House
Legislative
Analysis
Section

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SCHOOL DISTRICT FINANCIAL EMERGENCIES

Senate Bill 175 (Substitute H-1)
First Analysis (10-9-89)

Sponsor: Sen. Dan L. DeGrow Senate Committee: Education & Mental Health
House Committee: Education

THE APPARENT PROBLEM:

The Local Government Fiscal Responsibility Act was enacted in 1988 to help the state identify and react to local governments' fiscal problems by allowing it to impose various remedial measures depending on the depth of a municipality's problem. Many people now believe a similar measure should be approved to deal with financially troubled school districts. The Select Panel on the Detroit Public Schools (DPS), appointed in 1988, recommended that similar measures could help correct a consistent pattern of fiscal year deficits in Detroit's public schools that date back to the early 1970's. Reportedly, the district's deficit reached $82.9 million for fiscal year 1987 and $101.6 million for 1988, while the estimated deficit for the fiscal year ending June 30, 1989 reportedly will be over $150 million. (See BACKGROUND INFORMATION)

While the Detroit district has the largest and most widely publicized deficit, it certainly is not the only state school district suffering a fiscal crisis. According to one Department of Education (DOE) report, 28 school districts — including one intermediate school district — reported deficits for the 1989 fiscal year. The state superintendent of public instruction recently reported that, although it took Detroit's schools 11 years to accumulate a deficit of about 19 percent of its operating expenses, another district achieved the same dubious result in just one year. Although the state can take actions to deal with school districts reporting deficits, the most extreme being to reduce or withhold state school aid payments, less drastic, intermediary remedies are not available. Further, though districts can help alleviate a deficit with voter approval of millage increases or bond issues, many people feel reliance on successive deficit elimination bond issues amounts to poor fiscal and public policy. For these reasons, some people feel the state should be allowed to intervene in the fiscal problems of school districts.

THE CONTENT OF THE BILL:

The bill would repeal the local government fiscal responsibility act and re-enact it under the same name, containing virtually identical language for local governmental units but adding similar provisions for school districts. The state would work according to the following procedure to intervene in a local school district's fiscal affairs.

- The superintendent of public instruction could determine a school district had a serious financial problem if any of ten specified conditions existed. These conditions include, among others: ending the most recent school fiscal year with a deficit without having a deficit elimination plan in place three months before the district's annual financial statement was due; the school district board adopting a resolution declaring a financial emergency; submission of a petition containing specific allegations of financial problems, signed by a specific number of registered electors within the district, to the state superintendent; a written request by a creditor of the district for a finding of financial difficulty (this request could be honored only if certain other conditions existed); indication by a trustee, paying agent, note or bondholder, to the superintendent that bond or note covenants were being violated; a request by the Senate or House of Representatives for a review of a district's financial state, by resolution; violation by the district of the conditions of an order under the Municipal Finance Act, failure to comply with certain requirements in the Uniform Budgeting and Accounting Act, or failure to provide a required annual financial report or audit; or an additional court-ordered tax levy without prior approval of a school district's board. The superintendent of public instruction, upon determining a financial problem existed, would notify the governor and the state board of education of this and the basis for and findings which support this determination.

- The governor would appoint a review team composed of the superintendent of public instruction, the state treasurer, the Department of Management and Budget director, a nominee of the Senate majority leader, and a nominee of the Speaker of the House of Representatives to review a district's financial condition if any of the following occurred: the superintendent of public instruction determined that a serious financial problem existed; the district was defaulting on paying principal or interest on of its obligations, or failed to pay its employees within 5 days of any regularly scheduled payday; the district failed to contribute to a pension, retirement, or benefit plan as required by state law; the district did not comply with an approved deficit elimination plan's terms; or the state treasurer notified the governor that the review team should be appointed to protect either the school district's or the state's credit rating, or both.

- The review team would undertake a preliminary school district review and report to the governor on whether certain specified events had occurred or were likely to occur without state action, and would be required to reach one of the following conclusions: 1) a serious financial problem did not exist; 2) a problem existed but a consent agreement had been signed by the school district's superintendent providing for certain actions to be taken to address the problem; or 3) a school district financial emergency existed because no satisfactory plan existed to resolve the serious financial problem. The review team would have full power to examine the district's books and records, utilize the services of state agencies and employees and employ professionals necessary to help it fulfill its duties, and sign a consent agreement providing for a long-range financial recovery plan requiring specific school district actions, including periodic fiscal status reports, and for state financial management and technical assistance as needed. Before the agreement took effect, the school board, by a majority vote of its members, would have to approve the agreement. The review team would have 30 days to report

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to the governor after its appointment, or earlier if required by the governor. The governor could, if requested, grant one 60-day extension to this deadline. Copies of the report would also be sent to the superintendent of public instruction, the school district's board, the Senate majority leader, and the Speaker of the House of Representatives.

- The governor would make a determination within 30 days after receiving the report, either agreeing or disagreeing with the review team's conclusions. If the governor agreed a financial emergency existed, he or she would provide the school district's board with written notification of the determination along with supporting evidence. The school board would have ten days to request a hearing conducted by the governor's office. If no hearing were requested or if the deadline passed for requesting a hearing, the governor would have to confirm or revoke the determination. Upon confirmation of the determination, the governor would notify the board in writing of evidence which confirms this determination and an explicit statement supporting the determination. If, at any time the superintendent of public instruction informed the governor and the state board that a school district was not abiding by a consent agreement, the governor would have to determine the district had a financial emergency.

- Upon the governor's determination that a school district financial emergency existed, he or she would request the state board to submit within 30 days the names of three nominees to serve as the school district's emergency financial manager. Upon advice and consent from the Senate, the governor would appoint one of these nominees as the district's emergency financial manager to serve at his or her pleasure. The manager would be chosen solely on the basis of his or her competence in fiscal matters, could not have been either an elected or appointed official, or employee, of the district for at least five years prior to the appointment, could not be the superintendent of public instruction, and would not have to be a school district resident.

- An emergency financial manager would be reimbursed for expenses from the Department of Education, and could, with the state superintendent's approval, appoint additional staff and secure professional assistance considered necessary. The emergency manager would issue to appropriate district officials or employees orders he or she deemed necessary to accomplish the bill's purposes, including orders to implement a financial plan in a timely manner. An order would be binding on district officials or employees. In consultation with the school board, the emergency manager would develop a written financial plan to help the district conduct its operations within available resources (according to the manager's revenue estimate), and fully pay its scheduled debt service requirements on all bonds, notes, and other legal obligations. After initially developing the plan, the manager would regularly re-examine the plan with the school board. If his or her revenue estimates changed, the manager would modify the plan accordingly. The plan would be in a form specified by the manager, contain information for the year it was effective, and would be made public. The manager, however, would not need public approval to implement or modify the plan.

- After his or her appointment, an emergency manager would assume control over all school district fiscal matters, and make all of its fiscal decisions. A manager could: examine the district's books and records; review payrolls or claims against it; negotiate, renegotiate, approve, and enter into contracts on the district's behalf; receive and disburse on its behalf all federal, state, and local earmarked funds, including those for specific programs and debt retirement; adopt a final budget for the next school fiscal year and amend any adopted budget; act as an agent for the district in collective bargaining, as permitted under state labor laws, and negotiate new labor agreements; analyze factors contributing to the district's financial condition and make recommendations to the legislature; require compliance with his or her orders, by court action if necessary; require the attendance of witnesses and the production of documents relevant to analyze the district's financial state; recommend to the governor, the legislature, and the state board of education that the district be reorganized with one or more contiguous districts; consolidate divisions or transfer functions from one division to another within the district and appoint, supervise, and, at his or her discretion, remove district division heads; create a new position or approve or disapprove the creation of any new position or the filling of any vacancy in a permanent position by any appointing authority; seek approval from the state board for a reduced class schedule in accordance with administrative rules governing state school aid; employ or contract for, at the district's expense and with state superintendent approval, auditors and other technical personnel considered necessary to implement the bill's provisions; reduce district budget expenditures; borrow money on the district's behalf; approve or disapprove the issuance of obligations of the district; order one or more school millage elections for the district; sell or otherwise use district assets to meet past or current obligations, provided this use did not impair education in the district; exercise authority and responsibilities affecting the district's financial condition prescribed by law to the school board and the district superintendent; and file for bankruptcy under Chapter 9 of Title 11 of the U.S. Code (which applies to municipal debts).

- The state superintendent, education department, school board of a district with a financial emergency, and its employees and administrators would provide assistance and information deemed necessary and requested by the emergency manager in effectuating his or her powers and duties under the bill. The school board would have to comply with orders issued by the manager and could take actions necessary to comply with the bill or as prescribed by the review team, the state superintendent, or the emergency manager in implementing the bill's provisions. The state, state superintendent, and an emergency financial manager would not be liable for any obligation of or claim against a school district resulting from actions taken according to the bill.

- A school district could appeal the determination of a financial emergency in the Ingham County Circuit Court or the circuit court for a county in which the district was located. The court could not set aside a determination unless it found the determination could not be supported by competent evidence or was arbitrary, capricious, or clearly an abuse or unwarranted exercise of discretion. After receiving the emergency financial manager's recommendation, the governor could determine and certify that conditions for revoking the declaration of a financial emergency were met. The manager could condition the recommendation upon the school board's adoption of a resolution that would ensure the adoption of a balanced budget, elimination of any remaining accumulated deficit, and prevention of additional negative fund balances.

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BACKGROUND INFORMATION:

In June 1988, at the state board's suggestion, the interim superintendent of public instruction appointed a five-member panel to investigate matters related to the Detroit Public School District's deficit and to formulate recommendations for improved fiscal performance. Among the questions the select panel was charged with answering were: How large is the deficit? How can it be eliminated? How can future deficit spending be eliminated? What are the deficit's implications to educational quality and student performance?

The select panel issued its report in December, 1988 with the following recommendations, supported by the state board:

- The Detroit district should adopt specific and measurable quality education goals, and should allocate its resources to achieve these goals.

- The superintendent of public instruction should annually report to the public regarding the district's progress toward achieving quality education goals.

- The state board should revise the Michigan School Accounting Manual to conform with generally accepted accounting principles (reportedly, a revised manual has been adopted).

- The district and the state should jointly fund an operations improvement and restructuring project to reduce annual operating costs by $50 million, prioritize resources allocation, improve the district's financial management, and provide training in financial decision-making to key managers and school board members.

- The state board should identify a first class school district's incremental costs and recommend state funding of these costs. Any state aid increase in incremental costs should be tied directly to implementation of recommendations made by the operations improvement and restructuring project.

- The Detroit board should develop by January 1, 1989 a balanced budget for fiscal year 1989-90 following the timeline and procedures outlined by the select panel's draft legislation. The state superintendent should determine by March 1, 1989 whether the proposed budget was in balance.

- The legislature should revise the Detroit district's budget process and budgeting cycle to assure balanced budgets, and should provide for the creation of a public school emergency financial director who would oversee financial management and ensure fiscal accountability in the district.

- Detroit school voters should approve an operating millage increase and a deficit elimination bond issue. (Although Detroit voters rejected a six-mill property tax increase and a $160 million deficit elimination bond issue in 1988, they consequently approved a five-mill operations increase, and 1.5 mills for deficit reduction bonds, in September 1989.)

HOUSE COMMITTEE ACTION:

The House Education Committee adopted a substitute for the bill which specifies that the Department of Education would reimburse a school district's emergency financial manager for his or her necessary expenses. (This would also apply to emergency managers for local governments, who, under the Senate- passed version and the current fiscal responsibility act, are compensated by the local government.) Under the Senate-passed version, a school district emergency financial manager would be reimbursed directly by the school district and the amount of this compensation would be deducted from state aid payments to that district. This provision was deleted from H-1.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, Substitute H-1 would increase state expenditures since the state would have to reimburse both school districts and local governments who had emergency financial managers appointed for them, although the number that would be appointed under the bill could not be estimated. (10-9-89) According to the Senate Fiscal Agency (SFA), each manager would cost $100,000. The SFA said the bill as passed by the Senate (in which state-mandated costs would apply only to school district financial managers) would cost the state approximately $400,000 over three years. This figure is based on a Department of Education report which indicates four school districts could fall under the bill's provisions. (8-16-89)

ARGUMENTS:

For:

The bill would put in place a workable "early warning system" to enable the state to become aware of a school district's financial problems and intervene effectively when necessary. The state's ability to become involved in a school district's fiscal matters today depends on a patchwork of laws. A single, comprehensive statute — like that found in the Local Government Fiscal Responsibility Act enacted last year — is needed to clearly spell out the powers of various state agencies and officials. The bill contains significant flexibility: local schools' fiscal problems could be dealt with informally through discussions with the state superintendent or, in the most drastic cases, a financial control manager could be appointed with broad powers over a school's fiscal management. One intermediate step would involve the use of a review team to examine a school's finances with the power to enter into a consent agreement addressing the problems. A process would be established that at each step provides warning signs to instigate investigations and checks to guard against unwarranted or excessive interventions. Once in place, this process should help the state avoid the frustration of having to deal with school districts' fiscal crises after the fact and with few options.

For:

The bill would permit major creditors, voters, school employees, and pensioners to demand a review of a school's finances. These people have legitimate interests in the proper fiscal management of a local school and as such deserve corresponding rights to protect those interests. Since the effect on a community could be severe, it is unlikely these interested parties would intervene frivolously. Further, the bill specifies that requests for fiscal reviews by these parties could only be granted if certain specific conditions existed.

Response: On the contrary, the bill would limit public input, especially once an emergency financial manager was appointed. Unlike elected public officials of a local school board, an emergency manager would have no accountability to taxpayers, teachers, or students. While a

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review team presumably would be subject to the Open Meetings Act (as is a review team appointed for a municipality), once a manager was appointed no forum would exist where members of the public could voice their concerns or even observe the decision-making process.

Reply:

Once a financial crisis has been declared, one individual should have unrestricted authority to make essential decisions without having to be constantly answerable to competing local interests. If conditions had deteriorated to the point where an emergency manager was required, normal decision-making procedures, together with their existing public forums, probably have failed.

Against:

Some people doubt this bill is much of an improvement over the many existing laws that allow state intervention into local financial affairs, particularly those of schools. It is not clear this is any better an "early warning system," or that it would have prevented recent fiscal crises' in either local governments or schools. Also, since the bill was initiated primarily in response to the crisis in Detroit's public schools, it seems especially meaningless in light of the district's recent millage and bond approval which provide for more money through 1994. Further, Detroit and all state schools may get another boost if either of the state school finance proposals are passed this coming November.

Against:

The House substitute would unfairly penalize the rest of the state for the fiscal problems existing in a few school districts and municipalities by requiring the state to pay for emergency fiscal managers. While the state certainly has an interest in protecting the credit ratings of all its various governing units, the House version could encourage fiscal irresponsibility at the local level. At $100,000 per manager, the state could easily be liable for over $1 million just to compensate those districts and municipalities that currently need help.

Response: Responsibility for the fiscal plight of local governmental units, especially public schools, belongs primarily to the state. Such being the case, the state should be willing to pay the costs of helping school districts and other local units of government straighten themselves out with the help of emergency financial managers. The House substitute recognizes this by requiring the state to reimburse emergency managers for their costs in nursing school districts or municipalities back to fiscal health.

Against:

The emergency financial manager should be appointed by the review team or the state board of education (upon recommendation from the state superintendent) rather than by the governor. These officials are in a better position to understand the scope of a school district's problems and needs and could select a candidate with both strong accounting and curriculum experience required for the job. Further, a single, permanent review team should be established to review schools, rather than a separate team for each financially-troubled district. A permanent review team would provide continuity and would be more consistent with current provisions for local governments.

Response: Some people believe that allowing others to appoint the manager would interfere with the governor's constitutional authority. Besides, the state board would have considerable influence under the bill since the governor's appointment would have to be made from nominees submitted by the board.

Against:

The bill would undermine Michigan's long tradition of local control, and implies that a local board is to blame for the district's financial troubles. Even if this were so, local electors can remove school officials from power and work to effectuate change themselves. The state should not attempt to intervene in the local affairs, either fiscal or otherwise, of its citizens.

POSITIONS:

The Department of Education generally supports the concept of the bill but feels the appointment of the emergency financial manager should be made by the superintendent of public instruction rather than by the governor. (5-15-89)

The Michigan Education Association supports the bill. (10-6-89)

The Michigan Federation of Teachers supports the bill. (10-6-89)

The Michigan Association of School Administrators is not opposed to the bill. (10-9-89)

The Michigan Association of School Boards has no position on the bill but said it generally opposes state intervention in local fiscal matters. (10-3-89)

The Michigan Municipal League has no position on the bill. (10-9-89)

The Department of Treasury opposes the bill. (10-3-89)