



STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

ANDY DILLON
STATE TREASURER

DATE: April 2, 2012

TO: Governor Snyder

FROM: Muskegon Heights School District Financial Review Team:
Frederick Headen
David Martell
Dale Nesbary
Doug Ringler
Thomas F. Saxton
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SUBJECT: Report of the Muskegon Heights School District Financial Review Team

On March 2nd, 7th, 20th and April 2nd, 2012, Muskegon Heights 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 Muskegon Heights 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 December 19, 2011, the Michigan Department of Education commenced a preliminary review of the finances of the Muskegon Heights 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 Muskegon Heights School District resulted from the condition enumerated in subdivisions (a) and (r) of Section 12(1) having occurred within the School District.¹

¹ Subdivision (a) provides that “[t]he governing body or the chief administrative officer of a local government requests a preliminary review under this act. The request shall be in writing and shall identify the existing or anticipated financial conditions or events that make the request necessary.” 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 preliminary reviews, the Department of Education developed six critical factors to determine if a finding of probable financial stress was warranted. Those factors are:

1. A school district has a deficit for three or more consecutive years, including the current year.
2. A school district's existing deficit is greater than \$1,000,000.
3. A school district's existing deficit is greater than 15 percent of general fund revenues, excluding incoming transfers.
4. A fiscal review by a program office of the Michigan Department of Education, or an external auditor, reveals 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 of 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.
5. A school district shows 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, and 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.
6. The failure by a 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 for the Muskegon Heights School District:

- The School District ended fiscal year 2006 with a \$0.9 million deficit. The deficit persisted in each of subsequent fiscal years, with School District officials projecting that the School District will remain in a deficit condition for fiscal years 2012 through 2015.
- The School District had a cumulative general fund deficit of \$8,472,543 as of June 30, 2011. In addition, the cumulative general fund deficit exceeded \$1.0 million since the 2009 fiscal year.
- The fund balance of the School District, expressed as a percentage of general fund revenues, was a negative 48 percent as of June 30, 2011. This negative percentage exceeded the negative 15 percent threshold at which the Department attaches concern.
- The financial audit report of the School District for the 2011 fiscal year included 11 findings of material weaknesses, significant deficiencies, or noncompliance, compared to the financial audit report of the School District for the 2010 fiscal year which included four findings of significant deficiencies.
- The School District demonstrated unsatisfactory progress in eliminating its cumulative general fund deficit. The deficit has increased from \$0.9 million at June 30, 2006, to \$8.5 million at June 30, 2011.
- The School District was approximately \$1.4 million in arrears to the Public School Employees Retirement Service through November 2011.

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

- The School District experienced cash-flow stress despite having received approximately \$7.9 million through the Michigan Department of Treasury for cash flow purposes.
- The School District had been the subject of an ongoing investigation by the Michigan State Police related to the possible misuse of federal Title I funds.
- The School District and its staff had been unable to agree upon concessions.
- The most recent financial audit report and comprehensive financial report of the School District were not submitted to the Department of Education by the statutory due date of November 15, 2011. As a result, the Department withheld the December 20, 2011 State school aid payment. The State school aid payment was released when the reports subsequently were submitted.

Based upon the preliminary review, the Superintendent of Public Instruction concluded and reported to the Governor on January 10, 2012, that probable financial stress existed in the Muskegon Heights School District and recommended the appointment of a financial review team.

B. Review Team Findings

On January 31, 2012, the Governor appointed an eight-member Financial Review Team. The Review Team convened on March 2nd, 7th, 20th, and April 2nd, 2012.

1. Conditions Indicative of a Financial Emergency

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 102 percent, from \$4,195,864 (as restated) as of June 30, 2010 to \$8,472,543 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 \$4,276,679.
- Since at least the 2006 fiscal year, the School District has not had a positive year-end fund balance in its general fund. Based upon information on file with the Michigan Department of Education, the negative year-end general fund balance during these years has ranged from \$900,378 for the 2006 fiscal year to a projected \$9,442,788 for the current fiscal year which ends on June 30, 2012.
- 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:

	<u>2008-09</u>	<u>%</u>	<u>2009-10</u>	<u>%</u>	<u>2010-11</u>	<u>%</u>
<u>Revenues</u>						
Original	\$22,481,370		\$21,964,880		\$19,743,100	
Final	\$22,481,370		\$21,048,383		\$20,007,464	
Actual	<u>\$22,770,560</u>		<u>\$20,437,910</u>		<u>\$17,784,569</u>	
Variance	\$289,190	1.29	(\$610,473)	(2.9)	(\$2,222,895)	(11.1)
<u>Expenditures</u>						
Original	\$22,481,370		\$21,949,880		\$23,230,460	
Final	\$22,481,370		\$23,781,642		\$21,950,437	
Actual	<u>\$23,608,408</u>		<u>\$23,032,858</u>		<u>\$22,061,248</u>	
Variance	(\$1,127,038)	(5.01)	\$748,784	3.15	(\$110,811)	(0.50)

The numbers suggest a mixed picture. There are instances where actual revenue exceeded finally budgeted revenue (i.e., fiscal year 2009) and actual expenditures were less than finally budgeted expenditures (i.e., fiscal year 2010). However, instances of the opposite also are reflected where actual revenue was less than final budgeted revenue (i.e., fiscal years 2010 and 2011) and expenditures exceeded final budgeted expenditures (i.e., fiscal years 2009 and 2011).

- As depicted below, the School District's pupil enrollment decreased by 34.3 percent, from 2,142 pupils for the 2006 fiscal year to 1,408 pupils for the 2012 fiscal year. The decline in the number of pupils in the School District has had a corresponding impact upon the general fund revenues available as school funding continues to be based upon the number of pupils.

Fiscal Year	Pupil Count	General Fund Revenue
2006	2,142	\$24,224,178
2007	2,046	\$22,032,907
2008	1,909	\$21,701,821
2009	1,820	\$22,033,838
2010	1,599	\$19,894,627
2011	1,537	\$17,784,577
2012	1,408	\$17,600,387

- Pursuant to documents School District officials signed on August 1, 2011, related to a \$7.9 million State aid note for the School District, the Department of Treasury was required to intercept a portion of the School District's State aid payments beginning in February 2012 in order to help ensure the timely repayment by the School District of that State aid note. The intercepts are a direct result of the School District's loss of students and associated State aid. These intercepts will continue through July of 2012, in the amount of \$113,678.46 (approximately 12 percent) from each State aid payment. These partial intercepts will be in addition to a 100 percent intercept of the School District's August 2012 State aid payment, which also is required pursuant to the August 1, 2011 documents. Even after the intercepts, the School District still will owe approximately \$6.3 million on its State aid note which is due August 20, 2012.

2. Review Team Meetings²

On March 2, 2012, Review Team members Frederick Headen, Dale Nesbary, Doug Ringler, Thomas F. Saxton, Brom Stibitz, and John VanWyck met with Brian McFarren, of the certified public accounting firm Brickley Delong, P.C.

² On February 9, 2012, the Ingham County Circuit Court issued injunctive relief based upon a verbal ruling from the bench that review teams appointed pursuant to Public Act 4 of 2011, the Local Government and School District Fiscal Accountability Act, are public bodies for purposes of Public Act 267 of 1976, the Open Meetings Act. On February 29, 2012, the court issued an order for declaratory judgment and injunctive relief to the same effect. As a result, all meetings of this Review Team were conducted in public. The ruling by the court currently is on appeal.

On March 7, 2012, Review Team members Frederick Headen, David Martell, Dale Nesbary, Doug Ringler, Carol Wolenberg, and John VanWyck conducted a series of interviews in the School District with David L. Sipka, Muskegon Intermediate School District (and interim Muskegon Heights School District) Superintendent; Marios Demetriou, Muskegon Area Intermediate School District Deputy Superintendent (and interim Muskegon Heights School District Finance Director); Sue McCarty, School District Human Resources Manager; Joy Robinson, President, Muskegon Heights Education Association; Krista Abbott, Director, Michigan Education Association (Uniserv); William Kuiper, Michigan Education Association; Dave Neifer, Title I Director; Avery Burrel, School Board President; Ron Jenkins, School Board Vice President; Franklin Brewer, School Board Secretary; Ivory Morris, School Board Treasurer; and School Board members Nathaniel Johnson, Cassandra Kitchen, and Trinell Scott.

On March 20, 2012, the Review Team discussed in detail the various statutory conclusions provided in Section 13(4) of the Act and, after deliberation and public comment, concluded that a financial emergency existed in the School District.

3. Other Considerations

While the Review Team gave serious consideration to all of the statutory conclusions provided in Section 13(4) of the Act, the Review Team concluded that a financial emergency existed, that no satisfactory plan exists to resolve the emergency, and that appointment of an emergency manager should be recommended. This conclusion was reached for several reasons.

First, the School District has experienced turnover in at least two key positions. As noted earlier, the Intermediate School District Superintendent presently has been serving as the interim Superintendent for the School District since January of this year. In addition, the Intermediate School District Deputy Superintendent has been serving as the interim Finance Director for the School District. Given their detailed involvement in the day-to-day operations of the School District, these two officials likely possess the most comprehensive understanding of the School District's financial condition of anyone associated with the School District. Therefore, it was significant that both officials expressed to the Review Team their unequivocal opinion that an emergency manager would be necessary.

Second, by letter dated December 7, 2011, the School Board requested that "the Michigan Department of Education assist the District in facilitating the appointment of an Emergency Manager under Public Act 4 of 2011." It is noteworthy in this regard that School Board members apparently considered the financial condition of the School District to be so dire that no real attempt was made by them even after the Review Team was appointed to devise a consent agreement nor actively to lobby for consideration of a consent agreement by the Review Team.³

³ At the March 7, 2012 site visit, the Review Team determined that five School Board members had voted in favor of the request that an emergency manager be appointed, one School Board member had voted against it, and one School Board member had been absent. On March 7, several School Board members who voted in favor of the request

Finally, during the March 7, 2011, site visit, several School Board members expressed the need for them to impose more stringent monitoring over School District's administration. However, the actual experience of School Board members in carrying out such monitoring is untested. Therefore, appointment of an emergency manager may allow the School Board to establish and refine its monitoring role, and under the tutelage of an emergency manager, better prepare itself for a transition back to an effective Superintendent-School Board relationship once the financial condition of the School District has been stabilized.

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 Muskegon Heights 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).⁴ The conditions in subdivisions (b)(iii), (e), and (f) of Section 13(3) exist or are likely to occur, as follows:

clarified their position as not favoring such an appointment, but concluding that one was necessary. We concur. Indeed, 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.

⁴ 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.

- As previously noted, the School District was approximately \$1.4 million in arrears to the Public School Employees Retirement System through November 2011. (Section 13(3)(b)(iii)).
- The School District had a general fund deficit of \$8,472,543 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)).
- The School District is projecting a cumulative general fund deficit of \$9,442,788 for the current fiscal year which ends on June 30, 2012, which would exceed 5 percent of the \$17,600,387 in budgeted revenues for the general fund.

III. Review Team Report Transmittal Requirements

Section 13(3) of Act 4 also requires that a copy of this report be transmitted to Interim Superintendent David Sipka, the Muskegon Heights Board of Education, the Speaker of the House of Representatives, and the Senate Majority Leader.

cc: David L. Sipka, Interim Superintendent
Muskegon Heights Board of Education
James Bolger, Speaker of the House of Representatives
Randy Richardville, Senate Majority Leader

(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.

(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.