August 28, 2013

**Financial Accountability for Schools’ Workgroup: Final Synopsis**

Situation Analysis

Nobody thinks that it befits students, families, faculty, administrators, and policy makers to find financial crises popping up too late to stave off financial catastrophe. Some have caused or threatened the closure of schools during or at the opening of school years. It’s untenable and unnecessary.

Tom Saxton offers a simple but profound comment: “Everyone knows something that should be shared with someone.” There are plenty of people who can bring to the attention of others warnings of financial distress. They include vigilant reporters, school board members and administrators, parents, state and local lawmakers, and creditors. Too, there are plenty of triggers, facts, and anecdotes to warrant early investigation by Intermediate School Districts (ISDs) and the Michigan departments of education (MDE) and treasury.

There is no single action necessary to get ahead of financial crises; rather, many arrows in many quivers. People just have to be proactive in sounding alarm bells and taking immediate action.

In a July 25, 2005 essay in the American Review of Public Administration, Philip Kloha, Carol Weissert, and Robert Kleine (former Michigan Treasurer) found that Michigan “utilizes the most indicators [of local governments’ fiscal positions], having identified 30 triggers thought to be associated with fiscal distress.” That is a far cry from indicting Michigan; it’s a salute to our vigilance.

Even that has not been enough. We need to push the envelope. We may need fifty or more triggers. We need to identify problems 90 or more days earlier than we now do.

Interrupting, by threatened closures, of a school year is unconscionable. Threats to opening school doors in September similarly are unconscionable. With local control comes responsibility. People who are elected to school boards and people hired to supervise and oversee finances carry critical responsibilities.

Recommendations

It must be noted that this synopsis has been compiled and written by Craig Ruff, who bears responsibility for errors. A reader should not attribute to any or all members of the workgroup endorsement of one or more recommendations.

* ISDs must compare October student counts to those projected in local districts’ budgets and deficit elimination plans, if they are in place. In situations where the October count is considerably lower than that budgeted and the district is under a deficit elimination plan, ISDs should report them to MDE and Treasury within 30 days of the October count.
* Both MDE and Treasury should designate a single person responsible for receiving all reports of fiscal distress.
* MDE and Treasury are woefully understaffed to meet current and future investigations and inquiries. Ideally, the State would have a SWAT team singularly assigned to make those inquiries, follow up, and take action. The team should be funded and built within one or both of the departments.
* The State should give green, yellow, and red lights on all districts.
	+ Green lights are given to districts that have audited fund balances at or above 15% expressed as a percentage of total general fund expenditures as of any fiscal year (audited.) And, after the fall student count, the adjusted budget does not reduce the general fund balance to be less than 10% of adjusted current operating expenditures. And, any amended budget does not reduce the general fund balance to less than 10% of current operating expenditures.
	+ Yellow lights are given to districts that have audited fund balances greater than 10% but less than 15% expressed as a percentage of total general fund expenditures as of any fiscal year. And, after the fall student count, the adjusted budget does not reduce the general fund balance to less than 5% of adjusted current operating expenditures. And any amended budget does not reduce the general fund balance to less than 5% of current operating expenditures.
	+ Red lights are given to districts that have audited fund balances greater than 0% but less than 5% expressed as a percentage of total general fund expenditures. And, after the fall student count, the adjusted budget does not reduce the general fund balance to less than 0% of adjusted current operating expenditures.

This rating provides a just-in-time measurement as opposed to a depletion trend. It reflects real-time budgets amended to adapt to circumstances and that maintain a fund balance. A district may start the fiscal year with a green light and be downgraded to a yellow or red light if it’s budget is not amended to reflect declines in its current year’s revenue. Measurements for audited results are more robust than mid-year assessments.

* Everyone has access, at reasonable costs, to masadda.com and munetrix.com. Each provides real-time, public data that offers a rich array of potential warning signs. Providing access to the media would prompt more public attention to financial problems.
* The Local Financial Stability and Choice Act (P.A. 436 of 2012) stipulates 19 conditions, any one of which may trigger a preliminary review by MDE. They are straightforward. They are listed in Addendum A. However, as the state superintendent continues to initiate preliminary reviews, MDE lacks the capacity to handle this ever-expanded workload and needs additional funding and staff to meet the timelines specified in law.
* ISDs should review and comment on local districts’ budgets. Comments may be directed to the local district, MDE, and/or Treasury. Comments also should be communicated to area state legislators.
* More a question than a recommendation: Can the fiscal year, the school year, pupil accounting cycle, and reporting of count data be better aligned?
* Policy makers should consider mandating that school board members take certain financial literacy educational programs. The Michigan Association of School Boards offers many such workshops. Bay Mills Community College’s chartering authorizer offers on-line training. Likely there are many other such training tools and sources.
* Any agency should report promptly to MDE and Treasury lengthy delays in required payments, for example the State Retirement Office. The state’s Unemployment Insurance office should provide both state departments with anticipated payments owed. The Michigan Tax Tribunal should report any adverse rulings that could affect tax collections concurrently to local districts, county treasurers, ISDs, and Treasury.
* Not only agencies but other organizations, entities, and individuals can contribute mightily to early alerts. The Michigan Education Association’s Uniserve staff, as just one example, are on-the-ground, in-the-know talent who could offer valuable help.
* Through interlocal agreements, such as the Michigan Municipal Services Authority, stipulate the investigation into financial distress by expert staff or consultants. This likely will require more funding and staffing.
* In a select and few cases of fiscally troubled districts, Treasury should limit school district borrowing options so that districts are less likely to overextend financial resources and jeopardize the State’s credit rating. MDE and Treasury see habitually districts unable to meet current obligations because they have to pay principal and interest on the previous year’s state aid note. Emergency loans complicate the payback process. In fiscally responsible districts, loans are essential inasmuch as districts do not receive State payments until the end of the first quarter of their fiscal year.

Other States

This section portrays how Colorado (retrospectively) and New York (prospectively) measure fiscal stress in schools.

Annually in Colorado, the State Auditor produces an analysis entitled “Fiscal Health Analysis of Colorado.” The auditor has produced this for five years. For the latest report, please see

[www.leg.state.co.us/OSA/coauditor1.nsf/UID/1DA6099D5CFA418E87257BA5007CD72B/$file/2127+Fiscal+Health+Sch+Dist+June+2013+REPORT.pdf?OpenElement](http://www.leg.state.co.us/OSA/coauditor1.nsf/UID/1DA6099D5CFA418E87257BA5007CD72B/%24file/2127%2BFiscal%2BHealth%2BSch%2BDist%2BJune%2B2013%2BREPORT.pdf?OpenElement)

The public document is designed to be used by local districts, the Colorado Department of Education, reports, and the public.

The analysis uses six ratios to assess school districts’ financial health, stretching back over the most recent three fiscal years. The ratios are:

* Asset Sufficiency Ratio, which indicates whether the district’s total assets are adequate to cover all of its obligations or amount owed. It divides general fund total assets by general fund total liabilities. The warning indicator is a consistent deficit in assets’ adequacy to meet obligations over the three-year period.
* Debt Burden Ratio, which indicates whether the district’s annual revenue will cover its annual debt payments, including principal and interest. This ratio divides total government revenue of funds paying debt by the total government debt payments. The warning indicator is when annual revenues consistently are below the annual debt payment for each of the three years.
* Operating Reserve Ratio, which indicates the school district’s reserve to cover future expenditures. This ratio divides the fund balance of the general fund by total general fund expenditures (net of transfers). The warning indicator is when a reserve that covers less than one week of future expenditures, which is the equivalent of 0.0192 or 1/52, for each of the three years.
* Operating Margin Ratio, which indicates the amount added to the school district’s reserves for every $1 generated in revenue. This ratio subtracts general fund total expenditures (net of transfers) from general fund total revenue and divides by general fund total revenue. The warning indicator is a loss in reserves for each of the three years.
* Deficit Fund Balance Ratio, which indicates the portion of annual revenue the district must generate simply to cover an existing deficit fund balance in a government fund. This ratio is only calculated when a net deficit fund balance exists. This ratio subtracts the fund balance of the general fund, if the balance is positive, from the total deficit fund balances (shown as an absolute value) and divides the total by the total revenue in the deficit funds. The warning indicator is the portion of annual revenue need to cover the deficit fund balance is increasing over the three-year period.
* Change in Fund Balance Ratio, which indicates whether the school district’s reserves in its general fund are increasing or decreasing. This ratio subtracts the prior year fund balance of the general fund from the current year fund balance and divides by the prior year fund balance. The warning indicator is consistent decreases in revenues.

The analysis depicts the districts with one or more warning indicators, along with steps that the district will take.

The New York State Comptroller published “Proposed Fiscal Stress Monitoring System ” in September 2012. The report may be found at: <http://www.osc.state.ny.us/localgov/pubs/fiscalmonitoring/pdf/fiscalstressmonitoring.pdf>

In the report’s introduction is found the goal that we, in Michigan, share:

“A first step to helping local governments [including school districts] deal with these fiscal challenges is to identify clearly those local governments and school districts that are moving towards, or are already in, fiscal stress. Such monitoring of the fiscal health of local governments and school districts should allow for early actions to prevent these entities from ending up in severe fiscal stress. Such preventative actions should result in less cost and less disruption to vital services.”

The suggested set of warning indicators is far more comprehensive than Colorado’s. While using similar financial data as Colorado (but including cash positions,) the report recommends using a set of environmental indicators. For example, change in property value, enrollment, defeat of the first budget presented to the board, graduation rates, and percentage of students in free or reduced lunch. We might consider adding the community’s poverty rate and demographic trends, including increase/decrease in population along with trends in the school-age population.

Addendum A

P.A. 436 of 2012 permits MDE to conduct a preliminary review to determine the existence of probably financial stress. The act provides 19 factors, any one of which could trigger such a review. Requesting a review may be

* The governing board or chief administrator of a local district or ISD.
* A creditor with an undisputed claim that remains unpaid for 6 or more months and is greater than $10,000 or 1% of the annual general fund budget.
* A petition signed by registered electors numbering at least 5% of all votes cast for governor within the jurisdiction. The petition must contain specific allegations of financial distress.
* A local government pension fund reports that a municipality has not timely deposited its minimum obligation payment.
* A district has failed for a period of 7 days or more after the scheduled date of payment to pay wages and salaries or other compensation owed to employers or benefits owed to retirees.
* A trustee, paying agent, bondholder, or auditor engaged by a district reports a default in a bond or note payment or a violation of 1 or more bond or note covenants.
* A resolution from either the senate or the house of representatives.
* A district violates a requirement or condition of an order related to the issuance of bonds and notes.
* A municipality violates the conditions of an order issued by the local emergency financial assistance loan board.
* A district violates certain requirements of the uniform budgeting and accounting act.
* A district fails to timely file an annual financial report or audit.
* A district fails to provide an annual financial report or audit that conforms with the minimum procedures and standards of the state school superintendent and is required under the state school code or school aid act.
* A municipality is delinquent in distributing tax revenues.
* A district is in breach of its obligations under a deficit elimination plan.
* A court has ordered an additional tax levy without the prior approval of the local governing body.
* A municipality ends a fiscal year in a deficit or fails to comply with requirements in a financial plan to correct the deficit condition.
* A district ends its most recent fiscal year with a deficit in 1 or more of its funds and has not submitted a deficit elimination plan to MDE within 30 days after the district’s deadline for submitting its annual financial statement.
* A district is assigned a long-term debt rating within or below the BBB category by any one national credit rating agencies.
* The state school superintendent finds any fact or circumstance indicative of probable financial stress.

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