STATE OF MICHIGAN
DEPARTMENT OF TREASURY

RICK SNYDER
GOVERNOR

NICK A. KHOURI
STATE TREASURER

DATE: May 31, 2018

TO: Governor Rick Snyder

FROM: Shelbi Frayer, Executive Director
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. 4**

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 on the date the District became qualified as a District, which was June 21, 2016. The FRC has the legislative, fiscal, administrative authorities, and duties as prescribed by the Act. This is the FRC's fourth bi-annual report.

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 has submitted (75) applicable contracts. All have been approved by the FRC.
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 (1) CBA to be ratified this year and (1) that required a letter of agreement to amend. A total of (7) CBA's have been presented to the FRC and subsequently approved by the FRC.
Quarterly debt service certifications.	6(11)	Detroit Public Schools (DPS) has provided all required quarterly certifications. The new District, DPSCD has not issued any debt.

FRC review of DPSCD revenue estimates.	7(a)	DPSCD has 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 submitted its FY 2018 adopted budget to the FRC and it was approved by the FRC membership on June 26, 2017. DPSCD submitted two amendments to the FY 2018 budget to date. The FY 2019 budget was submitted and approved at the April 16, 2018 FRC meeting.
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 (121) reimbursement requests for out-of-state travel to the FRC. All have been approved.

Financial Update –DPSCD

Based on budget projections as of March 31, 2018, the District estimates it will finish the fiscal year ending June 30, 2018, with a General Fund surplus of approximately $17.5 million, and a General Fund balance of approximately $96.4 million.

The District's ending cash balance at the close of March 2018 was $128.4 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 4th quarter report for FY 2018, DPS's principal balance for the reporting period was $1.9 billion. A total of $177.1 million of debt service payments are due in FY 2018 and the District paid $177.1 million to-date against this obligation. According to the 1st quarter report for FY 2019, a total of $225.3 million of debt service payments are due in FY 2019 and the District paid $16.0 million to-date against this obligation. DPS has a plan to pay off $570 million in operating debts over an 11-year period. The remaining bonded debt is projected to be paid by calendar year 2041 along with amounts owed to the School's Revolving Fund when debt service requirements fall below 7 mills. The FRC will continue to monitor DPS's management of debt to ensure payments continue to be made timely.

FY 2018 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.

Proposed FY 2018 Budget Amendment No. 2

The District's Chief Financial Officer presented an update to the FY 2018 adopted budget (amendment No. 2) which was approved by the FRC at the April 16, 2018 meeting. The updated assumptions are as follows:

1. **Revenues:** An increase in total revenue and sources of $41.7 million, primarily due to an increase of $2.8 million from a special education transportation reimbursement, an increase in state sources of $19.4 million due to an increase of 2,127 students in enrollment as well as an increase in federal sources of $19.4 million from carryover Title funds.

2. **Expenditures:** Expenditures have increased by $13.3 million in the following areas: Purchased Services $8.7 million, Supplies $16.0 million, and Equipment & Capital $9.9 million.

3. **Vacancies: Personnel** savings from vacancies is projected to reduce the budgeted expenditures by $10.2 million which has a positive impact on General Fund (GF) operational budget.

4. **Contingency:** The FY 2018 budget amendment No. 2 increased the General Fund contingency to $18.0 million.

5. **Operating Surplus and Fund Balance:** DPSCD's FY 2018 adopted budget amendment No. 1 projected an operating surplus of $4.3 million and ending fund balance of $83.3 million. The FY 2018 budget amendment No. 2 projects an operating surplus of $17.5 million and ending fund balance of $96.4 million.

6. **Transitional Fund Summary:** Of the $25 million transitional funds allocated to DPSCD, $5.3 million was expensed in FY 2017, $9.6 million is projected to be spent in FY 2018, $5.1 million is projected to be spent in FY 2019, and a remaining minimum cash balance of $5 million is projected.

7. **Equipment and Capital:** The amended capital and equipment budget was increased by $0.1 from $10 million in the FY 2018 adopted budget amendment No. 2.

Adopted FY 2019 Budget

Key Assumptions

The table below describes the District's key assumptions used to develop the FY 2019 budget. These assumptions, including maintaining current enrollment and a foundation allowance increase of $120 per pupil.

Assumption	Projection methodology
Revenues:	
Enrollment (FTE)	• Proposed FY 2019 budget assumes current enrollment (49,839 student FTEs).
Foundation allowance (State Aid)	• Foundation allowance grows at a rate of $120 / pupil in FY 2019 (1.6%).
Other Revenue	• Enhancement millage rate per pupil was held constant in FY 2019. • Act 18 revenue and special education transportation revenues were reduced for FY 2019 • Title IA includes $30M of anticipated carryover dollars. • Federal revenue sources are conservatively budgeted with anticipated increases in budget amendment #1, after final allocations. • $6.9M transfer from DPS related to establishment of DPSCD.
Expenditures:	
Personnel	• Projection assumes CBA wage increases, credit of teaching experience, normal step movements, and retirements. • Teacher vacancies are budgeted at Step 8 ($52,800), assuming external teacher experience is recognized for all new teachers hired. • Establishes and fully funds a standard school staffing model, which will increase school personnel to support instruction, climate and culture.
Non-personnel	• Lays foundation to upgrade technology districtwide at the school level (laptops, interactive TV monitors) with consistent online learning programming (supplement, not core). • Establishes one-time funding for school level programmatic build out, including accelerated programs, performing arts, and STEM. • Includes a $17.8M reoccurring general fund contingency and an additional projected reoccurring $8M surplus.
Fund Balance:	
Reserve	• Establishes a $42M restricted reserve based on 10% of budgeted state aid.

The District's CFO presented a FY 2019 adopted budget to the FRC which projected an operating surplus of $8.1 million for the fiscal year ending June 30, 2019. The FY 2019 adopted budget was approved at the April 16, 2018 meeting and included the following assumptions:

1. **Revenues:** The District is projecting $503.3 million in State's revenues. This projection is based on the current DPSCD student enrollment of 49,839.

2. **Expenditures:** The District is projecting an increase in personnel costs established by the new staffing model, in addition to wage increases and routine step movements.

3. **Contingency:** The FY 2019 adopted budget allocated $17.8 million in contingency funding for unexpected costs.

4. **Operating Surplus and Fund Balance:** DPSCD's FY 2019 adopted budget includes a projected operating surplus of $8.1 million and fund balance of $104.5 million.

5. **Equipment and Capital:** The FY 2019 adopted budget allocated $4.0 million for capital and equipment. The District has $18.7 million in remaining transition funds and plans to allocate a portion of this year's projected fund balance into a restricted fund for capital improvements.

School Staffing Model

The District's FY 2019 budget implements a new staffing model. The school staffing model creates equity in services and personnel among schools with a dedication to the Strategic Plan.

- All schools should have a basic set of services and support, which are increased or decreased based on the school's enrollment
- Staff allocation will be based on winter count student enrollment. Enrollment will be monitored over the summer and the start of the school year to adjust allocations. This creates stabilization with staffing and incentive to retain and recruit students at school level.

DPSCD Preliminary 5 Year Budget Projection

The District's CFO presented an overview of the preliminary five-year budget projection. The projection assumes enrollment grows at 1% per year during FY 2020 – FY 2023 and the State's foundation allowance grows at a rate of 1% every year ($75 per student). Health, Dental, Life and Vision (HDLV) benefits are projected to increase 5.6% per year, while all other benefits (retirement, payroll taxes, and workers compensation) are maintained at current levels, as a percentage of payroll. During the five-year period, fund balances are projected to grow from $105 million in FY 2019 to $140 million in FY 2023.

Final Audit Update

As required, the District reported its annual audit to the FRC commission. Below is a summary of the DPSCD FY 2017 audit:

Audited Financial Statements

The Districts' FY 2017 audit report was filed by the required November 1st deadline. The District's audited FY 2017 financial statements reflect a surplus of $32.8 million of revenue over expenditures. The Detroit Public Schools Community District FY 2017 audited year end fund balance is $79.0 million. The District adjusted the audited fund balance as part of the FY 2018 budget amendment No. 2.

Audit Findings

The audit revealed that the District has significant deficiencies and material weaknesses. These deficiencies and material weaknesses were primarily the result of poor General Ledger (GL) internal controls and noncompliance with federal grant program spending and monitoring. 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 2018.

Collective Bargaining Agreements (CBA's)

The District is currently negotiating with the Detroit Organization of School Administrators and Supervisors (OSAS), the entire OSAS contract is being rewritten to include important contract language. To date, an agreement has not been reached between DPSCD and OSAS.

The District ratified the Detroit Teacher Federation (DFT) CBA on June 12, 2017 and it was approved by the FRC on July 27, 2017. On May 10, 2018, the FRC approved the 2018-2019 Letter of Agreement (LOA) reached with the DFT presented by the District. The LOA provided the terms and conditions that provides a one-time bonus of $1,373.60 for the 2018-2019 school year for members at the top step, the District's crediting of internal and external teaching service to current and future teachers, and the repayment of Termination Incentive Plan (TIP) funds at an earlier date than stipulated in the 2017 DFT agreement.

The District's CFO presented six additional unions (AFSCME, DAEOE, Teamsters, Paras SSAS, Para NHA, & NISP) with ratified CBA's to the FRC. These CBA's were approved by the FRC on November 20, 2017. The aforementioned CBAs each have 3-year terms. The 3rd year term is non-economic and allows each contract to be reopened for negotiations by March 2019.