STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

GRETCHEN WHITMER
GOVERNOR

RACHAEL EUBANKS
STATE TREASURER

DATE: December 1, 2019

TO: Governor Gretchen Whitmer

FROM: Rachael Eubanks, State Treasurer
Chelan Burks-Andrews, Financial Specialist
Financial Review Commission

SUBJECT: **Detroit Financial Review Commission (FRC) - Biannual Report for the Detroit Public Schools Community District (DPSCD) No. 7**

Pursuant to the requirements of Section 6(8) of Public Act 181 of 2014, the Michigan Financial Review Commission Act (the "Act"), this report is being filed on behalf of the Detroit Financial Review Commission. A copy of this report will be delivered to the Senate Majority Leader, the Speaker of the House of Representatives, the Superintendent of the Detroit Public Schools Community District ("DPSCD") and will be posted on the FRC's Michigan Department of Treasury website located at http://www.michigan.gov/treasury/.

Pursuant to Section 6(1) of the Act, the FRC's oversight of the DPSCD began June 21, 2016, the date the District became qualified as a District. The FRC has the legislative, fiscal, administrative authorities, and duties as prescribed by the Act.

Statutory Oversight Activities

Sections 6 and 7 of the Act describe various duties and responsibilities for which the FRC are statutorily required to perform. Below is a summary of the status of these requirements.

Requirement	FRC Act Sec. No.	Compliance
FRC review and approval of all applicable contracts.	6(6)	DPSCD submitted 174 applicable contracts. The FRC approved 174 applicable contracts.
DPSCD and its CFO provides needed information and documents to the FRC and attend FRC meetings as needed.	6(7), 7(d), and 7(o)	DPSCD representatives have been responsive to requests for information, documents and have attended meetings when requested to attend.
FRC review and approval of collective bargaining agreements (CBAs).	6(9)	DPSCD have a total of 15 CBAs that have been ratified, and 11 that required a letter of agreement (LOA) to amend. The FRC approved 15 CBAs and 11 LOA.
Quarterly debt service certifications.	6(11)	Detroit Public Schools (DPS) provided all required quarterly certifications. The new District, DPSCD has not issued any debt.

FRC review of DPSCD revenue estimates.	7(a)	DPSCD provided its revenue estimates to the FRC in connection with its budget submissions per subsection 7(c) of the Act.
FRC review and approval of the annual budget and accompanying budget amendments.	7(c)	DPSCD did not submit a budget or budget amendment to the FRC for approval. DPS did not submit a budget or a budget amendment to the FRC for approval.
FRC review and approval of requests to issue debt.	7(e)	DPSCD has not submitted any requests to issue debt.
FRC review compliance by a qualified school district with a deficit elimination plan under article I of the State School Aid Act of 1979.	7(f)	DPSCD has not been required to submit a deficit elimination plan.
FRC approval of the Chief Financial Officer's appointment	7(h)	DPSCD submitted its appointment of its Chief Financial Officer. FRC approved the appointment on November 20, 2017.
FRC approval to alter the DPSCD Superintendent's contract or to terminate the DPSCD Superintendent.	7(i)	FRC approved the proposed DPSCD Superintendent's contract on May 22, 2017.
FRC review and approval of reimbursements for out-of-state travel.	7(q)	DPSCD submitted 149 reimbursement requests for out-of-state travel to the FRC. FRC approved 149 reimbursement requests.

Financial Update – DPSCD

Based on budget projections as of September 30, 2019, the District estimates it will finish the fiscal year ending June 30, 2020, with a general fund surplus of approximately $7.8 million, and a general fund balance of approximately $117.8 million.

The District's ending cash balance at the close of September 2019 was $119.3 million. The District has sufficient cash-on-hand to ensure timely payroll payments, payments to vendors, and support of other expenses for the remainder of the fiscal year.

Financial Update – DPS

As statutorily required, the District provided its quarterly debt obligation summary for DPS. According to the 3rd quarter report for FY 2020, DPS's principal balance for the reporting period was $2.018 billion. This consists of $1.464 billion capital debt, $402.5 million operating debt and $152.2 million School Loan Revolving Fund (SLRF) debt. A total of $227.1 million of debt service payments are due in FY 2020 and DPS paid $57.0 million to-date against this obligation.

DPS capital debt is projected to be paid off by calendar year 2052, the operating debt is projected to be paid off by calendar year 2027 and the SLRF debt final mandatory repayment date is May 1, 2046. Current projections estimate the SLRF debt will not be paid off until calendar year 2065. The FRC will continue to monitor DPS's management of debt to ensure payments continue to be made timely.

FY 2019 Budget Amendment Review

Pursuant to Section 7(c) of the Act, the FRC is required to review, modify, and approve proposed and amended operational budgets of a qualified city or qualified school district. A proposed budget or budget amendment does not take effect unless approved by the FRC.

DPSCD FY 2019 Proposed Budget Update – General Fund

In June 2019, the District prepared a second budget amendment; however, that budget was not formally adopted by the Board of Education. As a result, a formal second budget amendment was not presented to the FRC for approval. In lieu of bringing a formal second budget amendment to the FRC for approval the District's Chief Financial Officer (CFO) presented an overview of the updated changes to the FY 2019 adopted budget (amendment No. 1) to the finance subcommittee on June 3, 2019. The budget update increases the projected surplus to $39.7 million at the end of the fiscal year. A decrease in total revenue and sources of $32.7 million based on actual expenditures through April 30, 2019 and projected expenditures for May and June. Total expenditures decrease by $66.6 million based on the projected salary and contract expenses.

DPS FY 2019 Proposed Budget Update

In June 2019, the District prepared a budget amendment; however, that budget was not formally adopted by the Board of Education. As a result, a formal budget amendment was not presented to the FRC for approval. In lieu of bringing a formal budget amendment to the FRC for approval the District's Chief Financial Officer (CFO) presented an overview of the updated changes to the FY 2019 adopted budget to the finance subcommittee on June 3, 2019. The budget update increases the projected surplus to $17.0 million at the end of the fiscal year. An increase in total revenue and sources of $8.7 million, primarily due to an increase in local sources based on current tax collections as well as a conservative forecast for the remaining months. Total expenditures are increased by $5.9 million based on an additional principal and interest payment made on the debt service expense. Per the master debt indenture excess funds collected from the combined 18 non-homestead mills and property tax abatements (Renaissance Zone) must be applied to the outstanding debt on the stabilization bonds, MPSERS liability and emergency loan service in order to accelerate repayment.

Final Audit Update - DPSCD

The District's FY 2019 audit report was filed by the required November 1 deadline. The District's audited FY 2019 financial statements reflect a surplus of $6.1 million of revenue over expenditures and year end fund balance of $139.5 million. As noted above, the second budget amendment was not formally adopted by the Board of Education as a result, the most recent Board of Education adopted budget is the first budget amendment that was adopted in January 2019. Therefore, the first budget amendment is presented as the final budget in the financial statements. The financial impact is as follows:

1. **Revenues:** A decrease in total revenue and sources of $38.0 million, primarily due to an increase of $7.6 million in local sources due to an increase in Act 18 revenue and Enhancement Millage revenue, an increase in state sources of $6.7 million due to an increase in 31a revenue and MPSERS funding, offset by a decrease in federal sources of $52.3 million due to a decrease in Title IA, Title IIA, Title IV and SIG funding. $32.8 million of the federal sources the District received in September, 60 days after the close of the fiscal year. The revenue will be carried over and recognized in FY 2020.

2. **Expenditures:** Expenditures have decreased based on the final expenditures for reimbursable grants, the reduction in general fund vacancies and contract services. Expenditures have decreased by $77.8 million in the following areas:
   - $42.4 million, Purchased services
   - $6.1 million, Benefits
   - $29.3 million, Title I restricted

3. **Vacancies:** Personnel savings from vacancies reduce the budgeted expenditures by $14.6 million which has a positive impact on the general fund operational budget.

4. **Operating Surplus and Fund Balance:** DPSCD's FY 2019 adopted budget amendment No. 1 projected an operating surplus of $12.7 million and ending fund balance of $153.7 million. The FY 2019 audited budget reports an operating deficiency of $(1.6) million and ending fund balance of $139.5 million.

5. **Transitional Fund Summary:** Of the $25.0 million transitional funds allocated to DPSCD; $4.8 million was expensed in FY 2017, $3.7 million was expensed in FY 2018, $10.0 million was transferred to the capital projects budget in June 2018 and the remaining $6.5 million is projected to be spent before June 30, 2020.

6. **Equipment and Capital:** The capital and equipment budget of $3.4 million was increased by $0.4 million from $3.0 million in FY 2019 audited budget.

<u>Audit Findings</u>

The audit revealed that the District has significant deficiencies that are not considered material weaknesses. The District has developed a corrective action plan to address the audit findings and implemented the necessary changes to ensure corrective action occurs by the end of FY 2019. Per the FY 2019 *Comprehensive Annual Financial Report,* listed below are the details of the significant issues and findings:

1. Several account balances in the District's books and records for the 2019 fiscal year were identified by either the District or as part of the audit process to be improperly recorded. Several adjustments and reclassifications, none of which were deemed to be material (individually or aggregate), were discussed with and recorded by management to the District's general ledger during our audit process. The most significant of these adjustments related to federal revenue, accounts receivable, and unavailable revenue. There were also adjustments made to the schedule of expenditures of federal awards. Although much improved, this condition did exist during the prior fiscal year.

2. The District has one bank account for which individuals at the District can unilaterally initiate and approve transactions. Additionally, there was no reconciliation of this account during the year, and the account was not initially recorded in the General Fund general ledger as of June 30, 2019 (this was identified during the audit process and corrected by management).

Final Audit Update - DPS

DPS's FY 2019 audit report audit report was filed by the required November 1 deadline. DPS's audited FY 2019 financial statements reflect a surplus of $19.3 million of revenue over expenditures and year end fund balance of $17.5 million.

Audit Findings

The audit revealed that DPS has material weaknesses and a significant deficiency. Per the FY 2019 *Financial Report,* listed below are the details of the significant issues and findings:

1. Debt obligations were recorded at incorrect amount and debt balanced were not classified properly.

2. Various account reconciliations were not prepared in a timely, accurate manner during the year. This resulted in management reconciling accounts and calculating and recording significant adjustments after the commencement of the audit process.

Collective Bargaining Agreements (CBAs)

The District had been in extensive and lengthy negotiations with all of their collective bargaining units regarding the wages for the final year of a three-year contract, which expires in June 2020. On June 18, 2019, the Detroit Board of Education approved the 2019-2020 Letter of Agreement (LOA) for the FY 2019-2020 Wage Reopener Agreement reached with the Detroit Federation of Teachers American, American Federation of Teachers Local Unit 231 (DFT). The LOA was approved by the FRC on August 26, 2019.

On October 15, 2019, the Detroit Board of Education approved the 2019-2020 Letter of Agreement (LOA) for the FY 2019-2020 Wage Reopener Agreement reached with the American Federation of State, County and Municipal Employees (AFSCME) Local Unit 345, Detroit Association of Educational Office Employees (DAEOE) Local Unit 4168, International Brotherhood of Teamsters (Teamsters) Local Unit 214, Detroit Federation of Para-Professionals (DFP-SSAS and NHA) Local Unit 2350, International Union of Operating Engineers – Non-Instructional Supervisory Personnel (NISP) Local Unit 324 and the Organization of School Administrators and Supervisors (OSAS). The LOA was approved by the FRC on August 26, 2019.

The total cost for all the third-year wage reopener agreements is $29.2 million, the District budgeted $7.4 million in the FY 2020 budget for salary increases. The $21.7 million in proposed costs above the budget includes $16.8 million in one-time bonuses. The District budgeted $26.0

million in the FY 2020 budget for one-time expenditures including bonus payments for various unions, the $21.7 million cost increase will be covered through a reallocation of one-time general fund and grant expenditures. $14.1 million will be one-time expenditures for bonuses and $7.6 million will be recurring expenditures for salary increases.