



STATE OF MICHIGAN
DEPARTMENT OF EDUCATION
LANSING

RICK SNYDER
GOVERNOR

MICHAEL P. FLANAGAN
STATE SUPERINTENDENT

April 22, 2014

Harlan Goodrich, Secretary
Local Emergency Financial Assistance Loan Board
Local Audit and Finance Unit
Michigan Department of Treasury
Lansing, MI 48909

Dear Mr. Goodrich:

As required in § 4(2) of P.A. 436 of 2012, the Local Financial Stability and Choice Act, I am providing a Final Report of my Preliminary Review of Benton Harbor Area Schools to the Local Emergency Financial Assistance Loan Board.

An Interim Report of the Preliminary Review was sent to Benton Harbor Schools on April 11, 2014. The district was given five days to respond to that Interim Report. Copies of both the Interim Report of the Preliminary Review (Attachment D) and the Benton Harbor Area Schools' response (Attachment E) are attached.

Questions may be directed to Dan Hanrahan at HanrahanD@Michigan.gov and Kyle Guerrant at GuerrantK@Michigan.gov or by fax to (517) 241-0196.

Sincerely,

Mike Flanagan
State Superintendent

cc: Senator John Proos, 21st District
Representative Al Pscholka, 79th District
Leonard Seawood, Superintendent, Benton Harbor Area Schools
Martha Momany, President, Benton Harbor Board of Education
Willie Lark, Vice President, Benton Harbor Board of Education
Sharon James, Secretary, Benton Harbor Board of Education
Joseph Taylor, Treasurer, Benton Harbor Board of Education
Lue Buchana, Trustee, Benton Harbor Board of Education
Lisa Gulley, Trustee, Benton Harbor Board of Education
Angelika MacGowan, Trustee, Benton Harbor Board of Education

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Leonard Seawood
Martha Momany
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April 11, 2014


Kevin Ivers, Superintendent, Berrien RESA
Kyle Guerrant, Deputy Superintendent, MDE
Daniel Hanrahan, Director, State Aid and School Finance, MDE



STATE OF MICHIGAN
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RICK SNYDER
GOVERNOR

MICHAEL P. FLANAGAN
STATE SUPERINTENDENT

DATE: April 22, 2014
TO: Local Emergency Financial Assistance Loan Board
FROM: Mike Flanagan, State Superintendent 
SUBJECT: Final Report – Preliminary Review of Benton Harbor Area Schools

The following represents the Final Report of the Preliminary Review under the Local Financial Stability and Choice Act (PA 436 of 2012) for Benton Harbor Area Schools (the "District"). We appreciate the level of cooperation received from the District's administration during this process.

I. Background

In a letter dated March 17, 2014, I advised Benton Harbor Area Schools that I was not approving the Deficit Elimination Plan (DEP) and that, pursuant to my authority vested under PA 436 of 2012, I was also initiating a Preliminary Review of the District's finances to determine the existence of probable financial stress within Benton Harbor Area Schools (Attachments A and B). §4(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 conditions listed in §4(1) are met. The Preliminary Review of Benton Harbor Area Schools resulted from the following conditions enumerated in §4(1) of the Act: "(j) the local government has violated a requirement of Sections 17 to 20 of the Uniform Budgeting and Accounting Act, 1968 PA 2, MCL 141.437 to 141.440" and "(n) the local government is in breach of its obligations under a deficit elimination plan or an agreement entered into pursuant to a deficit elimination plan." Also, comments received in an April 16, 2014 response to the Interim Report of Preliminary Review from Benton Harbor Area Schools indicate financial stress is evident and that additional guidance and direction are needed.

In addition to the conditions above that initiated the Preliminary Review, the District also meets the condition in §4(1)(s) which references other facts or circumstances that in the sole discretion of the Superintendent of Public Instruction are indicative of probable financial stress. Specifically, as provided by law, I granted the District an extension of four years to eliminate the deficit beyond the two-year requirement

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specified in law for a total of six years. This extension effectively began in 2010 with the deficit to be eliminated by June 30, 2016. The District was unable to eliminate the deficit by that extended due date and requested an additional 12 years to June 30, 2028 for a total of 18 years.

Please know the decision to begin the PA 436 process with the District was made taking into consideration the fact that I had conducted a Preliminary Review in December 2011 under PA 4 of 2011. At that time, the District met all six of the factors used by the Michigan Department of Education (the "Department") to determine if a school district is under financial stress. However, the Department learned while conducting the Preliminary Review that the District had taken several steps to correct the deficit including:

- Closed two buildings at semester end in January 2012,
- Closed the District's 5-6 grade center at year end,
- Approved the layoff of 13 teachers, an administrator, and several support staff,
- Hired Plante Moran to manage the District's financial services,
- Approved the Berrien County Land Bank to demolish six vacant District buildings and sell others,
- Worked closely with the City of Benton Harbor emergency manager and major corporations to help facilitate the deficit elimination, and
- Teacher acceptance of a 10% reduction in pay for the second semester and increased copays.

Based on the Preliminary Review completed in 2011, I had determined that a finding of probable financial stress existed. However, in light of the events outlined above, I did not recommend a Review Team under PA 4 at that time, but did reserve the right to recommend the Governor appoint a Review Team should it be determined that the District had not met established deadlines and was, at any point in the future, not continuing to make progress on elimination of the deficit. Because PA 4 has been replaced by PA 436, I initiated the process under the current law.

II. Final Report of Findings

The Michigan Department of Education (the "Department") has developed critical factors to determine whether probable financial stress might exist in a school

district. The process calls for a review of a district's financial operation related to five (5) 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 15% of general fund revenues excluding incoming transfers; and
- 3) 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
- 4) The 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
- 5) District's failure to comply with bond or note covenants, failure to make pension fund deposits, failure to make payroll, and/or closure of school prior to the end of the school year.

The Department assessed Benton Harbor Area Schools with regard to the above five (5) factors. The results of the assessment are as follows:

- 1) Benton Harbor Area Schools has been in deficit since it ended the 2006-2007 fiscal year with a \$3.0 million deficit. The District projects the deficit balance for the year ending June 30, 2014 will be \$14.7 million. The District projected it will emerge from deficit in the 2027-28 fiscal year.
- 2) Benton Harbor Area Schools' projected June 30, 2014 deficit balance expressed as a percentage of the general fund revenues is projected to be a negative 46%. The percentage far exceeds the Department's parameter of a negative 15% to indicate concern.
- 3) The District's privately audited financial report for the year ended June 30, 2013, included three findings of material weaknesses, significant deficiencies, or non-compliance. The District's June 30, 2012 audit included six findings of material weaknesses, significant deficiencies, or non-compliance. See Attachment C for more information.
- 4) Benton Harbor Area Schools has shown unsatisfactory progress in eliminating the deficit. The deficit increased from \$3.0 million on June 30, 2007 to \$15.5 million on June 30, 2013. Additionally, the District requires an additional 12 years beyond the DEP that had been previously approved by the Department to eliminate the deficit.
- 5) The District has not failed to comply with bond or note covenants, failed to make pension fund deposits, failed to make payroll, and/or closed school prior to the end of the school year. The Department has not been notified that the District is delinquent in its payments to the Michigan Public School Employees Retirement System (MPSERS).

In addition to the assessment above related to the District and the five (5) critical factors that the Department developed to assist in analyzing a district's level of financial stress, the following factors were also noted:

1. As provided by law, I granted the District an extension of four years to eliminate the deficit beyond the two-year requirement for a total of six years. This extension effectively began in 2010 with the deficit to be eliminated by June 30, 2016. The District was unable to eliminate the deficit by that extended due date and requested an additional 12 years to June 30, 2028 for a total of 18 years.
2. Cash flow is distressed even though the District has been provided two emergency loans through the Department of Treasury (\$2,000,000 in September 2012 and \$2,000,000 in December 2013). Most recent cash

flows provided by the District depict a cash shortfall occurring in May 2014. Based on discussions with the District, the shortfall will be addressed by managing accounts payable to get through the year. This will result in significant vendor payment issues which could affect services provided to the District and its students.

3. The District also participates in the Michigan Finance Authority's (MFA) pooled State Aid Note (SAN) program. Historically, the District has borrowed at the program cap (for the most recent transaction the cap is 55% of state aid revenue). The District also participates 100% in the no-set aside pool, which means the only payment made on the short-term note is the final balloon payment at maturity. However, in an attempt to reduce the amount of the SAN borrowing that is rolled over from year to year, for the first time in 2013, the MFA required eight districts who have repeatedly rolled their short-term cash flow notes to make mandatory set aside payments. Benton Harbor is one of the eight districts. The District will make three equal mandatory payments in May, June and July totaling \$1.6M. This was necessary so that the amount paid at maturity in August does not exceed 45% of their annual state aid amount (this is the program maximum). Still, the amount paid at maturity will most likely be made with a new SAN borrowing for the next fiscal year, which continues the cycle of borrowing to stay solvent which does not address the growing structural deficit.

An Interim Report detailing my Preliminary Review was sent to Benton Harbor Area Schools on April 11, 2014. The District was given five days to respond to that report. Copies of both the Interim Report (Attachment D) and the response from Benton Harbor Area Schools (Attachment E) are attached. Please note that Factor 3 above on this page was modified based on the District's response and additional clarification by Treasury.

As the state financial authority for school districts, I am forwarding this Final Report of the Preliminary Review to the Local Emergency Financial Assistance Loan Board pursuant to the language in § 4(2) of PA 436 of 2012.

Questions should be directed to Dan Hanrahan, Director of the Office of State Aid and School Finance, at hanrahand@michigan.gov or by fax to (517) 241-0196.

Attachment

cc: Senator John Proos, 21st District
Representative Al Pscholka, 79th District
Leonard Seawood, Superintendent, Benton Harbor Area Schools
Martha Momany, President, Benton Harbor Board of Education
Willie Lark, Vice President, Benton Harbor Board of Education

Local Emergency Financial Assistance Loan Board

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April 22, 2014

Sharon James, Secretary, Benton Harbor Board of Education

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Lisa Gulley, Trustee, Benton Harbor Board of Education

Angelika MacGowan, Trustee, Benton Harbor Board of Education

Rhonda Hildebrand, Plante Moran

Kevin Ivers, Superintendent, Berrien RESA

Kyle Guerrant, Deputy Superintendent, Michigan Dept. of Education

Dan Hanrahan, Director, State Aid and School Finance, Michigan Dept. of Education



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MICHAEL P. FLANAGAN
STATE SUPERINTENDENT

March 17, 2014

Leonard Seawood, Superintendent
Martha Momany, Board President
Benton Harbor Area Schools
636 Pipestone Rd.
Benton Harbor, MI 49022

Dear Superintendent Seawood and Board President Momany:

Benton Harbor Area Schools was required to submit a revised Deficit Elimination Plan (DEP) by February 12, 2014. We received the revised DEP by the due date and have completed our review. The revised DEP will not be approved because of the length of time that the district projects to remain in deficit. Benton Harbor Area Schools was the first district that I granted six (6) years to eliminate the deficit, until June 30, 2016. Despite your best efforts, some of which are outlined in the next paragraph, the revised DEP indicates that the deficit cannot be eliminated until June 30, 2028, twelve (12) years beyond the original extension, or eighteen (18) years in total.

As you know, I began the P.A. 4 (Local Government and School District Fiscal Accountability Act) process with the district in late 2012, based on the district's severe financial situation. To the district's credit, it has made many difficult decisions to help mitigate the deficit including staff rightsizing, wage concessions, building closures, and outsourcing services. Based on this progress and district commitment to eliminate the deficit within the established timelines, I did not recommend to the Governor that a Review Team be put in place after my Preliminary Review under P.A. 4 was completed in December 2012. I did, however, reserve the right to continue the process if the district did not make significant progress to eliminate the deficit as required by law. The district has been in deficit since June 30, 2007. While the deficit has not increased in the last three (3) years, despite continuing enrollment declines, the deficit reduction has been only nominal even with the receipt of Emergency Loans totaling \$4 million through the Michigan Department of Treasury. Consequently, I remain very concerned about the financial viability of the district.

Therefore, I am exercising my authority under Section 4(1)(a) of Public Act 436 of 2012 (P.A. 436, the Local Fiscal Stability and Choice Act) to initiate a Preliminary Review of the district's financial operations to determine the level of financial stress in the district.

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Section 4(2) of P.A. 436 requires that I provide specific written notification of the Preliminary Review prior to the review taking place; this letter meets that requirement.

Specifically, I am initiating this action based on the following triggers from Section 4(1): "(j) the local government has violated a requirement of Sections 17 to 20 of the Uniform Budgeting and Accounting Act, 1968 P.A. 2, MCL 141.437 to 141.440" and "(n) the local government is in breach of its obligations under a deficit elimination plan or an agreement entered into pursuant to a deficit elimination plan."

To be clear, this is a Preliminary Review at this point. It does not automatically mean that the end result would be for the Governor to declare a financial emergency in the district. The law provides for certain additional steps before that could occur. I must provide a Final Report of the Preliminary Review to the Local Emergency Financial Assistance Loan Board. If a finding of probable financial stress is made by that Board, the Governor shall then appoint a Review Team for the district.

The Review Team will provide a report to the Governor, generally within 60 days of commencing its review. Should both the Review Team and the Governor determine that a financial emergency exists in the Benton Harbor Area Schools, the local board of education would be required to choose one of the following four (4) options provided in law to address the financial emergency:

- 1) Consent Agreement
- 2) Emergency Manager
- 3) Neutral Evaluation Process
- 4) Chapter 9 Bankruptcy

You will be contacted by Carol Wolenberg, Deputy Superintendent, and Dan Hanrahan, Director of the Office of State Aid and School Finance, on Tuesday, March 18, 2014 (NOTE: Wednesday, March 19, can be an alternative date based on your availability), to discuss the P.A. 436 process. The Preliminary Review will officially begin on Monday, March 24, 2014. I would strongly recommend that you meet with your team prior to this contact to determine if any circumstances, such as additional expenditure adjustments, may have changed that would be helpful as we work with you during the Preliminary Review or if a viable DEP can be generated with a timeline that does not go out an additional twelve (12) years or until 2028. State school aid payments will continue through the P.A. 436 determination process.

Leonard Seawood
Martha Momany
Page 3
March 17, 2014

If you have questions, please contact Ms. Wolenberg at 517-241-0062
(wolenbergc@michigan.gov) or Mr. Hanrahan at 517-335-0521
(hanrahand@michigan.gov).

Sincerely,

A handwritten signature in blue ink, appearing to read "Mike Flanagan", with a stylized flourish at the end.

Mike Flanagan
State Superintendent

cc: Kevin Clinton, State Treasurer
Harlan Goodrich, Emergency Financial Assistance Loan Board
Kevin Ivers, Superintendent, Berrien RESA
Carol Wolenberg, Deputy Superintendent, MDE
Dan Hanrahan, Director, Office of State Aid and School Finance, MDE



STATE OF MICHIGAN
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MICHAEL P. FLANAGAN
STATE SUPERINTENDENT

March 27, 2014

Leonard Seawood, Superintendent
Benton Harbor Area Schools
636 Pipestone Road
Benton Harbor, MI 49022

Dear Superintendent Seawood:

The purpose of this letter is to follow-up on our telephone conversation of Wednesday, March 19, 2014, pertaining to the initiation of PA 436 (Local Fiscal Stability and Choice Act) with the Benton Harbor Area Schools (BHAS). This action was conveyed to the district in a letter from State Superintendent Mike Flanagan dated March 17, 2014. I would first like to thank you and the key administrators and board members who were on the call as I believe the call was beneficial to all involved. We felt that everyone at the district level had an opportunity to get questions asked and answered and fully understand the impact of this action as well as next steps. Based on that call, we agreed to the following key dates using the timelines prescribed in law:

March 24, 2014	Start PA 436 Preliminary Review
April 11, 2014	Interim Report due to BHAS
April 16, 2014	BHAS response due to MDE
April 22, 2014	Final Report due to the Local Emergency Financial Assistance Loan Board (ELB)

During the call, we also reiterated information that was shared in the March 17, 2014, letter referred to above. That is, this is a Preliminary Review by the State Superintendent at this point. The Final Report of the Preliminary Review will be sent to the ELB stating the facts; it does not contain a recommendation on whether or not the district is in financial stress. The ELB will then determine if the Governor should appoint a Review Team. If a Review Team is appointed, this team will make a recommendation to the Governor regarding whether or not the district is in financial stress. The Governor will make the final determination as to whether or not a financial emergency exists in the district.

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Leonard Seawood

March 27, 2014

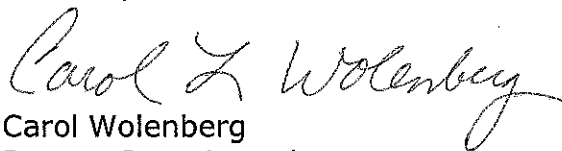
Page 2

A key word in the name of PA 436 is "choice." Should a financial emergency be declared by the Governor, the district and your board of education will have the choice of how to proceed under the four (4) options provided in the Act.

- 1) Consent Agreement
- 2) Emergency Manager
- 3) Neutral Evaluation Process
- 4) Chapter 9 Bankruptcy

As stated in the March 17, 2014 letter, we appreciate the work that has been accomplished by you and the board to begin to rectify the district's financial situation. We look forward to continuing to work collaboratively with you and our colleagues in Treasury toward a solution that eliminates the deficit and continues to serve the best educational needs of the BHAS students. Should you have questions at any time during the PA 436 process, please don't hesitate to us.

Sincerely,



Carol Wolenberg
Deputy Superintendent

Cc: Dan Hanrahan, Director, Office of State Aid and School Finance, MDE
Tom Saxton, Deputy Treasurer

Attachment C

Benton Harbor Area Schools			
Findings	2012-2013		
Financial Statement Findings			
Finding Number	Type of Finding	Program Office	Condition
2013-1	Significant deficiency		Certain general ledger balances were inaccurate at the end of the fiscal year.
2013-2	Material noncompliance with laws and regulations		The Benton Harbor Area Schools' General Fund has been in a deficit fund balance position for seven consecutive years.
Federal Program Findings			
2013-3	Material Weakness and material noncompliance with laws and regulations	Title I	The District requested from the awarding agency, Michigan Department of Education, reimbursement for grant expenditures that were neither incurred nor expended, which resulted in the District receiving funding in excess of its cash needs.

Benton Harbor Area Schools			
Findings	2011-2012		
Financial Statement Findings			
Finding Number	Type of Finding	Program Office	Condition
2012-1	Material Weakness		The District lacks segregation of duties with respect to its cash transfer and journal entry procedures.
2012-2	Material Weakness		General ledger balances were inaccurate during the fiscal year.
2012-3	Material Weakness		Bank reconciliations were not performed properly or timely throughout the year.
2012-4	Material Weakness and material noncompliance with laws and regulations		The Benton Harbor Area Schools' General Fund has been in a deficit fund balance position for six consecutive years.
Federal Program Findings			
2012-5	Material Weakness and material noncompliance with laws and regulations	Title I	One employee charged to Title I refused to sign personnel activity reports, despite supervisory efforts to compel him to do so. Additionally, business office personnel failed to note that an employee who was charged to Title I in 2010-11 should not have been charged to the grant in 2011-12.
2012-6	Material Weakness and material noncompliance with laws and regulations	Safe and Drug-free Tobacco	The District requested from the awarding agency, Michigan Department of Education, reimbursement for grant expenditures that were neither incurred nor expended, which resulted in the District receiving funding in excess of its cash needs.



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April 11, 2014

Leonard Seawood, Superintendent
Martha Momany, Benton Harbor Board President
Benton Harbor Area Schools
636 Pipestone Rd.
Benton Harbor, MI 49022

Dear Superintendent Seawood and Board President Momany:

In a March 17, 2014 letter to you, I advised that I was initiating a Preliminary Review under Section 4 of PA 436 of 2012, the Local Financial Stability and Choice Act. The purpose of the Preliminary Review is to "determine the existence of probable financial stress" within the district. This section of law also requires that an Interim Report be provided to the district within 20 days following commencement of the Preliminary Review. This letter is to transmit the Interim Report to meet that requirement.

The district has five (5) days from the date that the Interim Report is submitted to the district to provide comments on this Report. The law requires that I must complete a Final Report of the Preliminary Review within 30 days following the commencement of the Preliminary Review and submit it to the Local Emergency Financial Assistance Loan Board. If a finding of probable financial stress is made by that Board, the Governor shall appoint a Review Team to determine if a financial emergency exists.

Please provide your comments on the Interim Report to both Dan Hanrahan at HanrahanD@Michigan.gov and Carol Wolenberg WolenbergC@Michigan.gov or by fax to (517) 241-0196. We appreciate your cooperation in this matter.

Sincerely,

A handwritten signature in blue ink that reads "Mike Flanagan".

Mike Flanagan
State Superintendent

cc: Senator John Proos, 21st District
Representative Al Pscholka, 79th District
Willie Lark, Vice President, Benton Harbor Board of Education
Sharon James, Secretary, Benton Harbor Board of Education
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DATE: April 11, 2014

TO: Leonard Seawood, Superintendent, Benton Harbor Area Schools
Martha Momany, President, Benton Harbor Board of Education

FROM: Mike Flanagan, State Superintendent

SUBJECT: Interim Report – Preliminary Review of Benton Harbor Area Schools

The following represents the Interim Report of the Preliminary Review under the Local Financial Stability and Choice Act (PA 436 of 2012) for Benton Harbor Area Schools (the "District"). We appreciate the level of cooperation received from the District's administration during this process.

I. Background

In a letter dated March 17, 2014, I advised Benton Harbor Area Schools that I was not approving the Deficit Elimination Plan (DEP) and that, pursuant to my authority vested under PA 436 of 2012, I was also initiating a Preliminary Review of the District's finances to determine the existence of probable financial stress within Benton Harbor Area Schools (Attachments A and B). §4(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 conditions listed in §4(1) are met. The Preliminary Review of Benton Harbor Area Schools resulted from the following conditions enumerated in §4(1) of the Act: "(j) the local government has violated a requirement of Sections 17 to 20 of the Uniform Budgeting and Accounting Act, 1968 PA 2, MCL 141.437 to 141.440" and "(n) the local government is in breach of its obligations under a deficit elimination plan or an agreement entered into pursuant to a deficit elimination plan."

In addition to the conditions above that initiated the Preliminary Review, the District also meets the condition in §4(1)(s) which references other facts or circumstances that in the sole discretion of the Superintendent of Public Instruction are indicative of probable financial stress. Specifically, as provided by law, I granted the District an extension of four years to eliminate the deficit beyond the two-year requirement specified in law for a total of six years. This extension effectively began in 2010 with the deficit to be eliminated by June 30, 2016. The District was unable to

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eliminate the deficit by that extended due date and requested an additional 12 years to June 30, 2028 for a total of 18 years.

Please know that the decision to begin the PA 436 process with the District was made taking into consideration the fact that I had conducted a Preliminary Review in December 2011 under PA 4 of 2011. At that time, the District met all six of the factors used by the Michigan Department of Education (the "Department") to determine if a school district is under financial stress. However, the Department learned while conducting the Preliminary Review that the District had taken several steps to correct the deficit including:

- Closed two buildings at semester end in January 2012,
- Closed the District's 5-6 grade center at year end,
- Approved the layoff of 13 teachers, an administrator, and several support staff,
- Hired Plante Moran to manage the District's financial services,
- Approved the Berrien County Land Bank to demolish six vacant District buildings and sell others,
- Worked closely with the City of Benton Harbor emergency manager and major corporations to help facilitate the deficit elimination, and
- Teacher acceptance of a 10% reduction in pay for the second semester and increased copays.

Based on the Preliminary Review completed in 2011, I had determined that a finding of probable financial stress existed. However, in light of the events outlined above, I did not recommend a Review Team under PA 4 at that time but did reserve the right to recommend that the Governor appoint a Review Team should it be determined that the District has not met established deadlines and was, at any point in the future, not continuing to make progress on elimination of the deficit. Because PA 4 has been replaced by PA 436, I must now initiate the process under the current law.

II. Interim Report of Findings

The Michigan Department of Education (the "Department") has developed critical factors to determine whether probable financial stress might exist in a school

district. The process calls for a review of a district's financial operation related to five (5) 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 15% of general fund revenues excluding incoming transfers; and
- 3) 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
- 4) The 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
- 5) District's failure to comply with bond or note covenants, failure to make pension fund deposits, failure to make payroll, and/or closure of school prior to the end of the school year.

The Department assessed Benton Harbor Area Schools with regard to the above five (5) factors. The results of the assessment are as follows:

- 1) Benton Harbor Area Schools has been in deficit since it ended the 2006-2007 fiscal year with a \$3.0 million deficit. The District projects that the deficit balance for the year ended June 30, 2014 will be \$14.7 million. The District projected that it will emerge from deficit in the 2027-28 fiscal year.
- 2) Benton Harbor Area Schools' projected June 30, 2014 deficit balance expressed as a percentage of the general fund revenues is projected to be a negative 46%. The percentage far exceeds the Department's parameter of a negative 15% to indicate concern.
- 3) The District's privately audited financial report for the year ended June 30, 2013, included three findings of material weaknesses, significant deficiencies, or non-compliance. The District's June 30, 2012 audit included six findings of material weaknesses, significant deficiencies, or non-compliance. See Attachment C for more information.
- 4) Benton Harbor Area Schools has shown unsatisfactory progress in eliminating the deficit. The deficit increased from \$3.0 million on June 30, 2007 to \$15.5 million on June 30, 2013. Additionally, the District requires an additional 12 years beyond the DEP that had been previously approved by the Department to eliminate the deficit.
- 5) The District has not failed to comply with bond or note covenants, failed to make pension fund deposits, failed to make payroll, and/or closed school prior to the end of the school year. The Department has not been notified that the District is delinquent in its payments to the Michigan Public School Employees Retirement System (MPSERS).

In addition to the assessment above related to the District and the five (5) critical factors that the Department developed to assist in analyzing a district's level of financial stress, the following factors were also noted:

1. As provided by law, I granted the District an extension of four years to eliminate the deficit beyond the two-year requirement for a total of six years. This extension effectively began in 2010 with the deficit to be eliminated by June 30, 2016. The District was unable to eliminate the deficit by that extended due date and requested an additional 12 years to June 30, 2028 for a total of 18 years.
2. Cash flow is distressed even though the District has been provided two emergency loans through the Department of Treasury (\$2,000,000 in

September 2012 and \$2,000,000 in December 2013). Most recent cash flows provided by the District depict a cash shortfall occurring in May 2014. Based on discussions with the District, the shortfall will be addressed by managing accounts payable to get through the year. This will result in significant vendor payment issues which could affect services provided to the District and its students.

3. The District also participates in the Michigan Finance Authority's pooled State Aid Note (SAN) program. Historically, the District has borrowed at the program cap (for the most recent transaction the cap is 55% of state aid revenue). The District also participates 100% in the no-set aside pool, which means the only payment made on the short-term note is the final balloon payment at maturity. In the most recent years, this balloon payment is made with a new SAN borrowing for the next fiscal year which continues the cycle of borrowing to stay solvent which does not address the growing structural deficit.

III. Next Steps

As the state financial authority for school districts, I am forwarding this Interim Report of my preliminary review to Benton Harbor Area Schools pursuant to the language in §4(2) of PA 436. The District may provide comments on this Interim Report within five (5) days after the date that this Report is provided. Please direct these comments to Dan Hanrahan at hanrahand@michigan.gov and Carol Wolenberg at wolenbergc@michigan.gov or by fax to (517) 241-0196. A Final Report of the Preliminary Review incorporating the District's comments will be provided to the District and the Local Emergency Financial Assistance Loan Board on or before the 30-day timeframe required in law or no later than April 22, 2014. The Local Emergency Financial Assistance Loan Board will determine if probable financial stress exists for the District.

Attachment

cc: Senator John Proos, 21st District
Representative Al Pscholka, 79th District
Carol Wolenberg, Deputy Superintendent, Michigan Dept. of Education
Dan Hanrahan, Director, State Aid and School Finance, Michigan Dept. of Education



STATE OF MICHIGAN
DEPARTMENT OF EDUCATION
LANSING

RICK SNYDER
GOVERNOR

MICHAEL P. FLANAGAN
STATE SUPERINTENDENT

March 17, 2014

Leonard Seawood, Superintendent
Martha Momany, Board President
Benton Harbor Area Schools
636 Pipestone Rd.
Benton Harbor, MI 49022

Dear Superintendent Seawood and Board President Momany:

Benton Harbor Area Schools was required to submit a revised Deficit Elimination Plan (DEP) by February 12, 2014. We received the revised DEP by the due date and have completed our review. The revised DEP will not be approved because of the length of time that the district projects to remain in deficit. Benton Harbor Area Schools was the first district that I granted six (6) years to eliminate the deficit, until June 30, 2016. Despite your best efforts, some of which are outlined in the next paragraph, the revised DEP indicates that the deficit cannot be eliminated until June 30, 2028, twelve (12) years beyond the original extension, or eighteen (18) years in total.

As you know, I began the P.A. 4 (Local Government and School District Fiscal Accountability Act) process with the district in late 2012, based on the district's severe financial situation. To the district's credit, it has made many difficult decisions to help mitigate the deficit including staff rightsizing, wage concessions, building closures, and outsourcing services. Based on this progress and district commitment to eliminate the deficit within the established timelines, I did not recommend to the Governor that a Review Team be put in place after my Preliminary Review under P.A. 4 was completed in December 2012. I did, however, reserve the right to continue the process if the district did not make significant progress to eliminate the deficit as required by law. The district has been in deficit since June 30, 2007. While the deficit has not increased in the last three (3) years, despite continuing enrollment declines, the deficit reduction has been only nominal even with the receipt of Emergency Loans totaling \$4 million through the Michigan Department of Treasury. Consequently, I remain very concerned about the financial viability of the district.

Therefore, I am exercising my authority under Section 4(1)(a) of Public Act 436 of 2012 (P.A. 436, the Local Fiscal Stability and Choice Act) to initiate a Preliminary Review of the district's financial operations to determine the level of financial stress in the district.

STATE BOARD OF EDUCATION

JOHN C. AUSTIN – PRESIDENT • CASANDRA E. ULBRICH – VICE PRESIDENT
DANIEL VARNER – SECRETARY • RICHARD ZEILE – TREASURER
MICHELLE FECTEAU – NASBE DELEGATE • LUPE RAMOS-MONTIGNY
KATHLEEN N. STRAUS • EILEEN LAPPIN WEISER

608 WEST ALLEGAN STREET • P.O. BOX 30008 • LANSING, MICHIGAN 48909
www.michigan.gov/mde • (517) 373-3324

Section 4(2) of P.A. 436 requires that I provide specific written notification of the Preliminary Review prior to the review taking place; this letter meets that requirement.

Specifically, I am initiating this action based on the following triggers from Section 4(1): "(j) the local government has violated a requirement of Sections 17 to 20 of the Uniform Budgeting and Accounting Act, 1968 P.A. 2, MCL 141.437 to 141.440" and "(n) the local government is in breach of its obligations under a deficit elimination plan or an agreement entered into pursuant to a deficit elimination plan."

To be clear, this is a Preliminary Review at this point. It does not automatically mean that the end result would be for the Governor to declare a financial emergency in the district. The law provides for certain additional steps before that could occur. I must provide a Final Report of the Preliminary Review to the Local Emergency Financial Assistance Loan Board. If a finding of probable financial stress is made by that Board, the Governor shall then appoint a Review Team for the district.

The Review Team will provide a report to the Governor, generally within 60 days of commencing its review. Should both the Review Team and the Governor determine that a financial emergency exists in the Benton Harbor Area Schools, the local board of education would be required to choose one of the following four (4) options provided in law to address the financial emergency:

- 1) Consent Agreement
- 2) Emergency Manager
- 3) Neutral Evaluation Process
- 4) Chapter 9 Bankruptcy

You will be contacted by Carol Wolenberg, Deputy Superintendent, and Dan Hanrahan, Director of the Office of State Aid and School Finance, on Tuesday, March 18, 2014 (NOTE: Wednesday, March 19, can be an alternative date based on your availability), to discuss the P.A. 436 process. The Preliminary Review will officially begin on Monday, March 24, 2014. I would strongly recommend that you meet with your team prior to this contact to determine if any circumstances, such as additional expenditure adjustments, may have changed that would be helpful as we work with you during the Preliminary Review or if a viable DEP can be generated with a timeline that does not go out an additional twelve (12) years or until 2028. State school aid payments will continue through the P.A. 436 determination process.

Leonard Seawood
Martha Momany
Page 3
March 17, 2014

If you have questions, please contact Ms. Wolenberg at 517-241-0062
(wolenbergc@michigan.gov) or Mr. Hanrahan at 517-335-0521
(hanrahand@michigan.gov).

Sincerely,

A handwritten signature in blue ink, appearing to read "Mike Flanagan", with a stylized flourish at the end.

Mike Flanagan
State Superintendent

cc: Kevin Clinton, State Treasurer
Harlan Goodrich, Emergency Financial Assistance Loan Board
Kevin Ivers, Superintendent, Berrien RESA
Carol Wolenberg, Deputy Superintendent, MDE
Dan Hanrahan, Director, Office of State Aid and School Finance, MDE



STATE OF MICHIGAN
DEPARTMENT OF EDUCATION
LANSING

RICK SNYDER
GOVERNOR

MICHAEL P. FLANAGAN
STATE SUPERINTENDENT

March 27, 2014

Leonard Seawood, Superintendent
Benton Harbor Area Schools
636 Pipestone Road
Benton Harbor, MI 49022

Dear Superintendent Seawood:

The purpose of this letter is to follow-up on our telephone conversation of Wednesday, March 19, 2014, pertaining to the initiation of PA 436 (Local Fiscal Stability and Choice Act) with the Benton Harbor Area Schools (BHAS). This action was conveyed to the district in a letter from State Superintendent Mike Flanagan dated March 17, 2014. I would first like to thank you and the key administrators and board members who were on the call as I believe the call was beneficial to all involved. We felt that everyone at the district level had an opportunity to get questions asked and answered and fully understand the impact of this action as well as next steps. Based on that call, we agreed to the following key dates using the timelines prescribed in law:

March 24, 2014	Start PA 436 Preliminary Review
April 11, 2014	Interim Report due to BHAS
April 16, 2014	BHAS response due to MDE
April 22, 2014	Final Report due to the Local Emergency Financial Assistance Loan Board (ELB)

During the call, we also reiterated information that was shared in the March 17, 2014, letter referred to above. That is, this is a Preliminary Review by the State Superintendent at this point. The Final Report of the Preliminary Review will be sent to the ELB stating the facts; it does not contain a recommendation on whether or not the district is in financial stress. The ELB will then determine if the Governor should appoint a Review Team. If a Review Team is appointed, this team will make a recommendation to the Governor regarding whether or not the district is in financial stress. The Governor will make the final determination as to whether or not a financial emergency exists in the district.

STATE BOARD OF EDUCATION

JOHN C. AUSTIN – PRESIDENT • CASANDRA E. ULBRICH – VICE PRESIDENT
DANIEL VARNER – SECRETARY • RICHARD ZEILE – TREASURER
MICHELLE FECTION – NASBE DELEGATE • LUPE RAMOS-MONTIGNY
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Leonard Seawood

March 27, 2014

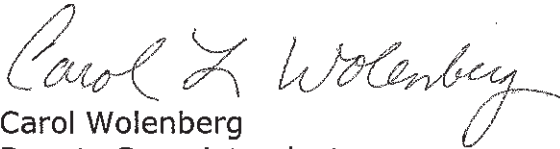
Page 2

A key word in the name of PA 436 is "choice." Should a financial emergency be declared by the Governor, the district and your board of education will have the choice of how to proceed under the four (4) options provided in the Act.

- 1) Consent Agreement
- 2) Emergency Manager
- 3) Neutral Evaluation Process
- 4) Chapter 9 Bankruptcy

As stated in the March 17, 2014 letter, we appreciate the work that has been accomplished by you and the board to begin to rectify the district's financial situation. We look forward to continuing to work collaboratively with you and our colleagues in Treasury toward a solution that eliminates the deficit and continues to serve the best educational needs of the BHAS students. Should you have questions at any time during the PA 436 process, please don't hesitate to us.

Sincerely,



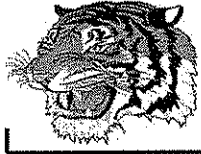
Carol Wolenberg
Deputy Superintendent

Cc: Dan Hanrahan, Director, Office of State Aid and School Finance, MDE
Tom Saxton, Deputy Treasurer

Attachment C

Benton Harbor Area Schools			
Findings	2012-2013		
Financial Statement Findings			
Finding Number	Type of Finding	Program Office	Condition
2013-1	Significant deficiency		Certain general ledger balances were inaccurate at the end of the fiscal year.
2013-2	Material noncompliance with laws and regulations		The Benton Harbor Area Schools' General Fund has been in a deficit fund balance position for seven consecutive years.
Federal Program Findings			
2013-3	Material Weakness and material noncompliance with laws and regulations	Title I	The District requested from the awarding agency, Michigan Department of Education, reimbursement for grant expenditures that were neither incurred nor expended, which resulted in the District receiving funding in excess of its cash needs.

Benton Harbor Area Schools			
Findings	2011-2012		
Financial Statement Findings			
Finding Number	Type of Finding	Program Office	Condition
2012-1	Material Weakness		The District lacks segregation of duties with respect to its cash transfer and journal entry procedures.
2012-2	Material Weakness		General ledger balances were inaccurate during the fiscal year.
2012-3	Material Weakness		Bank reconciliations were not performed properly or timely throughout the year.
2012-4	Material Weakness and material noncompliance with laws and regulations		The Benton Harbor Area Schools' General Fund has been in a deficit fund balance position for six consecutive years.
Federal Program Findings			
2012-5	Material Weakness and material noncompliance with laws and regulations	Title I	One employee charged to Title I refused to sign personnel activity reports, despite supervisory efforts to compel him to do so. Additionally, business office personnel failed to note that an employee who was charged to Title I in 2010-11 should not have been charged to the grant in 2011-12.
2012-6	Material Weakness and material noncompliance with laws and regulations	Safe and Drug-free Tobacco	The District requested from the awarding agency, Michigan Department of Education, reimbursement for grant expenditures that were neither incurred nor expended, which resulted in the District receiving funding in excess of its cash needs.



Benton Harbor Area Schools

Quality Learning For Every Student Every Day

April 16, 2014

Michigan Department of Education
Mike Flanagan, State Superintendent
PO Box 30008
Lansing MI 48909

Dear Mr. Flanagan,

Thank you for the Interim Report – Preliminary Review of Benton Harbor Area Schools and the acknowledgement that the District has made significant progress toward eliminating its current deficit, which began in 2006-2007. The District clearly recognizes that we need the Michigan Department of Education to be a major partner in eliminating the large deficit and enabling the district to reinvest in educating the youth of the Benton Harbor community.

This letter addresses the five-day period for Benton Harbor Area Schools to respond to this report. I understand that the factors included on page 3 were used to evaluate Benton Harbor Area Schools. In the assessment results on page 4, you listed the following as related to Benton Harbor Area Schools:

1. Benton Harbor Area Schools has been in deficit since it ended the 2006-2007 fiscal year with a \$3.0 million deficit. The District projects that the deficit balance for the year ended June 30, 2014 will be \$14.7 million. The District projected that it will emerge from deficit in the 2027-28 fiscal year.
2. Benton Harbor Area Schools' projected June 30, 2014 deficit balance expressed as a percentage of the general fund revenues is projected to be a negative 46%. The percentage far exceeds the Department's parameter of a negative 15% to indicate concern.
3. The District's privately audited financial report for the year ended June 30, 2013, included three findings of material weaknesses, significant deficiencies, or non-compliance. The District's June 30, 2012 audit included six findings of material weaknesses, significant deficiencies, or non-compliance.
4. Benton Harbor Area Schools has shown unsatisfactory progress in eliminating the deficit. The deficit increased from \$3.0 million on June 30, 2007 to \$15.5 million on June 30, 2013. Additionally, the District requires an additional 12 years beyond the DEP that had been previously approved by the Department to eliminate the deficit.
5. The District has not failed to comply with bond or note covenants, failed to make pension fund deposits, failed to make payroll, and/or closed school prior to the end of the school year. The Department has not been notified that the District is delinquent in its payments to the Michigan Public School Employees Retirement System (MPSERS).

I would like to respond to some points included in the Interim Report. Under additional factors noted on pages 4-5, item #2 addressed cash flow and emergency loans of the District. Benton Harbor Area Schools' original emergency loan need was identified as \$6 million in 2012 based upon the economic and budgetary situation of the District. The District anticipated receiving the full loan amount with a significantly longer payback period, as was granted to other school districts. However, the District received \$4 million with overlapping 4- and 5-year payback cycles which severely limited the District's cash flow and impacted the overall recovery plan of the District.

Under additional factors noted on pages 4-5, item #3 stated that "The District also participates 100% in the no-set aside pool, which means the only payment made on the short-term note is the final balloon payment at maturity." This is incorrect as Benton Harbor Area Schools has three set-aside payments of more than \$550,000 per month beginning in May 2014. This will negatively impact the District's immediate cash flow and its ability to stay current with payroll and vendors. This issue will need immediate attention before the final review process is complete.

In response to the assessment results, the 2011-2012 and 2012-2013 audit findings have been addressed. Since my arrival in fall 2010, the District has undergone significant change including:

- six building closures
- staff layoffs
- administrator reductions
- sale of vacant buildings
- insurance benefit reductions
- 10% cut in pay across the board
- outsourcing of all non-instructional services

To address additional District cutbacks, I have secured in excess of \$1 million of private dollars to fund a portion of basic materials/supplies, professional development and enrollment management services. These cuts, along with additional private funds, have not been enough to eliminate the deficit and have actually resulted in some negative financial consequences offsetting the cost savings realized. High caliber teachers have left the District to take higher paying jobs in other school systems, resulting in the District hiring less experienced teachers or utilizing substitute teachers to teach a high number of students with low academic achievement. Students are seeing programs cut and good teachers leaving the District which has resulted in a decline in enrollment and less state aid, negatively impacting the financial condition of Benton Harbor Area Schools.

Based on strategic actions taken since 2010 and the current financial state of the District, it is clear that financial stress is evident. I look forward to partnering with the Michigan Department of Education to provide the necessary guidance and direction to allow Benton Harbor Area Schools to move forward as we strive to reinvest in the classroom as well as attract and retain experienced teachers to educate our students.

Sincerely,



Dr. Leonard Seawood, Superintendent

cc: Dan Hanrahan, Director, State and School Finance
Senator John Proos, 21st District
Martha Momany, BHAS Board of Education
Sharon James, BHAS Board of Education
Lue Buchana, BHAS Board of Education
Angelika MacGowan, BHAS Board of Education
Rhonda Hildebrand, Plante Moran

Carol Wolenberg, Deputy Superintendent
Representative Al Pscholka, 79th District
Willie Lark, BHAS Board of Education
Joseph Taylor, BHAS Board of Education
Lisa Gulley, BHAS Board of Education
Jeff Egberts, Plante Moran
Kevin Ivers, Berrien-RESA