

the CSEF resource

Center for Special Education Finance

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A Look at Changes in the Finance Provisions for Grants to States Under the IDEA Amendments of 1997

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The 1997 Amendments to the Individuals with Disabilities Education Act (IDEA, P. L. 105-17) make comprehensive changes to IDEA, including significant changes to the finance provisions for grants to states and preschool programs. This article highlights fiscal changes in the Part B State Grants program, focusing on changes in funding formulas and changes that impact special education policy at the state and local levels.

Grants to States

Until appropriations for the Part B Grants to States program (section 611) exceed \$4,924,672,200, state and substate grants will be calculated using the formula in the prior law, which is based on the number of children with disabilities who are receiving special education and related services. When appropriations exceed that \$4.9 plus billion amount, a new permanent formula will take effect.

States will continue to receive a base amount of funding equal to their award in the year before this “trigger” appropriation was reached. However, 85% of the funds above the base year amount will be distributed based on states’ relative share of the entire school-aged population, and 15% of the funds above the base year amount will be distributed

based on states’ relative share of the entire school-aged population in poverty.

Certain restrictions, including minimum and maximum grant provisions, apply to state allocations under the new formula.

This new formula likely will not become effective for several years. Appropriations for Part B Grants to States for Fiscal Year 1997 totaled \$3.1 billion. It appears likely that appropriations will reach the \$4.9 plus billion level sometime between 1999 and 2005, at which time the new formula would take effect.

State Education Agency (SEA) Allocations

The 1997 Amendments also revise IDEA funding for SEAs as follows:

■ **State Set-aside**—25% of the total amount the state received under IDEA in 1997, cumulatively adjusted each year by the lesser of the growth in inflation or the percent increase in the state award over the previous fiscal year, may be “set aside” for administration and other direct services and support.

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About CSEF

The Center for Special Education Finance was established in 1992 to address a comprehensive set of fiscal issues related to the delivery and support of special education services to children throughout the United States. CSEF’s mission, as well, is to provide information needed by policymakers to make informed decisions regarding the provision of services to children with disabilities, and to provide opportunities for information sharing regarding critical fiscal policy issues.

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Movement Toward Census-Based Funding Continues Amidst Questions

Daniel R. Kaleba and Thomas B. Parrish

National Context

Recently, two of the nation's largest states have committed to, or appear headed in the direction of, census-based special education funding (i.e., formulas based on total district enrollment rather than counts of special education students). California has already approved a census-based system, and New York is currently considering similar reform proposals. Prior to this, only six states—Massachusetts, Montana, North Dakota, Pennsylvania, Alabama, and Vermont—had implemented census-based special education funding models.¹

This trend is further supported by recent reauthorization of the federal Individuals with Disabilities Education Act (IDEA, P.L. 105-17), which incorporates a census-based funding adjustment in the federal funding formula. (See cover story for details.) Some of the reasons given by adopting states include attempts to remove fiscal incentives for identifying special education students, containment of increasing special education expenditures, and a break in the link between the manner and location in which children are served.

Other recent developments, however, point to concerns associated with census-based funding. After lengthy deliberations, Illinois has for now decided against such a system. Massachusetts, which has a census-based system, is still seeking ways to curb spiraling special education costs and enrollment. In Alabama, the census-based special education funding system was held to be unconstitutional by the State Supreme Court. California, although it has adopted a census-based system, still seeks answers to some fundamental questions associated with its implementation.

Funding Reform in California

With the passage of the *Poochigian and Davis Special Education Reform Act of 1997*, California special education funding has changed from a resource-based model to a census-based model.² Under the old approach, funding was linked directly to "units" of special education services received and programs provided at the special education local plan area (SELPA) level. Much criticism has been levied toward this model on the grounds that it was

inequitable, created incentives to place students in special education programs, was complex, and was inflexible regarding where children could be served.

According to the Bill, the reform was enacted for five principal reasons: (1) to ensure greater equity in funding among SELPAs; (2) to eliminate financial incentives to inappropriately place pupils in special education programs; (3) to enhance funding flexibility at the SELPA level; (4) to require fiscal and program accountability; and (5) to create a funding formula that is understandable and avoids unnecessary complexity.

Full implementation of the new census-based approach is scheduled to commence in the 1998–99 fiscal year. Although no district will lose funding through the phase-in period, provisions for increasing the overall equity of the system have been adopted, and over time all funds will be determined by a fixed amount per unit of average daily attendance (ADA) within each SELPA. Annual appropriations will be adjusted to annual shifts in ADA, equalization to the statewide target amount, inflation, and the incidence of severe or high cost disabilities.

CSEF is pleased to announce that a joint committee of the California Office of the Legislative Analyst, the California Department of Education, and the California Department of Finance recently awarded the Education and Public Sector Finance Group at the American Institutes for Research (AIR) contracts to conduct both the Disability Incidence and NPSA Cost studies. CSEF Co-Director Tom Parrish, who will be directing both the studies, has convened a group of researchers and special education finance experts to address these topics of national significance. CSEF expects to disseminate results of these important studies in summer 1998.

Census-Based Funding

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This landmark legislation was approved with the recognition that several important questions still need to be addressed. The legislation clearly designated two areas of education policy as requiring further study and appropriated the funds for these studies. The first set of issues relates to the incidence of disabilities across the state that are "severe and/or significantly above-average" in cost. If these incidence levels are found to be unevenly distributed across the state, the study is to recommend methods to adjust the funding formula to allow for these variations.

A second set of issues to be studied relates to nonpublic schools and agencies (NPSA). The purpose is to understand NPSA costs as compared to costs of public school placements, the cause of continuing increases in nonpublic school and agency costs and placements, and recommendations for cost containment. In addition, a major policy question is whether the state policy of reimbursing 100% of NPSA costs for children placed by the state in foster homes creates an incentive for this type of placement. If yes, how might these fiscal provisions be altered to remove such incentives?

Proposals for Reform in New York

The New York Board of Regents and Governor's Office have proposed separate changes to the state's special education funding system. Special education resources are currently driven by placements along a continuum of services, ranging from less restrictive speech and counseling services in general education classroom settings, to more restrictive placements in self-contained classes, to most restrictive residential, home, or hospital placements.

Concerns motivating the reforms are that the current system provides incentives for districts to place students in special education, and that these placements may be disproportionately in more restrictive settings.³ In addition, because the state's formula is based on the type of service delivered, and since districts receive more resources for more restrictive placements, districts may face financial incentives to place students in more restrictive placements.⁴ Such incentives conflict with the least restrictive environment (LRE) placement

service. The period 2001 through 2004 will mark the transition to a census-based model, such that all funding will be allocated through a census model by 2005.

The Governor's Office has also expressed interest in a census-based approach, and is expected to include a special education finance reform modified from the Regents' plan in its January 1998 budget. The Governor is expected to recommend a census-based funding system with a shorter transition period.

While census-based funding may be a move in the right direction, a number of important questions remain regarding this simple approach to special education funding. Will this solution for today produce the problems of tomorrow?

provisions of IDEA, and may be in violation of new fiscal provisions of the reauthorized law.⁵

The Board of Regents proposed special education funding reforms in December 1997. Foremost among these reforms is a change in special education funding from a placement-based to a census-based model. The Regents' plan includes a gradual phase-in of a funding model resembling the one adopted in the recently reauthorized IDEA. Like the federal plan, the Regents' plan includes an adjustment for poverty: at full implementation, 85% of funds will be allocated based on district enrollment, and 15% will be adjusted for district poverty.

The Regents' plan is to be implemented over a seven-year period, beginning in school year 1998-1999 with the existing weighted placement. Commencing in 1999 through 2001, funding will be allocated as a percentage of special education students in each district not weighted for level of

Census-Based Questions Remain

Other recent developments point to continuing questions about the merits of census-based systems. In Illinois, after struggling with questions relating to special education finance reform for quite some time, a decision was made, at least for now, against a census-based model. After lengthy deliberations, in 1994 a state-level special education finance reform committee settled on a set of census-based funding proposals for the state. However, these proposals failed to gain the support needed to be enacted into law; and four years later, overall special education finance reform based on some form of census model is no longer being actively considered. Rather, a current committee is attempting to remove existing funding distinctions between "high cost" special education students when served in public versus private settings.

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State Special Education Finance Systems, 1994–95

In June 1997, CSEF published an updated summary of state special education finance systems, based on a survey of the states conducted in 1995–96. Part of CSEF's *State Analysis Series*, this report includes an overview of state special education funding systems and the policies that guide them, abstracts of each state's special education funding formula, the most current available data on federal and state special education revenues and expenditures, and trends in special and general education expenditures. The report suggests that special education finance policy may be at an important crossroad as special education enrollments and demand for services continue to grow and special education budgets continue to be strained. To keep abreast of ongoing state special education funding reforms and expenditures, CSEF hopes to collect and disseminate updated information from states during 1998.

The current report can be accessed and downloaded from CSEF's World Wide Web page [<http://csef.air.org>] or ordered in hard copy from CSEF.

Several CSEF staff are now conducting two important state cost studies related to California's newly adopted census-based special education funding system. One study examines the incidence of students with severe disabilities across the state, while the other focuses on the growing costs of nonpublic school placements. (The article on census-based funding reform describes these studies in more detail.)

AEFA Yearbook Due in Fall

Edited by CSEF staff, the 1998 American Education Finance Association (AEFA) Yearbook, entitled *Funding Special Education*, is scheduled for release in fall 1998. This volume of papers, written by CSEF staff and other experts in the field of education finance and special education reform, will provide an overview of the current status of special education funding in the U.S., as well as an international perspective on special education funding and inclusion. Papers also address

special education finance reforms in Massachusetts, New York City, New York State, and Pennsylvania; recent judicial decisions on the constitutionality of state special education finance systems; consolidation of categorical education programs at the local level; and the inclusion of students with disabilities in standards-based education reform. Information on how to obtain a copy of the 1998 Yearbook will be provided upon its publication by Corwin Press.

CSEF's Evolving Role in 1998

Since CSEF's inception in 1992, our role has evolved to meet a growing demand for accurate and meaningful information about the costs of special education and for expert analyses and guidance to support policymaking related to special education finance. Emerging information needs have led to increased activity by CSEF in providing on-site technical assistance to states wrestling with special education funding issues and fast turnaround responses to inquiries from diverse stakeholders at the federal, state, and local levels.

Several priorities characterize CSEF's busy agenda this year: (1) conducting state studies, (2) consulting with states engaged in special education finance reform and sharing related information across the states (*see story on census-based funding*); (3) providing updates related to changes in the fiscal provisions mandated by the IDEA Amendments of 1997 (*see cover story*); (4) conducting analyses of extant data to better document special education expenditures; and (5) expanding the use of technology and CSEF's Web page to disseminate policy-relevant data to our diverse stakeholders more rapidly and efficiently.

Of particular interest is Tom Parrish's continuing consultation with states and professional organizations. Over the past year, Dr. Parrish has provided technical assistance to the states of California, Illinois, Michigan, New Hampshire, New York, North Carolina, Oregon, and Wyoming; made presentations at the New York Board of Regents State Finance Conference relating to the state's new special education funding initiative, and at an OSEP-sponsored international conference on special education finance; and participated on a special education finance panel for the National Research Council.

NEW AND ON THE HORIZON FROM CSEF

■ The Federal Resource Center for Special Education (FRC) recently published *Special Education Finance*, a paper by CSEF's Co-Director Tom Parrish, as part of a series titled *Special Education in an Era of School Reform*. The report provides an overview of current issues related to special education finance and discusses some of the major fiscal policy questions surrounding the funding of special education programs under IDEA. It also describes new state and federal reform initiatives to finance special education; how funding methods affect instructional program objectives; criteria to consider when developing funding systems; how state fiscal policies can encourage integrated services; and how states can overcome difficulties in implementing fiscal reform policy. *The report is available through the Federal Resource Center, Academy for Educational Development, 1875 Connecticut Avenue, Suite 900, Washington, DC 20009, (202) 884-8215.*

■ The New York State Board of Regents invited Tom Parrish to prepare a paper for its October 1997 Education Finance Symposium on "restructuring education funding in New York to promote the objective of high learning standards for all students." The paper provides a national perspective on special education finance and related reform issues and proposals, with emphasis on those of particular relevance for New York. It also focuses on the current New York funding system as it pertains to students with disabilities and to promoting high learning standards for all students. The paper concludes with an examination of recent proposals to reform special education finance in New York and several observations related to the alignment of the proposed census-based funding system and the state's reform goal of assuring that students with disabilities are educated with their nondisabled peers to the greatest extent possible. (*See article on census-based funding.*) *This paper will be published as a monograph through the New York Board of Regents at a later date.*

IDEA AMENDMENTS OF 1997

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■ **State Administration**—The larger of either 20% or \$500,000 of the set-aside may be used for administration, including costs for technical assistance and coordinating activities with other programs that provide assistance to children with disabilities. (A smaller amount for administration is specified for outlying areas.)

■ **State Services and Direct Support**—The remainder of the funds retained by the state, and not used for administration, must be used for direct and support services, for monitoring and complaint investigation (above the amount spent in FY 1985), to establish and implement the mediation process, to assist LEAs in meeting personnel shortages, to develop a State Improvement Plan (SIP), for state and local activities to meet performance goals and support SIP implementation, to supplement other amounts used to develop and implement a Statewide Coordinated Services System designed to improve results for children with disabilities (capped at no more than 1% of total state grant), and for subgrants to LEAs for system capacity building and improvement.

■ **Mandated Grants to LEAs**—Additional funds (if at least \$100,000) for new subgrants to LEAs are required in every year that the state's allocation increases by more than the rate of inflation over the prior year. These funds are to be used for making systemic changes to improve results for children with disabilities.

Fiscal Policy Provisions

The IDEA Amendments of 1997 also enact significant change related to least restrictive environment (LRE) provisions, benefits for nondisabled students, fiscal accountability, and schoolwide programs under the Elementary and Secondary Education Act (ESEA), Title I.

■ **Placement Neutrality**—States with funding formulas that distribute assistance to LEAs based on the type of setting in which a child is served must have policies and procedures to assure that their funding provisions do not result in restrictive placements that violate the LRE

requirement of IDEA. This new requirement could affect about one-quarter of the states, whose special education funding systems are based primarily on placement, unless they can insure that placements are not being made in violation of the LRE requirements. It could affect additional states with subsidiary provisions based on placement, such as additional funding for students served in separate schools or institutions, or categorical funding for special education transportation services, if those provisions are resulting in placements that violate the LRE requirements.

■ **Benefits for Nondisabled Students**—Another change allows nondisabled students to receive benefits from special education services provided for children with disabilities. The provision encourages LEAs to meet an important intent of the law—that children with disabilities are educated to the maximum extent possible with children without disabilities—without having to fear audit exceptions under the excess costs or commingling of funds requirements.

■ **Schoolwide Programs**—For the first time, LEAs may use Part B funds to carry out schoolwide programs under Title I, ESEA (with restrictions).¹

■ **Bridging Services**—An LEA may also use up to 5% of its State Grant funds, in combination with other funds, to develop and implement a coordinated service system designed to improve results for

children and families, including children with disabilities. A state may use not more than 1% of its grant funds, which must come out of the state set-aside, to supplement other funds used to develop and implement a statewide coordinated service system.

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The 1997 Amendments also enact significant change related to LRE provisions, benefits for nondisabled children, fiscal accountability, and schoolwide programs under Title I.

¹Under ESEA, schools with at least 50% of their children in poverty are eligible to provide schoolwide programs, which allow funds from a variety of state and federal categorical programs to be combined in ways that promote the provision of a unified set of instruction for all children in the school. IDEA funds must meet other IDEA requirements, and other restrictions apply, including a limitation on the amount of IDEA funds that may be used in a schoolwide project.

Census-Based Funding

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In Massachusetts, the experience with census-based funding suggests that it may be insufficient alone to solve state funding problems. Although a census-based system was implemented under the Education Reform Act of 1993, a group of legislators has introduced a plan to overhaul the state's special education system in an attempt to curb its increasing costs and enrollment.⁶ Although it is unclear that the census-based system in the state is in jeopardy, Massachusetts' experience seems to suggest that census-based approaches alone, in the absence of a broader set of reforms, may be relatively ineffective.

In Alabama, concern with the state's census-based approach to special education funding came from the judicial branch of government. The State Supreme Court found that Alabama's census-based formula violated the equal protection clause of the state constitution because as numbers of special education students identified in a school district increased, the funding per child decreased. However, the Alabama court also refused to endorse the major finance alternatives to a census-based system, expressing concerns that they may produce incentives to over-identify special education children or to place them in more restrictive settings. (See CSEF Brief No. 9 for details.)

Other states may also have adopted census-based systems more by default than due to compelling evidence that it provides clear answers to state funding questions. As described above, in California there are lingering dilemmas of how to address such questions as variations in the true incidence of special education needs across districts. For example, do districts offering exemplary services

for students with disabilities attract disproportionate shares of such children, and as a result become penalized by census-based systems that do not reflect such variations?

In addition, as we look to the 21st century, how will census-based systems operate in such general education reform environments as increased parental choice and charter schools? Initiatives providing for enhanced student choice and mobility among school districts seem to work against the assumptions of equal incidence upon which census-based systems are based.

Summary

Census-based funding models appear to be the answer of the day in special education finance reform. They have clearly received considerable attention, and have been adopted by some of the nation's largest states. The inclusion of a census-based adjustment in the 1997 IDEA reauthorization has undoubtedly encouraged this trend. These states are moving away from prior formulas that were considered outmoded. Many of the old funding models are seen as encouraging expanding identification for special education services, as inflexible, and as fostering more restrictive placement. In addition, the prior California system was also viewed as highly inequitable and incomprehensible.

While census-based funding may be a move in the right direction, a number of important questions remain regarding this simple approach to special education funding. Will this solution for today produce the problems of tomorrow? One of the most important questions is the extent to which census-based

systems create funding inequities by failing to recognize variations across districts in the true incidence of severe or high-cost students. The purpose of the new CSEF study for the state of California is to explore this very important special education finance policy question. □

¹Parrish, T., O'Reilly, F., Dueñas, I., and Wolman, J. (1997). *State special education finance systems, 1994–95* (State Analysis Series). Palo Alto, CA: Center for Special Education Finance, American Institutes for Research, p. 13.

²California Assembly Bill 602, Chapter 854, Statutes of 1997, approved and filed October 10, 1997.

³Fruchter, N., Parrish, T., and Berne, R., (forthcoming). Financing special education: Proposed reforms in New York City. *Funding Special Education*, 1998 AEFA Yearbook. Thousand Oaks, CA: Corwin Press.

⁴It can be argued that fiscal incentives exist only when revenues exceed cost of placement. This argument, however, is only half true. If marginal revenues are equal between a less restrictive and a more restrictive placement, no incentive should exist other than the incentive to best serve the child. If costs are unequal, the incentive exists to select the placement with the higher marginal revenue. If costs, marginal or net, are equal, the incentive also exists to place the student in the highest revenue-generating placement, which is the most restrictive.

⁵For a discussion of removing fiscal incentives for restrictive placements, see also Parrish, T. (1995). *Fiscal policies in special education: Removing incentives for restrictive placements* (Policy Paper No. 4). Palo Alto, CA: Center for Special Education Finance, American Institutes for Research.

⁶Cahir, W., ed., "Mass. Considers Scaling Back Special Education Standards," *Special Education Report*, 24 (2) (January 21, 1998): 8.

IDEA Amendments of 1997

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■ SEA Fiscal Accountability

Provisions—Under new provisions for maintenance of effort, states may not reduce the amount of state funding for special education below the level of the prior year.

■ LEA Fiscal Accountability

Provisions—As before, LEAs are required to use Part B funds for the excess costs of providing education and related services to children with disabilities, to supplement-not-supplant other funds, and to maintain spending at the level of the prior year. However, several exceptions provide increased flexibility to LEAs by permitting reduced expenditures under specified circumstances, and allowing certain increases in federal funds to be treated as local funds.

Likely Impact

It is too early to assess the impact of these federal funding provisions. However, CSEF, in collaboration with OSEP, plans to gather and disseminate further information about the new provisions, and their potential impact to state and local stakeholders over time. □

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