SENATE FISCAL AGENCY
MEMORANDUM

DATE: September 22, 2008

TO: Members of the Senate

FROM: Kathryn Summers-Coty, Chief Analyst

RE: Financial Review Team Process for Detroit Public Schools

As has been reported recently, on September 17, 2008, the State Superintendent of Public Instruction requested the Governor appoint a financial review team to review the financial condition of the Detroit Public Schools (DPS). This memo describes the process that led to the requesting of the financial review team, and how the findings of that team can lead to the appointment of an emergency financial manager for a school district, according to the Local Government Fiscal Responsibility Act, PA 72 of 1990. This Act provides for the review, management, planning, and control of the financial operation of units of local government, including school districts, which will be the focus of this memo, and prescribed under Article 3 of the Act.

The Act prescribes that the State Superintendent of Public Instruction is responsible for monitoring and periodically reviewing the financial condition of school districts to ensure their compliance with State laws regulating budgetary and accounting practices and their financial soundness. The Act goes on to state that the Superintendent may determine that a school district has a serious financial problem if one or more of the following conditions exist:

- The school district ended the most recently completed school fiscal year with a deficit and the superintendent has not approved a deficit elimination plan within three months after the district's deadline for submission of its annual financial statement.
- The school board of the district adopts a resolution declaring that the school district is in a financial emergency.
- The superintendent receives a petition containing specific allegations of school district financial distress, signed by at least 10.0% of the total vote cast for governor.
- The superintendent receives a written request, from a creditor of the school district with an undisputed claim, to find the district has a serious financial problem.
- The superintendent receives written notification for a trustee or bondholder, or the State treasurer, of a violation of the district's bond or note covenants.
- The superintendent receives a resolution from either the Senate or the House of Representatives requesting a review of the financial condition of the district. (The Senate did request this review of Detroit Public Schools, via passage of Senate Resolution 209 on July 8, 2008.)
- The district is in violation of the conditions of an order issued pursuant to, or as a requirement of, the Revised Municipal Finance Act.
- The district is in violation of the requirements of sections 17 to 20 of the Uniform Budgeting and Accounting Act. (This Act prohibits a district from operating in deficit, and the DPS board of education adopted a budget for the 2008-09 fiscal year that is a deficit budget.)

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- The district fails to provide an annual financial report or audit that confirms with the minimum procedures and standards of the State Board and required under the Revised School Code.
- A court has ordered an additional tax levy without the prior approval of the school board of the district.

Under the review of the financial conditions of DPS as requested under S.R. 209, the Superintendent identified three critical areas of financial weakness: 1) FY 2006-07 Financial and Single Audits: the single audit included 120 findings; 2) the Deficit Elimination Plan submitted on August 14, 2008, is not approvable in its current form; and, 3) the district was put in high-risk status for all Federal education programs on August 26, 2008. Also, the Superintendent's report on the financial review found that the district continues to operate under significant cash flow issues, and that monthly financial reports, required of the district as part of its borrowing in 2004 of $216.0 million, have failed consistently to reflect the actual financial condition of the district. Therefore, the Superintendent determined that the district has a serious financial problem and notified the Governor and State Board of Education of that determination, and, per the Local Government Fiscal Responsibility Act, requested the appointment of a review team.

The Act provides that the Governor appoint a review team within 30 days after the requested appointment, and that the review team consist of the State Superintendent, the State Treasurer, the Director of the Department of Management and Budget, a nominee of the Senate Majority Leader, and a nominee of the Speaker of the House of Representatives. The review team has full power to:

- Examine the books and records of the district;
- Utilize the services of other State agencies and employees and employ professionals necessary to assist in its duties;
- Sign a consent agreement with the superintendent of DPS that may provide for a long-range financial recovery plan, that may utilize State financial management and technical assistance, and that may provide for periodic fiscal status reports to the State superintendent. This agreement must be approved by a majority vote of the DPS school board for it to be effective.

The review team must report its findings to the Governor and the State Board within 30 days after its appointment, though the Governor may grant one 60-day extension. Copies of the report also must be sent to the State Superintendent, DPS' board, the Senate Majority Leader, and the Speaker of the House of Representatives. The review team must conclude one of the following: 1) the district does not have a serious financial problem; 2) the district does have a serious financial problem, but a consent agreement containing a plan to resolve the problem has been adopted; or, 3) the school district has a financial emergency because a consent agreement containing a plan to resolve the problem has not been adopted.

Within 30 days after the State Board receives the report from the review team, the State Superintendent must make one of the same three determinations as listed above (no financial problem, financial problem but a plan in place, or financial emergency because no plan in place). If the Superintendent determines that a financial emergency exists, written notification of that determination will be sent to DPS' board, and the board has 10 days to request a hearing to contest the determination. If the determination stands after any hearing, the State Superintendent has 30 days to submit to the State Board the names of nominees to be considered for appointment to serve as an emergency financial manager for the school district. The State Board then must forward no more than three nominees to the Governor, and the Governor must choose one of those nominees, with advice and consent from the Senate. The term of office for the emergency financial manager shall be fixed by the Governor, but not exceed one year, and may be renewed on an annual basis for not more than one year.

Upon appointment by the Governor, an emergency financial manager immediately assumes control over all fiscal matters of, and makes all fiscal decisions for, the school district. The manager may examine the books and records, review payrolls or other claims against the district, negotiate, renegotiate, approve, and enter into contracts on behalf of the district, receive and disburse funds, adopt a final budget for the next school fiscal year, act as an agent of the district in collective bargaining, and to the extent possible under State labor law, renegotiate existing and negotiate new labor agreements. The manager may recommend to the Legislature steps that need to be taken to improve the district’s financial condition, require compliance with the manager's orders via court order if necessary, and require the attendance of witnesses and the production of documents relevant to an analysis of the district's financial health.

The manager also may recommend that the district be reorganized with one or more contiguous school districts, create new positions, seek approval from the State Board for a reduced class schedule, employ auditors, reduce expenditures in the budget, borrow money on behalf of the district, approve or disapprove the issuance of school district obligations, order school millage elections consistent with the Revised School Code, sell or other use the assets of the district to meet past or current obligations, and, after giving written notice to the State Superintendent, may authorize the district to proceed under Chapter 9 of Title 11 of the United States Code, such that the district may become a debtor. In consultation with the district's board, the emergency financial manager shall develop a written financial plan, providing for conducting the operations of the district within the resources available, and the payment in full of the scheduled debt service requirements on all bonds and notes and other uncontested legal obligations.

If an emergency financial manager is appointed, that person serves until the declaration of financial emergency is revoked by the State Superintendent. The Superintendent may determine and certify that the conditions for the revocation have been met after receiving a recommendation from the emergency financial manager, though the manager may condition the recommendation upon the school board's adoption of a resolution that will ensure the adoption of a balanced budget, elimination of any remaining accumulated deficit, and the prevention of additional negative fund balances.

If you have any questions on this matter, please don't hesitate to call.

/kjh

c: Gary S. Olson, Director
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