



State Education Funding Accounting Shifts

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The state of Minnesota has used accounting shifts in the education finance area to reduce general fund operating deficits on a short term basis. There are two kinds of accounting shifts that have generally been used: the school aid payment percentage shift and the property tax recognition shift.

There are two types of accounting shifts that have historically been used in education finance to generate state appropriation savings: school aid payment shifts and property tax recognition shifts. The savings generated by these shifts are one-time in nature (although small ongoing savings occur if funding amounts, aid or levy, are increasing), and the costs to pay them back are also one-time. Also, the cost to repay a given shift is always equal to the accumulated savings that resulted from the creation of the shift. A third type of shift was first employed in FY 2010 to help improve the state's cash flow position. This shift allows the state to withhold payments to school districts during a fiscal year, but those payments must be made to districts by May 30 of that fiscal year. This procedure helped state cash flow, but does not generate state appropriation savings. The law authorizing this cash flow shift was repealed in the 2011 legislative session, making it unavailable as a tool to help manage the state's cash flow.

School Aid Payment Shifts

The state aid share of school district revenue allocated through each education finance formula is called the "aid entitlement." The amount paid to school districts by the state during each fiscal year is called the "appropriation." Most of the funding for public schools is paid during the fiscal year in which the aid entitlement exists (the "current year"), with the balance paid in final payments the next fiscal year.

The timing of the percentage of the entitlement paid in each fiscal year is set in state statute (M.S. 127A.45). In general, a split of 90 percent paid in the current fiscal year, with 10 percent paid in the subsequent year, is considered to be no shift, or the normal amount of shift. So, a reduction of the current year percentage below 90 percent is considered to be shifting for the purpose of saving the state money. Under current law, the aid payment percentage is 86.4 percent of the entitlement appropriated in the current fiscal year, and 13.6 percent in the subsequent fiscal year. This payment percentage was initially set at 60 percent for FY 2012-13, but automatic adjustments in statute at the time of the February 2012, November 2012 and February 2013 state budget forecasts changed the current year aid payment percentage during FY 2013 to 86.4 percent.

The primary reason for the staggering of payments in this manner is to account for projected versus final data in formula-based programs. For example, a formula that is based on the number of students in a school district generates a projected entitlement on which the current year payments are based. The final payment in the subsequent year allows for a "settle-up" payment to be made based on actual counts. With a 86.4 percent/13.6 percent split, districts are paid 86.4 percent of their projected entitlement in the current year, and the final payment of 13.6 percent is adjusted to account for final student count data and paid in the subsequent year.

School districts use an "accrual" method of accounting: regardless of when a payment toward their current year entitlement is received, they count the entitlement amount as their revenue for the current year. Because of this, from an accrual accounting standpoint, a district's revenue does not change with changes in the fiscal year the state payments are made. In reality, however, if payments are delayed, districts experience a fiscal impact. Districts receive state aid in 27 payments, but their expenditures may be less consistent than the timing of those receipts. So, if the state uses a shift to move money from one fiscal year to the next, school districts with low budget reserves may not have sufficient cash on hand in reserves to meet their day to day expenses, and may have to engage in

short term “aid anticipation” borrowing, which has an interest cost, to manage their cash flow. In addition, districts with sufficient reserves are forced to use those reserves, and lose the interest that they would have earned if they had not had to spend their fund balances.

The state can change the aid payment percentage (which is usually stated as the split percentage amounts: “the 90/10” split) as a method to help reduce a state budget deficit, because the state uses “cost” accounting, where obligations are counted in the year they are paid, not in the year in which they are due. In the simplest terms, the state “borrows” money from school districts for a short term by withholding a portion of the payments due in one fiscal year until the start of the next fiscal year.

Because districts use accrual accounting, a change in the aid payment percentage does not cause them to change their expected revenues for that fiscal year. Using 90/10 as an example, the state, in the fiscal year in which the payment percentage is changed (to 70/30 for example) pays the final payment from the previous year (10 percent in this example) and the NEW current payment for the current year (70 percent in this example). The sum of those payments, 10 percent plus 70 percent, is 80 percent. For the given year in which the payment percentage is changed, the state pays only 80 percent of the total entitlement. In the next year, the state pays 30 percent for the final payment from the previous year, and 70 percent for the current year, and the state's payments once again return to the full 100 percent of the entitlement.

Below is a table that shows how a change in the payment schedule might work, with the payment schedule changing from 90/10 to 70/30 for FY 2010, and then back again in FY 2012.¹

	Current	Final	Entitlement	Final Payment from Previous Year	Payment for Current Year	Total State Payments	Counted as Revenue
FY 2009	90%	10%	1,000,000				
FY 2010	90%	10%	1,000,000	100,000	900,000	1,000,000	1,000,000
FY 2011	90%	10%	1,000,000	100,000	900,000	1,000,000	1,000,000
FY 2012	90%	10%	1,000,000	100,000	900,000	1,000,000	1,000,000
FY 2013	90%	10%	1,000,000	100,000	900,000	1,000,000	1,000,000
FY 2009	90%	10%	1,000,000				
FY 2010	70%	10%	1,000,000	100,000	700,000	800,000	1,000,000
FY 2011	70%	30%	1,000,000	300,000	700,000	1,000,000	1,000,000
FY 2012	90%	30%	1,000,000	300,000	900,000	1,200,000	1,000,000
FY 2013	90%	10%	1,000,000	100,000	900,000	1,000,000	1,000,000
Difference							
FY 2009	0%	0%	0	0	0	0	0
FY 2010	-20%	0%	0	0	-200,000	-200,000	0
FY 2011	-20%	20%	0	200,000	-200,000	0	0
FY 2012	0%	20%	0	200,000	0	200,000	0
FY 2013	0%	0%	0	0	0	0	0

¹ In the tables the shift percentage is returned to 90 percent / 10 percent in FY 2012. This is for hypothetical purposes; FY 2012 is already completed, so in practice, such a change in the shift percentage would have to occur in a year later than FY 2012.

If the entitlement stays the same from one year to the next, when the payment schedule is changed from 90/10 to 70/30 in FY 2010, there is a reduction of \$200,000 in the current year payment and an overall reduction of \$200,000 in the total state payment, but there is no change in the entitlement or in revenue counted by schools. In FY 2011, the final payment increases by \$200,000 (30 percent instead of 10 percent) but since the current payment amount is reduced to 70 percent, the current payment falls by \$200,000, so the total state appropriation is the same as before the shift.

In this example, when the state chooses to “pay back” the loan and return the shift from 70/30 to 90/10 in FY 2011, there is an appropriation cost to the state that is counted as additional spending of \$200,000. As you can see, in the FY 2012 line in the “Difference” section of the table, moving to 90/10 in FY 2012 retains the extra \$200,000 for the final 20 percent payment for FY 2011 (the last year that 70/30 would have been in effect) and restores the current payment to the full 90 percent, which eliminates the \$200,000 in savings that were occurring. The net effect is an increase in the state appropriation of \$200,000 in FY 2012.

The situation is slightly different if the entitlement amount is increasing over time, as it has in the past in education finance. The next table is the same table as the previous one, but the entitlement amount for FY 2009 through FY 2013 increases by \$100,000 per year.

In the case of a growing entitlement amount, the same procedure applies when the payment percentage changes: the current payment is decreased, while the lower prior year payment is also made. In this example, in FY 2010, the prior year payment of \$90,000 in FY 2010 for FY 2009 stays the same, while the current payment of \$900,000 is reduced to \$700,000, generating \$200,000 in savings to the state. In FY 2011, because revenue is growing, the final payment from the prior year increases by \$200,000 (from \$100,000 to \$300,000 as the final payment on the \$1,000,000 entitlement increases from 10 percent to 30 percent) while the current payment is decreased by \$220,000 (from \$990,000 to \$770,000 as the current payment on the increased entitlement of \$1,100,000). The net result is additional state savings of \$20,000.

	Current	Final	Entitlement	Final Payment from Previous Year	Payment for Current Year	Total State Payments	Counted as Revenue by Schools
FY 2009	90%	10%	900,000				
FY 2010	90%	10%	1,000,000	90,000	900,000	990,000	1,000,000
FY 2011	90%	10%	1,100,000	100,000	990,000	1,090,000	1,100,000
FY 2012	90%	10%	1,200,000	110,000	1,080,000	1,190,000	1,200,000
FY 2013	90%	10%	1,200,000	120,000	1,080,000	1,200,000	1,200,000
FY 2009	90%	10%	900,000				
FY 2010	70%	10%	1,000,000	90,000	700,000	790,000	1,000,000
FY 2011	70%	30%	1,100,000	300,000	770,000	1,070,000	1,100,000
FY 2012	90%	30%	1,200,000	330,000	1,080,000	1,410,000	1,200,000
FY 2013	90%	10%	1,200,000	120,000	1,080,000	1,200,000	1,200,000
Difference							
FY 2009	0%	0%	0	0	0	0	0
FY 2010	-20%	0%	0	0	-200,000	-200,000	0
FY 2011	-20%	20%	0	200,000	-220,000	-20,000	0
FY 2012	0%	20%	0	220,000	0	220,000	0
FY 2013	0%	0%	0	0	0	0	0

When looking at the “payback” of a shift, it is often assumed that shifts cost more to pay back than they generate in revenue. This is not the case. What actually happens is that in the year that a shift is implemented, there is usually a large amount of aid savings to the state. Over time, as in the example, small additional shift savings are generated each year IF the entitlement for the formulas increases. When the shift is “paid back” (in FY 2012 in this example) the total cost to the state (\$220,000) is higher than the initial \$200,000 savings. However, in addition to the initial \$200,000 in savings, in this example, the state experienced a subsequent \$20,000 in savings. So the total savings to the state over time is \$220,000, which is equal to the cost of eliminating the shift. The NET cost of a shift over time, from the time that it is instituted to the time that it is eliminated, including both savings and costs to the state, will always be zero.

Property Tax Recognition Shifts

Property owners pay their property taxes in May and October during a calendar year, usually split into two equal payments. The county that receives the payments then transfers the school share to the school district or districts that have property in the county. If no shifting existed, all of the property tax collections paid in a calendar year would be counted (or “recognized”) as revenue to the school district for the fiscal year (and school year) that starts on July 1 of that calendar year. For example, taxes paid in calendar year 2012 are revenue for the 2012-13 school year (FY 2013). If there were no shift, districts would collect half of their revenue before the fiscal (and school) year started from the May payment, and half after, from the October payment.

When a property tax recognition shift is instituted, districts are told that they must recognize a portion of the May payment as revenue for the current year, rather than for the subsequent year. In turn, the State reduces the amount of state aid paid in the current fiscal year by any additional revenue districts show from early recognition of property tax payments. For example, assume a district has \$1,000,000 in annual property tax revenue, paid equally in May and October. If a 25 percent shift were instituted, 50 percent of the May 2012 property payment (\$250,000) would be recognized as revenue during the current fiscal year (FY 2012) just ending, instead of the subsequent fiscal year (FY 2013). The state would then reduce its payment of state aid to the district by \$250,000, resulting in overall state aid savings. To “pay off” a property tax recognition shift, the district is required to recognize the revenue for the fiscal year starting on July 1 of the year in which it is collected, and the state must provide sufficient aid for the fiscal year ending on June 30 of that calendar year to make sure that the district receives its entire entitlement amount.

Similar to aid payment schedule shifts, the “cost” of paying back recognition shifts can be more than the savings generated at the time of the creation of the shift only if the amount of total property tax levy increases between the time of the institution of the shift and elimination of the shift. There is not a change in total state funding over time, but as levies grow, there will be small amounts of shift savings each year subsequent to the initial large savings in the year in which the shift is instituted. If, on the other hand, levies are reduced during the time a shift is in place, there is a state aid cost to compensate for the lost shift benefit to the state when the levy is reduced.

Under current law, districts must recognize 48.6 percent of payments made in a calendar year (or an amount almost equivalent to the May payment) as revenue for the fiscal year that is ENDING in that

calendar year. In addition, 31 percent of a district's calendar year 2001 referendum levy amount is shifted forward one year. Finally, some specific property tax levies (Integration Revenue for first class cities and Career and Technical programs, for example) are shifted forward 100 percent so that districts can recognize all of the property tax revenue as revenue for the current school year. Debt levies are not shifted because of the timing of the debt payments to bond holders.

Mitigating the Impact of Shifting on Certain School Districts

With some past funding shifts, the Legislature mitigated the financial impact on school districts that have to engage in short term borrowing to meet their cash flow needs. For example, when the aid payment shift has been changed, districts in Statutory Operating Debt (having a negative unreserved general fund balance greater than 2.5 percent of expenditures) were able to apply to the state for an “advanced final payment” equal to an amount intended to effectively funding revenue in that program on a 90/10 basis for those districts, within certain limits.

The Legislature has also attempted to mitigate the impact of shifts on charter schools. In current law, the method for doing this is to pay charter schools at the same rate as a 90 percent/10 percent schedule, regardless of what the current year aid payment is set at. Because there is not enough funding appropriated to fully pay for 90 percent of charter school funding (as the appropriation amount is only enough to fund the current year aid payment percent), charter schools stop receiving payments during the school year, in the spring, when their advanced scheduled payments at the 90 percent rate are cumulatively equal to the current year aid payment percent (86.4 percent currently).

Implications in the Current (February 2013 Forecast) Environment

Estimated state savings can be calculated as a rule of thumb for each percentage of school payment shift, based on the current school payment percentage and property recognition shift amounts. Each added percentage of school payment shift generates approximately \$72 million of savings to the state budget for the year in which the payment shift starts.

In addition, it should be noted that shifts implemented late in the fiscal year may yield limited state aid savings, given that there are fewer payments remaining in the current fiscal year to shift into the subsequent fiscal year. The closer to the end of the State fiscal year, the less aid there is available to reduce for state aid savings.

Recent Changes in the School Aid Payment Percentage and the School Property Tax Recognition Shift Amounts

Legislative Session or Forecast*	Change	Initial Net Savings (Cost)	Citation
2002	90% / 10% to 83% / 17%	\$437.5 m	2002 Session, Ch. 374, Art. 1
2003	83% / 17% to 80% / 20%	\$183.7 m	2003 1 st Special Session, Ch. 9, Art. 5
2003	48.6% Recognition Shift	\$253.2 m	2003 1 st Special Session, Ch. 9, Art. 5
Nov-04	80% / 20% to 81.9% / 18.1%	(\$118.0 m)	November 2004 Forecast
Feb-05	81.9% / 18.1% to 84.3% / 13.7%	(\$150.0 m)	February 2005 Forecast
Nov-05	84.3% / 13.7% to 90% / 10%	(\$370.4 m)	November 2005 Forecast
Nov-05	48.6% to 10.8% Recognition Shift	(\$330.7 m)	November 2005 Forecast
Feb-06	10.8% to 0.0% Recognition Shift	(\$93.0 m)	February 2006 Forecast
2009	90% / 10% to 73% / 27%	[\$1,170.4 m]	Governor's Attempted Unallotment, 6/09**
2009	Property Tax Accounting Change	\$600.7 m	Governor's Administrative Action, 6/09***
2010	48.6% Recognition Shift	\$0 m	2010 1 st Special Session, Ch. 1, Art. 3***
2010	90% / 10% to 73% / 27% for FY 10	\$1,056.8 m	2010 1 st Special Session, Ch. 1, Art. 3
2010	73% / 27% to 70% / 30% for FY 11	\$314.3 m	2010 1 st Special Session, Ch. 1, Art. 3
2010	70% / 30% to 90% / 10% for FY 12	(\$1,371.1 m)	2010 1 st Special Session, Ch. 1, Art. 3
2011	90% / 10% to 60% / 40% for FY 12 -	\$2,194.8 m	2011 1 st Special Session, Ch. 11, Art. 5
Feb-12	60% / 40% to 64.3% / 35.7%	(\$313.5 m)	February 2012 Forecast
Nov-12	64.3% / 35.7% to 82.5% / 17.5%	(\$1,324 m)	November 2012 Forecast
Feb-13	82.5% / 17.5% to 86.4% / 13.6%	(285.9 m)	February 2013 Forecast

* In 2004 Laws, Ch. 272, Art. 3, M.S. 16A.152, subd. 2 was amended to require that after budget reserves were increased, any forecasted surplus would be allocated to reducing the education payment percentage and property tax recognition shifts.

** In June 2009, Governor Tim Pawlenty attempted to use his unallotment authority under M.S. 16A.152, subd. 4, to reduce school aid payments and, in effect, implement an aid payment shift of 73%/27%. An Appeals Court nullified that action, and the nullification of the unallotment was affirmed in a Supreme Court decision in May 2010.

*** At the time of Governor's Pawlenty's June 2009 unallotment action, the Commissioner of the Minnesota Department of Education also implemented an administrative action that required districts to change their accounting practices to recognize revenue for property tax payments in the year in which they were received, which in effect implanted a 48.6% recognition shift. This action was later implemented as a property tax recognition shift in the more traditional fashion by the 2010 Legislature, which resulted in no net savings or cost.

If you have questions about this subject, please contact Melissa Johnson at 651-296-4178 or via email at Melissa.johnson@house.mn.