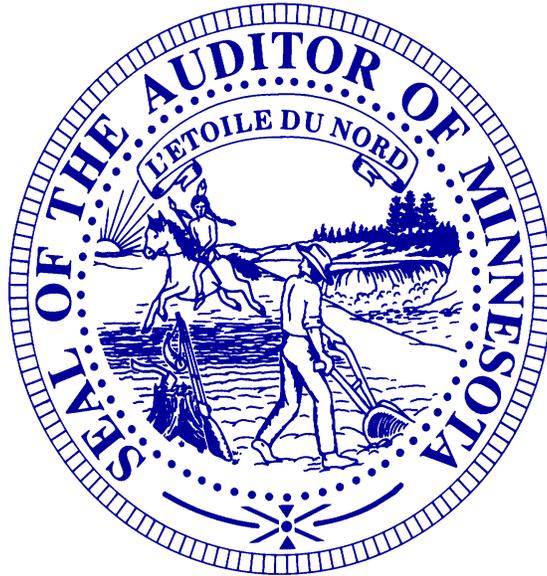


STATE OF MINNESOTA
Office of the State Auditor



Patricia Anderson
State Auditor

**Financial Trends of
Minnesota School Districts
and Charter Schools**

For the period 2000 to 2004

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Financial Trends of Minnesota School Districts and Charter Schools

Fiscal Years 2000 to 2004



June 20, 2005

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Introduction

This report presents education finance data for Minnesota's 346 school districts and 88 charter schools for the years 2000 through 2004. This is the second year that the Office of the State Auditor has compiled data on financial and demographic trends in education. In the first year, the Office issued two reports: one for school districts with over 1,000 students, and one for districts with less than 1,000 students. This year's report includes all school districts in one report, in addition to including charter schools.¹

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 2004 per pupil revenues and expenditures, and other statistics of school districts and charter schools.² The final purpose is to communicate areas of concern identified while conducting the oversight function of the Office.

To improve the oversight function that the State Auditor has of school districts and charter schools, the Office has initiated a process where staff from the Auditor's Office will perform desk reviews of the financial audits of all school districts and charter schools in the state. Appendix 1 of this report identifies areas of concern found during the review of school financial audits. Appendix 2 discusses the special challenges of charter school finances.

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 See Appendix 2 for an overview of charter schools.

² 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 Changes³

In 2004, public school districts in Minnesota ranged in size from 44,201 students in St. Paul to 68 in Pine Point. Among charter schools, enrollment ranged from 785 for the Minnesota Transition Charter School to 25 for the Blue Sky Charter School.

From 2000 to 2004, total enrollment for all school districts and charter schools declined slightly more than one percent.⁴ Among school districts, there were two opposite trends: schools with more than 1,000 students showed a 4 percent decline in enrollment while those with less than 1,000 students showed an increase of 11 percent. Charter schools experienced an increase of 127 percent.

While the growth in the number of students attending charter schools appears large, charter schools still accounted for just 1.7 percent of all students attending public schools in 2004. It is interesting to note that as of 2002, there were more students home schooled (15,610) than attended charter schools (10,101).

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

From 2000 to 2004, total enrollment for public schools declined 1.4 percent.

Table 1: Enrollment for Regular School Districts and Charter Schools, FY 00 to FY 04

<u>Districts with:</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>5-Year Change</u>
Over 1000 Enrollment	760,083	756,684	752,866	740,847	730,912	-3.8%
Under 1000 Enrollment	84,644	89,597	91,811	93,810	94,313	11.4%
Charter Schools	6,244	8,710	10,101	12,213	14,141	126.5%
All Districts & Charter Schools	850,970	854,991	854,778	846,870	839,367	-1.4%

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

³ While this report uses the terms “enrollments” and “per pupil,” these figures actually reflect what is called Average Daily Membership (ADM) served by the Minnesota Department of Education. See the glossary for a definition of this term.

⁴ A large decline between 2003 and 2004 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 Enrollment⁵

While overall enrollment declined among public schools, the number of students classified in various subgroups of total enrollment increased. Between 2000 and 2004, the number of students classified as minority increased 22 percent, the number of students classified as non-English speaking increased 50 percent, the number of students receiving special education services increased 6 percent, and the number of students classified as low-income increased 8 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 16.0 percent to 19.8 percent; the share of pupils with Limited English Proficiency (LEP) as a percent of total enrollment increased from 4.2 to 6.4 percent; special education enrollment increased from 12.4 percent to 13.4 percent of total enrollment; and low-income enrollment increased from 25.8 percent to 28.3 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)

LEP student enrollment grew by fifty percent between 2000 and 2004. 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 6 percent of the total enrollment in 2004 compared to 4 percent in 2000. There are clear differences in the concentration of LEP students between charter schools and school districts with over and under 1,000 students.

- **As a whole, 15 percent of charter school students were classified as LEP in 2004, compared to 7 percent for districts with more than**

⁵ 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.

LEP student enrollment grew by fifty percent between 2000 and 2004.

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 11 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.

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 listed in this report 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 2004, approximately 13 percent of the students in public schools were receiving special education services. The total number of students in this category grew by 7 percent between 2000 and 2004. Charter schools and regular school districts had similar concentrations of special education students.

- **In 2004, about 15 percent of charter school students received special education services compared to 13 percent for districts with over 1,000 students and 15 percent for districts with fewer than 1,000 students.**

Special education students as a percent of total enrollment in school districts ranged from 66 percent in the NE Metro Intermediate District 916 to 7 percent in the Stephen-Argyle Central District. Among charter schools, the range is from 100 percent at the Metro Deaf Academy to 2 percent at the Urban Academy Charter School. Seventy percent of school districts experienced growth in the percentage of children eligible for special education services between 2000 and 2004. Among charter schools open for five years, 69 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 28 percent in 2004. Overall, the number of students eligible for this program increased 9 percent between 2000 and 2004. There were clear differences between charter schools and school districts in the percent of students eligible for free or reduced price lunches.

- **About 55 percent of charter school students were eligible for free or reduced-price lunches compared to 27 percent of students in school districts with more than 1,000 students and 35 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 100 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 MN International Middle Charter School and the Twin Cities International Elementary Charter School to a low of 1.4 percent at the Math & Science Academy.

Minority Enrollment

At a time of declining enrollment overall, minority enrollment increased 22 percent between 2000 and 2004. With overall enrollment decreasing, particularly among white students, the percent of the total enrollment classified as minority rose from 16 percent in 2000 to 20 percent in 2004. There are clear differences in the composition of student bodies between charter schools and school districts.

- **Approximately 53 percent of charter school students are classified as minorities, compared to 21 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 seven districts.⁶ Among charter schools, the percentage ranged from 100 percent at four schools (Harvest Prep School/Seed Academy, MN International Middle Charter School, Twin Cities International Elementary Charter School, and the Woodson Institute for Excellence) to 1 percent at the Artech Charter School.

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

⁶ The districts are Bellingham, Evansville, Franconia, Holdingford, Mabel-Canton, Milroy, and Prinsburg.

Table 2: Trends in Special Population Enrollment, FY 00 to FY 04

	Fall Enrollment	Eligible for Free/Reduced Price Lunch		Limited English Proficiency		Special Education		Minority Students	
		Students	% of Total	Students	% of Total	Students	% of Total	Students	% of Total
2000	845,296	217,727	25.8%	35,682	4.2%	105,072	12.4%	135,190	16.0%
2001	846,228	217,046	25.6%	44,297	5.2%	106,904	12.6%	144,352	17.1%
2002	845,373	223,710	26.5%	47,886	5.7%	108,511	12.8%	152,077	18.0%
2003	840,772	229,768	27.3%	51,160	6.1%	110,032	13.1%	158,486	18.9%
2004	836,616	236,453	28.3%	53,371	6.4%	111,911	13.4%	165,530	19.8%
Percent Change	-1.0%	8.6%	9.7%	49.6%	51.1%	6.5%	7.6%	22.4%	23.7%

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 one, 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 2003-05) 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 15.4 in 2000 to 16.2 in 2004.⁷ For charter schools, the ratio decreased from 16.9 students per teacher in 2000 to 14.2 in 2004. For school districts with more than 1,000 students, the ratio increased from 16.2 to 16.8. School districts with fewer than 1,000 students saw their ratio increase from 10.8 to 13.1.

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

⁷ 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.

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 2000 and 2004, 62 percent of districts saw class sizes increase while 38 percent saw decreases. This trend seems to indicate that for a majority of school districts, class sizes are larger than 5 years ago.

Trends in Staffing

While overall enrollment declined by 1 percent between 2000 and 2004, the number of teachers fell by 6 percent. Among charter schools, the number of teachers has grown 170 percent, from 369 in 2000 to 997 in 2004. For school districts with more than 1,000 students, the number of teachers declined 7 percent, while districts with less than 1,000 students showed a decrease of 8 percent.

Teacher Salaries

The average teacher salary grew slower than the rate of inflation between 2000 and 2004.

Between 2000 and 2004, the average teacher salary increased from \$36,052 to \$40,099. This represents an increase of 11.2 percent. During this period, inflation grew at a rate of 13.8 percent indicating that the average teacher salary did not keep up with inflation.

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.

Table 3: Average Teacher Salaries for Charter Schools and School Districts, FY 00 to FY 04

District Name	2000 Average Teacher Salary	2001 Average Teacher Salary	2002 Average Teacher Salary	2003 Average Teacher Salary	2004 Average Teacher Salary	2000 to 2004 Percent Change
Charter Schools	32,742	33,512	35,211	35,735	36,151	10.4%
Districts Over 1,000 Students	38,691	40,908	41,055	43,507	43,950	13.6%
Districts Under 1,000 Students	34,342	35,794	36,172	37,951	38,424	11.9%
All Districts & Charter Schools	36,052	37,621	38,016	39,771	40,099	11.2%

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

Experience and Educational Attainment of Teachers

From 2000 to 2004, there was a decrease in the average number of years of teaching experience. In 2000, the average number of years experience was 18.4 compared to 16.3 in 2004. 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 2004, the average number of years teaching for teachers in charter schools was 8.6, compared to 16.9 for large districts and 18.7 for small districts.

Over the five-year period, there was a slight decrease in the percentage of teachers holding only bachelor's degrees. In 2000, 56.5 percent of teachers held at least a bachelor's degree but not masters compared to 51.5 in 2004. In contrast, the percentage of teachers holding masters or higher degrees remained at about 29.3 percent.⁸ 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 00 to FY 04

	<u>Number of Years Teaching</u>	<u>Percent with Bachelor's Degree</u>	<u>Percent with Master's Degree</u>	<u>Teachers Salaries</u>
2000	18.4	56.5	29.2	\$36,052
2001	17.9	56.3	29.2	37,621
2002	17.5	56.2	27.6	38,016
2003	16.9	54.1	28.5	39,771
2004	16.3	51.5	29.3	40,099
5-Year Percent Change	-11.3%	-8.8%	0.3%	11.2%

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

⁸ 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 13.5 percent between 2000 and 2004, while the total value of benefits paid to these employees increased 31.7 percent.

Benefits as a percent of salary increased steadily over this period of time. In 2000, benefits equaled 19.8 percent of salary compared to 28 percent in 2004.⁹ 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 6 shows salary and benefit trends from 2000 to 2004.

Table 5: Total Salary and Benefits Costs of the Operating Funds, FY 00 to FY 04

Category	2000	2001	2002	2003	2004	2000 to 2004 Percent Change
Salaries Paid	4,029,789,711	4,225,628,153	4,345,797,533	4,472,950,485	4,575,607,859	13.5%
Benefits Paid	997,019,267	1,072,071,384	1,146,484,485	1,245,861,706	1,312,932,797	31.7%
Total	5,026,808,978	5,297,699,537	5,492,282,018	5,718,812,191	5,888,540,656	17.1%
Salaries Percent	80.2%	79.8%	79.1%	78.2%	77.7%	-3.1%
Benefits Percent	19.8%	20.2%	20.9%	21.8%	22.3%	12.4%

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

⁹ 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 \$8.79 billion or \$10,469 per pupil in 2004. In actual dollars, total revenues grew 21 percent; on a per pupil basis, revenues grew 22 percent. The inflation rate over this period was 14 percent.

The trend was similar for charter schools and school districts with enrollments above 1,000 students, but was significantly different for districts with enrollments under 1,000 students. Due to increasing enrollments, these smaller districts showed an increase of just one percent. Interestingly, because these districts started out with higher per pupil funding, they still ended the five-year with a higher per pupil level than the other two district types.

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 00 to FY 04

Type of District	2000	2001	2002	2003	2004	2000 to 2004 Percent Change
	Total Revenues Per Pupil					
Charter Schools	8,454	9,487	10,206	10,094	10,329	22.2%
Districts Over 1,000 Students	8,339	9,005	9,326	10,013	10,442	25.2%
Districts Under 1,000 Students	10,553	10,430	10,540	10,746	10,699	1.4%
All Districts & Charter Schools	\$8,560	\$9,159	\$9,467	\$10,096	\$10,469	22.3%

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 2000 to 2004.

Table 7: Revenues Per Pupil by Source, FY 00 to FY 04

Year	Levy*	Total Local Revenues	Total State Revenues	Total Federal	Other Revenues	Total Revenues
2000	2,164	2,966	5,018	372	204	8,560
2001	2,101	3,013	5,541	395	211	9,159
2002	2,248	3,115	5,667	465	220	9,467
2003	1,167	2,057	7,269	538	231	10,096
2004	1,395	2,604	7,030	593	241	10,469
5-Year Percent Change	-35.5%	-12.2%	40.1%	59.4%	18.1%	22.3%

* 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 67 percent of all school district revenue in 2004. Federal aid and other local sources such as property taxes, fees, admission charges, tuition, interest earnings, rent, and gifts provided the other 33 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 reflect the state takeover of the general education formula which resulted in a reduction of locally supported tax levies.

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 2004

<u>Type of District</u>	<u>Levy *</u>	<u>Total Local Revenues</u>	<u>Total State Revenues</u>	<u>Total Federal</u>	<u>Other Revenues</u>	<u>Total Revenues</u>
Charter Schools	0	1,854	8,322	1,078	57	10,329
Districts over 1,000 Students	1,493	2,634	6,982	579	247	10,422
Districts under 1,000 Students	843	2,627	7,212	635	225	10,699
All Charters and Districts	\$1,395	\$2,604	\$7,030	\$593	\$241	\$10,469

<u>Type of District</u>	<u>Levy *</u>	<u>Total Local Revenues</u>	<u>Total State Revenues</u>	<u>Total Federal</u>	<u>Other Revenues</u>	<u>Total Revenues</u>
Charter Schools	0.0%	17.9%	80.6%	10.4%	0.6%	100.0%
Districts over 1,000 Students	14.3%	25.3%	67.0%	5.6%	2.4%	100.0%
Districts under 1,000 Students	7.9%	24.6%	67.4%	5.9%	2.1%	100.0%
All Charters and Districts	13.3%	24.9%	67.2%	5.7%	2.3%	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 67 percent of education costs in FY 03-04

Figure 1: Sources of School District Revenues, FY 04

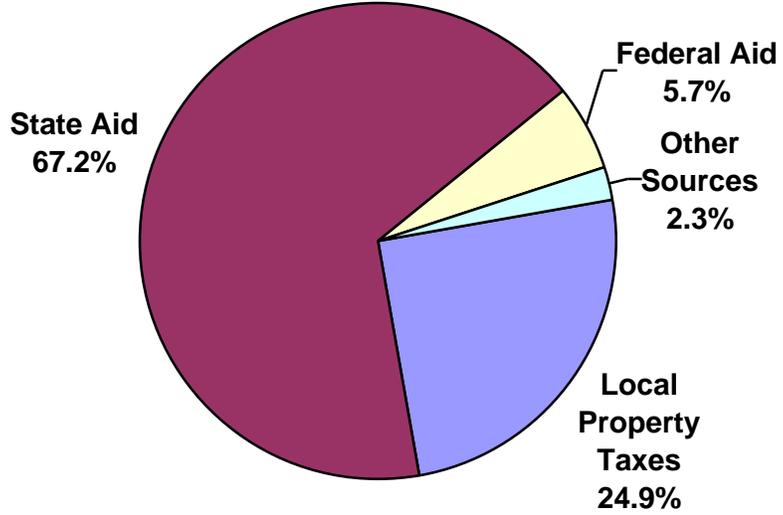
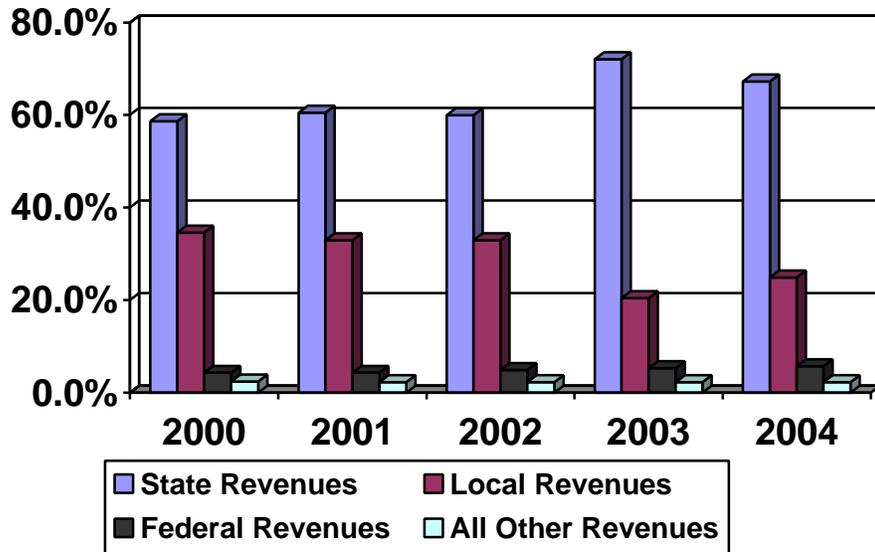


Figure 2: Percent of Total Revenues by Source, FY 00 to FY 04



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.¹⁰ 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 2001 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.¹¹

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 2004) multiplied by the adjusted marginal cost pupil unit (AMCPU). Under current law, the general education formula allowance is slated to stay at \$4,601 through 2005. With the formula allowance remaining at the same level from 2003 to 2005, increased revenue will depend on growth in enrollments or shifts in the composition of a district's enrollment. Basic general education aid accounted for about 87 percent of the general education revenue in 2004.

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

¹⁰ 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, 2004*. Both documents were a valuable resource for this report.

¹¹ 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 2004.

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 2004.

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 2004.

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 95th percentile in the four categories combined are eligible for equity revenue. Equity revenue accounted for about 0.7 percent of general education revenue in 2004.

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 2004.

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 willingness 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 2004. Each district's referendum revenue was reduced by \$415 per pupil unit. At the same time the referendum was reduced, the basic formula allowance for all districts was increased by \$415 per pupil unit.

The Legislature also imposed referendum caps. In 2004, districts could not levy more than 18.2 percent of the formula allowance (\$856 in 2004), or for those districts with authority from 1994 that were above the cap – their capped authority increased by 17.7 percent. 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.

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 \$2,164 in 2000 to \$1,395 in 2004. This represents a decrease of 36 percent.

Between 2000 and 2004, property tax revenues per pupil declined from \$2,164 to \$1,395.

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 2004, special education revenues represented an amount that was about 7 percent of the total of general education revenue.

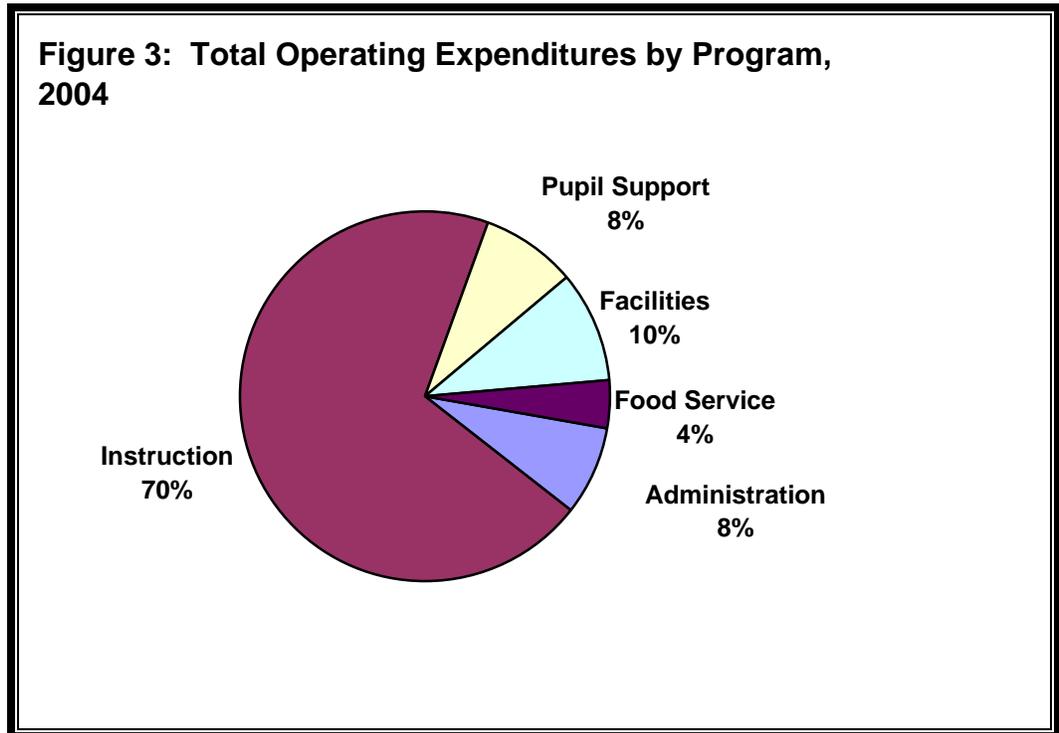
School District Expenditures

Expenditures by Program

School district operating expenditures are composed of 11 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 \$8,575 per pupil. Among individual school districts, total operating expenditures per pupil ranged from \$4,907 to \$16,964, 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 \$17,729 to a low of \$4,205.

**Instruction
accounted for 70
percent of
operating
expenditures.**

For the purpose of this analysis, we have grouped the eleven categories into 5 groups: administration, instruction, pupil support, facilities, and food service. The largest area of program spending is instruction, which represented 70 percent of all operating expenditures in 2004. This category includes regular instruction, vocational instruction, special education, and instructional support such as classroom aides. Figure 3 illustrates the relative share of program expenditures.



Since 2000, there has been a slight shift in the allocation of school district spending. Two categories accounted for a smaller percentage of total operating expenditures: administration and pupil support. The share of administration

Administration represented a smaller share of school district spending in 2004 than in 2000.

expenditures decreased from 8.5 percent in 2000 to 7.9 percent in 2004. Pupil support expenditures decreased from 8.7 percent in 2000 to 8.3 percent in 2004.

Two operating programs, instruction and facilities, each gained a larger share of total operating expenditures. Instruction expenditures grew from 69.9 percent to 70.0 percent, and expenditures of facilities increased from 8.7 percent to 9.6 percent. Spending on food service maintained a 4.2 percent share.

Table 9 illustrates the changes in program expenditures¹².

Table 9: Operating Expenditure by Program, 2000 and 2004

Program	2000		2004		2000-04 Percent Change
	Per Pupil Spending	Percent of Total	Per Pupil Spending	Percent of Total	
Administration	\$612	8.5%	\$674	7.9%	10.1%
Instruction	\$5,011	69.9%	\$6,002	70.0%	19.8%
Pupil Support	\$622	8.7%	\$713	8.3%	14.6%
Facilities	\$626	8.7%	\$827	9.6%	32.1%
Food Service	\$298	4.2%	\$359	4.2%	20.5%
Total PK-12 Operating Expenditures	\$7,169		\$8,575		19.6%
Inflation over the five years					13.8%

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

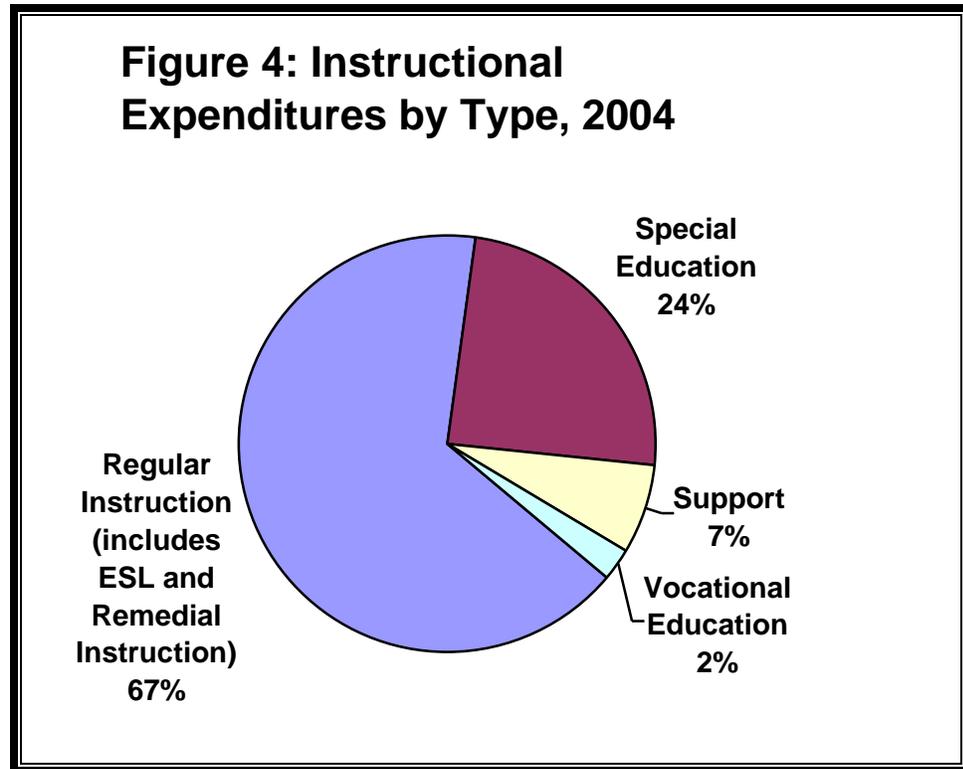
Spending on Instruction

Within the category of instructional expenditures, regular instruction accounts for 67 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.

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; Food Service = Food Service; and Facilities = Operations & Maintenance and Other Operating Programs.

As figure 4 shows, special education accounts for 24 percent of instructional spending. The remaining non-regular instructional spending went for instructional support services and vocational education.

Regular Instruction accounted for 67 percent of 2004 instructional expenditures.



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.

The average cost per pupil receiving special education services was \$10,977 in 2004

Between 2000 and 2004, total operating expenditures of Minnesota public school districts and charter schools increased an average of 18 percent, growing from \$6.10 billion to \$7.20 billion. On a per pupil basis, total operating expenditures grew from \$7,171 to \$8,575, a 20 percent increase.

The fastest growing major program between 2000 and 2004 was special education. Per pupil spending on special education grew 31 percent during this period, increasing from \$1,119 to \$1,464 (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 \$10,977. This represents an increase of 21 percent over the \$9,061 per recipient spent in 2000. Over the five-year period, the number of students receiving services increased 7 percent.

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

Table 10: Operating and Other Expenditures per Student by Program, FY 00 to FY 04

Category of Expenditure	2000	2004	Percent Change
District and School Administration	\$392	\$416	6.1%
District Support Services	220	258	17.3%
Regular Instruction	3,380	3,968	17.4%
Vocational Instruction	146	144	-1.4%
Special Education	1,119	1,464	30.8%
Instructional Support Services	366	426	16.4%
Pupil Support Services	233	262	12.4%
Operations and Maintenance	590	755	28.0%
Food Service	298	359	20.5%
Pupil Transportation	389	451	15.9%
Other Operating Programs	36	72	100.0%
Total PK-12 Operating Expenditures	\$7,169	\$8,575	19.6%
Capital Expenditures	332	316	-4.8%
Community Service	326	394	20.9%
Building Construction	694	810	16.7%
Debt Service	696	1,242	78.4%
Total of All Other Expenditures	\$2,048	\$2,762	34.9%
Total Education Expenditures	\$9,217	\$11,337	23.0%
Inflation Over Period			13.8%
Total Enrollment	850,970	839,367	-1.4%

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 \$4,907

to \$16,964 with an average of \$8,555. Rates of change ranged from negative 13 percent to positive 60 percent. Among charter schools, the range went from a low of \$4,205 to a high of \$32,248 with an average of \$9,714 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 2000 and 2004.

From 2000 to 2004, the average per pupil fund balance of the school districts and charter schools grew from \$535 to \$908, an increase of 70 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 \$1,510; school districts over 1,000 students had an average fund balance of \$801; and, school districts under 1,000 students had an average fund balance of \$1,649.

Thirty school districts and 8 charter schools posted a negative unreserved undesignated fund balance in 2004 compared to 20 in 2000.

Undesignated Unreserved General Fund Balance

From 2000 to 2004, the average per pupil undesignated unreserved fund balances of the general fund grew from \$493 to \$849, an increase of 72 percent. Charter schools had an average fund balance of \$1,529; 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 \$1,596.

Among the districts, 69 percent showed an increase over this period, 31 percent showed a decrease. Among charter schools, 78 percent showed an increase and 22 percent showed a decrease. The overall trend indicates an improving financial condition for school districts.

The number of school districts having a negative unreserved fund balance decreased from 57 in 2000 to 30 in 2004. 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 unreserved 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 2004 data for charter schools showed that 32 percent of charter schools had inadequate reserves, while 46 percent of districts over 1,000 students and 30 percent of districts under 1,000 students had inadequate reserves.

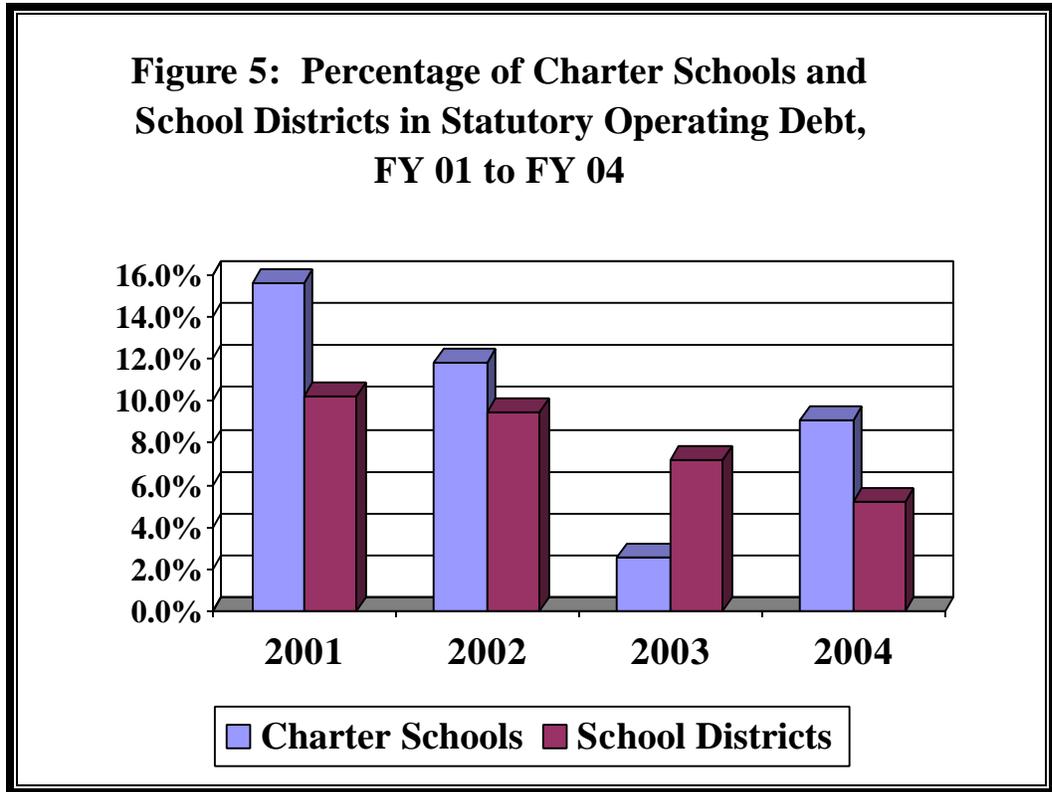
The overall trend for undesignated unreserved general fund balances as a percent of general fund expenditures showed that the percentage increased from 8.1 percent in 2000 to 11.6 percent in 2004. This trend indicates that the financial condition of many districts is improving. There were significant differences between charter schools and school districts. In 2004, charter schools showed an average fund balance as a percent of general fund expenditures of 16.9 percent, compared to 10.3 percent for school districts with more than 1,000 students and 19.6 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 2004, 8 charter schools and 18 school districts were in statutory operating debt. The overall trend has been fewer charter schools and school districts in SOD. The general trend for school districts has been a decrease in the number and percentage of school districts in SOD. The trend line for charter schools had been a declining number of schools in SOD but there was a significant increase between 2003 and 2004.



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 quadrupled between 2000 and 2004. In 2000 the average short-term debt ratio was .16 compared to 0.71 in 2003. 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 00 to FY 04

District Name	2000 Short-Term Debt Ratio	2001 Short-Term Debt Ratio	2002 Short-Term Debt Ratio	2003 Short-Term Debt Ratio	2004 Short-Term Debt Ratio	2000 to 2004 Percent Change
Charter Schools	0.05	0.05	0.05	0.08	0.28	444.6%
Districts Over 1,000 Students	0.15	0.17	0.24	0.54	0.80	429.7%
Districts Under 1,000 Students	0.18	0.20	0.22	0.32	0.42	130.0%
All Districts & Charter Schools	0.16	0.17	0.24	0.50	0.71	356.7%

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, 51 percent had a ratio of zero indicating that they had no short-term debt. Among charter schools, 66 percent had no short-term debt. Among the school districts that did have short-term debt, the ratios ranged from negative 42.42 in the Bellingham district to 0.20 in the Cleveland district. This means that Bellingham has a negative cash & investment balance and short-term debt that is 42 times greater than its negative cash & investment balance. Cleveland's ratio indicates that the district has short-term debt that amounts to 20 percent of its cash & investments.

Among charter schools, the range was from a negative 18.31 for the Family Academy Charter School to 0.09 at the El Colegio 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 2.23 in 2000 to 0.75 in 2004 – a decrease of 67 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 00 to FY 04

<u>District Name</u>	<u>2000 Quick Ratio</u>	<u>2001 Quick Ratio</u>	<u>2002 Quick Ratio</u>	<u>2003 Quick Ratio</u>	<u>2004 Quick Ratio</u>	<u>2000 to 2004 Percent Change</u>
Charter Schools	0.77	0.93	0.86	0.70	0.53	-31.2%
Districts Over 1,000 Students	2.17	1.97	1.38	0.92	0.67	-69.1%
Districts Under 1,000 Students	2.80	2.59	2.20	1.69	1.40	-50.0%
All Districts & Charter Schools	2.23	2.04	1.48	1.01	0.75	-66.4%

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

Among school districts, the quick ratios in 2004 varied from a positive 177.01 in Grygla to a negative 8.70 in Warroad. The quick ratio of 177.01 means that the district had cash and investments that was 177 times greater than its current payables. The negative 8.70 ratio indicates the district has payables of more than 8 times its cash and investments on hand. Among charter schools, the range was 104.08 for the Lake Superior High School Charter School and negative 0.40 for the Chiron Charter School.

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 2000 to 2002, 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, schools received 80 percent in the current year and 20 percent in 2005. 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.

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Appendix 1

Audit Reviews

The State Auditor's Office has not historically audited a significant percentage of school districts. Instead, school districts have generally been audited by private CPAs. School districts audited by private CPA firms must submit those audits to the Minnesota Department of Education and to the State Auditor's Office. School districts are required by statute to have an audit performed using the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. In addition; School Districts expending more than \$500,000 of federal awards in a year are required to have an audit performed under OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*—a single audit.

As part of its effort to exercise oversight of all local units of government, the State Auditor's Office has begun this year performing regular "desk reviews" of all school district and charter school audits done by private accounting firms. Desk reviews will include a review of management letter comments, fiscal trends, and legal compliance issues. Auditors performing desk reviews will also attempt to identify fiscal problems that should be brought to the attention of a school's governing board.

Regular desk reviews should give the State Auditor's Office a better understanding of the fiscal problems faced by Minnesota school districts. In addition, given the well-known financial problems surrounding charter schools and the fact that charter schools receive public funds with limited regulation, the State Auditor believes it is important that this Office and the Minnesota Department of Education closely monitor the fiscal operations of charter schools.

The State Auditor's Office will communicate with those school districts and charter schools in which desk reviews identify fiscal problems. The State Auditor may require the district or charter school to submit documentation showing that steps have been taken to address identified problems.

Findings of Reviews for Regular School Districts and Charter Schools

Below is a listing of the most common problems that were found in our review of school district and charter school audits for the fiscal year ended June 30, 2004. It should be noted that these were the most common problems identified,

however, that is not to say that most districts had these problems. Some may have had none, while others may have had only one or two.

1. Operating referendums to compensate for declining enrollments. Simply put, this means there are an increasing number of school districts that have fewer students, which in turn means less revenue from state aid. As a result, districts are turning to operating referendums to replace lost revenue. This comes at a time in which costs (health care, etc.) are increasing.
2. Lack of proper procedures in the student activity accounts:
 - Cash collection procedures were not in place;
 - Receipts were not signed and did not include the source;
 - Disbursements did not have proper support;
 - Negative account balances existed;
 - Checks did not include dual signatures;
 - Contracts were not between the school and the vendor (vending machine contracts); and
 - Salaries were paid from student activity accounts and should not have been.
3. Legal compliance violations for contracting and bidding including the lack of quotes, written bids, solicitation for bids, bonds, and retention of contract records.
4. Various funds where expenditures exceeded revenues. This occurred more often in the food service and community service funds.
5. Journal entries were not adequately documented, were not approved by someone other than the preparer, did not have supporting documentation, and were not sequentially numbered.
6. All check disbursements did not include the required dual signatures.
7. Lack of Board-approved policy regarding 'Electronic Fund Transfers' and authority to make transfers and approval of those transfers.
8. Payroll and cash and investment accounts were not reconciled to their general ledger control accounts on a monthly basis.
9. Checks did not include the proper declaration on the backside of checks.
10. Credit card purchases lacked supporting documentation.
11. Improper use of UFARS (budgets not matching to UFARS and incorrect coding).

12. School boards were not approving and checking various items such as budgets, amendments, disbursements, depositories and check signers, and formal policies (fixed assets, conflict of interest, electronic fund transfers and employment related policy).
13. Lack of accounting for fixed assets and no “Capital Asset Policy.”

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Appendix 2

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 88 in the 2003-04 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, 2001.

¹⁴ OLA Report 2003, 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 Charters Schools, 2004

District Number	Charter School	Enrollment	District Number	Charter School	Enrollment
4000	CITY ACADEMY	111	4058	SCHOOLCRAFT LEARNING COMMUNITY CHTR	160
4001	BLUFFVIEW MONTESSORI	178	4059	CROSSLAKE COMMUNITY CHARTER SCHOOL	87
4003	NEW HEIGHTS SCHOOL, INC.	128	4061	STUDIO ACADEMY CHARTER SCHOOL	122
4004	CEDAR RIVERSIDE COMMUNITY SCHOOL	102	4062	FAMILY ACADEMY CHARTER SCHOOL	243
4005	METRO DEAF CHARTER SCHOOL	70	4064	RIVERWAY LEARNING COMMUNITY CHTR	66
4006	SKILLS FOR TOMORROW CHARTER SCHOOL	96	4065	MINNESOTA BUSINESS ACADEMY CHARTER	375
4007	MINNESOTA NEW COUNTRY SCHOOL	102	4066	RIVERBEND ACADEMY CHARTER SCHOOL	118
4008	PACT CHARTER SCHOOL	354	4067	AURORA CHARTER SCHOOL	147
4011	NEW VISIONS CHARTER SCHOOL	170	4068	EXCELL ACADEMY CHARTER	184
4012	EMILY CHARTER SCHOOL	80	4069	MN INSTITUTE OF TECHNOLOGY CHARTER	381
4015	COMMUNITY OF PEACE ACADEMY	540	4070	HOPE COMMUNITY ACADEMY	456
4016	WORLD LEARNER CHARTER SCHOOL	118	4072	YANKTON COUNTRY CHARTER SCHOOL	30
4017	MINNESOTA TRANSITIONS CHARTER SCHOOL	870	4073	ACADEMIA CESAR CHAVEZ CHARTER SCH.	241
4018	ACHIEVE LANGUAGE ACADEMY	314	4074	AGRICULTURAL FOOD SCIENCE ACADEMY	162
4019	ST. PAUL FAMILY LEARNING CENTER	97	4075	AVALON SCHOOL	128
4020	EDISON CHARTER SCHOOL	773	4076	MINNESOTA ACADEMY OF TECHNOLOGY	63
4021	VILLAGE SCHOOL OF NORTHFIELD	52	4077	TWIN CITIES INTERNATIONAL ELEM SCH.	256
4025	CYBER VILLAGE ACADEMY	155	4078	MN INTERNATIONAL MIDDLE CHARTER	125
4026	E.C.H.O. CHARTER SCHOOL	158	4079	FRIENDSHIP ACDMY OF FINE ARTS CHTR.	66
4027	HIGHER GROUND ACADEMY	397	4080	PILLAGER AREA CHARTER SCHOOL	41
4028	ECT NOMPA WOONSPE	30	4081	COVENANT ACADEMY OF MINNESOTA CHTR.	49
4029	NEW SPIRIT SCHOOL	312	4082	BLUESKY CHARTER SCHOOL	19
4030	ODYSSEY CHARTER SCHOOL	207	4083	RIDGEWAY COMMUNITY SCHOOL	56
4031	JENNINGS EXPERIENTIAL HIGH SCHOOL	62	4084	NORTH SHORE COMMUNITY SCHOOL	220
4032	HARVEST PREP SCHOOL/SEED ACADEMY	349	4085	HARBOR CITY INTERNATIONAL CHARTER	153
4035	CONCORDIA CREATIVE LEARNING ACADEMY	87	4086	WOODSON INSTITUTE FOR EXCELLENCE CH	180
4036	FACE TO FACE ACADEMY	61	4087	SAGE ACADEMY CHARTER SCHOOL	59
4038	SOJOURNER TRUTH ACADEMY	241	4088	URBAN ACADEMY CHARTER SCHOOL	62
4039	HIGH SCHOOL FOR RECORDING ARTS	162	4089	NEW CITY SCHOOL	59
4042	TWIN CITIES ACADEMY	166	4090	PRAIRIE CREEK COMMUNITY SCHOOL	108
4043	MATH & SCIENCE ACADEMY	278	4091	ARTECH	108
4044	HEART OF THE EARTH CHARTER	202	4092	WATERSHED HIGH SCHOOL	101
4045	LAKES AREA CHARTER SCHOOL	67	4093	NEW CENTURY CHARTER SCHOOL	126
4046	LAKE SUPERIOR HIGH SCHOOL	80	4095	TRIO WOLF CREEK DISTANCE LEARNING	56
4048	GREAT RIVER EDUCATION CENTER	49	4096	CHIRON CHARTER SCHOOL	102
4049	COON RAPIDS LEARNING CENTER	167	4097	PARTNERSHIP ACADEMY, INC.	146
4050	LAFAYETTE PUBLIC CHARTER SCHOOL	90	4098	NOVA CLASSICAL ACADEMY	175
4051	HANSKA CHARTER SCHOOL	29	4099	TAREK IBN ZIYAD ACADEMY	177
4052	FOUR DIRECTIONS CHARTER SCHOOLS	84	4100	GREAT EXPECTATIONS	42
4053	NORTH LAKES ACADEMY	156	4102	MINNESOTA INTERNSHIP CENTER	274
4054	LACRESCENT MONTESSORI ACADEMY	59	4104	LIBERTY HIGH SCHOOL	112
4055	NERSTRAND CHARTER SCHOOL	154	4106	TREKNORTH HIGH SCHOOL	160
4056	ROCHESTER OFF-CAMPUS CHARTER HIGH	114	4107	VOYAGEURS EXPEDITIONARY	32
4057	EL COLEGIO CHARTER SCHOOL	84	4109	SOBRIETY HIGH	74

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.

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.

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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This annual report provides five years of data and rankings based on the per pupil revenues, expenditures, and debt for all regular Minnesota school districts with enrollments under 1,000 for the most recent year. The report also provides rankings on student demographics, average teacher salaries, fund balances, and other statistics. May 2004.

Special Study: Municipal Enterprise Activity

This study, requested by a bipartisan group of legislators, examines the financial information of enterprise fund operations of Minnesota cities from 1998 to 2002. March 2004

Financial Trends of Minnesota School Districts – School Districts Over 1,000 Enrollment

This annual report provides five years of data and rankings based on the per pupil revenues, expenditures, and debt for all regular Minnesota school districts with enrollments over 1,000 for the most recent year. The report also provides rankings on student demographics, average teacher salaries, fund balances, and other statistics. February 2004.

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This special study examined the compensation (salary, benefits, severance, etc.) of Minnesota School Superintendents from 1997 to 2002. September 2003

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