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# 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 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.

### **School 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). Under current law, for FY 2010-11 the payment percentage is 90 percent of the entitlement appropriated in the current fiscal year, and 10 percent in the subsequent fiscal year.

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 90%/10% split, districts are paid 90 percent of their projected entitlement in the current year, and the final payment of 10 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 those receipts. So, if the State uses a shift to move money from one fiscal year to the next, school districts with low reserves may not have sufficient cash on hand in reserves to meet their day to day expenses, and 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 their payments 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 80/20 for example) pays the final payment from the previous year (10 percent in this example) and the NEW current payment for the

current year (80 percent in this example). The sum of those payments, 10 percent plus 80 percent, is 90 percent. For the given year in which the payment percentage is changed, the State pays only 90 percent of the total entitlement. In the next year, the State pays 20 percent for the final payment from the previous year, and 80 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 80/20 for FY 2009.

	Current	Final	Entitlement	Final Payment from Previous Year	Payment for Current Year	Total State Payments	Counted as Revenue
FY 2007	90%	10%	1,000,000				
FY 2008	90%	10%	1,000,000	100,000	900,000	1,000,000	1,000,000
FY 2009	90%	10%	1,000,000	100,000	900,000	1,000,000	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 2007	90%	10%	1,000,000				
FY 2008	90%	10%	1,000,000	100,000	900,000	1,000,000	1,000,000
FY 2009	80%	20%	1,000,000	100,000	800,000	900,000	1,000,000
FY 2010	80%	20%	1,000,000	200,000	800,000	1,000,000	1,000,000
FY 2011	90%	10%	1,000,000	200,000	900,000	1,100,000	1,000,000
Difference							
FY 2007	0%	0%	0	0	0	0	0
FY 2008	0%	0%	0	0	0	0	0
FY 2009	-10%	10%	0	0	-100,000	-100,000	0
FY 2010	-10%	10%	0	100,000	-100,000	0	0
FY 2011	0%	0%	0	100,000	0	100,000	0

As you can see, if the entitlement stays the same from one year to the next, when the payment schedule is changed from 90/10 to 80/20 in FY 2009, there is a reduction of \$100,000 in the current year payment and an overall reduction of \$100,000 in the total State payment, but there is no change in entitlement or in revenue counted by schools. In FY 2010, the final payment increases by \$100,000 (20 percent instead of 10 percent) but since the current payment amount is reduced to 80 percent, the current payment falls by \$100,000, 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 80/20 to 90/10 in FY 2011, there is an appropriation cost to the State that is counted as additional spending of \$100,000. As you can see, in the FY 2011 line in the “Difference” section of the table, moving to 90/10 in FY 2011 retains the extra \$100,000 for the final 20 percent payment for FY 2010 (the last year that 80/20 would have been in effect) and restores the current payment to the full 90 percent, which eliminates the \$100,000 in savings that were occurring. The net effect is an increase in the State appropriation of \$100,000 in FY 2011.

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 2007 through FY 2011 increases by \$100,000 per year.

			Entitlement	Final Payment from Previous Year	Payment for Current Year	Total State Payments	Counted as Revenue by Schools
FY 2007	90%	10%	800,000				
FY 2008	90%	10%	900,000	80,000	810,000	890,000	900,000
FY 2009	90%	10%	1,000,000	90,000	900,000	990,000	1,000,000
FY 2010	90%	10%	1,100,000	100,000	990,000	1,090,000	1,100,000
FY 2011	90%	10%	1,200,000	110,000	1,080,000	1,190,000	1,200,000
FY 2007	90%	10%	800,000				
FY 2008	90%	10%	900,000	80,000	810,000	890,000	900,000
FY 2009	80%	20%	1,000,000	90,000	800,000	890,000	1,000,000
FY 2010	80%	20%	1,100,000	200,000	880,000	1,080,000	1,100,000
FY 2011	90%	10%	1,200,000	220,000	1,080,000	1,300,000	1,200,000
Difference							
FY 2007	0%	0%	0	0	0	0	0
FY 2008	0%	0%	0	0	0	0	0
FY 2009	-10%	10%	0	0	-100,000	-100,000	0
FY 2010	-10%	10%	0	100,000	-110,000	-10,000	0
FY 2011	0%	0%	0	110,000	0	110,000	0

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 2009, the prior year payment of \$90,000 in FY 2009 for FY 2008 stays the same, while the current payment of \$900,000 is reduced to \$800,000, generating \$100,000 in savings to the State. In FY 2010, because revenue is growing, the final payment from the prior year increases by \$100,000 (from \$100,000 to \$200,000 as the final payment on the \$1,000,000 entitlement increases from 10 percent to 20 percent) while the current payment is decreased by \$110,000 (from \$990,000 to \$880,000 as the current payment on the increased entitlement of \$1,100,000). The net result is additional State savings of \$10,000.

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 2011 in this example) the total cost to the State (\$110,000) is higher than the initial \$100,000 savings. However, in addition to the initial \$100,000 in savings, in this example, the State experienced a subsequent \$10,000 in savings. So the total savings to the State over time is \$110,000, 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 started on July 1 of that calendar year. For example, taxes paid in calendar year 2009 are revenue for the 2009-10 school year (FY 2010). 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 2009 property payment (\$250,000) would be recognized as revenue during the current fiscal year (FY 2009) just ending, instead of the subsequent fiscal year (FY 2010). 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 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 when 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, 31 percent of a district's calendar year 2001 referendum levy amount is shifted forward one year. In addition, 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. No other levies are shifted forward. 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 the institution of some past funding shifts, the Legislature has adopted methods to mitigate the financial impact on school districts that have to engage in short term borrowing to meet their cash flow needs. For example, in FY 2002-03, when the aid payment shift was changed to 83/17, districts that were 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 not more than 7 percent of the district’s general education aid, effectively funding revenue

in that program on a 90/10 basis for those districts. At the time, 30 districts and charter schools applied for and received \$11.2 million in advance final payments.

**Implications in the Current (November 2008 Forecast) Environment**

Estimated State savings can be calculated as a rule of thumb for each percentage of school payment or property tax shifts, based on the current school payment percentage and property recognition shift amounts. Each added percentage of school payment shift generates \$67.9 million of savings to the State budget for the year in which the payment shift starts. Each percentage of a property tax recognition shift excluding changing the referendum shift amount will generate \$5.5 million of state aid savings. If referendum revenue is included in the shift, the amount of shift savings generated by each percent of shift is not linear, due to referendums being partially shifted already. At lower shift percentages, there is little additional shift savings, but above 10 percent, shifting referendums significantly adds to the shift savings. For example, a 10 percent shift including referendum results in \$61.2 million in State savings, an increase of \$0.6 million per percent, while a 50 percent shift saves \$523 million, an additional \$5 million per percent at that level.

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. This is true for both the aid payment and the levy recognition shift. 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**

<b>Legislative Session or Forecast*</b>	<b>Change</b>	<b>Initial Net Savings (Cost)</b>	<b>Citation</b>
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 1st Special Session, Ch. 9, Art. 5
2003	48.6% Recognition Shift	\$253.2 m	2003 1st 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

\* 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.

*If you have questions about this subject, please contact Greg Crowe at 651-296-7165 or via email at [greg.crowe@house.mn](mailto:greg.crowe@house.mn).*