Legislative Analysis

Phone: (517) 373-8080
http://www.house.mi.gov/hfa

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

FINANCIALLY DISTRESSED SCHOOL DISTRICTS

House Bill 4325 as passed by the House
House Bill 4326 as passed by the House
Sponsor: Rep. Earl Poleski

House Bill 4327 as passed by the House
Sponsor: Rep. Al Pscholka

House Bill 4328 as passed by the House
Sponsor: Rep. Lisa Posthumus Lyons

House Bill 4329 as by passed the House
Sponsor: Rep. Pat Somerville

House Bill 4330 as by passed the House
Sponsor: Rep. Tim Kelly

Committee: Financial Liability Reform
Complete to 4-27-15

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.

<u>**House Bill 4325**</u>
HB 4325 would amend the Revised School Code to add Section 1219 to require districts, ISDs, and PSAs to report budgetary assumptions and to define the conditions under which Treasury may require a district or PSA to submit periodic financial status reports. However, if a school district or PSA had a positive general fund balance of at least 8% of total general fund revenues for each of the two most recently completed school fiscal years,

they would not be required to report budgetary assumptions or periodic financial status reports.

Budgetary Assumptions

Under HB 4325, by July 7 of each school fiscal year, an applicable district or PSA shall transmit its budgetary assumptions to the Center for Educational Performance and Information (CEPI). Upon receipt CEPI would have to compile and transmit the budgetary assumptions to Treasury. However, if a school district or PSA had a positive general fund balance of at least 8% of total general fund revenues for each of the two most recently completed school fiscal years, they would not be required to report budgetary assumptions. 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.
- The projected pupil membership used by a district's or PSA's governing body in adopting its budget for the current 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.

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 Treasurer to require a district or PSA to submit periodic financial status reports if the Treasurer determines any of the following:

- Potential financial stress may exist in the district or PSA.
- A deficit is projected during the current or following two fiscal years.
- The district 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.

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 or PSA does any of the following:

- Fails to pay a required obligation once or more in a school fiscal year.
- Has expended or distributed tax revenue in a manner prohibited by law.
- 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 expenditures per pupil that have increased by five percent or more compared to the previous fiscal year.
- Has an enrollment for a school fiscal year that was 96% or less of the enrollment used in its budgetary assumptions reported for the school fiscal year and failed to adopt an amended budget reflecting the actual enrollment by November 15.
- Has a foundation allowance for a school fiscal year that was 98% or less of its budgetary assumptions reported for the school fiscal year and failed to adopt an amended budget reflecting the actual foundation allowance by November 15.
- Applies for a loan under the Emergency Municipal Loan Act.

HB 4325 would require a district or PSA to submit the periodic financial reports in the form and manner and on the period basis prescribed by Treasury after consultation with CEPI and after approval by the governing body of the district or PSA. It would also require a district or PSA to provide Treasury with other financial data or information as requested and allow Treasury to examine financial and accounting records. If a district or PSA fails to submit periodic financial reports, or if Treasury determines that the report indicates that financial stress exists, that a deficit has occurred, or that the district 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 or PSA to submit an EDEP (see HB 4327).

A district or PSA would not be required to submit periodic financial status reports if it has a positive general fund balance of at least 8% of total general fund revenues for each of the two most recently completed school fiscal years, if it must already submit a DEP or EDEP, or if a financial emergency has been declared.

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.

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 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 and PSAs 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 add a requirement that Treasury report to the Legislature, both quarterly and annually, a list of districts and PSAs subject to periodic financial status reports or those required to submit an enhanced deficit elimination plan, and the progress made in adhering to that plan, as well as the requirement that the State Treasurer present the results quarterly to the House and Senate Appropriation Subcommittees on School Aid.

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.

<u>Enhanced Deficit Elimination Plans (EDEPs)</u>
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, a DEP, or a request from the State Superintendent – that <u>any</u> 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.
- Or, if a deficit has not been completely eliminated within five years after submitting its initial deficit elimination plan.

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 HB 4327.

HB 4328 would delete the prohibition on district deficits and the requirement for DEPs, which would shift to the Revised School Code under HB 4327. 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 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 MDE and 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.

<u>Local Impact</u>
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

Fiscal Analysts: Bethany Wicksall
Samuel Christensen

■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.