# STATE OF MINNESOTA
## Office of the State Auditor

**Patricia Anderson**
**State Auditor**

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# Financial Trends of Minnesota School Districts and Charter Schools

**For the period 2001 to 2005**

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Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 200 financial and compliance audits per year and has oversight responsibilities for over 3,600 local units of government and over 700 pension funds throughout the state. The office currently maintains five divisions:

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# Financial Trends of Minnesota School Districts and Charter Schools

**Fiscal Years 2001 to 2005**

**June 26, 2006**


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# Introduction

This report presents education finance data for Minnesota's 346 independent and intermediate school districts and 101 charter schools for the years 2001 through 2005.

There are several purposes to this report. The first is to provide citizens, district officials, and policy makers with a resource that facilitates a greater understanding of education finances in general. To this end, the report examines the factors that drive revenue formulas and expenditures. The second purpose is to offer stakeholders a tool that allows them to compare their district or charter school to other districts based on rankings of revenue and expenditure statistics. This is done by providing rankings on the 2005 per pupil revenues and expenditures, and other statistics of school districts and charter schools. [1] The final purpose is to communicate areas of concern identified while conducting the oversight function of the Office.

All data used in this report was provided by the Minnesota Department of Education but the analysis and presentation reflect the work of State Auditor's staff in consultation with Department of Education staff.

[1] The State Auditor's website features a tool that allows an individual to compare one district to another based on rankings for revenues and expenditures per pupil, as well as other demographic characteristics.

# Demographic Characteristics of School Districts

## Enrollment Changes[2]

In 2005, public school districts in Minnesota ranged in size from 42,974 students in St. Paul to 67 in Pine Point. Among charter schools, enrollment ranged from 939 for the Minnesota Transitions Charter School to 11 for the Minnesota North Star Academy.

**From 2001 to 2005, total enrollment for public schools declined 2.3 percent.**

From 2001 to 2005, total enrollment for all school districts and charter schools declined more than two percent.[3] Among regular and intermediate districts, school districts, those with more than 1,000 students showed a 2.4 percent decline in enrollment while those with less than 1,000 students showed a decrease of more than 9 percent. Charter schools experienced an increase of 102 percent.

While the growth in the number of students attending charter schools is large, charter schools account for just 2 percent of all students attending public schools in 2005. It is interesting to note that as of 2005, there were more students home schooled (16,934) than attended charter schools (16,671).

Table 1 summarizes the five-year trend of enrollment for charter schools and school districts.

### Table 1: Enrollment for Regular School Districts and Charter Schools, FY 01 to FY 05

| Districts with: | 2001 | 2002 | 2003 | 2004 | 2005 | 5-Year Change |
|---|---|---|---|---|---|---|
| Over 1000 Enrollment | 742,654 | 743,112 | 737,627 | 729,782 | 724,860 | -2.4% |
| Under 1000 Enrollment | 103,626 | 101,564 | 97,029 | 95,443 | 93,759 | -9.5% |
| Charter Schools | 8,260 | 9,534 | 11,417 | 13,414 | 16,671 | 101.8% |
| All Districts & Charter Schools | 854,541 | 854,211 | 846,074 | 838,639 | 835,290 | -2.3% |

**Source: Office of the State Auditor analysis of Minnesota Department of Education data.**

[2] While this report uses the terms "enrollments" and "per pupil," these figures actually refer to Average Daily Membership (ADM) served by the Minnesota Department of Education. See the glossary for a definition of this term.

[3] A large decline between 2002 and 2003 resulted from the limit on average daily membership to not more than 1.0. Previously, students who were enrolled in certain programs generated ADM greater than 1.0.

## Changes in Special Population Enrollment[4]

While overall enrollment declined among public schools, the number of students classified in various subgroups of total enrollment increased. Between 2001 and 2005, the number of students classified as minority increased 19 percent, the number of students classified as non-English speaking increased 28 percent, the number of students receiving special education services increased 5 percent, and the number of students eligible for free or reduced lunch increased 13 percent.

The rapid growth in special populations has changed the composition of enrollments across the state. Over the five-year period, special populations accounted for an increasing share of total enrollment. As a share of total enrollment, minority enrollment increased from 17 percent to 21 percent; the share of pupils with Limited English Proficiency (LEP) as a percent of total enrollment increased from 5 to 7 percent; special education enrollment increased from 13 percent to 14 percent of total enrollment; and low-income enrollment increased from 26 percent to 30 percent.

Trends also indicate that for many low income, non-English speaking, and special needs students, charter schools seem to offer an attractive alternative to traditional schools. It is worth noting that many charter schools were specifically designed to serve these populations. The following analysis illustrates these trends.

## Pupils With Limited English Proficiency (LEP)

**The percentage of LEP students in charter schools was 17 percent compared to 7 percent overall.**

LEP student enrollment grew by 28 percent between 2001 and 2005. The criteria used to classify LEP students are those students whose primary language is not English, whose English language skills do not allow full classroom participation, whose prior year score on an emerging academic test are below the cutoff score, and who are enrolled in an LEP educational program but have not been enrolled in Minnesota public schools for five or more years.

Among all charter and public school districts examined in this report, LEP students constituted 7 percent of the total enrollment in 2005 compared to 5 percent in 2001. There are clear differences in the concentration of LEP students between charter schools and school districts with over and under 1,000 students.

[4] Special population students in this report are defined as those that have special status in regards to the education finance formulas. They include those that are eligible for free or reduced-price lunch, minorities, Limited English Proficient (LEP), and those receiving special education services.

- **As a whole, 17 percent of charter school students were classified as LEP in 2005, compared to 7 percent for districts with more than 1,000 students, and 2 percent for districts with less than 1,000 students.**

While the majority of school districts and charters have concentrations of LEP students less than five percent of their total enrollment, the top 10 charter schools exceed 50 percent. Interestingly, charter schools hold the top 12 spots in terms of LEP students as a percent of total enrollment. Among regular school districts, the highest concentrations of non-English speaking students tended to be in the central cities and first ring suburbs, or in the Southwest and South Central regions of the state including Renville, Brown, Lyon and Cottonwood counties. Among charter schools, the highest concentrations are in those schools created to meet the needs of non-English speakers such as the Twin Cities International Elementary Charter School and the Hmong Academy.

The growth in LEP students indicates that school districts are adjusting to an increasingly diverse student population. The definition of these students and the funding that accompanies them is structured so that after five years, they are no longer classified as LEP. While funding accompanies LEP enrollment, school districts have had to hire staff specifically to provide services to these students. It is presumable that for many districts, when an influx of LEP students reaches the five-year mark, there will be a reduction in the number of students eligible for LEP status and layoffs may follow. The section on revenue will discuss the role of LEP students and LEP concentrations and its implications for school district funding.

## Special Education Students

Local school districts in Minnesota are required to provide special education services to children with disabilities from birth to 21 years of age. For this reason, the enrollment figures used for this analysis include pre-kindergarten enrollment, as districts must provide services to these children. Children with disabilities are defined in statute to include children who have a hearing impairment, visual disability, speech or language impairment, physical handicap, other health impairment, mental handicap, emotional/behavioral disorder, specific learning disability, or deaf/blind disability.

In 2005, approximately 14 percent of the students in public schools were receiving special education services. The total number of students in this category grew by 5 percent between 2001 and 2005. Charter schools and regular school districts had similar concentrations of special education students.

- **In 2005, about 12 percent of charter school students received special education services compared to 13 percent for districts with over 1,000 students and 16 percent for districts with fewer than 1,000 students.**

Special education students as a percent of total enrollment in school districts ranged from 63 percent in the NE Metro Intermediate District 916 to 7 percent in the Battle Lake District. Among charter schools, the range is from 100 percent at the Metro Deaf Academy and Minnesota North Star Academy to 1 percent at the Beacon Academy Charter School. Sixty-nine percent of school districts experienced growth in the percentage of children eligible for special education services between 2001 and 2005. Among charter schools open for five years, 71 percent experienced growth in the percentage of children receiving special education services.

Special education enrollment growth presents funding issues for many school districts because of the structure of special education funding. A school district's special education base revenue is determined by a revenue-capped reimbursement formula. Special education costs are calculated for a base year, two fiscal years prior to the year of the aid payment. Thus, when the number of special education students or the costs involved is growing, funding could be less than what is needed. Conversely, when the levels of students receiving special education services or the costs are declining, funding might be greater than what might be needed.

## Pupils Eligible for Free or Reduced Lunch

This category is an indicator of the family incomes of the student body. The data is derived from the Application for Education Benefits completed by families at the individual school districts. The percentage is calculated by dividing the number of eligible students by the total October 1 enrollment. The income guidelines for eligibility for a reduced-price lunch range from $16,613 for a family with 1 child to $57,276 for a family with 8 children.

Those students who qualify for free or reduced-price lunch are classified as special population students because they are the main factor in determining compensatory revenue for school districts. For some schools, compensatory revenue can add as much as fifty percent to the general education formula revenue.

The average proportion of students receiving free or reduced price lunches for all school districts and charter schools was 30 percent in 2005. Overall, the number of students eligible for this program increased 13 percent between 2001 and 2005. There were clear differences between charter schools and school districts in the percent of students eligible for free or reduced price lunches.

- **About 54 percent of charter school students were eligible for free or reduced-price lunches compared to 28 percent of students in school districts with more than 1,000 students and 36 percent for districts with less than 1,000 students.**

Among the school districts, the percent of students eligible for free or reduced lunch ranged from 97 percent in the Pine Point school district to 3 percent in the Minnetonka school district. For charter schools, the range was from a high of 100 percent at both the Twin Cities International Elementary Charter School and Ubah Medical Academy Charter School to a low of 0.3 percent at the Math & Science Academy.

## Minority Enrollment

At a time of declining enrollment overall, minority enrollment increased 19 percent between 2001 and 2005. With overall enrollment decreasing, particularly among white students, the percent of the total enrollment classified as minority rose from 17 percent in 2001 to 21 percent in 2005. There are clear differences in the composition of student bodies between charter schools and school districts.

**Charter school enrollment is about 51 percent minority compared to 21 percent for all school districts.**

- **Approximately 51 percent of charter school students are classified as minorities, compared to 22 percent of students in districts with more than 1,000 students and 8 percent for districts with fewer than 1,000 students.**

Minority enrollment as a percentage of total enrollment ranged from 100 percent at the Pine Point and Red Lake school districts to zero percent in ten districts. [5] Among charter schools, the percentage ranged from 100 percent at six schools (Harvest Prep School/Seed Academy, Hmong Academy, MN International Middle Charter School, Twin Cities International Elementary Charter School, Ubah Medical Academy Charter School and the Woodson Institute for Excellence) to 1 percent at the North Lakes Academy Charter School.

Table 2 on the following page shows the actual enrollment changes by type of special population for all charter schools and school districts.

[5] The districts are Balaton, Bellingham, Cyrus, Evansville, Franconia, Holdingford, Lake Benton, Mabel-Canton, Milroy, and Prinsburg.

## Table 2: Trends in Special Population Enrollment, FY 01 to FY 05

| | | Eligible for Free/Reduced Price Lunch | | Limited English Proficiency | | Special Education | | Minority Students | |
|---|---|---|---|---|---|---|---|---|---|
| | Fall Enrollment * | Students | % of Total | Students | % of Total | Students | % of Total | Students | % of Total |
| **2001** | 845,947 | 216,828 | 25.6% | 44,297 | 5.2% | 106,882 | 12.6% | 144,074 | 17.0% |
| **2002** | 844,906 | 223,393 | 26.4% | 47,886 | 5.7% | 108,477 | 12.8% | 151,612 | 17.9% |
| **2003** | 840,227 | 229,404 | 27.3% | 51,160 | 6.1% | 109,987 | 13.1% | 157,955 | 18.8% |
| **2004** | 836,133 | 236,099 | 28.2% | 53,371 | 6.4% | 111,877 | 13.4% | 165,063 | 19.7% |
| **2005** | 831,347 | 245,342 | 29.5% | 56,677 | 6.8% | 112,540 | 13.5% | 171,242 | 20.6% |
| **Percent Change** | -1.7% | 13.2% | 15.1% | 27.9% | 30.2% | 5.3% | 7.1% | 18.9% | 20.9% |

* The fall enrollment is different than the ADM served figures used for calculating revenue and expenditures per pupil.

SOURCE: Office of the State Auditor analysis of Minnesota Department of Education data.

## Trends in Class Size

One area that educators have identified as important to student achievement, particularly in the early grades, is class size. In an effort to reduce class size, state law requires that school districts reserve a portion of their basic revenue for class size reduction in kindergarten and first grades. Once the district achieves a class size of 17:1 in grades kindergarten and first, the district may use the remaining reserved revenue to reduce class size in each subsequent elementary grade. The amount that must be reserved for class size reduction is determined by multiplying their basic revenue formula allowance ($4,601 for 2004-05) by .057 of the kindergarten enrollment, .115 of the grades' 1-3 enrollment, and .06 of the grades' 4-6 enrollment.

The average number of students per teacher for all school district and charter schools increased from 15.9 in 2001 to 16.2 in 2005.[6] For charter schools, the ratio decreased from 14.6 students per teacher in 2001 to 14.3 in 2005. For school districts with more than 1,000 students, the ratio increased from 16.3 to 16.8. School districts with fewer than 1,000 students saw their ratio decrease from 13.5 to 13.0.

[6] This ratio was calculated by dividing the average daily membership for each district by the sum of the full-time equivalent (FTE) teachers in the district. It includes regular instruction, vocational education, and special education teachers.

- **Class sizes are increasing among large school districts while decreasing among small districts and charter schools.**

Some districts have argued that the requirement that they reserve funds for class size reduction in the early grades has resulted in the ratio rising in later grades. Between 2001 and 2005, about half the districts experienced increases in class sizes while half had a decrease in class size.

## Trends in Staffing

While overall enrollment declined by 2.3 percent between 2001 and 2005, the number of teachers fell by 4.3 percent. Among charter schools, the number of teachers has grown 106 percent, from 566 in 2001 to 1,165 in 2005. For school districts with more than 1,000 students, the number of teachers declined 5.4 percent, while districts with less than 1,000 students showed a decline of 6.3 percent in the number of teachers.

## Teacher Salaries

**The average teacher salary grew slightly less than the rate of inflation between 2001 and 2005.**

Between 2001 and 2005, the average teacher salary increased from $37,621 to $41,467. This represents an increase of 10.2 percent. During this period, inflation grew at a rate of 10.3 percent indicating that teacher salaries grew slightly slower than inflation during this period.

Several factors affect the average salary of teachers including the overall age of the teaching staff, the number of years of experience, and the educational attainment of the staff. As older teachers retire, their replacements generally have less experience and educational attainment which translates to less pay. This is part of the reason that average teachers salaries appear to have stagnated.

### Table 3: Average Teacher Salaries for Charter Schools and School Districts, FY 01 to FY 05

| District Name | 2001 Average Teacher Salary | 2002 Average Teacher Salary | 2003 Average Teacher Salary | 2004 Average Teacher Salary | 2005 Average Teacher Salary | 2001 to 2005 Percent Change |
|---|---|---|---|---|---|---|
| **Charter Schools** | **33,428** | **35,191** | **35,713** | **36,167** | **36,937** | **10.5%** |
| **Districts Over 1,000 Students** | **40,698** | **41,081** | **43,509** | **43,977** | **45,916** | **12.8%** |
| **Districts Under 1,000 Students** | **35,787** | **36,175** | **37,981** | **38,430** | **39,930** | **11.6%** |
| **All Districts & Charter Schools** | **37,621** | **38,020** | **39,787** | **40,121** | **41,467** | **10.2%** |

SOURCE: Office of the State Auditor analysis of Minnesota Department of Education data.

## Experience and Educational Attainment of Teachers

From 2001 to 2005, there was a decrease in the average number of years of teaching experience. In 2001, the average number of years experience was 17.9 compared to 15.4 in 2005. The downward trend in this category indicates that older teachers are retiring which results in a slightly less experienced teaching staff. This has the effect of keeping overall salary costs lower.

There was a significant difference in the average number of years experience between charter schools and school districts. In 2005, the average number of years teaching for teachers in charter schools was 7.4, compared to 15.2 for large districts and 17.8 for small districts.

Over the five-year period, there was a decrease in the percentage of teachers holding only bachelor's degrees. In 2001, 56.2 percent of teachers held at least a bachelor's degree but not masters compared to 49.5 in 2005. In contrast, the percentage of teachers holding masters or higher degrees increased slightly from 29.0 percent in 2001 to 30.9 percent in 2005.[7] Two trends are illustrated here: older teachers with high levels of educational attainment are retiring, while at the same time, younger teachers are continuing to raise their educational attainment.

Table 4 shows the changes in various teacher demographics.

## Table 4: Averages for Teacher Statistics, FY 01 to FY 05

| | Number of Years Teaching | Percent with Bachelor's Degree | Percent with Master's Degree | Teachers Salaries |
|---|---|---|---|---|
| **2001** | 17.9 | 56.2 | 29.0 | $37,621 |
| **2002** | 17.5 | 56.2 | 28.1 | 38,020 |
| **2003** | 17.0 | 54.1 | 29.1 | 39,787 |
| **2004** | 16.3 | 51.5 | 30.0 | 40,121 |
| **2005** | 15.4 | 49.5 | 30.9 | 41,467 |
| **5-Year Percent Change** | -14.0% | -11.9% | 6.6% | 10.2% |

SOURCE: Office of the State Auditor analysis of Minnesota Department of Education Data.

[7] The 20 percent that are unaccounted for in this analysis either had less than a bachelor's degree or the Department of Education had incomplete data on the teacher.

## Total Compensation Trends

An examination of the total dollars allocated for salaries paid to all employees funded through the operating funds (general, food service, and community service funds) including teachers, administrators, classroom aides, and other professional, administrative and maintenance staff showed an increase of 11.2 percent between 2001 and 2005, while the total value of benefits paid to these employees increased 29.7 percent.

Benefits as a percent of salary increased steadily over this period of time. In 2001, benefits equaled 20.2 percent of salary compared to 22.8 percent in 2005.[8] It is apparent that the cost of benefits is increasing at a much faster rate than that of salaries. As benefit costs have escalated, the amount of resources available for wage increases has diminished. This has forced many districts to offer smaller wage increases. Table 5 shows salary and benefit trends from 2001 to 2005.

## Table 5: Total Salary and Benefits Costs of the Operating Funds, FY 01 to FY 05

| Category | 2001 | 2002 | 2003 | 2004 | 2005 | 2001 to 2005 Percent Change |
|---|---|---|---|---|---|---|
| **Salaries Paid** | 4,224,025,631 | 4,344,001,689 | 4,470,931,244 | 4,573,487,516 | 4,699,190,487 | 11.2% |
| **Benefits Paid** | 1,071,703,850 | 1,145,964,069 | 1,245,404,509 | 1,312,288,923 | 1,390,016,095 | 29.7% |
| **Total** | 5,295,729,480 | 5,489,965,758 | 5,716,335,753 | 5,885,776,440 | 6,089,206,582 | 15.0% |
| **Salaries Percent** | 79.8% | 79.1% | 78.2% | 77.7% | 77.2% | -3.2% |
| **Benefits Percent** | 20.2% | 20.9% | 21.8% | 22.3% | 22.8% | 12.8% |

SOURCE: Office of the State Auditor analysis of Minnesota Department of Education data.

[8] Benefits include health insurance, retirement, FICA, workers compensation, retiree benefits, and deferred compensation.

# School District Revenues

Minnesota's charter schools and public school districts received revenues of $8.74 billion or $10,458 per pupil in 2005. In actual dollars, total revenues grew 13.5 percent; on a per pupil basis, revenues grew 16.1 percent. The inflation rate over this period was 10.3 percent.

On average, smaller school districts generate the most revenue per pupil at $10,871. They also have the highest rate of increase in total revenue per pupil at 20 percent. Charter schools, which receive no levy revenue, have the slowest rate of growth at 11.7 percent. The slower rate of growth among charter schools reflects a general education formula that was frozen for three years and the absence of levy revenue to supplement operating budgets. Among the three categories of schools and school districts used in this report, large school districts showed the lowest revenues per pupil at $10,402.

Table 6 shows the trend in total revenues per pupil over the five-year period.

**Table 6: Total Revenues Per Pupil for Charter Schools and School Districts, FY 01 to FY 05**

| Type of District | 2001 Total Revenues Per Pupil | 2002 Total Revenues Per Pupil | 2003 Total Revenues Per Pupil | 2004 Total Revenues Per Pupil | 2005 Total Revenues Per Pupil | 2001 to 2005 Percent Change |
|---|---|---|---|---|---|---|
| **Charter Schools** | **9,487** | **10,285** | **10,259** | **10,501** | **10,598** | **11.7%** |
| **Districts Over 1,000 Students** | **8,993** | **9,271** | **9,824** | **10,196** | **10,402** | **15.7%** |
| **Districts Under 1,000 Students** | **9,061** | **9,567** | **10,417** | **10,616** | **10,871** | **20.0%** |
| **All Districts & Charter Schools** | **$9,006** | **$9,318** | **$9,897** | **$10,249** | **$10,458** | **16.1%** |

SOURCE: Office of the State Auditor analysis of Minnesota Department of Education data.

## Trends in Revenues

The composition of school district revenues changed considerably over the five-year period this report examined. The largest change was the state's complete takeover of the basic general education formula funding for the FY 2002-03 school year. Prior to FY 03, local levies contributed between 32 and 37 percent of the total general education formula revenues. When the state assumed full funding of the formula, these levies zeroed out. The levy revenue remaining

represents voter-approved operating referendum dollars and dedicated debt service levies.

Table 7 shows the changes in revenue per pupil from 2001 to 2005.

## Table 7: Revenues Per Pupil by Source, FY 01 to FY 05

| Year | Levy* | Total Local Revenues | Total State Revenues | Total Federal | Other Revenues | Total Revenues |
|---|---|---|---|---|---|---|
| **2001** | 2,102 | 2,882 | 5,541 | 394 | 193 | 9,006 |
| **2002** | 2,249 | 2,989 | 5,666 | 465 | 203 | 9,318 |
| **2003** | 1,163 | 1,887 | 7,270 | 538 | 207 | 9,897 |
| **2004** | 1,671 | 2,414 | 7,031 | 593 | 215 | 10,249 |
| **2005** | 1,555 | 2,388 | 7,233 | 614 | 227 | 10,458 |
| **5-Year Percent Change** | **-26.0%** | **-17.1%** | **30.5%** | **55.8%** | **17.6%** | **16.1%** |

* Levies are included in total local revenues.

SOURCE: Office of the State Auditor analysis of Minnesota Department of Education data.

## Composition of School District Revenues

The funding of Minnesota school districts is derived from a combination of local, state, and federal revenues. The primary source of revenues is the state, which provided 69 percent of all school district revenue in 2005. Federal aid and other local sources such as property taxes, fees, admission charges, tuition, interest earnings, rent, and gifts provided the other 31 percent of revenues.

As Table 7 shows, the fastest growing revenue component over the five-year period was federal aid although it still only represents 6 percent of all revenues. The dramatic shifts in state and local revenues between 2002 and 2003 reflect the state takeover of the general education formula which resulted in a reduction of locally supported tax levies. A three-year freeze in the general education formula has forced many districts to supplement their operating budgets with voter-approved levies. This is evidenced by the increased levy revenue between 2003 and 2005.

The composition of revenues is quite different between charter schools and school districts but both receive similar amounts of revenues. Table 8 on the following page shows the per pupil dollar amount and the share of total

revenues that it represents for charter schools and school districts with enrollments above and below 1,000 students.

Charter schools rely considerably more on State and Federal revenues than school districts, but less on local revenues. This is because charter schools do not have taxing authority and consequently must receive their revenues from other sources.

## Table 8: Revenues Per Pupil in Dollars and by Percentage of Total Revenues, FY 2005

| Type of District | Levy * | Total Local Revenues | Total State Revenues | Total Federal | Other Revenues | Total Revenues |
|---|---|---|---|---|---|---|
| **Charter Schools** | 0 | 1,036 | 8,382 | 1,128 | 52 | 10,598 |
| **Districts over 1,000 Students** | 1,669 | 2,377 | 7,196 | 598 | 234 | 10,402 |
| **Districts under 1,000 Students** | 951 | 2,708 | 7,311 | 648 | 205 | 10,871 |
| **All Charters and Districts** | $1,555 | $2,388 | $7,233 | $614 | $227 | $10,458 |

| Type of District | Levy * | Total Local Revenues | Total State Revenues | Total Federal | Other Revenues | Total Revenues |
|---|---|---|---|---|---|---|
| **Charter Schools** | 0.0% | 9.8% | 79.1% | 10.6% | 0.5% | 100.0% |
| **Districts over 1,000 Students** | 16.0% | 22.9% | 69.2% | 5.7% | 2.2% | 100.0% |
| **Districts under 1,000 Students** | 8.7% | 24.9% | 67.3% | 6.0% | 1.9% | 100.0% |
| **All Charters and Districts** | 14.9% | 22.8% | 69.2% | 5.9% | 2.2% | 100.0% |

* This is a part of local revenues as well.

SOURCE: Office of the State Auditor analysis of Minnesota Department of Education data.

Figure 1 shows the relative shares of school district funding while Figure 2 shows changes in the composition over five years.

**The state funded 69 percent of education costs in FY 04-05**

**Figure 1: Sources of School District Revenues, FY 05**

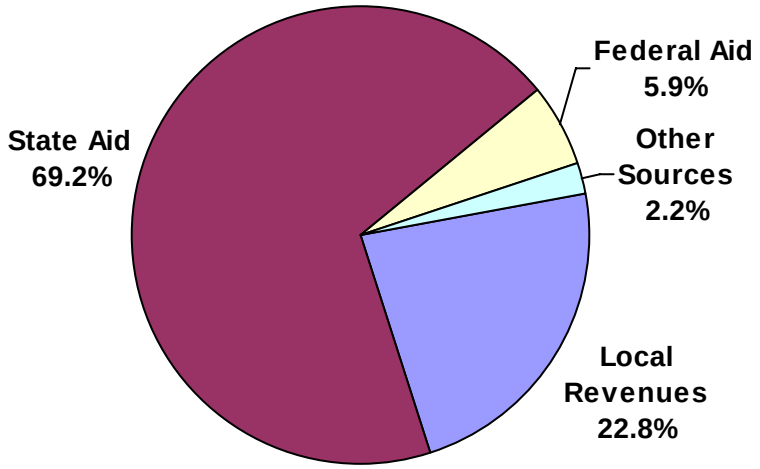
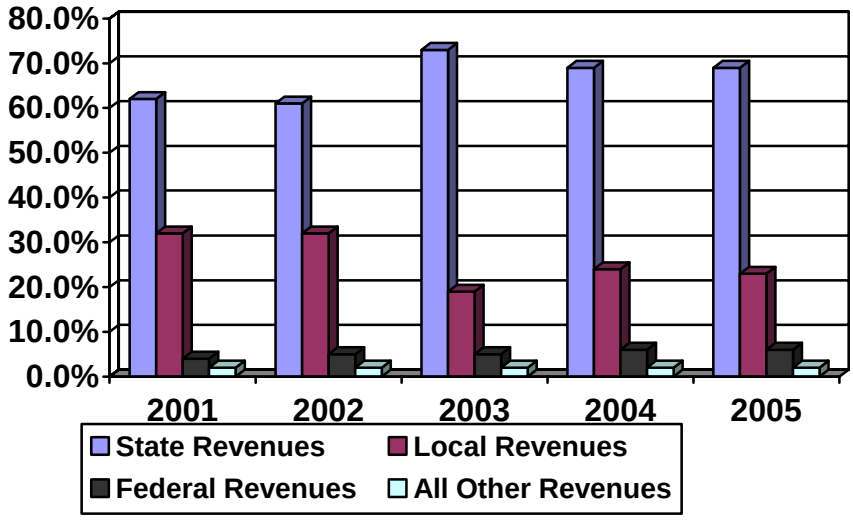



**Figure 2: Percent of Total Revenues by Source, FY 01 to FY 05**



## State Revenue Programs

The funding of school districts involves a number of complicated formulas that take into account a wide range of enrollment, geographic, and property wealth factors.[9] The driving factor behind most of the revenue formulas is school district enrollment. Other factors include the number of non-English speaking students, the number of students eligible for free or reduced-price lunch, the district's expenditures on special education, the training and experience of the district's teachers, the geographic density of the district, and several other transitional factors.

According to a survey of superintendents conducted for a 2002 report on school district finances by the Minnesota Legislative Auditor, the complexity of the formulas, and the fact that they changed so frequently, made it difficult for them to anticipate total revenues from one year to the next. [10]

### Basic General Education Formula Revenue

General education revenue is the primary source of operating funds for school districts and is composed of basic general education revenue, extended time revenue, basic skills revenue, (including compensatory revenue and LEP revenue), training and experience revenue, sparsity revenue, transportation sparsity revenue, operating capital revenue, equity revenue, and transition revenue.

The basic general education formula establishes the minimum level of funding for school districts. General education aid is determined by the formula allowance ($4,601 in 2005) multiplied by the adjusted marginal cost pupil unit (AMCPU). Between 2003 and 2005, the general education formula allowance was frozen at $4,601. With the formula allowance remaining at the same level from 2003 to 2005, increased revenue was achieved by growth in enrollments, shifts in the compositon of a district's enrollment, or the passage of voter-approved levies. Basic general education aid accounted for about 87 percent of the general education revenue in 2005.

The following description shows the complexity of the current funding formulas and represents just one of the components of many formulas.

[9] The definitions and examples are largely taken from the following documents: Minnesota House Research Department, *Minnesota School Finance, 2004* and Minnesota House of Representatives Fiscal Analysis Department, *Financing Education in Minnesota, 2005*. Both documents were a valuable resource for this report.

[10] See Minnesota Office of the Legislative Auditor Program Evaluation report, *School District Finances* – February 2001.

Pupil Weighting

| | | |
|---|---|---|
| One Kindergarten Pupil | = | .557 pupil units |
| One Elementary Pupil (grades 1-3) | = | 1.115 pupil units |
| One Elementary Pupil (grades 4-6) | = | 1.06 pupil units |
| One Secondary Pupil (grades 7-12) | = | 1.3 pupil units. |

A Preschool Pupil with Disabilities is counted as 1.25 pupil units for the ratio of hours of service with a minimum of .28 ADM and a maximum of 1.25 pupil units.

Weighted Average Daily Membership (WADM)

A WADM is the total of the above weighted pupil unit categories for a school district.

Adjusted Marginal Cost Pupil Units (AMCPU)

An AMCPU is the greater of the total of weighted average daily membership served by the school district multiplied by .77 plus the total of the weighted average daily membership served by the district the prior year multiplied by .23, or the actual current weighted average daily membership served by the district.

Other components of general education revenue from the state include basic skills revenue (compensatory revenue and LEP revenue), sparsity revenue, equity revenue, training and experience revenue, and transition revenue.

The major factors in the general education formulas are as follows:

**Compensatory Revenue** - based on the number of students eligible for free lunch plus half the students eligible for reduced-price lunch multiplied by $2,512. Compensatory revenue also increases as the percent of free and reduced-price pupils at a particular school site increases. Compensatory revenue must be used to meet the educational needs of pupils whose progress toward meeting state or local content or performance standards is below the level that is appropriate for learners of their age.

**Limited English Proficiency (LEP) Revenue** - based on the number of LEP marginal pupil units and LEP concentration pupils. This revenue is designated to provide instruction to students with limited English skills. It includes English-as-a-second language (ESL) programs. Students are limited to a maximum of five years of funding for LEP revenue. Compensatory and LEP revenue together accounted for about 6 percent of general education revenue in 2005.

**Sparsity Revenue** – has two components, secondary and elementary. The secondary sparsity formula measures the sparsity and isolation of the district and provides revenue to secondary schools that have less than 400 students. Elementary sparsity revenue is available if an elementary school is located 19 or more miles from the next nearest elementary school and has fewer than 20 pupils per grade. Sparsity revenue accounted for about 0.3 percent of general education revenue in 2005.

**Operating Capital Revenue** – provides $100 per AMCPU times the district's maintenance cost index. Districts with older buildings receive more revenue because of the maintenance cost index. Operating capital revenue accounted for about 4 percent of general education revenue in 2005.

**Equity Revenue** – equity revenue is intended to reduce the disparity between the highest and lowest revenue districts on a regional basis. The state is divided into a seven-county metro region and a Greater Minnesota region and equity revenue is calculated separately for districts within each region. Minneapolis, St. Paul and Duluth are not eligible for the program.

In each region, districts are ranked according to their total basic, transition, supplemental and referendum revenue. Districts below the 95$^{th}$ percentile in the four categories combined are eligible for equity revenue. Equity revenue accounted for about 0.7 percent of general education revenue in 2005.

**Training and Experience Revenue** – This program partially compensates school districts that have teachers who have a substantial number of years of service to the school district and higher levels of educational attainment. The program is currently being phased out and is limited to those teachers who taught in the district during the 1996-97 school year and are still teaching in the same school district during the current year. Training and experience revenue accounted for about 0.3 percent of general education revenue in 2005.

## Referendum Revenues

The current funding formulas have diminished the importance of property wealth and levies in school funding. We found that:

- **Outside of a few districts, the property wealth of the district has very little correlation to the general fund revenues of the district.**

Due to the level of state funding, equity revenue, referendum revenue caps, and referendum equalization, inequities in tax base do not translate into inequities in school funding. In fact, a statistical analysis of the data showed that there was only a small correlation between property wealth and the level of revenue for school districts. Differences in referendum revenue may have more to do with

the willingnesss of taxpayers to support referendums than the level of property wealth in the district.

The referendum revenue program, often referred to as the operating referendum levy or excess levy referendum, is a mechanism that allows school districts to obtain voter approval to increase its revenue beyond limits set in statute. The 2002 Legislature greatly reduced the referendum levy beginning in fiscal year 2003. Each district's referendum revenue was reduced by $415 per pupil unit. At the same time the referendum was reduced, the basic formula allowance paid for by the State was increased by $415 per pupil unit.

The Legislature also imposed referendum caps. In 2005, the amount a district could levy was limited to the greater of $855.79 per pupil unit (18.6 percent of the formula allowance) or 117.7 percent of the district's FY 1994 referendum allowance minus $415, times a statutory inflation factor based on the Consumer Price Index (CPI). These caps ensure that property wealth can only enhance educational opportunities in school districts by a maximum of $856 per pupil. Districts that are eligible for sparsity revenue may exceed the referendum limit.

**Between 2001 and 2005, property tax revenues per pupil declined from $2,102 to $1,555.**

In addition, the state provides equalization aid to ensure that the same tax rates in districts of different property wealth generate the same amount of revenue. Thus, districts with higher property wealth will pay a greater percentage of the levy with property taxes than a district with low property wealth. Overall, the changes in referendum levies have resulted in the per pupil revenues derived from property taxes shrinking from $2,102 in 2001 to $1,555 in 2005. This represents a decrease of 26 percent.

## Special Education Revenues

Districts receive revenue to recognize a portion of the additional costs of providing required services to students with a disability. Special education costs are calculated for a base year, two fiscal years prior to the year of the aid payment. A district's revenue is the amount obtained by summing the special education reimbursements.

Because the aid is calculated based on the costs incurred two years prior, districts with increasing special education enrollments or costs must use a greater amount of other general fund revenues to provide services in the interim. In 2005, special education revenues represented an amount that was about 7 percent of the total of general education revenue.

# School District Expenditures

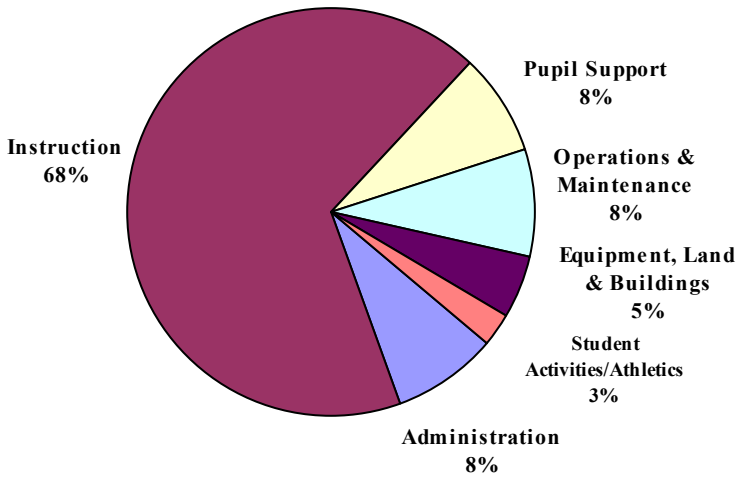
## Expenditures by Program

School district operating expenditures are composed of 12 different programs (see Table 10 for a listing of the program areas). Among all charter schools and school districts, the average amount spent on operating programs totaled $8,804 per pupil. Among individual school districts, total operating expenditures per pupil ranged from $4,916 to $18,359, more than a three-fold difference. The top three spending districts are within Native American Indian Reservations and receive special federal funding. Among charter schools, the range was from a high of $48,912 to a low of $6,016.

**Instruction accounted for 68 percent of operating expenditures.**

For the purpose of this analysis, we have grouped the twelve categories into 6 groups: administration, instruction, student activities/athletics, pupil support, equipment, land & buildings, and operations & maintenance. The largest area of program spending was instruction, which represented 68 percent of all operating expenditures in 2005. This category includes regular instruction, vocational instruction, special education, and instructional support such as classroom aides. [11] Figure 3 shows the distribution of operating expenditures.

**Figure 3: Total Operating Expenditures by Program, 2005**




[11] The category of Student Activities/Athletics was previously included as part of Regular Instruction. The Department of Education began segregating these activities in 2005.

Since 2001, there has been a slight shift in the allocation of school district spending. Three categories accounted for a smaller percentage of total operating expenditures: administration, pupil support, and equipment land and building. The share of administration expenditures decreased from 8.8 percent in 2001 to 8.3 percent in 2005; pupil support expenditures decreased from 8.7 percent in 2001 to 8.1 percent in 2005; and, equipment, land and building decreased from 5.7 percent in 2001 to 4.9 percent in 2005.

**Administration represented a smaller share of school district spending in 2005 than in 2001.**

Three operating programs, instruction, student activities & athletics, and operations & maintenance, each gained a larger share of total operating expenditures. Instruction expenditures grew from 66.3 percent to 67.9 percent, student activities & athletics expenditures grew from 2.4 to 2.6 percent, and expenditures on operations & maintenance increased from 8.1 percent to 8.2 percent.

Table 9 illustrates the changes in program expenditures.[12]

## Table 9: Operating Expenditures by Program, 2001 and 2005

| Program | 2001 Per Pupil Spending | 2001 Percent of Total | 2005 Per Pupil Spending | 2005 Percent of Total | 2001-05 Percent Change |
|---|---|---|---|---|---|
| **Administration** | $665 | 8.8% | $735 | 8.3% | 10.5% |
| **Instruction** | $5,033 | 66.3% | $5,974 | 67.9% | 18.7% |
| **Pupil Support** | $657 | 8.7% | $711 | 8.1% | 8.2% |
| **Student Activities/Athletics** | $184 | 2.4% | $227 | 2.6% | 23.4% |
| **Operations & Maintenance** | $613 | 8.1% | $724 | 8.2% | 18.1% |
| **Equipment, Land & Buildings** | $435 | 5.7% | $433 | 4.9% | -0.5% |
| **Total PK-12 Operating Expenditures** | $7,587 | | $8,804 | | 16.0% |
| **Inflation over the five years** | | | | | 10.3% |

SOURCE: Office of the State Auditor analysis of Minnesota Department of Education data.

[12] Administration = District and School Administration & District Support Services; Instruction = Regular, Vocational, Special Education, and Instructional Support Services; Pupil Support = Pupil Support Services and Pupil Transportation; Operations & Maintenance; Equipment, Land & Building = Capital Expenditures; Student Activities/Athletics .

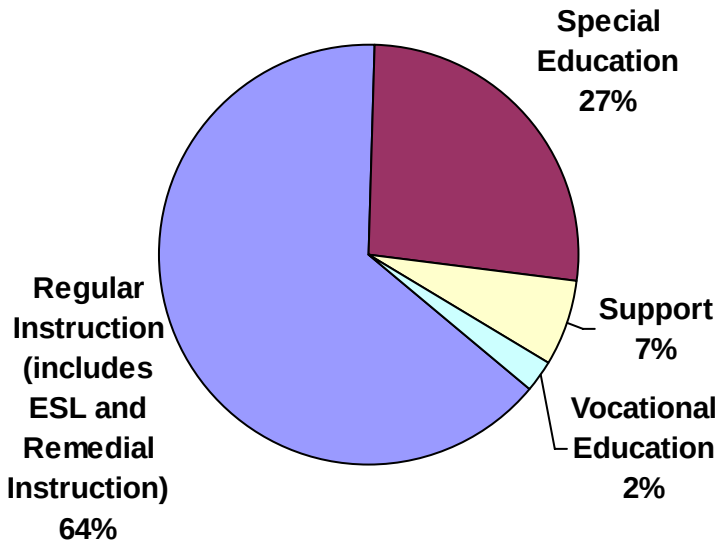
## Spending on Instruction

Within the category of instructional expenditures, regular instruction accounts for 64 percent of the total. Regular instruction includes classroom instruction as well as spending for students with limited English proficiency, students needing help with basic skills, and gifted and talented students.

As figure 4 shows, special education accounts for 27 percent of instructional spending. The remaining non-regular instructional spending went for instructional support services and vocational education.

**Regular Instruction accounted for 64 percent of 2005 instructional expenditures.**

**Figure 4: Instructional Expenditures by Type, 2005**




## Growth in Spending

We found that for the most part, the state funding formula dictates the level of spending in a district. Those districts that have a higher percentage of special population students receive and spend more money. Statutes dictate that the money is spent on the programs serving these students. Districts must show that they are spending the resources on these services. Most money is spent and not added to fund balances.

Between 2001 and 2005, total operating expenditures of Minnesota public school districts and charter schools increased an average of 13 percent, growing from $6.48 billion to $7.35 billion. On a per pupil basis, total operating expenditures grew from $7,587 to $8,804, a 16 percent increase.

**The average cost per pupil receiving special education services was $11,885 in 2005**

The fastest growing major program between 2001 and 2005 was special education. Per pupil spending on special education grew 33 percent during this period, increasing from $1,204 to $1,601 (this represents the total spending spread over all students, not just those receiving special education services).

Additional analysis of special education spending shows that the average cost per student receiving these services was $11,885. This represents an increase of 24 percent over the $9,623 per recipient spent in 2001. Over the five-year period, the number of students receiving services increased 5.3 percent.

Table 10 illustrates the change in per pupil spending among various categories.

## Table 10: Operating and Other Expenditures per Student by Program, FY 01 to FY 05

| Category of Expenditure | 2001 | 2005 | 2001-05 Percent Change | Inflation Adjusted % Change |
|---|---|---|---|---|
| **District Level Administration** | $328 | $370 | 12.8% | 4.2% |
| **School Level Administration** | 337 | 365 | 8.3% | 0.1% |
| **Regular Instruction** | 3,309 | 3,842 | 16.1% | 7.3% |
| **Career & Technical Education** | 146 | 142 | -2.7% | -10.1% |
| **Special Education** | 1,204 | 1,601 | 33.0% | 22.8% |
| **Student Activities/Athletics** | 184 | 227 | 23.4% | 14.0% |
| **Instructional Support** | 374 | 389 | 4.0% | -3.9% |
| **Pupil Support** | 246 | 235 | -4.5% | -11.7% |
| **Operations & Maintenance** | 613 | 724 | 18.1% | 9.1% |
| **Student Transportation** | 411 | 476 | 15.8% | 7.0% |
| **Equipment - Capital** | 341 | 315 | -7.6% | -14.7% |
| **Land & Buildings - Capital** | 94 | 118 | 25.5% | 16.0% |
| **Total PK-12 Operating Expenditures *** | $7,587 | $8,804 | 16.0% | 7.2% |
| **Food Service** | 322 | 388 | 20.5% | 11.3% |
| **Community Service** | 348 | 408 | 17.2% | 8.3% |
| **Building Construction** | 760 | 696 | -8.4% | -15.4% |
| **Debt Service** | 629 | 835 | 32.8% | 22.6% |
| **Total of All Other Expenditures** | $2,059 | $2,327 | 13.0% | 4.4% |
| **Total Education Expenditures** | $9,646 | $11,131 | 15.4% | 6.6% |
| **Inflation Over Period** | | | 10.3% | |
| **Total Enrollment** | 854,541 | 835,290 | -2.3% | |

* Exclusively General Fund expenditures

SOURCE: Office of the State Auditor analysis of Minnesota Department of Education data.

## Variation Among Districts

While average expenditures per pupil help identify trends, there is great variation among the individual districts. Wide variation exists in both the level of per pupil spending and the rate of growth. For example, in the case of school districts total operating expenditures per pupil, expenditures ranged from $4,916 to $18,359 with an average of $8,804. Rates of change ranged from negative 11 percent to positive 53 percent. Among charter schools, the range went from a low of $6,016 to a high of $48,912 with an average of $10,042 per pupil.

As was stated in the revenue section, property wealth accounts for very little of the variation among districts in the amount they spend on education. If the goal was to limit the importance of property wealth in education funding, Minnesota has accomplished it. Based on a statistical analysis of property wealth per pupil, less than three percent of the variation in spending among school districts can be attributed to property wealth.

There are many factors that can affect district expenditures in a given year or over a period of time. Significant growth or decline in special populations can affect the funding and spending of school districts. Because special populations receive categorical funding, the districts must spend the money on the specified purpose.

Districts that experience declining enrollment often are not able to reduce expenditures at the same rate resulting in an increasing per pupil expenditure. In contrast, because funding is tied to enrollment, the total revenues of the district or charter school decreases. It may take several years for districts to adjust their level of spending to their lower revenue amounts.

A district that has incurred damage due to a catastrophic event such as a tornado or flood may receive special state or federal aid for rebuilding facilities, or for providing interim classrooms. These districts will show very high expenditures for a period of time and then return to more normal expenditures.

# Financial Indicators

This section examines four indicators that can be used to help assess a school district's financial health. The first two indicators examined were the fund balances of the operating funds and the general fund. Fund balances can help indicate whether school district revenue and expenditures are balanced over a period of time, and how well the district can meet obligations over the course of the year.

The other indicators were short-term debt and quick ratios. The short-term debt ratio is a measure of a school district's short-term indebtedness in relation to its available cash and investments. Lower short-term debt ratios may indicate better financial conditions than higher ratios. The quick ratio is a district's cash and investments divided by its current payables, including short-term debt. A higher quick ratio indicates better ability to meet short-term obligations than a lower quick ratio. These ratios help assess the districts ability to meet current obligation with their cash and investments on hand. The fund balance data measures all financial resources whereas the short-term debt and quick ratios measure only cash and investments on hand.

## Fund Balances

Unreserved undesignated fund balances can be an important indicator of the overall fiscal health of a district. They can be looked at in two ways: whether they are increasing or decreasing on a per pupil basis, and the percent of expenditures they represent. We present two different fund balance measures, fund balances of the operating funds (General, Food Service, and Community Service funds) and exclusively the general fund.

Districts that have declining fund balances or negative fund balances are spending more than the revenues they receive. A downward trend over a five-year period could indicate that the district will have to adjust spending to keep their revenues and expenditures in balance.

### Undesignated Unreserved Operating Fund Balance

**Undesignated unreserved fund balances grew 40 percent between 2001 and 2005.**

From 2001 to 2005, the average per pupil fund balance of the school districts and charter schools grew from $572 to $901, an increase of 58 percent in unadjusted per pupil dollars. There were clear differences between charter schools and the two groups of school districts. Charter schools had an average fund balance of $1,537; school districts over 1,000 students had an average fund balance of $798; and, school districts under 1,000 students had an average fund balance of $1,585.

Thirty-one school districts and 11 charter schools posted a negative unreserved undesignated fund balance in 2005 compared to 43 school districts and 10 charter schools in 2001.

**Undesignated Unreserved General Fund Balance**

From 2001 to 2005, the average per pupil undesignated unreserved fund balances of the general fund grew from $528 to $844, an increase of 60 percent. Charter schools had an average fund balance of $1,547; school districts with more than 1,000 students had an average fund balance of $739; and, school districts with fewer than 1,000 students had an average fund balance of $1,533.

Among the districts, 55 percent showed an increase over this period, 45 percent showed a decrease. Among charter schools, 67 percent showed an increase and 33 percent showed a decrease. The overall trend indicates an improving financial condition for school districts.

The number of school districts and charter schools having a negative unreserved fund balance decreased from 61 in 2001 to 41 in 2005. Again, this represents an improving financial condition for many districts.

Another way to measure the level of unreserved fund balances in the general fund is to compare them to general fund expenditures. A 2002 report on charter school financial accountability from the Legislative Auditor's Office indicated that a reasonable target is a fund balance ranging from 10 to 20 percent of general fund expenditures. The Legislative Auditor's report found that 45 percent of charter schools and 42 percent of school districts had inadequate reserves. A review of 2005 data for charter schools showed that 41percent of charter schools had inadequate reserves, while 53 percent of districts over 1,000 students and 36 percent of districts under 1,000 students had inadequate reserves.

The overall trend for undesignated unreserved general fund balances as a percent of general fund expenditures showed that the percentage increased from 7.0 percent in 2001 to 9.6 percent in 2005. This trend indicates that the financial condition of many districts is improving. There were significant differences between charter schools and school districts. In 2005, charter schools showed an average fund balance as a percent of general fund expenditures of 15.4 percent, compared to 8.5 percent for school districts with more than 1,000 students and 15.9 percent for districts with fewer than 1,000 students.

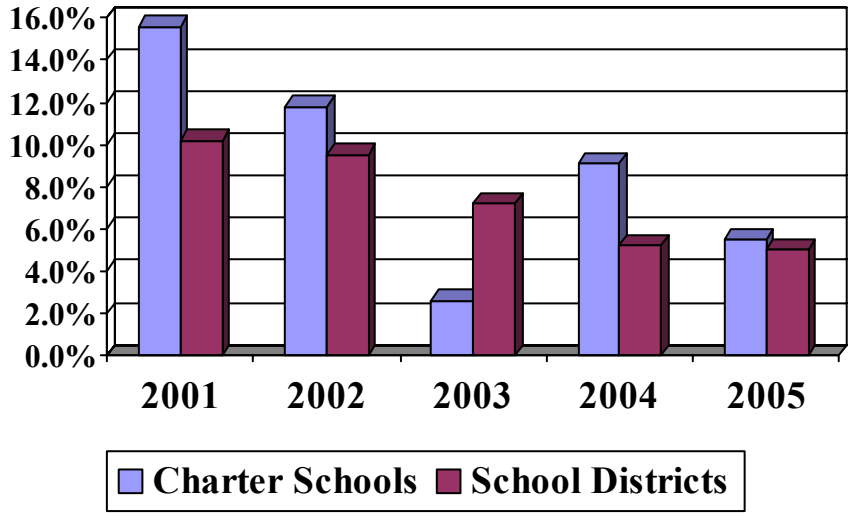
## Statutory Operating Debt

A district that reports a negative general fund undesignated unreserved fund balance in excess of 2.5 percent of its general fund expenditures is considered to

be in statutory operating debt (SOD). Districts that are in SOD are required to submit a plan to the Commissioner of Education explaining how they will eliminate the deficit.

In 2005, 5 charter schools and 19 school districts were in statutory operating debt. The overall trend has been fewer charter schools and school districts in SOD.

**Figure 5: Percentage of Charter Schools and School Districts in Statutory Operating Debt, FY 01 to FY 05**




## Short-Term Debt and Quick Ratio

The short-term debt ratio and quick ratio are two more financial indicators that can be used to assess the fiscal health of school districts.

### Short-Term Debt Ratio

The short-term debt ratio is a measure of a school district's short-term indebtedness in relation to its available cash and investments. Lower short-term debt ratios may indicate better financial conditions than higher ratios. The average short-term debt ratio more than tripled between 2001 and 2005. In 2001 the average short-term debt ratio was .17 compared to 0.50 in 2005. This change in ratio indicates that, on average, schools are using a greater amount of short-term debt (generally aid anticipation notes) to fund operations.

## Table 11: Short-Term Debt Ratio (Short-Term Debt to Cash & Investments), FY 01 to FY 05

| District Name | 2001 Short-Term Debt Ratio | 2002 Short-Term Debt Ratio | 2003 Short-Term Debt Ratio | 2004 Short-Term Debt Ratio | 2005 Short-Term Debt Ratio | 2001 to 2005 Percent Change |
|---|---|---|---|---|---|---|
| **Charter Schools** | **0.05** | **0.05** | **0.08** | **0.27** | **0.15** | **202.3%** |
| **Districts Over 1,000 Students** | **0.17** | **0.24** | **0.54** | **0.79** | **0.52** | **210.7%** |
| **Districts Under 1,000 Students** | **0.20** | **0.23** | **0.33** | **0.43** | **0.41** | **100.5%** |
| **All Districts & Charter Schools** | **0.17** | **0.24** | **0.50** | **0.71** | **0.50** | **185.9%** |

SOURCE: Office of the State Auditor analysis of Minnesota Department of Education data.

The variation in the short-term debt ratio was great. Among school districts, 53 percent had a ratio of zero indicating that they had no short-term debt. Among charter schools, 75 percent had no short-term debt. Among the school districts that did have short-term debt, the ratios ranged from negative 18.9 in the Bellingham district to 0.28 in the Henning district. This means that Bellingham had a negative cash & investment balance and short-term debt that was 19 times greater than its negative cash & investment balance. Henning's ratio indicates that the district has short-term debt that amounts to 28 percent of its cash & investments.

Among charter schools, the range was from a negative 79.3 for Heart of the Earth Charter School to .46 at the Twin Cities International Elementary Charter School.

### Quick Ratio

The quick ratio is a district's cash and investments divided by its current payables, including short-term debt. This quick ratio measure includes only the General and Special Revenue Funds. A higher quick ratio indicates better ability to meet short-term obligations than a lower quick ratio. The quick ratio for all districts and charter schools declined from 2.26 in 2001 to 0.99 in 2005 – a decrease of 56 percent over the five-year period. This trend indicates that school districts and charter schools have fewer resources available to meet short-term obligations than five years earlier.

## Table 12: Quick Ratio (Cash & Investments to Current Payables), FY 01 to FY 05

| District Name | 2001 Quick Ratio | 2002 Quick Ratio | 2003 Quick Ratio | 2004 Quick Ratio | 2005 Quick Ratio | 2001 to 2005 Percent Change |
|---|---|---|---|---|---|---|
| **Charter Schools** | **0.95** | **0.96** | **0.72** | **0.58** | **0.78** | **-17.9%** |
| **Districts Over 1,000 Students** | **2.16** | **1.53** | **0.99** | **0.71** | **0.92** | **-57.4%** |
| **Districts Under 1,000 Students** | **3.06** | **2.55** | **1.92** | **1.57** | **1.48** | **-51.6%** |
| **All Districts & Charter Schools** | **2.26** | **1.65** | **1.08** | **0.81** | **0.99** | **-56.2%** |

SOURCE: Office of the State Auditor analysis of Minnesota Department of Education data.

A declining quick ratio indicates schools have less in cash and investments available with which to begin the year. While an increase in the fund balance indicates schools may have increased other resources to compensate for the decrease in the cash and investments. The short-term debt ratio increased as more schools required short-term borrowing to meet current obligations as a result of the decrease in the cash and investments. The trends, while opposite, show that although cash and investments on hand are decreasing, other financial resources available to the districts are generally sufficient to cover expenses over the course of the year.

## Explanation of Contradictory Indicators

While the fund balance indicators seem to contradict the quick and short-term debt ratios, there are two explanations. The first has to do with how state aid payments are provided to the districts. From 2001 to 2003, districts were provided 90 percent of the revenues during the current year and 10 percent the next year. In 2003, the aid distribution formula changed to 83 percent in the current year and 17 percent in 2004. In 2004 and beyond, schools received 80 percent in the current year and 20 percent in the next year. As a result of the formula changes, school districts have had a decrease in cash of 10 percent and an increase of 10 percent in receivables. Also, whereas in the past, districts would receive a large property tax payment in May, the state takeover of general education formula means that they will no longer receive this infusion of cash near the end of the year.

# Appendix 1

## Charter School Background

In 1991, Minnesota became the first state in the nation to authorize charter schools. Minnesota's charter schools are publicly funded, non-sectarian schools formed by parents, teachers, or community members. A board elected by parents of students and by the school's staff governs each school. Charter schools in Minnesota are funded by the state; however, they are different from traditional public schools in that they are subject to less regulation in an effort to encourage educational innovation. Minnesota's charter school legislation requires that each school have a sponsor. Eligible sponsors include traditional school boards, non-profit organizations, and colleges and universities.[13]

Since their authorization, the number of charter schools has grown steadily. Initially, the state approved 6 charter schools. That cap was later raised and was lifted altogether in 1997, allowing the Department of Education to approve charter schools at its discretion. The number of charter schools in Minnesota has increased to 101 in the 2004-05 school year.

## Financial Problems at Charter Schools

While the total number of charter schools has increased in recent years, some charter schools have closed during the same time period, many due to financial problems. These cases have raised concerns about the financial health and accountability of charter schools in general. The fact that charter schools receive state aid but are subject to less regulation than their traditional school counterparts has heightened these concerns.

According to a report released by the Office of the Legislative Auditor, 16 charter schools had closed as of 2002. Of those 16 schools, 15 were forced to close due to poor financial management. The Legislative Auditor noted "egregious financial management errors, repeated overstatements of enrollment, failure to maintain accurate books and record or pay taxes, and the commitment to inappropriate building leases" in those 15 schools.[14]

Charter schools became the subject of significant public scrutiny in 2000 and 2001 when several schools were forced to close. Reasons for closing charter schools ranged from overspending and misuse of funds at Summit School for the Arts to delinquent taxes and poor financial records at the Right Step

[13] House Research, September, 2002.
[14] OLA Report 2004, page 5.

Academy in St. Paul.[15] Financial mismanagement was common to almost all of the charter schools that ceased operations.

In February of 2001, three other charter schools, located in Dundas, Pillager, and Duluth were ordered to repay state funds after they were found to have misreported enrollments. All three schools were founded by the same individuals and used a charter school model that emphasizes "project-based learning"[16] The Faribault and Pillager PEAKS schools closed after the 2000-2001 school year.

Early in the 2001 legislative session, Rep. Matt Entenza (DFL-St. Paul) called attention to the financial management of charter schools with a report that alleged a lack of financial accountability among charter schools. Entenza's office reviewed the audits and contracts of those charter schools that reported to the state office then known as the Department of Children, Families and Learning. Entenza claimed that the success of charter schools was "in deep doubt unless we can get the finances in order."[17]

Specifically, Entenza's review revealed conflicts of interest among board members, managers and employees of charter schools, poor financial monitoring, unwarranted contracts for management companies and other concerns. Entenza also found that 65 percent of charter schools failed to report their audited financial statements by December 31 as required by law.

In the wake of Entenza's report and the closing of several charter schools, the 2001 State Legislature amended the state's charter school law, adding requirements for charter schools. Under the legislation passed in 2001, if a charter school's annual audit shows a material weakness in the financial reporting systems of the school, the school is required to submit a plan to the Department of Education on how the weakness will be addressed. Similarly, if the audit shows a charter school is in statutory operating debt, the school is required to submit a plan demonstrating how it plans to get out of debt and to limit expenditures accordingly. In addition, charter school boards were required to keep minutes and adhere to the same requirements that apply to school districts regarding contracts for services. Finally, addressing some concerns over conflicts of interest, the Legislature barred charter school board members from working for or serving on the board of a for-profit contractor doing business with a charter school.

In 2002, the Legislative Audit Commission asked the Office of the Legislative Auditor to review the financial health of charter schools. The Legislative Auditor's report released in June of 2003 showed that 14 charter schools were

[15] OLA Report, page 6
[16] Derek Neas, "Charter School Gets Steep Bill From State," *Duluth News Tribune,* February 8, 2001
[17] Anthony Lonetree, "A Call to Act on Charter School Woes," *Star Tribune,* February 7, 2001.

financially at risk at the end of the 2002 fiscal year. Eight charter schools had negative fund balances; six were in statutory operating debt; five had operating deficits larger than their fund balances and one school failed to report any financial data to the Minnesota Department of Education as required by law. In addition, two other schools that closed during the fiscal year due to financial problems were not included in the analysis.

The Legislative Auditor's report cited poor financial planning and inadequate tracking of actual revenues and expenditures as reasons for the financial problems in many charter schools. The report also faulted a number of charter schools for failing to report their financial information to the Minnesota Department of Education in a timely manner, making financial oversight difficult.

In the summer of 2004, Rep. Entenza once again raised concerns about the financial accountability of charter schools. Entenza found that 26 of Minnesota's 88 charter schools did not submit their financial data to the Department of Education by the December 31st deadline. The report also showed that several charter schools failed to provide Entenza's office with the minutes of their board meetings upon request. The 2001 charter school legislation required that charter schools provide minutes of their board meeting upon request. Entenza called upon the State Department of Education to step up its oversight over charter schools and suggested that it might be appropriate for the State Auditor's Office to conduct spot audits of charter schools.

In late 2004, the financial collapse of the Col. Charles Young Military Academy prompted the Minnesota Department of Education to make management training a requirement for the sponsors and board members of charter schools.[18]

## Charter School Oversight

Charter schools are an interesting and innovative concept. They provide parents with additional options in selecting an educational experience for their children. Many charter schools offer concentrations in subject areas that students could not receive in a traditional school setting. While the concept has undoubtedly served many students well, it is a fact that many charter schools have been poorly managed. It does not appear that this mismanagement is intentional in most cases; rather, many charter schools appear to suffer from a lack of financial training and expertise.

In light of financial problems charter schools have and are experiencing, the State Auditor's Office will be increasing its oversight of charter schools. Specifically, the office has begun conducting desk reviews of the annual audits submitted by charter schools. If desk reviews reveal significant concerns, the

[18] John Welbes, *St. Paul Pioneer Press,* December 30, 2004.

office will conduct further examinations as necessary. Some examinations are already underway.

Because charter schools are publicly funded entities, financial mismanagement is especially troubling. Not only do charter school students miss out on educational opportunities when finances are mismanaged, the public trust is also violated as taxpayer dollars are squandered. As the taxpayer's watchdog, the State Auditor's Office will work to ensure that public dollars are spent appropriately in charter schools, so that an interesting and innovative concept is given the opportunity to succeed.

# Table 13: List of Existing Operating Charters Schools, 2005

| District Number | Charter School | Enrollment |
|---|---|---|
| 4000 | City Academy | 123 |
| 4001 | Bluffview Montessori | 194 |
| 4004 | Cedar Riverside Community School | 109 |
| 4005 | Metro Deaf Charter School | 57 |
| 4006 | Skills For Tomorrow Charter School | 104 |
| 4007 | Minnesota New Country School | 100 |
| 4008 | Pact Charter School | 538 |
| 4011 | New Visions Charter School | 207 |
| 4012 | Emily Charter School | 80 |
| 4015 | Community of Peace Academy | 558 |
| 4016 | World Learner Charter School | 138 |
| 4017 | Minnesota Transitions Charter Sch | 939 |
| 4018 | Achieve Language Academy | 344 |
| 4019 | New Voyage Academy Charter School | 81 |
| 4020 | Duluth Public Schools Academy | 762 |
| 4021 | Village School of Northfield | 56 |
| 4025 | Cyber Village Academy | 124 |
| 4026 | E.C.H.O. Charter School | 165 |
| 4027 | Higher Ground Academy | 422 |
| 4028 | Eci' Nompa Woonspe | 23 |
| 4029 | New Spirit Schools | 307 |
| 4030 | Odyssey Charter School | 200 |
| 4031 | Jennings Experiential High School | 84 |
| 4032 | Harvest Prep School/Seed Academy | 356 |
| 4035 | Concordia Creative Learning Academy | 113 |
| 4036 | Face To Face Academy | 57 |
| 4038 | Sojourner Truth Academy | 241 |
| 4039 | High School For Recording Arts | 198 |
| 4042 | Twin Cities Academy | 183 |
| 4043 | Math & Science Academy | 280 |
| 4044 | Heart of the Earth Charter | 206 |
| 4045 | Lakes Area Charter School | 80 |
| 4046 | Lake Superior High School | 91 |
| 4048 | Great River Education Center | 42 |
| 4049 | Coon Rapids Learning Center | 182 |
| 4050 | Lafayette Public Charter School | 105 |
| 4052 | Four Directions Charter Schools | 88 |
| 4053 | North Lakes Academy | 196 |
| 4054 | Lacrescent Montessori Academy | 59 |
| 4055 | Nerstrand Charter School | 154 |
| 4056 | Rochester off-Campus Charter High | 121 |
| 4057 | El Colegio Charter School | 85 |
| 4058 | Schoolcraft Learning Community Chtr | 157 |
| 4059 | Crosslake Community Charter School | 95 |
| 4061 | Studio Academy Charter School | 123 |
| 4062 | Family Academy Charter School | 217 |
| 4064 | Riverway Learning Community Chtr | 71 |
| 4065 | Minnesota Business Academy Charter | 289 |
| 4066 | Riverbend Academy | 100 |
| 4067 | Aurora Charter School | 182 |
| 4068 | Excell Academy Charter | 187 |
| 4070 | Hope Community Academy | 480 |
| 4072 | Yankton Country Charter School | 32 |
| 4073 | Academia Cesar Chavez Charter Sch. | 244 |
| 4074 | Agricultural Food Science Academy | 151 |
| 4075 | Avalon School | 119 |
| 4076 | Minnesota Academy of Technology | 68 |
| 4077 | Twin Cities International Elem Sch. | 429 |
| 4078 | Mn International Middle Charter | 225 |
| 4079 | Friendship Acdmy of Fine Arts Chtr. | 91 |
| 4080 | Pillager Area Charter School | 47 |
| 4081 | Covenant Academy of Mn. Chtr. | 38 |
| 4082 | Bluesky Charter School | 69 |
| 4083 | Ridgeway Community School | 62 |
| 4084 | North Shore Community School | 241 |
| 4085 | Harbor City International Charter | 197 |
| 4086 | Woodson Institute For Excellence Ch | 192 |
| 4087 | Sage Academy Charter School | 79 |
| 4088 | Urban Academy Charter School | 155 |
| 4089 | New City School | 87 |
| 4090 | Prairie Creek Community School | 109 |
| 4091 | Artech | 97 |
| 4092 | Watershed High School | 122 |
| 4093 | New Century Charter School | 149 |
| 4095 | Trio Wolf Creek Distance Learning | 73 |
| 4098 | Nova Classical Academy | 222 |
| 4099 | Tarek Ibn Ziyad Academy | 208 |
| 4100 | Great Expectations | 35 |
| 4101 | Minnesota North Star Academy | 11 |
| 4102 | Minnesota Internship Center | 370 |
| 4103 | Hmong Academy | 187 |
| 4104 | Liberty High School | 156 |
| 4105 | Great River School | 84 |
| 4106 | Treknorth High School | 152 |
| 4107 | Voyageurs Expeditionary | 52 |
| 4108 | General John Vessey Jr Leadership | 72 |
| 4109 | Sobriety High | 121 |
| 4110 | Main Street School Performing Arts | 106 |
| 4113 | Fraser Academy | 48 |
| 4114 | Ascension Academy Charter School | 28 |
| 4115 | Minneapolis Academy Charter School | 69 |
| 4116 | Lakes International Language Admy | 173 |
| 4118 | Kaleidoscope Charter School | 195 |
| 4119 | River Heights Charter School | 80 |
| 4120 | St. Croix Preparatory Academy | 199 |
| 4121 | Ubah Medical Academy Charter Schoc | 120 |
| 4122 | Eagle Ridge Academy Charter School | 118 |
| 4123 | Dakota Area Community Charter Sch | 62 |
| 4124 | Beacon Academy | 112 |
| 4126 | Prairie Seeds Academy | 127 |
| 4127 | Team Academy | 41 |

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# GLOSSARY

**Average Daily Membership (ADM):** The sum for all pupils of the number of days in the district's school year each pupil is enrolled, divided by the number of days the schools are in session.

**Adjusted Marginal Cost Pupil Units (AMCPU):** The counts of pupils used for most school funding formulas. The count is adjusted (meaning students served), marginal (the greater of the current year's count, or 77 percent of current year's count and 23 percent of the previous year's count), and weighted by grade level (pupil units).

**Adjusted Net Tax Capacity (ANTC):** The property value used for assessing most school taxes. ANTC is determined by equalizing differences in tax capacities by property type in different counties. This equalization process compares market values to actual sales and is intended to neutralize the effect of differing assessment practices. Also, the ANTC reflects the application of the classification rates to the market value of the property.

**District and School Administration:** Expenditures for the school board and for the office of the superintendent, principals, and any other line administrators who supervise staff.

**District Support Services:** Expenditures for central office administration and central office operations not included in district and school administration. Includes expenditures for business services, data processing, legal services, personnel office, printing, and the school census.

**Food Service:** Expenditures for the preparation and serving of meals and snacks to students.

**Instructional Support Services:** Expenditures for activities intended to help teachers provide instruction, not including expenditures for principals or superintendents. Includes expenditures for assistant principals, curriculum development, libraries, media centers, audiovisual support, staff development, and computer-assisted instruction.

**Operations and Maintenance:** Expenditures for operation, maintenance, and repair of the district's buildings, grounds, and equipment. Includes expenditures for custodians, fuel for buildings, electricity, telephones, and repairs.

**Other Operating Programs:** Expenditures for general fund operating programs necessary to a district's operations but not assignable to other programs. These can include federally funded community education services for

students, property and liability premiums, principal and interest on noncapital obligations, and nonrecurring costs such as judgments and liens.

**Pupil Support Services:** Expenditures for all non-instructional services provided to students, not including transportation and food. Includes expenditures for counseling, guidance, health services, psychological services, and attendance and social work services.

**Pupil Transportation:** Expenditures for transportation of students, including salaries, contracted services, fuel for buses, and other expenditures.

**Quick Ratio:** The quick ratio is a district's cash and investments divided by its current payables, including short-term debt. This quick ratio measure includes only the General and Special Revenue Funds. A higher quick ratio indicates better ability to meet short-term obligations than a lower quick ratio.

**Regular Instruction:** Expenditures for elementary and secondary classroom instruction, not including vocational instruction and exceptional instruction. Includes salaries of teachers, classroom aides, coaches, and expenditures for classroom supplies and textbooks.

**Short-Term Debt Ratio**: The short-term debt ratio is a measure of a school district's short-term indebtedness in relation to its available cash and investments. Lower short-term debt ratios may indicate better financial conditions than higher ratios.

**Special Education:** Expenditures for instruction of students who, because of atypical characteristics or conditions, are provided educational programs that are different from regular instructional programs. Includes expenditures for special instruction of students who are emotionally or psychologically disabled, or mentally retarded; for students with physical, hearing speech, and visual impairments; and for students with special learning and behavior problems.

**Vocational Instruction:** Expenditures in secondary schools for instruction that is related to job skills and career exploration. Includes expenditures for home economics, as well as industrial, business, agriculture, and distributive education.

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