STATE OF MICHIGAN
DEPARTMENT OF EDUCATION
LANSING

JENNIFER M. GRANHOLM
GOVERNOR

MICHAEL P. FLANAGAN
SUPERINTENDENT OF
PUBLIC INSTRUCTION

December 8, 2008

Dr. Carla Scott, President
& Board of Education Members
Detroit Public Schools Board of Education
7322 Second Avenue, Suite 485
Detroit, MI 48202-2711

Dear Dr. Scott and Detroit Board of Education Members:

The purpose of this letter is to inform you that, pursuant to section 36 of the Local Government Fiscal Responsibility Act, 1990 PA 72, MCL 141.1201 to 141.1291 (the Act), I have determined that a financial emergency exists in the Detroit Public Schools District (the District). This determination is based on the fact that the District's administration and board have failed to abide by the terms of the Consent Agreement (the Agreement) entered into by the Detroit Public Schools general superintendent and board on November 5, 2008. As such, section 35(2) and section 38 of the Act applies to the District.

The Agreement requires the District to submit to the Michigan Department of Education (MDE) a satisfactory Deficit Elimination Plan (the Plan) along with a revised budget and a resolution authorizing the general superintendent to take any and all action necessary to implement the Plan without further, or subsequent, approval by the District's board. On the due date, December 3, 2008, the District submitted two documents to the MDE: a board resolution entitled, "Detroit Board of Education Resolution Regarding Adoption of 2008-2011 Deficit Elimination Plan and Consent Agreement," and a draft copy of a document entitled, "Revised Budget Reduction Strategy Update" (the Update) dated December 1, 2008. Additional documents were submitted past the deadline on December 4, 2008. I have determined that together all of the documents submitted, including those submitted after the December 3rd deadline, do not meet the requirements of the Agreement and subsequently are unsatisfactory to the MDE. This is a failure to abide by the Agreement.

Section 35(2) of the Act requires that upon my determination of a financial emergency I provide you with written notification of the determination, findings of fact utilized as the basis upon which this determination was made, and a statement of the underlying facts supporting the factual findings.

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Background:
In a letter to Governor Jennifer M. Granholm on September 17, 2008, I declared that the Detroit Public Schools District had a serious financial problem, pursuant to the requirements of the Act. This determination was made due to the fact that the Senate had passed a resolution requesting a review and report of the financial condition of the District. My report identified multiple areas of financial weakness, three of which were considered critical: 120 findings from the 2006-2007 Single Audit; the District was placed in High Risk status for all federal education programs; and the District's submission of a Deficit Elimination Plan that was unacceptable to the MDE.

The District was given an opportunity to address its deficit by submitting in August a Deficit Elimination Plan to the MDE to resolve a projected shortfall of $112.8 million. In an attempt to reach out to the District and gain a better understanding of the details and viability of the Plan the District submitted, I initiated a September meeting with the District board president and appropriate committee chairs from the District board and the District administration. During the course of our meeting and after further review, it was clear that the Plan submitted was unacceptable due to lack of data integrity and the fact that little action had been taken to implement any of the budget reduction measures outlined in the Plan. This was just one in a series of previous instances in which District officials, both the administration and the board, failed to take necessary action to address the District's fiscal problems. I was compelled to declare a serious financial problem.

Following my declaration and pursuant to the Act, Governor Granholm appointed a Review Team (the Team) to review the District's financial situation and issue a report and recommendation based on the Team's findings. The report confirmed that the District had a serious financial problem and found, among other things, that District officials failed to implement provisions of prior agreements to address budgetary concerns; operated in a deficit condition numerous times over multiple years; and contributed to a pattern of deficit spending facilitated through a series of short-term notes and refinancing short-term debt into long-term debt. The Team cited several other factors that worked to compound the financial situation, including: "declining student enrollments, coupled with the inability or unwillingness of School District officials to make in a timely manner the budgetary adjustments necessitated by those declines in enrollment; a demonstrated inability of the administration and Board of Education of the School District to work cooperatively in a consistent manner over time; and administrative inconstancy due, in part, to a succession of general superintendents in the School District."

The Team's report highlighted the reality and seriousness of the District's financial problem. It also confirmed that District officials have not demonstrated the ability to resolve their budget problems and appropriately manage their finances. However, the Team reached a Consent Agreement (the Agreement) with the District general superintendent and the District board that was intended to resolve the District's serious financial problem by mandating that District officials perform specific actions within specific timeframes.

Under the provisions of the Act, the Superintendent of Public Instruction is required to make a determination regarding the Team's report within 30 days of receiving it. The Act requires that one of the following three determinations be made:

(1) The school district does not have a serious financial problem.
(2) The school district does have a serious financial problem, but a consent agreement containing a plan to resolve the problem has been adopted.
(3) The school district has a financial emergency because a consent agreement containing a plan to resolve a serious financial problem within the school District has not been adopted.

In my letter to Governor Granholm dated December 1, 2008, I determined that the District did have a serious financial problem, but a Consent Agreement (the Agreement) containing a plan to resolve the problem had been adopted.

The Agreement gives me the responsibility and authority to hold the District accountable for failure to abide by the Agreement. As it states, "the failure of the School District to comply in any respect with this Consent Agreement may be considered by the Superintendent of Public Instruction sufficient cause for recommending the immediate appointment of an emergency financial manager." [Consent Agreement, VII. Ongoing Requirements, 7, p. 11.]

Findings of Fact:
Section II of the Agreement requires that the District, within 28 days of the Agreement's execution, submit to the MDE a Deficit Elimination Plan (the Plan) that contains to my satisfaction specific and realistic expenditure reductions that will sufficiently address any current operating deficit and any accumulated deficit. [Consent Agreement, II. Deficit Elimination Plan, p. 5.] The Agreement also requires the submission of a revised budget adopted for the fiscal year commencing July 1, 2009, as well as a resolution adopted by the District's board which authorizes the District general superintendent to take any and all action necessary to implement the Plan without further, or subsequent, approval by the District's board. [Consent Agreement, II. Deficit Elimination Plan, p. 6.]

On December 3, 2008, the due date, the District submitted two documents to the MDE intended to meet the requirements described above: a board resolution entitled, "Detroit Board of Education Resolution Regarding Adoption of 2008-2011 Deficit Elimination Plan and Consent Agreement," and a draft copy of a document entitled, "Revised Budget Reduction Strategy Update" dated December 1, 2008. After thorough review, I determined that the documents do not meet the requirements of the Agreement and are unsatisfactory to the MDE due to the following reasons:

The District did not submit a board-adopted Deficit Elimination Plan or revised budget as required by the Agreement, the Uniform Budgeting and Accounting Act, MCL 141.1421 *et seq*, the State School Aid Act, MCL 388.1702, and the Michigan Public School Accounting Manual.

- The District did not submit a resolution adopted by the board that resolved to authorize the District general superintendent to take any and all action necessary to implement the Plan without further, or subsequent, approval by the District's board. This is clearly at odds with the unambiguous language of the Agreement and violates the Agreement's requirements.
- Though the MDE repeatedly provided the District with a prescribed Deficit Elimination Plan format, the District submitted "Revised Budget Reduction Strategy Update" dated December 1, 2008, which neither follows this format nor contains the information required by this format including a Standard Deficit Elimination Spreadsheet. Therefore, the District's documents were not submitted to the satisfaction of the MDE as required by the Agreement.
- The "Revised Budget Reduction Strategy Update" dated December 1, 2008, lacks the specific information and detail required by the Agreement for the MDE to determine whether or not it would sufficiently address the District's deficit. Necessary financial data such as a revised budget, trend data, administrative procedures, and even a deficit figure upon which a Deficit Elimination Plan could be based, are absent from the "Revised Budget Reduction Strategy Update" dated December 1, 2008. The "Revised Budget Reduction Strategy Update" dated December 1, 2008, also contains inconsistent data throughout. For example, it indicates monetary savings figures for employee reductions varying between $28 million and $36.7 million, giving the MDE no consistent savings figure.

Furthermore, on the afternoon of December 4, 2008, District officials submitted additional documentation to MDE intended to constitute a revised Deficit Elimination Plan. Beyond the fact that this submission was made after the December 3 deadline, this documentation still was not satisfactory to MDE as required by the Agreement. As in the previous submission, important financial information was inconsistent. The document included two different deficit amounts, neither of which matched the deficit amounts the District had submitted on previous reports. One budgetary document reflected an increase in the District's deficit from the 2007-2008 to the 2008-2009 fiscal year, a clear violation of the Uniform Budgeting and Accounting Act and of the Consent Agreement. Even if this documentation had been submitted by the deadline, it gives me no greater confidence in the ability of District officials to manage the District's finances and would have been found unacceptable regardless.

Finally, Section IV of the Agreement requires that the District submit an accounts payable listing (the Listing) detailing all accounts payable in the amount of $10,000 or more which are more than 30 days beyond their due date. Though the submission deadline was met, the Agreement requires that a proposed schedule for payment and information detailing accrued interest on the payables be included in the report. This information was not included, undermining the purpose of the requirement to force action in resolving overdue vendor payments.

Additional Information:
Detailing additional financial and management issues comprising the District's problems is warranted. The District has been in deficit for multiple years over the course of several decades. During that time, the MDE's interactions with the District have exposed numerous systemic issues including the failure to meet deadlines and requirements, the misappropriation and lapsing of significant amounts of federal dollars, and an inability to remedy its financial problem by taking appropriate action. In its report on the District, the Council of Great City Schools confirmed the District's lack of leadership acknowledging that the District board has "not always been clear or unified about where it was going or why." It calls for officials to demonstrate the "leadership necessary to improve and reform a school system that has been in deep trouble for some years." This has not occurred. Evidence of the lack of overall leadership, judgment, and management compounding the District's problems can be found in the following circumstances:

Due to federal audit findings that indicated the misuse of over $53 million in federal Title I education dollars, the District was placed in High Risk status in August 2008.

As part of the District's High Risk status designation, the MDE requested a copy of the District's conflict of interest policies. The District provided six different policies, some of which were in direct conflict with others.

The District consistently uses unconventional budget practices that make it difficult to monitor actual revenues and expenditures. For example, last year the District allocated the amount awarded for various grants to a "central office" account rather than allocating the money to the appropriate account reflective of the function for which the funds would be used. These expenditures were moved to different functions on the monthly budgetary control reports submitted to the MDE. These unconventional budget practices indicate the lack of internal controls necessary to manage expenses adequately.

The District consistently lapses federal program dollars due to a lack of timely action. For example, the recent Reading First final expenditure report was not submitted on time. Without the MDE's willingness to make another exception for the District, this would have resulted in the loss of millions of dollars in federal funds this academic year.

- The District consistently fails to pay vendors on time as evidenced by its recent accounts payable listing. The 7-page listing documented over 200 past due vendor payments totaling over $21 million. Some accounts payable have been overdue for over two years. Several vendors not included in the listing have publicly complained they are owed money. This raises the possibility that the report submitted should have included an even larger payables total with more vendors owed.

The District has consistently demonstrated poor cash management practices. Over the past several months, requests for last-minute wire transfers, particularly to cover payroll, have been made.

The District consistently fails to follow Generally Accepted Accounting Practices (GAAP).

- The District board has established separate legal and auditing functions and separate offices and staff from the administrative functions. This duplication of services increases administrative expenses and contributes to the lack of systemic controls.
- The District board did not approve until September 2008 a contract with an auditor to complete the 2008 financial audit due by statute on November 15 of every year. Much of the preliminary audit field work should have been completed by the end of June when the District budget is required to be adopted by the board.

While the above issues are significant and indicative of the widespread financial and management problems crippling the District, it is imperative we remember that these financial issues have serious implications for student learning and achievement. The education of the District's children is suffering because of the District's financial turmoil. Ensuring a stable and high quality education for all students should be its overarching mission, the foundation of its work, and the motivation for every decision made in confronting the District's fiscal problems.

Conclusion:
The Act establishes that I, as Superintendent of Public Instruction, am responsible for monitoring the financial condition of all school districts to ensure compliance with state laws as well as their financial stability. While I had hoped that District officials would have led the District to solid financial ground, they have repeatedly shown that they are incapable or unwilling to do so and the District remains in fiscal chaos. The District's severe and long-term financial problems cannot be ignored or allowed to continue.

In my December 1, 2008, letter to Governor Granholm, I determined that the Consent Agreement was in effect. I was also very clear that this Agreement was the District's final opportunity to successfully manage its affairs and avoid the appointment of an emergency financial manager. However, not one week passed before District officials failed to abide by the terms of this Agreement.

I am well aware of the weight and sensitive nature of the decision I am required to make. However, I am convinced that the District is teetering on a dangerous precipice. If allowed to continue on its present course, it will propel itself towards a financial disaster from which it will not recover. I also am convinced that this pivotal moment in the District's history is an opportunity for us to come together to salvage what is right with the District and repair what is wrong. I am not only required to take action because it is my duty, I am also compelled to take action because it is the right thing to do to protect the education of the District's children and the future of the Detroit Public Schools system.

The District is suffering from both a financial crisis and an educational emergency. Both are critical and interconnected. As the financial problem grows, so do the barriers to an education that will equip the District's children with the skills they need to thrive and succeed. In response to these barriers, increasing numbers of students leave the District compounding its financial troubles. The District must have help in resolving this double-edged crisis if it is to survive these challenges. The appointment of an emergency financial manager can offer the management and direction necessary to support the District's financial structure and enable the District's board and administration to focus all of their efforts on the pursuit of educational excellence for their students.

Therefore, based on the above findings of fact, I have determined that a financial emergency exists in the Detroit Public Schools District and that an emergency financial manager is required. As a result, I will submit to the Governor up to three names of nominees, one of which shall be appointed to serve as an emergency financial manager for the District.

Notice of Hearing:
As required by the Act, this letter also provides notice that the District board has 10 days after the date of this notification to request a hearing to contest this determination. The deadline for requesting a hearing is no later than 5:00 p.m. on December 18, 2008, and must be sent in writing to Carol Wolenberg, Deputy Superintendent of the MDE.

Sincerely,

Michael P. Flanagan
Superintendent of Public Instruction

cc: Jennifer M. Granholm, Governor
Dr. Connie Calloway, Detroit Public Schools General Superintendent
State Board of Education