

IN THE SUPREME COURT OF ARKANSAS

**LAKE VIEW SCHOOL DISTRICT NO. 25
OF PHILLIPS COUNTY, ARKANSAS, ET AL.**

APPELLANTS

v.

No. 01-836

GOVERNOR MIKE HUCKABEE, ET AL.

APPELLEES

**SPECIAL MASTERS' REPORT
TO THE SUPREME COURT OF ARKANSAS**

**SPECIAL MASTER BRADLEY D. JESSON
SPECIAL MASTER DAVID NEWBERN**

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This report is submitted by Bradley D. Jesson and David Newbern pursuant to an order of the Supreme Court of Arkansas of June 9, 2005. The order reappointed us to serve as special masters in this matter concerning the obligation of the State of Arkansas to provide public education to its citizens in accordance with requirements stated in the Constitution of Arkansas.

By its decision in *Lake View Sch. Dist. No. 25 v. Huckabee*, 351 Ark. 31, 91 S.W.3d 472 (2002), the supreme court held that the Arkansas school-funding system violates the equal-protection sections of the Arkansas Constitution and that the State of Arkansas failed to comply with the constitutional provision which

requires the state to provide a “general, suitable, and efficient system of free public schools.” Ark. Const. art. 2, §§ 2, 3, 18; Ark. Const. art. 14, § 1. The court stayed its mandate until January 1, 2004, noting that the 84th General Assembly was to hold its Regular Session in 2003.

On February 3, 2004, the court appointed us as special masters to review the progress made by the state toward meeting the constitutional requirements. *Lake View Sch. Dist. No. 25 v. Huckabee*, 356 Ark. 1, 144 S.W.3d 741 (2004). The 84th General Assembly continued its work in extraordinary session and enacted a number of measures aimed at curing the constitutional deficiency. We filed a report on April 2, 2004, and the supreme court issued its Supplemental Opinion, June 18, 2004, releasing its mandate. *Lake View Sch. Dist. No. 25 v. Huckabee*, ____ Ark. ____, ____ S.W.3d ____ (June 18, 2004).

The Arkansas General Assembly again addressed public-education issues in its 85th Regular Session, which began in January 2005. On April 14, 2005, after the General Assembly had concluded its work, Rogers School District No. 30 filed its motion to recall the mandate in this case. The motion was later joined by more than forty additional school districts which had been either parties or *amici curiae* of record. They alleged that they could not provide constitutionally adequate education because the General Assembly had not complied with certain

obligations it had undertaken in the 2003 legislation and that public schools had been underfunded as the result of legislated mandates and quirks in the scheme of public-school finance.

In its June 9, 2005 order, the court reappointed us to serve as special masters to examine issues surrounding allegations that the “General Assembly reneged on its legislative commitments and failed to comply with the landmark legislation” in support of public schools which was passed during the Second Extraordinary Session of 2003. According to the court’s order, our task is “to examine and evaluate” those issues and “any other issue [we] deem relevant to constitutional compliance.”

This report comprises three parts: a description of the major aspects of Arkansas public-school finance; findings of facts relevant to the issues raised by the movants; and our discussion and evaluations with respect to those issues and those facts.

I. Public-School Finance

The discussion that follows introduces basic terminology and concepts utilized in the legislation through which the State of Arkansas funds its public schools. Some repetition necessarily occurs in the latter parts of this report in which the funding devices are discussed in much greater detail.

A. Foundation Funding

The current system of Arkansas public-school finance was established, for the most part, by the General Assembly in the Second Extraordinary Session of 2003. Public schools, including kindergarten through grade twelve, are to receive “foundation funding” from the state, augmented by “categorical funds” for students who have special needs.

“Foundation funding” is defined at Ark. Code Ann. § 6-20-2303 (6) (Supp. 2005) (Act 59, 2nd Ex. Sess. of 2003) as “an amount of money specified by the General Assembly for each school year to be expended by school districts for the provision of an adequate education for each student.” For the school year 2004-2005, that amount was set by Act 59 at \$5400 per student. As we noted in our earlier report, filed with the supreme court on April 2, 2004, that amount was the subject of an explanatory letter filed by legislators with Act 59. The letter demonstrated the legislative means of reaching the \$5400 figure by adding together projected costs per student of teacher salaries, school resources, and basic maintenance and general operation costs referred to as “carry forward.”

The 2004-2005 foundation-funding amount for each school district was calculated by multiplying \$5400 by the average enrollment [average daily membership (ADM)] in the previous school year. For example, if a school district

averaged 1000 students in attendance in 2003-2004, its 2004-2005 foundation funding ostensibly amounted to \$5,400,000. Complication arises, however, because of further legislation designating the sources of, and the method to be used in computing, the foundation funding. The computation methods remain the same for the 2005-2006 and 2006-2007 school years, with \$5400 remaining the goal amount in 2005-2006, to be raised to \$5497 for the school year 2006-2007. Ark. Code Ann. § 2-20-2305(a)(2) (Supp. 2005).

The first source of a school district's foundation funding is the property tax assessed against citizens of the district pursuant to a "uniform rate of taxation" (URT) of 25 mills established by Ark. Const. art. 14, § 3(b)(1). The 25-mill URT is:

assessed and collected in the same manner as other school property taxes, but the net revenues from the uniform rate of tax shall be remitted to the State Treasurer and distributed by the state to the school districts as provided by law. No portion of the revenues from the uniform rate of tax shall be retained by the state. The revenues so distributed shall be used by the school districts solely for maintenance and operation of schools.

Ark. Const. art. 14, § 3(b) (3).

School districts are allowed to tax in excess of 25 mills for educational purposes. Revenue collected in excess of that resulting from the 25-mill levy is retained by the school districts and may be used either for operation and

maintenance of schools or dedicated to pay off indebtedness incurred in school building projects. Ark. Const. art. 14, § 3(c)(1). This revenue is not a component of the foundation-funding amount.

The second source of a district's foundation funding is "state foundation-funding aid" which is defined, and which is to be computed, in accordance with Ark. Code Ann. § 6-20-2305(a)(1) (Supp. 2005). It is "the difference between the foundation funding amount ... and the sum of ninety-eight percent (98%) of the uniform rate of tax multiplied by the property assessment of the school district plus seventy-five percent (75%) of miscellaneous funds of the school district." The "miscellaneous" funds, which compose the third source of a district's foundation funding, could be, for example, money received from the federal government for use of land within the district. Ark. Code Ann. § 6-20-2303(11). Thus, if 98% of the URT assessment plus 75% of miscellaneous funds amounts to \$5,400,000, or more, in our example, all of the district's foundation funding will come from its property-tax collection revenue. If, however, the district's assessment amounts to only \$2,000,000, and 75% of its miscellaneous funds amounts to \$5000, then the state foundation-funding aid will be determined as follows:

$$\$2,000,000 \times .98 = \$1,960,000$$

$$\$1,960,000 + \$5000 = \$1,965,000$$

$$\$5,400,000 - \$1,965,000 = \$3,435,000 \text{ State Foundation Funding Aid}$$

Although it will be the subject of discussion later in this report, it should be noted at this point that the state foundation-funding aid formula's URT factor is based upon the amount of the district's property assessment total rather than on the amount of tax revenue collected. Only a few Arkansas school districts are sufficiently wealthy to finance the \$5400 per student using only the URT and miscellaneous funds. If our example district is not sufficiently wealthy to finance the \$5400 per student through the URT and miscellaneous funds, and if it is able only to collect an amount less than 98% of the URT taxes due, the amount of state foundation-funding aid will not be increased to make up for the loss, and its foundation funding will thus be less than \$5400 per student.

B. The "40% Pullback"

The term "40% pullback" is used by Arkansas school officials to describe a somewhat puzzling method by which school districts are permitted to include in their revenue receipts for their June 30 fiscal year that sum equal to "forty percent (40%) of the proceeds of the local taxes which are not pledged to secured bonded indebtedness or forty percent (40%) of the revenue from the uniform rate of tax

whichever is greater collected in the succeeding calendar year.” Ark. Code Ann. § 6-20-401(4)(B) (Supp. 2005). The following explanation is derived from the statutory language and from the testimony in hearings before us of Dr. Don Stewart, Deputy Commissioner of Education, and Mr. David Cauldwell, Business Manager of the Rogers School District.

A school district may accrue (or “pull back”) into its fiscal year the 40% pullback amount, which is future tax revenue that will become payable during the second half of the school district’s fiscal year, or, said another way, during the “succeeding calendar year.” The delay in collection derives from the fact that a school district’s fiscal year overlaps two successive calendar years, whereas tax assessment and collection operate on a calendar-year basis. So, for example, in a school district’s July 1, 2004-June 30, 2005 fiscal year, the tax revenues that will fund its 40% pullback amount will include timely payments made pursuant to tax assessments that were performed in calendar year 2004, then billed and payable in spring, 2005 and finally due in October, 2005.

Dr. Stewart explained that the pullback phenomenon originated in the 1940s or 1950s when county collectors found themselves in possession of large amounts of unused funds, resulting from early collections, of which the school districts

were in need. He opined that, once the practice began and the school districts became accustomed to using the money early, it could not be stopped.

C. The Educational Adequacy Trust Fund

Act 107 of the Second Extraordinary Session of 2003 increased the Arkansas gross-receipts tax by 0.875% and applied it to a number of goods and services not previously subject to the tax. The act also increased the Arkansas compensating use tax by 0.875%. The act also levied an additional 1.5% wholesale vending tax upon goods sold or withdrawn from wholesale stock to be sold through vending machines. Revenues produced by the increases were designated to be included in the Educational Adequacy Trust Fund to be used solely for public-school education. The act also designated a portion of vending device decal fees to be included in the Trust Fund. The fund is a part of the public school money which is used to fund the state foundation-funding aid. The act provides for an annual allocation to the Trust Fund in an amount of gross receipts sales tax and compensating use tax collected in the preceding year multiplied by a factor of 0.0125.

D. The Educational Excellence Trust Fund

Another element of state revenue used to fund public schools is the Educational Excellence Trust Fund which was created by Act 10 of 1991. The

current codification of the law creating the fund is found in Ark Code Ann. § 6-5-301 (Repl. 1999). It provides for an annual allocation to the Educational Excellence Trust Fund in the amount of the net general state revenue in gross receipts sales tax and compensating use tax collected in the preceding year multiplied by a factor of 0.1414. The Educational Excellence Trust Fund money is also distributed to the public schools by the Arkansas Department of Education as a part of the state foundation-funding aid.

When the Arkansas Department of Education notifies each school district of the amount of state aid that it is to receive for a particular school year, it also informs the district of the portion of that figure that is attributable to the Educational Excellence Trust Fund. It is important for school districts to have that information because any increase in that amount over the amount of Trust Fund money received by the school district in 1991 may be used only by dividing it equally among certified teachers to increase their base teachers' salaries "and for no other purpose, except that required social security and teacher retirement matching required to be paid by the school districts for certified personnel may be paid from the funds." Ark. Code Ann. § 6-5-307(a) (Repl. 2005).

By Act 2165 of 2005, the General Assembly further restricted the use of the Educational Excellence Trust Fund portion of state foundation funding aid by

adding the following subsection (d) to Ark. Code Ann. § 6-5-307: “‘Salary increase,’ as used in this section, shall not include increments for experience or advanced hours or degrees.”

E.

Categorical Funding, Professional Development, and Student Growth Funding

In addition to state foundation-funding aid, the state provides funds to each school district for each student who is identified as having one or more of the special needs described in Ark. Code Ann. § 6-20-2303 (Supp. 2005). They include alternative learning environments (ALE), English language learners (ELL), and national school lunch students (NSLS or NSLA, which stands for National School Lunch Act). Other categories, including “vocational education” and “professional development,” as well as “student growth” are provided in § 6-20-2303. A brief description of each of those categories, with the 2004-2005 amount of funding provided for each follows.

1. Alternative Learning Environment and Vocational Education

Alternative learning environment (ALE) funding “means a student intervention program in compliance with §§ 6-18-508 and 6-18-509 that seeks to eliminate traditional barriers to learning....” Ark. Code Ann. § 6-20-2303(2)(A) (Supp. 2005). Generally speaking, the program allows schools to set up special

separate classes or even schools housed in separate buildings for students with physical or mental or social (including behavioral) disabilities which prevent them from learning in a traditional educational environment.

There are also separate secondary vocational area centers created for the “specific purpose of educating high school students in specific occupational or vocational areas and serving students from more than one ... particular school district.” See Ark. Code Ann. § 6-20-2303(16) (Supp. 2005).

School districts receive in the 2005-2006 and 2006-2007 school years, in addition to foundation funding, \$3250 for each secondary ALE student and the same amount for each vocational-education student who attends a vocational center. Ark. Code Ann. § 6-20-2305(b)(2)(A) (Supp. 2005).

2. English Language Learners

“English language learners” (ELL) are “students identified ... as not proficient in the English language based upon approved English proficiency assessment instruments administered annually in the fall of the current school year, which assessments measure oral, reading, and writing proficiency.” Ark. Code Ann. § 6-20-2303(5) (Supp. 2005). For each ELL student, so identified, a school district receives \$195 in the school year 2005-2006 as well as in 2006-2007. Ark. Code Ann. § 6-20-2305(b)(3)(A) (Supp. 2005).

3. NSLA Students

Federal guidelines determine whether a student is entitled to participate in the national school lunch program. Those guidelines are used to determine the level at which a school district will receive extra funding from the State of Arkansas to assist school districts with substantial numbers of low-income students. Thus, although we refer to the students so identified as “NSLA students” when speaking of it, the extra-funding program is funded only with state revenue that is added to the foundation funding for a district that has qualifying students.

For school years 2005-2006 and 2006-2007, a school district in which 90% or more of the students qualify as NSLA students receives \$1440 per student thus qualified; if at least 70% but less than 90%, the amount is \$960; if less than 70%, the amount is \$480. Ark. Code Ann. § 6-20-2305(b)(4)(A) (Supp. 2005).

4. Professional Development

“Professional development” is described in Ark. Code Ann. § 6-20-2303 (14)(A) (Supp. 2005) as “a coordinated set of planned learning activities for teachers and administrators that are standards-based.” The amount provided in Act 59 of the Second Extraordinary Session of 2003 for school year 2004-2005 was \$50 per student based on the school’s previous-year enrollment (ADM). For school years 2005-2006 and 2006-2007, the professional-development funding

“shall be equal to an amount of up to fifty dollars (\$50.00)” per student based on the school’s previous-year enrollment (ADM). Ark. Code Ann. § 6-20-2305(b)(5)(A) (Supp. 2005).

5. Student Growth Funding

“Student growth funding” refers to additional state financial aid to schools receiving numbers of students in excess of enrollment (ADM) in the previous school year. For school years 2005-2006 and 2006-2007, a district will receive \$5400 multiplied by the increase in its two-quarter enrollment (ADM) over the same period in the previous school year. Ark. Code Ann. § 6-20-2303(19) (Supp. 2005).

F. School Facilities Funding

Funding for school building projects is separate from the foundation funding. Historically, Arkansas school districts have funded building projects through bond issues financed by millage rates dedicated to specific projects. State aid for such projects has been provided in various forms. Act 69 of the Second Extraordinary Session of 2003 continued aid in the form of “debt service funding supplement” and “general facilities funding,” and created , in the alternative, “supplemental millage incentive funding.” Although Act 69 was repealed in 2005 by Act 2206, in favor of a new facilities-funding plan, its provisions have been

continued by Act 2206 with a potential one-time reduction in the amount of the debt service funding supplement but a ten-year phase-out of the general facilities funding and supplemental millage incentive funding programs.

Act 2206, § 1, of 2005 provides for state aid to school districts with respect to bonded indebtedness in existence as of January 1, 2005. The amount of state aid is calculated pursuant to a complex formula based upon the “state wealth index.” The primary element of the state-aid formula is the principal and interest payment schedule in effect and on file with the Department of Education on January 1, 2005. That amount is reduced by 10% in the formula, but the reduction is restored to the extent that the school district can demonstrate that the indebtedness is attributed to the support of academic facilities. The final decision as to the amount of assistance is made by the Commission for Public School Academic Facilities and Transportation.

As is discussed below in more detail, state aid for building projects, including repairs and new construction after January 1, 2005, is also based on an “academic facilities wealth index,” the intended purpose of which is to give greater assistance to districts having greater need due to low assessable property value.

II. Findings of Fact

A. Foundation Funding

1. In response to *Lake View Sch. Dist. No. 25 v. Huckabee*, 351 Ark 31, 91 S.W.3d 472 (2002), the Joint Committee on Educational Adequacy presented to the General Assembly *An Evidence-Based Approach to School Finance Adequacy in Arkansas*, an analytical report developed by Lawrence O. Picus and Associates, educational consultants employed by the state to perform an adequacy study. Educational finance recommendations in the report were on a per school basis. The joint committee accepted some of the recommendations, declined other recommendations, and attempted to extrapolate from the adequacy study an amount of money needed to fund the identified needs on a per student basis, rather than a per school basis. The total foundation-funding formula developed through this extrapolation process was set out in Act 59 of the Second Extraordinary Session of 2003. The foundation funding for the 2004-2005 school year was determined by the General Assembly to be \$5400 multiplied by the average daily membership (ADM) of the previous school year. Calculations are based upon an assumed school size of 500 students in grades kindergarten through twelve.

2. The largest portion of the \$5400 foundation funding was calculated to be \$3415 for teacher salaries. This category included classroom teachers, special education teachers, instructional facilitators, librarians, and counselors. That figure was based upon a presumed average salary of \$39,000 plus 25% additional for fringe benefits. Also included in the \$3415 was a salary for one principal at an average of \$71,837 including fringe benefits.

3. The number of classroom teachers for the 500-student prototype school was determined through pupil-teacher ratios. Kindergarten was set at a ratio of 20:1 and was determined to be eight percent of the student body population. Grades 1-3 were determined to be taught at a ratio of 23:1 and comprised 23% of the total students. Grades 4-12 were determined to be taught at a ratio of 25:1 and made up 69% of the student body.

4. Also included in the \$5400 foundation-funding calculation is per-pupil resources of \$789. This item included a calculated \$250 amount per student annually for the purchase, update, and maintenance of hardware and software, and \$250 per pupil for instructional materials. Extra-duty funds are also included in the foundation funding and the General Assembly assumed this cost to be \$60 per middle school student and \$120 per high school student, for an average of \$90. Funding for supervisory aids was included to reduce teacher noninstructional

duties. The amount allotted for such supervisory aids was \$35 per student.

Substitute teachers were included in the foundation funding at a rate of 10 days per teacher times \$121 and divided by 500 students as stated. Total for per pupil resources was figured at \$789.

5. The final category included in the \$5400 foundation funding is “carry forward” totaling \$1152 per ADM. Carry forward is the total cost for the following functions: Fiscal services, board and legal services, executive administration (superintendent), athletics, community services, other noninstructional services, operations, maintenance, transportation (buses, fuel, drivers, mechanics), technology services, and selected instructional support such as drug and crime prevention. The carry forward also includes utilities and insurance. The carry-forward amount came from the Picus report and was based on 2001-2002 expenditures.

6. The total Act 59 foundation funding was initially calculated at \$5356; however, the General Assembly chose to round this to a total of \$5400 per ADM for the school year 2004-2005. Senator David Bisbee was one of the principal authors of the foundation funding concept and Act 59. In Senator Bisbee’s prepared testimony before the Masters in February 2004, the question was asked

whether Act 59 was intended to be the “long-term solution” to the adequacy mandate. Senator Bisbee answered that it was not, and that

Act 59 is intended to be the funding formula for the 2004-2005 school year. It must be read in conjunction with Act 57 of the 2nd Extra. Session of 2003 which requires a continual adequacy evaluation. Act 57 specifically requires the Interim Committees on Education to challenge the validity of each of the dollar amounts in Act 59 and requires them to propose appropriate, adequate dollar amounts by September 1 of each year prior to the next biennium. As indicated above, the figure of \$5400 per ADM was derived from the adequacy study conducted by Odden and Picus but recognizes, as Professors Odden and Picus did, that adequacy is a dynamic concept.

7. Act 2283 of 2005 continued the foundation-funding amount at \$5400 for the 2005-2006 school year. The foundation funding for school year 2006-2007 increases to \$5497.

8. The so-called “double whammy” is a term used by Arkansas school officials to describe the state foundation-funding aid formula’s financially-adverse effect upon a school district that has decreasing enrollment (ADM) or increasing property assessment. In either of these scenarios, the formula operates to reduce the amount of state foundation-funding aid distributed to the school district although the school district has no comparable true increase in local wealth.

State foundation-funding aid is “the difference between the foundation funding amount ... and the sum of ninety-eight percent (98%) of the uniform rate

of tax multiplied by the property assessment of the school district plus seventy-five percent (75%) of miscellaneous funds of the school district.” Ark. Code Ann. § 6-20-2305(a)(1) (Supp. 2005). Thus, the \$5400 per student foundation-funding amount is composed of two shares: the district share (URT and miscellaneous funds) and the “state foundation-funding aid.”

When a school district loses students, it arguably suffers two losses. First, it has an actual loss of dollars because it receives no state foundation-funding aid for the lost students. Second, with respect to the \$5400 foundation-funding per student for the remaining students, the district’s proportional share of that cost will increase and the state foundation-funding aid must then decrease. This second “loss” is simply a function of the formula. The total foundation-funding amount for the school district decreases when enrollment (ADM) decreases because the total foundation-funding amount is computed by multiplying \$5400 by ADM, The district share, however, does not change because ADM is not a factor in computing URT, or, presumably, miscellaneous funds. Therefore, the district share is a fixed amount, so the state foundation-funding aid must decrease. Said another way, in this scenario, the state foundation-funding aid of the \$5400 foundation funding per student varies proportionately with the rise and fall of enrollment (and accompanying change in the total foundation-funding amount),

because the district share cannot change. Although the relative percentages of the state foundation-funding aid and the district share changes when enrollment (ADM) drops, the actual dollars allocated to the district share does not. Thus, this second “loss” is a paper loss only for the school district.

Likewise, when a school district enjoys increased local revenue, e.g., due to an increase in URT when property assessments increase, the district share of foundation funding must increase by operation of the state foundation-funding aid formula. In this scenario, assuming no change in enrollment (ADM), the total foundation funding amount does not change. Thus, when the district share of that total amount increases with its increased assessment, the state foundation-funding aid must decrease. In this scenario, the increase in the district share is in actual dollars, as well as its share percentage.

In both of these scenarios, the formula operates to present a “wealthier” school district even though, in the first scenario, a loss of students does not necessarily translate into a reduction in the district’s financial need, e.g, fewer students may not mean fewer teachers are needed, and, in the second scenario, an increased assessment does not necessarily translate into increased tax collection.

9. Act 2283 of 2005 continued student growth funding at \$5400 for school years 2005-2006 and 2006-2007. When responding to a question about student-

growth funding in his prepared testimony of February, 2004 Senator Bisbee stated that, “Obviously, student growth funding should always be equal to the foundation funding for each child.” The evidence has not explained why student growth funding is not equal to foundation funding in the 2006-2007 school year.

10. Act 1426 of 2005 requires that, beginning with the 2005-2006 school year, each school district must dedicate nine percent of its total foundation funding exclusively to payment of utilities and custodial costs, maintenance, repair, and renovation activities and related personnel costs. Any unspent funds will carry over, and the school district will transfer the remaining amount into an academic-facilities escrow account to be released only with the approval of the Division of Public School Academic Facilities and Transportation for use in conjunction with a local academic-facilities project. This act means that for school year 2005-2006, nine percent of the \$5400 per ADM, or \$486, can only be used for the purposes stated. This, in effect, limits the ability of districts to use any part of it for such things as increased transportation costs.

B. Uniform Rate of Taxation (URT)

11. Amendment 74 to the Arkansas Constitution established a “uniform rate of ad valorem property tax of twenty-five (25) mills to be levied on the assessed value of all taxable real, personal, and utility property in the state to be used solely

for maintenance and operation of the schools.” Under Ark. Const. art. 14, § (b)(3), the net revenues from the uniform rate of taxation (URT) are to be remitted to the State Treasurer. At that point, the local taxes become state funds, which are then distributed in their entirety to the school districts that collected them. Section (b)(3) provides that the URT revenues “shall be used by the school districts solely for the maintenance and operation of schools.” The URT is an element in the formula, set forth in Ark. Code Ann. §6-20-2305(a)(1), for state foundation funding aid. That amount is computed as “the difference between the foundation funding amount [which is set at \$5400 per student] ... and the sum of ninety-eight percent (98%) of the uniform rate of tax multiplied by the property assessment of the school district plus seventy-five percent (75%) of miscellaneous funds of the school district.” In the foundation-funding formula, a collection rate of 98% of assessed value is assumed. That percentage assumption was, according to John Kunkel, Associate Director of Finance for the Arkansas Department of Education, “an agreed-upon figure that was passed into law.” It has been employed for a substantial amount of time in various funding formulas. The remaining 2% of school tax revenue remains with the local district and is intended to cover the cost of collection. Testimony indicated, however, that the actual cost of collection can exceed the 2% figure.

12. Despite the posited 98% collection rate, the actual collection rate appears to be lower in many districts. Mr. Kunkel estimated an average of “about 94-95%.” Charles Vondran, retired Superintendent of the McCrory School District, put the collection rate at 92-94%, while other superintendents testified to similar discrepancies between the assumed and actual rates of collection. Because of the operation of the formula, a difference between the assumed and actual rates of collection can adversely affect the amount of state foundation-funding aid provided by the state. Each 1% of the difference between the 98% assumed collection and the actual figure can translate, for the individual school district, into thousands of dollars of lost state funding.

13. The URT for foundation funding for the 2005-2006 school year is estimated to be \$39,000,000 more than in 2004-2005. This equates to a \$39,000,000 reduction in state foundation funds to pay for the \$5400 per ADM.

C. Categorical Funding and Professional Development Funding

14. Act 59 of the Second Extraordinary Session of 2003 defined “additional education categories” to mean state funds distributed to school districts for alternative learning environments (ALE), English language learners (ELL), national school lunch students (NSLS or NSLA for National School Lunch Act), professional development, and technology. A school funding formula sets out the

funds each school district receives each year for both “foundation funding” and these “categorical funds.”

15. The *Arkansas Department of Education Rules Governing the Distribution of Student Special Needs Funding and the Determination of Allowable Expenditure of These Funds* became effective in July 2005. The Rules establish guidelines for funding eligibility, recite funding amounts, and set out the formulae for awarding the funds. Under the Rules, categorical funds may be carried over, but they remain restricted to the priority areas as set out in the Rules for each category.

1. Alternative Learning Environment (ALE)

16. “Alternative learning environment” (ALE) means a student intervention program in compliance with Ark. Code Ann. §§6-18-508 and -509 that seeks to eliminate traditional barriers to learning for students. Ark. Code Ann. §6-20-2303 (2)(A)(Supp. 2005).

17. Every school district is required to establish, alone or in conjunction with a public school educational cooperative, an alternative learning environment to afford “at risk” students an environment conducive to learning. Eligibility for placement in an ALE requires a student to manifest enumerated characteristics as set out in the applicable Department of Education Rules. The Department of

Education shall establish criteria for teacher preparation for ALE, to include in-service training. Yearly statistical reports are required to be sent to the Department of Education, which in turn must report to the Joint Interim Oversight Subcommittee on Educational Reform and the Arkansas Pygmalion Commission on Nontraditional Education by September 15 of each year. Ark. Code Ann. §6-18-508 (Supp. 2005).

18. Alternative learning environments provide “intervention services,” which means activities within or outside a school that will eliminate traditional barriers to learning. Students must be assessed and services designed to address specific educational needs of individual students. Students assigned to an alternative class or school for behavioral reasons must receive intervention services to address the behavioral problems, not for punitive reasons. A school district must report annually to the Department of Education and must submit an assurance statement that it is in compliance with establishment of an ALE, and the Department must monitor at least every three (3) years to ensure that ALEs have been established, are conducive to learning, and are providing intervention services designed to address individual needs of students. Ark. Code Ann. §6-18-509 (Supp. 2005).

19. The funding allocation for ALE learners for the 2005-2006 and 2006-2007 school years is \$3250 multiplied by the number of identified ALE students

enrolled during the previous school year; and the number of students enrolled in secondary vocational area centers during the previous school year. Ark. Code Ann. § 6-20-2305(b)(2)(A)(i)&(ii) (Supp. 2005).

20. The per student funding allocation for ALE learners is the same for this biennium as it was for the 2004-2005 school year. Act 2283 of 2005 (funding for 2005-2006 and 2006-2007); Act 59, 2nd Ex. Sess. 2003 (funding for 2004-2005). An increase in the Public School Fund for alternative learning in the current biennium resulted from an increase in student population, not an increase in per student funding.

2. English Language Learners (ELL)

21. “English language learners” (ELL) means students identified by the State Board of Education as not proficient in the English language based upon approved English proficiency assessment instruments administered annually in the fall of the current school year. These assessments measure oral, reading, and writing proficiency.

22. Funds allocated to school districts for ELL shall be expended only for eligible activities as identified in current rules promulgated by the State Board of Education. Ark. Code Ann. §6-20-2305(b)(3)(C) (Supp. 2005).

23. Act 2283 of 2005 provides that, for school years 2005-2006 and 2006-2007, the funding for ELL is \$195 for each eligible student. Ark. Code Ann. §6-20-2305(b)(3)(A)(Supp. 2005). The funding allocation remains the same in this biennium as it was for the 2004-2005 school year and testimony indicated this amount is not sufficient to cover the cost of this program.

24. Children from non-English-speaking homes have greater educational needs than those from English-speaking homes, and they require additional resources. Children of poverty who are also ELL students have a greater need for remediation than children categorized only as children of poverty. Insufficiency of funding for ELL children requires the expenditure of NSLA funding for ELL, thereby limiting a school district's ability to provide necessary help to non-ELL poverty children.

25. No inquiry was made nor input sought of school-district superintendents by members of Legislative Committees or others regarding the funding needs for ELL before or during the 2005 Regular Session of the General Assembly.

3. National Student Lunch Act (NSLA)

26. NSLA students are defined as “those students from low socioeconomic backgrounds as indicated by eligibility for free or reduced-price meals under the National School Lunch Act [NSLA] as calculated on October 1 of each year and

submitted to the [Arkansas Department of Education].” Act 59, 2nd Ex. Sess. 2003; codified at Ark. Code Ann. § 6-20-2303(12) (Supp. 2005).

27. In 2003, the funding for NSLA students was “based on the number of students eligible for a free or reduced-price lunch program under the NSLA and identified on the Arkansas public school computer network cycle two report.”

Ark. Code Ann. § 6-20-2305(b)(4)(B)(i) (Supp. 2005).

28. The additional funds so generated were to be expended only on programs approved by the Arkansas Department of Education, to include classroom teachers; before- and after-school academic programs, including transportation to and from; pre-kindergarten programs coordinated by the Arkansas Department of Human Services; tutors, teachers’ aides, counselors, social workers, nurses, and curriculum specialists; parent education; summer programs; early intervention programs; and materials, supplies, and equipment, including technology used in approved programs or for approved purposes. Ark. Code Ann. § 6-20-2305(b)(4)(C)(i) (Supp. 2005).

29. During the 2004-2005 school year, the Arkansas Department of Education approved approximately eight districts for 100% funding if at least 50% of each district’s students qualified as NSLA students. These districts were Provision 2 districts, under federal law, and their funding was \$1440 for each student in the

district, regardless of whether the individual student qualified as an NSLA student. Those districts receiving 100% funding whose superintendents testified were Blytheville, Forrest City, Osceola, and Brinkley.

30. In 2005, the General Assembly amended Act 59 through enactment of Act 2283; codified at Ark. Code Ann. §§ 6-20-2303 and -2305 (Supp. 2005). The four districts cited above testified that their NSLA funding for the 2005-2006 school year will be reduced.

31. In the new act, NSLA students were defined as:

[T]hose students . . . from low socioeconomic backgrounds as indicated by eligibility for free or reduced-price meals under [NSLA] as determined on October 1 of each previous school year and submitted to the [Arkansas Department of Education], unless the school district is identified by the [Arkansas Department of Education] as participating in the special assistance certification and reimbursement alternative implemented under 42 U.S.C. § 1759a, as interpreted in 7 C.F.R. § 245.9.

Ark. Code Ann. § 6-20-2303(12)(A) (Supp. 2005).

Further,

[i]f the school district is participating under 42 U.S.C. § 1759a, then for purposes of funding under § 6-20-2305(b), such a school district's annual percentage of national school lunch students shall be equal to the percentage submitted in the base year, which means the last school year for which eligibility determinations were made and meal counts were taken by type except for the 2005-2006 school year as explicated in subdivision (12)(B)(ii) of this section.

Ark. Code Ann. § 6-20-2303(12)(B)(i) (Supp. 2005).

If a school district received funding for national school lunch students in the 2004-2005 school year as though one hundred percent (100%) of its students were eligible for free meals because of the school district's participation under 42 U.S.C. § 1759a, then that school district shall be funded for the 2005-2006 school year based upon the October 1, 2005, submission by a school district to the [Arkansas Department of Education] if the school district has completed a new student eligibility determination and submitted that new eligibility determination to the [Arkansas Department of Education] by October 1, 2005[.]

Ark. Code Ann. § 6-20-2303(12)(B)(ii) (Supp. 2005).

“Previous year’ or `previous school year’ means the school year immediately preceding the school year or fiscal year in which funds are allocated[.]” Ark. Code Ann. § 6-20-2303(13) (Supp. 2005).

32. The 2005 amendments rewrote § 6-20-2305 to provide funding for the 2005-2006 and 2006-2007 school years for each identified NSLA student to be as follows:

- districts in which 90% or greater of the previous school year's enrolled students are NSLA, the funding shall be \$1440;
- districts in which at least 70% but less than 90% of the previous school year's enrolled students are NSLA students, the funding shall be \$960; and
- districts in which less than 70% of the previous school year's enrolled students are NSLA students, the funding shall be \$480.

Ark. Code Ann. § 6-20-2305(b)(4)(A) (Supp. 2005); Arkansas Department of Education *Rules Governing the Distribution of Student Special Needs Funding and the Determination of Allowable Expenditure of These Funds*, § 6.01.1–6.01.3 (July 2005).

33. While the funding amounts did not change from the 2004-2005 school year, change occurred in counting only NSLA-qualifying students in computing the percentages. According to Masters' Exhibit 1, the actual total expenditure for NSLA students in 2004-2005 was \$146,910,720, and the projected total expenditure in 2005-2006 is \$137,368,320. Masters' Exhibit 3. This represents a projected decrease for 2005-2006 of \$9,542,400.

34. The foundation amount of \$5400 per ADM appropriated in fiscal year 2004-2005 remains the same for fiscal year 2005-2006. While the foundation amount increases for fiscal year 2006-2007 to \$5497 per ADM, there is no corresponding increase in the NSLA allocation.

35. The funding for NSLA students is now based on either the base year or the previous year's qualifying ADM and does not account for any increase or decrease in the current year's qualifying ADM.

36. For districts that established Provision 2 funding under federal law several years ago, funding for NSLA-qualifying students now and in subsequent years will

be set by the number of students who qualified in that base year and will not reflect the number of poverty students enrolled in the current school year. This phenomenon particularly affects districts with decreasing enrollments coupled with increased percentages of students who qualify for NSLA status. The result is a decrease in NSLA funding for those districts. For example, in 2004-2005 the Blytheville district qualified as a Provision 2 school and received \$1440 per student for an estimated total of \$4,500,000, but for 2005-2006, the district is projected to receive only \$2,100,000.

37. Problems arise in obtaining accurate information from parents of potentially qualifying students. In some cases, the stigma attached to receiving a free lunch when other students pay for theirs inhibits qualifying students from participating. Further, some parents do not return needed information to the districts, resulting in fewer students qualifying for NSLA funds.

38. Previously, NSLA funding has been spent for development of remedial and mentoring programs; recruitment of literacy and math coaches, counselors, school nurses, and teachers; and homework hotlines. Of the superintendents who testified that their NSLA funding will be reduced, all indicated that remedial programs will be among the cuts made in programs and staff.

4. Professional Development

39. “Professional development” means a coordinated set of planned learning activities for teachers and administrators that are standards-based. Professional development shall result in individual, schoolwide, and systemwide improvement designed to ensure that all students demonstrate proficiency in the state academic standards. Ark. Code Ann. §6-20-2303 (14)(A)&(B) (Supp. 2005).

40. Professional development funding for school years 2005-2006 and 2006-2007 shall be up to \$50 multiplied by the school district’s previous school year’s average daily membership (ADM). Ark. Code Ann. §6-20-2305(b)(5)(A) (Supp. 2005). This amount of funding changes previous law. Act 59 of the Second Extraordinary Session of 2003 provided \$50, multiplied by the previous year’s ADM. Ark. Code Ann. § 6-20-2305(b)(5)(A) (Supp. 2003). Arkansas Department of Education 2006 Public School Funding projections dated July 13, 2005, Masters’ Exhibit 3, which shows projected funding by school district, computes Professional Development Funding at \$41.11 per student.

41. Professional development funding for teachers in public schools shall be used for professional-development training, conferences, materials, and other professional-development activities as outlined in rules promulgated by the State Board of Education.

42. Act 2318 of 2005 created the “Arkansas Online Professional Development Initiative,” a program to identify the professional-development needs of teachers and to prioritize those needs for the improvement of academic and teaching knowledge and skills of certified personnel. The Commissioner of the Department of Education, the Director of the Educational Television Division of the Department of Education, and local school districts are to work together to develop an online professional-development program for teachers. Ark. Code Ann. §6-17-705 (Supp. 2005).

43. Some school superintendents testified that the difference in funding (\$50 per student in 2004-2005 and \$41.11 per student in 2005-2006 and 2006-2007) was given to the Arkansas Educational Television Network to develop and provide the online professional-development program for teachers required by Act 2318 of 2005.

D. Cost-of-Living Adjustment (COLA)

44. The Department of Education is responsible for presenting budget requests on behalf of the state’s school districts. In a memo to Arkansas school superintendents dated June 6, 2005, Patty Martin of the Public School Finance and Administrative Support section of the Department of Education stated that, pursuant to Ark. Code Ann. § 6-17-2203, a cost-of-living increase of 3.1%, based

on the percentage of increase of the consumer price index (CPI), should be used in adjusting minimum hourly rates for classified school employees for 2005-06.

45. John Kunkel, Associate Director of Finance for the Arkansas Department of Education, is the person ultimately charged with the responsibility of determining how much the cost-of-living adjustment (COLA) should be for school personnel. Mr. Kunkel and Joe LeFace of the Department of Finance and Administration (DF&A) conferred and, utilizing the CPI, concluded that a COLA of 1.875% should be recommended to the General Assembly for the foundation-funding amount for the first year of the 2005-2007 biennium and 1.8% for the second year. Mr. Kunkel was unable to explain the discrepancy between the 3.1% CPI-derived figure for hourly employees in Ms. Martin's memo and the 1.875% and 1.8% CPI-derived COLA amounts for foundation funding presented for legislative consideration.

46. Richard Weiss, Director of the Department of Finance and Administration, discussed in his deposition the workings of a small, unpublicized group to which he belongs that met to balance the budget and to determine "the setting of the levels of distribution of money throughout all the government, including the public schools," that results in the Revenue Stabilization Act. Members of the "small group" included legislators, legislative staff, and DF&A personnel. The group's

final decision before the 2005 session regarding appropriations, along with the DF&A official forecast, was based upon available money. Mr. Weiss acknowledged that although notes are taken in the meetings of the small group, none are kept and none are available for examination.

47. In his deposition, Mr. Weiss stated that, prior to the 2005 session, “the Executive Budget and the Governor’s Budget was put together with a COLA for its submission to the Legislative Council.” The recommendation was for salaries for all state agencies, including education entities. At some point during the first two months of the 2005 legislative session, Senator Shane Broadway addressed a meeting of school superintendents and assured them that a bill providing for a cost-of-living adjustment to the \$5400 foundation-funding figure was in his SB939, the Education Bill.

48. Subsequently, Senator Broadway amended SB939, so that the foundation funding remained at the \$5400 level for fiscal year 2005-2006. The recommended 1.875% COLA, which amounted to \$45,000,000 and would have raised the \$5400 figure by \$101, was not added to the foundation-funding amount for the first fiscal year of the biennium. For the 2006-2007 school year, the second fiscal year of the biennium, the 1.8% COLA figure was added, increasing the amount of foundation

funding per student to \$5497. The legislation was enacted as Act 2283 of 2005. *See Ark. Code Ann § 6-20-2305(a)(2)(A), (B) (Supp. 2005).*

49. Senator Broadway indicated that one factor in the decision of legislators not to add a COLA was their provision of \$35,000,000 for the teacher health-insurance fund. Additionally, according to Senator Broadway, the General Assembly lacked sufficient information that would indicate a COLA was warranted. Richard Weiss stated in his deposition that the money for the COLA increase was “shifted ... into Facilities.”

50. In an e-mail to Senior Assistant Attorney General Timothy G. Gauger dated April 3, 2005, Senator Jim Argue said, “I know skipping the COLA is a problem, maybe a LV [*Lake View*] issue, and certainly a bad precedent.” In testimony during the Masters’ hearings, Senator Argue affirmed that he “would still maintain that position.”

51. Senator Argue testified that when the General Assembly was considering whether a COLA was required in the first fiscal year to maintain adequacy, legislators had in mind the fact that they “had just put \$380 million of new money into the K-12 system for the 04-05 school year, and that we did not have reporting available to us as to how that money had been spent.”

52. However, the General Assembly granted a cost-of-living adjustment to all state employees, including themselves.

53. The General Assembly had at its disposal \$52,000,000 in the General Improvement Fund, which was divided between the Senate and the House of Representatives. Thirty-five senators were allotted \$750,000 each, which was designated for appropriation for projects of their choosing. For a complete listing, *see* State's Weiss Exhibit 6.

E. Unfunded Mandates

54. School districts face new costs during the 2005–2006 school year as a result of acts passed by the 85th General Assembly or because of other factors. The movants describe these costs as “unfunded mandates.” The movants attempted to show through the testimony of various superintendents and charts prepared by them, which have been referred to as “grids,” the nature and extent of these unfunded mandates. The analysis of the unfunded mandates and the grid concept had its origin in the work of James Gilson, who is the special assistant to the executive director of the Arkansas School Boards Association. Mr. Gilson prepared Deposition Exhibit 47 (*Compare* Trial Exhibit 3, Cauldwell Pre-Filed Testimony, Question 17), which describes various mandates which are classified as either “New Expenses for Schools” or “Disputed New Expenses for Schools.” The

latter classification recognizes the state's contention that provision has been made for funding some of the alleged mandates. Mr. Gilson opines that school districts will have increased expenditures of approximately \$244 per student for the 2005-2006 school year and an additional \$215 per student for 2006-2007.

55. We find that there are increased financial burdens on school districts from some of the mandates, but, if nothing else, as a result of inflation. The effect of inflation, especially on such items as fuel and books, imposes additional burdens on school districts in 2005-2006, while revenues have not been increased over the prior year. Fuel costs are going up tremendously, and textbooks have skyrocketed. In some cases they have doubled and tripled in prices. Numerous superintendents testified that their districts will be forced to dip into their reserves to meet these expenses.¹ Commissioner of Education Kenneth James testified that it will cost school districts more money to provide the education resource in 2005-2006 than it cost in 2004-2005 because of inflation, and no additional money was appropriated to deal with inflationary costs.

56. The General Assembly froze foundation funding for the 2005-2006 school year, but it increased the financial obligation on school districts as a result of such

¹ A triggering mechanism for fiscal distress designation is a declining reserve fund balance. Arkansas Department of Education 158. Rules Identifying and Governing The Arkansas Fiscal Assessment and Accountability Program, § 4.01.1 (August, 2003).

factors as required annual step increases in salary schedules for certified employees pursuant to Ark. Code Ann. § 6-17-2403 (Supp. 2005) (\$450 for Bachelor of Arts and \$500 for Masters), and the cost to implement Academic Improvement Plans (AIP) mandated by Act 35, 2nd Ex. Sess. of 2003. AIP are required for students who score below the “Proficient Level” on statewide tests in order to improve students’ scores. The Department of Education projected cost for AIP is an average of \$470 for each student that needs remediation. No additional money over the \$5400 foundation and the categorical funding was provided for these AIP costs.

57. In 2006-2007, Act 2130 of 2005 requires the districts to increase the minimum teachers’ salaries by approximately 1.8%, and additional funding to meet this requirement can be found only in the \$97 increase in the foundation-funding amount, which will have a number of competing claims on this additional revenue.

58. In 2006-2007, the districts may be required to increase their contribution to teacher retirement. Act 1968 of 2005 authorizes the Board of Trustees of the Arkansas Teacher Retirement System to establish employer rates for the System prospectively each year, based on the actuary’s biennial determination of the rate required to fund the plan so that it remains approximately level from generation to generation. Annual contributions shall be sufficient to fully cover the costs of

benefit commitments to members for their service rendered in that year, and to make a level payment that, if paid annually over a reasonable period of future years, will fully cover the unfunded costs of benefit commitments for service previously rendered. For fiscal year 2005-2006, the employer contribution rate shall not exceed 14%, and for fiscal year 2006-2007, it shall not be increased by more than 1% above the fiscal year 2005-2006 rate. The Board shall notify the districts, the Department of Education, and other employers of the rate established for the coming year. According to Trial Exhibit 82, the employer-rate increase for fiscal year 2003-2004 was 13% and 14% for fiscal year 2004-2005.

59. The legislative process for education-related legislation is fragmented. Teachers, superintendents, the Department of Education, or other interests attempt and often succeed in getting education-related legislation passed, but there is a lack of coordination among these groups or the General Assembly to determine the impact on education funding before the legislature adjourns. The result can be a hodgepodge of acts (duty-free lunch for teachers, vision screening, teacher preparation time, professional development, certified teacher for art and music, physical-education requirements, and contributions to teacher retirement and health insurance), many very laudable, that must be implemented and all at a cost.

60. It has not been demonstrated that displaced or “freed-up” money offsets the costs attributable to inflation and “unfunded mandates.” The legislature is the appropriate forum to account for all these financial factors and to reconcile them with the other components of the funding formula to insure that revenues needed to fund an adequate education are in fact available for that purpose. The lack of evidence, either before the legislature or in these proceedings, indicating that an informed decision concluded that adequate money to address “new costs” was in place does not allow us to conclude, as the state argues, that there is money to reallocate.

F. Health-Insurance Funding

61. Local school districts are obligated to pay a health-insurance contribution for each eligible employee electing to participate in the public-school health-insurance program. Since October 1, 2004, the obligation has been \$131 per month per employee. Ark. Code Ann. §6-17-1117 (Supp. 2005). That amount, included in the districts’ foundation funding, is the minimum a district may pay. Some districts elect to pay more. At least one district in the state, the Little Rock School District, pays 100% of the health-insurance premium for its eligible employees under a collective-bargaining agreement.

62. By Act 1842 of 2005, the Arkansas Department of Education became obligated to pay the Employee Benefits Division of the Department of Finance and Administration \$61 per month for each eligible employee of a public-school district electing to participate in the public-school employees' health-insurance program administered by the State and Public School Life and Health Insurance Board.

63. By Act 2282 of 2005, the Revenue Stabilization Act, the General Assembly added \$35,000,000 in new money to the Department of Education Public School Fund Account for the public-school employees' health-insurance program. This additional money was allocated outside of the foundation-funding formula by design, to assure that every dollar of the \$35,000,000 would be used for health insurance. The money flows from the Department of Education to the health-insurance administration office for the state government. By Act 1842 of 2005, the enabling legislation for the Health Insurance Program, the Department of Education's transfer authority, which is included in its appropriation act, does not apply to this health-insurance program.

64. The General Assembly's infusion of \$35,000,000 into the teacher health-insurance program resulted from the belief held by some legislators that the program as described in the State's Post-Hearing Brief was "on the brink of collapse" and needed help. According to the testimony of Senator Jim Argue,

because of the low premium subsidy of \$131, the participation rate in the program had fallen substantially. The system as a whole, compared to other health-insurance systems, was insuring a much older, less healthy population, which had the effect of driving up premium costs. Senator Argue testified that the health-insurance system's actuaries advised that if significant and immediate action were not taken, "the system was going to literally implode, that we simply would not have health insurance that any teacher could afford to acquire."

65. Adding \$35,000,000 to the health-insurance system outside of the foundation-funding formula created an implication of "displaced local dollars," according to Senator Argue. Some districts voluntarily pay more than the minimum \$131 a month. Even though the \$131 was not increased directly, the provision of \$35,000,000 means that the "health-insurance subsidy is up to around \$190 for single coverage. That means \$60 of local money that they were putting into health insurance that's now available for whatever they want to use it for. It's a displaced local dollar [for the districts paying more than the minimum]." John Kunkel, Associate Director of Finance for the Department of Education, described the potential benefit to the districts as being "35 million dollars more put in the insurance system for the State of Arkansas for teachers. How that will eventually affect teachers, whether that will save them 35 million dollars in premium or

whether it will save school districts 35 million dollars in matching, I don't know how that's going to come out, but it was 35 million dollars put into the educational programs for the state of Arkansas.” The law requiring the districts to spend \$131 as an insurance benefit did not change in any manner, but for the districts that pay more than that, “It could reduce their matching back, if they chose to.” Some could reduce “matching back,” but others are prohibited from doing so contractually. The provision of the \$35,000,000 provided no additional monies to school districts to cover their costs.

G. Bonded Indebtedness in Existence as of January 1, 2005

66. State aid to school districts for assistance with the cost of repairing, renovating, or constructing academic facilities has been provided through a variety of programs over the years. For example, the 80th General Assembly in Act 917 of 1995, §3, provided a “debt supplement funding supplement” (DSFS) to qualifying school districts for the stated purpose of reducing debt service burdens and increasing the amount of local revenue available for maintenance and operations expenditures. Act 917 of 1995 also added “general facilities funding”(GFF) to provide an amount to each district voting the base millage from funds made available for that purpose based on a facilities needs adjustment approved by the Department of Education. The 84th General Assembly in the “Supplemental School

District Funding Act of 2003,” Act 69 of 2003, 2d Ex. Sess., continued the DSFS and GFF programs, which by then were described as “an integral part of school financing for a number of school districts.” Act 69 also added a new program, “supplemental millage incentive fund” (SMIF), as an elective alternative to DSFS and GFF. SMIF was intended to provide incentive funding and, thereby, encourage local financial support of schools, beginning with school year 2004-2005, for districts that voluntarily raised their millage beyond the requisite 25 mills pursuant to Amendment 74 to the Arkansas Constitution.

67. The 85th General Assembly in Act 2206 of 2005 repealed the Supplemental School District Funding Act of 2003, but, with amendments, retained its three programs – DSFS, GFF, and SMIF – codified, respectively, at Ark. Code Ann. § 6-20-2503 (“Bonded debt assistance”) (b), (e), (f) (Supp. 2005). The legislative purpose for these established programs now is to provide financial assistance to school districts for retirement of indebtedness in existence on January 1, 2005 (“Old Debt”).

68. Arkansas Code Annotated § 6-20-2503(b) (Supp. 2005) sets forth the state aid supplement that is the successor to DSFS and expressly states that the purpose of this state aid is retirement of Old Debt. The 85th General Assembly inserted a 10% reduction in the formula for computing this supplement to effectuate its intent

that the state should only assist with the support of “academic facilities,” a defined term excluding a building or space used for an extracurricular activity except as used for physical education training and instruction, e.g., a football field and stadium. Ark. Code Ann. § 6-20-2502(1) (Supp. 2005). The 10% reduction may be restored, however, upon a showing by the district that the indebtedness is not attributable to the support of non-academic facilities. Ark. Code Ann. § 6-20-2503(b)(3)(A)(i) (Supp. 2005). For each school district, the amount of the supplement is calculated based on the principal and interest payment schedule in effect and on file with the Department of Education on January 1, 2005. This amount is reduced by 10%. The remaining 90% of the principal and interest payment is divided by the total assessed value of the district, multiplied by 1,000, then multiplied by a statutorily defined funding factor, then multiplied by the state wealth index. Ark. Code Ann. § 6-20-2503(b)(1)-(3) (Supp. 2005). Use of funds received under Ark. Code Ann. § 6-20-2503(b) (Supp. 2005) by the school districts is unrestricted. The supplement is paid to the districts with no strings attached as to how the districts use it because the state is precluded from making a district’s bond payment. *See* § Ark. Code Ann. 6-20-2503(d) (Supp. 2005) (providing that the state shall not assume a debt of a school district or incur any obligation with regard to the district’s bonded indebtedness by virtue of the state

aid paid under this section). Funds received under § Ark. Code Ann. 6-20-2503(b) are expected to continue for the entire term of the district's related indebtedness.

69. Arkansas Code Annotated § 6-20-2503(e) (Supp. 2005) sets forth the current GFF program, pursuant to which financial assistance is received in addition to the financial assistance received under Ark. Code Ann. § 6-20-2503(b). The 85th General Assembly elected to phase out the GFF program over a ten-year period by reducing the amount received by each district after fiscal year 2005-2006 by 10% each year. The amount of the payment provided in fiscal year 2005-2006 is the amount that the district would have received during fiscal year 2004-2005 under the Supplemental School District Funding Act of 2003, which "is calculated by multiplying the school district's average daily membership for the previous school year by the state wealth index times a rate established annually by the State Board of Education." Ark. Code Ann. § 6-20-2405(a)(2) (Spec. Supp. 2003-2004). Act 2206 of 2005 does not place any restriction upon the use of this supplement by the school districts, but, historically, GFF payments were restricted, by statute, for purchase of school buses, furniture, equipment, computer software, or renovation or repairs of existing facilities. Ark. Code Ann. § 6-20-309(b) (Supp. 1995); Ark. Code Ann. § 6-20-2405(b)(1) (Spec. Supp. 2004-2005). The savings realized through the phase-out of this program will be distributed through the Educational

Facilities Partnership Fund in accordance with rules promulgated by the Facilities Commission. § 6-20-2503(e) (Supp. 2005).

70. Arkansas Code Annotated § 6-20-2503(f) (Supp. 2005) sets forth the current SMIF program, pursuant to which financial assistance is now received in addition to the financial assistance received under § 6-20-2503(b). The SMIF program was added in 2003 as an alternative to receipt of state aid under the combination of the DSFS and GFF programs. The 85th General Assembly in Act 2206 of 2005 elected also to phase out SMIF over a ten-year period by reducing the amount received by each district by 10% each year after fiscal year 2005-2006. The legislative concern became that, until adequacy is achieved, the state runs a legal risk if it supplements districts to raise their millage above 25 mills. The amount of the SMIF payment provided in fiscal year 2005-2006 is the amount by which the SMIF received in fiscal year 2004-2005 exceeds the sum of the amounts of DSFS and GFF that the district would have received in fiscal year 2004-2005 under the Supplemental School District Funding Act of 2003. The amount of the SMIF payment received in fiscal year 2004-2005, for a district that timely elected to receive SMIF, was “equal to the result of multiplying the lesser of the number ten (10) or [the number of mills, if any, by which the total millage rate exceeds the twenty-five (25) mills required by Amendment 74 to the Arkansas Constitution] by the school district's

supplemental millage incentive funding base multiplied by the school district's average daily membership times a funding factor to be determined by the department.” Ark. Code Ann. § 6-20-2406 (c)(1) (Spec. Supp. 2003-2004). Use of SMIF funds by the school districts is unrestricted. The savings realized through the phase-out of this program will be distributed through the Educational Facilities Partnership Fund Account in accordance with rules promulgated by the Facilities Commission. Ark. Code Ann. § 6-20-2503(f) (Supp. 2005).

71. Department of Education statewide annual funding reports tally the following facts:

“Old Debt” State Aid Program	2005 Public School Funding Actual (April 7, 2005)	2006 Public School Funding First Run (July 13, 2005)
Debt Service Funding Supplement (DSFS)/Bonded Debt Assistance	13,228,394	25,639,190
General Facilities Funding (GFF)	4,280,787	8,086,180
Supplemental Millage Incentive Funding (SMIF)	28,044,310	10,032,136
Total	45,553,491	43,757,506

(Masters’ Exhibit 1 and Masters’ Exhibit 3). To illustrate the effect of the 2005 changes to these three state-aid programs at the school district level, the Department of Education’s statewide annual funding reports show the following

for the districts from which the superintendent or another administrator testified at the proceedings before us:

School District	Total “Old Debt” State Aid Funding Program Payments 2005 Public School Funding Actual (April 7, 2005)	Total “Old Debt” State Aid Funding Program Payments 2006 Public School Funding First Run (July 13, 2005)
Rogers	\$927,429	\$773,944
Monticello	\$419,311	\$348,913
Earle	\$218,635	\$260,324
McCrorry	\$64,030	\$58,001
South Side	\$445,517	\$423,049
Blytheville	\$468,947	\$442,385
Wynne	\$575,790	\$528,864
Omaha	\$58,202	\$105,436
Alpena	\$73,061	\$69,839
Forrest City	\$531,054	\$479,565
W. Memphis	\$559,639	\$542,026
Brinkley	\$130,345	\$121,125
Barton-Lexa	\$125,335	\$122,173
Lafayette	\$67,822	\$61,150
Osceola	\$341,295	\$375,388
Little Rock	\$75,952	\$164,940
Pulaski County Special	\$695,136	\$511,990

A number of district superintendents testified that the 2005 amendments have left their districts with existing facilities-related bonded debt with respect to which state assistance is now unexpectedly reduced. The record developed in these

proceedings does not indicate what portion, if any, of the 2005-2006 bonded debt assistance/DSFS state-aid payment may be restored to any district upon a showing by it that the related indebtedness is not attributable to the support of non-academic facilities.

72. The state wealth index that factors into the computation of the bonded debt assistance/DSFS and GFF supplements is not the same as the facilities wealth index that factors into the three new facilities programs: Immediate Repair Program, Transitional Program, Partnership Program, discussed below. The state wealth index, for purposes of the § 6-20-2503 “old debt” state-aid programs, bonded debt assistance/DSFS, GFF, and SMIF, is defined as “the result of one (1) minus the ratio of local revenue per student divided by the difference between foundation funding and local revenue per student.” Ark. Code Ann. § 6-20-2503(a)(4) (Supp. 2005).

H. Facilities

73. The 84th General Assembly in Act 1181 of 2003 created the Joint Committee on Educational Facilities (Joint Committee), and charged it with making recommendations to the General Assembly relative to its responsibilities to provide adequate and substantially equal educational facilities for the state of Arkansas.

74. In June 2003, the Joint Committee established a Task Force on Educational Facilities to assist it in carrying out its functions. Ten million dollars was appropriated for a statewide facilities assessment and DeJong, Inc., was hired as program manager. Every educational structure in Arkansas was inspected and assessed as a part of this program.

75. On November 30, 2004, the Task Force filed its *Arkansas Statewide Educational Facilities Assessment – 2004* (Facilities Assessment Report) with the Joint Committee. The Facilities Assessment Report at page 20 listed total facility-condition costs of \$2,278,200,457, prioritized as follows:

Priority 1	Mission Critical, i.e., Health and Safety	\$ 86,666,992
Priority 2	Impact Functioning of School, i.e., Mechanical, Electrical and HVAC	\$1,674,015,698
Priority 3	Short Term Conditions, i.e., Finishes, Site Improvements, etc.	\$ 110,638,993
Priority 4	Least Critical, i.e., Program Enhancement, Aesthetics	\$ 406,878,774
Total		\$2,278,200,457

The Facilities Assessment Report at page 44 also estimated, for the next ten years, “Enrollment Growth Costs” of \$634,795,848 for 46,411 additional students in growing districts, broken down as follows: for the period 2004-2008, an additional 27,594 students and cost of \$368,260,775, and for the period 2009-2013, an additional 18,817 students and cost of \$266,535,073.

76. After the Facilities Assessment Report was filed, it was discussed with school-district officials and an addendum to the report was filed by the Task Force on February 22, 2005 (Facilities Assessment Addendum). In the Facilities Assessment Addendum, the total facility-condition cost was reduced by \$348,000,000 from the Facilities Assessment Report and the breakdown of that cost was set forth in nine major deficiency classifications, as follows:

1. Safe, Dry and Healthy	\$ 205,342,568
2. General Building Improvements	\$ 388,790,465
3. Year Zero Lifecycle	\$ 768,028,782
4. Interior	\$ 127,526,077
5. ADA	\$ 80,761,783
6. Site	\$ 60,871,350
7. Ed. Improvements	\$ 252,733,220
8. Specialities	\$ 23,741,637
9. Technology	\$ 22,346,530
Total	\$1,930,142,412

The facility-condition cost was calculated on the basis of bringing the facilities into compliance with current building-code requirements, but did not include any inflation factor.

77. The total appropriation for state assistance in facilities funding for the current biennium ending June 30, 2007, is \$120,000,000. This appropriation includes no monies earmarked for the Enrollment Growth Costs estimated in the Facilities Assessment Addendum to require anticipated construction costs of

\$361,769,048 during the five-year 2004-2008 period for 25,761 new students, or, said another way, an average cost of approximately \$72,000,000 each year.

78. The 85th General Assembly, in Act 1327 of 2005, created the Commission for Arkansas Public School Academic Facilities and Transportation (Facilities Commission) and placed under it the Division of Public School Academic Facilities and Transportation (Facilities Division). David Floyd is the Director of the Facilities Division, which is charged with the development and implementation of the Arkansas Public School Academic Facilities Program, as established by Act 1426 of 2005, and the administration of the various programs of state financial participation in support of local academic facilities. The Facilities Commission consists of three top state officials: the director of the Department of Finance and Administration (Richard Weiss), the president of the Arkansas Development Finance Authority (Mack Dodson), and the Commissioner of the Department of Education (Kenneth James). The Facilities Commission is charged with overseeing the operations of the Facilities Division and may perform any act necessary or desirable for carrying out the purposes of the Arkansas Public School Academic Facilities Program, including the adoption of administrative rules therefor and contracting with consultants, advisers, architects, engineers, and other independent contractors to carry out that program or related programs. The Facilities Commission is not presently under the control of the State Board of Education but

rather constitutes a separate and independent body; effective July 1, 2007, the Facilities Commission will expire, and all of its oversight powers and responsibilities regarding the Facilities Division will then transfer to the State Board of Education.

79. The 85th General Assembly, in Act 2206 of 2005, created the Academic Public School Academic Facilities Funding Act, which defines the “academic facilities wealth index.” The facilities wealth index is used to determine the shares of financial participation by the state and the school district in a local academic-facilities project eligible for state financial participation. The facilities wealth index states the financial participation percentage attributable to the school district; the financial participation percentage attributable to the state is calculated by this formula: one (1) minus the district’s facilities wealth index. Each school district is assigned a facilities wealth index, which is a percentage computed by the Facilities Division according to the complicated formula set forth in Ark. Code Ann. § 6-20-2502 (1)(A) (Supp. 2005). The formula is based on the value of one mill (\$0.001) per ADM for the district in the 95th percentile.

80. The Little Rock School District is the benchmark 95th-percentile school district in the computation of the Facilities wealth index. Thus, the Little Rock School District’s facilities wealth index is one (1), and, therefore, it qualifies for no financial participation by the state. Likewise, any school district with a facilities

wealth index greater than one (1) qualifies for no financial participation by the state. Said another way, districts with the highest value of one mill per student get no state money while districts with less are eligible for some state financial assistance on approved projects. In addition to Little Rock, some ten school districts, including Gravette, Eureka Springs, Fountain Lake, Jessierville, Ashdown, and Russellville, are not eligible for any state financial assistance with their facilities projects.

81. The school district eligible for the highest percentage of state assistance for approved projects is Poyen in Grant County, with a facilities wealth index of less than 18%, meaning it would be eligible for over 82% state funding, requiring less than 18% local funding. The percentage of state assistance available for any approved project may be very small. In the case of the Fayetteville district and the Hazen district, the state participation is less than one percent of the total approved cost of the project. In 18 districts, by contrast, the state's share is more than 70% of any approved project cost.

82. If the school district is unable to fund its share of the project cost, as determined by the facilities wealth index, the state does not financially participate in the project.

83. The facilities needs of a school district do not factor into the facilities wealth index formula. As the Facilities Assessment Report clearly reflects, the facilities

needs among the school districts vary widely. The Pulaski County Special School District has more than \$120,000,000 in facility-construction cost needs, which equates to \$6600 per student and is the highest in the state. Taking into account the state's financial contribution, pursuant to the operation of the facilities wealth index, one mill in the Pulaski County Special School District will produce 1.6% of its facilities needs. One mill in the Little Rock district will produce 2.79% of its facilities needs. Although the Little Rock district receives no state financial assistance with its facilities, its facilities needs are the second highest in Arkansas and average \$3883 per student. Likewise, neither the Ashdown nor the Cedar Ridge district receives any state financial assistance for its facilities needs – which average \$8718 per student for Ashdown, \$15,207 per student for Cedar Ridge. In Poyen, the state's poorest district according to the facilities wealth index, a one-mill increase, even with the highest percentage of state funding assistance, will produce only 1.4% of its facilities needs. By contrast, a one-mill increase in Siloam Springs produces 8.6% of that school district's facilities needs.

84. Act 1426 of 2005, the Arkansas Public School Academic Facility Program Act, provides in its introductory language that “in order to satisfy the constitutional expectations of the Supreme Court, the state should: (1) provide constitutionally appropriate public school academic facilities for the education of each similarly situated child in the public schools of Arkansas, regardless of where that child

resides within the state.” Act 1426, § 1, codified at Ark. Code Ann. §6-21-802(c) (Supp. 2005). By operation of the facilities wealth index formula, every school district in the state must bear some or all of the expense for the repair, renovation, or construction of its public school facilities before the state will contribute anything. In at least ten districts, the state contributes nothing. In several other districts the contribution would be less than one percent. In the event that a district is unable to meet its required contribution from its budgetary reserves or because the voters in the district are unwilling to approve a bond issue, the needed facilities will simply not be repaired or replaced.

85. There is no provision for the state to pay the entire cost of repairs, renovation, or construction, no matter how great the need, short of placing the district into the status of “Academic Facility Distress,” pursuant to Ark. Code Ann. § 6-21-811 (Supp. 2005). Even in that drastic circumstance, no state money is made available for the repairs, renovation, or construction of facilities. Rather, the Academic Facility Distress Program provides for state takeover of the district, basically, and the “final solution” of consolidation, annexation, or reconstitution. This would all come about only after years of delay. The facilities wealth index, as currently enacted, serves mainly to limit the state’s responsibilities for needed school facilities.

86. Act 2206 of 2005 also created the Public School Academic Facilities Funding Act, which established the Academic Facilities Immediate Repair Program (Immediate Repair Program). The General Assembly in Act 2138 of 2005 appropriated to that program the sum of \$20,000,000 for fiscal year 2005-2006, a sum considered to be “one time money” – no funds were appropriated to it for fiscal year 2006-2007. The Immediate Repair Program is not intended for new construction. The Immediate Repair Program is designed for projects necessary to resolve a deficiency that presents an immediate hazard to health and safety, the integrity of the facility with regard to minimum health and safety standards, or extraordinary deterioration of the facility, and comports generally with the Facilities Assessment Addendum’s deficiency classifications “Safe, Dry and Healthy” and “General Building Improvements.” Examples are projects that involve heating, ventilation, and air-conditioning systems, floors or roofs, fire-alarm systems, or any repair necessary to satisfy a life-safety code requirement. To be eligible for consideration, the estimated minimum cost of each project was \$50,000.

87. School districts were required to make application for state assistance under the Immediate Repair Program by July 1, 2005. One hundred forty-eight districts made application with the total dollar value of the projects requested of approximately \$82,000,000. The state, which is currently reviewing the

applications, hired five architectural and engineering firms to inspect and assess the projects submitted for the Immediate Repair Program. A four-factor 100-point scale was developed to rank the applications, as follows:

- Up to 50 points based upon the seriousness of the deficiency.
- Twenty points based upon whether or not the facility is reasonably expected to close or be substantially replaced within three years, with 20 points if the facility will be in use for that period of time and zero points if not.
- Up to 20 points based upon the facilities wealth index of the school district, with the most points awarded to the districts with the lowest index score.
- Up to ten points for the “prudent resourceful use of state funds” based upon the fiscal year 2004-2005 enrollment of the applicant district, with the most points awarded to the districts with the highest enrollment.

88. The actual amount of Immediate Repair Program funds to be received by an applicant district from the state depends upon the facilities wealth index of the applying district. Each school district receiving state assistance under this program is required to contribute local funds to the project cost, based upon its facilities wealth index. As noted above, this required “local money” can be anywhere from a low of 18% to a high of 100%. If all project applications submitted by July 1, 2005 were approved, the state’s share of the approximate \$82,000,000 total projects cost would equal approximately \$40,000,000, and the balance would be contributed by the districts in accordance with the facilities wealth index. The state’s estimated \$40,000,000 share is approximately twice the amount of the \$20,000,000 appropriation for the Immediate Repair Program.

89. The state has authority to transfer funds to the Immediate Repair Program from the Transitional Academic Facilities Program (Transitional Program), which is another one-year program established by Act 2206 of 2005. Ark. Code Ann. § 6-20-2506 (Supp. 2005). The General Assembly, in Act 2138 of 2005, appropriated to the Transitional Program the sum of \$50,000,000 for fiscal year 2005-2006; no funds were appropriated to it for fiscal year 2006-2007. This program is intended for new construction, as defined therein, for which debt is incurred or funds are spent after January 1, 2005, and on or before June 30, 2006. The Transitional Program provides state financial participation in the form of reimbursement to a district based upon the facilities wealth index, for eligible new construction projects. The rules and regulations for the Transitional Program are not yet developed, but they are anticipated to be in place by December 1, 2005, whereupon the districts can begin making application for these monies. Thus, at present, the school districts must proceed with their new-construction projects without knowing whether or not a project will qualify for state aid under this program. The districts, not the state, must be responsible for the repayment of any debt incurred for these new-construction projects. As with the Immediate Repair Program, the state's participation in the project cost is determined by the qualifying district's facilities wealth index and, accordingly, could range from a high of 82% to a low of zero.

90. Act 2206 of 2005 also created the Academic Facilities Partnership Program (Partnership Program). Ark. Code Ann. § 6-20-2507 (Supp. 2005). The General Assembly in Act 2138 of 2005 appropriated to this program the sum of \$50,000,000 for fiscal year 2006-2007, the second year of the biennium; no funds were appropriated to it for fiscal year 2005-2006. The Partnership Program is considered to be a continuing program, rather than a one-year program such as the Immediate Repair Program or the Transitional Program. The Partnership Program is designed for “new construction” as defined therein. In the Partnership Program, the school districts will apply for state financial assistance before the project is commenced and will know before any bonds are issued the amount, if any, of state participation. The state financial participation will be based upon a district’s facilities wealth index and will consist of cash payment to the school district, a so-called “pay as you go” plan. The district’s share, based upon its facilities wealth index, will be made from its budgetary reserve funds or, more likely, from proceeds of a locally approved bond issue. Under the Partnership Program, the district and the state will enter into an agreement specifying the terms of the state’s participation and the conditions that must be satisfied by the school district, which shall include that the agreement will be void and the state will have no further obligation to provide state funds if the school district does not raise local resources and apply them toward the new-construction project as provided under the

agreement. At present, no rules or regulations for the Partnership Program have been adopted. The Facilities Division is required to notify the school districts of its decisions concerning their applications for the Partnership Program and the estimated amount of the state financial aid no later than May 1, 2006, and, beginning in 2007, no later than May 1 of each odd-numbered year. Funds received from the state under this program will be accounted for by the school district as restricted funds.

91. The 85th General Assembly in Act 1426 of 2005 requires each school district to develop and submit a ten-year districtwide facilities master plan with a summary of public comments made at a local public hearing, for review and approval of the Facilities Division, by February 1 of each even-numbered year. Applicable rules are not yet adopted. The proposed master plan to be submitted by February 1, 2006, must include a description of planned new construction with cost estimates per facility and needs prioritized as follows:

- Immediate needs that the school district intends to address during the period of July 1, 2006 through June 30, 2007.
- Immediate needs that the school district intends to address during the 2007-2009 biennium.
- Short-term needs that the school district intends to address within the four to six years following the submission of the facilities master plan.
- Long-term needs that the school district intends to address within the seven to ten years following the submission of the facilities master plan.

The initial master plans for the districts shall be reviewed and approved by May 1, 2006. Ark. Code Ann. § 6-21-806 (Supp. 2005).

92. Act 1426 of 2005 also requires the Facilities Division to develop a comprehensive state master plan for managing state financial participation in local academic facility projects, to include a list of “committed projects” for public academic facilities for the upcoming fiscal year categorized by program and method of state financial participation. Ark. Code Ann. § 6-21-807 (Supp. 2005).

93. Act 2138 of 2005, § 4, directs that in fiscal year 2005-2006, the appropriation to the Immediate Repair Program and to the Transitional Program and, in fiscal year 2006-2007, the appropriation to the Partnership Program are payable from the Educational Facilities Partnership Fund Account.

I. Compliance with Act 57

94. Act 57, 2nd Ex. Sess. of 2003, codified at Ark. Code Ann. §10-3-2101 (Spec. Supp. 2003-2004) and Ark. Code Ann. § 10-3-2104 (Spec. Supp. 2003-2004), in pertinent part provides:

(c) The General Assembly further recognizes that while the adequacy study performed in 2003 is an integral component towards satisfying the requirements imposed by the Supreme Court, the General Assembly has a continuing duty to assess what constitutes an adequate education in the State of Arkansas.

....

(a) The House Interim Committee on Education and Senate Interim Committee on Education shall file, separately or jointly, or both, reports of their findings and recommendations with the President Pro Tempore of the Senate and the Speaker of the House of Representatives no later than September 1 of each year prior to the convening of a regular session.

(b) The report shall include for each recommendation, proposed implementation schedules with timelines, specific steps, agencies and persons responsible, resources needed, and drafts of bills proposing all necessary and recommended legislative changes.

Act 59, 2nd Ex. Sess. of 2003, in pertinent part provides:

(2) *For the 2004-2005 school year* [emphasis added], the foundation-funding amount is equal to five thousand four hundred dollars (\$5400) times the average daily membership of the previous school year.

95. The General Assembly was required to set the foundation-funding amount for 2005-2006 and 2006-2007 in the 85th General Assembly. Act 57 prescribes a framework for the General Assembly to determine a foundation amount for years subsequent to 2004-2005. An Act 57 review and report were not performed. The state initially argued a lack of timely data prevented the Act 57 assessment; however, there is no evidence that the General Assembly attempted to comply with Act 57 and was thwarted by the lack of information. Senator Argue admitted as much. The state now contends that Act 57 did not apply to the work of the 85th General Assembly and that the 2003 Odden-Picus Study meets the requirements of Act 57 for the session. This interpretation of Act 57 strains credibility in light of

Senator Bisbee's testimony to the Masters in 2004. He testified that the Interim Committees on Education are required to propose appropriate, adequate dollar amounts for the next biennium and that \$5400 was the funding only for the 2004-2005 school year. If the state's recently articulated interpretation is and has been its position, then it follows that the argument would have been made to the supreme court in response to the court's *per curiam* order dated May 5, 2005, but it cannot be found in the State's Supplemental Brief filed May 13. At that time, the state argued a lack of data. It appears this defense has recently evolved in an attempt to explain the failure to comply with Act 57.² But strict compliance with Act 57 is not the ultimate question because, irrespective of the exact process to be followed, the General Assembly was obligated to ascertain a foundation amount that would provide an adequate education for the 2005-2006 school year. The amount of \$5400 was established as adequate funding only for the 2004-2005 school year.

96. The General Assembly did not attempt to base its funding level for the 2005-2006 school year on a determination of the actual cost to provide an adequate education. The Interim Committees on Education conducted no hearings to determine what recommendation to make to the 85th General Assembly as to what an appropriate level for adequate funding would be. The Department of Education

²The Bureau of Legislative Research prepares the *Summary of the Legislation Enacted by the 85th General Assembly Concerning Public Education*. At page 2 of the Summary in discussing the "Adequacy Study," it states that "sufficient data were not available by September 1, 2004 or during the 85th General Assembly." It makes no reference to the Odden-Picus Study.

was never asked by the General Assembly to provide any information or assistance with respect to the requirements of Act 57 during the summer or fall of 2004. The Department of Education did nothing formally to examine, nor was it asked to make a recommendation, whether \$5400 was sufficient for the 2005-2006 school year.

97. At the beginning of the session, Senator Broadway and Senator Bisbee told the superintendents to anticipate at least a cost-of-living increase of about \$100 per student the first year of the biennium and something like that in the second year of the biennium. The expectation throughout the session was for a cost-of-living increase. During the last two or three weeks of the session, the decision was made to freeze the foundation funding at \$5400 for the 2005-2006 school year and to provide an increase of \$97 in the second year of the biennium. No one testified to either the Senate Committee or the House Committee that the funding that was ultimately adopted was an adequate funding level for the 2005-2006 and 2006-2007 school years.

98. The 85th General Assembly had the twofold responsibility of reviewing the system put in place in the Second Extraordinary Session of 2003 and setting the funding levels for the 2005-2006 school year. Prior to the session, but unquestionably during the session, information was available concerning problems with the foundation-funding formula and, if nothing else, the impact of inflation. If

the General Assembly had conducted hearings similar to the recently completed Masters' hearings, prior to or during the legislative session, it could have learned of problems or concerns with the foundation-funding formula that are discussed in more detail elsewhere in this report, such as the following:

- a possible flaw in the URT because it is based upon property assessment rather than actual tax collections; consequently, some districts receive less than \$5400 because they collect an amount from URT that is less than 98% of the taxes assessed;
- when a district loses students, its wealth index increases resulting in an emphasis on the URT component of the foundation-funding formula and a decrease in the state foundation-funding aid, which exacerbates the problem raised in the preceding paragraph;
- earmarking portions of the foundation funding for designated uses limits the districts' available revenues in other areas, for example:
 - ▶ Act 2121 of 2005, codified at Ark. Code Ann. § 6-5-307 (Supp. 2005), requires that an increase in the amount of foundation funding attributable to the Educational Excellence Trust Fund be used only for raising teacher salaries, and not for step increases, arguably resulting in a widening of the disparity in teachers' salaries across the state;
 - ▶ Act 1426 of 2005, codified at Ark. Code Ann. § 6-21-808 (d) (Supp. 2005), requires that each school district dedicate 9% of its foundation funding exclusively to payment of utilities and custodial, maintenance, repair, and renovation activities; thereby, limiting its use to cover increased fuel costs for its buses and the like; and
- impact of subsequent legislation, mandates, and inflation.

If the General Assembly had become aware of such concerns, it is assumed that it would have considered them and possibly taken action to redress any demonstrated problems with the funding formula when adopting the funding for the biennium.

99. The state has hired a consultant to assist the General Assembly in complying with Act 57 in anticipation of the 86th General Assembly in 2007. It is the same consultant hired to do the 2003 adequacy study, which is described in detail in our April 2, 2004, report in response to Question 1.

J. Surplus Funds

100. On April 4, 2005, the Department of Finance and Administration (DF&A) released its Official Revenue Forecast for the fiscal year ending June 30, 2005. The forecast estimated a surplus of \$146,400,000. The projected amount was included as a funding resource in the 2005-2007 biennium budget. At fiscal-year end, the actual amount of surplus was \$307,217,154.49, and that amount was entered into the General Revenue Allotment Fund. After various assignments and appropriations, the total remaining surplus amount at this time is \$107,800,000. This is unallocated money that could be appropriated and spent through a special legislative session.

101. The current forecast by DF&A for surplus in fiscal year ending 2005-2006 is \$98,900,000, and the forecast for fiscal year ending 2007 is \$68,700,000. In his

deposition, Richard Weiss, Director of DF&A, estimated that the surplus for this current biennium could be \$180,000,000.

102. The Educational Adequacy Trust Fund was created by Act 107, 2nd Ex. Sess. 2003. The purpose of the fund is to make additional resources available to the Department of Education Public School Fund Account and the Department of Education Fund Account as needed to fulfill the obligation of the state to provide an adequate education system as enacted by the Second Extraordinary Session of the 84th General Assembly. Richard Weiss estimated this is an unappropriated surplus of \$49,000,000 in the adequacy fund.

III. Discussion and Evaluation

From the largely uncontradicted evidence presented by the movants, we must conclude that the state has not lived up to the promise made by the 84th General Assembly Regular and Extraordinary Sessions of 2003 to make education the state's first priority. Without exception, the school superintendents who testified before us were of the opinion that regression in state-aid funding, costly unfunded new education mandates, and the General Assembly's failure to take inflation sufficiently into account had adversely affected their efforts to provide an "adequate" education to their students.

As a result of reassessments for purposes of the ad valorem property tax, property-value assessments have risen. Accordingly, local school-district

responsibility for foundation funding has risen, and the responsibility of the state for school year 2005-2006 is approximately \$39,000,000 less than it was for 2004-2005. The accompanying rise in responsibility resulting to the school districts may seem to be insignificant in view of their increased property “wealth.” The problem caused by the fact that the districts do not collect the entire formulary 98% is, however, obviously exacerbated when they are required to shoulder a larger portion of the foundation funding.

While there was general agreement among witnesses that the money raised by the URT is “state” money in that it is remitted to the state by county collectors and then back to the school districts, Department of Education documents refer to it as “local” funds. Nomenclature aside, it is clear that when assessments rise, the state need not contribute as much to the schools, the school-district citizens must contribute more, and in most instances, the schools receive less. More important is the illustration provided by this situation pointing up the inconsistency of our Constitution’s proclamation of the state’s responsibility to provide an adequate education to its citizens and the reality of placing a large portion of the burden on local school districts.

The 2005 legislation that retained \$5400 as the foundation-funding amount for school year 2005-2006 is difficult to defend. Although it is agreed that no one is to blame for failure to predict the very large increase in the cost of fossil fuel, it

is clear that some inflationary increase should have been foreseen. The predictable rise in the cost of items such as textbooks, food served in school cafeterias, and general supplies would have justified a cost-of-living increase. Also, an increase in foundation funding should have been forthcoming due to new spending requirements placed upon the school districts by the 85th General Assembly. A few of those requirements are the hiring of certified music and art teachers (Act 245), vision-screening personnel and equipment (Act 1438), duty-free lunch periods for teachers (Act 1881), and forty-minute preparation time for teachers (Act 1943). Additionally, there are statutorily required increases in “step” raises for teachers. The salary for a teacher with a bachelor’s degree was raised from \$27,500 to \$27,994 for 2006-2007; the raise for teachers holding master’s degrees went from \$31,625 to \$32,193 (Act 2130). Added to that is an anticipated requirement that the districts pay a one percent raise in the school districts’ teacher-retirement contributions (Act 1968).

Our main concern about the failure to provide a funding increase for the school year 2005-2006 and about the small increase for 2006-2007 goes much deeper. The fact that the school superintendents testified that they would be required to invade their reserve balances just to keep the level of performance reached in response to the legislation passed in the 84th General Assembly in place is very important. Perhaps even more important, however, is the evidence before

us that the discussions among legislators and Department of Education and Department of Finance and Administration personnel seemed foreign to the process envisioned by the 2003 legislation.

Rather than seeking to address the needs of the schools and the effort to achieve equal opportunities for all students across the state to obtain an adequate education, as could have been expected in view of the legislative priority expressed by the 84th General Assembly, the discussions were about how to spend available funds. Testimony about the reasons for not increasing the funding in 2005-2006 included legislators' desire to learn how the large infusion of money in 2003 had been spent and the fact that an additional \$35,000,000 had been allocated in 2005 for teachers' health-insurance premiums.

The insurance premium money appeared in those discussions to have been pitted against a cost-of-living increase in the foundation funding. Senator Shane Broadway had authored a bill including a cost-of-living increase for the schools, and he assured some concerned educators it would be there. Patty Martin of the Department of Education had recommended, or at least assumed, an increase of 3.1%. There was discussion in the Department of Finance and Administration of an increase of 1.875% for the first year of the biennium and 1.8% for the second year. According to the testimony found in the deposition of Richard Weiss, the increase for the first year of the biennium would have cost \$45,000,000, and would

have added \$101 to the foundation funding, making it \$5501. We note that the increase was a part of Governor Mike Huckabee's "Executive Recommendations" to the 85th General Assembly.

Yet, when the 85th General Assembly ended, there were cost-of-living-increases for other state agencies but there was no increase for the school districts for fiscal year 2005-2006. Surplus monies thought to be remaining to be spent were divided as "general improvement funds" (GIF) with half going to the governor's office and the remainder to the General Assembly. State senators were allowed \$750,000 each to be spent on projects recommended by them individually. It is unclear how the portion allocated to the House of Representatives was handled.

The increase in funding for teachers' health-insurance premiums, is undoubtedly a good thing, but its effect upon education is indirect at best and does not excuse the failure to fund educational resources adequately. The desire to learn how the 2003 money had been spent could best have been satisfied by asking the parties who were charged with spending it wisely, that is, the people running the schools. They could also have been asked about how they would be affected by obviously increasing costs in the face of no increase in funding. That brings us to Act 57 of the Second Extraordinary Session of 2003.

Act 57 made it clear that the \$5400 foundation-funding amount provided by Act 59 was meant to be for the school year 2004-2005 only. It required that, “[d]uring each interim” the House Interim Committee on Education and the Senate Interim Committee on Education meet separately or jointly to review a host of issues, all concerning the provision, including funding, of adequate educational opportunity.

Although the committees met a number of times, there is no indication that any discussion of the subject occurred. The school superintendents who testified before us were asked if they had been sought out by the committees to discuss the subject, and they had not. Nor is there any indication that officials of the Department of Education or the Department of Finance and Administration were consulted by the committees about education funding.

It is apparent that an atmosphere of satisfaction prevailed among state officials. They seemed satisfied that the supreme court had approved what they had done in 2003 and that they could simply rest upon the laurel bestowed by the court when it released its mandate after our initial report.

That same sense of satisfaction seems to be present with respect to the issue of school-district consolidation. Governor Huckabee, through his counsel, was a major participant in the hearings before us in 2004 as an advocate for achieving greater efficiency through consolidation of school districts. The governor is no

longer actively participating in this case. Despite the feeling, exemplified by the deposition testimony of Mr. Weiss, the state's chief financial officer, and the governor's earlier participation, that serious inefficiencies continue to result from our having more than 250 school districts, the issue has been ignored or forgotten by the General Assembly. Apparently, there is a new plan for district consolidation by default that results in even less efficiency.

Dr. Kenneth James, Commissioner of Education, acknowledged in his deposition testimony that the consolidations now occurring result from schools falling into "distress." As of the time the depositions which form a part of the record in these proceedings were taken, there were sixteen school districts in "fiscal distress" and, as indicated by Department of Education documents, some sixty-eight high schools on academic probation and possibly headed toward "academic distress." To those terms has now been added "facilities distress," which may have the same Draconian consequences, that is, school districts that fall into distress become subject to takeover by the Department of Education and may be consolidated forcibly when other attempted cures fail.

The problem with the approach of consolidation as the result of failure is that it ignores what is happening in the classrooms during the years leading up to one or more of the distress conditions and the ensuing struggle to cope with it at the local level. Several of the superintendents who testified before us said that their districts

would not be able to avoid fiscal distress if the level of funding were not raised, as they were having to invade their fund balances just to stay up with required programs.

Very large amounts of money have been spent on expert evaluation of the delivery of education in Arkansas, including a study of the buildings in which it is delivered. The facilities study was done by architects and engineers, hired under a contract with a consulting firm, DeJong, Inc. That study, at an expense of at least \$8,500,000, resulted in a report that required almost immediate revision after it was discussed with local school-district authorities, causing interested persons to wonder about its overall validity. We now find a newly legislated system for financing construction and repair of school buildings that continues to place a high responsibility upon school districts but places control of the projects largely in a Commission on Facilities and Transportation, a state agency. School-district financial responsibility is so great that a district which cannot raise its millage sufficiently to produce funds that, according to the facilities wealth index, are needed to enter a partnership program with the state will have to do without the needed construction and may face being placed in facilities distress.

The funds appropriated for facilities repair, renovation, and construction during this biennium (\$120,000,000) do not come close to addressing the state's public-school facilities needs. This is true even recognizing the requirement that

local districts must afford part or all of the expense. The state contends that before more money can be appropriated, it must first have a “master plan” which will not be operational until at least the 2007 or 2009 session. The state has already spent too much time “getting ready to get ready” as far as facilities are concerned. While rules have been developed with respect to the period for school districts to request participation in the \$20,000,000 immediate repair program which ended July 1, 2005, there is no evidence before us to show that rules have been developed for participation in the transition or partnership programs or for the “master plans.”

The complexities involved in assisting school districts to build buildings based upon a wealth index that does not take into account the actual need for new or improved structures are like the complexities inherent in the foundation-funding formula based on property assessments that result in unpredictable URT revenues. In discussing the information that the state obtains from school districts through an elaborate coding system, Dr. Don Stewart, Deputy Commissioner of Education, acknowledged that the department does “not get real good data.” When these vagaries are combined with the seeming impossibility of solving the perpetual inequities of teacher salaries in poor districts versus salaries in districts that raise far more than the URT amount, the search for simplicity and equity and adequacy is bewildering. Senator Jim Argue stated that it is impossible to have a streamlined system, given the legislative process.

The initial adequacy study, which, we believe, stimulated the education reform undertaken by the 84th General Assembly, was done by Drs. Picus, Odden, and Wallace. They recommended vastly increased funding in the form of additional money to be devoted to the school districts per se rather than the per-student type adopted by the General Assembly. The experts who testified before us in 2004 took no exception to either approach and praised the beginning made by the General Assembly.

These matters have already been sufficiently studied by outside experts. The adequacy study done in 2004 was competent and comprehensive, yet we note news reports that the legislative committees are again hiring Drs. Picus and Odden to help the committees in their consideration of what is needed for adequacy of educational opportunity. Presumably this move to conduct yet another study is meant to be a step toward fulfilling the *committees'* obligation pursuant to Act 57 to continue to study the adequacy issue to assure appropriate funding for education. Committee members should be aware of the extensive and valid recommendations made in the initial adequacy report, and they may want to avail themselves of the record of testimony and documents that we have compiled that are relevant to their task.

We note in closing our conclusion that there is at least \$107,000,000 of general revenue funds from the fiscal year 2004-2005 that have not been allocated

by the 85th General Assembly that could be spent to remedy some of the problems discussed here if they were appropriated and allocated in a special session. In addition, Mr. Weiss alluded to an estimated surplus of \$49,000,000 in the Educational Adequacy Fund. He reported a current conservative forecast of a surplus of \$180,000,000 in the present biennium. If those predictions hold true, and if the General Assembly lives up to its stated obligation to fund education first, the needs of Arkansas's children may well be served.

As has been recognized in each court decision in the long history of *Lake View Sch. Dist. No. 25 v. Huckabee*, Arkansas school children deserve, and are constitutionally entitled to have an opportunity to achieve, an efficient, suitable, equal, and adequate education. By its actions in 2003 and 2004, the 84th General Assembly recognized the deficiencies in our state's system for providing sustenance for our public schools, and it provided an admirable launch down the road toward achieving that goal. Legislators obviously realized that their work in 2003 and 2004 was only a beginning and that there was a great deal of "catching up" to do. They knew that achieving "adequacy" of educational opportunity was not just a matter of infusing the schools with \$380,000,000. They demonstrated a strong willingness to stay the course.

We recognize how difficult it may be to avoid the tendency to slip back onto the track of "business as usual." We have no doubt, however, that the means are

present for the governor and the members of the 85th General Assembly and their successors to regain the high ground and eventually to erase the stain of unconstitutionality from Arkansas's public schools.

Dated: October 3, 2005

Bradley D. Jesson, Special Master

David Newbern, Special Master