



## Statement of Position TIF Segregation of Funds

A development authority may spend tax increment only as authorized by the TIF Act.<sup>1</sup> The TIF Act requires authorities to segregate each TIF district's tax increment in a special account or accounts on its official books and records or as otherwise established by resolution of the authority to be held by a trustee or trustees for the benefit of bond holders.<sup>2</sup>

When the Office of the State Auditor (the OSA) reviews tax increment expenditures, it may review whether the authority has an accounting system that allows it to establish which expenditures were paid with tax increment from a particular TIF district and which expenditures were paid with some other source of funds. Each authority is required to segregate funds, to have an accounting system that keeps the receipts and disbursements of tax increment for each TIF district separate from the receipts and disbursements of all other money – including tax increment from other TIF districts.

### Accounting Systems and Practices

The TIF Act directs the State Auditor to develop a uniform system of accounting and financial reporting for TIF districts. The system of accounting and financial reporting must, as nearly as possible:

- (1) provide for full disclosure of the sources and uses of tax increment revenues in the district;
- (2) permit comparison and reconciliation with the affected local government's accounts and financial reports;
- (3) permit auditing of the tax increment revenues expended on behalf of a district, including a single district that is part of a multidistrict project or that is funded in part or whole through the use of a development account funded with tax increments from other districts or with other public money; and
- (4) *be consistent with generally accepted accounting principles.*<sup>3</sup>

Development authorities are responsible for financial reporting and compliance.<sup>4</sup>

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<sup>1</sup> The TIF Act can be found at Minn. Stat. §§ 469.174 to 469.1794 inclusive, as amended.

<sup>2</sup> Minn. Stat. § 469.177, subd. 5

<sup>3</sup> Minn. Stat. § 469.175, subd. 6 (emphasis added). Generally Accepted Accounting Principles (GAAP) require a city's accounting system to be structured to produce documentation that demonstrates which costs were paid with each district's tax increment so that legal compliance with the TIF Act can be demonstrated.

<sup>4</sup> Minn. Stat. § 469.175, subd. 6(b).

## Fund Accounting

Governmental accounting systems are organized and operated on a fund basis. Under the accounting standards, a fund is a fiscal and accounting entity with a self-balancing set of accounts recording accounting activities which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with regulations, restrictions, or limitations.

### Capital Projects Funds and Debt Service Funds

The funds most appropriate for TIF transactions are likely to be *capital projects funds* and *debt service funds*.

A capital projects fund is appropriate for financial resources that are restricted, committed, or assigned to be used to acquire or construct capital facilities. Accounting for tax increment revenues in a capital projects fund makes sense because most tax increment revenues are used in conjunction with the acquisition or construction of capital facilities. However, each TIF district must have its separate sub-account, and expenditures paid with some other source of funds should not be put in the TIF district sub-account.

Tax increment revenues can be put in a debt service fund if (1) all tax increment revenues are being accumulated solely for principal and interest payments maturing in future years, and (2) tax increment revenues are not being used for non-bond payments.<sup>5</sup>

### General Funds and Special Revenue Funds

Tax increment revenues should not be put in the general fund because they can be used only for specific limited purposes. Funding on-going activity is an integral part of the general fund. In addition, the general fund includes many different funding sources, making it difficult to keep tax increment revenues separate and creating the potential for skewing the reporting of the general fund.

Accounting for tax increment revenues in a special revenue fund is not appropriate pursuant to the definition of special revenue funds. The definition specifically excludes debt services. Separate debt service funds and capital projects funds are a better solution.<sup>6</sup>

## Prohibition on Commingling

Depositing non-tax increment revenue into the same fund with tax increment revenue results in the improper commingling of these different sources of funds. Such commingling of funds is a violation of Minn. Stat. § 469.177, subd. 5.<sup>7</sup>

If funds have been commingled, the problem should be proactively addressed by the authority. A basic accounting system should be set up which identifies (1) where the tax increment revenues came from (identifying the TIF district and type); (2) where the tax increment revenues were deposited; (3) where the tax increment revenues were spent; and (4) what tax increment (by TIF district) remains available to be expended. Invoices and other documents in support of TIF eligible expenses should be gathered. They will be needed to untangle the prior period disorder.

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<sup>5</sup> The TIF Act treats each of the following as bonds: (1) bonds or other obligations issued by an authority under the TIF Act, (2) refunding bonds, (3) notes (including pay-as-you go notes), (4) interim certificates and debentures, and (5) interfund loans or advances qualifying under Minn. Stat. § 469.178, subd. 7. See Minn. Stat. § 469.174, subd. 3. Private activity bonds issued under the Municipal IDB Act are not defined as bonds under the TIF Act.

<sup>6</sup> Use of a special revenue fund, however, would be preferable to using the general fund. Separate TIF debt service and TIF capital expenditures sub-accounts can be created within a special revenue fund.

<sup>7</sup> GASB Codification 2300.106.h. requires disclosure in the notes to the financial statements of any significant violations of finance-related legal or contractual provisions and actions taken to address such violations.

## **Segregation Process**

There is no set procedure that must be used to segregate the funds. Each authority has its own characteristics and will need to establish its own procedure. The authority's accountant will be a valuable resource in designing a procedure. Steps to consider include the following:

- Identify the available records.
- Identify the non-TIF eligible expenditures.
- Identify information from general ledgers and CAFRs that show whether you have complied or tried to comply.
- Prepare spreadsheets that identify sources and uses and tie back to general ledger.
- Separate sources and uses by TIF district.