HIGHER EDUCATION

MAJOR ISSUES

%***Proposed Higher Education Budgets Are Incomplete.*** Again this year, the budget is silent on many important points, such as enrollments and certain fee levels. We developed alternative budget proposals for the University of California (UC) and California State University (CSU) and made recommendations for the California Community Colleges (CCC) based on principles we identify to assist the Legislature in taking a balanced approach toward the twin goals of providing student access and maintaining program quality. (See page F-13.)

%***Balance Fee Increases and Program Quality.*** In our analysis of higher education issues, we have taken as a starting point the administration's total proposed funding levels. In this context, and recognizing the level of funding needed to address important instruction-related issues, we recommend undergraduate fee increases of 10 percent at the UC and the CSU, with higher fees for graduate students, and a $2 per credit unit fee increase at the CCC. We also recommend providing related financial aid. To the extent the Legislature increases the overall level of support for higher education, moderating the fee increase may be a high legislative priority. (See pages F-47, F-71, and F-86.)

%***Hold the Segments Accountable for Enrollments****.* For the UC, we recommend the Legislature adopt the UC's projected enrollment level. For the CSU we recommend a 2,000 full-time-equivalent (FTE) student increase over the current year, based on recent participation rates and other factors. For the CCC, we recommend

Budget Bill language that would require the Chancellor's Office to fund the level of actual FTE student enrollment assumed in the budget. (See pages F-61, F-72, and F-82.)

%***Focus on Higher Education Outcomes.*** We provide information on various legislatively specified outcome measures, such as graduation rates and degrees conferred in relation to (1) work-force needs and (2) statutory goals on racial and ethnic diversity. Additional information on four-year degree pledge programs at UC and CSU will be available this spring. We also recommend that the CCC Chancellor's Office propose outcome measures and performance standards that would permit it to allocate some state aid to the community colleges on a performance basis in 1996-97. In the future, the Legislature will need other "performance" measure information for the three segments. (See pages F-28 and F-89.)

%***Avoid Debt Financing for Deferred Maintenance***. We believe that proposed debt financing for deferred maintenance at UC and CSU in 1995-96 is ill-advised because prudent budget policy calls for annual balancing of operating budgets. We have recommended alternatives to the use of debt, such as the redirection of federal overhead funds at UC and the targeted use of carryover funds at UC and CSU. (See pages F-52 and F-74.)

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OVERVIEW

The budget proposes modest increases for all higher education segments.

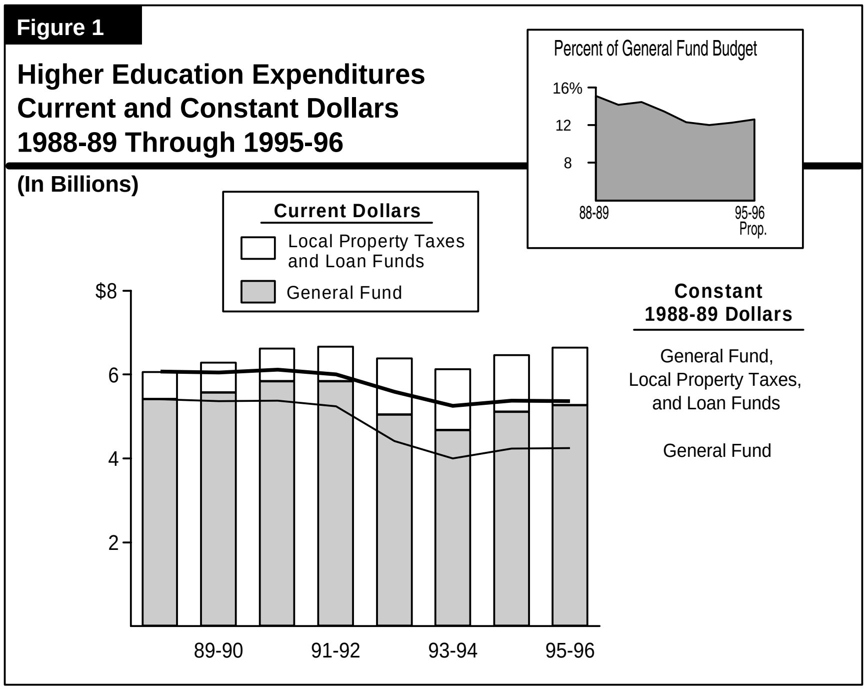
The budget proposes General Fund expenditures of $5.3 billion for higher education in 1995-96. This is $163 million, or 3.2 percent, more than estimated expenditures in the current year. Including local property taxes, the budget proposes spending of $6.7 billion, which is $177 million, or 2.7 percent, more than estimated expenditures in the current year.

Figure 1 (see next page) shows that higher education expenditures from the General Fund have decreased by $148 million since 1988-89, representing an average annual decrease of 0.4 percent. When these expenditures are adjusted for inflation, General Fund spending decreased over this time period by an average of 3.4 percent annually. The share of General Fund spending allocated to higher education has declined from 15 percent to 13 percent over this period.

Including local property taxes, and loan funds, higher education expenditures have increased by $580 million over the period, an average annual increase of 1.3 percent. Adjusted for inflation, spending has decreased an average of 1.8 percent annually.

Figure 1

Higher Education Expenditures Current and Constant Dollars 1988-89 Through 1995-96



SPENDING BY MAJOR PROGRAMS

Figure 2 shows spending from the General Fund, local taxes, loan funds, and student fee revenues (net of financial aid) in detail. The figure shows that the budget proposes modest increases for each segment of higher education.

For the University of California (UC) and the California State University (CSU), the budget proposes General Fund increases of $63.3 million (3.5 percent) and $3 million (0.2 percent), respectively. (As we show in Figure 3 below, the CSU figure understates actual budget-year growth, as the 1994-95 expenditures were high due to one-time spending. This issue is discussed further in our analysis of the CSU budget.)

The budget anticipates that fees will increase by at least 10 percent at the UC and CSU. Assuming a fee increase of 10 percent, combined General Fund and net student fee revenues would increase by $104 million (4.6 percent) at the UC and by $32 million (1.6 percent) at the CSU.

Figure 2

Higher Education Budget Summary General Fund, Local Property Taxes, Loan Funds, and Net Student Fee Revenues[a] 1993-94 Through 1995-96

(Dollars In Millions)

	Actual 1993-94	Estimated 1994-95	Proposed 1995-96	Change From 1994-95 Amount	Change From 1994-95 Percent
University of California					
General Fund	$1,793.2	$1,825.9	$1,889.2	$63.3	3.5%
Student fee revenues	416.6	454.0	495.1	41.1	9.1
Totals	**$2,209.8**	**$2,279.9**	**$2,384.3**	**$104.4**	**4.6%**
California State University[b]					
General Fund	$1,452.3	$1,599.6	$1,602.6	$3.0	0.2%
Student fee revenues	371.6	404.3	433.6	29.3	7.2
Totals	**$1,823.9**	**$2,003.9**	**$2,036.2**	**$32.3**	**1.6%**
California Community Colleges—local assistance					
General Fund (Proposition 98)	$936.0	$1,157.1	$1,221.6	$64.5	5.6%
General Fund (non-Proposition 98)	41.3	3.5	—	-3.5	-100.0
Local property taxes	1,278.5	1,369.0	1,382.4	13.4	1.0
General Fund loan	178.0	—	—	—	—
Student fee revenues	186.9	178.4	196.1	17.7	9.9
Totals	**$2,620.7**	**$2,708.0**	**$2,800.1**	**$92.1**	**3.4%**
Student Aid Commission—local assistance					
General Fund	$207.6	$226.2	$242.1	$15.9	7.0%

[a] Student fee revenues are net of financial aid.

[b] Includes California Maritime Academy.

For the California Community Colleges (CCC), the budget proposes to increase support from the General Fund in 1995-96 by $61 million (5.3 percent) and from combined General Fund, property tax revenues, and net student fee revenues by $92 million (3.4 percent). The budget proposes to raise fees from $13 per credit unit to $15 per credit unit, an increase of 15 percent.

MAJOR BUDGET CHANGES

Figure 3 presents the major budget changes in General Fund spending for higher education. For the UC and the CSU, the largest proposed General Fund increases ($37 million at UC and $31 million at CSU) are for unspecified two percent increases in general purpose expenditures.

Funding for debt service costs on previously authorized lease-payment bonds also accounts for a significant portion of the net General Fund increases at the UC and the CSU—$25 million and $13 million, respectively. For the community colleges, the budget proposes $4.9 million for these costs.

The budget funds a net General Fund increase of $61 million for the community colleges. The budget proposes an increase of $55 million to fund a 2.2 percent COLA for general-purpose spending. An additional $25 million is provided to fund statutory enrollment growth, but is partially offset by a $15 million reduction related to enrollment declines among bachelor's degree holders in prior years.

Other major funding increases for the community colleges include $22 million to backfill fee revenue shortfalls—primarily 1994-95 revenue losses not backfilled in the current year—and $10 million to restore a current-year funding reduction that recognized a one-time decrease in employer rates charged by PERS. These increases are offset by $33 million in reductions that are related to funding source shifts: $20 million due to a proposed $2 per unit fee increase, and $13 million due to increased property tax revenue. For the first time in recent years, the budget proposes to backfill current-year property tax shortfalls in the current year, instead of waiting until the budget year.

Figure 3

Higher Education
Proposed Major General Fund Changes for 1995-96

University of California	Requested:	$1.9 billion	
	Increase:	$63 million	(+3.5%)

+
- $37 million for unspecified general purposes
- $25 million for debt costs on lease-payment bonds

California State University	Requested:	$1.6 billion	
	Increase:	$3 million	(+0.2%)

+
- $31 million for unspecified general purposes
- $13 million for debt costs on lease-payment bonds

−
- $41million to eliminate one-time carryover funds in 1994-95

California Community Colleges—Local Assistance	Requested:	$1.2 billion	
	Increase:	$61 million	(+5.3%)

+
- $55 million for a 2.2 percent COLA for general-purpose spending
- $25 million for statutory enrollment growth
- $22 million to backfill fee revenue shortfalls
- $10 million to restore one-time portion of 1994-95 reduction in PERS rates

−
- $20 million due to a proposed $2 per unit fee increase
- $15 million for prior-year enrollment declines
- $13 million due to increased property tax revenue

Other Programs

+
- $16 million to the Student Aid Commission to augment the Cal Grants financial aid program
- $18 million for higher education general obligation bonds

ENROLLMENT

Figure 4 shows student enrollment at each of the segments. It shows that enrollments have declined at all the segments from 1992-93 to 1994-95. These declines are probably due to a number of factors, including course section reductions, fee increases, declines in the economy generally, and actions taken by the institutions to limit enrollment. The UC's full-time-equivalent (FTE) enrollment declined from 154,277 in 1992-93 to an estimated 149,481 in 1994-95, which is a 4,796, or 3.1 percent, decrease. The CSU's FTE enrollment declined from 259,309 in 1992-93 to an estimated 250,498 in 1994-95, which is a 8,811, or 3.4 percent, decrease.

Figure 4

Higher Education
Full-Time Equivalent (FTE) Students[a]
1992-93 Through 1995-96

	1992-93	1993-94	Estimated 1994-95	Proposed 1995-96
University of California				
Undergraduate	114,386	112,798	111,464	Open
Postbaccalaureate	747	750	502	Open
Graduate	26,374	25,930	25,515	Open
Health sciences	12,770	12,823	12,000	Open
Totals	**154,277**	**152,301**	**149,481**	**Open**
California State University				
Undergraduate[b]	222,313	213,632	215,498	Open
Postbaccalaureate	16,983	14,357	15,000	Open
Graduate	20,013	19,877	20,000	Open
Totals[b]	**259,309**	**247,866**	**250,498**	**Open**
California Community Colleges				
Resident	899,313	858,897	868,277	873,817
Nonresident	27,291	27,157	26,917	27,088
Totals	**926,604**	**886,054**	**895,194**	**900,905**
Hastings College of the Law	1,253	1,268	1,230	1,230

[a] Total actual enrollments including nonresidents for all segments. Nonresidents are separately identified for community colleges to allow comparison with the Governor's Budget, which identifies resident students only.

[b] Includes California Maritime Academy.

For the third year in a row, the administration does not propose budget-year enrollment levels for the UC and the CSU. Later in this *Analysis*, we discuss UC and CSU enrollment levels and their relationship to the state's Master Plan for Higher Education.

The community colleges have also experienced declines in total enrollments since 1992-93. Total actual FTE enrollment declined from 926,604 in 1992-93 to 895,194 in 1994-95, which is a 31,410, or 3.4 percent, decrease. The budget proposes enrollments of 873,817 resident FTE in 1995-96, which represents an increase of 5,540, or 0.6 percent from the current-year level. This is the net effect of an increase of 8,596 FTE students due to adult population growth of one percent and a decrease of 3,056 FTE students to reflect estimated attrition related to the proposed fee increase.

STUDENT FEES

Figure 5 (see next page) presents student fee levels from 1992-93 through 1995-96. The budget indicates that "it is expected that general student fees will increase by at least 10 percent at UC and CSU." Accordingly, Figure 5 displays the fee levels assuming an increase of 10 percent. For the community colleges, the budget proposes an increase in fees from $13 per credit to $15 per credit unit. For the CSU and the CCC, increasing student fees requires legislation.

From 1992-93 through 1994-95, fees have increased significantly at all three segments. Student fees rose at the UC by $975 (35 percent), at the CSU by $276 (21 percent), and at the CCC by $180 (86 percent). Despite these large increases, the budget estimates that current UC undergraduate resident student fees are $241 less than the average fee of the four public universities with which the UC compares itself on faculty salaries. The budget estimates that current CSU fees are $1,046 lower than the average fee of the 15 public universities with which the CSU compares itself on faculty salaries. The budget also shows that California's current community college fees are still the lowest in the nation.

Figure 5

Higher Education Student Fees 1992-93 Through 1995-96

	1992-93	1993-94	1994-95	Proposed 1995-96
University of California[a]				
Undergraduate/graduate	$2,824	$3,454	$3,799	$4,179
Medicine/law				
New students	3,200	3,830	6,175	Open
Continuing students	3,200	3,830	4,175	Open
Other graduate professional				
New students	2,824	3,454	5,799	Open
Continuing students	2,824	3,454	3,799	Open
California State University[a]	$1,308	$1,440	$1,584	$1,740
California Community Colleges	$210	$390	$390	$450
Hastings College of the Law				
New students	$3,200	$3,830	$6,175	Open
Continuing students	3,200	3,830	4,175	Open
California Maritime Academy	$1,370	$1,507	$1,658	Open

[a] Assumes a 10 percent fee increase at UC and CSU because the budget anticipates that the fees will increase by at least this amount and provides Cal Grant funding accordingly.

HIGHER EDUCATION

CROSSCUTTING ISSUES

HIGHER EDUCATION ALTERNATIVE BUDGET PROPOSALS

The budget's proposals for the University of California (UC) and the California State University (CSU) are silent on key decisions, such as the level of certain student fees and enrollment levels. We have developed alternative budget proposals again this year for these agencies, and have made recommendations for the California Community Colleges (CCC) and the Student Aid Commission (SAC) to assist the Legislature in balancing the twin goals of providing student access and maintaining program quality.

For the third year in a row, the proposed budgets for the UC and the CSU are incomplete, making it difficult for the Legislature to carryout its oversight and appropriations roles. They do not completely specify proposed fee levels or schedule related financial aid. They do not specify proposed enrollment levels or include expenditures needed to protect the state's investment in infrastructure. While the administration provides a more complete budget for the CCC, it does not sufficiently hold the CCC accountable for budgeted levels of enrollment.

During consideration of the 1994-95 higher education budget, the Legislature set specific fee levels, provided financial aid to offset the fee increases, attempted to meet Master Plan enrollment goals, and provided funds for merit salary adjustments. Over the past several years, the Legislature has also expressed concern that critical needs (such as deferred maintenance) be funded and that the segments align faculty workload to provide courses needed for normal progress to degree.

Based on these recent legislative actions, and in order to assist the Legislature with its deliberations this year, we have developed proposed 1995-96 budgets for the UC and the CSU. In developing our alternative budgets, we took as a starting point the administration's total proposed funding level for higher education. In that context, and given the significant instruction-related funding needs of the segments, we propose specific fee increases, financial aid spending, and enrollment levels. We have also made specific recommendations regarding these issues in our analysis of the CCC and SAC budgets.

We discuss our recommendations for each segment in detail in our analysis of each individual agency. As shown in Figure 6, the basic goals we used in developing the proposals include:

- Provide funds to recognize the costs of continuing the current program.
- Allocate funds for critical needs in the areas of deferred maintenance, instructional equipment, and library purchases where feasible.
- Balance fee levels and program quality.
- Specify greater fee increases for graduate students.
- Use non-General Fund resources to the maximum extent possible.
- Continue productivity increases.
- Establish enrollment levels in consideration of the Master Plan for Higher Education and hold segments accountable for these enrollment levels.

As has been true in previous years, additional enrollment and other information will become available in the spring. Also, the amount that can be allocated to these agencies may change due to changes in the condition of the General Fund and the rest of the budget. Thus, we may suggest modifications to the plans later to reflect such updates.

Figure 6

Principles for Proposed Alternative Higher Education Budgets

Fund the Continuing Costs of the Current Program

- Provide for increased costs related to faculty and staff salaries, merit salary adjustments, and operating expenses
- Fund the maintenance costs of new space
- Recognize savings from workload reductions at the CCC

Address Critical Funding Needs

- Provide funds for deferred maintenance, instructional equipment, and library purchases where feasible

Balance Fee Levels and Program Quality

- For undergraduate students at the UC and the CSU, specify a 10 percent fee increase
- For community college students, increase fees from $13 to $15 per credit unit
- For graduate students, specify greater fee increases
- Allocate a portion of increased fee revenues for financial aid
- Provide sufficient funding for the Cal Grants Program (which serves undergraduate students) to offset the impact of the proposed 10 percent fee increase at the UC and the CSU

Maximize the Use of Non-General Fund Resources

- At the UC, redirect federal overhead receipts, state research funds, and excess teaching hospital gains towards campus programs

Continue Productivity Increases

- Continue the second year phase-in of increases in the budgeted student-faculty ratio at the UC to provide for reasonable increases in faculty productivity

Maximize Access

- Establish enrollment levels, basing them on consideration of the Master Plan for Higher Education
- Specify that funds intended for enrollment growth at the CCC be used for growth
- Hold the segments accountable for enrollment levels

HIGHER EDUCATION FOUR-YEAR PLAN

We recommend that the Legislature review the administration's proposed UC and CSU budget "compact," which would absorb an additional $1.1 billion of General Fund resources on a cumulative basis over the next four years, in the context of its overall budget priorities. The Legislature needs to consider whether it wishes to "guarantee" a portion of the budget a specified rate of growth over a time period when the state's fiscal condition will be tight.

The budget proposes a "four-year compact" with UC and CSU which includes proposals in five areas—operating and capital outlay funding, student fees and financial aid, enrollment plans, productivity improvements, and budget priorities. The Legislature has already acted in many of these areas to set specific policies. We describe the proposals and provide comments on them below.

Operating and Capital Outlay Funding

The compact calls for operating budget increases averaging four percent over the three-year period beginning in 1996-97. (The budget proposes two percent increases for unspecified general purposes for the UC and CSU in 1995-96.) The administration also states that additional General Fund increases will be provided for debt service costs on lease-payment bonds used to finance capital outlay projects. In addition, the administration proposes to provide annual funding of about $150 million to each of the two four-year segments for new capital outlay over the four-year period beginning 1995-96. Priority would be given to seismic and life safety projects, infrastructure and educational technology. Absent voter approval of a general obligation bond for this purpose, the Legislature would be asked to authorize lease-payment bonds to finance these projects.

Comments. Our review indicates that the administration's proposed UC and CSU budget "compact" would absorb $1.1 billion on a cumulative basis over the four-year period beginning in 1995-96. To the extent the Legislature commits to a cumulative increase of this magnitude for higher education, its ability to address priorities in other areas of the budget will be limited accordingly. Thus, we believe the Legislature should review the proposed higher education compact in the context of the state's likely tight fiscal condition over this period and the resulting tradeoffs which would be required.

Student Fees and Financial Aid

The administration anticipates that the UC and CSU governing boards will act to raise fees by at least 10 percent, and pledges to support the UC and CSU governing boards' decisions regarding the fee levels "they deem appropriate for students attending their institutions." The administration also states that fee increases will include differential fees for UC professional students and CSU graduate students and at least one-third of additional fee revenues will be reserved for financial aid.

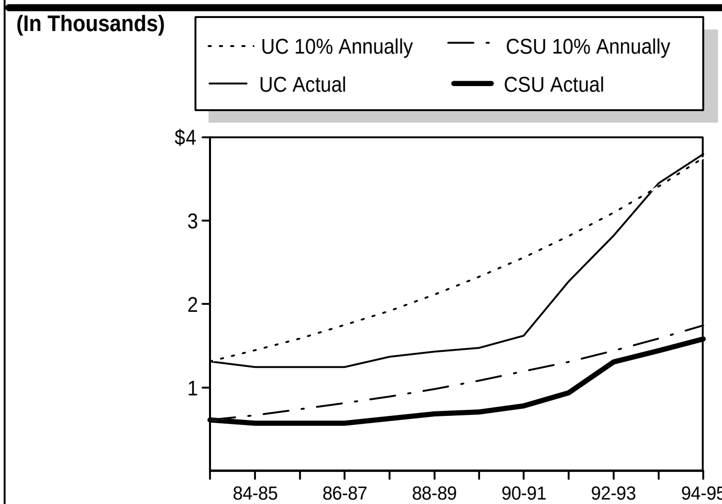
For 1995-96, the administration provides funding to the Cal Grants program administered by the Student Aid Commission to cover the anticipated 10 percent fee increases. The Governor's Budget document states that additional funding will be considered if the UC and CSU governing boards adopt larger increases.

Comments. The Legislature will face difficult decisions regarding student fee and financial aid policies over the next several years as it balances the priorities of student access and program quality. Current law specifies that the UC and CSU governing boards shall establish long-term student fee policies that ensure "that any necessary fee increases are gradual and moderate." Actual fee increases at the UC and CSU in the 1990's have not been gradual or moderate.

To assist the Legislature in its deliberations regarding fee policies, we have reviewed fee increases over a longer time period—from 1983-84 through 1994-95—to compare actual fee increases at the UC and CSU to what the fee increases would have been during this period if they had increased at a steady rate of 10 percent annually. A 10 percent increase is consistent with the maximum specified by the Legislature in Ch 572/90 (SB 1645, Dills). Figure 7 (see next page) displays the results of this analysis. As the figure shows, fees were actually rolled back in 1984-85 compared to the previous year. This rollback occurred as the state's economy rebounded after a recession in the early 1980s. Fees increased slowly thereafter throughout the decade. Between 1990-91 and 1994-95, however, fees increased rapidly—by 134 percent at UC and 103 percent at CSU. The fee increases were enacted to partially offset the impact of significant General Fund reductions during this time period.

Figure 7

UC and CSU Student Fees
Actual Compared to Ten Percent Annual Increase
1983-84 Through 1994-95



The figure also shows that if fees had increased by 10 percent annually from 1983-84 through 1994-95, the resulting fee levels in 1994-95 would be roughly equal to the actual fee levels.

As the economy improves, the Legislature may wish to limit student fee increases as it did after the recession of the early 1980's. However, as our analysis shows, gradual and moderate increases over time may avoid the imposition of more rapid fee increases. Ultimately, the Legislature will be faced with balancing fee levels, student access, and program quality.

Enrollment Plans

The administration's compact specifies that the UC and CSU will plan their enrollment so that over the four-year period enrollments will grow by an average of about one percent annually.

Comments. Based on the most recent enrollment projections by the Department of Finance (DOF), it appears that planning for enrollment growth of about one percent annually over the four-year period is reasonable for UC given anticipated enrollment demand. For the CSU, this would be slightly less growth over the four-year period than the DOF enrollment projections indicate. The Legislature will need updated projections each year, however, to ensure that planned enrollment increases are adequate. This is because the DOF's long-term enrollment projections have changed significantly in recent years. For example, the DOF's combined UC and CSU projections for 2005-06 were revised downward by more than 10 percent from fall 1989 through fall 1994.

The administration's compact is silent on a related enrollment budgeting issue—the need to hold the segments accountable for meeting planned enrollment levels, thereby maintaining the integrity of the budget process. Based on our recommendation last year, the Legislature established target enrollment levels for the UC and CSU in the *Supplemental Report of the 1994 Budget Act*. The Legislature also readopted Budget Bill language from the 1991 budget to adjust the UC and CSU budgets if actual enrollments varied from the targets by more than 2 percent. The Governor vetoed the language stating that funding for the UC and CSU "should be addressed through additional legislative action when compared to other essential financial needs." We believe the issue of accountability for planned enrollments should be addressed during consideration of the 1995-96 budget and make specific recommendations on this issue in our analysis of the UC and CSU budgets.

Productivity Improvements

The administration notes that while UC and CSU "have achieved dramatic increases in productivity necessitated by recent budgetary reductions" there will be a continued "need" for additional unspecified "productivity improvements" to save $10 million annually at each segment over the four-year period. The administration specifies that priority will be given to reducing administration costs, increasing management efficiency, and utilizing cost-effective instructional technology. Under the proposed compact, the systems apparently would be allowed to achieve and spend these"savings" in whatever way they wanted. It is also not clear under the administration's proposal whether the $10 million in annual productivity improvements would be "needed" to balance the UC and CSU budgets or whether the internal savings would be used at their discretion for their own priorities.

Comments. Over the past three years, the Legislature has taken specific actions to improve productivity at the UC and CSU. Beginning in the current year, for example, the Legislature increased the budgeted student-faculty ratio (SFR) at the UC from the traditional 17.6 to 18.7 over a two-year period. Our review indicates that this action will ultimately save the state about $55 million annually. The Legislature has also specified its intent that a planned teaching workload reduction at the CSU be deferred. The CSU has deferred the proposal indefinitely.

The administration's general emphasis on productivity improvements is in line with the Legislature's previous actions to increase productivity at the UC and CSU. However, the Legislature lacks information on the specific details of the proposal that it will need to determine how particular productivity improvements would mesh with the Legislature's priorities.

Budget Priorities

The administration's plan calls for the UC and CSU to "place high priority on providing needed classes so that full-time students are able to graduate in four years or less, and that part-time students can graduate in as few years as possible". The plan also calls for the UC and CSU to give high priority to restoring faculty salaries to competitive levels over the four-year period, with an emphasis on merit-based increases, to recruit and retain "high caliber" faculty.

Comments. The Legislature adopted supplemental report language to the 1994 Budget Act specifying legislative intent that the UC and CSU adopt four-year pledge programs (and other similar programs) on each UC and CSU campus by 1995-96 to encourage the campuses to improve, on their own, the management of faculty workload. Under such programs, the campus pledges to provide specialized advice to students and guarantees that students in the program will be able to take the courses they need to graduate in four years. The students, in turn, agree to meet with the advisors and to follow the agreed upon courses of study. It is not clear how the administration's proposal regarding improvements in students' time to degree go beyond the actions already taken by the Legislature.

The Legislature has also (within the limits of budget constraints) provided merit salary adjustments and general faculty salary increases at the four-year segments to improve the competitiveness of UC and CSU faculty salaries in comparison to the UC's eight and the CSU's twenty salary comparison institutions. In our analysis of the proposed 1995-96 UC and CSU budgets, we recommend that additional funds be provided for merit salary adjustments and general faculty salary increases. (We address a related issue—the faculty salary comparison institution methodology—in the next section.)

Recommendation

We recommend that the Legislature review the administration's proposed UC and CSU budget "compact" in the context of its overall priorities for funding various programs, including higher education. The Legislature needs to consider whether it wishes to "guarantee" a portion of the budget a specified rate of growth over a time period when the state's fiscal condition will be tight. With regard to other aspects of the proposed compact, we note that the Legislature has already acted to (1) allocate funding for specific enrollment increases, (2) require specific increases in productivity, and (3) ensure that four-year degree pledge programs and other programs designed to improve students' time to degree are established at all UC and CSU campuses.

UC AND CSU FACULTY SALARIES

We recommend that the Legislature direct the California Postsecondary Education Commission (CPEC) to consider an alternative faculty salary methodology because the current one is flawed.

Every year, pursuant to Senate Concurrent Resolution 51 of 1965, the CPEC submits to the Governor and the Legislature an analysis of faculty salaries at the UC and CSU in relation to the higher education institutions that the UC and CSU have agreed to use as a basis for comparing the adequacy of the faculty salaries they provide. The CPEC's analysis is based on a set of procedures and calculations that are collectively referred to as the "faculty salary methodology."

Figures 8 and 9 display the faculty salary comparison institutions for UC and CSU, respectively.

Figure 8

The University of California Comparison Institutions for Faculty Salaries 1995-96

Cornell University	University of Illinois (Champaign-Urbana)
Harvard University	University of Michigan (Ann Arbor)
Stanford University	University of Wisconsin (Madison)
State University of New York (Buffalo)	Yale University

The last comprehensive review of the faculty salary methodology occurred almost a decade ago. We believe it time for a new review of the methodology because, in our view, the methodology results in the identification of faculty salary gaps that are too large, particularly at the CSU. This is primarily because the methodology does not adequately account for the significantly higher proportion of full professors at the CSU compared to its 20 comparison institutions. (This issue also has implications for the UC, but to a much lesser extent, because the UC's faculty staffing patterns are more in line with its eight comparison institutions.)

Another reason for the overly large "gap" is that the CSU's comparison list includes major doctoral-granting institutions. Generally, such institutions pay higher faculty salaries than institutions with teaching missions that are more similar to the CSU.

We discuss these issues below.

Figure 9

**California State University
Comparison Institutions for Faculty Salaries
1995-96**

Arizona State University	Tufts University
Bucknell University	University of Bridgeport
Cleveland State University (Buffalo)	University of Colorado (Denver)
Georgia State University	University of Maryland (Baltimore)
Loyola University of Chicago	University of Nevada (Reno)
Mankato State University	University of Southern California
North Carolina State University	University of Texas (Arlington)
Reed College	University of Wisconsin (Milwaukee)
Rutgers University (Newark)	Virginia Polytechnic Institute and State University
State University of New York (Albany)	Wayne State University

Upward Bias Due to CSU Staffing Patterns

Under the current methodology, the CSU's faculty salary "gap" is computed by multiplying the average salary at each rank (such as full professor) at the CSU and its comparison institutions by the average of the staffing patterns at CSU and its comparison institutions. Based on this methodology, the CPEC estimates that CSU faculty salaries lag behind its comparison universities in the current year by approximately 9.6 percent. The CPEC estimates that this lag will increase to 12.6 percent in 1995-96 in the absence of a faculty pay increase.

We believe the faculty salary methodology is flawed because it provides for salary parity even though the CSU's staffing pattern (and, to a much lesser extent, the UC's staffing pattern) is far in excess of parity. Figure 10 (see next page) displays the faculty staffing patterns at the UC and CSU in relation to their comparison institutions.

Figure 10

Faculty Staffing Patterns 1994-95

	Professor	Associate Professor	Assistant Professor	Instructor
University of California (UC)	58.6%	22.4%	19.0%	—
UC comparison institutions	53.6	24.1	22.4	—
California State University (CSU)	64.4%	19.5%	14.6%	1.4%
CSU comparison institutions	38.3	34.8	24.6	2.3

As shown in Figure 10, over 64 percent of the CSU's faculty are full professors, while only 38 percent of its comparison institutions' faculty fall in this group. (In addition, CSU's proportion of full professors is far in excess of that of any single comparison institution. The next highest is 47 percent.) Figure 10 also shows that about 59 percent of the UC's faculty are full professors, while 54 percent of its comparison institutions faculty fall in this group.

Generally, the proportion of full professors in a given higher education institution reflects the following:

- The age of the faculty, because it generally takes a number of years for faculty members to advance to the highest paid rank of full professor.
- The institution's promotion and advancement policies, because more liberal promotion and advancement policies mean that faculty advance more quickly to the rank of full professor.

We are not aware of any particular reason why the faculty age patterns at the CSU (or UC) would vary from the age patterns at its comparison institutions. In the past, the CSU administration has defended its top-heavy distribution on the basis that a more liberal policy toward advancement is needed if CSU is to be competitive in hiring faculty. However, this argument gives CSU "the best of both worlds"—salary parity and a staffing pattern far in excess of parity.

Clearly, the CSU's comparison institutions have made trade-offs in using the funds available to them. They are able to pay higher salaries by rank (as shown in Figure 11) because they have proportionately *fewer* faculty at the highest paid rank of full professor. The CSU should be subject to a similar fiscal discipline if the comparison is going to be meaningful.

Figure 11

UC and CSU
Current Faculty Salary Methodology and Legislative Analyst's Office (LAO) Alternative

		Comparison Group	
	1994-95	**1994-95**	**1995-96**
UC			
Academic Rank			
Professor	$79,383	$85,379	$88,703
Associate Professor	53,309	56,166	57,968
Assistant Professor	46,185	47,482	49,045
Current methodology[a]	$66,466	$70,761	$73,368
UC faculty salary "gap"			
Amount	—	$4,295	$6,902
Percent	—	6.5%	10.4%
LAO alternative[b]	$67,246	$69,875	$72,440
UC faculty salary "gap"			
Amount	—	$2,629	$5,194
Percent	—	3.9%	7.7%
CSU			
Academic Rank			
Professor	$62,293	$70,321	$72,868
Associate Professor	49,979	52,094	53,911
Assistant Professor	40,854	43,203	44,596
Instructor	32,734	34,339	35,380
Current methodology[a]	$54,191	$59,379	$61,023
CSU faculty salary "gap"			
Amount	—	$5,188	$6,832
Percent	—	9.6%	12.6%
LAO Alternative[b]	$56,332	$56,475	$58,000
CSU faculty salary "gap"			
Amount	—	$143	$1,668
Percent	—	0.3%	3.0%

[a] Under the current methodology, these amounts are calculated by multiplying the average salary at each rank by the combined average staffing patterns of the comparison institutions and the UC or CSU.

[b] Under the LAO alternative, these amounts are simple average salaries.

Our analysis indicates that if the simple average CSU faculty salary were compared to the simple average faculty salary at the comparison institutions, the faculty salary gap of 12.6 percent in 1995-96 (absent faculty salary increases) identified under the current methodology would be reduced to 3 percent, as shown in Figure 11. Similarly, the estimated 1995-96 gap for UC would be reduced from an estimated 10.4 percent to 7.7 percent.

We recommend that the faculty salary methodology be based on simple average comparisons. We note that, while this change would reduce over time the overall faculty salary "gap," it would not diminish the systems' ability to reward outstanding faculty with salary increases. This is because the systems have considerable flexibility in awarding salary increases to individual faculty members.

CSU Comparison Institutions

In the past, the faculty salary comparison institutions for the CSU have been chosen to include institutions with similar teaching missions. Specifically, the comparison institutions for the CSU have included those that offer a wide variety of programs at both the undergraduate and Master's degree level, but that grant very few if any doctoral degrees. This is because, under the state's Master Plan for Higher Education, the CSU is authorized to offer doctoral degrees only through joint arrangements with the UC or private universities. Over the last decade, two of the comparison institutions—the University of Southern California and the Virginia Polytechnic Institute and State University—have become two of the nation's top 35 doctoral-granting institutions.

The inclusion of doctoral-granting institutions in the comparison university list for the CSU tends to increase the computed faculty salary "gap." This is because such institutions tend to have higher faculty salaries than institutions that are more truly comparable to the CSU.

Recommendation. As a practical matter, the issues we discuss above are not likely to have implications for the 1995-96 budget. This is because, even with our proposed changes, it is likely there will still be some level of faculty salary "gap" in 1995-96, given the state's fiscal constraints. (In our analysis of the UC and CSU budgets in later sections, we make recommendations for faculty salary increases that would help close the faculty salary gaps we identify.)

When significant policy and fiscal concerns have been raised regarding the faculty salary methodology in the past, the CPEC has convened a technical committee composed of representatives from the UC, CSU, Department of Finance, and Legislative Analyst's Office to advise it on proposed changes. Under such a process, the CPEC would ultimately be responsible for making recommendations to the Legislature and the Governor regarding changes to the methodology.

We recommend that the Legislature adopt the following supplemental report language in order to address the concerns we discuss above in time for the 1996-97 legislative budget hearing process:

> It is the intent of the Legislature that the California Postsecondary Education Commission convene a technical advisory committee composed of representatives from the University of California, the California State University, the Department of Finance, and the Legislative Analyst's Office to review specific faculty salary methodology issues. These issues shall include (1) revising the methodology to use the simple average faculty salaries at the UC and CSU in comparison to the simple average faculty salaries at their respective comparison institutions, and (2) replacing or eliminating institutions from the CSU's comparison list that grant significant numbers of doctoral degrees.
>
> The CPEC shall, in consultation with the technical advisory committee, make recommendations on these two faculty salary methodology issues and, as appropriate, other related issues to the legislative policy and fiscal committees that consider higher education issues, the Department of Finance, and the Legislative Analyst's Office by December 1, 1995.

HIGHER EDUCATION OUTCOME MEASURES

New information is available on several higher education outcome measures, as we describe below. In the future, the Legislature and the higher education systems will need additional information on these and other "performance" measures.

In our *Analysis of the 1994-95 Budget Bill*, we noted that each segment of higher education and the California Postsecondary Education Commission (CPEC) annually provide much information to the Legislature and the Governor on educational and financial inputs or processes, such as the number of students enrolled, expenditures per student, and the number of course sections offered. However, very little of the information is on the outcomes of higher education.

We recommended that the Legislature begin to focus more directly on the outcomes of higher education, rather than the inputs or processes. We further noted that if the Legislature can develop measures that accurately and reliably gauge outcomes, it could hold the segments accountable for their performance through such mechanisms as "performance budgeting." Thus, the budget debate would center around the "products" of higher education rather than on how different types of expenditures are scheduled.

Based on our recommendations, the Legislature adopted supplemental report language to the 1994 Budget Act specifying legislative intent that:

- The UC and CSU adopt four-year pledge programs (and other similar programs) on each UC and CSU campus to encourage the campuses to improve, on their own, the management of faculty workload.
- The CPEC analyze trends in UC and CSU degrees conferred (and, for the CCC, degrees and certificates conferred) in relation to trends in the state's work-force needs.
- The CPEC report on trends in UC and CSU degrees conferred (and, for the CCC, degrees and certificates conferred) by ethnicity in relationship to the Legislature's statutory goals.

In a related development, the CPEC issued its first performance measures report in December 1994, as required by Chapter 741, Statutes of

1991 (AB 1808, Hayden). The report includes information on students' participation, retention, and graduation rates as well as the work-force needs and ethnicity information specified above. In the following analysis, we provide an overview of the retention and graduation data contained in CPEC's report and an update on the three supplemental language issues identified above. In our analysis of community colleges, we also discuss additional community college accountability issues.

Graduation and Retention Rates

A high proportion of UC and CSU freshmen and transfer students graduate.

In its December 1994 report on various higher education performance measures, the CPEC provided information on the graduation and "persistence" rates of first-time freshmen and community college transfer students at UC and CSU. ("Persistence rate" is defined as the proportion of students who either graduate or are still enrolled during a specified time period.) As we discuss in a later section on accountability, information on graduation rates is not available for the community colleges.

First-time freshmen. Figure 12 (see next page) shows the status of first-time freshmen that were admitted under regular requirements five years after entering college. For the UC, the data are for the 1985 freshman class and for the CSU, the 1983 freshman class. For both systems, a majority of students had graduated or were still enrolled five years after entering college. At the UC, 68 percent had graduated and 7 percent were still enrolled, while 25 percent were not enrolled. At CSU, 28 percent had graduated and 31 percent were still enrolled, while 41 percent were not enrolled.

According to the UC and CSU systems, the vast majority of the students who were still enrolled are likely to graduate. The students who were not still enrolled include those who transfer outside their respective university systems, or drop out either on a temporary or permanent basis. The CSU data reflect that many students at the CSU attend part-time and may take more than five years to graduate.

Transfer Students. Figure 13 (see next page) shows the status of students at the UC and the CSU who transferred from a community college, three years after transfer. The data are for students entering the UC and the CSU in fall 1985. Again, the majority had graduated or were still enrolled three years prior to transferring. At the UC, 66 percent had graduated and 10 percent were still enrolled, while 24 percent were not enrolled. At the CSU, 29 percent had graduated and 38 percent were still enrolled, while 33 percent were not enrolled.

Figure 12

Outcomes of First-Time UC and CSU Freshman Five Years After Entering

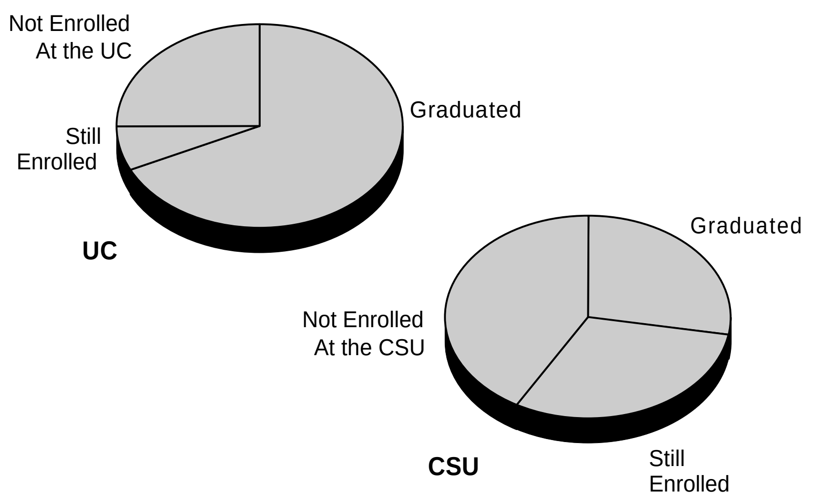
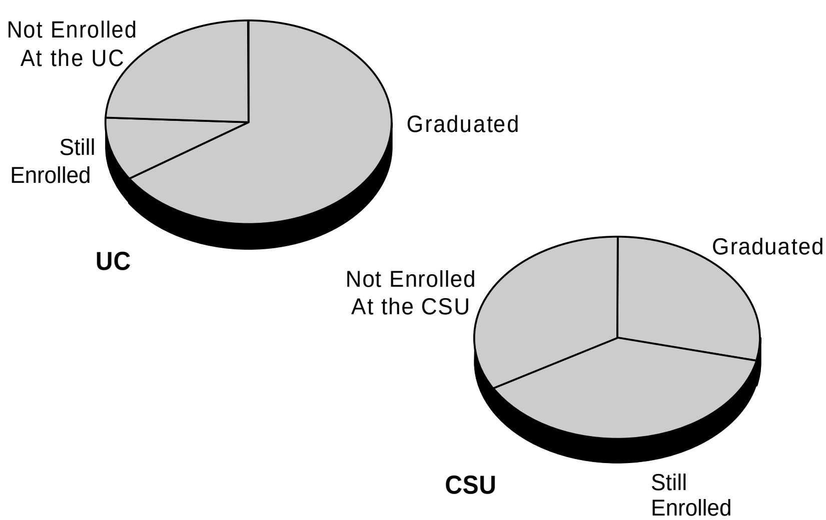


Figure 13

Outcomes of Transfer Students at the UC and CSU Three Years After Transfer



Summary. The CPEC notes that persistence rates at UC and CSU appear to be increasing, but indicates that there are no data available to compare the information presented above with a consistent "base" year (such as 1980). The information presented in the December 1994 CPEC report represents an important first step in developing "base year" information that will eventually allow the Legislature to compare UC and CSU graduation and persistence rates consistently over time.

Four-Year Degree Pledge

At the time of budget hearings, the Legislature will have updated information available on the development of four-year degree pledge programs and related measures at each campus.

Based on the latest available information, 30 percent of the UC's regularly-admitted freshmen graduate in four years. The average time to degree is 4.4 years. The CSU reports that 25 percent of first-time freshmen graduate in five years. (The CSU does not have data available on four-year graduation rates.) The average time to degree is 5.6 years.

In our *Analysis of the 1994-95 Budget Bill*, we recommended that four-year pledge programs be established at each UC and CSU campus to ensure that students wishing to graduate in four years are able to do so. Under such programs, the campus pledges to provide specialized advice to students and guarantees that students in the program will be able to take the courses they need to graduate in four years. The students, in turn, agree to meet with the advisors and to follow the agreed upon courses of study. We believe that a four-year pledge (and longer pledges for part-time students) is a relevant and reliable outcome measure that will direct campuses' actions to realign faculty and other resources to meet students' needs.

Based on our recommendation, the Legislature adopted supplemental report language to the 1994 Budget Act specifying legislative intent that four-year pledge programs and similar programs for part-time students be established on each UC and CSU campus by 1995-96. The language also requests the UC and CSU to submit reports to the Legislature by March 1, 1995 on each system's plans to start these programs and on related efforts to improve students' time to degree. We will provide comments on these reports, as appropriate, at legislative budget hearings.

Degrees Conferred and Work-Force Needs

In recent years, social science and humanities degrees conferred have outpaced the growth of science and engineering at the UC and CSU. While the number of life and physical science degrees and certificates has grown significantly faster at the CCC, degrees and certificates in these disciplines remain a much smaller portion of total awards earned than at the UC and the CSU.

Based on our recommendation in the *Analysis of the 1994-95 Budget Bill*, the Legislature adopted supplemental report language to the 1994 Budget Act specifying legislative intent that the CPEC, in its annual report required by Chapter 741/91 (AB 1808, Hayden), report on degrees conferred at the UC and CSU and on degrees and certificates conferred at the CCC, as compared to available data on the state's work-force needs. In its December 1994 report, the CPEC presents information on the number and types of degrees conferred at UC and CSU. Although the report does not contain similar information for the community colleges, we have worked with CPEC and the community colleges Chancellor's Office to obtain the information, which is presented below. The CPEC report also does not include comparison information on the state's work-force needs as requested by the Legislature. CPEC staff are working with other state agencies responsible for work-force data to address this issue in the next annual report, due in November 1995.

University of California. From 1987-88 to 1992-93, the number of undergraduate degrees conferred at the UC increased by 33 percent. Figure 14 shows that the number of humanities, professional, and social science degrees grew faster than average, while the number of life science and engineering degrees grew slower than average. During this time period, the number of physical science degrees declined by 16 percent.

The UC conferred 31,130 undergraduate degrees in 1992-93. Figure 15 shows that 53 percent were in social sciences and humanities and 28 percent were in science and engineering.

Figure 14

UC Growth in Undergraduate Degrees 1987-88 Through 1992-93

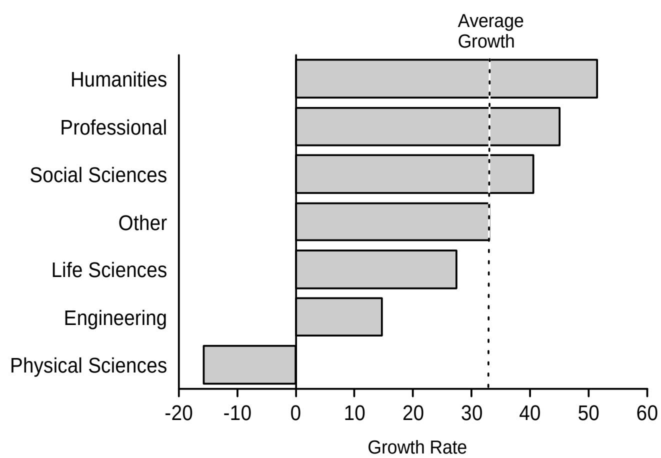
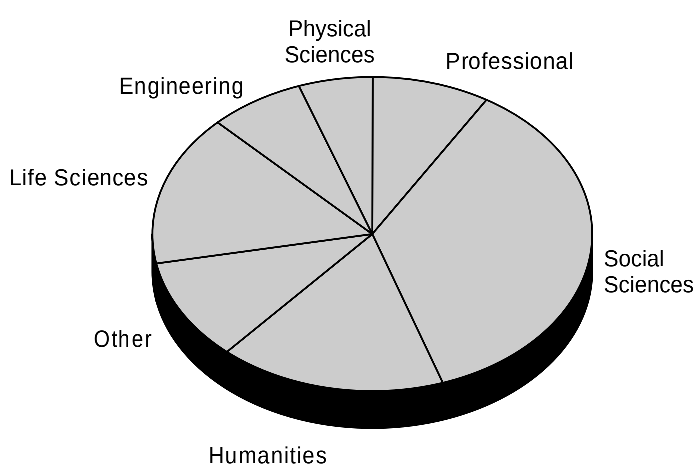


Figure 15

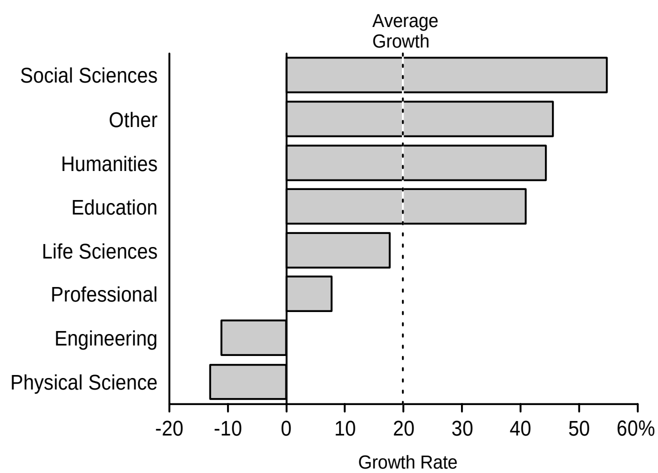
UC Proportion of Undergraduate Degrees 1992-93



California State University. From 1987-88 through 1992-93, the number of undergraduate degrees conferred at the CSU increased by 20 percent. Figure 16 shows that the CSU experienced the same trend as the UC—the number of social science and humanities degrees grew faster than average, while the number of life science degrees grew slower than average. During this time period, the number of engineering and physical science degrees declined by 11 and 13 percent, respectively.

Figure 16

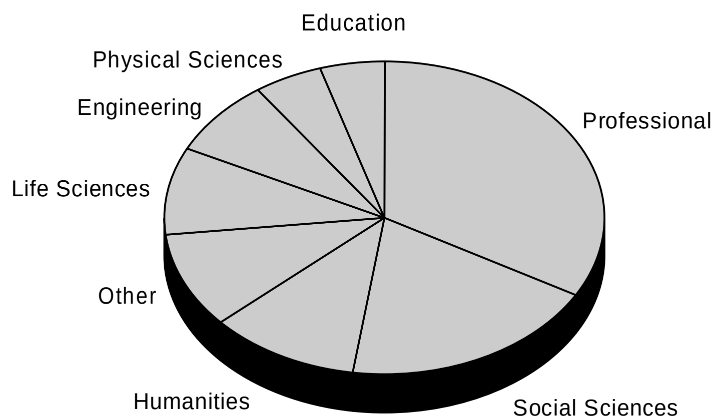
CSU Growth in Undergraduate Degrees 1987-88 Through 1992-93



The CSU conferred 55,665 undergraduate degrees in 1992-93. Figure 17 shows that 33 percent were in business and other professional areas, 30 percent were in the social sciences and humanities, and 22 percent were in science and engineering.

Figure 17

CSU Proportion of Undergraduate Degrees 1992-93



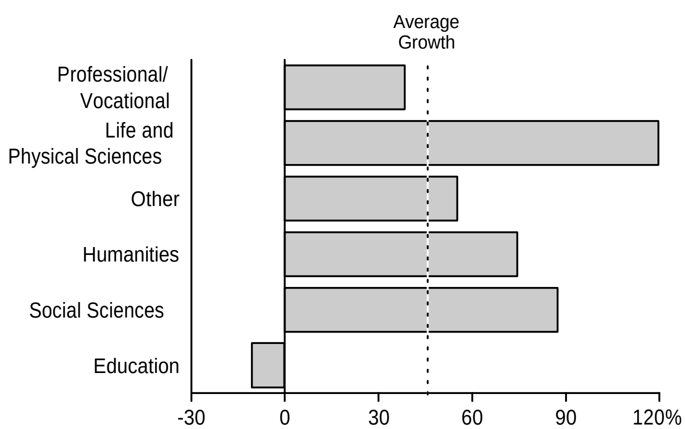
Community Colleges. Below is a description of degrees and certificates awarded by the CCC. It is not, however, a complete picture of the CCC response to workforce needs. This is because the CCCs are required to pursue a variety of educational missions, many of which do not lead to a degree or certificate as an outcome. Other outcomes, such as changes in earnings after participation in various CCC occupational programs, should be considered alongside degrees and certificates awarded. Moreover, the CCCs are by design more attuned to regional employment and training needs than they are to the needs of the state as a whole. Thus, their responsiveness to workforce needs should ultimately be measured on a regional basis, rather than on a statewide basis. For the present, this is not possible, because the CCC Chancellor's Office has only recently begun to collect the necessary information.

From 1987-88 through 1992-93, the number of associate degrees and various certificates of proficiency conferred by the CCCs increased by 50 percent. Figure 18 (see next page) shows that the CCCs, like the UC and the CSU, also experienced faster-than-average growth in the humanities and the social sciences. Unlike UC and CSU, however, CCCs experienced much faster than average growth in the physical and life sciences. The CPEC advises that this may result from regional growth in demand for individuals prepared to enter occupations that involve applications of basic science, such as health technologies or hazardous materials remediation. Moreover, CCCs awarded a relatively small number of degrees and certificates in the life and physical sciences in 1987-88. Thus, while the number of life and physical science degrees and certificates more than doubled in the five-year period examined here, these degrees and certificates still account for a much smaller share of the total than at the UC and the CSU.

Among the most heavily enrolled professional/occupational disciplines at the CCCs, degree and certificate awards increased at an above average rate in protective services (primarily law enforcement and emergency services) and vocational home economics (primarily child care and child development), but at lower than average rates in business, computer and information sciences, engineering, health occupations, production trades, and mechanical trades.

Figure 18

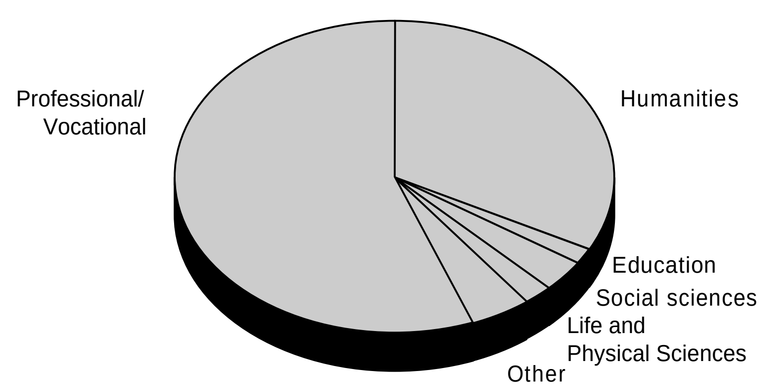
California Community College Growth In Degrees and Certificates 1987-88 Through 1992-93



The CCCs conferred 70,557 associate degrees and certificates of proficiency in 1992-93. Figure 19 shows that 56 percent were in various professional and occupational areas, 36 percent were in humanities and social sciences, and 2 percent were in the life and physical sciences.

Figure 19

California Community College
Proportion of Degrees and Certificates
1992-93



Summary. In all three segments, social science and humanities degrees have outpaced the average. According to CPEC, these changes reflect the national trend. However, the CPEC also notes that the decreases in physical science and engineering at the UC and CSU "run counter to recent state and national efforts to increase training in mathematics and the physical sciences needed in a technologically expanding society." On the positive side, however, "the disciplines with the greatest increases at UC and CSU have historically been those from which teacher candidates have arose. This is another high need area in the state, especially if coupled with bilingual proficiency."

Unlike the UC and CSU, the CCC's experienced significant growth in the physical and life services, which probably reflects regional growth in demand for specialized training in the health and environment technologies.

Ethnic Diversity of Higher Education Graduates

The racial and ethnic diversity of undergraduate degree recipients has increased but there continue to be disparities between the racial and ethnic diversity of high school graduates compared to college graduates.

Since the mid-1970's, the Legislature has clearly articulated outcome measures with regard to the ethnic diversity of undergraduate degrees conferred. Generally, these measures have involved comparisons with the ethnic diversity of high school graduates. (We discuss this issue in greater detail in our *Analysis of the 1994-95 Budget Bill*). Based on our recommendation, the Legislature adopted supplemental report language to the 1994 Budget Act specifying legislative intent that CPEC report on degrees conferred at the UC and CSU (and on degrees and certificates conferred by the community colleges) by ethnicity in comparison to high school graduates. The CPEC has provided the information requested in various recent reports. (The racial and ethnic categories we use below are as reported by CPEC.)

UC and CSU. Comparing 1987-88 to 1992-93, the UC and the CSU experienced increases in the proportions of Latino, Asian, and African-American students graduating with a Bachelor's degree. These changes are displayed in Figures 20 and 21 below. The increases generally reflect the increasing diversity of undergraduate enrollments.

Figure 20

UC Undergraduate Degrees Conferred By Ethnic and Racial Group

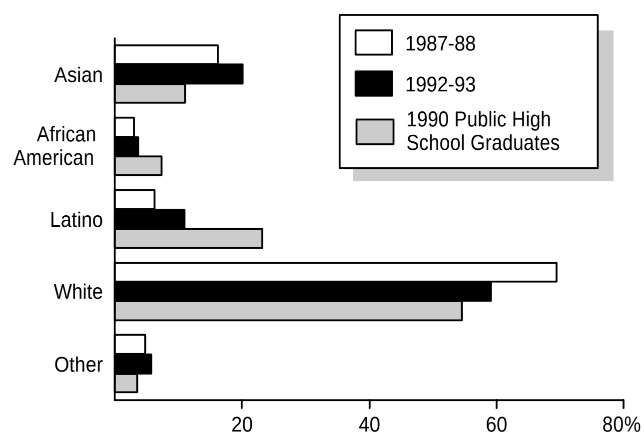
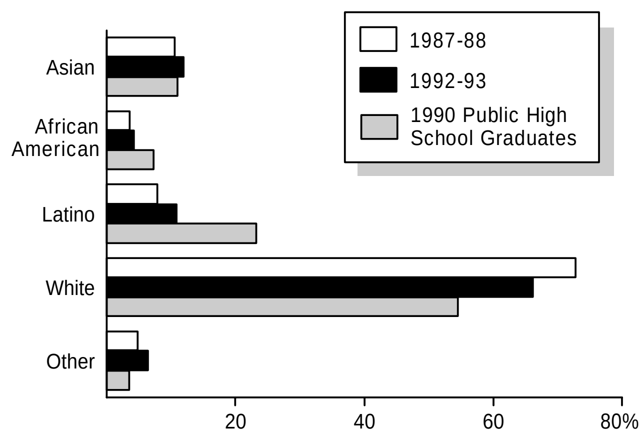


Figure 21

CSU Undergraduate Degrees Conferred By Ethnic and Racial Group

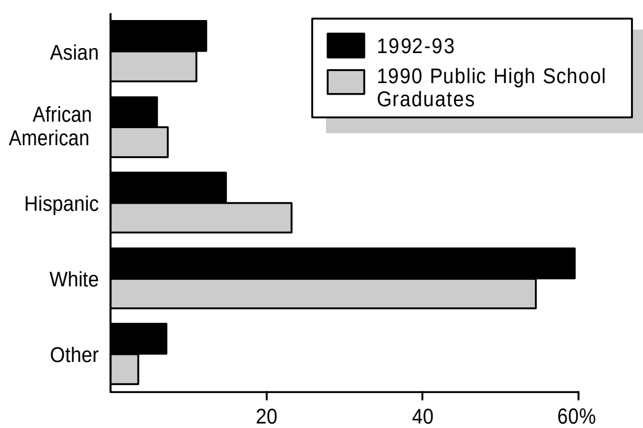


Community colleges. No conclusions can be drawn about the ethnic diversity of CCC degree and certificate recipients in 1987-88 because of data collection problems. Information from the community colleges Chancellor's Office, however, indicates an increase in ethnic diversity between 1991-92 and 1992-93 among degree and certificate recipients, and over the period 1990-91 through 1992-93 among students who transferred to the UC or CSU. Despite this progress, Figure 22 (see next page) shows that there continue to be disparities between the racial and ethnic diversity of high school graduates and CCC graduates and transfers.

Summary. The UC, CSU, and CCC have experienced increases in the proportion of Latino, Asian, and African-American undergraduate students that graduate (or transfer, in the case of the CCCs). However, there continue to be disparities between the racial and ethnic diversity of high school graduates compared to UC, CSU, and CCC graduates.

Figure 22

California Community College Degrees, Certificates, and Transfers By Ethnic and Racial Group



Conclusion

The three measures discussed above provide the segments and the Legislature with important information about the end products of state spending on higher education. These measures will become even more useful as a historical record of data is developed to show trends over time.

Of course, it is not possible to capture in three measures all the desired results from the segments. The Legislature will have to have other measures that provide a more comprehensive picture of the segments' performance. For instance, the systems need measures that reflect the *quality* of the educational services provided. These could be captured through such means as surveys of students (and their parents) and information on the average earnings of graduates. Currently, such information is available only for particular systems or programs. Another important measure—assessments of "improvements in student knowledge, capacity and skills between entrance and graduation"—has been called for in Chapter 741. The segments also need *productivity* data—such as annual information on cost per unit of lower-division and upper-division instruction—to measure how efficiently the systems are providing services. Finally, information linking productivity to outcomes—such as the cost per student who graduates—is needed.

The development of reliable, comprehensive outcome measures is critical, both for focusing efforts of the higher education segments and for providing the Legislature with practical tools for assessing the return on higher education spending.

HIGHER EDUCATION

DEPARTMENTAL ISSUES

UNIVERSITY OF CALIFORNIA (6440)

The University of California (UC) includes eight general campuses and one health science campus. The budget proposes General Fund expenditures of $1.9 billion. This is an increase of $63 million, or 3.5 percent, from estimated current-year expenditures. The General Fund increase is primarily for unspecified general purposes and additional costs for lease-payment bonds. The budget does not propose an enrollment level. It does, however, anticipate a fee increase of at least 10 percent.

ALTERNATIVE BUDGET PROPOSAL

We recommend that the Legislature take a variety of actions—in line with the principles we identify—in crafting a budget plan for the UC.

We have developed budget proposals for the UC and the California State University (CSU) based on several principles that we discuss in an earlier section on higher education crosscutting issues. Figure 23 (see next page) shows our proposal for the UC in detail, compared to the Governor's proposal. As the figure shows, our recommendations result in no net General Fund increase above the level proposed by the Governor. Below, we discuss individual recommendations for each item where our proposed funding level differs from the Governor's funding level.

Figure 23

University of California
Proposed 1995-96 General Fund Budget Changes
Governor's Budget and Legislative Analyst's Office (LAO)

(Dollars in Millions)

	Governor's Budget	LAO
1994-95 Expenditures (revised)	$1,825.9	$1,825.9
Cost increases for existing program		
General purpose expenditures	$77.7	—
Faculty salary increase (3 percent on July 1, 1995)	—	$21.9
Staff salary increase (1.2 percent on July 1, 1995)	—	13.6
Merit salary increases (full year)	—	30.3
Continuation costs of 1994-95 salary increases	—	13.4
Additional costs on lease-payment bonds	25.2	25.2
Price increase	—	8.0
Maintenance of new space	—	8.0
Technical adjustments	-1.1	-1.1
Loan repayment for 1994-95 deferred maintenance costs	2.7	2.7
Subtotals	($104.5)	($122.0)
Critical funding needs		
Deferred maintenance (one-time)	—	$5.5
Deferred maintenance	$25.0	25.0
Library books and materials (one-time)	—	1.3
Instructional equipment replacement (one-time)	—	2.2
Subtotals	($25.0)	($34.0)
Balance fee levels and program quality		
Undergraduate fee increase (10 percent)	-$57.0	-$57.0
Graduate student fee increase (varied)	-4.8	-14.1
Increase in student financial aid	20.6	23.7
Subtotals	($41.2)	(-$47.4)
Non-General Fund resources		
Loan authorization for deferred maintenance	-$25.0	—
Redirected federal overhead funds for deferred maintenance	—	-$25.0
Redirected research funds	—	-24.8
Redirected funds from teaching hospitals (one-time)	—	-9.0
Subtotals	(-$25.0)	(-$58.8)
Continue productivity increases		
Student-faculty ratio changes (results in long-term savings)	—	$13.5
1995-96 Expenditures (proposed)	$1,889.2	$1,889.2
Change from 1994-95		
Amount	$63.3	$63.3
Percent	3.5%	3.5%
Enrollment	Open	151,000

Faculty and Staff Salary Increases

We recommend expenditures of $79.2 million to provide a 3 percent faculty salary increase, a 1.2 percent staff salary increase, and merit salary increases for UC faculty and staff on July 1, 1995, and fund the continuation costs of salary increases provided in the current year.

The Governor's Budget does not specifically provide for faculty and staff salary increases or merit salary adjustments (MSAs). At the time of this analysis, the UC administration was proposing to allocate $13.4 million for the continuation costs of compensation increases granted in 1994-95. The UC administration was also proposing to allocate $59.4 million for additional compensation increases in 1995-96, which represents an overall increase of 3.2 percent.

In past years, the Legislature has sought to achieve a balance among various types of compensation increases. For example, the Legislature has provided funds both for general salary increases and for merit salary increases. With regard to faculty, the Legislature has been concerned about the extent to which the provision of any salary increases and MSAs would narrow or eliminate the gap between faculty salaries at UC in relation to the UC's comparison institutions. (As we discussed earlier in the higher education crosscutting issues section, our analysis indicates that UC faculty salaries would lag behind comparison institutions by 7.7 percent in 1995-96 in the absence of salary increases.)

We believe that providing an increase of roughly the amount proposed by the UC administration would be a reasonable step towards reducing the faculty salary gap we identify, given the fiscal constraints facing the Legislature. Consistent with past legislative action to provide funding for merit salary adjustments and balance various types of compensation increases, we recommend an expenditure of $68.5 million for employee compensation increases in the budget year, allocated as follows: $21.9 million for 3 percent general faculty salary increases, $13.6 million for 1.2 percent general staff salary increases (the same percentage we recommend for CSU staff), and $30.3 million for merit salary increases for faculty and staff. We also recommend an expenditure of $13.4 million for the continuation costs of salary increases granted in the current year. This increase is consistent with the Legislature's intent as specified in the *Supplemental Report of the 1994 Budget Act*.

Costs of Continuing Various Programs

We recommend an expenditure of $16 million for price increases and maintenance of new space.

The Governor's Budget does not address various costs of continuing existing programs at the UC.

- ***Price Increases***. Within the total amount of funds for UC and consistent with past legislative action, we believe it is reasonable to designate an amount to offset the impact of inflation on the non-salary budget and thus maintain the UC's purchasing power. Based on the assumption that prices for various commodities and services will increase by an average of two percent compared to the current year, $8 million would be needed for this purpose.
- ***Maintenance of New Space.*** The UC estimates that 1.2 million square feet of new space will be occupied in 1995-96 by programs eligible for state-funded operation and maintenance. The cost of operating and maintaining this space is $8 million. Lack of support for ongoing maintenance in the long run increases deferred maintenance.

Deferred Maintenance, Instructional Equipment Replacement, and Library Materials

We recommend the expenditure of $34 million in the critical areas of deferred maintenance, instructional equipment replacement, and library materials.

The Governor's Budget does not propose any funding changes in the areas of instructional equipment replacement (IER) and library materials. The budget provides authority for a $25 million loan for deferred maintenance. We recommend the expenditure of $34 million to address the highest priority needs in the areas of deferred maintenance, IER, and library materials. We discuss each of these areas below.

Deferred Maintenance. For 1992-93 (the most recent year for which detailed information is available), the UC's deferred maintenance backlog was approximately $348 million. The backlog of priority-one projects was $142 million. Priority-one projects are generally defined as those requiring "immediate action to return a facility to normal operation, stop accelerated deterioration, or correct a cited safety hazard." The 1992-93 deferred maintenance backlog for each campus is displayed in our *Analysis of the 1994-95 Budget Bill,* (please see p. F-29).

In 1994-95, the budget provides $36 million for priority-one deferred maintenance projects at UC campuses. Of this amount, $25 million was specified in the 1994 budget package as being from lease-payment bonds for priority-one deferred maintenance projects that would have an anticipated useful life of 15 years. Due to recent legal developments (which we discuss in a later section of this analysis), however, the UC is planning to use a loan instead for the projects. The remaining $11 million is from a redirection of teaching hospital excess gains, as specified by the Legislature in the *Supplemental Report of the 1994 Budget Act*. The backlog of priority-one projects as well as the overall backlog will continue to be significant in 1995-96. An additional $30.5 million ($5.5 million in one-time funds and $25 million in ongoing funds) would address a small portion of the shortfall.

Instructional Equipment Replacement. In the current year, the UC estimates that it will spend approximately $31 million for IER. This is one-half of the IER need as determined by the IER formula adopted by the Legislature in 1984. By 1995-96, the accumulated shortfall since 1990-91 will be $139 million. We believe that state-of-art equipment is essential for instruction, especially in engineering and the sciences, because of rapid technological advances requiring expensive, high-demand equipment. An additional $2.2 million in one-time funds can be used to address the most critical areas.

Library Materials. In the current year, the budget includes approximately $53 million for library books and materials. The UC estimates that the current-year amount falls short of the amount needed by approximately $24 million. The addition of the $1.3 million in one-time funds we recommend would address a small portion of the shortfall.

The $9 million in one-time funds for deferred maintenance, IER, and library materials would come from the second year of a planned redirection from teaching hospital excess gains, as was provided for in supplemental report language to the 1994 Budget Act. The $25 million in ongoing funds for deferred maintenance would come from redirected federal overhead funds used instead of the loan authorization proposed in the Governor's Budget. We discuss these issues later in this analysis.

Undergraduate Student Fee Increase

We recommend that undergraduate student fees be increased by $380 (10 percent)—from $3,799 to $4,179.

The Governor's Budget anticipates that student fees at UC will increase by at least 10 percent. The UC administration is proposing an undergraduate fee increase of $380 (10 percent). At the time of this analysis, the UC regents had not acted on this proposal.

We recommend an increase in the general undergraduate student fee of $380 (10 percent). We believe this is a reasonable increase given the state's fiscal condition and the level of UC fees relative to those at its comparison institutions. Figure 24 shows fees (including the mandatory fee and campus-based fees) in 1994-95 for undergraduates and graduates. It indicates that UC undergraduate fees are approximately $241 below the UC's four public comparison universities. More specifically, our review indicates that the UC's undergraduate fees in the current year place the UC in the middle of the range of its four public compar-ison universities. Even with the proposed increase, UC undergraduate fees will continue to be near the average.

Figure 24

University of California
Resident Student Fees and Tuition by Discipline
Relative to Comparison Universities[a]
1994-95

	University of California (UC)				
	Mandatory Fee Level	Average Campus-Based Fee	Total	Comparison Universities	Amount Above UC
Undergraduate	$3,799	$312	$4,111	$4,352	$241
General graduate	3,799	786	4,585	5,503	918
Medicine[b]	6,175	776	6,951	10,678	3,727
Dentistry[b]	5,799	491	6,290	9,396	3,106
Veterinary medicine[b]	5,799	554	6,353	8,330	1,977
Law[b]	6,175	602	6,777	8,559	1,782
Business[b]	5,799	770	6,569	8,827	2,258

[a] The UC's four public comparison universities include the University of Illinois (Champaign-Urbana), the University of Michigan (Ann Arbor), the State University of New York (Buffalo), and the University of Virginia. Additional public comparison institutions are used for veterinary medicine.

[b] UC professional school fees shown are for new students first enrolling in 1994-95. Continuing students that were enrolled in 1994-95 pay $2,000 less.

As we discuss earlier in the higher education crosscutting issues section, we took as a starting point the administration's total proposed funding levels for higher education in developing our alternative budget proposals. To the extent the Legislature increases the overall level of support for higher education, moderating the fee increase may be a high legislative priority. To assist the Legislature in its deliberations on this issue, we note that $38 million would be needed in 1995-96 to provide UC with the same level of resources as is provided by a 10 percent fee increase (net of financial aid).

Graduate Student Fees

We recommend that graduate student fees be increased by amounts ranging from $200 to $4,376 above the general fee increase for undergraduates.

The Governor's Budget does not propose a specific fee increase for graduate students. Figure 25 displays the UC administration's proposal for graduate students in selected professional programs.

Figure 25

University of California Professional School Fees[a] 1994-95 and 1995-96

	1994-95	Proposed 1995-96[b]
Law		
First-year students	$6,175	$8,555
Second-year students	4,175	6,555
Other continuing students	4,175	4,555
Business		
First-year students	$5,799	$8,179
Second-year students	3,799	6,179
Medicine		
First-year students	$6,175	$7,555
Second-year students	4,175	6,555
Other continuing students	4,175	4,555
Dentistry/Veterinary Medicine		
First-year students	$5,799	$7,179
Second-year students	3,799	6,179
Other continuing students	3,799	4,179

[a] The fee levels shown in each column are for the level of student in that year. For example, a student who first enrolled in 1994-95 would pay the first-year student fee shown under 1994-95 and the second-year student fee shown under 1995-96.

[b] Includes the general fee increase of 10 percent. The UC administration is considering “special arrangements” for selected professional schools.

In the *Supplemental Report of the 1994 Budget Act*, the Legislature expressed its intent that the UC increase fees for students enrolled in selected professional programs (medicine, dentistry, veterinary medicine, law, and business) over a five-year period to the average of fees charged by comparable public universities.

We recommend that all graduate students pay the general increase of $380 that we recommend for undergraduates. We further recommend that these graduate students (except for those in professional schools) pay an additional $200.

There are several ways to move towards the Legislature's goals for students in selected professional schools discussed above. The UC administration's proposal as shown in Figure 25 is one reasonable approach and we recommend that it be adopted. We believe that these recommendations are generally consistent with the Legislature's intent as described above, and are sound for the following reasons:

- Graduate programs, as a rule, cost more per student than undergraduate programs, due to the specialized nature of the instruction and the typically low student-faculty ratios.
- A greater portion of the benefits from graduate education accrues to the individual directly, because specialized knowledge is more likely to translate into higher income than is the general knowledge acquired as an undergraduate.
- Low student charges at the graduate level create incentives for over-investment in graduate education.

We also believe that the state's charges for graduate studies should not be so high as to disadvantage California in relationship to other states in competition to attract highly qualified students. To examine this issue, we reviewed graduate studies charges at comparable public universities. Figure 24 shows that UC charges for general graduate students are $918 below the average charge at the UC's four comparable public universities. The difference is much greater for selected professional programs. For example, UC charges for students enrolled in medical degree programs are $3,727 below the average charge, while UC charges for business (MBA) students are $2,258 below the average charge at comparable universities.

Report Due in March 1995. In the *Supplemental Report of the 1994 Budget Act*, the Legislature “strongly encourages the UC to develop programs to ensure that no professional school student wishing to pursue a career in the public sector is prohibited from doing so because of the burden placed upon them by any differential fee.” The UC's report on this issues is due to the Legislature by March 1, 1995. We will comment on it, as appropriate, during budget hearings.

Student Financial Aid

We recommend the expenditure of $23.7 million for additional student financial aid for needy students to offset our recommended fee increases.

This aid amount is equal to 33 percent of the total fee increase and should be sufficient to offset the fee increase for needy students. In our analysis of the Student Aid Commission, we recommend approval of a proposed $11.5 million increase to offset the impact of the 10 percent fee increase on Cal Grant award winners.

Teaching Hospitals Redirection

We recommend redirection of $9 million of teaching hospital net gains to fund campus-based programs, consistent with previous legislative actions.

Background. Last year we concluded that the UC teaching hospitals had net gains that exceeded the five percent level we identified as being needed for equipment and capital outlay purposes. We recommended that the UC reallocate teaching hospital net gains in excess of 5 percent of net operating revenues from the hospitals to the campuses, and dedicate the funds towards critical campus funding needs in the areas of deferred maintenance, instructional equipment replacement (IER), and library materials. The Legislature adopted our recommendation and in the *Supplemental Report of the 1994 Budget Act* provided that $18 million be redirected for these purposes in 1994-95, with an additional $17 million to be redirected in 1995-96. These $35 million in excess gains were realized in 1992-93 and 1993-94.

Our review of updated information indicates that the amount of net gains above the five percent level that will be available for redirection in 1995-96 is $9 million, rather than the $17 million anticipated last year. This is due to several factors, including declines in the number of patient days and increases in medical malpractice insurance costs.

We recommend that the $9 million be redirected for one-time expenditures in the areas of deferred maintenance, IER, and library book purchases, as provided in the following proposed supplemental report language:

> It is the intent of the Legislature that, for 1995-96, the University of California redirect $9 million of clinical teaching support funding on a one-time

basis to fund the following program areas: $5.5 million for deferred maintenance, $1.3 million for libraries, and $2.2 million for instructional equipment replacement. Supplemental language in 1994-95 recommended that $17 million be redirected for 1995-96; however, this amount is reduced to $9 million in recognition of updated information regarding the decrease in net gains for 1993-94.

Potential Additional Redirections. The UC's current projections for the immediate future indicate that the UC teaching hospitals will no longer achieve net gains above five percent. This is due to significant changes in public and private health care payment systems that are anticipated to result in decreases in the total number of patient days and payment rates for each patient-day. For planning purposes, however, we continue to believe that it is reasonable to redirect teaching hospital gains exceeding five percent for campus needs in the future. Thus, we recommend that the Legislature adopt a plan for redirecting net gains above five percent, if any, that are realized in 1994-95. (These gains would most likely be allocated in late 1995-96.)

Specifically, we recommend the adoption of the following supplemental report language:

> The UC's current projections for 1994-95 and for several years thereafter indicate that UC's teaching hospitals will experience financial difficulty due to a variety of factors, including an expected decline in the number of patient days; a decrease in the rate of reimbursement from Medicare, Medi-Cal, and disproportionate provider payments; and changes expected because of the emerging managed care environment. Consequently, these projections indicate that UC hospitals will no longer achieve net gains above five percent. However, in the event the fiscal difficulties do not materialize, it is the intent of the Legislature that any amount over a net gain of five percent for the UC system (excluding the Irvine hospital) for 1994-95 should be redirected to the same programs in the same proportions as specified above.

Later in this analysis, we discuss longer-term issues related to the teaching hospitals.

Debt Financing for Deferred Maintenance Is Ill-Advised

To avoid debt financing for ongoing deferred maintenance needs, we recommend that the Legislature reject the budget proposal to authorize a $25 million loan for deferred maintenance in 1995-96, and fund these critical deferred maintenance projects instead through a redirection of $25 million in federal overhead receipts.

The budget provides $2.7 million in 1995-96 for the UC to begin repayment on $25 million in loan funds that the budget anticipates the UC will borrow for deferred maintenance needs in 1994-95. The budget also authorizes the UC to obtain an additional $25 million loan for deferred maintenance in 1995-96, and suggests that similar annual loans would be made thereafter. The loan would be paid off over a 15-year period from General Fund payments.

Background. In the 1994 Budget Act and related legislation, the Legislature provided $25 million from lease-payment bonds for deferred maintenance projects (such as roof replacements). Roughly $10.5 million of this amount was to replace existing General Fund expenditures for deferred maintenance. The remainder was provided by the Legislature to offset General Fund reductions and redirections totalling about $14.5 million. Debt payments on the bonds would be made from an annual General Fund appropriation to the UC.

Typically, lease-payment bonds have been used for long-term capital improvements and not for deferred maintenance purposes, which have been funded as part of ongoing state operations. Given this departure, the Legislature adopted various provisions in the 1994 budget package regarding these bonds. First, the Legislature specified that the bonds were to be used for deferred maintenance projects with a useful life of at least 15 years. The Legislature also specified that the projects were to be "priority one" projects, which are those requiring "immediate action to return a facility to normal operation, stop accelerated deterioration, or correct a cited safety hazard."

Finally, the budget package provided for an "asset transfer" mechanism to ensure that sufficient "collateral" was available to back-up the sale of the bonds. Asset transfer involves identifying an asset of sufficient value to support the amount of bonds to be sold. Under this mechanism, the asset identified may bear no relationship to the deferred maintenance projects being undertaken, though the total value must generally be in the same range as the projects. For example, an existing building (on one campus) valued at $15 million may be identified through asset transfer as the collateral for lease-payment bonds, but the projects undertaken using the bond monies may be the replacement of 15 new building roofs (throughout the 9 campuses) at an average cost of $1 million each.

Under current law, the state Attorney General is responsible for determining whether a proposed use of lease-payment bonds meets various legal requirements, such as constitutional requirements related to debt. Since enactment of the budget package, the Attorney General has raised concerns that the proposed use of lease-payment bonds (and particularly the asset transfer provisions) may not meet various legal requirements. As of late-January 1995, the Attorney General had not made a positive determination that the use of $25 million in lease-payment bonds for deferred maintenance meets legal requirements.

Debt Financing Not Prudent. In our view, proposed debt financing of the UC's operating budget in 1995-96 is ill-advised because prudent budget policy calls for annual balancing of the UC budget. If the state provides new loans each year for the indefinite future, it will have to pay these loan amounts—plus interest—out of future years' operating budgets. We believe the state should recognize this ongoing cost and provide for it in the ongoing budget.

There are two major alternatives to borrowing funds for deferred maintenance: (1) make further reductions in planned expenditures and shift the freed-up monies to fund deferred maintenance and/or (2) identify other revenue sources besides a loan. As Figure 23 earlier in this analysis shows, virtually all the UC's planned expenditures are to (1) pay for continuing costs of operating the current program (including compensation costs needed to maintain the UC's competitiveness with other educational institutions), or (2) pay for staff-ratio changes that will ultimately save money. Thus, it would be difficult to reduce the planned expenditures by the $25 million necessary to avoid the planned borrowing. The other possibility is to identify additional revenue. In our review, we have identified $25 million in revenues from federal overhead receipts that could be redirected to avoid the loan.

Accordingly, we recommend that the Legislature reject the proposed authorization for a $25 million loan for deferred maintenance in 1995-96. We recommend instead that a like amount of funds be redirected from federal overhead receipts for this purpose. (We discuss our detailed recommendations regarding federal overhead funds in the next section.)

Federal Overhead Receipt Formula Needs Change

We recommend that the Legislature direct the UC Regents to enter into a new agreement with the state Department of Finance regarding federal overhead funds to (1) better account for the UC's direct costs of administration, (2) direct specific funds towards critical deferred maintenance needs, and (3) increase the state's share of the remaining funds.

The budget estimates that the UC will receive federal overhead receipts totalling $268.8 million in 1995-96. Based on current policy, $116.3 million of these receipts will be used to offset the UC's General Fund budget. This represents 55 percent of the total receipts after allowance for grant administration and related activities.

Background. The UC is the primary research university in the state. Its annual research program is approximately $1.4 billion in the current year.

Of this amount, about $799 million (56 percent) is federally funded. In recognition of the university's costs related to utilities, building amortization, grant administration, and certain indirect costs, the federal government pays the UC a negotiated overhead allowance on each grant. The percentage of overhead paid on each grant varies due to unique differences.

Prior to 1967, federal overhead receipts were not of significant magnitude; consequently, the university retained all overhead receipts. By 1967 the magnitude of overhead receipts was significant and the state sought to share the federal income. Sharing by the state was justified on the basis that state tax dollars paid for much of the UC's physical plant and personnel (especially faculty salaries); consequently, the state should share in the income derived from such an investment. On the other hand, the UC argued that it should continue to receive a major share of the income to pay its direct costs of grant administration and maintain its entrepreneurial incentive to acquire additional grants.

A memorandum of understanding was negotiated in 1967 by the Department of Finance and approved by the Legislature that provided for the state and the UC to share overhead receipts on a 50/50 basis after allowance for administration and related activities. This memorandum was amended in 1979 to increase the state's share to 55 percent. The UC share provides the funding source for the Regents' Opportunity Fund. Figure 26 (see next page) shows actual and estimated overhead receipts, and revenues to the Regents' Opportunity Fund, from 1990-91 through 1995-96. It shows that about two-thirds of the fund revenues go to support research activities.

Previous Recommendation. Two years ago, we recommended as part of a package of changes affecting the UC that the state share of federal contract and grant overhead receipts be increased. Our recommendation was based primarily on the state's legitimate claim to receive reimbursement for costs it had earlier incurred. We also noted, however, that a reallocation of overhead receipts was justified because the UC's overall research budget had increased, even at a time when General Fund support had declined and student fees had increased significantly. We recommended that the funds freed up as a result of this recommendation be redirected to address critical funding needs at the UC. This recommendation was not adopted; the Legislature instead chose to augment the UC budget to address the funding needs.

Figure 26

University of California Regents' Opportunity Fund Revenues and Expenditures 1990-91 Through 1995-96

(Dollars in Millions)

	1990-91	1991-92	1992-93	1993-94	Estimated 1994-95	Proposed 1995-96
Revenues						
Federal overhead receipts	$206.2	$224.1	$235.8	$242.2	$254.8	$268.8
Direct administrative costs	-41.3	-44.9	-49.0	-50.4	-53.4	-57.3
Available for allocation	$164.9	$179.2	$186.8	$191.8	$201.4	$211.5
State share (55 percent)	*90.7*	*98.6*	*102.7*	*105.5*	*110.8*	*116.3*
Regents' Opportunity Fund (ROF) (45 percent)	*74.2*	*80.6*	*84.1*	*86.3*	*90.6*	*95.2*
Expenditures - ROF						
Research						
Operating	$14.2	$11.3	$15.0	$19.2	$41.9	$41.9
Capital outlay	22.3	38.0	25.2	26.9	26.9	26.9
Subtotals	($36.5)	($49.3)	($40.2)	($46.1)	($68.8)	($68.8)
Instruction	11.2	10.2	13.9	13.9	11.4	11.4
Institutional support	19.5	19.4	18.4	20.7	13.3	13.3
Student and faculty affirmative action	2.9	3.4	5.7	5.9	2.5	2.5
Deferred maintenance	1.7	4.9	2.9	3.0	—	—
Other adjustments	2.4	-6.6	3.0	-3.3	-5.4	-2.3
Provision for cost increase	—	—	—	—	—	1.5
Totals	**$74.2**	**$80.6**	**$84.1**	**$86.3**	**$90.6**	**$95.2**

Current Situation. We continue to believe that a reallocation of federal overhead receipts to other critical needs within UC is justified for the reasons discussed above. We also believe that the federal overhead formula should be changed to address other technical issues related to changes in federal rules regarding grant funding. Specifically, we recommend that the allocation of federal overhead funds be modified to:

- Recognize various changes regarding direct administration costs that are a result of new federal grant funding rules.
- Direct funds towards critical deferred maintenance needs on the UC campuses.
- Increase the states' percentage share of the remaining funds to prevent a reduction in the amount of state funds available.

Figure 27 displays the effects of our recommendation, which we discuss below.

Figure 27

**University of California
Federal Overhead Receipts
Current Formula and Legislative
Analyst's Office (LAO) Proposal**

(Dollars in Millions)

	1995-96 Proposed		LAO Proposal	
	Amount	Percent[a]	Amount	Percent[a]
Federal overhead receipts	$268.8	—	$268.8	—
Direct administrative costs[b]	-57.3	21.3%	-67.2	25.0%
Critical needs (deferred maintenance)	—	—	-25.0	9.3
Available for allocation	$211.5	—	$176.6	—
State share	*116.3*	*55.0%*	*117.7*	*66.7%*
Regent's Opportunity Fund	*95.2*	*45.0*	*58.9*	*33.3*

[a] The percentages shown are based on the amount available for allocation identified in each step, and thus do not add to 100 percent.

[b] Dollars retained by UC for contract and grant management costs.

Direct Administration Costs. The federal government is phasing-in changes to its grant funding practices so that ultimately it will no longer pay for certain administrative costs (such as clerical support) as part of the direct costs of each grant. Instead, the federal government is anticipating that these costs would be funded through federal overhead receipts. The UC indicates that the amount of these "disallowed" charges could be ultimately in the range of $10 to $20 million though detailed data will not be available until after the full phase-in of new federal procedures is completed over the next several years. Currently, the UC is paying these costs through the use of short-term budget solutions. In the long run, we believe the state should recognize the actual administrative costs by allocating additional federal overhead receipts for direct administrative costs.

Currently, the UC retains roughly the first 20 percent of overhead receipts for contract and grant management costs (referred to as the "off-the-top" allocation). We recommend instead that the "off-the-top" amount be increased to 25 percent, which would provide roughly an additional $10 million to the UC to better reflect actual administrative costs.

Allocation For Deferred Maintenance. To avoid the proposed $25 million loan for deferred maintenance discussed in an earlier section, we recommend that $25 million of federal overhead revenues be taken off the top and, for the reasons discussed above, redirected for deferred maintenance needs on the campuses.

State Sharing Ratio. In order to ensure that the amount of the state share will not decrease as a result of acknowledging the UC's direct administrative costs and redirecting overhead funds for deferred maintenance, we recommend that the state share be increased from 55 percent to 66.7 percent. There is no particular analytical method for determining what the appropriate state share should be (and in fact the current 55 percent share is not based on a particular analytical rationale). As we noted earlier, the state provides the initial investment in faculty salaries and infrastructure that is then reimbursed through federal overhead receipts. Thus, a case could be made that *all* federal overhead funds should be reimbursed to the General Fund. However, the provision of some share to the UC may provide an incentive to negotiate favorable overhead rates with the federal government. We believe that increasing the state's share on the remaining balance to 66.7 percent would still provide the UC with such an incentive.

Redirect General Fund Research Support for Costs of Continuing Current Programs

We recommend redirection of $24.8 million of General Fund research support to address instruction-related costs, such as the gap in UC faculty salaries compared to similar institutions and planned investments in the student-faculty ratio that will ultimately result in long-term savings.

The budget proposes $181 million in General Fund support for UC research programs in 1995-96. The UC estimates that it will spend roughly $172 million (General Fund) for research in the current-year.

Figure 28 displays expenditures for organized research at the UC from 1990-91 through 1994-95. All the expenditures shown for the current year are estimates. If past spending trends continue, actual expenditures are likely to differ from the estimates.

As the figure shows, overall expenditures for UC research have increased from $1.2 billion in 1990-91 to an estimated $1.4 billion in 1994-95, an increase of $250 million, or 21 percent.

Figure 28

University of California
Expenditures for Organized Research
1990-91 Through 1994-95

(In Millions)

	1990-91	1991-92	1992-93	1993-94	Estimated 1994-95
General Fund	$175.8	$168.6	$158.5	$155.6	$172.3
State special funds/contracts	68.9	89.3	87.9	97.6	95.0
Regents Opportunity Fund	14.2	11.3	15.0	19.2	41.9
Federal funds	653.3	705.3	765.5	788.0	799.0
Other[a]	257.4	288.1	301.1	306.4	311.7
Totals[b]	**$1,169.7**	**$1,262.8**	**$1,328.0**	**$1,366.8**	**$1,419.8**

[a] Includes local government, endowment, and private funds.

[b] Detail may not add to totals due to rounding.

Figure 28 shows that federal funds are the UC's single most important source of support for research, accounting for about 56 percent of all university research expenditures. General Fund support is more important that its relative share (12 percent) would indicate for several reasons. According to the UC, state funds often provide the core level of investment needed in a research area to attract federal and other extramural support. Second, for some research fields in which there are few sources of federal or other support, such as in the arts and humanities, state funds may represent the major support available.

While General Fund support for research plays an important role at UC, there are also other critical funding needs at the university. For example, as we discussed earlier, we have identified a faculty salary gap of 7.7 percent in 1995-96 between the UC and comparable institutions, absent any salary increases. Later, we discuss the importance of funding the second-year phase-in of planned changes to the student-faculty ratio to achieve productivity increases and avoid significant future costs.

We believe it would be reasonable to redirect a portion of the General Fund support for research to address the faculty salary gap and changes in the student-faculty ratio, given the overall increases in the UC's research budget since 1990-91 and the need to fund instruction-related costs at the university.

Specifically, we recommend that $24.8 million in General Fund support be redirected to support the costs of continuing programs and ensuring productivity increases in 1995-96. We believe the UC can adjust to a lower level of General Fund support for research by setting priorities among research activities to ensure that the highest priorities are addressed and by relying to a greater degree on systemwide competition for research grants.

Student-Faculty Ratio Change

We recommend the expenditure of $13.5 million related to changes in the UC's budgeted student-faculty ratio (SFR), consistent with previous legislative actions. Ultimately, this change will avoid future enrollment-related costs of approximately $55 million annually.

Traditionally, the UC has developed its budget based on a policy of providing an SFR of 17.6. In our *Analysis of the 1994-95 Budget Bill*, we recommended that the UC's budgeted SFR be increased to 18.7 on a permanent basis. We further recommended that the Legislature take action to add faculty in order to achieve this level by 1995-96. Our recommendation to increase the SFR on a permanent basis from 17.6 to 18.7 was based on what we believe to be a reasonable increase in faculty productivity. In previous years, we have cited several areas, including a reallocation of faculty time from other activities to teaching, improvement in course management, and expanded use of educational technology, that could lead to better use of faculty resources. Finally, we noted an SFR of 18.7 would place the UC in the middle of the range of its comparable public universities and would ultimately result in a savings of approximately $55 million annually.

The Legislature adopted our recommendation and specified its intent in the *Supplemental Report of the 1994 Budget Act* to allocate an expenditure of $6.2 million in 1994-95 to add 85 faculty positions on the eight general campuses for the first year of the planned two year phase-in period. The Legislature also proposed to allocate $9 million in 1995-96 for 120 additional faculty positions on the eight general campuses to complete the phase-in to an SFR of 18.7. Finally, the Legislature's allocation plan for the UC budget recognized an additional $3 million in related costs in 1994-95 for other programs (particularly at the health sciences campus) to be funded within the overall budget plan. (Based on the same proportional second-year increase that will occur on the general campuses, our estimate of the related second-year cost for the other programs is $4.5 million, for a total of $13.5 million in 1995-96.)

Consistent with the Legislature's previous actions, we recommend an expenditure of $13.5 million to complete the phase-in costs related to increasing the budgeted SFR from 17.6 to 18.7. This will result in faculty productivity increases and will enable the state to avoid significant cost increases in the future.

Specify Enrollment Levels

We recommend that the Legislature specify an enrollment level for 1995-96 in supplemental report language.

In the *Supplemental Report of the 1994 Budget Act*, the Legislature specified an enrollment level of 149,713 full-time-equivalent (FTE) students for UC in 1994-95. The Legislature also specified its intent that the UC continue to accept in 1994-95 all applicants who are fully eligible, using the Master Plan definition of eligibility. Anticipating that enrollment decisions for 1995-96 would likely be made in the current year, the Legislature also requested 30 days prior written notification should the UC decide not to accept all applicants for enrollment in 1995-96 who are fully eligible under the Master plan.

We believe that the language is an important component of the overall UC budget, because it holds the UC accountable for meeting the Legislature's enrollment target, thereby maintaining the integrity of the budget process. We recommend that the Legislature adopt similar supplemental report language again this year. Our proposed enrollment level for the UC is 151,000 FTE students, an increase of about 1,500 FTE students from estimated current-year enrollments. We will propose specific supplemental language prior to budget hearings.

OTHER ISSUES

Long-Range Planning Needed to Address UC Hospital Issues

We recommend that the Legislature adopt supplemental report language requesting the UC to report next year on the long-term implications of managed care and other health care changes on support for medical education in teaching hospitals, and options for addressing related issues.

Based on our site visits to UC teaching hospitals and our review of various hospital programmatic and funding information, we have found that the hospitals have significantly reduced their costs and changed their medical education practices in response to increasing cost-cutting pressures related to managed care. Common changes include providing cost-benefit information on various prescription drugs and medical tests to medical staff to encourage the use of cost-effective medical practices.

Throughout our visits, however, we heard concerns that potential reductions in federal Medicare support for medical education and cost pressures related to managed care may eventually result in (1) significant unfunded medical education costs and/or (2) reductions in the level of medical education provided at UC teaching hospitals and other hospitals with significant teaching components. The UC indicates that teaching hospitals have a "competitive cost disadvantage" because they need more resources that other hospitals to accomplish their core teaching mission. For example, medical interns and residents need practice in reviewing various tests and observing the relative impact of various procedures. However, providing sufficient levels of practice can be costly.

In its oversight capacity, the Legislature needs information on the long-term implications of managed care and potential federal funding changes on the UC teaching hospitals. Accordingly, we recommend that the Legislature adopt supplemental report language requesting the UC, in consultation with other hospitals with a significant medical education component, to report at budget hearings next year on options for addressing the impact of future changes in the health care environment.

Specifically, we recommend adoption of the following supplemental report language:

> It is the intent of the Legislature that the University of California, in consultation with other educational institutions which operate teaching hospitals and other teaching hospitals with a significant medical education component, develop options to be presented to the Legislature during the 1996-97 budget hearings which address the implications of changes in managed care, federal reimbursement policies, the impact these changes are having on the education of physicians, and the ability of hospitals to function as teaching hospitals in a managed care competitive environment.

One-Time Carryover Funds

We recommend that the Legislature adopt Budget Bill language establishing limits on, and priorities for, the use of one-time carryover funds.

Prior to 1992-93, the annual Budget Act contained language providing that the UC could carry over ("reappropriate") General Fund monies for one year and specified that the funds could be spent for deferred maintenance and instructional equipment replacement. The language also required the UC, by September 30 of each year, to report to the Joint Legislative Budget Committee (JLBC) and the Department of Finance (DOF) on the amounts of funding carried over and the uses of these funds. The amounts carried over by the UC have generally been less than $5 million annually.

Beginning with the 1992 Budget Act, the Legislature removed the restrictions on the use of carryover funds at the UC in recognition of the impact of large General Fund budget reductions. We believe the impetus for the change—budget reductions—no longer exists. Furthermore, as we discussed in our analysis of the CSU budget, there is evidence that the current unlimited carryover authority was used by the CSU to address selected priorities without legislative oversight. While the UC has not taken similar actions, we see no reason to recommend different treatment of the UC and CSU regarding carryover funds, since the Legislature has adopted similar carryover language for the two segments in the past.

Accordingly, we recommend that the Legislature limit the UC's carryover authority to $15 million from each fiscal year, consistent with our recommendation for CSU. Given historic carryover levels at the UC, this amount should fully recognize "normal" levels of carryover. We further recommend that the Legislature re-establish prior Budget Bill language specifying that carryover funds shall be used for deferred maintenance and instructional equipment replacement, because (as we discussed in an earlier section) there are significant shortfalls in these areas that could be addressed through one-time expenditures.

Specifically, we recommend that the Legislature replace Provision 1 of the existing carryover language in Item 6440-490 with the following:

> Up to $15 million of the reappropriated funds from Item 6440-001-001, Budget Act of 1994, shall be available for deferred maintenance and special repair projects and replacement of instructional equipment. As of June 30, 1994, any amount above $15 million shall revert to the General Fund.

(In our analysis of the CSU budget, we recommend the adoption of similar language.)

Chapter 776 Progress Report

Chapter 776/93 (SB 506, Hayden) expressed the Legislature's intent that courses required for normal progress to a baccalaureate degree be provided in sufficient numbers at the UC. Chapter 776 requires the Legislative Analyst to review and analyze the annual reports the UC submits on reallocation of faculty workload. The 1994 report made various changes we suggested to improve its usefulness. The report provided trend data which indicated that total student credit hours per student increased by 1.9 percent from 1990-91 through 1992-93 and that faculty teaching workload, as measured by the numbers of classes taught and student credit hours per faculty member, increased by 7.4 percent on average during this period.

The UC's 1995 faculty workload report was due to the Legislature by February 1, 1995. We will comment on it, as appropriate, during budget hearings.

CALIFORNIA STATE UNIVERSITY (6610)

The California State University (CSU) consists of 21 campuses, including the new Monterey Bay campus (scheduled to open in fall 1995), which is located on a portion of the recently closed Fort Ord military base. In July 1995, the California Maritime Academy will become the twenty-second CSU campus. The budget proposes General Fund expenditures of $1.6 billion. This is an increase of $3 million, or 0.2 percent, from estimated current-year expenditures. The increase understates actual budget-year growth, as 1994-95 expenditures included $41 million in one-time spending. The General Fund increase represents the net effect of increases for unspecified general purposes and additional costs for lease-payment bonds, offset by a decrease due to the elimination of one-time carryover funds. The budget does not propose an enrollment level. It does, however, anticipate a fee increase of at least 10 percent.

ALTERNATIVE BUDGET PROPOSAL

We recommend that the Legislature take a variety of actions—in line with the principles we identify—in crafting a budget plan for the CSU.

We have developed budget proposals for the University of California (UC), and the CSU based on several principles that we discuss in an earlier section on higher education crosscutting issues. Figure 29 (see next page) shows our proposal for the CSU in detail, compared to the Governor's proposal. As the figure shows, our recommendations result in no net General Fund increase above the level proposed by the Governor. In sections below, we discuss individual recommendations for each item where our proposed funding level differs from the Governor's funding level.

Figure 29

California State University
Proposed 1995-96 General Fund Budget Changes
Governor's Budget and Legislative Analyst's Office (LAO)

(Dollars In Millions)

	Governor's Budget	LAO
1994-95 Expenditures (revised)	$1,599.6	$1,599.6
Cost increases for existing programs		
General purpose expenditures	$61.0	—
Faculty salary increase (1.2 percent on July 1, 1995)	—	$10.8
Staff salary increase (1.2 percent on July 1, 1995)	—	7.2
Merit salary increases (full-year)	—	19.6
Additional costs on lease-payment bonds	12.6	12.6
Price increase	—	6.8
Employee benefits	—	0.3
Maintenance of new space	—	1.3
Small campus adjustments	—	1.1
Technical adjustments	0.3	0.3
Phase-in new campus at Monterey Bay	—	2.8
Subtotals	($73.9)	($62.7)
Eliminate one-time carryover funds	-$41.1	-$41.1
Deferred maintenance	—	$5.4
Enrollment increase		
Add 2,000 full-time-equivalent students	—	$9.0
Balance fee levels and program quality		
Undergraduate fee increase (10 percent)	-$44.7	-$47.1
Graduate student fee increase ($90)	—	-2.5
Increase in student financial aid	14.9	16.5
Subtotals	(-$29.8)	(-$33.1)
1995-96 Expenditures (proposed)	$1,602.6	$1,602.6
Change from 1994-95		
Amount	$2.9	$2.9
Percent	0.2%	0.2%
Enrollment	Open	252,000

Faculty and Staff Salary Increases

We recommend expenditures of $37.6 million to provide a 1.2 percent salary increase and merit salary increases for CSU faculty and staff on July 1, 1995. We also recommend that CSU report at budget hearings on its plans regarding merit compensation.

The Governor's Budget does not specifically provide for faculty and staff salary increases or merit salary adjustments (MSAs). At the time of this analysis, the CSU administration was proposing to allocate

$37.5 million for compensation increases in 1995-96, which represents an overall increase of 2.5 percent.

In past years, the Legislature has sought to achieve a balance among various types of compensation increases. For example, the Legislature has provided funds both for general salary increases and for merit salary increases. With regard to faculty, the Legislature has been concerned about the extent to which the provision of any salary increases and MSAs would narrow or eliminate the gap between faculty salaries at CSU in relation to the CSU's comparison institutions. (As we discussed earlier in the higher education crosscutting issues section, our analysis indicates that CSU faculty salaries would lag behind comparison institutions by 3 percent in 1995-96 in the absence of salary increases.)

We believe an increase of roughly the amount proposed by the CSU administration is reasonable given fiscal constraints. In addition, it would eliminate most of the faculty salary gap we identify. Consistent with past legislative action to provide funding for merit salary adjustments and balance various types of compensation increases, we recommend an expenditure of $37.6 million for employee compensation increases, allocated as follows: $10.8 million for 1.2 percent general faculty salary increases, $7.2 million for 1.2 percent general staff salary increases (the same percentage we recommend for UC staff), and $19.6 million for merit salary increases for faculty and staff.

CSU Merit Proposal. For 1995-96, the CSU administration is proposing a new method for allocating employee compensation increases. Specifically, the administration is recommending that most or all the increases provided be based on employee merit. As is true for virtually all faculty and staff compensation issues at the CSU, this proposal would be subject to negotiation through the collective bargaining process. The CSU indicates that it will have more details available on its proposal this spring.

The Legislature, in its oversight role, needs additional information on CSU's merit proposal. Accordingly, we recommend that the CSU provide additional details on its proposal at budget hearings, including how the proposal would affect the traditional comparison of faculty salaries at CSU to the salaries at other comparable institutions.

Costs of Continuing Various Programs

We recommend an expenditure of $9.4 million for price increases, maintenance of employee benefits and new space, and small campus funding adjustments.

The Governor's Budget does not address various costs of continuing existing programs at the CSU. These costs are described below:

- ***Price Increases***. Within the total amount of funds for CSU, we believe it is reasonable to designate an amount to offset the impact of inflation on the nonsalary budget and thus maintain the CSU's purchasing power. Based primarily on the assumption that prices for various commodities and services will increase by an average of two percent compared to the current year, $6.8 million would be needed for this purpose.

- ***Employee Benefits Maintenance.*** The CSU estimates that the costs of providing various employee benefits—including health, dental and vision services, workers' compensation, and unemployment and disability insurance—will increase by $4.9 million compared to the current year. (This amount does not include increased costs of providing dental benefits to annuitants, which are funded in the Governor's Budget.) Roughly $4.7 million of the CSU's estimate is based on anticipated cost increases for health benefits. We believe that providing funding for health benefits increases is premature for three reasons: (1) the Governor's Budget does not provide for health benefit increases for other state agencies, (2) under current law the state's contribution for health benefits would decrease, and (3) at the time this analysis was prepared, the state was still negotiating with health care providers to establish the 1995-96 health insurance premiums. Accordingly, we do not recommend the allocation of additional funds for health benefit increases. (To the extent that additional information on health premiums is available this spring, we may recommend further adjustments then.) We recommend that $250,000 be allocated for other benefits increases identified by the CSU administration.

- ***Maintenance of New Space.*** The CSU estimates that 216,000 square feet of new space will be occupied in 1995-96 by programs eligible for state-funded operation and maintenance. The cost of operating and maintaining this space is $1.3 million. Lack of support for ongoing maintenance in the long run increases deferred maintenance.

- ***Small Campus Adjustments.*** The CSU estimates that it will need $1.1 million to fund cost increases at two small campuses. Specifically, the CSU administration proposes to allocate $832,000 for the final phase-in costs of the CSU San Marcos campus, which was established in 1989. The CSU also plans to allocate $300,000 to the California Maritime Academy (which will become part of the CSU system on July 1, 1995) to begin the restructuring of various programs (including the CMA's accounting structure) to ensure comparability with other CSU campuses.

Recommendation. We recommend the expenditure of $9.4 million to recognize the estimated costs of continuing current programs. This recommendation is based on the following allocation: $6.8 million for price increases, $250,000 for benefits increases, $1.3 million for the maintenance of new space, and $1.1 million for small campus adjustments.

Phase-in of New Campus at Monterey Bay

We recommend the expenditure of $2.8 million for phase-in costs related to the new CSU campus at Monterey Bay. We also recommend that the CSU report at budget hearings on its progress towards opening the campus in 1995-96.

Chapter 901, Statutes of 1994 (SB 1425, Mello) established a new CSU, Monterey Bay campus at Fort Ord, a former military base. The 1994 Budget Act provided $9.3 million in the current year for operating costs, in addition to $3 million that CSU had redirected from its own resources for this purpose. The federal government has also provided $15 million for capital outlay related to building alterations needed to open the campus. Another $14 million in federal funds for additional renovations has been approved by Congress.

In the *Supplemental Report of the 1994 Budget Act*, the Legislature adopted language specifying its intent that enrollment growth at the Monterey Bay campus be faster than projected by a March 1994 CSU report, "in order to (a) reduce the state's higher costs for funding enrollments at the campus and (b) utilize more of the existing Fort Ord facilities and thus reduce the state's future need to fund additional facilities at existing campuses." The language also specified enrollment goals of 4,000 FTES in 1999-2000 and 20,000 FTES in 2010-00, assuming that the federal government provides funding for facilities renovation and that "the state provides funding for systemwide enrollment growth above the 1994-95 level."

The CSU plans to open the new campus in fall 1995 with an initial enrollment of about 600 FTE students. Our analysis indicates that this is a reasonable first step in meeting the enrollment targets specified by the Legislature.

The CSU administration indicates that it will need an additional $2.8 million in 1995-96 for (1) full-year costs of 40 planning faculty hired in winter 1994 and (2) half-year costs of an additional 40 faculty to be hired by winter 1995. This funding level is consistent with the anticipated workload. Given the Legislature's interest in the new campus, we also recommend that the CSU report at budget hearings on its progress towards opening the campus and in ensuring that the Legislature's enrollment targets for CSU, Monterey Bay will be met.

Deferred Maintenance

We recommend the expenditure of $5.4 million in the critical area of deferred maintenance.

The Governor's Budget does not propose any funding changes in the area of deferred maintenance. We recommend the expenditure of $5.4 million to address the highest priority needs in this area.

For 1993-94 (the most recent year for which information is available), the CSU's deferred maintenance backlog was approximately $327 million. The backlog of priority-one projects was $35 million. Priority-one projects are generally defined as those requiring "immediate action to return a facility to normal operation, stop accelerated deterioration, or correct a cited safety hazard." The 1993-94 deferred maintenance backlog for each campus is displayed in our *Analysis of the 1994-95 Budget Bill*, (please see page F-48).

In 1994-95, the CSU plans to spend $25 million for priority one deferred maintenance projects. Of this amount, $17 million was specified in the 1994 budget package as being from lease-payment bonds for priority one deferred maintenance projects that would have an anticipated useful life of 15 years. Due to recent legal developments however, it appears that a different funding source (such as a loan) will be used for the planned expenditure. At the time of this analysis, the basis for the CSU's loan authority was not clear. The remaining $8 million is from one-time carry-over funds (as discussed in a later section). The backlog of priority one projects as well as the overall backlog will continue to be significant in 1995-96. An additional $5.4 million funds would address a small portion of the shortfall and would fully backfill a reduction of $5.2 million made in the current year. (We discuss the current-year reduction and the use of lease-payment bonds and/or loans for deferred maintenance in a later section.)

Undergraduate Student Fee Increase

We recommend that undergraduate student fees be increased by $156 (10 percent)—from $1,584 to $1,740.

The Governor's Budget anticipates that student fees at CSU will increase by at least 10 percent. The CSU Trustees have approved an undergraduate fee increase of $156 (10 percent) and have also adopted a resolution urging that sufficient funding be provided to eliminate the need for a fee increase. We believe that this is a reasonable increase given the state's fiscal condition and the relative level of CSU fees. The budget indicates that CSU undergraduate fees (including the mandatory fee and campus-based fees) in 1994-95 are approximately $1,046 below the CSU's 15 public comparison universities. Even with the proposed increase, CSU undergraduate fees will continue to be well below charges at comparable universities.

As we discuss earlier in the higher education crosscutting issues section, we took as a starting point the administration's total proposed funding levels for higher education in developing our alternative budget proposals. To the extent the Legislature increases the overall level of support for higher education, moderating the fee increase may be a high legislative priority. To assist the Legislature in its deliberations on this issue, we note that $29.8 million would be needed in 1995-96 to provide CSU with the same level of resources as is provided by a 10 percent fee increase (net of financial aid), given current enrollment levels. (Later, we recommend that enrollment be increased, thus, the amount that would be needed at the recommended enrollment level is $30 million.)

Graduate Student Fees

We recommend that graduate student fees be increased by $90 above the general fee increase for undergraduates.

The Governor's Budget does not propose a specific fee increase for graduate students. The CSU Trustees have approved the general increase of $156 proposed for undergraduates, plus an additional $90 fee increase for graduate and postbaccalaureate students (except for students in teaching credential programs). We believe this increase is reasonable, based on the reasons cited below:

- Graduate programs, as a rule, cost more per student than undergraduate programs, due to the specialized nature of the instruction and the typically low student-faculty ratios.
- A greater portion of the benefits from graduate education accrues to the individual directly, because specialized knowledge is more likely to translate into higher income than is the general knowledge acquired as an undergraduate.
- Low student charges at the graduate level create incentives for over-investment in graduate education.

We also believe that the state's charges for graduate studies should not be so high as to disadvantage California in relationship to other states in competition to attract highly qualified students. This is unlikely to be an issue at the CSU since graduate fees at the CSU are at least $1,046 below graduate fees at the CSU's 15 public comparison institutions.

We estimate that gross revenues prior to financial aid offsets from a fee increase of this amount would be approximately $2.5 million. However, this estimate may be subject to change later, pending receipt of additional information on the estimated number of teaching credential students who would be excluded from the fee increase.

Student Financial Aid

We recommend the expenditure of $16.5 million for additional student financial aid for needy students to offset our recommended fee increases.

This aid amount is equal to 33 percent of the total fee increase for our recommended enrollment level and should be sufficient to offset the fee increase for needy students. In our analysis of the Student Aid Commission, we also recommend approval of a proposed $11.5 million increase to offset the impact of the 10 percent fee increase on Cal Grant award winners.

Enrollments at the CSU

We recommend that the Legislature direct the CSU to increase its enrollment by 2,000 students in 1995-96.

The CSU estimates that it will serve roughly 250,000 students in the current year. The budget contains no enrollment proposal for 1995-96.

Current-year enrollments are roughly 28,000 students below the number served in 1990-91. This decline occurred during a period of little change in the population groups that typically attend the CSU. For example, the number of high school graduates and persons aged 18 to 35 (the major age group enrolled at the CSU) have shown slight *increases* between 1990-91 and 1994-95. Thus, the vast majority of the change is due to changes in "participation rates," that is, the proportions of (1) eligible students who enroll and (2) existing students who continue their education at the CSU.

The decline in participation rates is probably due to a number of factors, including course section reductions (and their impact on students being able to graduate in a timely manner) and other enrollment management techniques implemented by the CSU, fee increases, and declines in the economy generally.

If funding is provided for additional students, the CSU administration proposes to serve an additional 2,000 FTE students in 1995-96. Based on participation rates in the current year and on constraints due to the "pipeline" of existing students (for example, senior enrollments can only be increased significantly after freshman and transfer enrollments are increased), we believe an increase of 2,000 FTE students is reasonable. Accordingly, we recommend that the CSU be directed to enroll an additional 2,000 FTE students for a total enrollment of 252,000. This is the level that can be accommodated within the funding parameters we outlined earlier in this section. We propose $9 million to add faculty positions and related support to serve these students.

Specify Enrollment Levels

We recommend that the Legislature specify an enrollment level for 1995-96 in supplemental report language.

In the *Supplemental Report of the 1994 Budget Act*, the Legislature specified an enrollment level of 250,000 FTE students in 1994-95. The language also provided for a method of adjusting enrollments downward based on an amount of funding per additional student in anticipation of any budget declines that might occur later (such as through a veto or the budget "trigger" mechanism.) We believe that the language is an important component of the overall CSU budget, because it holds CSU accountable for meeting the Legislature's enrollment target, thereby maintaining the integrity of the budget process.

We recommend that the Legislature adopt similar supplemental report language again this year. Our proposed enrollment level for the CSU is 252,000 FTE students, an increase of 2,000 over 1994-95. (Including the transfer of California Maritime Academy FTE to the CSU systems in 1995-96, the total will be about 252,500.) We will propose specific supplemental report language prior to budget hearings.

OTHER ISSUES

Debt Financing for Deferred Maintenance Ill Advised

We recommend that the CSU report at budget hearings on its plans for funding deferred maintenance in the current year. We recommend that the Legislature avoid debt financing for deferred maintenance in 1995-96.

In the 1994 Budget Act and related legislation, the Legislature provided $17 million from lease-payment bonds for deferred maintenance projects (such as roof replacements). About $5.2 million of this amount was to replace existing expenditures—$3.2 million from the General Fund, and $2 million from redirection of ongoing CSU funds. Debt payments on the bonds would be made from an annual General Fund appropriation to the CSU.

Typically, lease-payment bonds have been used for long-term capital improvements and not for deferred maintenance purposes, which have been funded as part of ongoing state operations. Given this departure, the Legislature adopted various provisions in the 1994 budget package regarding these bonds. First, the Legislature specified that the bonds were to be used for deferred maintenance projects with a useful life of at least 15 years. The Legislature also specified that the projects were to be "priority one" projects which are those requiring "immediate action to return a facility to normal operation, stop accelerated deterioration, or correct a cited safety hazard."

Finally, the budget package provided for an "asset transfer" mechanism to ensure that sufficient "collateral" was available to back-up the sale of the bonds. Asset transfer involves identifying an asset of sufficient value to support the amount of bonds to be sold. Under this mechanism, the asset identified may bear no relationship to the deferred maintenance projects being undertaken, though the total value must generally be in the same range as the projects. For example, an existing building (on one campus) valued at $15 million may be identified through asset transfer as the collateral for lease-payment bonds, but the projects undertaken using the bond monies may be the replacement of 15 new building roofs (throughout all the existing campuses) at an average cost of $1 million each.

Under current law, the state Attorney General is responsible for determining whether a proposed use of lease-payment bonds meets various legal requirements, such as constitutional requirements related to debt. Since enactment of the budget package, the Attorney General has raised concerns that the proposed use of lease-payment bonds (and particularly the asset transfer provisions) may not meet various legal requirements. As of late-January 1995, the Attorney General had not made a positive determination that the use of $17 million in lease-payment bonds for deferred maintenance meets legal requirements.

At the time of this analysis, the CSU administration indicated that it was seeking an alternative funding source (such as a loan) for the $17 million in planned current-year expenditures. (As we discussed earlier in our analysis of the UC budget, the UC is also affected by the legal developments we describe above.) We recommend that the CSU report on its plans to fund deferred maintenance expenditures in 1994-95 including the estimated impact on the 1995-96 budget of any repayments needed for 1994-95 costs.

Debt Financing Not Prudent. At the time of this analysis, the CSU administration indicated that it was seeking an alternative funding source (such as a loan) for additional budget-year expenditures on deferred maintenance. In our view, proposed debt financing of the CSU's operating budget in 1995-96 is ill-advised because prudent budget policy calls for annual balancing of the CSU budget. If the state provides new loans each year for the indefinite future, it will have to pay these loan amounts—plus interest—out of future years' operating budgets. We believe the state should recognize this ongoing cost and provide for it in the ongoing budget.

We recommend that the Legislature avoid debt financing for deferred maintenance in 1995-96. In various sections of this analysis, we have recommended alternatives to the use of debt financing for deferred maintenance. Earlier, we recommended the expenditure of $5.4 million for deferred maintenance in 1995-96. This amount would fully backfill the $5.2 million in deferred maintenance reductions made in the current year. Later in this analysis, we recommend that the Legislature adopt Budget Bill language to target the use of carryover funds for deferred maintenance and instructional equipment replacement.

Legislative Oversight: One-time Carryover Funds

We recommend that the Legislature adopt Budget Bill language establishing limits on, and priorities for, the use of one-time carryover funds given serious concerns about the CSU's recent actions.

Prior to 1992-93, the annual Budget Act contained language providing that the CSU could carry over ("reappropriate") General Fund monies for two years and specified the purposes for which the funds could be spent. Generally, the main purposes identified were deferred maintenance and instructional equipment replacement, though additional purposes were sometimes added from year to year. The language also required the CSU, by September 30 of each year, to report to the Joint Legislative Budget Committee (JLBC) and the Department of Finance (DOF) on the amounts of funding carried over and the uses of these funds.

From the mid-1980s until 1992-93, the amounts carried over from the CSU's main support item averaged about $6 million annually, with a high of about $13 million.

Beginning with the 1992 Budget Act, the Legislature removed the restrictions on the use of carryover funds at the CSU in recognition of the impact of large General Fund budget reductions.

Current-Year Actions. Figure 30 below shows the expenditure plan for the $41 million (excluding lease-payment bond funds) in one-time carryover funds available in 1994-95. The CSU indicates that about $22 million from 1993-94 was carried over intentionally—that is, they are in excess of a "normal" carryover amount. We note that these "forced savings" occurred in a year (1993-94) when the number of course sections taught declined by about 2,000 and FTE student enrollments declined by 10,000.

According to the CSU, its decision to carry over 1993-94 funds into the current year was influenced by the failure of a higher education capital outlay bond measure in June 1994, and various budget "threats" such as possible (1) delays in enacting the 1994-95 budget, (2) shortfalls in the 1994-95 budget (such as through automatic budget "trigger" reductions), and (3) delays or shortfalls in the receipt of federal funds for earthquake-related repairs at CSU, Northridge. However, the CSU did not ultimately face the budget threats it identified (with the exception of the failure of the capital outlay bond measure).

Generally, we believe the expenditure plan for the $41 million shown in Figure 30 is reasonable. Many of the expenditures—such as in the areas of deferred maintenance, instructional equipment, and telecommunications infrastructure—reflect legislative priorities identified over the past several years.

Figure 30

California State University Expenditure Plan for One-Time Carryover Funds 1994-95

(Dollars in Millions)

Carryover Funds from 1992-93	
Workers' compensation and unemployment insurance	$1.7
Litigation settlement	1.6
Deferred maintenance	1.3
Automated building maintenance scheduling system	1.2
Matching funds for federal grant for underrepresented student programs	0.8
Other systemwide costs	0.2
Reappropriations to campuses	2.1
Reappropriations to systemwide office	0.7
Subtotals	($9.5)
Carryover Funds from 1993-94	
Deferred maintenance	$6.7
Telecommunications infrastructure and planning	4.5
Instructional equipment replacement	4.4
Pay back campuses to reflect adjustments in costs of 1992-93 early retirement program	2.7
Pay PERS for remaining costs of 1993-94 early retirement program	2.6
Technology initiatives	2.0
New campus at Monterey Bay	1.6
Other systemwide costs	0.2
Reappropriations to campuses	5.6
Reappropriations to systemwide offices	1.8
Subtotals	($32.1)
Less technical adjustments	-0.5
Totals	$41.1

We have serious concerns, however, that the CSU was generating this significant “savings” by limiting student access. For example, the $22 million the CSU intentionally carried over could have been used in the current year on a one-time basis to offer roughly 2,000 course sections (roughly the number lost in 1993-94), reduce the fee increase from 10 percent to about 3 percent, or some combination of the two.

The Legislature, however, was precluded from specifying its priorities for use of the funds in the current year. This is because the CSU did not file the report identifying the amounts of carryover funds available from 1993-94 until late-January 1995 even though the report was due September 30, 1994. Thus, the Governor's Budget document provided the first "notification" to the Legislature of the availability of carryover funds.

As a practical matter, however, the CSU informs us that it has already committed the entire $41 million in expenditures. Thus, it is too late for the Legislature to specify different priorities for use of the funds in 1994-95.

Budget-Year Implications. The CSU's actions in the current-year raise two fundamental legislative oversight issues for the budget year and beyond:

- Should the CSU continue to have unlimited authority to carryover funds to meet its own priorities, or should the carryover authority be eliminated or restricted?
- If some level of carryover authority is maintained, how can the Legislature ensure that its own priorities for use of the funds are observed?

For at least the past 15 years, the Legislature has granted the CSU more budget flexibility than most other state agencies. For most state agencies, any General Fund monies that are not spent by the end of the fiscal year revert to the General Fund. Given the Legislature's long history of providing budget flexibility to CSU, we believe it is reasonable to continue to provide some level of carryover authority to the CSU. Such authority would reduce the incentive to spend the funds quickly prior to the end of the fiscal year in which the funds were originally budgeted.

There is evidence, however, that the current unlimited carryover authority was used by the CSU to carry over high fund balances to address selected priorities without legislative oversight. Accordingly, we recommend that the Legislature limit the CSU's carryover authority to $15 million from each fiscal year, in recognition of "normal" levels of carryover funds. We further recommend that the Legislature re-establish prior Budget Bill language specifying that carryover funds shall be used for deferred maintenance and instructional equipment replacement, because there are significant shortfalls in these areas that could be addressed through one-time expenditures.

Specifically, we recommend that the Legislature replace Provision 1 of the existing carryover language in Item 6610-490 with the following:

> "Up to $15 million of the reappropriated funds from Item 6610-001-001, Budget Act of 1994, shall be available for deferred maintenance and special repair projects and replacement of instructional equipment. As of June 30, 1994, any amount above $15 million shall revert to the General Fund."

(In our analysis of the UC budget, we recommend the adoption of similar language.)

CALIFORNIA COMMUNITY COLLEGES (6870)

The California Community Colleges (CCC) provide instruction to about 1.4 million adults at 107 colleges operated by 71 locally governed districts throughout the state. The system offers academic and occupational programs at the lower-division (freshman and sophomore) level, basic skills education, and citizenship instruction.

The proposed 1995-96 CCC budget is $3 billion. This is an increase of $91.9 million, or 3.2 percent, above the amount provided in the current year. Of the proposed $3 billion, $1.2 billion is from the General Fund, $1.4 million is from local property tax revenues, and the remaining support is from student fees and a variety of other sources.

Figure 31 shows that actual full-time equivalent student (FTES) enrollments at the CCC have declined from 917,839 in 1991-92 to an estimated 868,277 in 1994-95. This represents a decrease of 49,562 FTES. The 49,562 FTES includes a 15,576 FTES reduction in Bachelor of Arts (BA) degree holders in 1992-93. Figure 31 also shows that the state has not made funding reductions commensurate with the reductions in enrollment. Funding from Proposition 98 sources and related sources—primarily state General Fund, local property taxes, and student fees actually increased somewhat, by $103 million. As a result, funding per actual FTES served at the community colleges has increased by $281. This reflects an increase, on average, of about 3.2 percent per year. Since this rate of growth outpaces the rate of inflation during the same period, community colleges actually have seen some growth in spending per pupil beyond what was necessary to protect the purchasing power of 1991-92 per-FTES spending.

LEGISLATIVE OVERSIGHT NEEDED

We recommend that the Legislature take action to hold the CCC accountable for budgeted enrollment levels.

In the Crosscutting Issues section of this chapter, we have suggested certain principles to guide the development of budgets for the University of California (UC), the California State University (CSU), and the CCC. Figure 32 shows how the major budget proposals for the CCC address these principles.

Figure 31

CCC Funding Per FTES 1992-93 Through 1994-95

(Dollars in Millions)

	1991-92	1992-93	1993-94	1994-95	Average Annual Percent Change
Actual FTES	917,839	896,899	858,951	868,277	-1.8%
Total Funding:					
Proposition 98 and related[a]	$2,605.9	$2,645.9	$2,621.9	$2,709.2	1.3%
Funding per FTES (in dollars)	$2,839	$2,950	$3,052	$3,120	3.2%

[a] Includes revenue from the following sources: Proposition 98 General Fund and loans, local property taxes, student fees, oil and mineral revenues.

Figure 32

Major Community College Budget Proposals (General Fund)

Fund the Continuing Costs of the Current Program

- $55.2 million increase to fund a 2.2 percent cost-of-living adjustment (COLA).
- $47 million increase on a one-time basis to backfill a current-year shortfall in property tax revenues
- $21.8 million increase to backfill a current-year shortfall in student fee revenues
- $10.4 million increase to backfill a 1994-95 one-time reduction in rates charged by the Public Employees' Retirement System (PERS)
- $4.9 million increase to reflect increased lease-payment bond costs
- $15.2 million reduction to recognize savings from enrollment reductions

Address Critical Funding Needs

- $6 million increase in 1994-95, on a one-time basis, for instructional equipment and library materials

Balance Fee Levels and Program Quality

- $19.5 million net reduction in state aid to reflect an increase in student fees from $13 to $15 per unit (the administration's proposal supports a $17 million increase in financial aid)

Maximize Access

- $24.7 million increase for enrollment growth

The budget proposal for the CCC is generally consistent with the principles we have suggested. We recommend, however, that the Legislature take the following steps to hold the CCC accountable for the enrollment levels funded in the budget:

- Ensure that $31.5 million provided to fund growth in 1994-95 and $24.7 million provided for growth in 1995-96 is actually allocated by the CCC to fund increased enrollment.
- Prevent the CCC from further reducing its enrollment on the basis of a $15.2 million reduction reflected in the budget that recognizes an enrollment decline that occurred two years ago.

We discuss these recommendations in detail below.

CCC Should Spend Growth Funding For That Purpose

We recommend that the Legislature adopt Budget Bill language and supplemental report language to ensure that the CCC uses current- and budget-year growth funding to support increased enrollments.

Under the state's Master Plan for Higher Education, the CCC is charged with being the point of access to higher education for the great majority of Californians. For this reason, preservation of access to the CCC has been a major priority for the Legislature.

Out of concern for protecting access to the CCC, the 1994 Budget Act directed the CCC to allocate $31.5 million to fund an increase in FTES enrollments, based on adult population growth. Instead of using these funds for growth, however, the CCC used them to partially backfill a property tax shortfall that it forecast for the current year.

The Chancellor's Office offered two reasons for taking this action: (1) protection of districts' base budgets should take priority over funding enrollment growth, and (2) allocation of growth funding as directed by the Legislature would disproportionately hurt fiscally troubled districts.

Diversion of Growth Funds Disadvantages High Growth Areas. In response to the first reason, we note that the Legislature directed the Chancellor's Office to fund growth, but also provided, through the *Supplemental Report of the 1994 Budget Act,* a mechanism to accommodate reduced revenues related to fee or property tax shortfalls by reducing district workload levels across the board. The Chancellor's Office, to be consistent with the Budget Act *and* this language, should have first allocated growth funds and adjusted district FTES workload accordingly, then reduced workload across the board by the amount necessary to accommodate reduced revenues. By acting as it did, the Chancellor's Office shifted general-purpose funding among community college districts, generally from districts located in rapidly growing population centers (generally in rural and suburban areas) to those located in established urban areas. This is because the CCC, in effect, allocated the $31.5 million in proportion to districts' base funding level, not in proportion to districts' adult population growth, as directed by the Legislature. As a result, districts in urban areas such as Los Angeles, San Diego, and San Francisco benefited from the CCC action and those in areas such as the Sierra foothills and various desert communities got less than they would otherwise have received.

Diversion of Growth Funds Does Not Consistently Protect Fiscally Troubled Districts. Staff of the CCC Chancellor's Office advise that the $31.5 million was allocated as a property tax backfill, instead of growth, in order to protect districts already in financial difficulty from further fiscal stress. In fact, it appears that this approach provided little help for districts in the greatest financial difficulty. The Chancellor's Office currently identifies four districts as being in moderate danger of default—that is, they could require emergency state aid in 6 to 18 months if they do not take action to correct existing problems. Based on information we received from the Chancellor's Office, however, it appears that only one of these districts received more general-purpose funds than it would have received if growth had been allocated. Two received *less*, and one received about the same amount.

The Chancellor's Office also identifies 18 districts that are not in imminent danger of major fiscal problems, but have displayed management patterns that, if continued over the long run, eventually could lead to difficulties. Among these districts, gainers from the CCC action are roughly equal in number to losers. However, losers generally lost more, as a percentage of their total general-purpose funding, than gainers gained.

Budget Control Action Needed. In order to ensure that the CCC allocates growth funding to support enrollment growth, and more generally hold the CCC accountable for the level of enrollment funded in the Budget Act, we recommend that the Legislature take the following actions:

- Require the CCC to allocate 1995-96 apportionments as if $31.5 million had been allocated for growth in 1994-95. Specifically, we suggest that the following language be added in Item 6870-101-001:

  > "Notwithstanding any other provision of law, for the purpose of allocating the funds appropriated in Schedule (a) to community college districts, the Chancellor's Office shall calculate districts' base workload measures and revenue as if $31,483,000 had been

> allocated in fiscal year 1994-95 by the method described in Section 58774 of Division 6 of Title 5 of the California Code of Regulations to support growth in FTES."

- Reduce the amount provided for apportionments in Schedule (a) of Item 6870-101-001 of the 1995 Budget Bill by the $24.7 million provided to fund enrollment growth. Appropriate this $24.7 million in a separate schedule in the same item, and add the following Budget Bill language:

  > "Notwithstanding any other provision of law, the funds appropriated in this section shall be allocated for growth in FTES, on a district-by-district basis, as determined by the Chancellor of the California Community Colleges pursuant to Section 58774 of Division 6 of Title 5 of the California Code of Regulations."

- Adopt supplemental report language, similar to the language adopted in the *Supplemental Report of the 1994 Budget Act*, expressing legislative intent concerning (1) the level of FTES enrollment funded by the amount provided for apportionments, and (2) the circumstances under which the CCC may adjust that level of funded FTES enrollment. We will provide appropriate language at the time of hearings.

$15.2 Million Funding Reduction Reflects Past-Year Workload Decline

We recommend approval of a proposed $15.2 General Fund reduction related to past-year enrollment declines. We also recommend Budget Bill language that would (1) prevent further enrollment declines as a result of this reduction, and (2) allocate this reduction among districts in proportion to enrollment declines.

The budget proposes a General Fund reduction of $15.2 million related to enrollment declines. Specifically, this reduction is related to enrollment declines that occurred in 1992-93, when the state imposed a sharp mid-year increase in student fees for BA degree holders.

Funding Reduction Consistent With Current Law. Current law—Ch 8/93 (AB 46, Archie-Hudson), amended by Ch 1132/93 (AB 39, Archie-Hudson)—permits the state to reduce the CCC budget over a three-year period, beginning in the current year, to reflect the impact of these enrollment declines. Accordingly, the 1994 Budget Act reduced the CCC budget by $15.2 million. The $15.2 million reduction proposed in this year's budget represents the second reduction in the series of three permitted under current law.

No Further Enrollment Reduction Should be Permitted. The 1994 Budget Act permitted the CCC to reduce the number of students served in the current year to accommodate the $15.2 million current-year reduction. We do not believe that a similar reduction should be permitted in response to the 1995-96 funding reduction. This is because the proposed funding reduction corresponds to a reduction in the number of students with BA or graduate degrees that occurred in 1992-93. Thus, if the CCC were permitted to reduce enrollments again in 1995-96, the CCC would have reduced it enrollments roughly twice as much as would be appropriate for a funding reduction of $15.2 million.

Given that the state has already allowed a significant increase in per-FTES spending at the CCC by not reducing funding in response to past-year enrollment reductions, we see no fiscal or policy justification for permitting the CCC to further reduce the number of students it serves in response to the proposed $15.2 reduction.

Reduction Should Be Allocated Where Enrollment Declines Occurred. Last year, we recommended that the current-year $15.2 million reduction be allocated only to those districts where enrollment declines actually occurred as a result of the differential fee. The Legislature, however, ultimately adopted Budget Bill language that directs the CCC to allocate the current-year funding reduction across all districts in proportion to their total enrollments. The Legislature's action was due in part to a concern that some districts already slated for budget reductions due to large enrollment declines would experience a "double hit" if the $15.2 million reduction was allocated on a district-specific basis.

We recommend that the Legislature consider a different approach with regard to the reduction proposed for 1995-96. First, allocation of the reduction in proportion to districts' overall current enrollment is not necessary, because the potential "double hit" can be eliminated through appropriate Budget Bill language. Moreover, allocation in proportion to current enrollment would unfairly penalize districts that experienced little or no enrollment decline as a result of the fee increase for BA-holders. Finally, such an allocation is contrary to Chapter 1132, which states that the district funding reductions for enrollment declines related to the differential fee shall not be distributed on a statewide average basis. Accordingly, we recommend that the Legislature require the CCC to allocate the 1995-96 reduction in proportion to districts' fee-related declines in FTES.

Budget Bill Language Needed. We recommend approval of the proposed $15.2 million reduction. Moreover, we recommend that the Legislature add the following Budget Bill language to Item 6870-101-001 to (1) prevent the CCC from reducing its FTES workload in proportion to this reduction, (2) require that the CCC allocate this reduction in proportion to district-specific FTES declines, and (3) ensure that this reduction does not apply to the extent that a district has already recognized fee-related workload declines under existing regulations (to avoid a "double hit"):

> "Notwithstanding any other provision of law, the Chancellor of the California Community Colleges shall reduce base apportionments by a total of $15,181,000 to reflect funding that has not been provided in Schedule (a) of this item. These base adjustments are related to an estimate of one-third of systemwide attrition resulting from the differential fee of $50 per unit authorized in January of 1993 for students having bachelor's or graduate degrees. These base apportionment adjustments shall be made for each district in proportion to its total actual FTES workload decline resulting from the fee, as determined by the Chancellor. They shall not apply to the extent that a district's base apportionment has already been adjusted due to declines in workload that are recognized under existing regulations and are related to the differential fee. No district's FTES workload obligation shall be reduced as a result of these base apportionment adjustments. This provision shall not be construed to further reduce the amount available for expenditure contained in Schedule (a) of this item."

OTHER BUDGET ISSUES

Budget Proposal Balances Fee Levels and Program Quality

We recommend approval of budget proposals to (1) increase regular student fees from $13 per credit unit to $15 per credit unit, and (2) continue the differential fee for BA holders at $50 per credit unit.

The budget proposes to increase student fees from $13 per credit unit to $15 per credit unit. The budget also proposes to continue a fee of $50 per credit unit for BA holders. Implementation of either proposal would require legislation. This is because the statutory authority for regular student fees expires on July 1, 1995, and the statutory authority for the differential fee for BA holders expires on January 1, 1996.

We believe that a $2 per unit increase in regular student fees meets the Legislature's concern that higher education fee increases be gradual and predictable. The full-year cost of attending a community college for a full-time student would increase by $60, from $390 to $450 per year. At $450 per year, California's community college fees would remain the lowest in the nation. Moreover, fees are waived entirely for the students in greatest financial need. The budget funds an increase of $17 million in fee waivers, on the assumption that more students will successfully apply for waivers as a result of the fee increase.

Given the state's fiscal condition, and the Legislature's statutory determination to make a cost-of-living adjustment (COLA) for K-12 general-purpose spending its highest priority within Proposition 98 programs, we believe that it is reasonable to increase regular student fees and continue the differential fee for BA holders. To the extent, however, that the Legislature wishes to increase the overall level of state support for higher education, we realize that moderating the proposed fee increase may be a high legislative priority. If the $2 per unit increase is not adopted, $19.5 million in Proposition 98 funds would have to be redirected to community colleges apportionments from K-12 education programs in order to maintain the level of apportionment spending supported by the budget. If the differential fee is not continued, an additional $6.8 million would have to be redirected. Redirections of this magnitude would increase the challenge already faced by the Legislature in its efforts to fund COLAs for selected K-14 programs.

Some Puente Project Funding Should Be Redirected

We recommend approval of a proposed $245,000 General Fund augmentation to support expansion of the Puente Project. We recommend that the remaining $125,000 augmentation provided for the Puente Project in Item 6870-101-001 be redirected to other K-14 programs, because it would supplant existing private support for the project.

The budget provides $904,000 in Proposition 98 General Fund support for the Puente Project, an increase of $370,000, or 69 percent. The budget proposes this increase in order to fund expansion of the program from 31 to 45 colleges, and provide state support for some program personnel currently funded by private donors.

Background. The Puente Project seeks to increase the success of Mexican American/Latino students in transferring from the community colleges to a baccalaureate institution (primarily the University of California). Participating colleges support the project from their apportionment funding by dedicating an English teacher/counselor team to the project. The goals of each team are to (1) provide intensive instruction that will move students to college-level writing capability within one year, (2) help students develop clear academic and occupational goals, (3) link students with community mentors according to their academic and occupational interests, and (4) monitor student progress and provide ongoing support and assistance in student efforts to transfer to a baccalaureate institution.

The amount provided for the Puente Project in the current year, $534,000, supports a central office staff that is responsible for providing technical assistance and training for Puente teams, site monitoring, statewide student activities, and evaluation activities. Other support for central office functions is provided by private donors (largely for personnel and program improvement grants), and the University of California Office of the President (largely through in-kind contribution of office space and equipment).

State Funding Should Not Supplant Private Support. The $370,000 increase proposed in the budget would support:

- Additional central office staff necessary to (1) better serve existing Puente programs at 31 colleges and (2) expand the program to include an additional 14 colleges—$245,000 for 4.7 personnel years.
- Existing central office staff that are currently supported by private funds—$125,000 for 2.05 personnel years.

Given past legislation commitment to this program, we do not take issue with its expansion. Accordingly, we recommend approval of an augmentation at the level of $245,000, which would improve support of existing Puente sites and would support the proposed program expansion.

Additional state funds, however, should not be provided to supplant existing private support of Puente. Private support for the program appears to have been reasonably consistent since 1992-93, in the range of $135,000 to $170,000 annually. Moreover, one of the 4.7 additional positions funded by the proposed program expansion would be a fund raiser. With a new position dedicated to fund raising, private support of Puente can be expected to increase. Accordingly, we recommend that the Legislature redirect $125,000 from Schedule (d) of Item 6870-101-001 to other higher priority K-14 education needs.

GAIN: Additional Federal Funds May Be Available

We recommend that the Chancellor's Office report to the budget committees by April 1, 1995 on the number of Greater Avenues for Independence (GAIN) FTES served by the community colleges for whom federal matching funds are not claimed.

As part of the Aid to Families with Dependent Children (AFDC) program, adults may participate in the GAIN program to acquire academic or occupational skills as a means of improving their chances of getting a job. The GAIN program is operated by county welfare departments and offers adult education, job search, and job training. In addition, GAIN participants receive child care and transportation assistance needed to permit each individual to attend education or training.

The GAIN program is funded with state and federal funds. The federal portion pays for 50 percent of the program's costs. California, however, does not use its entire allotment of federal funds. According to the Department of Social Services (DSS), California could claim up to $30 million more in federal funds if state matching funds were available. For more information on this issue generally, please see our analysis of the GAIN program in the Health and Social Services section.

State May Be Able to Claim Additional Federal Funds for GAIN FTES. The community colleges provide basic skills, English as a second language, and vocational instruction to GAIN participants. These services are funded in two ways. First, to the extent possible, community college districts claim apportionment funding for these students. No federal match is claimed for apportionment-funded GAIN recipients. If they serve GAIN recipients in excess of their apportionment-funded workload, districts claim categorical funding from the Chancellor's Office. The budget proposes to provide $16 million in categorical funding for this purpose ($8 million Proposition 98 General Fund, $8 million federal funds).

Our analysis indicates that the state could claim federal matching funds for services provided to GAIN participants that are currently funded from apportionments. These additional federal funds could be used to expand education and training services for AFDC recipients, or to free up General Fund monies that could be used for any Proposition 98 activity.

We are unable to advise the Legislature at this time of the number of GAIN recipients who are served by community colleges or of the number for whom no federal reimbursement is claimed. The Chancellor's Office is currently in the midst of its annual process of estimating these numbers. To inform the Legislature about the budget implications of pursuing additional federal matching funds, we recommend that the Chancellor's Office report to the Legislature by April 1, 1995 an estimate of the amount and cost of GAIN FTES workload for which no matching federal funds are claimed.

OUTCOME MEASURES AND ACCOUNTABILITY

In our general discussion of higher education outcome measures—please see the Crosscutting Issues section of this chapter—we recommend that the Legislature begin to focus more directly on outcomes of higher education, rather than inputs and processes. Last year, we made some recommendations to move the UC and CSU toward accountability for student time to degree, ethnic diversity of degree recipients, and providing programs that meet the state's work-force needs. This year we extend our discussion to the community colleges.

Outcome Focus Can Help Balance State's Interests and Local Flexibility

The Legislature has worked over a period of years to strike a balance between the state's interests in holding community colleges accountable to their obligations under the state's Master Plan for Higher Education and in allowing them sufficient flexibility to respond creatively and effectively to unique local circumstances. We believe that a budget process that focuses on the achievement of outcomes—and permits broad local discretion as to how they are achieved—is particularly suited to this balance.

State's Interest. Under the Master Plan, the state demands a great deal of the community colleges. As the initial point of access to higher education for most Californians, they are open to all high school graduates and others who are at least 18 years of age. The colleges are charged to provide:

- Academic and vocational instruction at the lower-division level for the great majority of students (leading to an associate degree or transfer to a baccalaureate institution).
- Remedial education for students inadequately prepared for postsecondary education.
- Various types of non-credit instruction (such as English as a second language and citizenship preparation).
- Fee supported community service classes (such as art and recreation classes).

Under existing fiscal arrangements, the state also provides a great deal of support to the community colleges. The state General Fund provides about $1.2 billion annually to the community colleges, about 44 percent of the budgetary resources available to them. Local property taxes and student fees (which are set by the state) make up the rest. Since Proposition 13 effectively removed local discretion over the growth of property tax revenues, however, changes in the level of community college funding are at the discretion of the state and are determined as part of the state's budget process.

Local Flexibility. While the state determines the broad mission of the community colleges and largely determines the level of resources they receive, the colleges are regional institutions by history and governance. California has 71 community college districts, each governed by a locally elected board of trustees. Each district has one or more colleges, each with its own administrative structure. Community college districts and individual colleges within districts have significant discretion in determining what programs they offer and how their resources are spent. Any district's or college's approach to its statewide mission is significantly shaped by local needs and circumstances. In order to do their job effectively, particularly in the areas of occupational education, non-credit basic skills, and English as a second language (ESL) instruction, the colleges must structure courses and programs in the context of local needs and in cooperation with local government and business organizations.

Linkage of Outcomes and Resources Could Satisfy State's Interest and Maintain Local Flexibility. Focusing on outcomes would allow the Legislature to ensure that the community colleges efficiently provide a quality education that meets statewide priorities, while continuing to give the colleges significant flexibility to provide educational services in locally appropriate ways. If the Legislature can develop consensus on a set of desirable outcomes, and develop measures that accurately and reliably gauge these outcomes, it could hold the colleges accountable for performance standards based on these measures, while avoiding micro-management of the processes by which the standards are met. Ultimately, the Legislature could implement performance budgeting so that its debate about fiscal inputs could be framed in terms of what is necessary to achieve desired outcomes.

Current Status: Community Colleges Not Accountable to the State for Improving Student Outcomes

In the discussion below, we present a working definition of accountability, and assess the state's efforts to hold the community colleges accountable for outcomes. We also note major federal accountability initiatives in higher education that affect the community colleges. We find that there is currently no system in place under which the state holds the community colleges accountable to produce desirable results. Even though the Chancellor's Office has made some substantial progress in its efforts to develop and report community college outcome measures, it does not yet report some key measures. Moreover, state policy makers have set few standards that define what outcomes they want the community colleges to achieve. Even where policy makers have set standards, there is no structure of outcome-based incentives or penalties that would drive the colleges toward meeting them.

What Is Accountability?

By "accountability," we mean a relationship in which one party—the community colleges—is responsible to other parties—the Legislature or students, for example—for performing to a specified standard. We view a system of accountability as having three key elements:

- A set of outcome measures that reliably and objectively measure performance.
- A set of performance standards defined in terms of these outcome measures.
- A set of incentives for meeting the standards and/or penalties for failing to meet them.

For example, the Legislature might want to hold the community colleges accountable for improving the success of students whose goal is to transfer to a four-year college or university. A performance measure related to this goal would be a transfer rate—for example, the proportion of successful transfers over a period of years among a group of students who indicated in a base year that transfer was their academic goal. The Legislature could set a performance standard by providing, for example, that the transfer rate should be no less than 50 percent—that is, at least half of the target group should succeed. Incentives could be created by setting aside some portion of community colleges funding to be distributed to districts on the basis of (1) attainment of the standard and (2) increases in the proportion of students in the target group that actually transfer.

State Initiatives in Outcome Measurement and Accountability

As a result of various state requirements, the community colleges Chancellor's Office now collects and reports—or will soon collect and report—data on a wide variety of student outcomes. Figure 33 summarizes the major requirements, including the outcome measures related to each. It also notes that there are few cases in which outcomes are required to meet a specific standard, and none in which failure to meet a standard has any consequence.

Figure 33

Community Colleges
Outcome Measures and Performance Standards:
Major State Requirements

CCC Accountability System	
Outcome Measures Required: • Student transfer rate • Student persistence from term-to-term • Student degree completion rate • Rate of course completion • Student rate of success in courses • Relationship of occupational programs to state's workforce needs • Influence of occupational programs on employment and earnings • Performance of remedial education and ESL programs • Student satisfaction	**Standards:** None **Incentives or Penalties:** None
Performance of Public Colleges and Universities	
Outcome Measures Required: • Retention and persistence of students • Number of degrees awarded by ethnicity of recipient and discipline	**Standards:** None **Incentives or Penalties:** None
Ethnic and Gender Representation	
Outcome Measures Required: 1. Student enrollment, by ethnicity and gender 2. Program completers and transfers, by ethnicity	Standards: 1. Not different from gender and ethnic composition of recent high school graduates 2. Not different from ethnic composition of current CCC total enrollment **Incentives or Penalties:** None
Various Program Evaluations	
Outcome Measures Required: Comparison of participants and non-participants by: • Student persistence • Program completion and transfer rates • Successful completion of courses	**Standards:** None **Incentives or Penalties:** None

AB 1725—Comprehensive Accountability System. Chapter 973 Statutes of 1988 (AB 1725, Vasconcellos) established the existing system of community college governance and the existing method of allocating general-purpose funding (apportionments) to community college districts. It also directed the Chancellor's Office to develop an "educational and fiscal accountability system" which would provide participants in the community college system sufficient information to (1) identify the strengths and weaknesses of the colleges, and (2) improve the educational quality of the colleges. This statute requires the Chancellor's Office to define measures of various outcomes (see Figure 33), and begin collecting and reporting information about these measures.

The Chancellor's Office has begun to report information on some of these outcomes: course completion rates, the number of pupils who obtain degrees and certificates, the number of students who transfer, and the rate at which students persist in community college enrollment from term to term.

Projects are underway that should soon yield information about transfer rates (the proportion of transfer-bound students who actually reach their goal), and about the influence of community college instruction on employment and earnings. A complete picture of the community colleges' performance in preparing students for transfer and success in upper division work at a four-year institution will not be available unless the state develops a student information system that is capable of tracking the progress of individual students between (1) the various community colleges, and (2) the community colleges and the state's other public higher education segments. Such a system would most reasonably be operated and maintained by the California Postsecondary Education Commission (CPEC).

The Chancellor's Office currently does not report information about the relationship between community college occupational programs and state/regional workforce needs, the success of remedial education and ESL programs, and student satisfaction.

AB 1808—CPEC Report on Performance of Public Colleges and Universities. Chapter 741, Statutes of 1991 (AB 1808, Hayden) requires the CPEC to report annually on various indicators of college and university performance. The report will ultimately include information on changes over time in retention rates of various categories of students, degrees awarded by discipline compared to estimated state workforce needs, and degrees conferred by ethnicity of degree recipients.

Various Requirements to Measure Program Effectiveness. Existing law requires the Chancellor's Office to report student outcomes in its annual review of the effectiveness of several restricted-purpose programs. For example, the Chancellor's Office periodically issues reports that compare outcomes of participants in programs for disabled students and socially and economically disadvantaged students with outcomes of non-participants. Outcomes measured include rate of degree completion, rate of occupational program completion, rate of successful course completion, and student retention. The Chancellor's Office requires the colleges to track and report information on similar outcomes for students in historically underrepresented groups as a part of its student equity initiative.

Chancellor's Office Management Information System (MIS). In order to support the various information collection and reporting activities required of the Chancellor's Office under existing law, the Legislature has provided $29.1 million since 1987-88 to establish the Chancellor's Office MIS. Figure 34 summarizes the objectives, funding, and implementation history of the MIS. Among other things, it shows that

Figure 34

Community Colleges
Management Information System (MIS) at a Glance

Objectives

To provide a research database that the Chancellor's Office can use for management purposes and to provide information about activities of the community colleges. Specifically:

- Provide information about student outcomes
- Track student progress over time
- Support Chancellor's Office and district accountability activities
- Address multiple reporting requirements from a single database
- Add flexibility to meet new information requirements

Funding History

Chancellor's Office

One-time: $4.6 million

Ongoing annual: Approximately $0.7 to $0.9 million

Local assistance

One-time: $24.5 million (includes $13.8 million for matriculation data processing. Matriculation program reports are now produced via the MIS.)

Implementation History

Pilot testing: 1987-88 through 1989-90

Phase 1: Funded 1989-90, most elements complete by June 1994
Information about: student characteristics, student support programs, certificate and degree completion, course outcomes

Phase 2: Funded 1992-93, complete by June 1995
Information about: staff characteristics, vocational education, basic skills instruction, transfers to four-year institutions

Phase 3: Not funded
Information about: district finances, district facilities, student services utilization, program and course approval

$24.5 million, or 84 percent, of MIS funding provided by the Legislature went to community college districts to support new information processing requirements of the system. The remaining $4.6 million has gone to the Chancellor's Office for implementation of the system.

At its current stage of implementation, the MIS is capable of providing a great deal of information about current student outcomes. More importantly, it can provide information about progress over time—starting as early as 1991-92—for students of various characteristics that may be of interest to policy makers. How this information will be used to improve outcomes and progress has yet to be determined.

Federal Initiatives in Outcome Measurement and Accountability

Figure 35 summarizes various federal accountability initiatives, and the information that the community colleges will have to report in response to each. Two of these initiatives do set performance standards. In one case, the penalty for non-compliance is potentially severe.

State Postsecondary Review Entity (SPRE). Congress created the SPRE program in 1992 to help prevent fraud and abuse by institutions participating in federal student financial aid programs. Federal statute requires that any postsecondary institution participating in these programs which meet certain review criteria (a high student loan default rate, for example) be referred for review to a designated state entity. The Governor has designated the California Postsecondary Education Commission (CPEC) as California's SPRE.

The CPEC has developed a set of standards according to which it would review referred institutions. As Figure 35 shows, the standards applicable to the CCC include four that are outcome-based. These standards relate to rates of completion, withdrawal, employment, and licensure.

The CPEC has submitted its proposed SPRE standards to the U.S. Department of Education (USDE) for approval, and is seeking legislation to establish them as state regulations. If they are approved, any CCC that is referred to the SPRE and fails to meet the standards would have to pursue corrective action. In a serious case, the USDE could terminate a college's participation in all federal financial aid programs for failure to meet the standards.

Figure 35

Community Colleges
Outcome Measures and Performance Standards: Major Federal Requirements

State Postsecondary Review Entity (SPRE)	
Outcome Measures Required:	**Standards:**
1. Program completion and transfer rate	1. Number of completers and transfers at least 11 percent of Fall enrollees with degree, certificate, or transfer as primary goal
2. Student withdrawal rate	2. Meet federal standards
3. Student employment rate in students' vocational fields	3. Placement rate of no less than 70 percent
4. Student licensure rate	4. No less than 1 standard deviation below average licensure rate reported by the licensing agency
	Incentives or Penalties: Penalty in a serious case—loss of eligibility for federal financial aid programs
Student Right-to-Know Requirements	
Outcome Measures Required: • Program completion and graduation rates	**Standards:** None **Incentives or Penalties:** None
Carl D. Perkins Vocational and Applied Technology Education Act	
Outcome Measures Required: • Student success: Percent of students who earn "C" or better in specified courses • Student retention: Percent of students who complete course with "D" or better • Student placement: Percent of course completers who go on to employment or other training • Student wages during and after CCC enrollment	**Standards:** No less than statewide average rate in all vocational programs **Incentives or Penalties:** None

Student Right-to-Know. The USDE is currently developing regulations that will require any postsecondary institution that participates in a federal financial aid program to provide certain information about the institution to all enrolled and prospective students. Among the things that community colleges (and other California postsecondary institutions) would have to disclose is a completion or graduation rate for their students.

Carl D. Perkins Vocational and Applied Technology Education Act. The Perkins Act determines how federal funds for vocational education are allocated to the states. It holds community college districts (and other recipients of federal vocational education funds) accountable for outcomes that result from the use of federal funds, and requires them to evaluate vocational programs annually using measurable, objective criteria. In response, the state has developed a system of "core measures and standards" applicable to secondary and postsecondary institutions that receive federal funds under the Perkins Act.

Within this system, community colleges are expected to be at the statewide average or show progress toward the statewide average in each of the following measures:

- Successful course completion: Percent of students who earn a grade of "C" or better in vocational education courses that (1) integrate academics into the vocational curriculum and (2) lead to a degree or certificate.
- Retention: Percent of students who complete vocational education courses with a grade of "D" or better.
- Placement: Percentage of course completers who (1) are placed into employment, (2) transfer to higher education, or (3) progress to additional training.

The Chancellor's Office, in cooperation with the Employment Development Department, is developing a data base which will enable the colleges to track the placement and wages of any student who earns 12 or more units of credit in vocational education courses. While this data base is being developed primarily to provide colleges with the means of fulfilling the Perkins Act requirements for program improvement, it will also be a rich source of information on issues of concern to state-level policy makers:

- What are the employment rates and earnings of former community college students with various characteristics (gender, ethnicity, English proficiency, disability, etc.)?
- What difference does attainment of a degree or certificate make for placement and earnings?
- What difference does major field make in job placement and earnings of former students?
- Where geographically, and in what industries have former students found employment?

- How effective are student services and special programs that attempt to increase the employability of students?

Community Colleges Should Move Toward Performance-Based Budgeting

To date, the state's investment in a community college performance measurement and accountability system has yielded a quite sophisticated means of collecting and reporting information on student outcomes and the status of the community colleges generally. The Chancellor's Office MIS has the potential of providing policy makers with (1) information about the status of a vast variety of student outcomes, and (2) a means of examining the linkage between program interventions and student outcomes.

At this time, however, there is no clear set of standards that allow this information to be meaningfully interpreted as a measure of performance, and no clear motivational force to drive the community colleges toward program improvement on the basis of this information. In a recent paper, William Armstrong, Director of Research and Planning for the San Diego Community College District, provided the following apt summary of the current linkage between outcome measurement and program improvement:

> "[It is] an assumption that the collection, aggregation, and dissemination of data will create a climate for accountability that will provide its own impetus for positive change and improvement among staff. However, how this is to occur beyond merely reporting benchmark data is unclear."

The collection and reporting of outcome data may create some momentum for improvement. We recommend, however, that the Legislature take a more direct approach to accountability by (1) ensuring that measures of the key outcomes identified in AB 1725 are reported annually in a public forum, (2) charting the course that it wishes the community colleges to follow by establishing outcome-based performance standards, and (3) providing budget-based incentives that reward improvement toward those standards.

Recommendation of a specific performance-based budgeting system for the community colleges is beyond the scope of this analysis. We do suggest, however, some criteria that we believe such a system should meet. Moreover, we recommend that the Legislature go on record through supplemental report language that it intends for the Chancellor's Office, in consultation with the CPEC and appropriate legislative staff, to develop a proposal for a performance-based budget that could be tried on pilot basis in 1996-97.

Criteria for a Performance-Based Budgeting System

We suggest that a performance-based budgeting system for the community colleges should meet the following criteria.

Focus on Program Improvement. This means that a system should reward value added (improvement from a baseline), as well as attainment of a standard. For example, a standard might be: at least 75 percent of students who successfully complete remedial English courses and enroll in a college-level English course should successfully complete the college-level course. In this case, the system should reward the district that increases its performance from 50 to 60 percent, as well as the district that attains 75 percent. This would recognize that the community colleges start from different levels of performance. By immediately rewarding incremental improvement, it would encourage efforts to make further progress.

Recognize Goal Diversity. An accountability system should contain standards and measures that pertain to the whole spectrum of missions pursued by the community colleges. Degree/certificate completion and transfer rates capture an important part of what the colleges do, but are not the whole story. Policy makers also need, for example, a window to the effectiveness of community colleges efforts in the area of remedial and basic skills education. During our visits to the field last Fall, administrators and faculty told us repeatedly that many students attend the community colleges only long enough to complete a course or two that are necessary for them to retain their existing employment, or to move on to another job. An accountability system, therefore, should also include some general measure of student goal satisfaction and earnings improvement to capture the difference community colleges make for students who, for various personal reasons, do not persist to the point of completing an academic or vocational program.

Reward Efficiency. Based on our four-year outlook for Proposition 98 funding (please see our K-12 Budget Priorities section for details), it appears that even in the best case, community colleges will receive very little funding for program improvement (funds in excess of statutory growth and COLA). Together with K-12 education and a host of other government programs, the community colleges will be challenged to improve student outcomes with few additional resources. Consequently, we believe that an accountability system should reward increases in productivity and efficiency. For example, a college should be rewarded if it is able to maintain or increase the percentage of students who successfully complete freshman English, while reducing through technology or other means the cost per student contact hour of this program. Improved efficiency in the utilization and operation of a college's physical plant could also be rewarded.

Focus on Incentives. We make this suggestion for the purely practical reason that incentives (rewards for achievement) are more likely to be consistently applied than penalties (take-aways for failure). In an atmosphere of continued fiscal constraints, with community college budgets expanding a little more or a little less than the rate of inflation, we anticipate that it will be very difficult for policy makers to take resources away from low-performing districts. By the same reasoning, we also anticipate that (1) it will be difficult as a practical matter to redistribute base funding among districts on the basis of performance—even through incentives—and (2) there will be little new money beyond growth or COLA—termed "program improvement" funds in CCC regulations—that could potentially be allocated on a performance basis.

In order to provide meaningful incentives for improved outcomes even when program improvement funds are not available, we suggest that a significant part of the annual COLA be allocated on a performance basis. Should any available program improvement funding become available, we suggest that it also be allocated on a performance basis.

Protect Access. Access to the community colleges is not strictly an outcome. We suggest, however, that it be treated as an outcome for the purposes of an accountability system. This is because maintaining access to higher education for all California adults is a crucial mission of the community colleges. Performance-based budgeting, without appropriate controls, could lead the colleges to informally screen out the students that they believe are least likely to perform well. These may be the very students, however, that the Legislature wants colleges to serve as a high priority. Consequently, the Legislature may wish to reward colleges that improve or maintain access as measured, for example, by improvements in the ratio of regional high school graduates that attend a college, or by increases in enrollment of groups traditionally underrepresented at a college.

CCC Should Pilot Performance-Based Budgeting in 1996-97

We recommend that the Legislature supplemental report language that requires the CCC Chancellor's Office, in consultation with the CPEC, to develop a proposal for a pilot performance-based budgeting

program that would, beginning in 1996-97, allocate a portion of state aid to the CCC based on attainment of, or improvement towards, performance standards.

In order to move the community colleges forward toward accountability for student outcomes, we recommend that the Legislature adopt supplemental report language that requires the Chancellor's Office, in consultation with the CPEC, to:

- Report annually, beginning in November 1995, data on specified student outcomes.
- Develop standards related to these outcomes that define a reasonable expectation of the quality of education to be provided by the community colleges.
- Develop a proposal for a pilot performance-based budgeting program that would, beginning in 1996-97, allocate no less than one-third of the amount provided for an apportionment COLA based on attainment of, or improvement toward, these standards.

Specifically, we recommend the following language:

> ***Reporting of Outcome Measures.*** It is the intent of the Legislature that the CCC Office of the Chancellor, in consultation with the CPEC, shall establish and annually report data for a broad range of student outcomes. The outcomes measured shall be generally consistent with the outcomes required to be measured under the comprehensive community college accountability system mandated in Ch 973/88 (AB 1725, Vasconcellos). At a minimum these outcomes shall include: transfer rate, degree and certificate completion rate, average time to degree/certificate or transfer, rate of successful course completion, job placement and earnings improvement for vocational program completers, student satisfaction, weekly student contact hours per faculty member, a measure of the effectiveness of remedial credit education in preparing students for success in college level courses, and a measure of access. Baseline data shall be reported in the CPEC's November 1995 report, mandated by Ch 741/91 (AB 1808, Hayden), on significant indicators of the performance of California's higher education segments. If baseline data on these outcomes cannot be presented in November 1995, the Chancellor's Office shall report to the Joint Legislative Budget Committee no later than November 30, 1995 (1) the reasons that the data cannot be reported, and (2) the steps it will take to ensure that baseline data can be reported by November 1996.

We also recommend the following language:

> ***Performance-Based Budgeting.*** It is the intent of the Legislature that the CCC Office of the Chancellor, in consultation with the CPEC and appropriate legislative staff, shall develop performance standards related to the following outcomes, that define a level of educational quality that can reasonably be expected of the community colleges: transfer rate, degree and

certificate completion rate, average time to degree/certificate or transfer, rate of successful course completion, job placement and earnings improvement for vocational program completers, student satisfaction, weekly student contact hours per faculty member, a measure of the effectiveness of remedial credit education in preparing students for success in college level courses, and a measure of access. No later than November 1996, the Chancellor's Office shall propose a pilot performance budgeting program, together with any necessary statutory or regulatory changes, whereby the Chancellor's Office would allocate no less than one-third of the 1996-97 community colleges COLA on the basis of attainment of, or improvement toward, these standards.

STUDENT AID COMMISSION (7980)

The Student Aid Commission (SAC) provides financial aid to students through a variety of grant, loan, and work-study programs. The proposed 1995-96 SAC budget is $624 million, which represents a $16 million (2.6 percent) increase compared to estimated current-year expenditures. The commission receives about 60 percent of its funding from federal funds. Most of the remaining funding is from the General Fund, of which the vast majority is for the Cal Grants Program.

The Cal Grants Budget Should Reflect Fee Increases at UC and CSU

We recommend approval of the proposed $11.5 million General Fund increase for Cal Grants to conform to the fee recommendations in our proposed budgets for UC and CSU.

The budget provides $242 million from the General Fund to the SAC for local assistance. This represents a $16 million, or 7 percent, increase compared to estimated current-year expenditures.

Of the increased amount, $3 million is to fund changes in the mix of Cal Grant students and $1.4 million is to backfill a loss of federal funds. The remaining $11.5 million is to offset 10 percent fee increases for Cal Grant recipients who attend the UC and the CSU. The budget indicates that fees "are anticipated to increase by at least 10 percent, which is the basis for the amount proposed. If fees increase by a larger amount, additional funding will be considered."

We recommend approval of the $4.4 million proposed to fund changes in the mix of Cal Grant students and backfill the loss of federal funds. Since we recommend a fee increase of 10 percent for undergraduates at UC and CSU (please see our analysis of this issue in the UC and CSU items), we also recommend approval of the $11.5 million proposed increase to offset the effect of those fee increases.

Legislative Oversight: Federal Audit, Automation, and Management Issues

We recommend that the SAC report at budget hearings on its progress in addressing significant concerns raised by a federal audit and independent reports on the automated Financial Aid Processing System (FAPS) and on the SAC management structure.

During various legislative policy and budget hearings in spring 1994, the SAC was requested to keep the Legislature informed about key issues relating to a major federal audit, FAPS, and SAC management. We provide brief updates on these issues below.

Federal Audit. In 1993-94, the U.S. Department of Education (USDE) concluded that the SAC owed at least $49 million from the loan fund to the federal government related to various audit exceptions. Specifically, the USDE found that the SAC did not provide sufficient oversight on some loan claims and did not process claims and pay lenders for defaulted loans in a timely manner. In our *Analysis of the 1994-95 Budget Bill*, we noted that the SAC was appealing the USDE's findings. Most importantly, the SAC claimed that much of the at least $49 million figure was based on projections from inadequately small and statistically invalid samples. The SAC reported at budget hearings on the progress of its appeal, per our recommendation.

In August 1994, the USDE rejected the SAC's appeals and requested the repayment of $62.6 million from the loan fund within a month. In response, the SAC filed suit in the northern California U.S. District Court requesting that the court stop the USDE's request from being implemented. While the SAC acknowledged that it was late in paying lenders' claims, the SAC (in addition to repeating the claims cited above) alleged that the lenders and the federal government did not suffer any net monetary losses as a result.

In late October 1994, the Chair of the SAC reported that "discussions (with the USDE) have been very fruitful to date." At the time of this analysis, SAC staff indicated that discussions between the SAC and USDE were continuing, but that information on the exact nature of the discussions could not be shared as a result of the confidentiality surrounding the lawsuit.

FAPS Implementation Problems. The automated FAPS system has been in operation since May 1990 for the Cal Grants program and since January 1993 for the federal loan programs. In June 1994, the Department of Finance's Office of Information Technology indicated that the system's total costs were $51 million—$18 million for development and $33 million for ongoing operation.

In early 1994, a draft independent report by Deloitt & Touche raised several significant concerns about FAPS. Major short-term concerns included the lack of documentation of the FAPS computer programs and the faulty method for determining some loan repayment refunds and liabilities. The major longer-term issue identified was the need for "at least partial, if not total, replacement" of FAPS. (The final report, issued in September 1994, contained no significant changes to the draft report's findings.)

The Legislature adopted supplemental language to the 1994 Budget Act, per our recommendation, requesting that the SAC report by March 1, 1995 on its progress in addressing each of the report's major issues and recommendations. SAC staff advise us that most of the short-term issues have been addressed. At the time of this analysis, the SAC had not determined how to address the longer-term issue of FAPS replacement and in fact was proceeding with "re-procurement" plans to continue the current system for at least another two to three years.

Management Issues. In spring 1994, an independent report by MGT Associates identified numerous management problems within the SAC, including communications problems between the SAC, schools, and lenders. The report found that the SAC "must address and fix shortcomings of FAPS as soon as possible in order to restore the confidence of its staff and customers in the agency's short-term and long-term capability to provide excellent services."

The Legislature adopted supplemental language to the 1994 Budget Act, per our recommendation, requesting that the SAC report by March 1, 1995 on its progress in addressing each of the report's major issues and recommendations. At the time of this analysis, the SAC staff indicated that many recommendations had been addressed and that action will not be taken on others (primarily the creation of high level financial and information services positions) until a new Executive Director is hired.

Recommendation. The Legislature has expressed considerable interest in the issues identified above. The SAC indicates that additional information will be available on these issues this spring. Accordingly, we recommend that the SAC report at budget hearings on its progress in addressing the significant concerns raised by the federal audit and independent reports on FAPS and the SAC's administration, including the SAC's plans regarding the replacement and reprocurement of FAPS.

Related Issues

The Governor's Budget proposes $500,000 to fund student financial aid counseling services through the K-12 budget. The funds would be used to expand services that are currently provided through the SAC-administered California Student Opportunity and Access Program (Cal-SOAP). Please see our analysis of intersegmental issues in the "K-12 Budget Priorities" section.

List of Findings and Recommendations

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Crosscutting Issues

1.	**Higher Education Four-Year Plan.** Recommend that the Legislature review the administration's proposed UC and CSU budget "compact," which would absorb an additional $1.1 billion of General Fund resources on a cumulative basis over the next four years, in the context of its overall budget priorities. The Legislature needs to consider whether it wishes to "guarantee" a portion of the budget a specified rate of growth over a time period when the state's fiscal condition will be tight.	F-16
2.	**UC and CSU Faculty Salaries.** Recommend that the Legislature direct the California Postsecondary Education Commission to consider an alternative faculty salary methodology because the current one is flawed.	F-22
3.	**Outcome Measures.** New information is available on several higher education outcome measures. In the future, the Legislature and the higher education systems will need additional information on these and other "performance" measures.	F-28
4.	**Graduation Rates.** A high proportion of UC and CSU freshmen and transfer students graduate.	F-29
5.	**Four-Year Degree Pledge.** At the time of budget hearings, the Legislature will have updated information available on the development of four-year degree pledge programs and related measures at each UC and CSU campus.	F-31
6.	**Degrees Conferred and Work-Force Needs.** In recent years, social science and humanities degrees conferred have outpaced the growth of science and engineering degrees at the UC and CSU. The number of life and physical science degrees and certificates has grown significantly faster at the	F-32

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CCC, but remain a much smaller portion of the total.	
7. **Racial and Ethnic Diversity of BA Degree Recipients.** The racial and ethnic diversity of undergraduate degree recipients has increased but there continue to be disparities between the racial and ethnic diversity of high school graduates compared to college graduates.	F-37

University of California

8. **UC Alternative Budget Proposal.** Recommend that the Legislature take a variety of actions—in line with the principles we identify—in crafting a UC budget plan.	F-43
9. **Faculty and Staff Salary Increases.** Recommend expenditures of $79.2 million to provide a 3 percent faculty salary increase, a 1.2 percent staff salary increase, and merit salary increases for UC faculty and staff on July 1, 1995, and fund the continuation costs of salary increases provided in the current year.	F-45
10. **Cost of Continuing Various Programs.** Recommend the expenditure of $16 million for price increases and maintenance of new space.	F-46
11. **Critical Needs.** Recommend the expenditure of $34 million in the critical areas of deferred maintenance, instructional equipment replacement, and library materials.	F-46
12. **Undergraduate Student Fees.** Recommend that undergraduate student fees be increased by $380 (10 percent)—from $3,799 to $4,179.	F-47
13. **Graduate Student Fees.** Recommend that graduate student fees be increased by amounts ranging from $200 to $4,376 above the general fee increase for undergraduates.	F-49
14. **Student Financial Aid.** Recommend the expenditure of $23.7 million for additional student financial aid for needy students to offset our recommended fee increases.	F-51
15. **Teaching Hospitals Redirection.** Recommend redirection of $9 million of teaching hospital net gains to fund campus-	F-51

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	based programs, consistent with previous legislative actions.	
16.	**Debt Financing for Deferred Maintenance.** To avoid debt financing for ongoing deferred maintenance needs, we recommend that the Legislature reject the budget proposal to authorize a $25 million loan for deferred maintenance projects in 1995-96, and fund these projects instead through a redirection of $25 million in federal overhead receipts.	F-52
17.	**Federal Overhead Funds.** Recommend that the Legislature direct the UC Regents to enter into a new agreement with the state regarding federal overhead funds to (1) better account for direct administration costs, (2) fund critical deferred maintenance needs, and (3) increase the state's share of the remaining funds.	F-54
18.	**Redirection of Research Support.** Recommend redirection of $24.8 million of General Fund research support to address instruction-related costs.	F-58
19.	**Student-Faculty Ratio.** Recommend the expenditure of $13.5 million related to changes in the UC's budgeted student-faculty ratio (SFR), consistent with previous legislative actions. Ultimately, this change will avoid future enrollment-related costs of approximately $55 million annually.	F-60
20.	**Specify Enrollment Levels.** Recommend that the Legislature specify an enrollment level for 1995-96 in supplemental report language.	F-61
21.	**Long-Range Teaching Hospital Planning.** Recommend that the Legislature request the UC to report next year on long-term implications of managed care and other health care changes on support for medical education in teaching hospitals.	F-61
22.	**One-Time Carryover Funds.** Recommend that the Legislature establish limits on, and priorities for, the use of one-time carryover funds in Budget Bill language.	F-62

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32.	**Specify Enrollment Levels.** Recommend that the Legislature specify an enrollment level for 1995-96 in supplemental report language.	F-73
33.	**Debt Financing for Deferred Maintenance.** Recommend that the CSU report at budget hearings on its funding plans for deferred maintenance in the current year. Further recommend that the Legislature avoid debt financing for deferred maintenance in 1995-96.	F-74
34.	**One-Time Carryover Funds.** Recommend that the Legislature adopt Budget Bill language establishing limits on, and priorities for, the use of one-time carryover funds given serious concerns about the CSU's recent actions.	F-75

California Community Colleges

35.	**Use Enrollment Growth Funding For its Intended Purpose.** Recommend Budget Bill language and supplemental report language to ensure that the California Community Colleges (CCC) uses current- and budget-year enrollment growth funding for that purpose.	F-82
36.	**$15.2 Million Funding Reduction Reflects Past-Year Workload Decline.** Recommend approval of a proposed $15.2 million General Fund reduction that recognizes past-year enrollment declines. Further recommend Budget Bill language that would (1) prevent budget-year enrollment reductions as a result of this reduction, and (2) allocate this reduction among districts in proportion to past-year enrollment declines.	F-84
37.	**Balance Fee Levels and Program Quality.** Recommend approval of budget proposals to (1) increase regular student fees from $13 per credit unit to $15 per credit unit, and (2) continue the differential fee for BA holders at $50 per credit unit.	F-86
38.	**Some Puente Project Funding Should be Redirected.** Recommend approval of a proposed $245,000 General Fund augmentation to support expansion of the Puente Program.	

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	Recommend that the remaining $125,000 augmentation be directed to other K-14 programs, because it would supplant existing private support for the project.	F-87
39.	**GAIN: Federal Funds.** Recommend that the CCC Chancellor's Office report to the budget committees by April 1, 1995, on the number of GAIN students served for whom federal matching funds are not claimed.	F-88
40.	**CCC Should Move Toward Performance-Based Budgeting.** Recommend supplemental report language that requires the CCC Chancellor's Office, in consultation with the CPEC, to develop a proposal for a pilot performance-based budgeting program that would, beginning in 1996-97, allocate a portion of state aid to the CCC based on attainment of, or improvement towards, performance standards.	F-101

Student Aid Commission

41.	**Student Aid Commission Budget.** Recommend approval of the proposed $11.5 million General Fund increase for Cal Grants to conform to the fee recommendations in our proposed budgets for the UC and CSU.	F-104
42.	**Audit, Automation, and Management Issues.** Recommend that the SAC report at budget hearings on its progress in addressing significant concerns raised by a federal audit and independent reports on the automated Financial Aid Processing System (FAPS) and on the SAC management structure.	F-105