



RICK SNYDER
GOVERNOR

STATE OF MICHIGAN
DEPARTMENT OF EDUCATION
LANSING

MICHAEL P. FLANAGAN
SUPERINTENDENT OF
PUBLIC INSTRUCTION

DATE: January 10, 2012
TO: Rick Snyder, Governor
FROM: Mike Flanagan, Superintendent of Public Instruction 
SUBJECT: Preliminary Review of Muskegon Heights Public Schools

The following represents the Preliminary Review under PA 4 of 2011 for Muskegon Heights Public Schools. We appreciate the level of cooperation received from the district's administration during this process.

I. Background

In a letter dated December 19, 2011, I advised Muskegon Heights Public Schools that pursuant to my authority vested under PA 4 of 2011, I initiated a Preliminary Review of the district's finances to determine if a finding of probable financial stress is warranted. Section 12(1) of the Act states that the state financial authority of a local government (the State Superintendent in the case of a school district) may conduct a Preliminary Review to determine the existence of a local government financial problem if one or more of the criteria listed in Section 12(1) are met. The preliminary review of Muskegon Heights Public Schools resulted from the conditions enumerated in subdivisions (a) and (r) of Section 12(1), which require the existence of "The governing body or the chief administrative officer of a local government requests a preliminary review under this act" and "other facts and circumstances...that in the Superintendent of Public Instruction's sole discretion...are indicative of school district's financial stress", respectively.

II. Preliminary Review Findings

The Michigan Department of Education (the "Department") has developed critical factors to determine if a finding of probable financial stress is warranted. The guidance calls for a review of a district's financial operation related to six (6) critical factors. The factors are:

- 1) The district has been in deficit for three or more consecutive years (including the current year); and
- 2) The district's existing deficit is greater than \$1,000,000; and

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- 3) The district's existing deficit is greater than 15% of general fund revenues excluding incoming transfers; and
- 4) A fiscal review by one of the Department's program offices or an external auditor has revealed one or more material internal control weaknesses as evidenced by notes/findings in the financial audit related to:
 - a) Lack of written policies and procedures or failure to follow the written policies and procedures
 - b) Poor cash management
 - c) Failure to provide Personnel Activity Reports (PAR) for employees paid with federal funds
 - d) History of spending outside the appropriations established by the local school board (Violation of Uniform Budgeting and Accounting Act)
 - e) Use of grant funds on unallowable expenditures
 - f) Going Concern/Qualified Opinion; and
- 5) District has shown unsatisfactory progress in eliminating a deficit. This is determined by identifying one or more of the following conditions:
 - a) A deficit increase from the previous year
 - b) Lack of cooperation from the district in submitting deficit information (i.e., late submission of Deficit Elimination Plans (DEP), delinquent return of phone calls or correspondence relating to the DEP, chronic late submission of Monthly Budgetary Control Reports)
 - c) History of supplying the Department with DEP information that is inaccurate or inconsistent with actual revenues and expenditures at year end; and/or
- 6) District's failure to comply with bond or note covenants or failure to make pension fund deposits.

The Department assessed Muskegon Heights Public Schools with regard to the above six (6) factors. The results of the assessment are as follows:

- 1) Muskegon Heights Public Schools ended the 2005-06 fiscal year with a \$0.9 million deficit. The deficit persisted in each of the subsequent years and the deficit for the year ended June 30, 2011 was \$8.5 million. The district projected that it will remain in deficit in the 2011-12, 2012-13, 2013-14, and 2014-15 fiscal years.
- 2) Muskegon Heights Public Schools' general fund balance confirmed by an independent financial audit at June 30, 2011, was a negative \$8.5 million. The district's fund balance deficit has exceeded \$1,000,000 since 2008-09.
- 3) Muskegon Heights Public Schools' June 30, 2011 deficit balance expressed as a percentage of their general fund revenues was a negative 48%. The percentage exceeds the Department's parameter of a negative 15% to indicate concern.
- 4) Muskegon Heights Public Schools' audited financial report for the year ended June 30, 2011, included 11 findings of material weaknesses, significant deficiencies, or non-compliance. The district's June 30, 2010, audit included four (4) findings of significant deficiencies. See Attachment A for more information.
- 5) The district has shown unsatisfactory progress in eliminating the deficit. The deficit has increased from \$0.9 million at June 30, 2006, to \$8.5 million at June 30, 2011.
- 6) The district was \$1.4 million in arrears to the Public School Employees Retirement Service (PSERS) through November 2011.

In addition to the assessment above related to the Muskegon Heights Public Schools and the six (6) critical factors that the Department developed to assist in analyzing a district's level of financial stress, the following factors were also considered:

- Cash flow is distressed even though the district borrowed \$7.9 million through Treasury for cash flow purposes.
- The district has an ongoing State Police investigation related to the misuse of federal Title I funds. Department Title I staff is currently in the process of determining the amount of federal funds that will need to be repaid from the district's 2010 Title I allocation.
- The district has been unable to reach concessions with its staff.
- The district's financial audit and comprehensive financial report/FID were not submitted by the statutory due date of November 15, 2011.

Therefore, the Department was required to withhold the December 20, 2011 state school aid payment. The audit and FID have subsequently been submitted by the district and state school aid payments have been released.

- Following a November 16, 2011 meeting with Muskegon Heights board members and administrators, Muskegon Area Intermediate School District (ISD) staff, Department of Treasury Staff and Michigan Department of Education staff, the district was given until December 9, 2011 to submit a DEP. The DEP has not been received, however, due to a recent changeover in administration to the Muskegon ISD, an extension was granted to February 2, 2012.
- The district's board of education requested the appointment of a Financial Manager in a letter dated December 7, 2011 to me from board president Avery Burrel. This is a trigger under PA 4 of 2011 to initiate a Preliminary Review.

III. Conclusion

Section 12(4) of PA 4 of 2011, the "Local Government and School District Fiscal Accountability Act", states that the purpose of a Preliminary Review is to determine if a finding of probable financial stress is warranted. It further states that if a finding of probable financial stress is made, the Governor shall appoint a Review Team to undertake a "school district's financial management review." The Department determined six (6) factors to use as a basis for determining a school district's financial stress. As outlined in the Preliminary Review Findings above, Muskegon Heights Public Schools meets all six (6) factors. The district board of education's request to appoint a Financial Manager was also taken into consideration. Based on the above information, as the State Financial Authority for a school district under PA 4 of 2011, I have determined that a finding of probable financial stress exists. PA 4 of 2011 now requires that the Governor appoint a Review Team.

Attachment

cc: Andy Dillon, State Treasurer
John Nixon, State Budget Director
Jase Bolger, Speaker of the House
Randy Richardville, Senate Majority Leader
Avery Burrel, Muskegon Heights Public Schools, Board President
Dave Sipka, Superintendent, Muskegon Area ISD; Interim Superintendent,
Muskegon Heights Public Schools

Muskegon Heights Public Schools			
Findings	2010-2011		
Financial Statement			
Finding Number	Type of Finding	Program Office	Condition
2011-1	Noncompliance	Title I, Part A; Special Education; TANF	Missing documentation
2011-2	Material Weakness		Noncompliance with Michigan Uniform Budget and Accounting Act and noncompliance with Deficit Elimination Plan
2011-3	Material Weakness		Account balances not reconciled to supporting documentation
2011-4	Material Weakness		Check release procedures
2011-5	Significant deficiency		Timely general ledger posting
2011-6	Significant deficiency		Accounts payable cut-off procedures
2011-7	Significant deficiency		Establishment of authorized bank accounts
Federal Programs			
2011-8	Significant deficiency	Title I, Part A; Special Education; TANF; Head Start	Transaction documentation
2011-9	Significant deficiency	Title I, Part A	Allocation of funds
2011-10	Significant deficiency	Child Nutrition Cluster	Claims for reimbursement
2011-11	Significant deficiency	Child Nutrition Cluster	Documentation of Eligibility

Muskegon Heights Public Schools			
Findings	2009-2010		
Federal Programs			
2010-1	Significant deficiency	Title I, Part A	Compliance with suspension and debarment requirements
2010-2	Significant deficiency	Title I, Part A	Allocation of funds
2010-3	Significant deficiency	Title I, Part A	Allowable costs
2010-4	Significant deficiency	Title I, Part A; Special Education; Child Nutrition; Head Start; TANF	Non-compliance with the Equipment and Real Property Management requirement