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Three Interrelated and Frequently Confused Concepts That Affect Local Funding Requirements for Education

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There are three entirely separate provisions that affect the amount of local revenue that must be devoted to education. In a nutshell, they are

- ***Maintenance of Effort**—prevents local governments from reducing funding for education from one year to the next*
- ***Matching Requirements**—establishes a specific dollar amount that must be provided in a particular year from local sources in exchange for a specific amount of state funding*
- ***Fiscal Capacity**—used to determine how to allocate matching requirements among local governments and school systems*

State legislators often hear complaints from local officials that they are not getting credit for capital outlay and debt service for education. These complaints relate to local education funding requirements imposed by the state, particularly since the adoption of the Basic Education Program (BEP) funding formula in 1992 as part of the Education Improvement Act (EIA).

The BEP produced a dramatic increase in state funding for public schools phased in over a period of six years, and the EIA gave school boards and directors more flexibility in meeting a new set of goals. Many regulations were removed, and earmarks were reduced to essentially two: funding generated by the classroom components of the BEP formula had to be spent in the classroom, and the Career Ladder and Extended Contracts programs were retained without change.[1] Tennessee no longer had categorical funding programs such as pupil transportation, capital outlay, benefits for teachers, textbooks, leave for teachers, duty-free lunch, teachers' aides, guidance counselors, alternative schools, at risk students, attendance supervisors, supervising principals, and so on. All of those programs were incorporated into the new BEP formula in 1992.

In return for the additional state funds and increased flexibility, school systems were required to reduce class sizes by an average of 4½ students and accept considerably stronger accountability measures, both for student achievement and for fiscal effort. The new fiscal requirements raised the bar on local governments and even today, more than ten years later, are not well understood. Three separate provisions determine the amount of

[1]The Career Ladder program has since been cancelled, and no new applicants have been accepted since 13 June 1997. Career Ladder supplements for educators who earned them prior to that time continue until they resign or retire.

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local funding that must be provided for education. Two work together to determine the local matching requirement for the BEP. The other is designed to ensure that state funds are not substituted for local funds as time goes by. It predates the BEP formula, but was strengthened as a major component of the new focus on fiscal accountability under the EIA.

Maintenance of Effort

Maintenance of effort requirements, sometimes referred to as supplanting prohibitions, prevent local governments from substituting state (or federal) funds for local revenues as state (or federal) funding increases. The rationale is to ensure that the additional funds provided are used for improvements or inflation, not simply to maintain spending levels previously supported by local revenue.

Maintenance of effort requirements differ from matching requirements in that the former do not require a minimum amount of local funds in exchange for receipt of state or federal funds, but rather prohibit reductions in local funding from one year to the next. In fact, Tennessee's maintenance of effort requirement is not directly related to the BEP formula and actually predates it.

Tennessee state law on maintenance of effort, codified at *Tennessee Code Annotated* §49-2-203 (a)(10)(A)(ii) and §49-3-314(c), is consistent with federal requirements under the Elementary and Secondary Education Act in that both exclude capital outlay and debt service from the maintenance of effort requirement. If capital outlay and debt service were not excluded from these provisions, then school systems and the local governments that fund them would be forced to maintain the effort necessary for one-time capital expenditures and repayment of debt after the capital asset were acquired and any related debt repaid. Tax increases adopted for those purposes would have to remain in place after the capital assets were acquired and any related debt repaid or an equivalent amount of revenue would have to be substituted. No doubt, most Tennessee school systems could use the additional funds, but if the law were to require it, at best it might be seen as punitive and at worst it might discourage local governments from making the effort to build and equip schools in the first place.

Comparison of Statutory Loca

	Maintenance of Effort Requirements
Establishes specific funding requirements?	Yes
Excludes capital outlay and debt service?	Yes-otherwise revenue increases would have to be maintained after debt was retired
Directly related to revenue raised in the past?	Yes

* Does not include bond proceeds or transfers used to fund capital outl

Local Matching Requirement

In contrast to the year-to-year comparisons made to enforce maintenance of effort requirements, matching requirements stand on their own each year and depend on current calculations based on the cost of a program and the predetermined percentages to be paid by different levels of government that work together to fund the program. In the case of the BEP, the local share is thirty-five percent of the cost of instructional positions (mainly teachers), twenty-five percent of the cost of other classroom components and fifty percent of non-classroom components (*Tennessee Code Annotated* §49-3-356). The specific local matching requirement varies from county to county based on differences in fiscal capacity.

In most cases, because school systems are already spending more from local funds than the BEP requires, the matching requirement is less than the maintenance of effort requirement. There are several other essential differences between the two.

First, the state maintenance of effort requirement does not dictate how the funds are spent. In contrast, the matching requirement relates directly to the components of the BEP.

al Education Funding Provisions

	Matching Requirements	Fiscal Capacity
	Yes	No-used to allocate matching requirements for state programs among the state's 95 counties.
	No- local revenue that funds either can be used to match state non-classroom dollars.*	No-includes any local revenues to support those expenditures reported by LEAs.*
	No	No-predicts ability to raise revenue.

lay or debt service.

Second, revenue used to comply with the maintenance of effort requirement can be shifted from program to program without penalty. In contrast, classroom funds earned through the BEP formula are earmarked for use in the classroom (*Tennessee Code Annotated* §49-3-354(c)).

Third, the BEP formula includes a component for capital outlay that is based on estimating the cost of issuing debt to build schools; therefore, local revenue raised for capital outlay or debt service may be used to meet the matching requirement even though it does not have to be maintained after debt is repaid.

The Department of Education looks broadly across all local government entities to identify all revenues that might support BEP components in order to ensure that all school systems meet the matching requirement. Such revenues may include funds used by cities and counties for education capital outlay and debt service outside school systems' budgets. Far from failing to give local governments credit for capital outlay and debt service, the Department counts every penny in order to qualify school systems to receive BEP funding.

Fourth, the revenue required to meet the maintenance of effort requirement typically exceeds the amount required by the BEP match because the BEP does not cover every kind of expenditure required to operate a school system. Consequently, school systems generally spend far more than the minimums the BEP imposes. Perhaps the most significant items not fully funded by the BEP are services necessary to provide substantially equal educational opportunities for disadvantaged students and English language learners. Other items not included in the BEP are many central office functions such as fiscal and information systems staff.

Fiscal Capacity

The primary purpose of fiscal capacity is to allocate responsibility for paying the local match required to receive state BEP funds among Tennessee's counties. The general directive on fiscal capacity is codified along with the BEP matching requirement at *Tennessee Code Annotated* §49-3-356.

The current fiscal capacity formula is designed to estimate the amount of local revenue each county can be expected to raise for education based on its tax base, its education service responsibility, its relative tax burden, and the ability of its residents to pay taxes. It takes into account all current revenue, including revenue used by school systems to repay debt. The reason for this is to ensure as close a match as possible between the fiscal capacity calculation and the components of the BEP formula, which is the primary use of fiscal capacity.

One difference between the revenues used in the fiscal capacity formula and those used to determine whether the local matching requirement has been met is that *fiscal capacity does not include revenue for education debt service outside the school systems' budgets*. While the Department of Education asks school systems to report those items, there is no statutory provision or regulation requiring them to do so and little incentive otherwise. The result is that fiscal capacity in the aggregate (i.e., for all counties combined) is probably understated.

The fiscal capacity formula does not directly compute the BEP matching requirement. The revenues on which it is based include much more than the amounts required for the BEP. In fact, they exceed even those

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used to determine maintenance of effort because they include revenues that support capital outlay and debt service.

The revenue used to compute fiscal capacity exceeds the BEP matching requirement in order to fulfill the broader purpose of determining what each county can reasonably be expected to do based on what all counties do. Limiting the analysis to the BEP would over time, in a sense, create a self-fulfilling prophecy.

Once fiscal capacity is determined, the Department of Education scales back the county figures to equal the aggregate local share. For the most recent school year, total fiscal capacity was estimated at more than $2 billion, but the local share for the classroom components for the BEP was only $1.2 billion and the share for the non-classroom components was only $580 million. TACIR provides percentages for the Department to use for this purpose. Essentially, the effect is to determine each county's requirement by multiplying the ratio between total fiscal capacity and the total matching requirement by that county's fiscal capacity.[2]

[2]The TACIR staff have produced a number of publications explaining the details and presenting the results of the fiscal capacity calculations, most recently in May 2004. See our web site at www.state.tn.us/tacir.

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