

Legislative Analysis



FINANCIALLY DISTRESSED SCHOOL DISTRICTS

Phone: (517) 373-8080
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House Bill 4325 as introduced
House Bill 4326 as introduced
Sponsor: Rep. Earl Poleski

Analysis available at
<http://www.legislature.mi.gov>

House Bill 4327 as introduced
Sponsor: Rep. Al Pscholka

House Bill 4329 as introduced
Sponsor: Rep. Pat Somerville

House Bill 4328 as introduced
Sponsor: Rep. Lisa Posthumus Lyons

House Bill 4330 as introduced
Sponsor: Rep. Tim Kelly

Committee: Financial Liability Reform
Complete to 3-16-15

SUMMARY:

The package of bills would amend the Revised School Code (MCL 380.1 – 380.1852), the State School Aid Act (MCL 388.1601 – 388.1702) and the Local Financial Stability and Choice Act (MCL 141.1541 – 141.1575) to provide the Department of Education (MDE) and Treasury with earlier financial information with which to do the following:

- Identify potential fiscal stress in school districts, Intermediate School Districts (ISDs), and Public School Academies (PSAs).
- Require additional financial reporting by districts, ISDs, and PSAs.
- Revise the existing Deficit Elimination Plan (DEP) requirements.
- Create an Enhanced Deficit Elimination Plan (EDEP).
- Revise the authority provided to MDE and Treasury to withhold state school aid payments.
- Create an additional trigger under which the Treasurer can determine the existence of probable financial stress for a district with a deficit elimination plan, which then triggers the appointment of a financial review team.
- Create an additional trigger under which the Treasurer can declare a financial emergency and recommend the appointment of an emergency manager.

A more detailed summary of each bill follows.

House Bill 4325

HB 4325 would amend the Revised School Code to add Section 1219 to require districts, ISDs, and PSAs to report budgetary assumptions; to define the conditions under which Treasury may require a district, ISD, or PSA to submit periodic financial status reports; and to create a workgroup to create recommendations for an information system or processes to provide earlier access to financial information that would allow districts, ISDs, and PSAs to address budgetary and financial difficulties earlier.

Budgetary Assumptions

Under HB 4325, by July 7 of each school fiscal year, each district and PSA shall transmit its budgetary assumptions to the Center for Educational Performance and Information (CEPI). The budgetary assumptions would have to include the following:

- The projected foundation allowance used by a district's or PSA's governing body in adopting its budget for the current fiscal year and an indication of whether the projected foundation allowance is an increase, a decrease, or the same as the previous fiscal year.
- The projected pupil membership used by a district's or PSA's governing body in adopting its budget for the current fiscal year and an indication of whether the projected pupil membership is an increase, a decrease, or the same as the previous fiscal year.
- The expenditures per pupil from the immediately preceding fiscal year.
- The projected expenditures per pupil for the current fiscal year calculated by dividing the total general fund operating expenditures approved in the budget by the projected pupil membership.

Under the bill, by July 21 of each year, CEPI would prepare and transmit to each ISD or PSA authorizer in the state a summary of the budgetary assumptions for each district located in an ISD or each PSA authorized by the authorizer. CEPI also would have to transmit the summaries to the State Superintendent and the Treasurer.

By July 28 of each year, each ISD superintendent and PSA authorizer would have to review the assumptions made by each of their districts or PSAs and report to CEPI whether they concur with those assumptions.

By August 10 of each year, CEPI would have to prepare and transmit to the state Superintendent and Treasurer a final summary of budgetary assumptions for each ISD and PSA authorizer along with any changes or concurrence reported by an ISD or PSA authorizer.

By August 20 of each year, the Treasurer would have to review each final summary of budgetary assumptions. If the Treasurer concurs with an ISD or PSA authorizer that an assumption is unreasonable, or if the Treasurer does not concur with an ISD or PSA authorizer that an assumption is reasonable, then the Treasurer shall notify the district or PSA by August 20. Once notified, a district or PSA must post a notice on its website's main page indicating that it has adopted a budget that relies upon unreasonable budgetary assumptions, and that notice would have to remain there until either the end of the fiscal year or until the adoption of an amended budget based on assumptions that the ISD or PSA authorizer and the Treasurer determine are reasonable.

Fiscal Stress, Deficit, or Potential Financial Emergency

Under HB 4325, if a district, ISD, or PSA determines that it may be facing fiscal stress, a deficit, or potential financial emergency, it shall notify the State Superintendent and request technical assistance from the state. After consultation and review by MDE and Treasury within 45 days, and subject to available resources, Treasury would have to provide

technical assistance including data analysis tools to assist the district, ISD, or PSA in avoiding fiscal stress, deficit, or financial emergency.

[For the purposes of this section, the bill defines "fiscal stress" as a situation in which either a district, ISD, or PSA is unable to meet short- or long-term financial obligations or one or more of the conditions described in Section 4 of the Local Financial Stability and Choice Act exist or are likely to occur. The bill defines "financial emergency" as a situation in which one or more of the conditions described in Section 5 of the Local Financial Stability and Choice Act exist or are likely to occur in the current or next fiscal year and threaten the ability to provide necessary governmental services.]

The bill would allow the State Superintendent or Treasurer to require a district, ISD, or PSA to submit periodic financial status reports if either determines any of the following:

- Potential financial stress may exist in the district, ISD, or PSA.
- A deficit is projected during the current or following two fiscal years.
- The district, ISD, or PSA is unable to meet its financial obligations while also satisfying its obligations or abilities to provide public education services as required by the State School Aid Act.

This determination would be based on financial information provided to the state either in general, related to a request to issue debt, or provided by a district's ISD or a PSA's authorizer; financial information in audited financial statements or the district's budget; enrollment data including non-resident pupils enrolled in the district and resident pupils enrolled in other districts; and budgetary assumptions with which a district's ISD or PSA's authorizing body did not concur.

Periodic Financial Status Reports

HB 4325 would require the State Superintendent or Treasurer to notify a district and its ISD or a PSA and its authorizer not less than 14 days before determining that potential financial stress may exist. After determining that potential financial stress exists, the State Superintendent or Treasurer may require the district to submit periodic financial status reports if a district, ISD, or PSA does any of the following:

- Fails to make a payment to the Michigan Public School Employees Retirement System (MPSERS) or the Michigan Unemployment Insurance Agency.
- Fails to timely transmit employee income tax withholding to Treasury.
- Is more than 90 days in arrears on a payment owed to a vendor.
- Expends, deposits, transfers, distributes, or refunds tax revenue in an unauthorized manner or contrary to state law.
- Fails to pay employees within the time period required by law.
- Fails to comply with the Uniform Budgeting and Accounting Act.
- Has a general fund balance as a percent of current operating expenditures that has declined by five percentage points or more over three consecutive fiscal years.
- Has expenditures per pupil that have increased by five percent or more compared to the previous fiscal year.
- Has a pupil enrollment that has declined by five percent or more in a single year or 15 percent or more over three years and fails to reduce expenditures accordingly.

- Has had a request for determination submitted to the State Superintendent or Treasurer by its board.
- Is likely to have a deficit in the current or next fiscal year and does not take action to prevent the deficit.
- Applies for a loan under the Emergency Municipal Loan Act.
- Has a budget in place based on budgetary assumptions with which the ISD or authorizer did not concur.

HB 4325 would allow Treasury, in consultation with MDE, CEPI, and school administration organizations to determine the timing, form, and manner of the periodic financial reports and the information required within reports. If a district, ISD, or PSA fails to submit periodic financial reports or if Treasury determines that the report indicates that financial stress exists or that the district, ISD, or PSA will have a deficit in the current or next fiscal year for which it lacks the capacity to address without state assistance, the Treasurer may require the district, ISD, or PSA to submit an EDEP (see SB 4327).

A district, ISD, or PSA that must submit a DEP or EDEP would not have to submit periodic financial status reports. A district that receives a loan under the Emergency Municipal Loan Act would have to submit periodic financial reports for at least four years following the issuance of the loan. A district, ISD, or PSA would be required to file periodic financial reports until Treasury determines that potential financial stress no longer exists; that the district, ISD, or PSA is not likely to have a deficit within the current or following two fiscal years; and that it will be able to meet its financial obligations while meeting its obligations to provide public education in compliance with the State School Aid Act and applicable rules promulgated by MDE.

Joint Workgroup

HB 4325 requires that within 60 days of enactment, the State Superintendent and Treasurer must convene a joint workgroup to assist MDE and Treasury in developing recommendations for the creation of an information system or processes to provide earlier access to financial information that would allow districts, ISDs, and PSAs to address budgetary and financial difficulties earlier. The bill requires the workgroup's recommendations to address the following:

- Creating an information system that uses and expands upon existing data collection processes and requirements that provides more timely access and analysis of data at the state level while also promoting local and regional collaboration.
- Allowing the uploading of school budget and current year-to-date financial information on a periodic basis through the Financial Information Database maintained by CEPI.
- Permitting the upload of year-to-date expenditure data on at least a quarterly basis.
- Providing MDE and Treasury with access to data through the information system.
- Reducing or consolidating reporting requirements.
- Estimating the cost of the information system.

The bill also requires the workgroup to make recommendations on statutory changes related to periodic financial status reports, DEPs, and EDEPs including new data analysis tools and changes to warning signs, data needs, and proper timing.

The workgroup would have to include representatives from MDE, Treasury, the Department of Technology, Management and Budget, CEPI, districts, ISDs, PSAs, authorizers, school business officials and certified public accountants. The workgroup would have to complete its work by September 30, 2015. The State Superintendent and Treasurer would have to submit joint recommendations by December 31, 2015, to the Governor, Senate and House standing committees on Education, and Senate and House Appropriations Subcommittees on School Aid.

House Bill 4326

HB 4326 would amend the Local Financial Stability and Choice Act to provide that the state financial authority for a school district with a deficit elimination plan would be the State Treasurer rather than the State Superintendent.

The bill would also require a district's state financial authority to conduct a preliminary review to determine the existence of probable financial stress within a district if either of the following occur:

- The district has a DEP and the Treasurer determines the district has failed to submit or comply with the requirements of the DEP.
- The district has a DEP that provides for the elimination of its deficit over a period exceeding five years.

The bill would provide that if the state financial authority conducts a preliminary review and the final report confirms the existence of either of the factors described above, the confirmation is prima facie evidence that probable financial stress exists for the district.

House Bill 4327

HB 4327 would create Section 1220 of the Revised School Code to shift and expand the requirements related to deficit elimination plans from Section 102 of the School Aid Act to the Revised School Code and to create and require enhanced deficit elimination plans under certain circumstances.

Deficit Elimination Plans (DEPs)

HB 4327 would shift the prohibition on a district, ISD, or PSA from adopting or operating under a deficit budget or incurring an operating deficit from the State School Aid Act to the Revised School Code. It also would shift the requirement that a district, ISD, or PSA with a deficit submit a DEP and, once approved, post its DEP on its website. The bill would expand the current DEP process to do the following:

- Require a district, ISD, or PSA, immediately upon occurrence of the deficit, to notify the State Superintendent and the Treasurer of the deficit, and to provide a copy of the notice to a district's ISD or a PSA's authorizer.
- Require a district, ISD, or PSA, within 30 days of the initial notice, to submit a preplan financial report, as prescribed by the Treasury, and submit the report to the

State Superintendent and the Treasurer. Under the bill, a preplan financial report would include, but not be limited to, financial data and other information on liabilities, payments, enrollment, borrowing, and other criteria related to the financial conditions of the district, ISD, or PSA.

- Require a district, ISD, or PSA, within 90 days of the initial notification, to submit an amended budget for the current school fiscal year and a DEP to the State Superintendent, the Treasurer, a district's ISD, and a PSA's authorizer.
- Allow MDE to withhold and release state school aid payments as provided under Section 102 of the School Aid Act.
- Allow the State Superintendent to require that a DEP include an academic plan.
- Requires a district, ISD, or PSA to post its DEP on its website after approval by the State Superintendent.

HB 4327 also would shift from Section 102 of the School Aid Act, a requirement that MDE report to the Legislature, both quarterly and annually, a list of districts with deficits and their progress in eliminating their deficits, as well as the requirement that the State Superintendent present the results quarterly to the House and Senate Appropriation Subcommittees on School Aid. The bill also would shift from Section 102 of the School Aid Act, a requirement that districts, ISDs, or PSAs that have a DEP, submit monthly monitoring reports on revenues and expenditures but would direct the reports to the State Superintendent, the Treasurer, a district's ISD, and a PSA's authorizer. It would also allow a district to contract with its ISD or another entity to provide the monthly monitoring report.

HB 4327 would require the State Superintendent to establish a time period within which a deficit must be eliminated and would allow the State Superintendent to set special conditions a district, ISD, or PSA must meet while the deficit elimination plan is in effect. HB 4327 would require MDE, when administering a DEP, to consult with Treasury; the district, ISD, or PSA in question; a district's ISD; and a PSA's authorizer. Finally, a DEP would no longer apply if a district, ISD, or PSA is required to submit an EDEP.

Enhanced Deficit Elimination Plans (EDEP)

HB 4327 would *allow* the Treasurer to require a district, ISD, or PSA to submit an EDEP if the Treasurer determines – based on periodic financial status reports proposed under HB 4325, preplan financial reports proposed under HB 4327, a DEP, or a request from the State Superintendent – that any of the following circumstances exist:

- Rapidly deteriorating financial circumstances.
- Persistently declining enrollment.
- Other indicators of financial stress likely to result in recurring operating deficits or recurring financial stress within a district.

The EDEP would have to address the above circumstances and would be subject to the approval of the Treasurer. The Treasurer could require a district, ISD, or PSA to enter into a Financial Recovery Agreement, which may include, but would not be limited to, all of the following:

- Assistance and guidance from Treasury and other state departments and agencies.
- A financial operating plan.

- The appointment of a local auditor or inspector, or both.
- Remedial measures or other action necessary to address financial circumstances.
- The retention of a consultant or one or more other experts for the purpose of achieving the goals and objectives of the financial recovery agreement.

Under HB 4327, once an EDEP has been deemed necessary, a district, ISD, or PSA must submit and have the plan approved by its board. The bill would allow the Treasurer to establish a time period for the elimination of the deficit and set special conditions a district, ISD, or PSA must meet while the EDEP is in effect. The Treasurer could withhold some or all of a district's, ISD's, or PSA's state school aid payments and could release funds as provided under Section 102 of the State School Aid Act.

HB 4327 would require Treasury, when administering an EDEP, to consult with MDE; the district, ISD, or PSA in question; a district's ISD; and a PSA's authorizer. The bill would require a district, ISD, or PSA to post its EDEP on its website after approval by the Treasurer.

HB 4327 would require a district, ISD, or PSA that has an EDEP to submit to the Treasurer and State Superintendent and post on its website an enhanced monthly monitoring report on revenue, expenditures, cash flow, debt, other liabilities, assets, budget amendments, pupil membership, and other data relating to school finances as prescribed by Treasury.

House Bill 4328

HB 4328 would amend Section 102 of the State School Aid Act, which currently prohibits a district, ISD, or PSA from adopting or operating under a deficit budget and provides for the existing DEP requirements and process. The bill would limit the purview of Section 102 to MDE and Treasury's authority to withhold state school aid payments from a district, ISD, or PSA that is required to submit a DEP or EDEP under the proposed Section 1220 of the Revised School Code per SB 952.

HB 4328 would delete the prohibition on district deficits and the requirement for DEPs, which would shift to the Revised School Code under SB 952. The bill would retain the authority for MDE to withhold state school aid payments to a district, ISD, or PSA until it submits and MDE has approved its DEP.

HB 4328 would add authority for both MDE and Treasury to withhold a portion or all of state school aid payments to a district, ISD, or PSA with an EDEP in an amount the Treasurer determines necessary to incentivize a district, ISD, or PSA to eliminate its deficit until it submits, and Treasury has approved, its EDEP.

House Bill 4329

HB 4329 would amend the Local Financial Stability and Choice Act to allow the Treasurer to declare a financial emergency and recommend that the Governor appoint an emergency manager within a school district if the Treasurer determines that the district has failed to submit or comply with an EDEP.

[For the purposes of the Local Financial Stability and Choice Act, "school district" means either a district or an ISD. Currently under the Local Financial Stability and Choice Act, upon confirmation of a finding of financial emergency under a process defined in that act, a district or ISD may choose from four options: a consent agreement, an emergency manager, a neutral evaluation process, or chapter 9 bankruptcy.]

House Bill 4330

HB 4330 would amend Sections 17a and 18 of the State School Aid Act to expand the conditions under which MDE and the Treasurer may withhold a district's or ISD's state school aid payments. (For the purposes of the State School Aid Act, district also means a PSA.)

Section 17a currently allows MDE or the Treasurer to withhold a district's or ISD's state school aid payments if required to repay funds borrowed under the Revised Municipal Finance Act; the Emergency Municipal Loan Act; the Local Financial Stability and Choice Act; and the School Bond Qualification, Approval, and Loan Act.

The bill would add to that list, withholding state school aid payments for the repayment of funds borrowed under Section 1356 of the Revised School Code, which allows a district with a deficit that exceeds \$100 per pupil to borrow in order to fund an operating deficit.

Section 18 currently establishes the allowable uses for funds received by a district or ISD under the State School Aid Act and establishes the requirements for annual audits, submission of financial data, and the publication of budgets and other financial information on a district's or ISD's website.

HB 4330 would amend Section 18 to do the following:

- Require that a district or ISD adopt an annual budget that complies with the Uniform Budgeting and Accounting Act.
- Delay the date by which a district or ISD must submit to MDE its financial information for the prior fiscal year from October 15 to November 1. (Sec. 18 has since been amended to do this in PA 5 of 2015, House Bill 4110.)
- Allow MDE to withhold up to 10% of a district's or ISD's total state school aid if a district or ISD adopts a budget not in compliance with the Uniform Budgeting and Accounting Act or fails to post its budget and other financial on its website, as required under this section. A district or ISD would forfeit the amount withheld if not in compliance by the end of the fiscal year.

Finally, the bill would make the receipt of a district's or ISD's state school aid payments contingent upon its compliance with both Sections 17a and 18.

FISCAL IMPACT:

The bills would have an indeterminate fiscal impact on the state and districts, ISDs, and PSAs, as described below.

State Impact

The bills would increase administrative costs for MDE, Treasury and CEPI (which is in the Department of Technology, Management and Budget) by increasing the volume of school financial data and reports they receive and monitor, including budgetary assumptions information, periodic financial status reports, and enhanced deficit elimination plans. Additionally, HB 4325 would require Treasury to provide technical assistance, subject to availability of funding, to districts, ISDs, and PSAs facing fiscal stress, a deficit, or potential financial emergency.

The FY 2014-15 budget for MDE originally included \$778,100 and 4.0 full-time-equivalent (FTE) positions to recognize its additional responsibilities under the package; however, PA 6 of 2015 reduced that funding by 50% to \$389,000 as a one-time reduction to help solve a state General Fund shortfall. (The Executive budget restores full funding for FY 2015-16.)

The FY 2014-15 budget for Treasury included \$4.5 million and 9.0 FTE positions in preparation for its increased responsibilities; however, PA 6 of 2015 reduced that funding by 50% to \$2.25 million as a one-time reduction to help solve a state General Fund shortfall. (The Executive budget restores most of funding for FY 2015-16, bringing the total to \$4.0 million.) Some of the funds appropriated to Treasury would be used to contract for private services to provide the required technical assistance to districts, ISDs, and PSAs under fiscal stress, including assistance with improving cash flow, managing debt and retirement liabilities, reviewing and negotiating collective bargaining agreements, forensic auditing, and real estate services.

Local Impact

Additionally, the bills would create increased administrative costs for districts, ISDs, and PSAs by requiring the submission of additional school financial data/reports, as well as additional auditing, which would likely require increased staff. However, the magnitude is unknown because Treasury would have discretion over who must report and how often.

The bills also could affect a district's, ISD's, or PSA's receipt of state school aid by expanding the circumstances under which MDE or Treasury may withhold its payments.

Finally, HB 4326 and 4329 would expand Treasury's authority (1) to establish probable financial stress for a district or ISD with a DEP, thus triggering a financial review team, and (2) to declare a financial emergency and recommend an emergency manager for a district or ISD if it fails to submit or comply with an EDEP, thus potentially shifting control of a district's or ISD's operations and finances from the local board to the state.

TIE-BARS:

The bills in this package, along with HBs 4331 and 4332, which are summarized in a separate document, are tie-barred as described in the table below. A bill does not go into effect unless each of the bills to which it is tie-barred is enacted.

Bill	Direct Tie-Bars	Indirect Tie-Bars
4325	4327,4328,4330	N/A
4326	N/A	N/A
4327	4325,4328,4330	N/A
4328	4325,4328,4330	N/A
4329	4327,4331	4325,4328,4330
4330	4325,4327,4328	
4331	4325,4326	4327,4328,4330
4332	N/A	N/A

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