

CONNECTICUT SCHOOL FINANCE PROJECT



AN ANSWER TO CONNECTICUT'S SPECIAL EDUCATION FUNDING CHALLENGES

Introducing the Special Education Predictable Cost Cooperative, a new finance model for equitably distributing state and local funds to support special education, increase predictability and transparency, and benefit all students

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Executive Summary

Every day, Connecticut's public schools educate more than 74,500 students requiring some type of special education service.¹ The individual learning needs of these students are wide-ranging and unique. Their diagnoses vary from autism to speech and language disabilities to learning and intellectual disabilities. As a result of these wide-ranging needs, the resources required to provide students with a "free appropriate public education"² vary significantly, and often pose difficult planning and financial questions to Connecticut's public schools and municipalities.

Compounding this difficulty is the fact that Connecticut is one of only four states with no system for funding all of its special education students.³ As a result of these factors, special education costs are unpredictable for Connecticut's public schools,⁴ making it difficult for districts and municipalities to plan budgets that meet the needs of all the students they serve. In this report, we provide an overview of the challenges Connecticut currently faces in funding special education and how the state's current funding mechanisms for special education align to six identified best practices for statewide special education finance systems, based on a 50-state survey of special education finance systems.⁵ These best practices include:

1. **Differentiating funding based on students' learning needs:** State education aid for special education services should be differentiated based on student need.⁶ There is tremendous variation in the resources required to provide students with different disabilities and needs with a free appropriate public education. A state's special education finance system should recognize this variability in cost and attempt to differentiate the funding provided for students with disabilities accordingly. In general, as a student's learning needs increase, funding should increase.
2. **Distributing state funding for special education equitably:** A special education finance system should distribute resources equitably. As a general rule, lower-wealth districts should receive more state resources than higher-wealth districts to enable them to provide appropriate special education services.
3. **Providing school districts with state funding that is consistent and makes local expenses predictable:** Currently, one of the most significant challenges faced by school districts is that special education costs are unpredictable from year to year, wreaking havoc on district budgets. The special education finance system should provide a mechanism for smoothing out the inconsistency, unpredictability, and variability of special education costs in individual school districts.
4. **Controlling costs while maintaining quality:** The special education finance system should give all districts a stake in controlling total special education costs, without incentivizing the under or misdiagnosis of students with disabilities.
5. **Providing school districts with flexibility and encouraging innovation:** School districts should be incentivized to experiment with new ways of providing special

education services that result in the effective and efficient delivery of high-quality services.

- 6. Limiting financial responsibility for students with extraordinary needs:** In every state, a small percentage of students with disabilities have extraordinary needs that impose costs well above the average. State funding models must have a method of limiting local financial responsibility for providing students with extraordinary needs with a free appropriate public education.

Additionally, this report details a new model for equitably distributing state and local funds to support special education. This model, called the Special Education Predictable Cost Cooperative (the Co-op), meets all six identified best practices for statewide special education finance systems and helps address the challenges Connecticut is currently facing in funding special education services.

The Co-op allows state and local governments to share in the cost of funding special education through a cooperative model that uses actuarial principles to increase stability and predictability in special education funding for school districts while ensuring decisions in service delivery remain local. The Co-op aggregates special education costs together at the state level to leverage the fact that, on a statewide basis, special education costs are predictable,⁷ even though they are frequently volatile at the district level.⁸ Aggregating these costs together creates greater predictability in special education costs for districts and municipalities.

The Co-op is designed to achieve four primary goals:

1. Protect both general education and special education students by ensuring adequate special education resources remain available when district special education costs exceed projections, all while keeping decisions about, and delivery of, special education services local.
2. Improve predictability for districts and towns by allowing districts to know what their current year special education expenses will be in the prior year, allowing for better budget planning.
3. Increase equity by ensuring towns with greater need receive more state support for special education.
4. Strengthen fiscal transparency for special education expenditures, and assist the State Education Agency (SEA) with demonstrating that it is meeting maintenance of support requirements under the federal Individuals with Disabilities Education Act (IDEA).

As designed, local governments and the State of Connecticut will each make annual contributions to the Co-op, and districts will be reimbursed for 100 percent of their actual special education costs in the current year. Because every district educates special education students, every district will receive some state support for special education, although high-need districts will receive more state aid.

Local governments will contribute to the Co-op by making a Community Contribution for each special education student who lives in their town. To ensure districts have an incentive to manage their special education costs appropriately, Community Contributions will be adjusted to reflect each school district's actual special education costs in the prior year. Additionally, all communities' contributions will be lower than their actual special education costs.

To ensure the Co-op is fiscally viable, and meets the best practices requirements listed above, the Co-op is based on five fundamental actuarial principles:

1. A base Community Contribution adjusted so it is sufficient to cover total expected special education expenditures in the coming year.
2. A retroactive experience-based formula that adjusts the following year's base Community Contribution for each school district to reflect special education costs above or below a pre-determined level. The level is a realistic number that reflects the most recent statewide average cost per general special education student.
3. A reserve fund, or alternatively, a stop-loss policy, to cover the contingency that actual special education costs, in a given year, exceed collected Community Contributions and state contributions.
4. A contribution refund, as a credit to future Community Contributions, to ensure that during periods of good experience, and after a required reserve fund balance is maintained, any excess contributions are refunded to the individual school districts in an equitable manner.
5. An equity adjustment that provides a discount to the Community Contribution based on that community's wealth and need.

Furthermore, the Co-op model has the flexibility to adjust to the changing needs of school districts and the state, with respect to the management and governance of special education, without violating its fundamental principles.

The Co-op's flexibility and sound actuarial principles, offer a model for a special education finance system that is transparent and financially viable, and meets best practices while making special education costs predictable for school districts across Connecticut.

By creating predictability in special education costs, the Co-op benefits all students, whether they need special education services or not. All students benefit from the Co-op because it stabilizes general education funding and helps ensure districts don't have to resort to dipping into their general education funding to pay for necessary special education services. Additionally, the predictability and stability created by the Co-op protects students with disabilities by ensuring adequate funding for special education services—even during financially uncertain times—and by keeping decisions and delivery of those services local.

The Co-op offers a solution, based on sound actuarial principles, to the challenges districts and communities across Connecticut face every day by aggregating special education costs together at the state level to ensure predictable, stable funding for special education services—even during financially uncertain times—while keeping decisions and delivery of those services local.

Learn more about the Co-op at www.ctschoolfinance.org/our-solutions/special-education.

Backgroundⁱ

In our 2016 report *Improving How Connecticut Funds Special Education*, the Connecticut School Finance Project analyzed how each of the nation's 50 states provides funding for students with disabilities.⁹ The report found that while no two states utilize the same methods to fund students with disabilities, special education finance systems across the country can be categorized into eight classifications:¹⁰

1. Single Student Weight
2. Multiple Student Weights
3. Resource-Based
4. Census-Based
5. Partial Reimbursement
6. Block Grant
7. Combination
8. No Separate Special Education Funding

Connecticut is one of only four states—along with Rhode Island, West Virginia, and Arkansas—to fall into the “No Separate Special Education Funding” category, which effectively means the state has no system for funding all students with disabilities.

The comprehensive survey of state mechanisms for funding students with disabilities also revealed six key principles and practices all special education finance systems should follow. (Note: this is not intended to be a complete or exhaustive list of best practices, but rather, it is a group of identified best practices based on our research.) Those best practices are:

1. **Differentiates funding based on students' learning needs:** State education aid for special education services should be differentiated based on student need.¹¹ There is tremendous variation in the resources required to provide students with different disabilities and needs with a free appropriate public education. A state's special education finance system should recognize this variability in cost and attempt to differentiate the funding provided for students with disabilities accordingly. In general, as a student's learning needs increase, funding should increase.
2. **Distributes state funding for special education equitably:** A special education finance system should distribute resources equitably. As a general rule, lower-wealth districts should receive more state resources than higher-wealth districts to enable them to provide appropriate special education services.

ⁱ This section is a summary of a comprehensive survey of the special education funding systems in all 50 states, which was prepared by the Connecticut School Finance Project and was released in March 2016. The report can be accessed online, with a comprehensive list of statutory and governmental sources. Recommended citation: Connecticut School Finance Project. (2016). *Improving How Connecticut Funds Special Education*. New Haven, CT. Available from <http://ctschoolfinance.org/reports/improving-sped>.

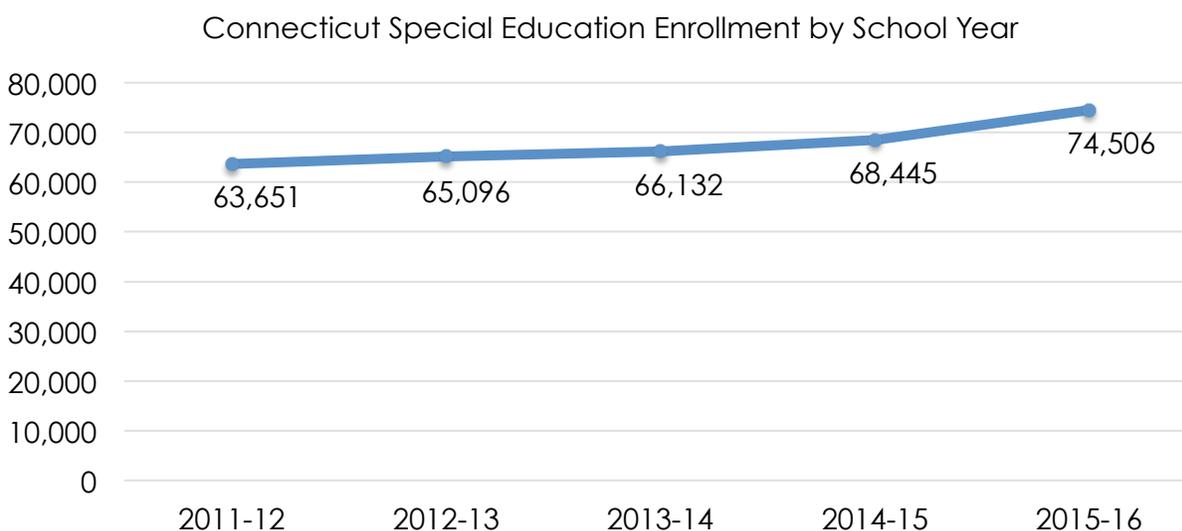
- 3. Provides school districts with state funding that is consistent and makes local expenses predictable:** Currently, one of the most significant challenges faced by school districts is that special education costs are unpredictable from year to year, wreaking havoc on district budgets. The special education finance system should provide a mechanism for smoothing out the inconsistency, unpredictability, and variability of special education costs in individual school districts.
- 4. Controls costs while maintaining quality:** The special education finance system should give all districts a stake in controlling total special education costs, without incentivizing the under or misdiagnosis of students with disabilities.
- 5. Provides school districts with flexibility and encouraging innovation:** School districts should be incentivized to experiment with new ways of providing special education services that result in the effective and efficient delivery of high-quality services.
- 6. Limits financial responsibility for students with extraordinary needs:** In every state, a small percentage of students with disabilities have extraordinary needs that impose costs well above the average. State funding models must have a method of limiting local financial responsibility for providing students with extraordinary needs with a free appropriate public education.

The report found no state's current system meets all six best practices, and that Connecticut is one of only four states with no separate special education funding system.¹² Thus, in partnership with the University of Connecticut's Goldenson Center for Actuarial Research and Neag School of Education, the Connecticut School Finance Project sought to develop a new model for funding special education that would be better aligned to these best practices. The resulting model, called the Special Education Predictable Cost Cooperative (the Co-op), meets all the best practices outlined above.

Overview of Special Education Funding in Connecticut

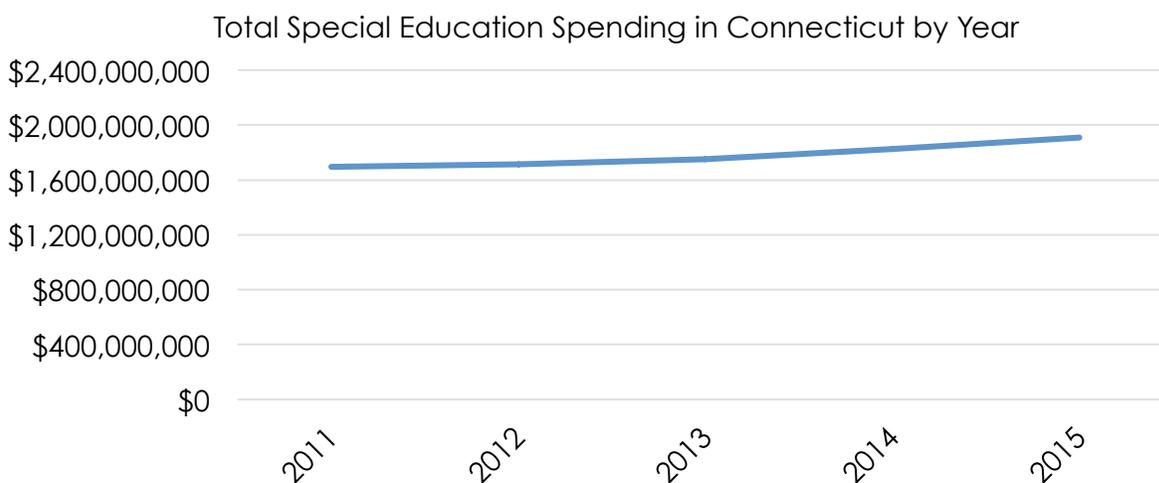
Over the last five years, the total number of students enrolled in Connecticut public schools has decreased by more than 16,500 students (three percent),¹³ and the state's school-age population (5-to-19-year-olds) is projected to decline an additional 12 percent by the year 2025.¹⁴ However, as the overall student population has declined, the total number of students identified as needing special education services has increased more than 17 percent over the past five years—from 63,651 in 2011 to 74,506 for the 2015-16 school year (see Figure 1).¹⁵ This translates to a two-percentage point increase in the special education identification rate since the 2010-11 school year.¹⁶

Figure 1



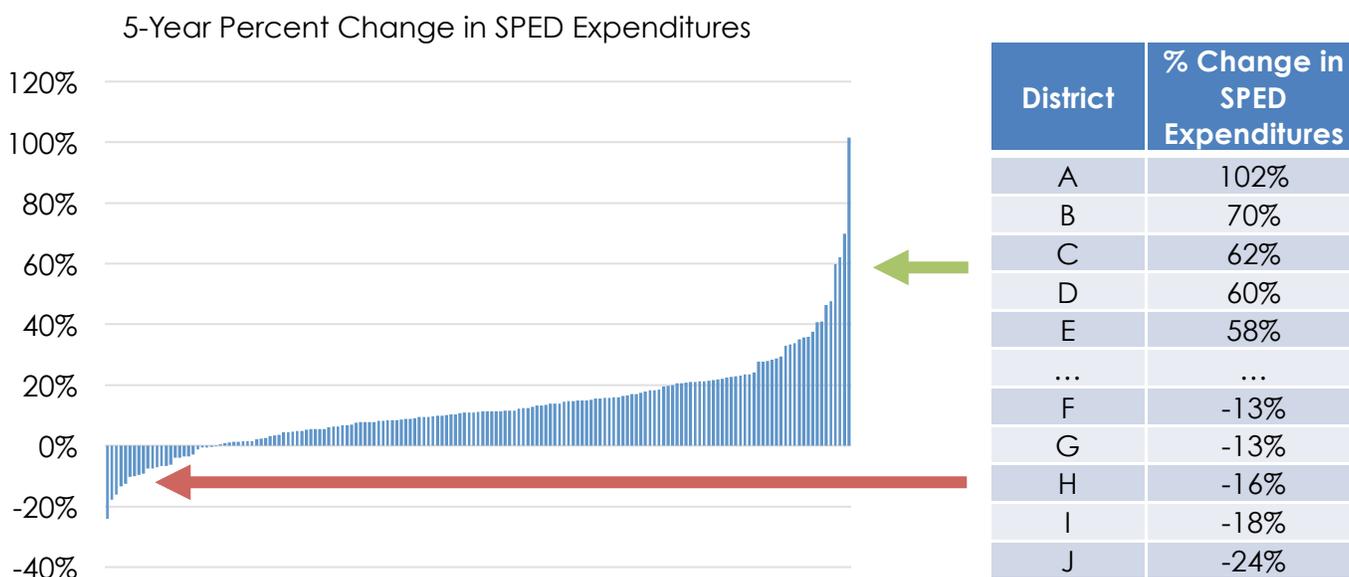
Despite the increase in special education students in Connecticut over the past five years, total special education spending in Connecticut has been predictable; increasing steadily (an average of 3.01 percent per year) for the past five years (see Figure 2).¹⁷

Figure 2



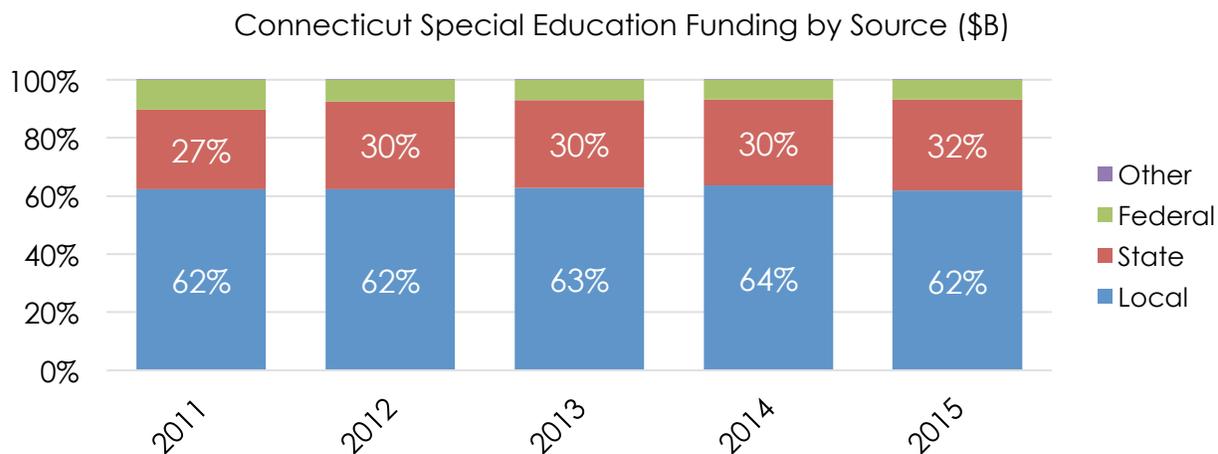
While Connecticut's special education expenditures are predictable when aggregated at the state level,¹⁸ a volatility analysis shows the same cannot be said for expenditures at the school district level, which have experienced a high level of volatility in their special education costs from year to year.¹⁹ From 2009-15, Connecticut school districts saw changes in district special education expenditures ranging from decreases of 24 percent to increases of up to 102 percent (see Figure 3).²⁰ Districts with the largest variances were among the smallest districts in the state, where unanticipated special education costs have significant impact on a district's budget.²¹

Figure 3



Funding for special education in Connecticut comes from a combination of federal, state, and local sources.²² Since 2010, the proportion of funding from each source has remained relatively steady (see Figure 4).²³ In fiscal year 2015, 62 percent of Connecticut special education spending came from local tax revenues, 32 percent from state sources, and seven percent from federal sources.²⁴

Figure 4



State Funding for Special Education in Connecticut

More than \$1.9 billion is spent annually on special education in Connecticut.²⁵ Of that, over \$788 million comes from state revenue sources.²⁶ The majority of state support for special education is “incorporated” into the formula for the Education Cost Sharing (ECS) grant, which is Connecticut’s main education equalization aid grant to municipalities.²⁷ In fiscal year 2015, approximately \$462 million, or 59 percent, of state funding for special education was attributable to the special education portion of the ECS grant.²⁸

In addition to funding incorporated into the ECS grant, there is categorical funding to help offset the cost of educating students with extraordinary needs, called the Excess Cost grant.²⁹ In fiscal year 2015, approximately \$140.5 million, or 18 percent, of state special education funding was distributed to districts through the Excess Cost grant. In addition to the special education portion of ECS and the Excess Cost grant, another \$186 million, or 24 percent of total state special education spending, was spent by state agencies other than the State Department of Education, such as the Department of Children and Families, to provide education services to students with disabilities.³⁰

Education Cost Sharing Grant

The ECS grant is Connecticut’s method of providing equalization aid to school districts, and is based on the ECS formula originally designed in 1988.³¹ The ECS formula was intended to distribute state education funding to cities and towns in order to make up the difference between the cost of operating a local public school system and each community’s ability to raise the required funds necessary through local property taxes. Since its inception in 1988, the ECS formula has been revised multiple times.³²

In 1995, the Connecticut General Assembly added students with disabilities to the ECS resident student count, and increased the per-pupil foundation amount by \$911, while at the same time eliminating Connecticut’s primary special education grant.³³ Since 1995, the state’s share of special education funding has remained “incorporated” into the state’s main education equalization aid grant, known as the ECS grant. Today, approximately 18-22 percent of total ECS funding is assumed to be attributed to special education expenditures.³⁴ In fiscal year 2015, this portion of the ECS grant accounted for 59 percent of state special education spending, totaling \$462 million.³⁵ The impact of incorporating special education funding into the ECS formula’s foundation amount is that 59 percent of state special education aid is not distributed based on the needs of the students served or the costs associated with the needs of those students.³⁶ In addition, Connecticut is no longer faithfully using the ECS formula to allocate funding to local public schools. Although the block grants provided to municipalities^{37,38} through the ECS formula are based on historical ECS formula calculations, the current grant amounts have not been determined using a formula since 2013.³⁹

Excess Cost Grant

In addition to the ECS grant, Connecticut supports districts in paying for extraordinary special education costs through the Excess Cost grant. The Excess Cost grant reimburses schools districts when the cost of educating a special education student exceeds 4.5 times the district’s net current expenditures (NCEP) per pupil, and the cost above the

district's NCEP for students in state agency placements.⁴⁰ However, the Excess Cost grant has had a statutory cap, limiting funding to no more than \$140 million,⁴¹ and is not fully funded.^{42,43} This lack of full funding has caused the percent level of reimbursement to districts to decrease.⁴⁴ In fiscal year 2016, districts received approximately 68 percent of their total reimbursement amount.⁴⁵ In addition, district NCEP's vary significantly, with a spending per pupil range of \$17,397 in school year 2015-16.⁴⁶ As a result, in fiscal year 2016, the district with the lowest NCEP, Danbury, is eligible for reimbursement through the Excess Cost grant at \$57,573 per pupil while the district with the highest NCEP, Cornwall, is eligible for reimbursement through the Excess Cost grant at \$135,860.⁴⁷

The Special Education Predictable Cost Cooperative Model

The Special Education Predictable Cost Cooperative is a special education finance system that allows the state and local governments to share in special education expenditures. The Co-op aggregates special education costs together at the state level to leverage the fact that, on a statewide basis, special education costs are predictable,⁴⁸ even though they are frequently volatile at the district level.⁴⁹

Aggregating these costs together creates predictability in special education costs for districts and municipalities. The Co-op is designed to achieve four primary goals:

1. Protect both general education and special education students by ensuring adequate special education resources remain available when district special education costs exceed projections, all while keeping decisions about, and delivery of, special education services local.
2. Improve predictability for districts and towns by allowing districts to know what their current year special education expenses will be in the prior year, allowing for better budget planning.
3. Increase equity by ensuring towns with greater need receive more state support for special education.
4. Strengthen fiscal transparency for special education expenditures, and assist the State Education Agency (SEA) with demonstrating that it is meeting maintenance of support requirements under the federal Individuals with Disabilities Education Act (IDEA).

As designed, local governments and the State of Connecticut will each make annual contributions to the Co-op, and districts will be reimbursed for 100 percent of their actual special education costs in the current year. Because every district educates special education students, every district will receive some state support for special education, although high-need districts will receive more state aid. Local governments will contribute to the Co-op by making a Community Contribution for each special education student who lives in their town. To ensure districts have an incentive to manage their special education costs appropriately, Community Contributions will be adjusted to reflect each school district's actual special education costs in the prior year. Additionally, all communities' contributions will be lower than their actual special education costs.

The Co-op model is a significant step toward overcoming the limitations of the funding models currently in use by states, and is designed to achieve all six best practices for special education finance systems mentioned previously. The Co-op model encompasses five fundamental actuarial principles:

1. A base Community Contribution adjusted so it is sufficient to cover total expected special education expenditures in the coming year.

2. A retroactive experience-based formula that adjusts the following year's base Community Contribution for each school district to reflect special education costs above or below a pre-determined level. The level is a realistic number that reflects the most recent statewide average cost per general special education student.
3. A reserve fund, or alternatively, a stop-loss policy, to cover the contingency that actual special education costs, in a given year, exceed collected Community Contributions and state contributions.
4. A contribution refund, as a credit to future Community Contributions, to ensure that during periods of good experience, and after a required reserve fund balance is maintained, any excess contributions are refunded to the individual school districts in an equitable manner.
5. An equity adjustment that provides a discount to the Community Contribution based on that community's wealth and need.

The Co-op model is actuarially sound, transparent, fiscally viable, and meets the best practices requirements listed previously. Furthermore, the Co-op model has the flexibility to adjust to the changing needs of school districts and the state, with respect to the management and governance of special education, without violating its fundamental actuarial principles.

How the Co-op Works

The steps below outline how proposed Community Contributions would be determined using actuarial principles.

Step 1: Initial Base Community Contribution

The Initial Base Community Contribution (IBCC) is the first step in determining the Community Contribution amount. The IBCC is the average basic expenditure per special education student in Connecticut based on the prior year's expenditures. Because the IBCC is based on the state average, it is the same amount per special education student for each school district. Using the prior year's average expenditure per special education student ensures the IBCC reflects the most recent special education costs experienced in Connecticut.

Step 2: Margin-adjusted Community Contribution

The IBCC is then adjusted for each school district by a contribution margin. The contribution margin helps to account for the volatility associated with the actual basic per-pupil special education expenditures each district incurs, when compared to the state average basic per-pupil special education expenditure. The contribution margin has been set to a constant value of \$2,000 per special education student. This is approximately one half of the standard deviation of the IBCC for all the districts. The Margin-adjusted Community Contribution (MACC) is calculated by adding the contribution margin to the IBCC. The MACC is the same for each district, as it is equal to the IBCC plus \$2,000.

Step 3: Experience Adjustment

After an accurate MACC has been calculated, the next step in the Co-op model is to apply an experience adjustment to the MACC. The experience adjustment is a factor that adjusts the school district's MACC based on the district's actual special education expenditures in the prior year, compared to the state average from the prior year. The experience adjustment works by increasing the MACC per special education student in the following year for districts that experienced actual expenditures higher than the state average, and lowering the MACC for districts with actual expenditures below the state average. The experience adjustment is done retroactively and only impacts the MACC for the following year, and will not impact the MACC for the current year.

To ensure schools and districts experience the desired predictability, the experience adjustment is calculated using two separate standards. Special education students are separated into two groups: costs associated with educating general special education students, and special education students with associated costs that are considerably higher than average.⁵⁰ A district's per-pupil costs for general special education students are compared to the state average per-pupil costs for general special education students, and a district's per-pupil costs for considerably higher-need special education students are compared only to the state average per-pupil costs for considerably higher-need special education students.

This methodology ensures a given district is not unduly penalized for a small number of extremely high-cost students moving into the district. This aspect of the funding model

incentivizes efficient cost management in a fair and equitable manner by ensuring each district is responsible for its own decision-making, while still allowing districts to manage special education service delivery at the local level. Further, it ensures school districts with lower special education expenditures will not offset districts with higher special education expenditures.

This is the first step in the Co-op model where differences will start to occur in the Community Contribution for each district.⁵¹ Each district will be provided with the state average cost per special education student at the start of the fiscal year. If the school district ensures its special education cost per student stays within the state average in the current year, the following year's MACC will be close to the current year's MACC, thus ensuring current and future special education costs are predictable for districts.

Step 4: Reserve Fund or Stop-Loss Policy

A reserve system, or, alternatively, a stop-loss policy, is required so in years where special education expenditures exceed the total amount of state and Community Contributions, each district can still be reimbursed for 100 percent of its special education expenditures. In years where special education expenditures exceed the total amount of state and Community Contributions, the reserve fund can be tapped so the shortfall in funding would resultantly not become the collective responsibility of districts. In the first year of establishing the Co-op, an initial amount will be required to establish the reserve fund.

Based on an actuarial analysis, we estimate 2.5 percent of Connecticut's total special education spending (approximately \$50 million in fiscal year 2015) should be a sufficient reserve to ensure the solvency of the Co-op. Thus, in year one, the reserve system will begin and end with a balance of \$50 million. The 2.5 percent factor was determined by testing various reserve levels to find the appropriate level that balances the need for fiscal solvency of the Co-op without over-reserving for the shortfall risk. Too high a reserve level could lead to overly high Community Contributions to meet both reserve requirements and special education costs, while too low a reserve level could result in a funding shortfall during years of high special education costs. The adequacy of the reserve fund would be evaluated from time to time and adjusted to reflect actual experience over time.

It is proposed that the initial reserve fund be established through the re-allocation of existing state special education funds to the Co-op. In subsequent years, an annual amount, currently estimated at seven percent of the state's share of special education funding, will be added to the reserve at the beginning of each year. Following a year where special education expenditures exceed the total amount of state and Community Contributions, the seven percent addition to the reserve will replenish the reserve fund to its maximum value, entitled the Required Reserve Balance (RRB). Similar to the initial reserve, the RRB is 2.5 percent of the total special education expenditures from the prior year. The RRB is a floating number rather than a constant to protect the reserve fund in future years from increasing costs and inflation. In years that the reserve fund exceeds 2.5 percent of total special education expenditures, the excess reserve can be returned to districts in the form of a contribution refund, which is discussed in the

next section. The reserve fund protects the integrity of the model during years of higher-than-predicted statewide spending, thus ensuring the Co-op is financially stable.

Alternatively, the Co-op could purchase a stop-loss policy to cover years when special education costs exceed expectations. A stop-loss policy could replace a reserve system, or it could be purchased in addition to, or to supplement, the reserve fund.

Step 5: Contribution Refund

The Contribution Refund ensures any surplus contribution dollars collected will be returned to districts to serve special education students and their needs. After districts have been reimbursed for all their special education expenditures, and the RRB has been met, the excess funds would be distributed to districts whose special education expenditures fell below the state average. The refunds would be distributed proportionally to each district on a per-pupil basis, depending on the district's actual experience.

In years where special education expenditures statewide are greater than the initial available funds, there are no refunds. To ensure refunds distributed to each district are used only to fund special education, they are distributed as a discount to a qualifying district's Community Contribution in the following year. Qualifying districts are those whose actual special education expenditures per student are below the state average for per-pupil special education expenditures. For non-qualifying districts, the Community Contribution will not be impacted in the following year by the contribution refund even when the district's spending per student is higher than the state average.

Step 6: Equity Adjustment

The Equity Adjustment is the final step in calculating the Community Contribution for each school district. After the Community Contributions have been adjusted for experience, and a contribution refund been applied to the districts that qualify, the Community Contribution is adjusted by an equity factor based on the Public Investment Communities (PIC) index, which measures the relative wealth and need of a community in Connecticut.⁵² Each municipality's PIC score ranges in value from 0 to 500, with 500 being a low-wealth community, and zero being a high-wealth community.⁵³ Each district receives a discount to its Community Contribution, which ensures each community receives some state funding for special education, but the exact amount of the discount is directly related to the community's PIC score. The higher a community's PIC score, the higher the percentage discount a district receives to its Community Contribution.

Proposed Governance Structure

In order to maintain fiscal solvency into the future, a strong governance structure must be created to oversee the functions of the Co-op. The primary objectives a governance and oversight system must meet are:

1. Ensuring there is appropriate and sound fiduciary oversight of the Co-op's funds.
2. Creating a process by which necessary policy adjustments can be made to keep the Co-op operating smoothly:
 - To ensure fiscal solvency
 - To adjust for any unintended consequences experienced by Co-op members
 - To account for future changes in special education policy or program implementation at the federal, state, or local levels
3. Building stakeholder involvement and investment by ensuring all Co-op members have a voice in the governance process.

In order to meet these goals, it will be necessary to form a board of directors for the Co-op who have expertise in government, finance, actuarial science, and education and are thus qualified to make policy decisions related to protecting the integrity of the Co-op. The board of directors' responsibilities may include:

- Ensuring the Co-op is administered in a fiscally responsible manner and maintains fiscal solvency.
- Selecting an administrator to perform the functions of assessing Community Contributions and processing payments to districts.
- Soliciting advice and recommendations from Co-op members and practitioners when making policy changes and governance decisions.

In addition, it will be important to have a mechanism by which Co-op members are able to have a voice in the governance process, so the board of directors' decisions are informed by the experience of district leaders and practitioners. Unforeseen problems in implementation or practice can be anticipated to occur and it is imperative that decisions can be made to address these issues as they are presented.

There is more than one way these key objectives may be met in constructing the governance and oversight mechanisms of the Co-op. If the decision was made to include governance and oversight structure in legislation, the board of directors responsible for fiscal oversight could be defined in statute with key stakeholders and stakeholder groups identified. A policy and review board could also be created with statutorily defined membership requirements and appointments then made by elected officials. However, this method would be inflexible, as legislation would have to be changed if it were found that additional or alternate membership would be beneficial. In addition, creating the governance and oversight structure within statute reduces direct involvement in Co-op management by Co-op members (i.e. Connecticut's school districts), which may reduce their investment in, and understanding of, Co-op operations and governance.

Potential Structural Framework

There is a pre-existing structure, called a captive insurance company (CIC), which could meet the governance and oversight needs of the Co-op. A CIC is an entity wholly owned and controlled by its members and its primary purpose is to insure the risks of its members.⁵⁴ The most common use of a CIC is when a large organization, or a group of organizations, chooses to self-insure against risks, rather than purchase commercial insurance. In a corporate setting, this increases the control of the members, and ensures any monies collected by the CIC can be redistributed to its members. Because CICs are organized as independent entities, they operate on behalf of, but independent from, their members. They have boards of directors, bylaws, organizing documents, and operators distinct from their members. In addition, CICs are able to purchase reinsurance, such as stop-loss policies, as an insurer through the reinsurance market.⁵⁵

There are instances, both in Connecticut and in other states, where municipalities have joined together to create their own governmental risk pools. In Connecticut unless statutorily specifically enabled, governmental risk pools are organized as CICs. Each member town generally has an equitable “ownership” stake in the CIC and they or a sponsor contributes start-up capital to finance the entity. For example, in 2014 Massachusetts’ municipalities formed the Massachusetts Mutual Reinsurance Arrangement (MMRA) to provide reinsurance to three joint purchasing groups of municipalities in Massachusetts.⁵⁶ In Connecticut, the Capital Region Education Council (CREC) administers a nonprofit group CIC, called CT Prime, on behalf of 13 member municipalities and school districts that joined to self-insure employee health insurance. CT Prime then purchases a stop-loss policy from the reinsurance market to account for any costs that outpace the funds held in the CIC.⁵⁷ Nearly all CT towns, totaling 396 municipal, school, and local public agencies participate in a similarly-governed risk entity called The Connecticut Interlocal Risk Management Agency (CIRMA), which was formed by statute in 1980 to assist municipalities in self-insuring workman’s compensation benefits, among other products.⁵⁸

In the case of the Co-op, however, the State of Connecticut could contribute the statutorily required start-up capital, under what is termed a “sponsored captive insurance company.” Sponsored CICs (SCIC) are a specific type of CIC, formed by its owner(s) for whom a sponsor may contribute the SCIC’s start-up capital; the sponsor may also be the “owner” of the entity. The insureds whose risks are underwritten in a sponsored CIC are called “participants.”⁵⁹ In this example, as the “owner,” the State—through an organizing committee—would be responsible for the application and incorporation process, which includes conducting a feasibility study, making an application to the commissioner of the Connecticut Insurance Department, and constructing organizational documents, bylaws, and procedures, among other tasks.⁶⁰ Towns/districts that join the Co-op as participants would do so under a membership agreement, which describes the rights and responsibilities of participants, including the ability to participate in CIC governance and oversight.⁶¹

The primary strengths of organizing the Co-op under a CIC model are two-fold. First, as a member governed entity it would have the flexibility to make necessary policy adjustments without the need for legislative action. Second, CICs allow for more

investment, input and control by Co-op participants. A traditional governance structure of a CIC includes a board of directors, with executive officers who are appointed to oversee all of the functions performed by the entity.⁶²

The makeup of the board of directors, and the process by which board members are appointed, would be articulated in the organizational documents of the CIC. Typically, the directors would be informed through a number of committees made up of representatives of Co-op participant towns and districts. For CICs, these often include executive, underwriting, reinsurance, claims, strategic planning, nominating, finance, risk management, and audit committees, but could also include other functions, such as a policy and practice committee. Often, for established CICs, board members can only be nominated once they have served a certain amount of time on one or more committees.⁶³ This structure ensures there is a direct mechanism for Co-op participants to advise the board of directors and recommend changes based on the experience of practitioners.

Best Practices Met by the Special Education Predictable Cost Cooperative

The Co-op model is based on sound actuarial principles, and ensures special education funding is transparent, predictable, and financially viable at both the school district and state levels. The Co-op can serve as a model for other states struggling with the challenge of providing predictable and consistent funding to support high-quality special education services. In addition, the Co-op meets all six best practices described in the background section:

1. **Differentiates funding based on students' learning needs:** The Co-op allows for differentiated funding based on the learning needs of special education students because it does not cap expenditures based on a disability type or a cost threshold. Instead, it reimburses districts for 100 percent of actual special education expenditures in the current year. In addition, the separate standards for general special education students and considerably higher-need special education students ensures districts do not incur financial penalties due to the excess special education costs associated with a single student.
2. **Distributes state funding for special education equitably:** Because all districts serve special education students, the Co-op ensures all districts receive some amount of state aid. However, high-wealth districts will receive less state aid than lower-wealth districts. This is accomplished by the Equity Adjustment, which discounts the Community Contributions on a scale determined by the community's PIC index score.
3. **Provides school districts with state funding that is consistent and makes local expenses predictable:** The Co-op makes special education costs predictable for schools and districts by aggregating special education costs at the state level, protecting any one district from bearing extraordinary costs in a single year. In addition, Community Contributions will be determined before school districts set their budgets, so districts will know their exact special education costs for the upcoming year.
4. **Controls costs while maintaining quality:** Although there is no explicit cost-control mechanism in the Co-op, such as a spending cap or a penalty for spending above a standard, there are incentives to control costs at the district level. The Experience Adjustment ensures districts' Community Contributions are reflective of their actual spending. If a district chooses to spend more per pupil than the state averages, it will be reflected in the next year's Community Contribution. Conversely, if a district has managed costs well (for example by serving more students in-district and reducing outplacements), its Community Contribution will be lower in the following year. The Experience Adjustment protects against a "tragedy of the commons" scenario where there is no incentive to control costs. Additionally, districts who spend below the state averages receive a Contribution Refund when excess funds are collected by the Co-op. This serves

as an additional incentive for districts to control their spending, without penalizing districts that have spent more.

- 5. Provides school districts with flexibility and encourages innovation:** The Co-op provides districts with flexibility and encourages innovation by keeping all decision-making regarding service delivery at the local level. The model does not interfere with service delivery and all funds reimbursed by the Co-op are unrestricted as long as they are spent on special education services.
- 6. Limits financial responsibility for students with extraordinary needs:** The Co-op model ensures districts will not experience high volatility in special education costs from year to year, especially when caused by a few students with extraordinary needs entering the school system. This is done through the aggregation of special education expenditures at the state level, and through the dual standards that separate students associated with considerably higher special education costs from those with general special education costs. In addition, the Reserve System protects the fiscal solvency of the Co-op in years where statewide special education costs exceed expectations.

Conclusion

Connecticut is currently one of only four states with no system for funding all of its nearly 75,000 students who require some special education services.⁶⁴ The state's current special education funding mechanisms pose challenges to school districts and communities and have caused costs to be unpredictable.⁶⁵

The Co-op model helps address these challenges and achieve cost predictability. Designed to meet identified best practices for special education finance systems, the Co-op's flexibility and sound actuarial principles, offer a model for a special education finance system that is transparent and financially viable, and make special education costs predictable for school districts across Connecticut.

By creating predictability in special education costs, the Co-op benefits all students, whether they need special education services or not. All students benefit from the Co-op because it stabilizes general education funding and helps ensure districts don't have to resort to dipping into their general education funding to pay for necessary special education services. Additionally, the predictability and stability created by the Co-op protects students with disabilities by ensuring adequate funding for special education services—even during financially uncertain times—and by keeping decisions and delivery of those services local.

The Co-op offers a solution, based on sound actuarial principles, to the challenges districts and communities across Connecticut face every day by aggregating special education costs together at the state level to ensure predictable, stable funding for special education services—even during financially uncertain times—while keeping decisions and delivery of those services local.

Learn more about the Co-op at www.ctschoolfinance.org/our-solutions/special-education.

Endnotes

¹ Connecticut State Department of Education. (2016). *CT Public School Enrollment_2000.mdb*. Available from <http://ctschoolfinance.org/data/connecticut-school-enrollment>.

² Individuals with Disabilities Education Improvement Act of 2004, 20 U.S.C. § 1400 (2004).

(9) Free appropriate public education. --The term `free appropriate public education' means special education and related services that--

(A) have been provided at public expense, under public supervision and direction, and without charge;

(B) meet the standards of the State educational agency;

(C) include an appropriate preschool, elementary school, or secondary school education in the State involved; and

(D) are provided in conformity with the individualized education program required under section 614(d).

³ Connecticut School Finance Project. (2016). *Improving How Connecticut Funds Special Education*. Available at <http://ctschoolfinance.org/reports/improving-sped>.

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¹⁰ Ibid.

¹¹ Rossmeier, V. (2016). *A Primer on Differentiated Funding*. New Orleans, LA: Tulane University, Cowen Institute. Retrieved from <http://www.coweninstitute.com/wp-content/uploads/2016/03/CI-Differentiated-Funding-Draft.pdf>.

¹² Connecticut School Finance Project. (2016). *Improving How Connecticut Funds Special Education*. New Haven, CT. Available from <http://ctschoolfinance.org/reports/improving-sped>.

¹³ Connecticut State Department of Education. (2016). *CT Public School Enrollment_2000.mdb*. Available from <http://ctschoolfinance.org/data/connecticut-school-enrollment>.

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¹⁵ Connecticut State Department of Education. (2016). *CT Public School Enrollment_2000.mdb*. Available from <http://ctschoolfinance.org/data/connecticut-school-enrollment>.

¹⁶ Ibid.

¹⁷ Connecticut State Department of Education. (2016). *LEA Special Education Expenditures*. Available from <http://ctschoolfinance.org/data/lea-special-education-expenditures>.

¹⁸ Ibid.

¹⁹ Connecticut State Department of Education. (2016). *Connecticut End of Year School Reports (ED001s) for Local Public School Districts, 2009-15*. Available from <http://ctschoolfinance.org/data/ed001s-local-districts>.

²⁰ Ibid.

²¹ Connecticut Conference of Municipalities. (2012). *Education Finance in Connecticut: Overreliance on the Property Tax*. New Haven, CT: Available from <http://ctschoolfinance.org/assets/uploads/files/Education-Finance-in-Connecticut-Overreliance-on-the-Property-Tax.pdf>.

²² Connecticut State Department of Education. (2016). *LEA Special Education Expenditures*. Available from <http://ctschoolfinance.org/data/lea-special-education-expenditures>.

²³ Ibid.

²⁴ Ibid.

²⁵ Ibid.

²⁶ Connecticut State Department of Education. (2016). *Individuals with Disabilities Education Act, 2016-17 State Maintenance of Effort*. Available from <http://ctschoolfinance.org/data/connecticuts-2016-17-state-maintenance-of-effort-for-the-individuals-with-disabilities-education-act-idea>.

²⁷ Conn. Gen. Statutes ch. 172, § 10-262h (2013).

²⁸ Connecticut State Department of Education. (2016). *Individuals with Disabilities Education Act, 2016-17 State Maintenance of Effort*. Available from <http://ctschoolfinance.org/data/connecticuts-2016-17-state-maintenance-of-effort-for-the-individuals-with-disabilities-education-act-idea>.

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³⁶ Ibid.

³⁷ Conn. Acts 16-2 (May Special Session).

³⁸ Conn. Acts 16-3 (May Special Session).

³⁹ Conn. Acts 14-47.

⁴⁰ Conn. Gen. Statutes ch. 164, § 10-76g (a) & (b).

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⁴⁷ Ibid.

⁴⁸ Connecticut State Department of Education. (2016). *LEA Special Education Expenditures*. Available from <http://ctschoolfinance.org/data/lea-special-education-expenditures>.

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⁵⁰ For the purposes of the Co-op model, we defined considerably higher-need special education students as Connecticut students who are currently eligible for state reimbursement under the Excess Cost grant.

These students are those whose special education costs exceed 450 percent of a district's per-pupil expenditure. For the purposes of the Co-op model, we then used a 125 percent factor estimate for actual Excess Cost reimbursement in recognition that the Excess Cost grant is limited by state statute. General special education costs are those associated with students who require special education services but fall below the Excess Cost threshold.

⁵¹ The 2011 IBCC for the medium-wealth district as shown in Figure 5 is \$25,799. The corresponding experience adjustment is a reduction of \$987 resulting in a reduced MACC for the following year of \$24,812. The experience adjustment for the high-wealth district in 2011 shows an increase of \$9,493 to the current year's IBCC of \$25,799 resulting in an increased MACC for the following year of \$35,292.

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