalization funding having a priority.

Current revenue estimates, as well as other factors in the Proposition 98 formula, provide increased funding of \$256 million in 2003-04 and \$275 million in 2004-05 for K-14 education above the Governor's Budget level. Consistent with the agreements for 2004-05, the Administration proposes full funding for K-12 and Community College growth and cost-of-living adjustments, restoration of K-12 and Community College equalization funding to the levels proposed in January, and significant increases in K-12 deferred maintenance and instructional materials funding above the levels proposed in April. Separate legislation will be proposed to appropriate the additional funding available in 2003-04 as a partial settle-up of the State's Proposition 98 obligations for that year.

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## K-12 Categorical Reform

The May Revision incorporates \$36 million of growth and COLA adjustments into the proposal to shift the funding for 22 categorical programs into local educational agency general purpose funding allocations. This will provide a total of \$2.1 billion for districts to use more flexibly than current program requirements allow. The Administration continues to believe that student achievement will be improved



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if schools have more discretionary funding to allocate to meet the unique needs of each school. The shift of this funding to revenue limits provides a significant opportunity for school districts to implement more participatory budgets including budgets allowing school site decision-making and using funding that follows the student. The Administration continues to support additional public disclosure of school budgets and opportunities for participation in school budgeting by school site leaders, parents, teachers, and community members, as provided in the Administration's categorical reform bill, AB 2824 (Runner).

Allowing flexible use of such a significant portion of school funding in 2004-05, approximately 5 percent of K-12 Proposition 98 resources, also provides opportunities for the fiscally stressed school districts to preserve their most important core educational functions.

The Administration continues to support improved systems of accountability and assistance to help students achieve high academic goals and is working with the Legislature and other parties to develop a coordinated and effective approach synthesizing the existing State and federal approaches.

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## **School Fiscal Conditions**

Although revenues from all sources available to schools in 2004-05 have increased by \$819 million, or 1.5 percent over the Governor's Budget level, school budgets will continue to operate under significant fiscal pressures. This is reflected in the steady increase in the number of school districts with negative and qualified certifications of their interim budget reports, rising from no more than 26 from 1995-96 through 2000-01 to 57 at the first interim report for 2003-04. To meet both State and federal academic achievement goals, school districts will need to increase services to students.

In recognition of this, the Administration has sponsored AB 2756 (Daucher) to improve school district budgeting, fiscal analysis, and oversight of school fiscal conditions. This legislation also improves existing provisions of law that deal with the conditions for receiving emergency loans when districts become insolvent. The goal is to prevent insolvencies, and, if emergency loans and temporary State takeover of a few districts becomes necessary, to correct the problems as quickly as possible and return decision-making authority to the district boards while achieving educational quality.

The May Revision reflects an estimated balance of \$181 million in emergency loans to school districts by the end of 2003-04, including \$60 million for a new loan recently requested by Vallejo Unified School District. These funds are drawn from the non-Proposition 98 portion of the General Fund and thus reduce resources available for health and human services, higher education, and other programs. The Administration proposes to refinance the initial General Fund loans with lease-revenue debt secured by school district property. This financing will be arranged

through the State’s Infrastructure Bank under new authority to be provided in proposed legislation. This will reduce 2004-05 General Fund expenditures by a net of \$167 million in 2004-05.

## K–12 Education Proposition 98 Funding

<b>2003-04</b>	<b>\$41,721.2 million</b>
<b>2004-05</b>	<b>\$42,087.3 million</b>

The May Revision increases funds from the Governor’s Budget level for K–12 education by \$230.4 million in 2003-04 and \$145.3 million in 2004-05. Proposition 98 General Fund increases by \$3.6 billion, while the local revenue contribution declines by \$3.5 billion. Total General Fund allocations of \$30.9 billion for K–12 education now represents 39.8 percent of the General Fund budget.

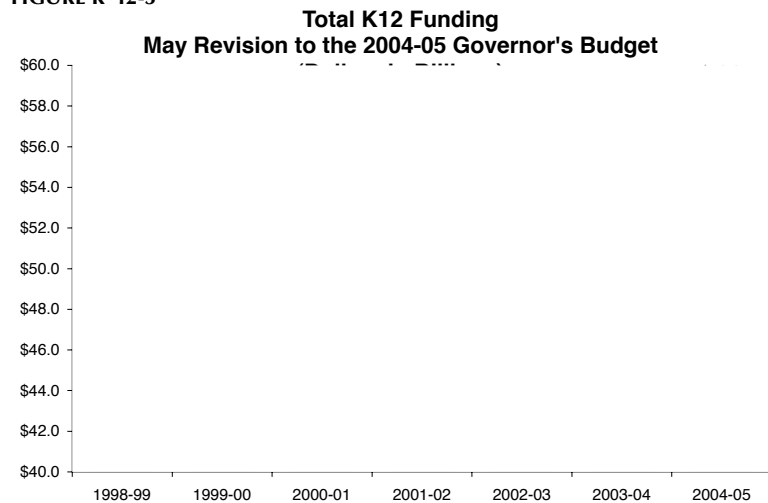
## Total K–12 Funding

The total of funding from all sources is increasing as shown in Figure K–12-3. For 2003-04, the May Revision reflects an increase of \$524.1 million from the Governor’s Budget level of \$50.2 billion. For 2004-05, an increase of \$818.7 million brings total funding to \$58.9 billion.

From 2003-04 to 2004-05, General Fund increases \$4.2 billion, while local property taxes fall by \$2.4 billion and federal funds grow by \$480.1 million. Major General Fund changes include:

- An increase of \$3.6 billion to Proposition 98 General Fund.
- An increase of \$157.1 million in the use of Proposition 98 Reversion Account General Fund.

FIGURE K-12-3



## Attendance Changes

The May Revision includes estimated 2003-04 K–12 ADA growth of 0.75 percent, down from 1.23 percent in the Governor’s Budget. General Fund costs for school district and county office of education revenue limits decrease by \$43.6 million,



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owing primarily to lower than expected ADA figures, which are partially offset by lower than expected local property tax revenue.

In 2004-05, the revised ADA growth is down, from 1.02 percent to 0.95 percent (32,309 ADA lower than the January estimate). The total number of ADA is estimated to be 5,950,626 in 2003-04 and 6,006,898 in 2004-05.

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## **Revenue Limits**

Revenue limit funding constitutes the basic funding source for classroom instruction. The May Revision reflects an increase of over \$3.4 billion in General Fund to replace property taxes shifted to local government as part of the local government revenue swap. The May Revision includes a decrease in growth of \$118.2 million reflecting lower than anticipated ADA, and an increase of \$168.8 million reflecting the change from an estimated 1.84 percent COLA to an actual of 2.41 percent.

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## **Basic Aid District Conforming Funding Reduction**

The May Revision proposes to reduce categorical funding to basic aid districts by \$2.7 million. This would effectively reduce General Fund support for the districts by an amount commensurate with a 0.3-percent revenue limit reduction. Basic aid districts fund their revenue limits exclusively through local revenues, and they are therefore not affected by the revenue limit deficit factor applied to all other districts. This reduction would conform to current year practice.

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## **Equalization**

Consistent with the agreement reflected in the April Finance Letter, as more Proposition 98 funds have become available than anticipated at that time, we propose restoring equalization funding to the original Governor's Budget level. The May Revision provides \$27.8 million to fund school district revenue limit equalization at \$110 million. In April, funding for equalization was proposed for reduction as part of an adjustment to reduce the revenue limit deficit factor from 1.2 percent to 0.3 percent and fund growth and cost-of-living adjustments for additional items. The Administration intends that these funds to be allocated in the manner specified in SB 1298 (Brulte).

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## **Instructional Materials**

The May Revision provides \$100 million to partially restore funding for the purchase of standards-aligned Instructional Materials to the level proposed in the Governor's Budget. In January, \$188 million was budgeted for this purpose in addition to the \$175 million base amount that is proposed to be shifted to revenue limits. In April, the \$188 million augmentation was proposed for deletion as part of an adjustment to reduce the revenue limit deficit factor from 1.2 percent to

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0.3 percent and fund growth and cost-of-living adjustments for additional items. As noted above, the agreement allows an increase in Proposition 98 funds available above the amount anticipated in January to be used to make a restoration of the initial augmentation.

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### **Deferred Maintenance**

The May Revision provides an additional \$107.1 million for the Deferred Maintenance Program above the adjusted level proposed in an April Finance Letter. This brings the proposed funding level for the Deferred Maintenance Program to \$184.1 million. As noted above, the agreement allows an increase in Proposition 98 funds available above the amount anticipated in January to be used to make a restoration of the augmentation proposed in the Governor's Budget.

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### **Special Education**

The May Revision provides a General Fund increase of \$44.0 million and also includes an additional \$63.7 million in federal funding over amounts proposed in the Governor's Budget. The General Fund increase is caused by the reduction in property taxes due to the local government revenue swap. These increases allow for full funding of growth at 0.95 percent, COLA at 2.41 percent, and maintains the State funding commitment at the 2003-04 level, consistent with federal requirements. In addition, \$31 million in federal funds is allocated to schools as a permanent increase to the base funding level for the special education program to assist in continuing the provision of federally required mental health related services, as discussed in greater detail below. Further, the May Revision provides \$38.4 million to partially fund a revised formula for allocating funding for pupils with exceptional needs placed in non-public, non-sectarian schools (NPS) who reside in licensed children's institutions (LCI).

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### **Individuals with Disabilities Education Act (IDEA)-Required Mental Health Services**

The May Revision sets aside \$31 million, in addition to the \$69 million in federal funds already included in the Governor's Budget, to provide mental health services for children with exceptional needs, as required by the IDEA. The Administration plans to work with the Legislature and interested parties to develop legislation that will ensure the provision of these services and do the following:

- Encourage cost containment.
- Outline clear roles and responsibilities among local agencies and other service providers for the provision of Individualized Education Plan (IEP)-related mental health services.



- Provide clarification as to what distinguishes “educationally necessary” treatment from “medically necessary” treatment.
- Address quality control issues, perhaps through the formation of a special entity to hear appeals.
- Allow for reasonable flexibility from IEP specifications. There should be allowances for providers, in accordance with professional standards, to alter the frequency and duration of treatments based on the pupil’s response.

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### **NPS/LCI Funding Reform**

The May Revision proposes a \$38.4 million augmentation for the funding of pupils with exceptional needs that reside in licensed children’s institutes and attend non-public schools. This augmentation is intended to reform the current funding system from a 100-percent reimbursement system that incentivizes inappropriate placements to one that allocates funds through a weighted formula that focuses on pupil needs. Allocation of the funding is subject to pending legislation.

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### **Charter Schools Facilities Grants**

The May Revision provides \$7.7 million in one-time Proposition 98 Reversion Account funding to fully meet the legislative intent to fund the Charter School Facilities Grant Program for three years. The program’s authorizing legislation stated the intent to fund grants for classroom-based charter schools that primarily serve low-income populations from the 2001-02 fiscal year through the 2003-04 fiscal year, but only two years have been funded due to the delay of the program’s startup and ultimate deletion of funding for the 2001-02 fiscal year. The funding proposed would match the current year level.

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### **Public School Library Materials**

The May Revision provides \$95.1 million in one-time Proposition 98 Reversion Account funding for the provision of classroom or school library materials. As the State’s recent budget difficulties have led to significant reductions in this program, the Administration believes it is appropriate to expend some of the available one-time resources to replenish and refresh classroom or school library materials. This will provide a one-time funding level of \$99.4 million for these purposes in 2004-05.

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### **Accountability**

The May Revision continues to provide \$77.4 million, including federal funds, for the third year of implementation funding for schools in the Immediate Intervention/Underperforming Schools Program that made significant progress but did not meet

their growth targets and \$208.6 million, including federal funds, for the third year of funding for schools participating in the High Priority Schools Grant Program.

The May Revision provides \$67.9 million in federal Title I School Improvement funds pursuant to legislation to fund accountability activities. The federal No Child Left Behind Act of 2001 requires states to ensure that all schools and school districts are meeting adequate yearly progress benchmarks. If a Title I school or school district fails to make adequate yearly progress for two consecutive years, it is identified as a Program Improvement school, and subject to interventions. Currently, 1,199 schools have been identified for Program Improvement. Beginning in September 2004, the State will be required to identify Program Improvement school districts as well.

The May Revision also proposes \$2.5 million in federal funds for increased support of the Statewide System of School Support, which provides assistance to schools, school districts, and county offices of education that are in need of improvement.

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## Pupil Testing

The May Revision continues funding of \$109.2 million, including federal funds, for various statewide exams. These assessments provide valuable information to parents, teachers, schools, and the State regarding pupil performance, and are the foundation of the State's accountability system for both State and federal purposes.

- **Standardized Testing and Reporting (STAR) Exam**—This exam, which serves as the primary indicator for the State's Academic Performance Index and the federal measure of Adequate Yearly Progress, measures pupil performance on various State-adopted content standards, coupled with a national norm-referenced exam in grades 3 and 8. The May Revision includes \$66 million for this exam, an increase of \$535,000 over the funding level proposed in the Governor's Budget. Because the STAR program currently has a January 1, 2005, sunset date, the Administration will be working with the Legislature to ensure that this sunset date is extended. SB 1448 (Alpert) would extend the sunset to January 1, 2011.
- **High School Exit Exam (HSEE)**—This exam helps to ensure that pupils who graduate from public high schools can demonstrate grade level competency in English-language arts and mathematics. Commencing with the Class of 2006, all pupils must pass the HSEE in order to receive a diploma. The May Revision includes \$21.2 million for this exam.
- **California English Language Development Test (CELDT)**—This exam is required to be administered to pupils whose primary language is not English within 30 days of enrollment and annually thereafter to pupils identified as English language learners. This assessment allows schools to ensure pupils are being taught using the correct curriculum. The May Revision reflects



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\$21.9 million for this exam, an increase of \$3.1 million over the funding level proposed in the Governor’s Budget. This increase includes \$2.5 million for CELDT apportionments funding and \$563,000 for contract costs.

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### **Alternative Education Facilities**

Consistent with the discussion in the Governor’s Budget Summary, the Administration proposes legislation in the May Revision to reform the State’s funding practices for alternative school facility construction for County Office of Education (COE) operated schools. In all cases except the Juvenile Court school programs, school districts may opt out of providing instruction and alternatively enroll certain students in alternative schools operated by the COEs. Under current school facility funding policy, COEs receive financial hardship funding for facilities construction because they do not have the taxing authority of school districts; thus no local match is provided and the State funds 100 percent of the cost. The Administration proposes that the appropriate school districts share the local match in proportion to the students referred from their attendance areas. This will restore the appropriate level of responsibility for the local match requirement in the School Facilities Program. Even with the passage of Proposition 55, known demand for modernization and new construction exceeds the availability of current bond authorizations with consequent pressure on State debt service. Failure to correct this policy flaw will exacerbate the pressure.

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### **Child Care Programs**

The May Revision includes a comprehensive Legislative proposal to address the issues of fiscal integrity including both overpayments and fraud as promised in the Governor’s Budget. Additionally, the Administration proposes several revisions to policies within the January child care reform proposal, reduces the calculated savings from those reforms, reflects reduced caseload in Stages 2 and 3 based on current year experience, and makes numerous technical adjustments to the funding sources for various programs to utilize additional one-time, prior year savings that have become available since the January budget. Significant highlights are discussed below:

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### **Comprehensive Fiscal Integrity Legislation**

As part of the January Governor’s Budget, the Administration committed to work with the State Department of Education (SDE) in the development of an anti-fraud proposal that will ensure that services are available to the neediest eligible families. The May Revision delivers on that promise, including a proposal that for the first time clearly defines fraud in child care programs, standardizes fraud prevention efforts and overpayment collection processes, authorizes the investigation and prosecution of fraud by county special investigative units, establishes sanctions,



and provides for compliance monitoring by the SDE. No budget savings are achieved by this proposal, which simply strengthens the fiscal integrity of the State's child care system and ensures that increasingly scarce dollars are used appropriately.

In addition to a package of necessary statutory changes, this proposal includes an increase of \$1.6 million in one-time federal funds relative to the Governor's Budget for the following purposes:

- \$530,000 for the establishment of 5.5 positions for SDE to conduct compliance monitoring and audits of providers and to annually quantify the results of its findings of overpayments and fraud. This will provide the State with increased information about how and where fraud occurs, aiding future refinements to this fiscal integrity proposal.
- \$3.1 million in reimbursements from SDE to the Department of Social Services (DSS) to fund 31 county investigator equivalents throughout the State that will be dedicated to the prevention and prosecution of fraud in all child care programs.

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## Child Care Reform Revisions

**CalWORKs Stage 3**—The Administration is aware of CalWORKs Stage 3 out-year cost pressures and equity issues for access to non-time limited services among the cash-aided populations and other working poor families. While the Governor's Budget originally proposed a one-year time limit for Stage 3 child care, effective July 1, 2004, the May Revision reflects an amended proposal in response to concerns raised by citizens, the Legislature, and other stakeholders.

This amended proposal will create a significant expansion in the number of non-time-limited slots in the Alternative Payment (AP) program, and provide greater opportunity for equitable access to services for both populations in the longer run. Moreover, it will provide a longer transition for those CalWORKs families whose income has increased over time due to past policies that prevented their application for regular child care waiting lists when they entered the work force. Finally, the proposal is conditioned upon the enactment of legislation in the 2004 session that permanently reforms Stage 3 and implements the reasonable reimbursement limit, family fee, and eligibility reforms proposed in January to address future cost pressures. The four essential parts of the amended proposal for Stage 3 include the following:

- Consistent with the original Governor's Budget proposal, all families in CalWORKs will be able to place their names on waiting lists for general child care programs once they have earned income.

































































































































































