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Amy M. Elliott

BY: _____
(DEPUTY ATTORNEY GENERAL)

JUL 08 2014

DATE OF APPROVAL

Check if applicable
Copy not approved. Objections attached.

Copy below is here by certified to be a true and correct copy of a document issued, prescribed or promulgated by:

State Board of Education
(AGENCY)

DOCUMENT/FISCAL NOTE NO. 6-329

DATE OF ADOPTION: November 14, 2013

BY: *Karen McClain*

TITLE Executive Director
(EXECUTIVE OFFICER, CHAIRMAN OR SECRETARY)

Copy below is hereby approved as to form and legality. Executive or Independent Agencies.

[Signature]

MAY 28 2014

DATE OF APPROVAL

Deputy General Counsel
(~~Chief Counsel, Independent Agency~~)
(Strike inapplicable title)

Check if applicable. No Attorney General approval or objection within 30 days after submission.

PROPOSED RULEMAKING

STATE BOARD OF EDUCATION

[22 PA. CODE CH. 18]

Financial Recovery

The State Board of Education (Board) adopts Chapter 18 (Financial Recovery) as a proposed rulemaking to read as set forth in Annex A. The Board is acting under the authority of section 6-621-A(a)(2)(i) of the Public School Code of 1949 (24 P.S. § 621-A(a)(2)(i) (relating to issuance of declaration)).

Purpose

This proposed rulemaking establishes criteria the Secretary of Education may consider in determining whether to place a school district in financial recovery status and provides guidance to the Secretary in determining whether a district would be deemed in either moderate or severe recovery status.

Background

Act 141 of 2012 added section 621-A(a)(2)(i) to the Public School Code, which identifies 15 criteria the Secretary of Education (Secretary) may consider in determining whether to issue a declaration that a school district is in financial recovery status. That same section of the Public School Code directs the Board to promulgate regulations that establish additional criteria the Secretary may consider in determining whether to issue a declaration of financial recovery status and whether a financial recovery school district should be deemed in either moderate or severe recovery status.

In promulgating the regulations mandated by Act 141, the Board was required by section 6-621-A(a)(2)(ii)(A) of the School Code (24 P.S. § 621-A(a)(2)(ii)(A)) to convene and consult with a statewide Advisory Committee comprised of representatives of the Department of Education and the Governor's Office of the Budget, and a superintendent, school board member and school business official representative of urban, rural and suburban school districts. The Advisory Committee convened four times throughout the fall of 2012 to develop a draft proposed regulation for the Board's consideration. All Advisory Committee meetings were open to the public and public comment was invited at each convening.

From its first meeting on September 6, 2012, through the conclusion of its deliberations on December 6, 2012, the Advisory Committee worked in conjunction with the Board's Standing Committee on Financial Recovery. The full Board was kept abreast of the Advisory Committee's work through regular reports of the chairman made during the Board's bi-monthly public meetings.

In the early stages of its deliberations, the Advisory Committee reviewed its statutory charge and received a presentation on Act 141 so that Advisory Committee members had a comprehensive understanding of how their work fit into the broader system of supports for struggling school districts established by the General Assembly in the Act. This included receiving a presentation on the new Early Warning System developed by the Department of Education (Department) to identify districts that show indications of financial challenges and provide them with technical assistance early on in the hopes that their challenges may be addressed before a declaration of financial recovery status would become necessary.

In the next stage of its deliberations, the Advisory Committee reviewed approaches used by other states to identify school districts facing financial challenges and discussed whether criteria used by those states were factors that should be included in the Board's regulation. In total, the Committee reviewed relevant policies in Michigan, California, Texas, Florida, Arizona and Illinois. Finally, the Advisory Committee also reviewed other Pennsylvania laws concerning financially distressed entities to inform itself of the criteria used in other Commonwealth policies to classify distressed local governments.

Upon receiving the Advisory Committee's recommendation on Chapter 18, the Board's Standing Committee on Financial Recovery held a public meeting on January 9, 2013, and adopted amendments to further refine areas where the Standing Committee felt the Advisory Committee's recommendation needed greater clarity. The proposed Chapter 18, as approved by the Standing Committee on Financial Recovery, was then presented for additional comment to both the Board's Council of Basic Education at its public meeting on January 9, 2013, and the full State Board of Education at its public meeting on January 10, 2013. Both the Council and the Board provided an opportunity for public comment prior to approval of the proposed regulation.

Subsequently, the Board withdrew its proposed rulemaking to engage in continued discussion of the criteria identified for the Secretary's consideration. On November 14, 2013, the Board discussed and approved a revised rulemaking that removed criteria that were identified as being duplicative and, therefore, unnecessary. An additional opportunity for public comment was made available prior to the Board's

consideration of the revised proposed rulemaking at its public meeting on November 14, 2013.

Provisions of the Proposed Rulemaking

The regulations establish a new chapter – Chapter 18 – to address the requirements outlined in section 621-A(a)(2)(i) of the School Code. Major components of the regulation include:

Issuance of Declaration

Sections 18.4 and 18.5 address the issuance of a declaration of financial recovery status.

Section 18.4 (relating to issuance of declaration under section 621-A(a)(1) of the School Code). This section reflects statutory criteria that require the Secretary to place a school district in financial recovery status and is included in the proposed regulations for completeness. The section also contains, again for completeness, statutory provisions that allow the Secretary to decline to issue a declaration of financial recovery status to districts that meet the criteria established in section 621-A(a)(1) of the School Code if the circumstances facing a district were caused by an emergency that occurred within the past five years and that prohibit a district from being placed under such a declaration if its financial circumstances were caused by the failure of the Commonwealth to make timely payments of state or federal funds due to the district.

Section 18.5 (relating to issuance of declaration under section 621-A(a)(2) of the School Code). This section establishes criteria the Secretary may consider in determining whether to issue a declaration that a school district is in financial recovery status. Section 621-A(a)(2) of the School Code identifies 15 criteria that the Secretary may consider in

deciding whether to issue a declaration. Those 15 statutory criteria are included in the proposed regulation for completeness and are reflected in § 18.5(a)(1)-(6), (9)-(16) and (18).

The Board is proposing 3 additional criteria for the Secretary's consideration in determining whether to issue a declaration of financial recovery status:

Section 18.5(a)(7) and (8): The Board is proposing to include the criteria proposed in § 18.5(a)(7) and (8) because they are conceptually congruent to the criteria identified in section 621-A(a)(2)(i)(F) of the School Code (*this statutory criteria is reflected in § 18.5(a)(6) of proposed Chapter 18*). Section 18.5(a)(6) directs the Secretary to consider whether a district is subject to withholding of state appropriations because the district met statutory thresholds that allow for withholding due to missed bond payments. The Board is proposing that the Secretary take into consideration whether a district is subject to withholding of state appropriations because the district met other statutory thresholds that allow for withholding either due to missed payments to the State Public School Building Authority or missed SWAP payments.

Section 18.5(a)(17). The Board is proposing this criterion as a means for the Secretary to assess districts facing a deficit situation by directing the Secretary to examine whether a district is experiencing a deficit of 3 percent or more for three consecutive years that results in an annual reduction of the district's unassigned fund balance. The Board recognizes that there are circumstances where deficit spending may be appropriate, including situations where a district is tapping its fund balance to meet pension obligations or to avoid increasing taxes. To address the use of fund balance in such circumstances, the Board has focused the proposed criterion on comparing a district's deficit only to reductions in a district's unassigned fund balance, recognizing that these appropriate uses of fund

balance should have a dedicated purpose and not fall into the category of unassigned expenditures. Further, the Board crafted the criterion to look only at deficits of 3 percent or more that continue for 3 consecutive years to avoid identifying districts that are experiencing short-term circumstances that result in a deficit situation. The proposed regulation also includes a safeguard for districts experiencing circumstances outside of their control from being identified for a declaration of recovery status by including a provision in § 18.5(c) that would allow the Secretary to decline to issue a declaration if a district's challenges were caused by an emergency. This provision could prevent identification of districts that may need to tap unassigned fund balance to address extenuating circumstances.

Section 18.5(b). Section 621-A(b) of the School Code (24 P.S. § 6-621-A(b)) prohibits the Secretary from placing a school district in financial recovery status if the circumstances facing a district were caused by the failure of the Commonwealth to remit timely payments of state or federal funds owed to the district. This statutory limitation is included in the proposed regulations for completeness.

Section 18.5(c). Section 621-A(a)(1)(ii)(B) of the School Code (24 P.S. § 6-621(a)(1)(ii)(B)) grants the Secretary the discretion to decline to issue a declaration of financial recovery status to districts subject to a designation by section 621-A(a)(1) of the School Code if the Secretary determines that the circumstances facing a district were caused by an emergency that occurred within the past 5 years. The Board is proposing to extend this provision to districts potentially subject to a declaration of financial recovery status under § 18.5 to grant the Secretary discretion to decline to issue a declaration of financial recovery status in all situations where the circumstances facing a district were caused by an emergency that occurred within the past 5 years.

Section 18.5(d). The Board is proposing to require the Secretary to identify which criteria were used as the basis for issuing a declaration of financial recovery status when making such a declaration.

Limitations

Section 18.6(a). Section 621-A(a)(1)(ii)(A) of the School Code (24 P.S. § 6-621(a)(1)(ii)(A)) limits the number of school districts that may be in either financial recovery status or receivership at any one time to 9. This statutory limitation is included in the proposed regulations for completeness.

Section 18.6(b). The Board is of the opinion that declarations of financial recovery status should be based on the most current information available to the Secretary. To provide guidance to the Secretary in executing decisions based on the criteria proposed in § 18.5(a), the Board is proposing that the Secretary not use information related to the criteria that is more than 5 years old. The Board is proposing a 5-year period based on a provision in the underlying statute (section 621-A(a)(1) of the School Code) that allows the Secretary to consider a 5-year period in determining whether circumstances facing a district were caused by an emergency.

Moderate and Severe Recovery Status

Section 18.7. This proposed section would provide guidance to the Secretary in determining whether a financial recovery school district will be deemed in either moderate recovery status or severe recovery status. The Board is proposing that such decisions be guided by whether a district is unable, or is reasonably unlikely to be able, to access enough revenue to complete the current school year or to fulfill the required amount of instruction to complete the forthcoming school year. The proposed regulations would guide the Secretary

to issue a declaration of severe recovery status to districts that would not be able to access enough revenue to complete the required instruction.

Appeal

Section 18.8. Section 621-A(c) of the School Code (24 P.S. § 6-621-A(c)) provides for declarations of financial recovery status to be subject to appeal under the Administrative Agency Law (2 Pa.C.S. §§ 501-08, 701-04) and is included in the proposed regulation for completeness.

Affected Parties

The proposed rulemaking would guide the decision-making of the Secretary of Education and affect work of the Department's staff.

Cost and Paperwork Estimates

The proposed rulemaking establishes new responsibilities for the Secretary of Education and staff of the Department of Education to collect and analyze information, as well as to support certain legal procedures. State government incurred one-time costs of \$75,000 in the 2012-13 fiscal year to develop, populate and reconcile models to be used by the Department for information collected relevant to the Department's Early Warning System and criteria identified in the proposed regulation.

Beginning in the current fiscal year, the Department estimates it would incur an annual cost of \$549,080 to support staffing necessary to carry out the requirements of the proposed rulemaking. Specifically, the Department anticipates the following implementation costs: \$399,500 to annually support 1-2 full-time equivalent employees, plus outside counsel, to undertake legal procedures associated with opinions, declarations, appeals, petitions, contracts and challenges; \$72,500 to annually support one

full-time equivalent staff to coordinate and consolidate information, communications and procurement; and \$77,080 to support staffing to conduct preliminary reviews, request and review information, produce summary reports and provide expert advice to the Department.

Effective Date

The proposed rulemaking would become effective upon final publication in the *Pennsylvania Bulletin*.

Sunset Date

The Board will review the effectiveness of Chapter 18 every 4 years in accordance with the Board's policy and practice respecting all of its regulations. Thus, no sunset date is necessary.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P.S. § 745.5(a)), on July 8, 2014, the Board submitted a copy of this proposed rulemaking and a copy of a Regulatory Analysis Form to the Independent Regulatory Review Commission (IRRC) and to the Chairpersons of the House and Senate Committees on Education. A copy of this material is available to the public upon request.

Under section 5(g) of the Regulatory Review Act, IRRC may convey any comments, recommendations or objections to the proposed rulemaking within 30 days of the close of the public comment period. The comments, recommendations or objections must specify the regulatory review criteria that have not been met. The Regulatory Review Act specifies detailed procedures for review, prior to final publication of the

rulemaking, by the Board, the General Assembly and the Governor of comments, recommendations or objections raised.

Public Comments and Contact Person

Interested persons and individuals affiliated with small businesses are invited to submit written comments, questions, suggestions, commendations, concerns, or objections regarding this proposed rulemaking to Karen Molchanow, Executive Director, State Board of Education, 333 Market Street, Harrisburg, PA 17126, ra-stateboardofed@pa.gov. Comments must be submitted to Board within 30 days of publication of this notice of proposed rulemaking in the *Pennsylvania Bulletin*.

Persons with disabilities needing an alternative means of providing public comment may make arrangements by calling Karen Molchanow at (717) 787-3787 or TDD (717) 787-7367.

KAREN MOLCHANOW,
Executive Director