



Understanding Tennessee's Maintenance of Effort in Education Laws

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Key Points

Tennessee's maintenance of effort laws ensure that local funds budgeted for schools do not decrease as state funding for schools increases. These laws, which also exist for county law enforcement, libraries, highways, and election commissions, are to prevent local governments from reducing funding when they receive new or increased funding from the state, a practice known as supplanting.

County commissions, city councils, and special school districts must budget at least the same total dollars for schools that they did the previous year to comply with maintenance of effort laws. If student enrollments are declining, the funding bodies have to budget at least the same dollars per student as the previous year. Dollars budgeted for capital projects and debt service are not included in maintenance of effort calculations.

If a local budget does not meet maintenance of effort requirements, the Department of Education can withhold state Basic Education Program (BEP) funds from the school district until the funding body passes a budget that is in compliance. The department does not track the number of districts that initially fail to meet maintenance of effort each budget cycle but estimates that each year a handful of districts have to revise their budgets in order to comply. Department staff indicate they have not observed a pattern of the same districts repeatedly failing to comply with maintenance of effort requirements. Generally, districts that have initially failed to comply with maintenance of effort requirements have ultimately come into compliance because local funding bodies have not allowed their school districts to operate without BEP state funding for an extended period.

New school districts in any county where the county and city schools are being combined are exempt by law from maintenance of effort requirements for three years. The Department of Education has interpreted this provision to include any newly-created district. In these cases, the first maintenance of effort amount will be set by a new district's third-year operating budget and will be used as the baseline for maintenance of effort in subsequent years. Thus, the six new municipal districts in Shelby County, as well as Shelby County Schools – which is considered a new district following the creation of the six municipal districts – are all exempt from maintenance of effort compliance until school year 2016-17.

Maintenance of effort laws were passed prior to the implementation of the BEP, and maintenance of effort requirements differ from BEP local match requirements. The local funding required for BEP purposes is based on the Department of Education's formula for calculating the basic costs of education for a district's enrollment and the county's fiscal capacity to provide education funding. Many local governments contribute significantly more funds toward education than required to meet their local match. Maintenance of effort requires that districts maintain their current level of funding, regardless of how much it exceeds the required BEP local match amount.

Introduction

The laws requiring school districts to maintain local funding levels for education were adopted in 1987, five years before the state's Basic Education Program (BEP) funding formula was created in law. Maintenance of effort laws are sometimes confused with the local funding requirements of the BEP, also known as the "local match." This brief provides a history of Tennessee's maintenance of effort requirements, describes how maintenance of effort is determined, and explains how maintenance of effort is related to the BEP.

What is the purpose of maintenance of effort requirements?

The purpose of maintenance of effort requirements at both state and local levels is to ensure that financial contributions by one funding body are used to enhance existing financial support from another. These laws ensure that new or increased funding provides additional support to a program or function, and does not result in simply replacing funding from an existing funder, also known as supplanting.

The state's maintenance of effort laws for education require that local funding bodies allocate at least the same amount to school districts that they budgeted the previous year.^A Maintenance of effort provisions are not unique to education funding. In Tennessee, several other county departments have maintenance of effort provisions, including law enforcement, public libraries, highways, and election commissions, although they may be calculated in different ways.¹ There are also maintenance of effort requirements that states must meet for certain federal funds, such as the Individuals with Disabilities Education Act (IDEA) Part B funds.²

What is the history of Tennessee's maintenance of effort requirements?

State maintenance of effort provisions for local education funding were passed in 1987. One provision prohibits school districts from using state funds to supplant total local current operating funds, excluding capital outlay and debt service.³ A second provision, passed under the same public act, prohibits school districts from submitting budgets to their local legislative bodies (county commissions or city councils) that directly or indirectly propose to use state funds to supplant any local current operating funds, excluding capital outlay and debt service.⁴

^A Funding bodies for county school districts are county commissions and for city school districts are city councils. Special school districts are considered their own funding bodies because they can set a special tax rate with the approval of the General Assembly, giving them more direct responsibility for maintaining local funding levels than city and county school districts. City and special school districts receive local county funding, but the apportionments of county funds to these districts are made by the county trustee according to statute and not by county commissions.

The third provision in the original maintenance of effort law is that newly-created districts in any county “where the county and city schools are being combined” are not subject to maintenance of local effort for their first three years.⁵ The language in the law is unclear as to whether the three-year exception also applies to new districts created in counties where county and city school systems are not being merged, as was noted in OREA’s 2012 report on statutory options for school district mergers.⁶ The Department of Education has interpreted this maintenance of effort exception to apply to any newly-created district.

Revisions to the maintenance of effort law were made in 1992, the same year the state adopted the BEP funding formula. The revisions provided that in a year when state funding is less than the amount in fiscal year 1990-91, or less than the previous fiscal year’s state funding, any local funds allocated to offset state funding cuts shall be excluded from maintenance of effort requirements. In cases where districts receive lower levels of state funding as a natural result of student enrollment decreases, however, the exclusion does not apply, and any local funds allocated to offset such declines in state funds would be included in future years’ maintenance of effort requirements.

A 1994 State Board of Education rule requires the Department of Education to review school systems’ budgets to ensure school districts are not using state funds to supplant local funds. The rule further states that revenue derived from local sources must equal or exceed prior year actual revenues, excluding capital outlay and debt service and adjusting for any decline in average daily membership (ADM).⁷

After the General Assembly passed increased education funding, dubbed BEP 2.0, in 2007, it requested a study by the BEP Review Committee to address concerns and perceptions that local funding bodies were cutting local funds on the heels of the increased state funding and to make recommendations on whether statutory revisions were needed.⁸ The committee recommended revisions that would require local funding bodies to appropriate at least the same level of funding as the prior year, including an adjustment for inflation. The recommendation was not acted on by the General Assembly.

How is maintenance of effort determined?

The Department of Education makes the determination as to whether districts’ proposed budgets meet maintenance of effort requirements. The department conducts several financial comparisons to test districts’ compliance, once districts have submitted their budgets to the department by the annual August 1st deadline. The department notifies a district if its budget does not meet maintenance of effort requirements and sets a deadline for the district to submit a revised budget in order to come into compliance.

Compliance tests

Level One

The first test of maintenance of effort compliance is a determination that a district's total budgeted local revenues for day-to-day operations are not less than its budgeted local revenues from the previous year, excluding capital outlay and debt service. Local revenues include property taxes, fees, and local sales taxes that are designated for schools, as well as any allocated license and permit fees, state shared tax proceeds, and city general fund revenues, if applicable. Districts can generally determine if they are in compliance with the level one test before they submit their budgets for department approval.

Level Two

A second level compliance test is triggered when districts do not meet the level one test, often because they have declining student enrollment. It is generally expected that districts' budgeted revenue will decrease in such situations; maintenance of effort is thus determined on per-pupil revenues rather than total revenues. Districts must demonstrate that their budgeted per-pupil local revenues are not less than their budgeted per-pupil local revenues from the previous year. The department makes the determination using the weighted average daily membership (ADM) figures calculated for the BEP funding formula.^B If districts do not pass the level one test, but can pass the level two test, they have met maintenance of effort requirements.

It is possible for districts with increasing enrollment to meet maintenance of effort requirements by holding total budget levels steady, while their per-pupil funding declines. Such a scenario might be due to realizing economies of scale or to local funding commitments that remain unchanged as enrollments rise, or both. In these cases, because districts have met the level one test, they are not subject to the level two test. (See also "Adjustment for Inflation.") For example, in fiscal year 2015, nine districts with increased enrollments met their maintenance of effort obligations with budgeted local revenues equal to, or with very small increases (less than one-half percent) over, the previous year's budget, resulting in lower per-pupil local revenues. Such situations occur in any district where enrollment increases outpace budget increases. Conversely, 20 districts with declining enrollments from fiscal years 2014 to 2015 had increasing per-pupil local revenues, despite declining or steady budgeted local revenues.

^B Weighted ADM calculations are based on four reporting periods: 2nd month (12.5%), 3rd month (17.5%), 6th month (35%), and 7th month (35%).

Actual to Budgeted Revenues

Because maintenance of effort tests at both levels are “budget-to-budget” comparisons (either total or per-pupil revenues) and not based on actual revenues or expenditures, it is possible for districts to keep local budget items set artificially high in order to pass the level one test. Another comparison closely associated with maintenance of effort identifies discrepancies between budgeted revenues and actual local revenues collected for the current year.

If actual revenues are less than the budgeted revenues, the district must establish a BEP reserve equal to the difference between the amount budgeted and the amount collected. The BEP reserve, which is part of the general fund balance that most districts maintain, is restricted and can only be used for one-time, non-recurring expenditures. The funds in the BEP reserve do not count as local revenue for purposes of calculating maintenance of effort.

When are districts excused from meeting maintenance of effort requirements?

In certain circumstances, a district may reduce its funding or allocate additional funding that will not be included in future maintenance of effort calculations. These circumstances are outlined below.

Allowable reduction of local funding

A district is excused from maintaining the same total amount of local funding if student enrollment declines. The total funding may be reduced as long as the budgeted per pupil revenues remain at least as high as the previous year, based on the weighted average daily membership enrollment figure used by the department for determining BEP allocations.⁹

Exemption from maintenance of effort calculation

A district is allowed to budget additional money without it counting toward future maintenance of effort calculations:

- for replacing state decreases in BEP funding from the previous year that are unrelated to enrollment decreases,
- for capital outlay expenditures or debt payments,
- for nonrecurring budgeted expenditures as outlined in written agreements.¹⁰

The original maintenance of effort laws included the exemption for capital outlay and debt payments. The second exemption, for local funds used specifically to replace state cuts in BEP funding that are not due to declining student enrollment, was added in 1992. The third exemption was added to the statutes in 2013 to permit the exclusion of any nonrecurring expenditures, when detailed by a written agreement between the district and its funding body for the use of the funds. Many nonrecurring expenditures are for capital needs; in those cases, the exemption simply clarifies the exclusion of capital outlay expenditures from maintenance of effort calculations. The department must review the agreement to ensure the nonrecurring nature of the expenditures.¹¹ As of the 2014-15 school year, at least one school district received an exemption under this provision for capital improvements, including a gas boiler, telephone wires, and intercoms.

Delay in calculation

New school districts are exempt from the maintenance of effort requirements for their first three years of operation. In these cases, the first maintenance of effort amount will be set by a new district's third-year operating budget and will be used as the baseline for maintenance of effort in subsequent years. In fiscal year 2015, seven Tennessee districts do not have maintenance of effort requirements; they are the six new municipal districts that began operation in Shelby County, as well as the Shelby County school district, which is considered a new district following the creation of the six new municipal districts.¹² These districts are exempt from maintenance of effort compliance until school year 2016-17.

What happens if a district fails to meet its maintenance of effort requirement?

State law provides the Commissioner of Education the authority to enforce maintenance of effort requirements by withholding a portion or all of the state education finance funds that the district is eligible to receive.¹³ Typically, once the Department of Education notifies the district of maintenance of effort non-compliance, the district has until September 30 to amend its budget.^c Should a district fail to submit a budget that meets maintenance of effort rules by September 30, the department would begin to withhold BEP payments beginning October 1. The department can continue to withhold BEP monthly payments until the district submits a budget that meets maintenance of effort requirements. Once in compliance, the district receives the BEP funding withheld by the department.

^c Districts that are not able to finalize their budgets by the department's August 1st deadline, whether for maintenance of effort or other reasons, may operate month-to-month under a continuing budget resolution from the previous year, but may not spend more than 1/12 (one-twelfth) of the budget per month.

Department staff indicate that every year a handful of districts have to revise their budgets because of non-compliance with maintenance of effort. The department does not track the number of districts that initially fail to meet maintenance of effort each budget cycle, and staff indicate they have not observed a pattern of the same districts repeatedly failing to comply with maintenance of effort requirements.

Districts will generally fail to meet maintenance of effort when there is a drop in revenues, such as decreased sales tax revenues resulting from a drop in local business activity. Funding issues between local governments can also result in a failure to meet maintenance of effort. In one example, a city that had contributed to a county school system chose to end those contributions, resulting in a loss of local revenue to the county system. In another example, a dispute over the required sharing of county tax revenue between a county school system and a city school system resulted in a significant drop in county revenue shared with the city system. In cases where student enrollment is dropping, any decline in budgeted revenues cannot result in a lower level of per-pupil revenue.

Maintenance of effort issues may be resolved by redirecting local funds from another department, accessing reserve funds, or increasing local taxes. Non-compliance impacts school districts from the temporary loss of state funding, but the authority to move districts into compliance rests with the county or city funding bodies, given Tennessee's unique school finance model. As a 2005 TACIR report stated:

Most states have fiscally independent school systems with a single source of local revenue: taxable property. No other state [except Tennessee] has overlapping, interdependent school systems supported by cities and counties with multiple sources of revenue and intra-county sharing requirements.¹⁴

Generally, districts that have initially failed to comply with maintenance of effort requirements have ultimately come into compliance because local funding bodies have not allowed their school districts to operate without BEP state funding for an extended period.^D

^D A notable exception occurred with the Memphis City Council's decision to reduce local funding for the former Memphis City Schools by \$57.5 million for the 2008-09 school year. Despite notification by the Tennessee Department of Education that failure to meet the maintenance of effort laws could result in the withholding of state funding, the city's school budget funding issue was not resolved, and the school board filed suit. The ruling by the Chancery Court of Shelby County, and affirmed by the state Court of Appeals, found that the city should restore funding to the district for the 2008-09 school year in order to comply with state law. Counter lawsuits and appeals delayed settlement until Jan. 2015, when the city agreed to pay \$28 million in cash over the next 15 years to Shelby County Schools (which by then had assumed responsibility for the former city school district's operations) and to provide \$13.8 million worth of other funding and services.

Maintenance of local funding effort is based on total local funding, whether it is from the county, city, or special school district. In the case of city school districts, the responsibility for maintaining local funding levels is split between county commissions and city councils because counties must generally share revenues raised for education with all the districts in the county proportionate to student enrollment.^E Some city school districts have experienced maintenance of effort disputes involving their city and county funding bodies.

How is maintenance of effort related to the BEP?

Required local match

Maintenance of effort laws are often linked to a provision within the BEP known as “required local match.” This provision requires local governments to appropriate funds sufficient to fund the local share of the BEP after accounting for the county’s fiscal capacity.¹⁵ The majority of districts receive additional local funding beyond the required BEP match, resulting in total local funding levels that exceed the BEP match. Because maintenance of effort requires that districts maintain their total current level of funding, most districts’ maintenance of effort requirements exceed their local BEP match amount.

In fiscal year 2015, 65 districts (46 percent) budgeted from 10 percent to 50 percent more than the required match, and 54 districts (39 percent) budgeted more than 50 percent above their BEP local match. The average rate of local dollars budgeted above the required local match for all districts statewide was 50 percent.¹⁶

Adjustment for inflation

Maintenance of effort laws do not require local funding levels to be adjusted for inflation, only that the current, unadjusted dollars (or nominal dollars) budgeted for schools are not lower than the previous year. In comparison, the BEP formula includes inflation adjustments for some components and/or incorporates averages of actual expenditures in some component calculations, which automatically provide some adjustment for rising prices.^F The inflation

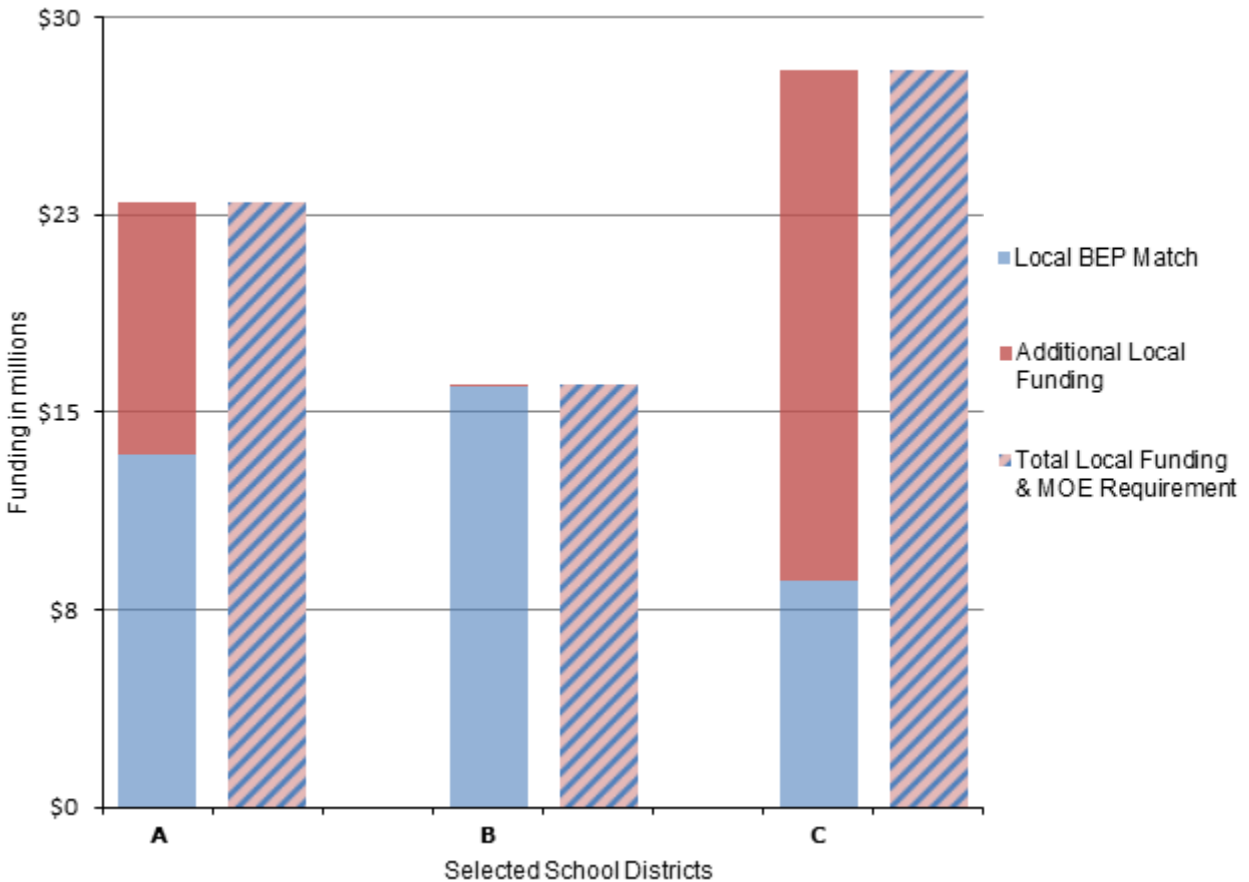
^E Gibson County is the only Tennessee county that does not operate a county-level school district; Carroll County has a limited-function county district and does not operate any traditional K-12 schools. In both counties, most or all students are served by city and special school districts.

^F For example, the instructional equipment component is based on an average of the three prior years’ actual expenditures per pupil, then inflated for two fiscal years using the Center for Business and Economic Research deflator schedule. Other components adjusted for actual costs and/or inflation include support staff salaries, insurance premiums, textbooks, materials, supplies, equipment, student transportation, maintenance and operations, and construction costs.

adjustments in the BEP that result in state funding increases for school districts will also cause increases in the required local match. Because most districts' total local funding levels exceed their required BEP match, inflation adjustments to the BEP have little to no impact on their maintenance of effort funding levels. (See [Exhibit 1](#), examples A and C.) But for districts with total local funding levels similar to their BEP required match, the inflation and actual cost adjustments within the BEP formula can increase the maintenance of effort funding level. (See [Exhibit 1](#), example B.)

From fiscal years 2009 to 2015, local funding budgeted for school operating expenses statewide increased at a lower rate than the required local BEP match. The state-level BEP funding for all districts increased 15.2 percent and the required local BEP match increased 16.8 percent. During the same six-year period, total local funds (BEP local match plus any additional local funding) budgeted for districts increased 10 percent.¹⁷

Exhibit 1: BEP, Local Funding, and Maintenance of Effort



Source: Data adapted from actual Tennessee districts, fiscal year 2013, Department of Education. Local funding data includes only operating revenues that the department uses to determine maintenance of effort. Revenues for capital outlay and debt service are not included.

Teacher Salary Increases

When the General Assembly approves an increase in funding for teacher pay, usually the increase will be reflected in the BEP salary unit cost for teachers. The salary unit cost is applied to the number of BEP-funded positions calculated under the instructional component of the BEP. In fiscal year 2015, the salary unit cost applied to the calculated number of instructional positions was \$40,447.¹⁸ The General Assembly in 2015 approved the Governor's plan for increasing teacher pay by \$97.6 million, reflected as a 4 percent increase to the salary unit cost. For fiscal year 2016, each funded instructional position calculated under the BEP will be funded at \$42,065.¹⁹ The distribution of these additional funds is determined by each district, under their own state-approved salary policies. Because the BEP is a funding, not a spending, plan, and because most districts have more teachers on staff than the number of instructional positions calculated by the BEP formula and pay teachers more than the state's required minimums, state-funded percentage increases in the BEP salary unit cost do not necessarily translate into the same percentage increase for every teacher's pay rate.

Any change that results in an increase to the amount of total BEP funding calculated for a district – such as teacher salary increases – means not only an increase in state funds distributed to districts, but also an increase in the local match required. In the case of salary increases, the state requires a 30 percent local match from districts on a statewide basis, but each district may have to contribute significantly more or less than 30 percent based on their fiscal capacity. As shown in [Exhibit 1](#), an increase in the local match requirement can impact districts' maintenance of effort if local funding levels are similar to the required local match. Apart from state-funded raises, districts may choose to offer raises paid out of local funds, which would be reflected in higher maintenance of effort levels going forward.

Endnotes

- ¹ See County Technical Assistance Service “Ask e-Li: Maintenance of Effort,” <http://ctas-eli.ctas.tennessee.edu/>, for specifics about other county maintenance of effort requirements.
- ² 34 CFR § 300.203.
- ³ *Public Acts, 1987*, Chapter 280, passed April 20, 1987; codified in *Tennessee Code Annotated* 49-3-314(c)(2).
- ⁴ *Public Acts, 1987*, Chapter 280; codified in *Tennessee Code Annotated* 49-2-203(a) (10)(A)(ii).
- ⁵ *Public Acts, 1987*, Chapter 280; codified in *Tennessee Code Annotated* at 49-2-203(a)(10)(C) and 49-3-314(c)(2). Although not necessarily related, Knoxville held a referendum in 1986 for approval to transfer its city school system to the Knox County Board of Education; the two systems were merged for the 1987-88 school year.
- ⁶ Tennessee Comptroller Offices of Research and Education Accountability, *Statutory Options for School District Mergers: Report addressing House Resolution 30, 2011*, March 2012, p. 13, <http://www.comptroller.tn.gov/> (accessed May 20, 2015).
- ⁷ Rules of the Tennessee State Board of Education, Chapter 0520-01-02.13(3), *Minimum Requirements for the Approval of Public Schools*, <http://state.tn.us/sos/> (accessed Aug. 31, 2015).
- ⁸ 105th Tennessee General Assembly, Resolutions, 2008, Senate Joint Resolution 1180, A resolution to call for the review, study and recommendations necessary to address the reduction and/or redistribution of local education funding relative to increased state education funding.
- ⁹ Rules of the Tennessee State Board of Education, Chapter 0520-01-02.13(3), *Minimum Requirements for the Approval of Public Schools*, <http://state.tn.us/sos/> (accessed Aug. 31, 2015).
- ¹⁰ *Tennessee Code Annotated* 49-2-203(a)(10) and 49-3-314(c).
- ¹¹ *Tennessee Code Annotated* 49-3-314(c)(4).
- ¹² Tennessee Department of Education Local Finance staff, interview, April 22, 2015.
- ¹³ *Tennessee Code Annotated* 49-3-314(c)(1).
- ¹⁴ Tennessee Advisory Commission on Intergovernmental Relations, *A Prototype Model for School-System-Level Fiscal Capacity in Tennessee: Why & How*, Oct. 2005, p. 7, <http://tn.gov/tacir/> (accessed June 5, 2015).
- ¹⁵ *Tennessee Code Annotated* 49-3-356.
- ¹⁶ OREA analysis of data provided by Tennessee Department of Education, July 2, 2015.
- ¹⁷ Data provided by Tennessee Department of Education, July 2, 2015.
- ¹⁸ State Board of Education, *BEP Blue Book*, 2014-15.
- ¹⁹ 109th Tennessee General Assembly, Public Chapter 427, 2015, p.47.



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