3500 (Rev. 01-11)

STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

ANDY DILLON
STATE TREASURER

DATE: January 3, 2012 **(Adopted and Resubmitted on February 22, 2012)**

TO: Governor Snyder

FROM: Highland Park School District Financial Review Team:
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SUBJECT: Report of the Highland Park School District Financial Review Team

On November 14th, 17th, 28th and December 1st, 8th, and 21st, 2011, Highland Park School District Financial Review Team members met and reviewed information relevant to the financial condition of the School District. Based upon those reviews, the Review Team concludes, in accordance with Section 13(4)(d) of Public Act 4 of 2011, the Local Government and School District Fiscal Accountability Act, that a local government financial emergency exists within the Highland Park School District, and that no satisfactory plan exists to resolve that emergency. Therefore, the Review Team recommends the appointment of an emergency manager.

I. Background

A. Preliminary Review

On August 1, 2011, the Michigan Department of Education commenced a preliminary review of the finances of the Highland Park School District to determine whether or not probable financial stress existed. Section 12(1) of the Act permits a preliminary review to be conducted if one, or more, of the conditions enumerated therein occurs. The preliminary review of the Highland Park School District resulted from the condition enumerated in subdivision (r) of Section 12(1) having occurred within the School District.[1]

[1] Subdivision (r) provides that "[t]he existence of other facts or circumstances that in the state treasurer's sole discretion for a municipal government are indicative of municipal financial stress, or, that in the superintendent of public instruction's sole discretion for a school district are indicative of school district financial stress."

For the purposes of the preliminary review, the Department of Education developed six critical factors to determine if a finding of probable financial stress was warranted. Those factors were:

- The School District had been in deficit for three or more consecutive years, including the current year.

- The district's existing deficit was greater than $1,000,000.

- The district's existing deficit was greater than 15 percent of general fund revenues, excluding incoming transfers.

- A fiscal review by one of the Department's program offices, or an external auditor, had revealed one or more material internal control weaknesses as evidenced by notes or findings in the financial audit related to any of the following:

  (a) A lack of written policies and procedures or a failure to follow the written policies and procedures.

  (b) Poor cash management.

  (c) A failure to provide personnel activity reports for employees paid with federal funds.

  (d) A history of spending outside the appropriations established by the local school board, in violation of Public Act 2 of 1968, Uniform Budgeting and Accounting Act.

  (e) The use of grant funds on unallowable expenditures.

  (f) Going concern issue, or qualified financial audit opinions, or both.

- The School District had shown unsatisfactory progress in eliminating a deficit, which was determined by identifying one or more of the following conditions:

  (a) A deficit increase from the previous year

  (b) Lack of cooperation from School District officials in submitting deficit information (i.e., late submission of deficit elimination plans, delinquent return of phone calls or correspondence relating to deficit elimination plans, chronic late submission of monthly budgetary control reports).

  (c) A history of supplying the Department with deficit elimination plan information which either was inaccurate or inconsistent with actual revenues and expenditures at year end.

- A failure by the School District to comply with bond or note covenants or to make pension fund deposits.

Based upon the foregoing six critical factors, the preliminary review found, or confirmed, the following:

- The School District had a general fund deficit in fiscal years 2007, 2009 and 2010; there was a modest fund balance of $7,282 for fiscal year 2008. At the time of the preliminary review, School District officials also projected that the School District would remain in a deficit condition through fiscal year 2014.

- The School District had a cumulative general fund deficit of $7,467,527 as of June 30, 2010. In addition, the cumulative general fund deficit had exceeded $3,000,000 since the 2009 fiscal year.

- The fund balance of the School District, expressed as a percentage of general fund revenues, was projected to be a negative 54 percent as of June 30, 2011. This negative percentage was the highest among all school districts in the State and far exceeded the negative 15 percent threshold at which the Department attaches concern.

- The financial audit report of the School District for the 2010 fiscal year included 19 findings of material weaknesses, significant deficiencies, or noncompliance. The findings included the failure to obtain a bond audit and poor cash management. Sixteen of the 19 findings were repeated from the financial audit report for the 2009 fiscal year.

- The School District had demonstrated unsatisfactory progress in eliminating its cumulative general fund deficit. The deficit had increased from $3,000,000 at June 30, 2009, to more than $7,000,000 at June 30, 2010, and at the time of the preliminary review, was projected to increase to more than $10,000,000 as of June 30, 2011.

- On July 11, 2011, School District Superintendent wrote to the Superintendent of Public Instruction advising him that the School District would be unable to timely repay a short-term State aid note in the amount of $11,152,865. In order to avoid a default, the School District Superintendent requested a State school aid adjustment of $4,190,000 to be repaid over a four-year period. The Superintendent of Public Instruction approved this hardship request pursuant to Section 15 of the State School Aid Act.

In addition to the foregoing preliminary review findings, the Department of Education gave consideration to the following information:

- The School District's blended pupil count, which is utilized for purposes of calculating State school aid, decreased from 1,858 pupils in fiscal year 2010 to 1,331 pupils in fiscal year 2011, which was a decrease of 527 pupils, or 28 percent. By comparison, the next highest pupil decrease in any other school district with more than 10 pupils was only 17 percent. The precipitous decline in the number of pupils in the Highland Park School District was critical as school funding continues to be based on the number of pupils. Based upon a per pupil foundation of $7,936 for the 2011 fiscal year, the 527 pupil decrease represented a reduction of $4,182,272 in school aid or 20 percent of the prior year's revenue for the School District.

- As a result of the district's failure to meet federal procurement standards, the district had lost approximately $230,000 in federal food and nutrition funds. Consequently, the corresponding food and nutrition costs were covered with general funds, which further exacerbated the general fund deficit.

Based upon the preliminary review, the Superintendent of Public Instruction concluded, and reported to the Governor on August 11, 2011, that probable financial stress existed in the Highland Park School District and recommended the appointment of a financial review team.

B. Review Team Findings

On November 3, 2011, the Governor appointed a ten-member Financial Review Team. The Review Team convened on November 14th, 2011, November 17th, 2011, November 28th, 2011, December 1st, 2011, December 8th, 2011, and December 21st, 2011.

1. Conditions Indicative of Severe Financial Stress

The Review Team found, or confirmed, the existence of the following conditions based upon information provided by School District officials, or the School District's audit firm, or other relevant sources:

- According to the School District's 2011 fiscal year financial audit, the School District's cumulative general fund deficit increased by 51.0 percent, from $7,467,527 as of June 30, 2010 to $11,251,484 as of June 30, 2011. The one-year increase in the School District's cumulative general fund deficit resulted from general fund expenditures and transfers out exceeding general fund revenues by $3,784,046.

- The School District has incurred an operating deficit (i.e., expenditures in excess of revenues) in five of its last six fiscal years. (See Table 1.) These operating deficits have ranged from a low of $597,733 during the 2007 fiscal year to a high of $3,572,662 during the 2010 fiscal year. The average operating deficit for the seven years in question was $2.3 million.

- According to information provided by School District officials, as of November 15, 2011, the School District owed $1,720,955.43 in accounts payable to various vendors. This total consisted of $1,206,411.02 in accounts payable which were 30 to 90 days aged, $280,257.70 in accounts payable which were 91 to 180 days aged, and $18,305.87 in accounts payable which were more than six months aged.

Each of the accounts payable, particularly those which are most aged, pose the risk that residents of the School District would be required to pay additional property taxes were one, or more, of the accounts payable converted to a court ordered judgment levy. Section 6094 of Public Act 236 of 1961, the Revised Judicature Act of 1961, authorizes a party who is owed an unremitted sum of money by a school district to obtain a court judgment which that party may then have placed upon the tax rolls of that school district without a vote of the electors.

- The School District's pupil enrollment decreased by 58 percent, from 3,179 pupils for the 2006 fiscal year to 1,331 pupils for the 2011 fiscal year. (See Table 1.) Current estimates place the School District's pupil enrollment at approximately 969. As the preliminary review noted, the precipitous decline in the number of pupils in the School District was critical as school funding continues to be based on the number of pupils.

- Financial audit reports for the School District for its last three fiscal years reflect the following variances between general fund revenues and expenditures, as initially budgeted and as amended, versus general fund revenues and expenditures actually realized:

	2008-09	%	2009-10	%	2010-11	%
Revenues						
Original	$33,065,124		$19,960,964		$22,650,634	
Amended	$31,488,255		$24,654,730		$19,940,717	
Actual	$27,632,441		$21,202,706		$18,853,207	
Variance	($3,855,814)	(12.25)	($3,452,024)	(14.0)	($1,087,510)	(5.45)
Expenditures						
Original	$32,235,400		$19,110,964		$24,060,085	
Amended	$30,738,255		$26,713,187		$22,178,197	
Actual	$29,749,084		$24,775,368		$21,972,315	
Variance	$989,171	3.22	$1,937,819	7.25	$664,938	3.00

It is noteworthy that the variances between budgeted expenditure and actual expenditures were positive in each year, meaning that the latter were less than the former. However, the opposite was the case in respect to revenues; in each year, actual revenues were less than budgeted revenues. This may have been the result, at least in part, of declining pupil enrollments during the course of a fiscal year. However, budgeted revenues should have been adjusted accordingly.

It also should be noted that in both the 2010 and 2011 fiscal years, the general fund budget *as amended* reflected expenditures and transfers in excess of revenues. Since the School District had no existing general fund balance in either year, School District officials apparently made a conscious decision -- at least from a budget amendment standpoint -- to incur an operating deficit in violation of Public Act 2 of 1968, the Uniform Budgeting and Accounting Act. [2]

- In addition to its regular December State aid payment, on December 20, 2011, the School District received a supplemental payment which covered 27 percent of the $100 per pupil financial best practice incentive. However, on that same date, School District officials informed the Michigan Department of Education of the School District's projected inability to meet, in full, its December 30, 2011 financial obligations.

- Department of Treasury officials have determined that it will be necessary to intercept a portion of the School District's State aid payments beginning in February in order to ensure the timely repayment by the School District of an outstanding State aid note. The amount to be intercepted in February will be $276,928, which will reduce that State aid payment by approximately 49 percent to $281,236. These partial intercepts will be in addition to a 100 percent intercept of the School District's August 2012 State aid payment.

2. Review Team Meetings

On November 14, 2011, the Review Team met with Anil Sakhuja and Rajeev Shah of the certified public accounting firm Alan C. Young & Associates, PC. On November 17, 2011, Review Team members Robert Bovitz, Frederick Headen, David Martell, Phillip Pierce, Doug Ringler,

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[2] Section 17 of the Act requires, among other things, as follows:

> If, during a fiscal year, it appears to the chief administrative officer or to the legislative body that the actual and probable revenues from taxes and other sources in a fund are less than the estimated revenues, including an available surplus upon which appropriations from the fund were based and the proceeds from bonds or other obligations issued under the fiscal stabilization act, 1981 PA 80, MCL 141.1001 to 141.1011, or the balance of the principal of these bonds or other obligations, *the chief administrative officer or fiscal officer shall present to the legislative body recommendations which, if adopted, would prevent expenditures from exceeding available revenues for that current fiscal year.* The recommendations shall include proposals for reducing appropriations from the fund for budgetary centers in a manner that would cause the total of appropriations to not be greater than the total of revised estimated revenues of the fund, or proposals for measures necessary to provide revenues sufficient to meet expenditures of the fund, or both. The recommendations shall recognize the requirements of state law and the provisions of collective bargaining agreements. Emphasis supplied.

Thomas Saxton, Brom Stibitz, and Carol Wolenberg conducted a series of interviews in the School District with Edith Hightower, Superintendent; Randy Lane, Finance Director; Jack Bauman, Human Resources Director; Steve Ezikian, Associate Superintendent, Business and Finance, Wayne Regional Educational Service Agency; Alma Greer, School Board President; John Holloway, School Board Treasurer; Robert Davis, School Board Secretary; School Board Members Jamille Edwards, Brenda Epperson, Debra Humphrey, and Katherine Joyner, School Board Vice-President; Katrina Henry, President, Highland Park Federation of Teachers (Assistants, Professionals, and Technicians Local 684); Glinda McDonald Vice President; Local 684; Carolyn Brown, Executive Secretary, Local 684; and John Middleton, Local 684.

3. Other Considerations

The Review Team gave serious consideration to the statutory option of a consent agreement, but concluded that it would not provide an effective remedy of the financial emergency within the School District. This conclusion was reached for several reasons.

First, the School District has experienced a precipitous decline in its pupil enrollment. A number of School District officials articulated to Review Team members various plans to attract pupils to the School District. However, the Review Team reached the conclusion that School District officials lacked the ability to convert the various plans into an actual course of action even if such a course of action would successfully stabilize student enrollments and the underlying financial condition of the School District. The severity of the financial emergency is such that the Review Team cannot assure you that the School District can survive as a standalone entity.

Second, more than half of the School District's current enrollment consists of residents of the City of Detroit. To the extent that efforts are successful at improving educational conditions within the City of Detroit School District, one effect may be a further, and accelerated, decline in the pupil enrollment in the Highland Park School District. Recently enacted legislation which removes restrictions upon the number of charter schools will likely further exacerbate this trend.

Third, the Review Team observed notable differences of opinion concerning the functioning of the School Board, the timeliness and utility of the information received by it, and whether sufficient strides were being made to address the School District's financial stress. Regardless of whether these varying sentiments constitute merely a healthy diversity of views, or dysfunction within the School Board, they cast doubt upon the ability of School District officials to abide by and successfully implement a Consent Agreement.

Finally, during its November 17, 2011, site visit, Review Team members requested additional financial information from School District officials. As of the date this report was finalized, that information had not been provided. On December 15, 2011, a School District official did contact the Michigan Department of Education to request a 30-day extension to file the financial information in question. The requested extension was denied because it would have fallen beyond the statutory timeframe of the Review Team. However, the inability, or unwillingness, of School District officials promptly to provide the Review Team with requested information clearly called into question the ability of School District officials to comply with a Consent Agreement.

C. Conclusion and Recommendation

Based upon the foregoing meetings and review, the Review Team confirms the findings of the preliminary review, concludes that a local government financial emergency exists within the Highland Park School District, and that no satisfactory plan exists to resolve the emergency. Therefore, the Review Team recommends the appointment of an emergency manager.

II. Section 13(3) Requirements

Section 13(3) of Act 4 requires that this report include the existence or an indication of the likely occurrence of any of the conditions set forth in subdivisions (a) through (l).[3] The conditions in subdivisions (e), (g) and (j) of Section 13(3) exist or are likely to occur, as follows:

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[3] Subdivisions (a) through (l) of Section 13(3) of the Act provide as follows:

> (a) A default in the payment of principal or interest upon bonded obligations, notes, or other municipal securities for which no funds or insufficient funds are on hand and, if required, segregated in a special trust fund.
>
> (b) Failure for a period of 30 days or more beyond the due date to transfer 1 or more of the following to the appropriate agency:
>
> (*i*) Taxes withheld on the income of employees.
>
> (*ii*) For a municipal government, taxes collected by the municipal government as agent for another governmental unit, school district, or other entity or taxing authority.
>
> (*iii*) Any contribution required by a pension, retirement, or benefit plan.
>
> (c) Failure for a period of 7 days or more after the scheduled date of payment to pay wages and salaries or other compensation owed to employees or benefits owed to retirees.
>
> (d) The total amount of accounts payable for the current fiscal year, as determined by the state financial authority's uniform chart of accounts, is in excess of 10% of the total expenditures of the local government in that fiscal year.
>
> (e) Failure to eliminate an existing deficit in any fund of the local government within the 2-year period preceding the end of the local government's fiscal year during which the review team report is received.
>
> (f) Projection of a deficit in the general fund of the local government for the current fiscal year in excess of 5% of the budgeted revenues for the general fund.

- The School District had a general fund deficit of $11,251,484 as of June 30, 2011, which was not eliminated within the two-year period preceding the end of the fiscal year of the School District during which this Review Team report is received. (Section 13(3)(e)).

- As previously noted, the School District has failed to comply with deficit elimination plans. (Section 13(3)(g)).

- As previously noted, the School District general fund had structural operating deficits (i.e., expenditures and transfers out exceeded revenues and transfers in) of $2,010,596 as of June 30, 2006; $597,733 as of June 30, 2007; $2,116,643 as of June 30, 2009; $3,572,662 as of June 30, 2010, and $3,119,108 as of June 30, 2011. (Section 13(3)(j)).

III. Review Team Report Transmittal Requirements

Section 13(3) of Act 4 also requires that a copy of this report be transmitted to Superintendent Edith Hightower, the Highland Park Board of Education, the Speaker of the House of Representatives, and the Senate Majority Leader.

cc: Edith Hightower, Superintendent
Highland Park Board of Education
James Bolger, Speaker of the House of Representatives
Randy Richardville, Senate Majority Leader

(g) Failure to comply in all material respects with the terms of an approved deficit elimination plan or an agreement entered into pursuant to a deficit elimination plan.

(h) Existence of material loans to the general fund from other local government funds that are not regularly settled between the funds or that are increasing in scope.

(i) Existence after the close of the fiscal year of material recurring unbudgeted subsidies from the general fund to other major funds as defined under government accounting standards board principles.

(j) Existence of a structural operating deficit.

(k) Use of restricted revenues for purposes not authorized by law.

(l) Any other facts and circumstances indicative of local government financial stress or financial emergency.

Table 1

Highland Park School District
General Fund Revenues, Expenditures, Change in Fund Balance, and Enrollment

	2005-06	2006-07	2007-08
Revenues			
Local	2,908,209	$2,590,904	3,275,440
State	24,034,868	24,347,337	25,940,982
Federal	3,556,613	4,708,051	3,841,990
Total Revenue	**$30,499,690**	**$31,646,292**	**$33,058,412**
Expenditures			
Instruction	$15,505,264	$15,997,864	16,288,492
Support Services	16,274,152	16,084,666	15,198,653
Comm. Service	244,845	161,495	37,372
Debt Service	--	--	--
Capital Outlay and Other	486,025	--	--
Total Expenditures	**$32,510,286**	**$32,244,025**	**$31,524,517**
Current Surplus/ (Deficit)	**($2,010,596)**	**($597,733)**	**$1,533,895**
Other Finance Sources			
Transfers In	1,120,807	0	115,179
Transfers Out	0	(852,625)	(1,081,000)
Total Other Financing Sources	**1,120,807**	**(852,625)**	**(965,821)**
Net Change in Fund Balance	**(889,789)**	**(1,450,358)**	**568,074**
Prior Period Adjustment	--	804,261	--
Beginning Fund Balance	**$975,094**	**$85,305**	**($560,792)**
Ending Fund Balance	**$85,305**	**($560,792)**	**$7,282**
Enrollment	**3,179**	**3,132**	**3,419**

Source: Annual Financial Audits. Enrollment, Michigan Department of Education.

Table 1
General Fund Revenues, Expenditures, Change in Fund Balance, and Enrollment (Continued)

	2008-09	2009-10[4]	2010-11[4]
Revenues			
Local	$2,353,876	$1,218,222	$2,414,774
State	20,816,850	14,865,730	11,115,649
Federal	4,461,715	5,118,754	5,322,784
Total Revenue	**$27,632,441**	**$21,202,706**	**$18,853,207**
Expenditures			
Instruction	$15,442,576	$13,343,619	10,341,079
Support Services	14,090,912	11,234,288	11,444,202
Comm. Service	32,717	36,150	187,034
Debt Service	--	--	--
Capital Outlay and Other	182,879	161,311	--
Total Expenditures	**$29,749,084**	**$24,775,368**	**$21,972,315**
Current Surplus/ (Deficit)	**($2,116,643)**	**($3,572,662)**	**($3,119,108)**
Other Finance Sources			
Transfers In	--	--	--
Transfers Out	(961,042)	(824,462)	(664,938)
Total Other Financing Sources	**(961,042)**	**(824,462)**	**(664,938)**
Net Change in Fund Balance	**(3,077,685)**	**(4,397,124)**	**(3,784,046)**
Prior Period Adjustment	--	--	--
Beginning Fund Balance	**$7,282**	**($3,070,403)**	**($7,467,438)**
Ending Fund Balance	**($3,070,403)**	**($7,467,527)**	**($11,251,484)**
Enrollment	**2,769**	**1,858**	**1,331**

Source: Annual Financial Audits. Enrollment, Michigan Department of Education. [4]Financial audit ending balance ($7,467,527) in 2010 did not match beginning balance ($7,467,438) in 2011.

ADDENDUM

On February 22, 2012, the Highland Park School District Financial Review Team convened a public meeting to comply with a ruling by the Ingham County Circuit Court concerning the Open Meetings Act. After receiving a status report concerning the financial condition of the School District and public comment, the Review Team again concluded that a local government financial emergency exists within the School District, and that no satisfactory plan exists to resolve the emergency. Therefore, the Review Team again recommended the appointment of an emergency manager. Among the information received by the Review Team on February 22, 2012, was the following:

- The School District ended its 2009 fiscal year with a deficit fund balance of $3,070,471. Total revenue from all sources was $27.6 million. The School District received $9,979 per pupil, but expended $10,744 per pupil.

- The School District ended its 2010 fiscal year with a deficit fund balance of $7,467,527. Total revenue from all sources was $21.2 million. The School District received $11,412 per pupil, but expended $13,334 per pupil.

- The School District ended its 2011 fiscal year with a deficit fund balance of $11,251,484. Total revenue from all sources was $18.9 million. The School District received $14,165 per pupil, but expended $16,508 per pupil.

- For the 2010 fiscal year, the most recent for which data is available, the School District's per pupil revenue ranked 76 out of 783, which placed the School District in the top 10 percent.

- In January of 2012, the School District was confronted by not being able to meet its January 13, 2012 payroll obligation. On January 13, 2012, the Michigan Department of Education processed a $188,000 State aid advance under Section 17b of the State School Aid Act to ensure that the School District could meet its January 13, 2012 payroll obligation.

- On February 8, 2012, the Michigan Department of Education processed a $261,000 State aid advance under Section 17b of the State School Aid Act to ensure that the School District could meet its February 10, 2012 payroll obligation.

- School District officials continue to demonstrate an inability to timely pay vendors. For example, the School District owes more than $500,000 to the Wayne Regional Educational Service Agency (i.e., $110,000 in costs related to substitute teachers utilized by the School District, but paid for under an agreement with the Wayne Regional Educational Service Agency, $163,000 for Individuals with Disabilities Education Act funds to repay a prior year audit finding related to special education, and $227,000 in miscellaneous fees).

- Finally, School District officials have failed to comply with State law which requires school districts operating in a deficit condition to file an approvable deficit elimination plan with the Michigan Department of Education. The chief financial officer for the School District had indicated that a revised 2011 deficit elimination plan would be submitted to the Michigan Department of Education by December 15, 2011. To date, that plan has not been received.