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Senate Bill 951 (Substitute S-3)
Senate Bill 952 (Substitute S-2)
Senate Bills 953 and 954 (as introduced 5-21-14)
Senate Bill 957 (Substitute S-5)
Sponsor: Senator Howard C. Walker (S.B. 951, 952, 953, & 954)
Senator Roger Kahn, M.D. (S.B. 957)
Committee: Appropriations

Date Completed: 11-12-14

CONTENT

Senate Bills 951 (S-3), 952 (S-2), 953, 954, and 957 (S-5) would amend various statutes to prescribe measures for financially distressed school districts.

Each bill is described individually below. The bills are tie-barred.

Senate Bill 951 (S-3)

Withholding of State Aid for Failure to Comply with Uniform Budgeting and Accounting Act

The bill would amend Sections 17a and 18 of the State School Aid Act to do all of the following:

- Allow the Michigan Department of Education (MDE) to withhold all or part of the payment due to a district or intermediate school district (ISD) to the extent the withholdings were part of a plan developed and implemented pursuant to Section 1356 of the Revised School Code, which provides for the borrowing of money by districts with deficits of \$100 or more per pupil with State approval, and allows for the pledging of future State school aid payments. (The Department currently may withhold payments as part of a plan under the Emergency Municipal Loan Act or the Local Financial Stability and Choice Act.)
- Make an allocation to a district or ISD contingent upon the district's or ISD's compliance with Section 17a.
- Require a district or ISD to adopt an annual budget in a manner that complied with the Uniform Budgeting and Accounting Act. (This already is required under that Act which includes school districts in its definition of "local unit".)
- Allow the Department to withhold up to 10% of total State school aid if a district or ISD did not meet requirements to submit an annual budget complying with the Uniform Budgeting and Accounting Act and make information on various expenditures available on a district's or ISD's website homepage. If the district or ISD did not comply by the end of the fiscal year, the withheld amounts would be forfeited.
- Make an allocation to a district or another entity contingent upon the district's or entity's compliance with Section 18.
- Delay the annual deadline for reporting financial data from October 15 to November 1.

Senate Bill 952 (S-2)

Educational Entities in Deficit or in Potential Financial Stress

The bill would add Section 1220 to the Revised School Code to do all of the following for **deficit elimination plans** (as currently provided, for the majority of the provisions, in Section 102 of the School Aid Act):

- Prohibit a district, intermediate district, or public school academy (PSA) from adopting or operating under a deficit budget or from incurring an operating deficit in a fund during a fiscal year.
- Require a district, ISD, or PSA that had an existing deficit fund balance, incurred a deficit in the previous school year, or adopted a budget that projected a deficit fund balance, to immediately notify the Superintendent of Public Instruction and the State Treasurer.
- Require a district, ISD, or PSA that made a notification of a deficit, within 30 days, to submit a preplan financial report in the form and manner prescribed by the Department of Treasury, and submit the report to its board.
- Require the district, ISD, or PSA, within 90 days of notification, to submit to the Superintendent of Public Instruction in the form and manner prescribed by the Department an amended budget for the current school fiscal year and a deficit elimination plan (DEP) approved by the board, with a copy to the State Treasurer. (The current MDE policy and procedure require this within 30 days of notification.)
- Require a district, ISD, or PSA to submit an enhanced deficit elimination plan if a deficit were not completely eliminated within five years after an initial deficit elimination plan was submitted.
- Allow the MDE to withhold and release some or all of the money payable as provided under Section 102 of the School Aid Act (which Senate Bill 954 would amend).
- Allow the Superintendent to require a deficit elimination plan (DEP) to include an academic plan for the district, ISD, or PSA.
- Upon approval by the MDE of the DEP, require the school district, ISD, or PSA to post the DEP to its website.
- Require the MDE to consult with the Department of Treasury; the school district, ISD, or PSA required to submit a DEP; the superintendent of the ISD in which the district is located; or the authorizing body of the PSA.
- Require the MDE to prepare a report, not later than March 1 of each year, of deficits incurred or projected by school districts, ISDs, and PSAs in the immediately preceding fiscal year and the progress made in reducing those deficits, and submit the report to the legislative standing committees responsible for K-12 education, the Appropriations subcommittees, the Senate and House Fiscal Agencies, the State Treasurer, and the State Budget Director.
- Require the MDE to submit quarterly interim reports concerning progress made.
- Require a school district, ISD, or PSA that was required to submit a DEP also to submit to the Superintendent of Public Instruction and the State Treasurer a monthly monitoring report on revenue and expenditures in a form and manner prescribed by the Department; post the reports on its website; and transmit copies to the ISD superintendent and authorizing body as appropriate.
- Specify that an ISD or other entity may be contracted with to provide the monthly monitoring report (although this already is allowed under general powers).
- Upon approval of a DEP, allow the Superintendent of Public Instruction to continue allotment and payment of funds as provided under Section 102.
- When approving a DEP, require the Superintendent to establish the period within which a deficit would have to be eliminated and set special conditions that would have to be met.

The bill also would include provisions in Section 1220 to do all of the following for **enhanced deficit elimination plans**:

- If the State Treasurer determined that a school district, ISD, or PSA was subject to rapidly deteriorating financial circumstances, or persistently declining enrollment, or that other indicators of financial stress were likely to result in recurring operating deficits or recurring financial stress, allow the State Treasurer to require the entity to submit an enhanced deficit elimination plan (enhanced DEP) in the form and manner prescribed by the Department of Treasury.
- Require an enhanced DEP to provide for the resolution of the deteriorating financial circumstances, persistently declining enrollment, or other indicators of recurring deficits or financial stress, and subject it to approval by the State Treasurer; and authorize the State Treasurer to require the submission of an enhanced DEP in order for an entity to enter into a financial recovery agreement.
- Allow a financial recovery agreement to provide for assistance and guidance from the Department of Treasury and other State departments and agencies; a financial and operating plan for the entity; the appointment of a local auditor or inspector, or both; remedial measures or other action necessary to address the financial circumstances of the entity; or the required retention by the entity of a consultant or one or more other experts for the purpose of assisting the entity to achieve the goals and objectives of the agreement.
- Require the board of an entity to approve an enhanced DEP before the entity submitted it.
- Allow the Department to withhold some or all of the money payable to an entity required to submit an enhanced DEP.
- When approving an enhanced DEP, allow the State Treasurer to establish the period within which a deficit would have to be eliminated and set special conditions that would have to be met.
- Require the Department of Treasury to consult with the MDE; the school district, ISD, or PSA required to submit an enhanced DEP; the superintendent of the ISD in which the district was located; or the authorizing body of the PSA.
- Upon approval by the State Treasurer of an enhanced DEP, require the school district, ISD, or PSA to post the enhanced DEP to its website.
- Require an entity that was required to submit an enhanced DEP to submit to the Superintendent and State Treasurer an enhanced monthly monitoring report on revenue, expenditures, cash flow, debt, other liabilities, assets, budget amendments, pupil membership, and other data relating to the finances of the entity, in a form and manner prescribed by Treasury, and post the reports on its website.

Senate Bill 953

The bill would add Section 7a to the Local Financial Stability and Choice Act. This section would allow the State Treasurer, in a situation in which a school district was subject to an enhanced deficit elimination plan and failed to submit the plan or comply with its requirements, to declare that a financial emergency existed within a school district and recommend that the Governor appoint an emergency manager to address the financial emergency.

Senate Bill 954

Withhold Funds for Failure to Submit DEPs or Enhanced DEPs

The bill would amend Section 102 of the State School Aid Act to do all of the following:

- Allow the MDE to withhold some or all of the money payable to a district, ISD, or PSA if the entity were required, but failed, to submit a deficit elimination plan or enhanced DEP, or if the DEP or enhanced DEP, as applicable, were not approved. The Department could determine the amount to withhold necessary to "incentivize" the entity to eliminate the deficit.

- Require the MDE to release money withheld upon departmental approval of the DEP or enhanced DEP.
- Require the MDE and the Department of Treasury to jointly consult, and consult with the chief administrative officer of the district or ISD required to submit a DEP under Section 1220 of the Revised School Code, and the superintendent of the ISD in which the district was located. (The MDE currently has a policy and procedure for collaborating with these entities related to deficit districts.)
- Delete language requiring a quarterly deficit district report to the Legislature, and language prescribing the existing process for submitting DEPs. (This language is proposed to be moved to Section 1220 of the Revised School Code by Senate Bill 952.)
- Make a district's or ISD's school aid payment contingent upon compliance with Section 102.

Senate Bill 957 (S-5)

For Educational Entities Facing a Potential Financial Emergency – Early Warning

The bill would add Section 1219 to the Revised School Code to do all of the following:

- Require each school district and PSA to transmit by July 7 of each school year a budgetary assumption report, to the Center for Educational Performance and Information (CEPI), and require the report to include at least the assumed foundation allowance, projected pupil membership, expenditures per pupil for the prior year, and projected expenditures per pupil.
- Require CEPI to complete and transmit by July 21 an assumption summary report for each ISD and authorizing body that included at least the name of each school district or PSA, the projected foundation allowance, the projected membership, and the reported expenditures per pupil.
- Require the superintendent of each ISD to review the budgetary assumptions included in the assumption summary report for each school district in the ISD and report to CEPI by July 28 whether he or she agreed with the assumptions included in the summary report. Each authorizing body would review the assumptions for each PSA and report whether the authorizing body concurred with the assumptions. In determining whether to concur with budgetary assumptions, all of the following would be considered: foundation allowance and membership for prior years; projections used by other school districts within the ISD or projections used by other PSAs authorized by the same authorizing body; projections released by the Department of Treasury, the House Fiscal Agency, the Senate Fiscal Agency, or the revenue estimating conference; and, projections based on pending or enacted legislation.
- Require CEPI to prepare by August 10 a final assumption summary report for each ISD and authorizing body that reflected any changes reported to CEPI in budgetary assumptions, and transmit the final report to the State Superintendent, the State Treasurer, and the respective ISD superintendents and authorizing bodies.
- Require the State Treasurer by August 20 to review each final assumption summary report. If the State Treasurer concurred with a determination of unreasonable assumption(s), or if the State Treasurer did not concur in an ISD superintendent's or authorizing body's determination of reasonableness, the State Treasurer would notify the district or PSA and provide a copy of the notice to the Superintendent of Public Instruction, the ISD superintendent, the authorizing body, and affected school board members.
- If a district or PSA received a notice of unreasonable budgetary assumptions, within five days of that notification, require the school to post a notice on its website indicating that it adopted a budget that relied upon unreasonable assumptions, and require the notice to remain until the following June 30 or until the school adopted a budget that the ISD or authorizing body, and the State Treasurer, determined contained reasonable assumptions.
- If a school district, ISD, or PSA, or the authorizing body of a PSA determined that conditions of fiscal stress, a deficit, or conditions indicating a potential financial emergency

had arisen or could arise, require the entity to notify the Superintendent of Public Instruction and request technical assistance from the State in addressing the fiscal stress, deficit, or potential financial emergency, and require the Superintendent to notify the State Treasurer of any request for assistance.

- Within 45 days after receiving a request for assistance, require the MDE to consult with the Department of Treasury regarding the provision of technical assistance.
- Subject to available resources, require the MDE and the Department of Treasury to review the financial condition and budget of the entity, and after consultation, provide technical assistance, including data analysis tools, with the objective of avoiding conditions of fiscal stress, a deficit, or a potential financial emergency before further State intervention.
- Require the MDE and Department of Treasury to consult with the superintendents of the school district and ISD in which the district is located, or the governing body of the PSA, as appropriate.
- Allow the ISD in which the entity is located to provide assistance that complemented and supported the State assistance; and allow the authorizing body of a PSA to provide assistance that complemented and supported State assistance to a PSA.
- Allow the Superintendent or State Treasurer to require an entity to submit periodic financial status reports if either determined that potential financial stress existed, that a deficit could arise during the current year or the following two years, or that the entity could be unable to meet its financial obligations while also satisfying the entity's obligations or abilities to provide public educational services based upon one or more of eight specified conditions. (Treasury currently may require periodic reports for districts using short-term borrowing, and MDE has that ability with the monthly budgetary control reports.)
- Identify the 10 conditions that could trigger the periodic reporting as follows: 1) financial data or other information submitted to a State department or agency; 2) financial data or other information included within an audited financial statement; 3) financial data or other information provided to a State department, agency, or authority in connection with a request to issue bonds, notes, or other debt obligations; 4) financial data or other information included within a recommended budget; 5) financial data or other information provided to a State department, agency, or authority by an officer, employee, contractor, or agent of the entity; 6) data relating to pupil enrollment in a school district; 7) financial data or other information provided to MDE and the Department of Treasury by the ISD in which the school district is located; 8) for a PSA, financial data or other information provided by the authorizing body of the PSA; 9) for a district, the ISD did not concur with the budgetary assumptions submitted; and, 10) for a PSA, the authorizing body did not concur with the budgetary assumptions submitted.
- Require the Superintendent or State Treasurer to provide at least 14 days' notice to a school district or ISD before making a determination of potential financial stress; and require the Superintendent to notify the authorizing body of a PSA of a potential determination of financial stress.
- After the notification of potential financial stress, allow the Superintendent or State Treasurer to require submission of a periodic financial status report on a periodic basis determined by the Superintendent or State Treasurer if one or more of 17 identified conditions were met.
- Identify the 17 conditions that would trigger the submission of a periodic financial status report as follows: 1) the entity failed to make a required payment to the Michigan Public School Employees' Retirement System (MPERS); 2) the entity failed to make a required payment to the Michigan Unemployment Insurance Agency; 3) the entity failed to timely transmit a required payment of tax withheld from payments to employees; 4) information submitted by a vendor indicated that the entity was more than 90 days in arrears on a payment under contract; 5) the district or ISD spent tax revenue for an unauthorized purpose, or deposited tax revenue in an unauthorized manner; 6) the district or ISD failed to distribute tax revenue as required by law or to make timely refunds as required by law; 7) the entity failed to pay employees within the time required by law; 8) the entity failed to comply with a material requirement in the Uniform Budgeting and Accounting Act and the

material violation was noted in an audit or audited financial Statement; 9) the general fund balance of the entity, expressed as a percentage of current operating expenditures, had declined by five percentage points or more each year over three consecutive school fiscal years; 10) the expenditures per pupil had increased by 5% or more in the most recent school fiscal year; 11) pupil enrollment declined by 5% or more in a single fiscal year or by 15% or more over a period of three consecutive years, and the entity failed to reduce expenditures to address the decline in enrollment; 12) a school district made a request for determination to the Superintendent or State Treasurer; 13) the board or authorizing body of a PSA made a request for a determination to the Superintendent or State Treasurer; 14) action necessary to prevent a projected deficit from arising at a school district or PSA was not taken; 15) the school district applied for a loan under the Emergency Municipal Loan Act; 16) the State Treasurer had issued a notice of a concurrence that a budget was based upon unreasonable assumptions; and, 17) for a school district or PSA, as appropriate, the ISD or authorizing body did not concur with the budgetary assumptions submitted.

- Require the periodic financial status report to include financial data and other information the Department of Treasury determined could assist the State in developing an early warning system of financial stress or operating deficits, after consultation with the MDE, organizations representing administrators and business officials, and CEPI.
- Require periodic reports to be submitted to school district board members and to the ISD superintendent, and to board members and the authorizing body of a PSA; and require an ISD submitting periodic reports to submit them to its board.
- Require an entity that was required to submit periodic reports to provide other financial data or information relating to the financial condition as requested by the Department of Treasury or MDE, allow for examination of all financial records and books, and promptly and fully provide the assistance and information necessary and properly requested by the Department of Treasury or MDE. (The MDE already has the authority to examine all financial records and books of a district under Section 1281 of the Revised School Code.)
- Provide that, if an entity failed to submit periodic financial reports as required, or if information provided indicated that financial stress existed, or a deficit had occurred or was projected to occur, and the entity lacked the capacity to address the situation without State assistance, the entity could be required by the State Treasurer to submit an enhanced deficit elimination plan, which would occur after the Treasurer notified the State superintendent, the board, the ISD Superintendent, or the board and authorizing body of a PSA, as appropriate.
- Provide that if an officer of an entity failed to prepare and submit periodic financial status reports, the failure would constitute malfeasance and would be grounds for removal from office.
- If an entity were required to submit a DEP or enhanced DEP, or if a financial emergency had been declared under the Local Financial Stability and Choice Act, specify that the entity would not be required to submit periodic financial status reports.
- If an entity were required to submit periodic reports and a loan were issued under the Emergency Municipal Loan Act, require the school district to submit periodic reports for at least four years after the loan was issued.
- Provide that an entity would no longer be required to submit periodic reports if the State Treasurer, after consultation with the State Superintendent, determined that the reports indicated that potential financial stress did not exist, that an operating deficit was not projected to arise, and that the entity would be able to meet its financial obligations while also satisfying its obligations or abilities to provide educational services.
- Allow the ISD in which a district was located, or the authorizing body of a PSA, to advise the State Treasurer regarding the development and implementation of periodic financial reports.
- Require the State Treasurer and the Superintendent to convene a joint workgroup within 60 days of the effective date to assist the two Departments in developing recommendations for the creation of an information system or processes that would provide earlier access to financial information and other data to address budgetary difficulties sooner.

- State that the early warning information system should expand upon existing data collections, should allow the uploading of school budget and current financial information on a periodic basis using the Financial Information Database maintained by CEPI, should permit the upload of current expenditure data on at least a quarterly basis, should provide the MDE and Department of Treasury with access to data on the system, should reduce or consolidate reporting requirements, and should provide an estimate of costs.
- Require the workgroup to include representatives from the MDE; the Department of Treasury; the Department of Technology, Management, and Budget; CEPI; school districts; ISDs; PSAs; authorizing bodies; school business officials; and certified public accountants.
- Require completion of the work by September 30, 2015, with submission of joint recommendations to the Governor, the Senate and House standing committees on Education, and the Senate and House Appropriations Subcommittees on School Aid, by December 31, 2015.
- Require the workgroup to make recommendations on changes in State law relating to periodic financial status reports, DEPs, and enhanced DEPs, including new data analysis tools, and recommendations on changes to warning signs, data needs, and proper timing of reporting in a manner that would reduce administrative bureaucracy.
- Define various terms, including authorizing body, deficit, financial emergency, fiscal stress, foundation allowance, governing body, membership, and pupil.
- Define "financial emergency" to mean that one or more conditions described in Section 5(3)(a) to (m) of the Local Financial Stability and Choice Act exist or are likely to occur in the current or next year and threaten the ability of the entity to provide necessary governmental services essential to public health, safety, and welfare.
- Define "fiscal stress" to mean one or both of the following: that an entity is unable to meet its short-term or long-term financial obligations, or that one or more conditions described in Section 4(1)(a) to (s) of the Local Financial Stability and Choice Act exist or are likely to occur.

MCL 388.1617a & 388.1618 (S.B. 951)

Proposed MCL 388.1220 (S.B. 952)

Proposed MCL 141.1547a (S.B. 953)

MCL 388.702 (S.B. 954)

Proposed MCL 380.1219 (S.B. 957)

FISCAL IMPACT

State: For fiscal year (FY) 2014-15, the Department of Education budget included 4.0 full-time equivalent (FTE) positions and \$778,100 General Fund/General Purpose (GF/GP) funding. In the Department of Treasury budget, 9.0 FTE positions were added for financial independence teams, with funding of \$4.5 million GF/GP. Of the \$4.5 million appropriation in Treasury, \$3.0 million is for outside private resources to help distressed districts with things such as cash flow development, debt verification, retirement costs, review of collective bargaining agreements, forensic auditing, and real estate services. The Governor had proposed higher levels of funding in the Treasury budget, so there is some question as to whether additional State resources may be sought in the future for the Department of Treasury and MDE to staff the financial independence teams. The Center for Educational Performance and Information also could see some additional costs with respect to the collection of data related to budgetary assumptions and the compilation and distribution of summary budgetary assumption reports.

Local: School districts in deficit currently are required to submit deficit elimination plans, but the enhanced DEPs and the periodic financial reporting associated with the early warning system would be new, and likely would result in increased staff and auditing costs at the local level. However, the amount is indeterminate due to the open-ended ability of the Department of Treasury and MDE to require reporting and potentially audit district activity on a sporadic or periodic basis. From the perspective of the Department of Treasury, there should be little

increased local staff and auditing costs for all additional financial reporting information, where all financial data (revenue, expenditures, cash flow, debt, assets, budget amendments, and others) should be readily available.

However, according to the Michigan School Business Officials, for districts that would be subject to enhanced reporting or audits, the staff time and general fund expenses to complete the reporting could be significant. It is possible that the reporting required under this package of bills would result in financial "book-closing" to occur on a regular basis, rather than solely at year-end, which would require estimates to be made mid-year, accruals and reversals, and significant staff time, with at least one additional high-level FTE employee (e.g., assistant finance director or the equivalent) necessary at each district that was subject to enhanced reporting.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.