

# HANDOUT # 1

## A Review of "Investing In Our Future" Report

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### Introduction

In July 2004, the Education Finance Reform Task Force report was made public. The report titled: "Investing In Our Future: Seeking a Fair, Understandable, and Accountable 21<sup>st</sup> Century Education Finance System for Minnesota" was written as the result of work done by the 19 member task force appointed in June of 2003 by Governor Tim Pawlenty. In February 2004, the Schools for Equity in Education (SEE) contracted JL Myers Group (JLMG) to review the consulting work done for the task force on school finance adequacy and equity.

This review will summarize the key recommendations of the task force report, identify some of the strengths of the report, examine the consultants work for the task force, and make recommendations for next steps. This review is more general than originally contemplated because neither the consultants' costing-out study nor a detailed school finance equity and adequacy simulation became the core of the report. Rather than focus on details within the costing-out study or the appropriateness of a school funding adequacy level which was not set, this review will draw attention to the work of the consultants for the task force based on what is in the task force report.

### Key Task Force Report Recommendations

The task force recommendations provide a good first step in the crafting of a new school funding system for Minnesota. The recommendations are expectations for what the State of Minnesota needs to do primarily on basic principles and potential formula structures. The brief summary of the key recommendations are:

- rationally determined, learning-linked, student-oriented and cost-based
- link education funding to school and student performance
- local discretion in spending
- equalized local option referendums
- promote innovation to maximize resources
- five-tier system: instructional services, local district revenue, innovative programs, categorical programs, and facilities and debt service

### Strengths of the Report

There are several strengths in the task force report that make it the potential framework for new formula. The recommendations in the report were agreed upon by seventeen of the nineteen task force members. The most important of these is recognition that a school district should be able to decide how it spends its funds. The report suggests

support for experimenting with new governance structures for some schools. Although, until these include a significant number of schools, states will need to continue to fund school districts not schools. Distribution of funds to school districts can be made based on specific school and pupil needs; however, the interest in having dollars follow students is premature until the increased cost of the disaggregation of students is properly understood.

Section 1: Minnesota's Changing Profile is another one of the strengths of the task force report. Few state level efforts to understand school funding issues sufficiently examine the demographics that influence student and district needs. The report contains a considerable amount of data on the achievement gap, student population diversity, student mobility, increased poverty, rural decline, aging population, and stagnating taxes.

Appendix B details the work of Management Analysis and Planning, Inc. (MAP) in doing a costing-out study. There are four approaches being used by consultants to assist states in setting levels of school funding for school finance formulas based on the resources needed to meet state standards. MAP is one of the leading firms in doing these studies and their work using the professional judgment approach is a strength of the task force work.

The work by MAP and the recommendations of the task force recognize the full range of activities needed to run school districts including student, school, and district needs. To meet those needs in the current governance structure, school finance systems attempt to combine state, local, and federal dollars. Increased expectations on the system raises the pressure on those existing resources.

Finally, another strength of the task force report is in the dissenting letter. The debate between those proposing to radically reform education and those who want to improve the existing system is intensifying. School finance formulas were developed to assure that local wealth was not the determining factor in how much funding was available for education. Those school finance formulas are consistent with improving the existing system. Dramatic change in the way we educate students would require a new governance system, a new organizational model, and a new funding system.

### **Consulting work on Equity and Adequacy**

MAP's consulting work to study the resources needed for students to meet state standards used the respected professional judgment approach as a costing-out study. Using a professional judgment approach is a significant undertaking that requires considerable expertise and creates a large amount of data. As mentioned above, MAP's efforts are an overall strength of the work done for and by the task force. Unfortunately, their work did not provide the clarity needed by the task force to establish a new school finance formula.

The first two paragraphs of Appendix B make it clear that the consultants did not fully support or utilize their own study and they do not show an appreciation for the appropriate role of the state in establishing a school finance formula. Specifically, MAP should have provided a set of base student costs and special needs adjustments that could have been used by the task force to establish "a single bottom line." Additionally, they should not have suggested that policymakers select among five alternative sets of funding levels.

Ultimately, the task force was shown five different sets of funding levels based on the work of three study teams. The three study teams' results were represented by a change in expenditure that would create a state-wide impact of 1.42%, -2.82% or 14.75%. These were used along with two results, 6.85% and 6.89%, that were created by modifying the study team's results that found the highest expenditure. The modifications lowered the expenditure that team found. The explanation given for the modification is that the highest expenditure study team found a need for a higher level of non-personnel resources. It seems equally logical to ask what the results would be if the non-personnel resources from the highest expenditure team were applied to the other two teams. Regardless of whether their conclusion should have been an increase of about 6.9% or somewhere between 6.9% and 14.75%, no adequacy level was recommended by the consultants.

The task force report also does not show that the consultants made suggestions for the implementation of some of the task force recommendations. It is unclear how and whether tax equity would be achieved in Tier II, Tier IV, and Tier V. Although the recommendation appears to assume full state funding of Tier I and Tier III, without knowing the adequacy level with both a base student cost and proper adjustments for special needs, it is unclear how and whether pupil equity would be achieved.

In all five tiers it is unclear whether the tier is based on revenues or expenditures. Good school funding systems separate the local wealth of a school district to create revenue from its expenditure needs. Clear identification of the expenditures expected in each tier is needed. Also needed is a clearer picture of the revenue sources and distribution mechanisms that will be used for each tier.

On page 23 of the report the task force noted that its charge did not include a detailed study of transportation, special education, personnel management, expenditure controls, and revenue options. Still, the consultants should have provided a clearer picture of the adjustments needed to the adequate expenditure level for school districts to account for differences in transportation, special education and other needs both for students and districts.

Finally, on page 33 there is list of next steps that are needed for implementation. This list would be shorter had the consultants been clear about the items discussed above. The statement at the bottom of page 33 in the report is unclear in whether it is referring to the additional technical studies needed or the full implementation of a new education finance system. If it refers to the creation and implementation of new system then it is most likely not correct. It is unlikely that the existing state and local revenue system has the necessary resources to complete the work suggested. Assuring that all students meet state standards will require additional resources dedicated to education. The cost impact of meeting the expectations of No Child Left Behind (NCLB) add to the required additional resources. States that make significant school finance formula changes tend to add additional resources, lower property taxes (in at least most school districts), and add other tax sources. It is not clear in the task force report that the consultants work was done in a manner that will assist with these important next steps.

## **Recommendations for Future Work**

Not only did the task force do a good job of taking the first step in creating a new education funding system, they also did a good job of identifying the future work that needs to be done. Their list on page 33 is consistent with what JLMG would recommend. Our recommendations include:

- conducting a costing-out study that results in funding levels for a base student cost and adjustments for special needs,
- identifying the level of revenue separated from the expected expenditure level for each component of a school finance formula,
- creating a simulation of a new formula that identifies each school district's revenues and expenditures, and
- evaluating the equity of the new formula based on district wealth and student needs.

Finally, JLMG recommends work on a new funding system that would play a role in dramatic education reform. Radical reform of the governance and organization of public education has been an issue in Minnesota for more than a decade. What is not clear from the dissenting letter or from the proponents of these changes is the increased resources that are needed to make them work. Mixing parental choice within a public education system with private education services will increase the need for public resources.

*Minnesota*  
**Department**  
*of* **Education**

**DISTRICTS WITH  
FISCAL YEAR 2004  
STATUTORY  
OPERATING  
DEBT**

**As of June 30, 2004**

**REPORT  
TO THE  
LEGISLATURE**

**As required by  
Minn. Stat. § 123B.83,  
Subd. 3**

# Minnesota Department of Education

**COMMISSIONER:**  
Alice Seagren

**Districts With  
Fiscal Year 2004  
Statutory  
Operating  
Debt**

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**As of June 30, 2004**

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**REPORT  
TO THE  
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**as required by  
Minn. Stat. § 123B.83,  
Subd. 3**

**MINNESOTA DEPARTMENT OF EDUCATION  
FISCAL YEAR 2004 LEGISLATIVE REPORTS:  
ESTIMATED COST OF PREPARATION**

Minnesota Statutes, Chapter 3.197 requires the following:

"A report to the legislature must contain, at the beginning of the report, the cost of preparing the report, including any costs incurred by another agency or another level of government."

The following provides estimated costs incurred in the preparation of this report.

This report provides information that the Department of Education already collects as part of its normal business function. The cost information reported below does not include the cost of gathering and analyzing the data but rather is limited to the estimated cost of actually preparing this report document.

Special funding was not appropriated to cover the costs of preparing this report.

Supervisor who worked on the Report	\$400.00
Support Staff	\$460.00
MDE General Overhead (Indirect Cost)	70.00
Report Printing Cost	<u>5.00</u>
<b>TOTAL ESTIMATED COST FOR PREPARING THIS REPORT</b>	<b>\$935.00</b>

January 12, 2005

**Financial Management Section  
Division of Program Finance**

**Report on Minnesota School Districts and Charter Schools With Excess  
Net Negative Operating Fund Balances at the End of Fiscal Year 2004**

Minnesota Statute 123B.83, Subdivision 3, (2004) states:

If a school district does not limit its expenditures in accordance with this section, the commissioner may so notify the appropriate committees of the legislature by no later than January 1 of the year following the end of the fiscal year.

This report is to so notify the legislative committees.

Public schools have until November 30 to have their audited data for the previous fiscal year (FY) reported to the Minnesota Department of Education (MDE) (Minn. Stat. § 123B.77, Subd. 3). The list of districts and charter schools in this report has been established through the use of Uniform Financial Accounting and Reporting Standards (UFARS) and verified by independent auditor reports.

Districts and charter schools exceed their expenditure limitations when their Net Unreserved General Fund Balance (NUGFB) at year-end (June 30) is a negative amount which exceeds 2.5% of their unreserved/undesignated operating expenditures. Units that exceed this operating debt limitation are in Statutory Operating Debt (SOD).

Fiscal Year 2004 is the fourth year that Statutory Operating Debt is calculated using the Net Unreserved General Fund Balance. The NUGFB is the Unreserved/Undesignated and Encumbrance accounts of the general fund. Prior to Fiscal Year 2001, the SOD calculation included two other reserved accounts as well as the Unreserved/Undesignated in the General Fund. Those funds were the Food Service and Community Service Funds. The statute was changed to more directly exhibit the financial status of a school district or charter school. The principal reasons for the change in statute were: first, the Food Service and Community Funds cannot be used for K-12 activity expenditures; and second, all other reserve accounts in the General Fund are restricted to specific functions.

One of the objectives of the Financial Management Section of the Department of Education is to provide financial management assistance. Staff members not only monitor districts and charter schools in SOD, but also work with those entities whose financial health is deteriorating. They work closely with units identified with declining financial status to improve their financial position and avoid statutory operating debt.



## **Summary**

The number of active school districts and charter schools in SOD at the end of FY 2003 was 25 with Native Arts Charter School going out of business. For FY 2004, there was an increase of active SOD units from 25 to 26. The FY2003 SOD report displayed 3 charters in SOD. Subsequent to that report, two of those charter schools submitted final data well beyond the statutory deadline and removed the condition of SOD for FY2003.

There were three school districts and eight charter schools on the FY 2004 SOD list that were not on the FY 2003 SOD list. Nine school districts and one charter school on the SOD list in FY 2003 were not in SOD for FY 2004.

The lowest number of school districts and charter schools in SOD was 15 in FY 1998. The largest number of districts in SOD was 59 in FY 1994.

The number of school districts remained the same at 343, while the number of reporting charter schools increased by twenty-four (24). There were 112 charter schools reporting in Minnesota during FY 2004.

From 1990 to 2004, the number of entities with a negative unappropriated operating fund balance was at a low of 27 in FY 1996. The highest number of districts with a negative unappropriated operating fund balance was 87 in FY 1993.

### **AUDIT VERIFICATION OF UFARS DATA**

The Department of Education validates the reported financial data (UFARS) of school districts and charter schools with the audit reports completed for each entity by independent certified audit firms. The common school listed in Table 1 and one charter school with a negative Net Unreserved General Fund Balance (NUGFB) exceeding the statutory limit did not provide the MDE with a Compliance Table from a final audit report by January 12, 2005. Therefore, validation of UFARS data was not possible. An additional four regular school districts and seven charter schools also failed to provide a Compliance Table from a final audit report by January 12, 2005.

Twenty-seven (27) regular school districts and sixteen (16) charter schools did not submit a hard copy audit to MDE by January 12, 2005.

## Summary of Tables

### **Table 1: Districts & Charter Schools with a Negative Net Unreserved General Fund Balance Exceeding 2 1/2% of Yearly General Fund Operating Expenditures: FY 2004.**

1. As of June 30, 2004, there were 17 independent school districts, one common school district, and eight charter schools that had a net negative unreserved general fund balance exceeding 2½% of Fiscal Year 2004 unreserved/undesignated general fund expenditures.
2. Three of the 18 school districts and all eight charter schools were new to the SOD list for Fiscal Year 2004. Five of the eight charter schools achieved SOD in their planning year and had minimal debt.

### **Table 2: School Districts and Charter Schools Out of Statutory Operating Debt, Reorganized or Closed as of June 30, 2004.**

1. Nine school districts and one charter school removed their SOD condition as of June 30, 2004, with one charter school going out of business.
2. Of the 10 school districts and charter schools out of statutory operating debt, four school districts had a positive Net Unreserved General Fund Balance.

### **Table 3: School Districts and Charter Schools Not Reporting.**

All reporting units submitted preliminary UFARS data, but five traditional school districts and seven chartered schools did not report final UFARS data (Minn. Stat. §123B.77, subd. 3).

### **Table 4: Minnesota School Districts and Charter Schools – Fiscal Years 1990 Through 2004: Negative Operating Debt and Statutory Operating Debt.**

1. The lowest number of entities (school districts and charter schools) over this period of time was 374 in 1997. The largest number was 455 units in 2004. The increase was due to the large number of newly opened chartered schools.
2. The number of entities with Net Negative Unappropriated Operating Balances ranged from a low of 27 in FY 1996 to a high of 87 in FY 1993.
3. The number of entities with a Net Negative Unreserved General Fund Balance dropped by 4 from FY 2003 to FY 2004 (36 to 32).
4. The number of entities with Statutory Operating Debt was a low of 15 in FY 1998 to a high of 59 in FY 1994.

**Table 1<sup>1</sup>**  
**Minnesota Department of Education**  
**Districts & Charter Schools with a Negative Net Unreserved General Fund Balance**  
**Exceeding 2 1/2% of Yearly General Fund Operating Expenditures: FY 2004**

Regular and Common District Information			Unreserved	General	New	Final	Hard	First
No.	Type	Name	Gen. Fund	Fund	SOD	UFARS	Audit	Year of
			Balance	Expenditures	Calc	Rec'd	Rec'd	SOD
16	1	Spring Lake Park	-778,400	27,614,230	-2.82%	X	X	2001
93	1	Carlton	-392,088	4,606,554	-8.51%	X	X	2002
182	1	Crosby-Ironton	-261,534	9,955,679	-2.63%	X	X	2002
200	1	Hastings	-2,196,326	33,805,704	-6.50%	X	X	2004
256	1	Red Wing	-1,451,031	21,187,247	-6.85%	X	X	2002
286	1	Brooklyn Center	-871,209	12,565,430	-6.93%	X	X	2002
316	1	Greenway	-1,183,593	10,116,653	-11.70%	X	X	1996
371	1	Bellingham	-405,856	980,240	-41.40%	X	X	2002
458	1	Truman	-325,704	2,933,605	-11.10%	X	X	2000
577	1	Willow River	-246,064	2,836,077	-8.68%	X	X	2004
623	1	Roseville	-2,269,090	51,781,636	-4.38%	X	X	1999
635	1	Milroy	-93,321	902,648	-10.34%	X	X	2003
695	1	Chisholm	-274,037	5,814,657	-4.71%	X	X	2002
815	2	Prinsburg	-97,643	427,602	-22.83%	NO	NO	2001
2071	1	Lake Crystal-Wellcome Memorial	-312,337	6,135,323	-5.09%	X	X	2000
2172	1	Kenyon-Wanamingo	-344,896	6,267,272	-5.50%	X	X	2004
2859	1	Glencoe-Silver Lake	-518,146	12,632,166	-4.10%	X	X	2001
2890	1	Renville County West	-1,108,773	5,386,839	-20.58%	X	X	2001

**Charter School Information**

4069	7	MN Institute of Tech. (McGee)	-151,593	4,208,614	-3.61%	X	X	2004
4086	7	Woodson Institute (WISE)	-121,541	2,136,888	-5.69%	X	X	2004
4088	7	Urban Academy	-260,688	1,154,178	-22.59%	X	X	2004
4108	7	Gen. John Vessey Academy	-13,278	79,786	-16.64%	X	X	2004
4116	7	Lakes International Charter	-16,215	63,328	-25.60%	X	X	2004
4122	7	Eagle Ridge Charter	-15,476	81,173	-19.07%	X	X	2004
4123	7	Dakota Area Academy	-667	7,124	-9.36%	X	X	2004
4128	7	Col. Charles Young Academy	-104,041	158,041	-65.83%	NO	NO	2004

<sup>1</sup> Data Compiled as of 1/12/05

Key on Types

Type 1 = Independent School District  
Type 2 = Common School District  
Type 7 = Charter School

**Table 2****School Districts and Charter Schools Out of Statutory Operating Debt,  
Reorganized or Closed as of June 30, 2004**

District		6/30/2003		6/30/2004	
Number and Type	Name	Net Unreserved General Fund Balance	Percent Deficit	Net Unreserved General Fund Balance	Percent Balance
177-1	Windom	-757,457	-9.44%	452	0.01%
203-1	Hayfield	-273,461	-5.06%	-95,491	-1.85%
277-1	Westonka	-1,135,546	-6.64%	-156,455	-0.92%
482-1	Little Falls	-597,745	-2.99%	-362,588	-1.83%
712-1	Mountain Iron-Buhl	-151,200	-3.26%	20,222	0.35%
738-1	Holdingsford	-203,697	-3.12%	-82,568	-1.24%
806-1	Elgin-Millville	-142,753	-3.96%	107,022	3.11%
836-1	Butterfield-Oden	-118,073	-5.61%	-42,222	-2.34%
2887-1	McLeod West	-289,513	-9.35%	183,181	6.13%
4036-7	Face to Face Academy	-33,758	-5.97%	-532	-0.09%
4071-7	Native Arts	-70,435	-30.31%	No data reported	Out of business

**Table 3****School Districts and Charter Schools Not Reporting Final Audited UFARS Data**

Number and Type	Unit Name	Reporting Unit Data 6/30/03		Reporting Unit Data 6/30/04	
		Net Unreserved General Fund Balance	Fund Balance Percent	Net Unreserved General Fund Balance	Fund Balance Percent
11-1	Anoka-Hennepin	24,785,711	9.42%	36,132,707	12.63%
314-1	Braham	433,128	7.20%	1,060,079	17.91%
500-1	Southland	723,809	13.98%	551,075	10.73%
815-2	Prinsburg	-87,778	-22.08%	-97,643	-22.83%
2886-1	Glenville-Emmons	334,442	9.70%	457,880	15.36%
4054-7	LaCrescent Montessori Charter	77,389	20.87%	77,015	29.34%
4064-7	Riverway Learning Community	77,516	12.18%	1,440	0.28%
4065-7	Minnesota Business Academy	300,777	6.59%	217,922	5.16%
4067-7	Aurora Charter School	205,272	27.28%	183,776	12.62%
4091-7	SE MN School Arts-Technology	Not opened	Not opened	44,126	3.52%
4096-7	Chiron Charter	79,254	5.64%	79,254	5.12%
4102-7	MN Internship Charter	40	0.06%	96,743	3.36%
4128-7	Col. Charles Young Academy	Not opened	Not opened	-104,041	-65.83%

**Table 4**

**Minnesota School Districts & Charter Schools – Fiscal Years 1990 through 2004  
Negative Net Unappropriated Operating Debt and Statutory Operating Debt**

Category	Fiscal Years of Study														
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Number of School Districts and Charter Schools	436	430	425	413	401	395	378	374	378	387	402	416	411	431	455
Number with Net Negative Unappropriated Operating Fund Balance (1,2,4)	71	79	82	87	68	33	27	29	33	52	56	49	46	34	34
Number with Net Negative Unreserved General Fund Balance	New SOD Calc										71	69	55	40	32
Number of Active Units in Statutory Operating Debt	52	47	48	54	59	29	17	19	15	31	33	45	40	25	26