DIAGNOSTIC FINANCIAL ASSESSMENT OF DETROIT PUBLIC SCHOOLS

FINAL DIAGNOSTIC REPORT

SUBMITTED TO:

FINANCE COMMITTEE OF THE GOVERNOR'S TRANSITION TEAM

SUBMITTED BY:

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1.0 INTRODUCTION AND BACKGROUND

1.0 INTRODUCTION AND BACKGROUND

In March 2005, the Finance Committee of the Governor's Transition Team for Detroit Public Schools contracted with MGT of America, Inc. to conduct a diagnostic assessment of the school district. In the assessment, MGT was asked to provide the Finance Committee with an independent, objective evaluation of the management and operations of DPS in three discrete areas:

- planning and budgeting;
- financial management; and
- purchasing.

These functions were evaluated against MGT's databank of school district best practices. MGT has conducted comprehensive management and performance reviews of 16 of the largest 25 school districts in the country. Our prior experience in working with these districts will be cited as comparisons throughout this report.

The results of MGT's diagnostic financial assessment of Detroit Public Schools are included in this report.

1.1 Introduction

Detroit Public Schools (DPS) has had to address a number of difficult issues in recent years. These issues include, but are not limited to:

- declining economic conditions in the State of Michigan;
- a declining population within the City of Detroit;
- a declining property tax base;
- a declining student enrollment in the school district;
- the loss of a number of students to charter schools; and
- operating deficits in the DPS General Fund.

Michigan Public Act 10 of 1999 authorized the removal of Detroit's elected school board to be replaced with a school reform board to serve at the will of the Mayor. The reform board had the power to appoint a chief executive officer authorized to possess the powers, rights and duties otherwise conferred by law upon the former elected school board. DPS has been given $15 million annually to support this reform effort.

Once the CEO had been retained, the role of the reform board is limited to:

- retaining or replacing the CEO;

- approving the appointments of the

  - Chief Operating Officer
  - Procurement Officer
  - Chief Financial Officer
  - Chief Information Officer; and

- approving the

    - School District Improvement Plan
    - Annual Report to the Mayor.

A feature of Public Act 10 of 1999 was the requirement that, after five years of using the CEO management model, the question of retaining the reform Board and the CEO be placed on the ballot. This question was presented to Detroit voters in November 2004 and the vote was to return to the traditional Board of Education/Superintendent organizational format. An election will be held in November 2005 to elect an 11-member Board of Education.

Michigan State law requires any school district that incurs an operating deficit to prepare and submit to the Michigan Department of Education a Deficit Elimination Plan. The Comprehensive Annual Financial Report (CAFR) of Detroit Public Schools for the year ending on June 30, 2004 reflected a General Fund deficit of $48,687,349. Therefore, DPS had to complete a Deficit Elimination Plan. DPS has issued $213,000,000 in short-term notes to be converted to 15-year notes prior to the end of the 2004-05 fiscal year to address this deficit. These notes are required to provide adequate resources to allow DPS to end the 2004-05 fiscal year with a fund balance in the General Fund that is estimated to be $40,539,153. The DPS Deficit Elimination Plan has been accepted by the Michigan Department of Education.

Detroit Public Schools obviously faces a number of challenges; however, with challenges, there are often numerous opportunities. The implementation of the Deficit Elimination Plan and the change back to the traditional Board of Education governance structure can be beneficial to DPS if the causal factors associated with the current financial shortfalls can be clearly identified and steps taken to establish budgetary discipline, in conjunction with implementation of an effective planning and management process.

This report is designed to provide an assessment of the financial management issues facing DPS and to provide recommendations as to how these issues can be addressed to the benefit of the district. MGT's diagnostic assessment report is organized into the following five sections:

1.0 Introduction and Background
2.0 Financial Management
3.0 Purchasing
4.0 Planning and Budgeting
5.0 Summary

1.2 General Financial Background

The current financial position of DPS is not a recent circumstance. DPS has been operating with limited resources for a number of years; however, prior to the conversion to the CEO management model, there appears to have been efforts to assure that the annual operating expenditures in the General Fund were financed by current year operating revenues.

Exhibit 1-1 provides a summary of the revenues and expenditures for DPS for the five-year period preceding the change to the CEO model. Exhibit 1-1 shows that, although there were two years where expenditures exceeded revenues to some extent, the 1996-97 through 1998-99 period reflects a consistent pattern of operating the General Fund within the limitations of current available resources.

EXHIBIT 1-1
DETROIT PUBLIC SCHOOLS
GENERAL FUND
REVENUES AND EXPENDITURES
1994-95 THROUGH 1998-99 FISCAL YEARS

YEAR	REVENUES	EXPENDITURES	REVENUES OVER (UNDER) EXPENDITURES	% REVENUES OVER (UNDER) EXPENDITURES
1994-95	$1,231,301,510	$1,240,484,828	($9,183,318)	-0.75%
1995-96	$1,331,774,719	$1,357,565,784	($25,791,065)	-1.94%
1996-97	$1,358,618,682	$1,313,296,268	$45,322,414	3.34%
1997-98	$1,396,068,891	$1,328,502,459	$67,566,432	4.84%
1998-99	$1,446,240,642	$1,424,344,728	$21,895,914	1.51%

Source: June 30, 2004 Comprehensive Annual Financial Report Statistical Section.

Exhibit 1-2 provides similar information for the period after the change to the CEO management model.

EXHIBIT 1-2
DETROIT PUBLIC SCHOOLS
GENERAL FUND
REVENUES AND EXPENDITURES
1999-2000 THROUGH 2003-04 FISCAL YEARS

YEAR	REVENUES	EXPENDITURES	REVENUES OVER (UNDER) EXPENDITURES	% REVENUES OVER (UNDER) EXPENDITURES
1999-2000	$1,468,111,964	$1,478,743,301	($10,631,337)	-0.72%
2000-01	$1,455,438,670	$1,491,006,820	($35,568,150)	-2.44%
2001-02	$1,606,848,507	$1,584,054,314	$22,794,193	1.42%
2002-03	$1,602,623,033	$1,631,576,025	($28,952,992)	-1.81%
2003-04	$1,511,803,610	$1,635,140,968	($123,337,358)	-8.16%

Source: June 30, 2004 Comprehensive Annual Financial Report Statistical Section.

Exhibit 1-2 shows that, with the exception of the 2001-02 fiscal year, DPS has consistently expended resources in excess of current revenues since 1999-2000. The resources to offset the annual deficits were provided by the fund balance in the General Fund. This approach is similar to individuals using savings to pay for ongoing living costs (such as a mortgage, etc). The use of past savings can only be used once. The critical year was clearly 2003-04 when the current expenditures exceeded current revenues by $123,337,358. The ongoing deficit spending, exacerbated by the magnitude of the

2003-04 activities, has led to the current negative fund balance, and to the need to implement the Deficit Elimination Plan.

Exhibit 1-3 identifies how these activities have impacted the fund balance in the DPS General Fund since 2001-02. Exhibit 1-3 indicates that, without the debt funding of $213,000,000, DPS would have had a second consecutive annual deficit in excess of $123 million and an estimated negative fund balance in the General Fund of $172,459,845 at the end of the 2004-05 fiscal year.

EXHIBIT 1-3
DETROIT PUBLIC SCHOOLS
GENERAL FUND
CHANGES IN FUND BALANCE
2001-02 THROUGH 2004-05 (ESTIMATED) FISCAL YEARS

YEAR	BEGINNING FUND BALANCE	REVENUES	EXPENDITURES	REVENUES OVER (UNDER) EXPENDITURES	ENDING FUND BALANCE
2001-02 (1)	$126,397,194	$1,606,848,507	$1,584,054,314	$22,794,193	$103,603,001
2002-03[1]	$103,603,001	$1,602,623,033	$1,631,576,025	($28,952,992)	$74,650,009
2003-04[2]	$74,650,009	$1,511,803,610	$1,635,140,968	($123,337,358)	($48,687,349)
2004-05 Estimate[3]	($48,687,349)	$1,446,035,988	$1,569,808,484	($123,772,496)	($172,459,845)
2004-05 w/DEP[3]	($48,687,349)	$1,659,035,986	$1,569,808,484	$89,227,502	$40,540,153

Sources: [1]June 30, 2003 Comprehensive Annual Financial Report.
[2]June 30, 2004 Comprehensive Annual Financial Report.
[3]Deficit Elimination Plan, Schedule 1, DS-4511-C Supporting Schedules (Amended).

Based upon the information contained in Exhibits 1-1 through 1-3, it is clear that significant circumstances must have occurred in DPS to cause such large deficits for the 2003-04 and 2004-05 fiscal years.

These circumstances are addressed in Sections 2, 3, and 4 that follow. A total of 31 findings and recommendations are made to the Finance Committee in these subsequent sections of the diagnostic assessment report.

2.0 FINANCIAL MANAGEMENT

2.0 FINANCIAL MANAGEMENT

Overall financial management in a school system consists of three basic elements:

- Planning and Budgeting
- Interim Financial Reporting
- Annual Financial Reporting

The planning and budgeting topic is included in Section 4 of this report. This section (Section 2) is focused on those day-to-day systems, processes, and procedures that assure compliance with the adopted budget.

DPS has installed and is operating an automated financial management system. One overall issue addressed in this assessment pertains to the management of the information provided by the automated system and the use of financial information to support management decisions.

Discussions with the top management of DPS imply that the implementation of the all-day kindergarten program and an upgrade in the preschool program have been the most significant factors supporting the current financial issues. These actions have been justified based on the need to provide DPS students with a good start in the educational process. This action is a sound educational practice that, by itself, could have been implemented in a manner that would have minimized the fiscal impact on DPS if other factors had not been present.

Exhibit 2-1 provides a summary of the information contained on pages 43 through 48 of the 2003-04 Comprehensive Annual Financial Report. A brief review of Exhibit 2-1 indicates that the original budget was adopted to reduce the fund balance in the General Fund by $52,581,740, leaving an ending fund balance of $22,068,269. The adoption of this budget, using 70 percent of the fund balance, leaves very little room for error and would have placed DPS in a position of being unable to continue existing programs in 2004-05.

The adjustment to this budget represents a very short-sighted approach as the revenues were increased by $56,912,486 while the expenditure budget was increased by $103,228,741 leaving an estimated $1,735,571 as an ending fund balance for an organization with a $1.5 billion annual operating budget. This estimated ending fund balance represents .12 percent of the estimated revenues for the 2003-04 fiscal year when the Government Finance Officers Association recommends that governmental entities "maintain unreserved fund balance in their general fund of no less than five to 15 percent of regular general fund operating revenues." Five percent of the originally budgeted revenues for DPS in 2003-04 would be $76,768,528, a amount very close to the beginning fund balance for the 2003-04 fiscal year.

The end result of this information is somewhat misleading as it implies the General Fund Budget was underexpended by $47,884,711, while the expenditure budget was increased by $103,228,741.

Exhibit 2-2 provides a more detailed look at the revenue estimates.

EXHIBIT 2-1
DETROIT PUBLIC SCHOOLS
BUDGETARY COMPARISON
GENERAL FUND
YEAR ENDED JUNE 30, 2004

CATEGORY	ORIGINAL BUDGET	FINAL BUDGET	ACTUAL	ORIGINAL BUDGET VARIANCE POSITIVE (NEGATIVE)	FINAL BUDGET VARIANCE POSITIVE (NEGATIVE)
BEGINNING FUND BALANCE	**$74,650,009**	**$74,650,009**	**$74,650,009**	**$0**	**$0**
Revenues					
Local	139,298,818	161,736,131	150,653,121	11,354,303	(11,083,010)
State	1,163,308,531	1,154,646,309	1,119,522,326	(43,786,205)	(35,123,983)
Federal	232,763,205	275,900,600	240,881,118	8,117,913	(35,019,482)
Total Revenues	**1,535,370,554**	**1,592,283,040**	**1,511,056,565**	**(24,313,989)**	**(81,226,475)**
Expenditures					
K-12 Instruction	492,215,184	491,024,393	534,238,715	(42,023,531)	(43,214,322)
Preschool	33,758,376	32,908,674	35,745,644	(1,987,268)	(2,836,970)
Summer School	7,739,367	19,509,244	21,528,598	(13,789,231)	(2,019,354)
Special Education	183,090,733	185,824,911	167,235,048	15,855,685	18,589,863
Compensatory Education	161,338,800	157,686,452	139,728,428	21,610,372	17,958,024
Vocational Education	32,003,935	34,267,157	39,357,130	(7,353,195)	(5,089,973)
Adult Education	10,290,249	7,592,176	5,898,421	4,391,828	1,693,755
Total Instruction	**920,436,644**	**928,813,007**	**943,731,984**	**(23,295,340)**	**(14,918,977)**
Pupil Services	70,434,042	87,652,671	94,094,719	(23,660,677)	(6,442,048)
Instructional Support Staff	65,555,543	42,335,595	46,219,051	19,336,492	(3,883,456)
School Administration	154,760,070	149,791,260	137,831,706	16,928,364	11,959,554
General Administration	13,895,506	22,351,774	16,860,052	(2,964,546)	5,491,722
Business Office	28,065,186	54,008,723	52,378,243	(24,313,057)	1,630,480
Operations & Maintenance	173,397,067	177,730,838	187,218,929	(13,821,862)	(9,488,091)
Transportation	55,110,359	57,518,916	55,286,353	(175,994)	2,232,563
Other Support Services	86,828,385	150,573,981	89,295,113	(2,466,728)	61,278,868
Total Support Services	**648,046,158**	**741,963,758**	**679,184,166**	**(31,138,008)**	**62,779,592**
Community Service	5,902,452	6,567,020	6,922,133	(1,019,681)	(355,113)
Miscellaneous	160,209	404,919	51,210	108,999	353,709
Debt Service	3,334,500	3,360,000	3,334,500	0	25,500
Total Expenditures	**1,577,879,963**	**1,681,108,704**	**1,633,223,993**	**(55,344,030)**	**47,884,711**
Other Financing Sources (Uses)					
Transfers In	105,394,265	108,201,375	0	(105,394,265)	108,201,375
Transfers Out	(115,466,596)	(92,290,149)	(1,916,975)	113,549,621	(90,373,174)
Proceeds from Sale of Assets	0	0	747,045	747,045	(747,045)
Total Other (Sources) Uses	**(10,072,331)**	**15,911,226**	**(1,169,930)**	**8,902,401**	**17,081,156**
Net Change in Fund Balance	**(52,581,740)**	**(72,914,438)**	**(123,337,358)**	**(70,755,618)**	**(50,422,920)**
ENDING FUND BALANCE	**$22,068,269**	**$1,735,571**	**($48,687,349)**	**($70,755,618)**	**($50,422,920)**

Source: 2003-04 Comprehensive Annual Financial Report.

EXHIBIT 2-2
DETROIT PUBLIC SCHOOLS
GENERAL FUND
REVENUE BUDGET ANALYSIS
YEAR ENDED JUNE 30, 2004

REVENUE SOURCES	ORIGINAL BUDGET	FINAL BUDGET	ACTUAL REVENUES	(OVER) UNDER ORIGINAL BUDGET	OVER) UNDER FINAL BUDGET
Local Sources					
Property Taxes	$80,000,000	$80,000,000	$79,111,256	($888,744)	($888,744)
Tuition/Investments	2,080,000	2,080,000	1,454,653	(625,347)	(625,347)
Special Education	51,035,321	51,035,321	55,969,355	4,934,034	4,934,034
Other	6,183,497	28,620,810	14,117,857	7,934,360	(14,502,953)
Total Local	139,298,818	161,736,131	150,653,121	11,354,303	(11,083,010)
State Sources	1,163,308,531	1,154,646,309	1,119,522,326	(43,786,205)	(35,123,983)
Federal Sources	232,763,205	275,900,600	240,881,118	8,117,913	(35,019,482)
Total Revenues	**1,674,669,372**	**1,754,019,171**	**1,661,709,686**	**(12,959,686)**	**(92,309,485)**
Less Federal Sources	(232,763,205)	(275,900,600)	(240,881,118)	(8,117,913)	35,019,482
Total State/Local	**$1,441,906,167**	**$1,478,118,571**	**$1,420,828,568**	**($21,077,599)**	**($57,290,003)**

Source: 2003-04 Comprehensive Annual Financial Report.

Exhibit 2-2 provides the following information:

- the original budget estimates for the local revenues were generally accurate;
- there was an adjustment to the "Other" category that increased the budget by $22,437,313, an amount that was not totally achieved resulting in a shortfall of $14,502,953 in this category;
- the majority of the shortfall in the state resources is based on the student enrollment projections as the reduction in enrollment was greater than anticipated; and
- the federal sources are netted out because revenues for federal programs are matched to expenditures, meaning they have no impact on the overall fund balance shortfall as the expenditures will equal the revenues.

Position Control

FINDING

The key to understanding the budget deficit focuses on the management of expenditures. Exhibit 2-3 provides insight to perhaps the most significant factor associated with the budget deficit—the salaries and benefits categories. Between these two accounts, there was an overexpenditure of $56,366,935 or 18 percent. The salary category was reduced from the original budget, yet was overexpended by over $32 million.

EXHIBIT 2-3
DETROIT PUBLIC SCHOOLS
GENERAL FUND
EXPENDITURE ANALYSIS
K-12 EDUCATION
YEAR ENDED JUNE 30, 2004

K-12 INSTRUCTION	ORIGINAL BUDGET	FINAL BUDGET	ACTUAL EXPENDITURES	(OVER) UNDER ORIGINAL BUDGET	(OVER) UNDER FINAL BUDGET
Salaries	$349,005,445	$332,515,051	$364,696,110	($15,690,665)	($32,181,059)
Benefits	110,474,723	110,556,753	134,742,629	(24,267,906)	(24,185,876)
Purchased Services	393,039	443,911	1,368,555	(975,516)	(924,644)
Supplies	32,000,496	37,703,781	32,396,753	(396,257)	5,307,028
Capital Outlay	131,683	117,206	79,627	52,056	37,579
Other	209,798	9,687,691	955,041	(745,243)	8,732,650
Total K-12 Instruction	**$492,215,184**	**$491,024,393**	**$534,238,715**	**($42,023,531)**	**($43,214,322)**

Source: 2003-04 Comprehensive Annual Financial Report.

The original assumption may be that the salaries and benefits for K-12 instruction had been underbudgeted. In reviewing this specific issue in more detail, it became apparent that the concern involved the management of human resources and the allocation of teaching staff for the schools. The allocation of teachers within the budget is based upon a staffing ratio that is controlled by a position control process. The position control process is designed to ensure that staffing within DPS is consistent with the staffing authorized in the budget.

The position control process in DPS does not appear to be working effectively. In 2003-04, a number of schools had staff in excess of the amount authorized by the formula used to establish the budget, and that often substitute teachers remained in the schools after the regular teacher returned. In other words, schools have been overstaffed and the systems in place have either been unable to control this process or certain schools are receiving special treatment. In either case, it is clear that principals are taking advantage of the inability of the Human Resources Department to manage this process. There is a high probability that a similar circumstance has been occurring during the 2004-05 fiscal year.

DPS uses PeopleSoft financial software and this same software is being used successfully by numerous school districts across the country. Managing school-level staffing seems to work for other districts using the same software. However, the system is not working in Detroit Public Schools.

The issue involving enrollment projections will be discussed in Section 4, Planning and Budget Management.

RECOMMENDATION

Recommendation 2-1:

Undertake an in-depth study to determine compliance with school staffing formulas for both the 2003-04 and 2004-05 fiscal years to determine how these circumstances occurred, and establish a process to correct the problem. This study should include contacting other school districts utilizing the PeopleSoft software to determine how they make the position control component of the human resources system operate effectively.

FINDING

The management of the position control process had been the responsibility of the Budget Office in the past. In the 2003-04 school year, this function was transferred to the Human Resources Department. Given the apparent impact of the difficulties associated with the current management of this system, this responsibility should be managed by the part of the organization responsible for financial activities. Most school districts have position control under the aspices of the Budget Office.

RECOMMENDATION

Recommendation 2-2:

Transfer responsibility for the management of the position control system to the Budget Office.

FINDING

There appears to be a number of inconsistencies in the manner in which retired teachers, who return to work for DPS, are compensated. In a letter of understanding dated October 28, 1999, between DPS and the Detroit Federation of Teachers Local 231 (DFT), it is noted that "retired DPS teachers may work full-time or part-time in regular positions, as a mentor, or in relief of regular teachers participating in professional development activities."

The language of this Letter of Understanding includes the following work conditions:

- *teachers can only be placed in critical shortage areas as identified by the State Superintendent of Education;*
- *teachers shall be certified to teach the subject they've been assigned;*
- *former school district employees shall be placed on, but not higher than, Step 10 according to the degree held (Note: If not former school district employees, maximum step shall be Step 9); and*
- *teachers shall not receive any benefit beyond salary, except those required by law.*

The compensation for retired teachers has included an additional stipend for the cost of benefits that would have been paid if they were full-time teachers. This is not consistent with the Letter of Understanding. Moreover, there is evidence that certain retired employees filling positions within DPS are compensated as contractors with the payment being identified in the purchased services category rather than as salaries. Therefore, these former employees are filling full-time positions that are not identified in the position control system. The use of this approach adds to the difficulty in managing positions for DPS. This same situation apparently exits for administrators and non-certificated staff.

Additional irregularities exist in the system. For example, another reported circumstance involves a full-time employee that commutes between Detroit and another location, and is only at work on Tuesdays through Thursdays. The nature of these circumstances may be magnified in some cases, however, it appears clear that there are issues to be addressed involving the provision of unique compensation arrangements that are inconsistent with DPS human resources policies and letters of understanding.

RECOMMENDATION

Recommendation 2-3:

Review the payroll records for all retired teachers and other employees retained by DPS for the 2003-04 and 2004-05 fiscal years to assure that the compensation paid has been consistent with the Letters of Understanding between DPS and DFT (as well as other unions); perform a similar review of purchased services contracts to identify any retired teachers or other former employees that are filling positions in DPS, but are being compensated as consultants; and evaluate any other unique employment arrangements that fail to comply with DPS policies and letters of understanding.

Substitute Teachers

DPS attempted to implement a central substitute teacher system which had school-based staff call in if they were going to be absent. The Human Resources Department provided staff to contact substitutes to report for the teachers who would be absent. This type of system is used by most large school districts across the country and the system is working effectively elsewhere.

DPS terminated this system and established a program where permanent substitutes are assigned to the schools. The change to the building substitute model was identified as an "action taken" to reduce the 2004-05 budget costs. Nonetheless, this approach could result in additional costs in situations where the permanent substitutes could exceed the number of substitutes required for any given day.

RECOMMENDATION

Recommendation 2-4:

Review the impact of the building substitute model to determine if it has had a positive financial and operational impact on DPS. This analysis is beyond the scope of the current study; however, there is evidence that the building-level

substitute model is costing DPS additional resources, which is not the intent for which it was created.

Central Office Administrators

Exhibit 2-4 identifies the average for the peer districts excluding DPS and the Philadelphia City School District (as indicated in the NCES database Note 1 in the exhibit). Exhibit 2-4 indicates that DPS would have only 129 central administrators if the number of administrators for DPS were to be consistent with the other peer districts. Based on this comparison, in 2002-03 DPS had an excess of 67 central administrators when compared to the peer districts. The salary and benefits for the 67 excess administrators is probably in excess of $6 million.

The number of excess central administrators is even more significant when the fact that DPS contracted in 2002-03 for the management of Technology Services, Maintenance Management, and Food Services. The managers provided for these services are not included in positions identified in Exhibit 2-4. If DPS were managing these services directly, the number of central administrators would be even higher.

EXHIBIT 2-4
DETROIT PUBLIC SCHOOLS
CENTRAL OFFICE ADMINISTRATORS PER 1,000 STDENTS[1]
ESTIMATED EXCESS CENTRAL ADMINISTRATORS
2002-03 SCHOOL YEAR

SCHOOL SYSTEM	TOTAL STUDENT POPULATION	TOTAL NUMBER OF DISTRICT ADMINISTRATORS (FTE)	DISTRICT ADMINISTRATORS PER 1,000 STUDENTS
Baltimore City Public Schools, MD	96,230	78	0.81
Dallas Independent School District, TX	163,347	159	0.98
DeKalb County Schools, GA	97,967	54	0.55
Milwaukee Public Schools, WI	97,293	47	0.48
SCHOOL SYSTEM AVERAGE	**113,709**	**85**	**0.74**
Detroit Public Schools, MI	173,742	196	1.13
Detroit Public Schools, MI With Average Administrators	173,742	129	0.74
EXCESS CENTRAL ADMINISTRATORS	**-**	**67**	**-**

Source: NCES, CCD public school district data for 2002-03 school year.
[1]Excludes Philadelphia City School District as only three administrators are identified. This information is not consistent with the other peer district information.

RECOMMENDATION

Recommendation 2-5:

Undertake an in-depth organizational review to determine how DPS can reduce the number of central office administrators to be more in line with the average number of central office administrators in the peer school districts.

Monthly Financial Reviews

FINDING

The Deficit Elimination Plan approved by the Michigan Department of Education appears to be extremely optimistic given the financial performance of DPS during the 2003-04 and 2004-05 fiscal years. Exhibit 2-5 provides a summary of the DPS Five-Year Deficit Elimination Plan.

The 2003-04 budget materials (a series of powerpoint presentation materials provided to MGT) included information about the adopted budget. The same information with slightly different language was provided for the 2004-05 fiscal year. In both cases, the balanced budgets included resources from the fund balance with no comment as to how adjustments would be made in the future to move towards a truly balanced budget where current expenditures would be provided by current revenues.

The 2003-04 budget materials also note the following:

- *Organizational budget discipline must be enforced if we are to maintain a balanced budget.*
- *The increased use of the budget controls within our financial system will be utilized to ensure this is accomplished.*

The estimated fund balances over the five-year period of the Deficit Elimination Plan are quite low, leaving little room for error—a potential problem given the history of the past two years. As noted in Recommendations 2-1 and 2-2, much of problem will be in maintaining the budget discipline identified above. Several interviewees noted that when resources were not available for a specific activity, senior managers often directed them to do the work and thus expend the resources regardless. This approach is clearly at odds with the desire for budget discipline.

The key to managing within the limitations imposed by the Deficit Elimination Plan will be to provide an in-depth financial review on a monthly basis and be in a position to make immediate adjustments as necessary.

Prior to the development of Deficient Elimination Plan, current financial reporting to the Cabinet consisted of a monthly review of the costs associated with personnel services (salaries and benefits). Based on this review, the CEO and the top management staff attempted to make adjustments. This action causes difficulties as staff are often laid off during the year, and as noted in Exhibit 2-5, these adjustments have failed to achieve the necessary results.

EXHIBIT 2-5
DETROIT PUBLIC SCHOOLS
FIVE-YEAR DEFICIT ELIMINATION PLAN SUMMARY

CATEGORY	2003-04 ACTUAL	2004-05 ESTIMATE	2005-06 ESTIMATE	2006-07 ESTIMATE	2007-08 ESTIMATE	2008-09 ESTIMATE
Beginning Fund Balance	**$74,650,009**	**($48,687,349)**	**$40,539,155**	**$10,876,693**	**$16,403,860**	**$21,174,362**
Revenues						
Operating Revenues	1,511,056,565	1,446,035,988	1,406,841,300	1,363,785,981	1,312,775,237	1,265,609,985
Tax Anticipation Notes[1]	0	213,000,000	0	0	0	0
Total Revenues	1,511,056,565	1,659,035,988	1,406,841,300	1,363,785,981	1,312,775,237	1,265,609,985
Total Resources Available	1,585,706,574	1,610,348,639	1,447,380,455	1,374,662,674	1,329,179,097	1,286,784,347
Less:						
Expenditures	1,634,393,923	1,569,809,484	1,436,503,762	1,358,258,814	1,308,004,735	1,259,785,881
Ending Fund Balance	**($48,687,349)**	**$40,539,155**	**$10,876,693**	**$16,403,860**	**$21,174,362**	**$26,998,466**

Source: Schedule 1, DS-4511-C Supporting Schedules (Amended) prepared by DPS.

[1]The Plan calls for the conversion of the $213,000,000 in short-term notes into long-term debt payable over a 15-year period.

Compliance with the Deficit Elimination Plan requires a monthly report to be sent to the Michigan Department of Education. Monthly financial reporting is an important component of effective financial management. Monthly financial reports should be compared to projected revenues and expenditures for each period rather than just compared with the budget on a monthly basis. In this way, it is possible to track the estimated year-end position on a monthly basis.

The Chief Financial Officer is now preparing the monthly report in the format required by the Michigan Department of Education (MDE). The February 28, 2005 report complies with MDE requirements and includes a brief written description of anticipated variances. The February 2005 Report projects an ending fund balance for 2004-05 of $37,051,530, which is $3,487,684 or 8.6 percent less than the anticipated ending fund balance per the Deficit Elimination Plan.

Although the monthly report fulfills the requirements associated with the Deficit Elimination Plan, it is a summary document and does not contain the kind of detail that is needed to identify the specific areas where the variances are occurring. An expansion of this approach to provide the detail that supports the summary categories would identify the specific areas where variances are occurring.

Exhibit 2-6 provides an example of what such a report could look like. This report should be accompanied with a written analysis discussing significant variances and, if the projected results appear to be negative, this information should be used to develop a corrective action plan to make changes that will result in a positive shift of resources.

RECOMMENDATION

Recommendation 2-6:

Establish a formal process whereby the overall revenue position of DPS and the expenditure position of each department and the overall school-based programs are projected on a monthly basis for the 2005-06 fiscal year. An in-depth monthly review should be prepared by the Chief Financial Officer with an expectation that the cause of any variances from the projections will be addressed immediately.

Office Space

FINDING

In 2003, DPS sold the School Center Building (five buildings) and related land parcels which previously housed the central office administration to Wayne State University between $8 and $9 million. The proceeds from the sale of the old facilities were recorded in the General Fund for the 2002-03 fiscal year.

DPS has subsequently leased office space in three facilities (Fisher Building, City Center Building, and Albert Kahn Building). DPS acquired 137,000 square feet of office space in the Fisher Building as office condominiums, 15,000 square feet of the concourse (basement) in the Fisher Building where the data center is located, and 720 parking spaces. DPS paid $24 million and $16 million for the improvements of the condominium space in the Fisher Building from bond proceeds. DPS staff indicated that the decision to purchase the condominium properties has resulted in an annual savings of $3 million in the General Fund.

EXHIBIT 2-6
DETROIT PUBLIC SCHOOLS
SAMPLE INTERIM FINANCIAL REPORT

	ORIGINAL BUDGET	REVISED BUDGET	ACTUAL TO DATE	ESTIMATED ADDITIONAL	ESTIMATED TOTAL	VARIANCE POSITIVE (NEGATIVE)
REVENUES						
Local Sources						
Property Taxes	$ xxxxxxx	$ xxxxxxx	$ xxxxxxx	$ xxxxxxx	$ xxxxxxx	$ xxxxxxx
Tuition/Investments	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Special Education	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Other	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Total Local	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**
State Sources						
State Aid Foundation	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
AT Risk	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Other	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Total State Sources	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**
Federal Sources						
Title I	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Other	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Total Federal Sources	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**
Total Revenue	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**
Transfers In						
List transfers	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Total Transfers In	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**
Total Resources Available	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**
EXPENDITURES						
Instruction K-12						
Salaries	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Benefits	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Purchased Services	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Supplies	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Capital Outlay	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Other	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Total Instruction K-12	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**
List all Other programs and	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Departments in the CAFR[1]	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Total Expenditures	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**
Transfers Out						
List Transfers	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Xxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Xxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx	xxxxxxx
Total Transfers Out	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**
Total Expenditures and Transfers Out	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**	**xxxxxxx**
Resources over (Under) Expenditures and Transfers Out	**$xxxxxxx**	**$xxxxxxx**	**$xxxxxxx**	**$xxxxxxx**	**$xxxxxxx**	**$xxxxxxx**

Source: Crated by MGT of America, 2005.
[1]Comprehensive Annual Financial Report

Exhibit 2-7 identifies information on the administrative space being leased.

EXHIBIT 2-7
DETROIT PUBLIC SCHOOLS
LEASED OFFICE SPACE
2005-06 FISCAL YEAR

LEASED FACILITY	LEASE PERIOD	SQUARE FOOTAGE	2005-06 AMOUNT	COST PER SQUARE FOOT
Fisher Building				
Suite 1800	3/1/03 - 1/31/13	9,764	$182,587	$18.70
Suite 450[1]	2/1/04 - 1/31/14	10,031	112,848	$11.25
Lathrop Landing Retail Center	4/1/03 - 4/1/12	2,888	49,440	$17.12
Total Fisher Building		22,683	344,875	$15.20
New Center One				
Suite 136	3/14/02 - 3/13/12	28,667	474,470	$16.55
Suite 450	5/1/03 - 5/1/12	45,024	776,664	$17.25
Total New Center One		73,691	1,251,134	$16.98
Albert Kahn Building				
First Floor	1/1/03 - 12/31/13	16,062	296,344	$18.45
Total Lease Payments		**112,436**	**$1,892,353**	**$16.83**

Source: DPS Real Estate Office, 2005.
[1]Paid with Title I resources

DPS is responsible for paying electric and water utilities for the leased and owned (condo) office facilities. With the 112,436 of leased space and the 152,000 of owned space in the Fisher Building, DPS has 264,436 square feet of administrative space.

With financial issues being faced by DPS and pending reductions in staffing, the need for excessive space should be reevaluated.

RECOMMENDATIONS

Recommendation 2-7:

Reassess the office space needs for DPS and evaluate options that should result in a reduction in the spaces currently being leased or the possibility of a major relocation of the central office. MGT's walk-through of the DPS space in the Fisher Building identified many unused offices and extra space.

Recommendation 2-8:

Review the process and evaluation associated with the decision to sell the previous administrative facilities and enter into the current condominium and lease arrangements to determine if the savings identified for the General Fund have been achieved.

Early Retirement Options

FINDING

DPS implemented an early retirement program for teachers in 2004-05. Programs of this type are frequently effective because of the nature of the teacher's salary schedule. This approach has not been considered for non-certificated staff. In the case of DPS, each time an employee is laid off, a cost is incurred for unemployment insurance. It may be possible for some type of early retirement plan for non-certificated employees.

For certain non-certified positions (such as custodians, food services workers, and operating engineers), an agreement of this nature could involve the use of the retired employees as substitutes. This action would provide possible savings from unemployment insurance, provide a stable pool of substitutes, and could be viewed as an employee-friendly measure during a period of fiscal crisis.

RECOMMENDATION

Recommendation 2-9:

Explore the potential for establishing an early retirement program for non-certificated DPS employees.

Special Education Funding

FINDING

Much discussion has taken place regarding the cost of providing services to special education students in DPS, and there are several problems associated with special education. DPS has been cited for a number of non-compliance issues involving special education class size, evaluations, and staffing. To address these issues, a plan has been developed by the Department of Student Support Programs.

One item that has been overlooked involving special education, is that, because of the problems in achieving the necessary level of staffing and other non-compliance areas, special education resources has been underexpended in the General Fund. Without these underexpenditures in the special education area, the financial impact on the General Fund would have been even greater. This occurs because the special education operations are budgeted to reflect full compliance, while the actual expenditures have been less because of financial difficulties.

A plan to *Close the Achievement Gap in Special Education* has been developed and, as this plan is implemented, the actual expenditures for special education will begin to be more in line with the budget, eliminating the budget cushion that has been provided by this program in the past.

Exhibit 2-8 shows a comparison of the special education expenditures for the 2002-03 and 2003-04 fiscal years. Exhibit 2-8 provides information on how the move to fill positions with qualified staff and meet other compliance requirements have changed between the 2002-03 and 2003-04 fiscal years.

EXHIBIT 2-8
DETROIT PUBLIC SCHOOLS
GENERAL FUND
ANALYSIS OF SPECIAL EDUCATION EXPENDITURES
2002-03 AND 2003-04 FISCAL YEARS

CATEGORY	2002-03				2003-04			
	FINAL BUDGET	ACTUAL EXPENDITURES	OVER (UNDER) BUDGET	% OVER (UNDER) BUDGET	FINAL BUDGET	ACTUAL EXPENDITURES	OVER (UNDER) BUDGET	% OVER (UNDER) BUDGET
Salaries	$123,573,863	$106,900,145	($16,673,718)	86.51%	$129,487,012	$117,759,201	($11,727,811)	90.94%
Benefits	42,273,595	35,936,097	($6,337,498)	85.01%	44,367,745	40,861,853	($3,505,892)	92.10%
Purchased Services	2,754,325	1,607,317	($1,147,008)	58.36%	5,554,118	3,392,992	($2,161,126)	61.09%
Supplies	4,596,385	1,980,903	($2,615,482)	43.10%	5,865,157	4,910,674	($954,483)	83.73%
Capital Outlay	990,623	1,562,146	$571,523	157.69%	517,742	293,104	($224,638)	56.61%
Other	112,570	6,669,258	$6,556,688	5924.54%	33,137	17,224	($15,913)	51.98%
Total Expenditures	**$174,301,361**	**$154,655,866**	**($19,645,495)**	**88.73%**	**$185,824,911**	**$167,235,048**	**($18,589,863)**	**90.00%**

Source: 2002-03 and 2003-04 Comprehensive Annual Financial Reports

As can be seen, there has been an incremental shift in the level of spending for special education between 2002-03 and 2003-04. This shift will continue as the Executive Director of the Department of Student Support Programs works with the Human Resources Department to identify and hire additional qualified staff for DPS special education programs.

A second issue involves the manner in which reductions associated with special education are addressed in the Deficit Elimination Plan. The current plan is to reduce eight administrative positions; however, all but one of these positions will be reclassified to a direct service position and remain in the budget at a lower salary. This action will result in fewer administrators, but will increase the number of staff members providing direct service to students.

A final issue regarding special education involves the issue of maintenance of effort. The special education resources received from the *Individuals With Disabilities Act* (IDEA) are designed to supplement and not supplant local resources. This means that IDEA funds may not be used to reduce the level of expenditures by DPS for the education of pupils with disabilities from one year to the next. It is currently estimated that the maximum reduction that can be made from the General Fund in the area of special education and still be in compliance with federal guidelines is $400,000.

RECOMMENDATION

Recommendation 2-10:

Ensure that the budget for special education complies with the IDEA maintenance of effort requirements, assume that the 2005-06 budget will be developed to meet current compliance guidelines, and that the budget will be expended during the 2005-06 fiscal year.

Textbook Management

DPS maintains an inventory of textbooks. DPS has implemented a program for elementary schools designed to provide textbooks for both the classroom and for students to take home. In many cases, textbooks are not returned by students and DPS has had difficulty recovering the cost for the books. With the cost of textbooks being in the $40 to $50 range, this loss can be a very costly one for Detroit Public Schools, and not characteristic of other peer school districts.

RECOMMENDATION

Recommendation 2-11:

Undertake a detailed review of the effectiveness of the provision of textbooks for students to take home and the costs associated with the two-textbook program to include the initial cost of the additional textbooks as well as the number of books that have been lost with no cost recovery to DPS. Also evaluate the entire textbook management process to include the manner in which the inventory is determined and maintained, and use this information as a basis to evaluate potential revisions to the existing program or changes in the overall management of the costs associated with textbooks.

Payroll

FINDING

The DPS Payroll Department uses PeopleSoft software to manage the payroll and financial activities. The Payroll Department has 49 employees and one student assistant. The 49 employees include five administrative positions. This number represents an increase from 39 employees and three student assistants for this purpose identified in the 1999-2000 budget document. Exhibit 2-9 identifies how DPS compares with four other school districts using the same PeopleSoft software.

EXHIBIT 2-9
COMPARATIVE PAYROLL STAFFING WITH PEOPLESOFT PAYROLL SYSTEMS USERS IN OTHER SCHOOL SYSTEMS

SCHOOL DISTRICT	TOTAL EMPLOYEES	NUMBER OF UNIONS OR PAYROLL GROUPS	TYPES OF PAYROLLS	TOTAL PAYDAYS	NUMBER OF PAYROLL STAFF	EMPLOYEES PER PAYROLL STAFF
Detroit Public Schools	**20,000**	**16**	**Bi-Weekly Semi-Monthly**	**50**	**49**	**408**
Boston City Schools	8,400	12	Weekly Bi-Weekly	78	9	933
San Diego City Schools	22,000	4	2 Monthly	24	18.5	1,189
Pittsburgh School District	6,000	6	Bi-Weekly	50	6	1,000
Jefferson County Schools	11,000	3	Monthly	12	7	1,571

Source: PeopleSoft homepage and contacted school districts, 2005.

Discussions with other PeopleSoft users found that the number of pay days is more of a factor in determining the staff required rather than the number of employee organizations, as the system is set up to manage the different organizations once they have been established in the system.

Beyond the above comparisons, other school districts identified by MGT have the following staffing for payroll:

- Memphis City Schools, Tennessee – 13,000 employees and 11 employees in payroll;
- Broward County School District, Florida – 20,000 employees and 20 employees in payroll;
- Prince George's County, Maryland – 15,000 employees and 12 employees in payroll; and
- Wake County Public Schools, North Carolina – 13,000 employees and 13 employees in payroll.

As can be seen, DPS provides significantly more resources for managing the payroll process than other major PeopleSoft users and other large districts in general. It appears that DPS is still using a number of manual procedures when the PeopleSoft system has the capability to automate the process, reducing the manual requirements that require the additional staff members.

RECOMMENDATION

Recommendation 2-12:

Analyze the manner in which payroll information is processed and contact other PeopleSoft users in large school districts to determine how they process the payroll with significantly fewer employees. In conducting this analysis, DPS should set as a goal the reduction of at least 20 payroll positions.

<u>Food Services</u>

FINDING

There appears to be some unusual accounting practices that have been occurring within the Food Services Fund for the 2002-03 and 2003-04 fiscal years. This fund has been established as a separate fund to account for the food services activities. Exhibit 2-10 provides an analysis of the activities in this fund for the 2002-03 and 2003-04 fiscal years.

EXHIBIT 2-10
DETROIT PUBLIC SCHOOLS
ANALYSIS OF FOOD SERVICES FUND
2002-03 AND 2003-04 FISCAL YEARS

CATEGORY	ORIGINAL BUDGET	FINAL BUDGET	ACTUAL	VARIANCE POSITIVE (NEGATIVE)
2002-03				
Beginning Fund Balance	**$0**	**$0**	**$0**	**$0**
Revenues	49,805,778	49,805,778	47,495,840	(2,309,938)
Expenditures	48,005,778	48,005,779	46,560,627	1,445,152
Revenues Over (Under) Expenditures	1,800,000	1,799,999	935,213	(864,786)
Transfer to General Fund	(1,800,000)	(1,800,000)	(935,213)	(864,787)
Ending Fund Balance	**$0**	**($1)**	**$0**	**$0**
2003-04				
Beginning Fund Balance	**$0**	**$0**	**$0**	**$0**
Revenues	46,859,641	46,859,616	47,328,018	468,402
Expenditures	45,659,641	46,278,938	49,752,778	(3,473,840)
Revenues Over (Under) Expenditures	1,200,000	580,678	(2,424,760)	(3,005,438)
Transfer to General Fund	(1,200,000)	(1,200,000)	0	(1,200,000)
Note Proceeds	0	3,100,005	3,100,005	0
Ending Fund Balance	**$0**	**$2,480,683**	**$675,245**	**($1,805,438)**

Source: 2002-03 and 2003-04 Comprehensive Annual Financial Report.

The budget information contained in Exhibit 2-10 for each year indicates that the plan has been to supplement the resources available to the General Fund with any excess of revenues over expenditures in this fund. This occurred in 2002-03, but the activities in 2003-04 are unusual. The revenues remained consistent for each year, but the expenditures for the Food Services Fund increased by over $3 million and the negative fund balance was offset by note proceeds in the amount of $3,100,005.

The circumstances involving this fund are not referenced in the footnotes to the 2003-04 Comprehensive Annual Financial Report (CAFR). There is only a reference to an aggregate borrowing of $265,734,805 which appears on the General Fund Balance Sheet. There is also a misleading statement in the section of the CAFR entitled Management's Discussion and Analysis which states: "Overall, Special Revenue Funds remained stable from the prior years, showing a net increase of approximately $675,000." This $675,000 is the ending fund balance in the Food Services Fund after inclusion of the note proceeds. The increase of expenditures in the amount of $3 million does not reflect a "stable" position.

MGT has tried to identify the reason for the $3 million increase in expenditures and the background on the note proceeds; however, after repeated requests for information, no one in DPS returned calls or e-mails to respond to questions on this topic. One explanation could be that numerous costs that DPS felt supported this fund could have been included in the Food Services Fund, thus, reducing the total expenditures in the General Fund by a similar amount.

RECOMMENDATION

Recommendation 2-13:

Review the circumstances that led to the increase in expenditures and the need for issuance of a note to assure a positive fund balance in the Food Services Fund.

FINDING

DPS has established the Food Services Fund as a Special Revenue Fund. Special Revenue Funds are used to account for the proceeds of specific revenue sources that are restricted for specified purposes. Thus, it would appear that the Food Services Fund is properly classified as a special revenue fund. When food services funds are classified as special revenue funds, the total costs of providing the services are usually not identified, and these costs are absorbed within the General Fund.

Food Services Funds are normally treated as enterprise funds. Enterprise funds are proprietary funds that are established to account for those services that are funded primarily by user fees. Fees to the users for services are based upon the full-cost recovery of providing the service. The full cost of providing the service not only includes labor and materials, but also a proportional share of capital costs of equipment consumed (depreciation) as well as other expenses such as utilities and general overhead. In most school districts nationally, the food services funds are established as enterprise funds and the direct support costs such as accounting, warehouse services, etc. as well as the general overhead allocation, typically based on the indirect cost rate available to the district for use with federal grant programs, are charged to the fund.

The use of the enterprise fund approach allows the school district to charge those central costs being incurred to support food services to this fund as it is designed to operate like a business.

It is possible that the increased expenditures in the Food Services Fund for 2003-04 was an attempt to allocate central costs to this fund; however, this amount seems somewhat high. A food services program, with the number of students qualifying for free and reduced lunch being in excess of 80 percent, should be capable of absorbing the increased costs and operating a financially successful program.

RECOMMENDATION

Recommendation 2-14:

Establish the Food Services Fund as an Enterprise Fund, and allocate all costs required to support the program to this fund with an expectation that the fund will be operated in a manner that will allow the program to be financially successful as an Enterprise Fund.

Construction Program

DPS is in the process of completing an extensive construction program that appears to be managed effectively. MGT found there is significant documentation supporting the program, but this information is not provided in a manner that can effectively communicate the construction program to the community.

One way to effectively communicate information regarding major facilities improvement programs is to develop a formal document that can be updated annually to identify the overall financial information as well as a separate page for each facility that includes information such as:

- year the facility was opened;
- current and projected student enrollment;
- a written overview of the facility that would include any previous improvements made to the facility;
- a list of the completed projects, including the year completed, the budget, actual costs, and the amount under (over) budget;
- a list of projects still to be completed with information identifying the year the projects will be completed and the source of the resources for the projects; and
- a list of any future needs for each facility that are not being met by the existing program.

Also included in this document could be introductory material identifying the decision-making process for selecting the various projects, and a separate section that identifies the surplus properties owned by DPS along with the estimated costs for maintaining existing surplus buildings.

The creation of this document will provide a basis for addressing issues raised regarding the decision-making process, and also provide an ongoing mechanism for identifying future capital improvement needs.

Without such a formal document that provides justification for a strong construction program, and especially during a prior of fiscal crisis, capital outlay expenditures might well become a target for fiscal reductions as any deficit reduction plan is implemented.

RECOMMENDATION

Recommendation 2-15:

Develop a formal facilities management planning document that includes a separate page for each school and identifies surplus properties owned by DPS.

<u>Foundation</u>

Foundations have been successfully implemented by numerous school districts across the country. DPS has recently established a 501(c)(3) non-profit foundation called the Detroit Public Schools Foundation. In the proposal for the foundation entitled *Expecting Excellence*, a number of programs are identified as possible activities to be funded by the Foundation. These include reading programs, support for the "Centers for Excellence" schools, and leadership training for school-based administrators.

COMMENDATION

Detroit Public Schools is commended for establishing a Foundation to support programs within the school system.

3.0 PURCHASING

3.0 PURCHASING

The overall purchasing activities in DPS appear to be operating effectively. A *Contracting and Procurement Policy Manual* clearly outlines the purchasing and contracting procedures to be followed in Detroit Public Schools.

DPS participates in the Wayne County Regional Education Service Agency and MiCTA (technology) co-operative purchasing groups, as well as with U.S Communities, a nationwide governmental purchasing alliance to make large purchases. DPS has effectively implemented the use of a procurement card (P-Card) system that can be used by the schools. The school system has also recently implemented a process for the use of a restricted checking account program which allows schools and departments to process payments to vendors on a timely basis.

Internal Service Funds

FINDING

The current operation of the DPS Print Shop involves billing for some services (which requires a journal entry to be made to transfer the resources between the Print Shop and the paying school/department), while other services are provided at no cost to the user. This inconsistent practice often leads to situations where there are questions regarding who should pay for these services. This practice is cumbersome, and it places the individuals responsible for the printing services in a position of having no control over their budget.

Most governmental organizations, including school systems, establish the printing function as an Internal Service Fund whereby the budget currently in the General Fund for printing services would be distributed to the schools and departments throughout the organization, and the Print Shop would be in the business of selling printing services to the internal users. The internal users also have the ability to acquire these services from an outside source, if the pricing and service provided internally are not satisfactory.

Internal service funds are accounted for as proprietary funds, and all costs to include depreciation of equipment, direct costs such as utilities, and indirect costs are charged to the fund. The Print Shop would function as a business selling services and all customers would be required to pay for these services. These funds are expected to operate on a break-even basis and have modest retained earnings from year to year.

The experience of one school district provides an example of how this approach can be beneficial to DPS. In 1981, the Jeffco Printing Department employed 16 employees with a printing volume of 425,000 to 595,000 impressions per month. The departmental budget in the General Fund was $525,000. This program was converted to an internal service fund in 1982 which required the inclusion of various overhead costs, and by 1995, the department had 6.5 employees generating 800,000 to 1,000,000 impressions per month with billings of $586,000. The overall district cost for this service increased by 11 percent over 14 years while the cost per impression declined by approximately 40 percent. The key to the success of this program was the ability of the schools and departments to determine the level of service required based on a market environment that encouraged the printing department to function as a service organization.

RECOMMENDATION

Recommendation 3-1:

Establish the Print Shop operation as an Internal Service Fund.

FINDING

DPS is a large organization with over 300 separate facilities. The current process is for each school to enter into a contract with a copier vendor with the copiers provided centrally being on a single contract. The current process not only requires principals to make purchasing decisions and process payments on a monthly basis, but it also fails to take advantage of the immense economies of scale available to DPS. Although the copiers are probably being purchased with the current purchasing cooperatives in which DPS participates, given the size of the school system, it is highly probable that a separate Request for Proposals (RFP) would generate much lower costs for these services. The number of copiers in use at DPS could not be provided to MGT and the average cost per copy and the aggregate cost of providing copier services to DPS are unknown.

DPS could achieve significant cost savings and reduce the time required of the staff at the school sites, as well as the central accounts payable activities, if DPS were to enter into a single contract and incorporate these copiers as a part of the Printing Internal Service Fund. In this circumstance, the copiers would be owned by the Internal Service Fund and the users would be charged on a per copy basis.

RECOMMENDATION

Recommendation 3-2:

Complete an inventory of copiers throughout DPS to include the current contracts, and create a process to establish the provision of copier services within the Printing Internal Service Fund.

FINDING

Although not a purchasing function, the services of the Technology Department also provide an opportunity for the establishment of an Internal Service Fund. This department expends considerable resources that are required by other departments and the schools, yet the cost of these services is not identified with the user departments. Like the Printing Department, this department has also been placed in circumstances where they are required to provide unbudgeted services, making it difficult for the manager of this service to control the budget.

RECOMMENDATION

Recommendation 3-3:

Establish the Technology Services Department as an Internal Service Fund.

FINDING

There are numerous opportunities to develop internal service funds at DPS. Services could include equipment repair services (AV and computers), fleet maintenance, fax machines, cell phones, and basic telecommunications services.

RECOMMENDATION

Recommendation 3-4:

Evaluate the potential for the implementation of the Internal Service Fund concept in areas beyond printing, copiers, and technology.

Vending Machines

FINDING

Each school and the central operational unit currently have separate contracts for vending machines at various locations throughout DPS. School districts across the country have been successful in taking advantage of economies of scale by seeking a contract with a single soft drink vendor for these services. These contracts have raised concerns of late regarding the overall health habits of students causing more recent contracts to include requirements for the inclusion of healthy products as well. In the case of DPS, the machines are already in the schools and this is an area where it will be possible to generate significant resources for DPS while increasing the commissions earned at the schools.

In 1997, one urban school district entered into such an agenda. There were 15 high schools as well as a number of central service locations and machines in employee lounges in over 100 elementary and middle schools. The Request for Proposals (RFP) to provide services with a single vendor resulted in a seven-year contract where the district was paid $2.3 million upfront and the commissions for the schools were increased to the point where the average increase in commissions for each high school was in the range of $7,000 to $14,000. The program also called for creation of a scholarship program to be based on a donation by Pepsi, the successful bidder for these services. Since then, many other school districts have entered into such contracts and obtained million of dollars from the soft drink vendor.

When implementing programs of this nature, it is best to keep the requirements simple and to minimize clauses that may base the resources to be received on the amount of products sold. Some school districts have had difficulties in this area. It is also important to ensure that what will be provided is clearly delineated as there are often efforts by the vendors to provide services, such as materials for athlete teams, that could cause long-term difficulties if not funded.

RECOMMENDATION

Recommendation 3-5:

Complete an inventory of vending machines throughout DPS and develop a Request for Proposal(s) for one vendor to provide exclusive vending machine services with the resources received earmarked to be used to increase the fund balance of the General Fund.

FINDING

DPS has entered into three contracts to privatize the management of certain services. These privatization contracts include the following:

- **Management of Technology Services with Compuware Corporation.**

  This is a five-year agreement with the option to extend it for an additional two years. The agreement allows for DPS to terminate the contract after one year by providing Compuware with a 180-day notice. DPS may also terminate the agreement with 60 days notice if funding becomes unavailable.

- **Management of Maintenance Management Services with Aramark**

  This contract was originally a three-year agreement with options for renewal. The original agreement was revised to be a ten-year contract and extended through June 14, 2011. The revised contract assumes a three percent increase in the Consumer Price Index (CPI) and identifies a 33 percent reduction of costs from the original contract for the seven-year period of July 2004 through July 2011. This action reduced the cost of the contract from $6.3 million annually to $4.3 million for the 2004-05 fiscal year, with annual increases, resulting in a payment of $5.2 for the 2010-11 fiscal year.

  The Maintenance Department Services contract with Aramark includes a number of requirements that must be met if DPS were to cancel the agreement. Aramark provided a contribution of $1.6 million in October 2003 for new vehicles and other equipment to improve the productivity of DPS employees. In the event the contract is terminated, DPS would be required to repay the unamortized portion of this donation with interest. There is also a requirement for DPS to pay Aramark the unamortized portion of its initial investment (start-up costs) of $2,500,000 amortized on a straight-line basis over the period July 15, 2001 through July 15, 2011.

- **Management of Food Services with Aramark-Gourmet.**

  This is a one-year contract (June 18, 2001 through June 30, 2002) with four one-year renewal options. The contract is currently being reviewed annually.

The contracting for services by school districts has been occurring for a number of years. In the case of DPS, however, it would be appropriate to undertake a detailed financial review of the costs for these services under the current contracts and the estimated costs if these services were provided with in-house resources. Our experience in other large school systems has found that the size of DPS would indicate that it may be more efficient to provide services of this nature internally under the umbrella of DPS managers.

RECOMMENDATION

Recommendation 3-6:

Undertake an independent review of the services currently being outsourced to determine if each of these contracts is still in the best financial and operational interests of Detroit Public Schools.

<u>In-house Mail</u>

FINDING

DPS currently requires 10 employees to deliver in-house mail to schools and various central office locations. Many school districts have integrated this service with the transportation system, and in at least one case, with the delivery of meals from a central food preparation site. These actions by other school systems eliminated the need for all but one or two positions to handle deliveries to central sites. Although there is still the need to sort the mail, a reduction in the current number of employees delivering in-house mail can be cost effective.

DPS provides transportation services with a contract vendor and with DPS staff; thus, this approach would have to be reviewed carefully to determine if it would be feasible with two different transportation service providers.

RECOMMENDATION

Recommendation 3-7:

Evaluate the possibility of using the student transportation system to transport mail among DPS schools and central office locations.

4.0 PLANNING AND BUDGETING

4.0 PLANNING AND BUDGETING

School systems make program and service decisions and allocate scarce resources to support programs and services via the budget process. As a result, this process should be one of the most significant activities undertaken by a school system. The quality of the decisions resulting from the budget process and the level of acceptance of these decisions by all parties is directly related to the process utilized, and the ability of the proposed and final budget documents to communicate the priorities of the school system in financial terms.

Once a mission statement has been developed and systemwide goals and objectives have been determined, the allocation of financial resources required to achieve the goals and objectives must be addressed through the planning and budgeting process. An effective planning and budgeting process facilitates a long-term strategic view towards the allocation and management of resources, rather than a short-term, year-to-year allocation based on resources currently available.

The Government Finance Officers Association (GFOA) and seven other state and local government associations created the National Advisory Council on State and Local Budgeting (NACSLB) in 1995 and charged the Council with developing a set of recommended practices in the area of state and local budgeting. The Council concluded its work in December 1997.

The GFOA endorsed the work of the NACSLB, including the NACSLB's definition, mission, and key characteristics of the budget process as follows:

- *Definition of the Budget Process – The budget process consists of activities that encompass the development, implementation, and evaluation of a plan for the provision of services and capital assets.*

- *Mission of the Budget Process – To help decision makers make informed choices about the provision of services and capital assets, and to promote stakeholder participation in the process.*

- *Key characteristics of the budget process are identified as follows:*

  - *incorporates a long-term perspective;*

  - *establishes linkages to broad organizational goals;*

  - *focuses budget decisions on results and outcomes;*

  - *involves and promotes effective communication with stakeholders; and*

  - *provides incentives to government management and employees.*

The NACSLB also states:

> *The key characteristics of good budgeting make it clear that the budget process is not simply an exercise in balancing revenues and expenditures one year at a time, but is strategic in nature, encompassing a multi-year financial and operating plan that allocates resources on the basis of identified goals. A good budget process moves beyond the traditional concept of line item expenditure control, providing incentives and flexibility to managers that can lead to improved program efficiency and effectiveness.*

The implementation of a budget process meeting the definition, mission, and characteristics of an effective budgeting process should provide a clear picture of how DPS resources are to be allocated and the expected results to be achieved from the expenditure of these resources.

Budget Document

FINDING

The materials provided to MGT as the 2003-04 and 2004-05 budgets consisted of 35 to 40 pages of powerpoint materials used for public presentations. These materials identified the following goals:

- Improve Student Achievement
- Create a Safe School Environment
- Enhance Parental and Community Involvement
- Transform the District into an Effective and Efficient Organization

The materials also identified a number of financial issues involved with the current year, but there is no formal budget document.

The materials accompanying the 2005 presentation indicated that the budget had been balanced via the following:

- required staff reductions will be implemented (2,100 to date);
- labor contract negotiations will provide assistance; and
- class size requirements are maintained.

It was also noted in the 2004-05 materials that “the full impact of the early retirement incentive projections are not included.”

The 2004-05 document noted that the following actions had been taken:

- budget for purchased services, supplies, equipment, travel, and consultants was reduced by $43.8 million to include a 33 percent reduction of the Aramark Maintenance Management Contract and the extension of mowing and school cleaning cycle time;

- reduce overtime by approximately 15 percent;

- change to building substitute model;
- adjustments to the second semester staffing;
- tiering the busing to reduce transportation cost;
- close five schools;
- deferring building maintenance and do safety and health repairs as needed;
- reduce textbook adoption;
- shorten the athletic season to the minimum requirement; and
- reduce property casualty insurance expenditures.

Below we compare the budget materials provided by DPS with the factors identified by NACSLB:

- **Long-term Perspective** – There is no long-term perspective included in any of the budget materials. DPS has a 2003-2006 Technology Plan and a multi-year Capital Improvement Plan, but neither of these documents are addressed in the budget materials. The focus is on the operating funds and only the current year is addressed. The annual budgeting process for DPS is clearly a year-to-year activity with no process to identify how the results of the current year activities will impact the organization in the future. This is significant given the current financial position of the district caused by annual operating deficits. The use of fund balance and continued deficit spending with no long-term planning as to how to reduce or eliminate the reliance on fund balance is the reason DPS is required to address a Deficit Elimination Plan and borrow $213 million to be paid from operating resources over the next 15 years.

- **Establishes Linkages to Broad Organizational Goals** – The goals are referenced, but the remainder of the budget materials addresses only financial issues with no reference to how the allocation of these resources will achieve DPS goals.

- **Focuses on Results and Outcomes** – The budget materials provided reflect the financial issues, but fail to reference expected outcomes from the expenditure of the resources budgeted. This is especially important given the expanded preschool program, the all-day kindergarten, and the new reading program, each of which have had an impact on the financial position of the district.

- **Involves and Promotes Effective Communication with Stakeholders –** The process associated with the development of the budget for DPS is an internal process that lacks citizen and school-level input.

- **Provides Incentives to Government Management and Employees –** The current budget process includes no incentives for managers to identify how current processes can be modified to reduce costs. It is an annual process that must be endured while trying to retain budget resources.

NACSLB states that the mission of the budget process is to help decision makers make informed choices about the provision of services and capital assets, and to promote stakeholder participation in the process. Although the CEO organizational structure currently in use by DPS lacks the need for providing information to a Board of Education for decisions, there is still a need to prepare budget information in a fashion that will communicate the background to the public to support various decisions.

When a school district is experiencing financial difficulties, with the expansion of charter schools and decline in student enrollment, it is necessary to prepare a budget document that provides the necessary information to support the decisions being made by the CEO and the management team. The powerpoint materials have their place, but they should be supported by a budget document that includes information on the number of authorized positions for each school and department, and identifies the fiscal impact of budget decisions on various programs, schools, and departments.

The last budget document prepared by DPS was during the transition year to the CEO management model in 2000-01. This budget document contained a significant amount of information, including a separate budget page for each school. The 2000-01 budget document was well-developed.

RECOMMENDATION

Recommendation 4-1:

Develop a formal budget document that includes revenue information as well as the number of authorized positions and expenditure data for the prior year, the budget and estimated amounts for the current year, and the proposed budget amounts for the year of the budget. This document should also include five-year projections for revenues and expenditures.

<u>Analysis of Budget Reductions</u>

The information provided to MGT which identifies the budget reductions for 2003-04 and 2004-05 shows the positions and general categories of the budget reductions. Yet, these data fail to indicate specific impacts or the locations of the reductions. In other words, there is no indication of who will do the work as positions/offices are deleted.

One example of a reduction that occurred in 2003-04 was the elimination of the Lock Shop which had four employees. A reduction in this support service may have been warranted; however, the Lock Shop provided keys that could not be duplicated. Key control in a school district is a major component of the overall security program. It may have been more appropriate to reduce the level of service in this area, but retain the capability to support the security needs of the district. No mention of this was made in the budget document.

RECOMMENDATION

Recommendation 4-2:

Undertake a formal analysis, under the direction of the Budget Office, for all major budget reductions, to ensure that both the operational and fiscal impacts of budget reductions are identified.

<u>Budget Development</u>

FINDING

By being in a reactive rather than proactive mode regarding financial activities, DPS has been unable to establish a position of control over the budget process. An effective budget process provides the foundation for the effective financial management of school districts and all other governmental entities.

The Government Finance Officers Association (GFOA) has extensive materials involving best practices for various finance-related activities. Perhaps the most extensive involves best practices in public budgeting. These practices are based on four principles and 12 elements which are outlined below.

- **Principle I – Establish Broad Goals**

  Element 1 – Assess Community needs, priorities, challenges and opportunities.

  Element 2 – Identify opportunities and challenges for district services, capital assets, and management.

  Element 3 – Develop and disseminate broad goals.

- **Principle II – Develop Approaches**

  Element 4 – Adopt financial policies.

  Element 5 – Develop programmatic, operating, and capital policies and plans.

  Element 6 – Develop programs and services that are consistent with policies and plans.

  Element 7 – Develop management strategies.

- **Principle III** – **Develop Budget**

  Element 8 – Develop a process for preparing and adopting a budget.

  Element 9 – Develop and evaluate financial options.

Element 10 – Make choices necessary to adopt a budget.

- **Principle IV – Evaluate Performance**

  Element 11 – Monitor, measure, and evaluate performance.

  Element 12 – Make adjustments as needed.

The above materials represent only a basic outline that is followed by a number of specific practices. For example, Element 2 provides the following description:

> *A government should undertake an assessment of its own operations, including the services it currently provides, the assets it owns, its management structure, and the opportunities and challenges that may affect them. A government should review existing services and assess how well services address community needs and changes that may be necessary to respond to opportunities and challenges. There should also be a corresponding review of existing capital assets. Note that this element provides only for an evaluation of services and capital assets, and does not address decisions as to whether to provide or maintain them. Since internal management practices can affect achievement of goals, issues such as organizational structure, information flow, and employees motivation should be reviewed to determine whether changes will be needed to achieve goals.*

The information provided by GFOA also includes samples of documents provided by other governmental entities that represent examples of these best practices. Additional information involving the best practices in public budgeting can be found at the GFOA Web site www.gfoa.org.

RECOMMENDATION

Recommendation 4-3:

Establish a budget development process that is focused on goals, and create a budget document that will identify how financial decisions have been and are being made based upon these goals, using the GFOA best practices in public budgeting as a general guideline.

School-Level Planning and Budgeting

FINDING

There is virtually no linkage between planning and budgeting at the school level in DPS. Most decisions are made centrally with little or no involvement of principals. MGT conducted a focus group with 18 principals representing all three levels of schools (elementary, middle and high) The focus group revealed:

- Principals are given a budget by the central office with no input into the budget planning process.

- Although schools develop School Improvement Plans which contain budget elements (as required by NCLB and DPS), the budget element is not addressed with the principals' supervisor (i.e., the executive director over a cluster of schools) or others in the central office. Nor is there evidence of, or a requirement for, stakeholder involvement at the school level.

- In March 2005, principals were told that their procurement cards could no longer be used for the year. Principals who had completely expended or overexpended their budgets had no repercussions, but principals who still had funds remaining in their budgets were adversely affected.

- Several examples were provided of school budgets being reduced with no prior discussion with principals; school administrators were just told that their budget had been reduced.

- Sufficient textbooks have not been purchased by the central office for many schools—this is especially apparent for special education and at-risk students.

Under *No Child Left Behind* (NCLB), schools and especially principals are held accountable for student performance. Principals can not be held accountable if they have no voice in use of their budget or funds that are needed to implement their school improvement plans. Although beyond the scope of this study, the MGT team was told repeatedly of teachers being placed in schools without principals' input—once again a significant concern which must be addressed immediately if principals are to be responsible for student performance.

In discussions with central office administrators, MGT consultants found that, in prior administrations, principals had much more authority over their school budgets, but because of some irregularities by some principals, the budgets are now centrally controlled.

RECOMMENDATION

Recommendation 4-4:

Ensure that principals are provided school-based budgets to manage, and are held accountable for managing their budgets. Under *No Child Left Behind*, this is a critical variable affecting school performance. Principals who abuse this responsibility should be disciplined or removed from school management responsibilities.

<u>Student Enrollment Estimates</u>

FINDING

The most significant information impacting the resources available to DPS is the accuracy in estimating student enrollment. Student enrollment is the basis for the revenue derived from the State Foundation Allowance which is allocated on a blended student count (80 percent from the September count and 20 percent from the February count).

The use of per student allocations is standard throughout the country and is especially difficult for school systems with declining enrollments. There are numerous fixed costs in school districts, and the removal of one or a group of students does not eliminate these fixed costs. Conversely, in school districts with increasing enrollment, the cost of educating each additional student is typically less than the per pupil amount received as they are absorbed into a system based upon formulas for staff allocations and into schools where the fixed costs will not change dramatically.

School districts with declining enrollments typically react to reduced resources by closing schools, reducing support staff, and cutting programs, while strictly adhering to the formulas for school-based staff. Planned staffing is based on the estimated revenue that will be available and, if the enrollment falls below this number, adjustments must be made to accommodate the circumstances caused by the reduced resources.

Exhibit 4-1 identifies the budget estimates and the actual revenues received by DPS from the State Aid Foundation for the 2002-03 and 2003-04 fiscal years.

EXHIBIT 4-1
DETROIT PUBLIC SCHOOLS
STATE AID FOUNDATION REVENUES
BUDGET AND ACTUAL
2002-03 AND 2003-04 FISCAL YEARS

STATE AID FOUNDATION	ORIGINAL BUDGET	FINAL BUDGET	ACTUAL	AMOUNT OVER (UNDER) ORIGINAL BUDGET	AMOUNT OVER (UNDER) FINAL BUDGET
2002-03	$1,066,045,166	$1,104,050,166	$1,083,956,145	$17,910,979	($20,094,021)
2003-04	$1,041,712,010	$1,041,489,079	$1,021,558,047	($20,153,963)	($19,931,032)

Source: 2002-03 and 2003-04 Comprehensive Annual Financial Reports.

In 2002-03, the original estimate was low, but the revised estimate was much too high; in 2003-04, the estimates changed very little. In both years, the failure to accurately estimate the revenues from this source resulted in a $20 million revenue shortfall. In both years, the failure to estimate this source of revenue more accurately was one of the significant factors in the resulting General Fund deficits. A factor in the 2003-04 State Foundation revenue was a reduction of the state aid amount during the year which reduced the resources to DPS by $11.2 million, yet there was no budget amendment reducing this estimate.

MGT is unsure of exactly how the enrollment estimates are currently determined. DPS uses two demographers to support the construction program, but MGT was told that the actual enrollment information was provided by the Student Information Department. MGT was unable to get additional information about this important aspect of the budget after repeated contacts with DPS staff. In other words, we were unable to get to the root of the problem. Nonetheless, it is clear that one of the major problems in DPS is providing accurate enrollment estimates.

One missing element of the enrollment estimating process appears to be the lack of the involvement of principals. In most school systems, base enrollment projections are provided to the principals who are aware of issues within their school communities. This can include potential loss of students to charter or private schools, knowledge of family situations, and the general experience with student enrollment at the school. Principals communicate this information to those responsible for the budget process and adjustments are made as deemed necessary.

One problem that DPS has had in the past has been the need to reduce staff after the beginning of the school year. This results in complications as the agreement with the Detroit Federation of Teachers (DFT) calls for 60 days notice of layoff for non-tenured teachers and 60 days notice before the end of the school year for tenured teachers. If a non-tenured teacher is to be laid off after the school year has started, that teacher will be on staff for an additional 60 days and a tenured teacher cannot be laid off after the school year has begun. The lay-off procedure can be complicated further by the “bumping rights” of senior teachers. The notification period for non-certificated personnel is typically seven days; thus, the process for addressing issues with these employee groups are less complicated.

In declining student enrollment situations, it is best to take a conservative position and budget for staff to meet a lower estimated enrollment. This action would allow for the reduction in force to occur at the end of the prior fiscal year and, if necessary, teaching staff can be recalled after the actual enrollment is validated.

RECOMMENDATIONS

Recommendation 4-5:

Review the process that led to an overestimate of revenue from the State Aid Foundation to determine how the revenue estimates for this revenue source were overestimated by $20 million for both the 2002-03 and 2003-04 fiscal years.

Recommendation 4-6:

Establish a process whereby principals are involved in the evaluation of the estimated enrollment information for their schools, use conservative enrollment estimates, and establish a process within the budget development cycle that provides for any major reductions in staff to occur prior to the beginning of the fiscal year.

Role of Employee Organizations

The 2004-05 budget materials indicated that the 2005 Adopted Budget had been balanced with a number of assumptions to include: “Labor contract negotiations will provide assistance.” This assumption did not come to fruition. In discussions with DPS management, it was determined that there would be adjustments to a number of labor agreements during the development of the 2005-06 budget, but because negotiations were taking place, the specifics of any contract adjustments were not communicated to MGT.

With 16 different employee organizations, negotiations can be difficult. DPS currently provides a very costly employee package for the various organizations, and in the current environment of limited resources being faced, not only by DPS, but most school districts and other governmental units and corporations nationally, it is not unreasonable to expect that some adjustments should be possible to existing contracts that can achieve operating savings for the district and minimize the negative impact on employees.

MGT is not familiar with the relationship between the management of DPS and the labor organizations. However, given the apparent lack of planning involving the recent reductions in force and the lack of progress in achieving agreements for adjustments in 2004-05, it is probable that the relationships are not good.

To effectively work with employee organizations, the management of DPS must have credibility. This can only be achieved over time and when information is presented by DPS, it must be well thought out and well documented.

Many school districts establish citizen or employee committees to participate in the budget development process to assure that the employee organizations and citizens have the opportunity to address the budget issue in more detail. These committees typically meet over a period of time with each meeting being designed to address one or two specific issues or departments.

The Introduction of the GFOA *Best Practices in Public Budgeting*, addresses this issue with the following:

> *A company is not likely to remain in business if it does not stay in touch with its customers. While governments that are not in touch and do not have involved citizens may remain in business, the results are often not pleasant for the citizens or the government. Apathy is a serious illness of government. It is in the best interests of government to have involved "stakeholders."*
>
> *The term "stakeholder" refers to anyone affected by or who has a stake in government. This term includes, but is not limited to: citizens, customers, elected officials, management, employees and their representatives (whether unions or other agents), businesses, other governments, and the media.*
>
> *It is vital that the budget process include all stakeholders. The budget process should accomplish the following:*
>
> - *achieve stakeholder acceptance of decisions related to goals, services, and resource utilization;*
> - *report to stakeholders on services and resource utilization; and*
> - *serve generally to enhance the stakeholders' view of government.*

> *The importance of this aspect of the budget process cannot be overstated. Regular and frequent reporting is necessary to provide accountability, educate and inform stakeholders, and improve their confidence in the government. Communication and involvement is an essential component of every aspect of the budget process.*

RECOMMENDATION

Recommendation 4-7:

Establish a DPS Budget Advisory Committee to assist in the development of the budget that includes representation from each employee organization as well as citizen groups.

Discretionary Funds

FINDING

A significant problem in most governmental entities with established annual budgets is the "spend it or lose it" mentality that results in year-end spending that may not always represent the effective use of governmental resources. This approach can be magnified when the organization has experienced circumstances where discretionary resources are reduced during the fiscal year. The decision to cut off the use of the procurement cards (p-cards) and other discretionary resources for the schools during the 2004-05 fiscal year will, in the long term, exacerbate the "spend it our lose it" approach by creating an environment where schools will feel compelled to expend resources even earlier in the year so as not to lose them.

The most effective use of DPS resources can be improved by allowing the schools to carry forward any unspent discretionary resources into the following fiscal year. This action will allow more effective long-term financial planning by schools and assure more effective use of the resources. This approach can only be effective, however, if it is clear that these resources will not be reduced at some future point in time. The time to reduce resources is during the development of the budget; once discretionary resources are allocated to the schools, they should not be rescinded regardless of the circumstances. This action may limit short-term financial options, but it will result in more efficient long-term use of these resources.

RECOMMENDATION

Recommendation 4-8:

Establish a policy allowing schools to carry discretionary resources forward into future fiscal years, and include in this policy the requirement that once discretionary resources are assigned to the schools, they will not be reduced by the central office at some point in the future.

Budget Amendments

A close review of the information contained in the budgetary comparison schedules in the 2002-03 and 2003-04 Comprehensive Annual Financial Reports gives the impression that no serious review of budget amendments ever occurred. Exhibit 4-2 provides an overview of the General Fund to include the original budget, the final budget, the actual financial activity, and the variances. It can be seen that amendments to the revenues and expenditures bear little resemblance to the actual activity. It can also be seen that the amendments were estimated to reduce the fund balance even further than the original budget while the amendment to the expenditure budget for Support Services leaves the impression that this category was underexpended; however, when compared to the original budget it would have been overexpended.

EXHIBIT 4-2
DETROIT PUBLIC SCHOOLS
GENERAL FUND
ANALYSIS OF REVENUES, EXPENDITURES AND ENDING FUND BALANCE
YEAR ENDED JUNE 30, 2004

	ORIGINAL BUDGET	FINAL BUDGET	ACTUAL	VARIANCE POSITIVE (NEGATIVE) ORIGINAL	VARIANCE POSITIVE (NEGATIVE) FINAL
Beginning Fund Balance	**$74,650,009**	**$74,650,009**	**$74,654,009**	**$0**	**$0**
Revenues					
Local Sources	139,298,818	161,736,131	150,653,121	11,354,303	(11,083,010)
State Sources	1,163,308,531	1,154,646,309	1,119,522,326	(43,786,205)	(35,123,983)
Federal Sources	232,763,205	275,900,600	240,881,118	8,117,913	(35,019,482)
Total Revenues	1,535,370,554	1,592,283,040	1,511,056,565	(24,313,989)	(81,226,475)
Expenditures					
Instruction	920,436,644	928,813,007	943,731,984	(23,295,340)	(14,918,977)
Support Services	648,046,158	741,963,758	679,184,166	(31,138,008)	62,779,592
Community Service	5,902,452	6,567,020	6,922,133	(1,019,681)	(355,113)
Miscellaneous	160,209	404,919	51,210	108,999	353,709
Principal Retirement	3,030,000	3,030,000	3,030,000	0	0
Payment of Interest	304,500	330,000	304,500	0	25,500
Total Expenditures	**1,577,879,963**	**1,681,108,704**	**1,633,223,993**	**(55,344,030)**	**47,884,711**
Other Financing Sources (Uses)					
Transfers In	105,394,265	108,201,375	0	(105,394,265)	(108,201,375)
Transfers Out	(115,466,596)	(92,290,149)	(1,916,975)	113,549,621	90,373,174
Sale of Capital Assets	0	0	747,045	747,045	747,045
Total Other Financing Sources (Uses)	**(10,072,331)**	**15,911,226**	**(1,169,930)**	**8,902,401**	**(17,081,156)**
Ending Fund Balance	**$22,068,269**	**$1,735,571**	**($48,683,349)**	**($70,755,618)**	**($50,422,920)**

Source: 2003-04 Comprehensive Annual Financial Report.

Exhibit 4-3 provides a more detailed examination of the General Administration Program.

EXHIBIT 4-3
DETROIT PUBLIC SCHOOLS
GENERAL ADMINISTRATION
ANALYSIS OF EXPENDITURES
YEAR ENDED JUNE 30, 2004

GENERAL ADMINISTRATION	ORIGINAL BUDGET	FINAL BUDGET	ACTUAL	VARIANCE POSITIVE (NEGATIVE) ORIGINAL	VARIANCE POSITIVE (NEGATIVE) FINAL
Salaries	$5,890,772	$9,350,315	$8,144,776	($2,254,004)	$1,205,539
Benefits	1,677,861	2,620,187	2,563,855	(885,994)	56,332
Purchased Services	3,834,356	5,481,044	4,636,876	(802,520)	844,168
Supplies	351,676	333,913	313,431	38,245	20,482
Capital Outlay	191,609	72,187	35,888	155,721	36,299
Other	1,949,232	4,494,128	1,165,226	784,006	3,328,902
Total	**$13,895,506**	**$22,351,774**	**$16,860,052**	**($2,964,546)**	**$5,491,722**

Source: 2003-04 Comprehensive Annual Financial Report.

Exhibit 4-3 shows that the budget for General Administration was increased by $8,456,268, providing a positive variance at year end when compared with the final budget, but overexpended in comparison to the original budget. The budget amendments, with the possible exception of the supplies line item (whatever they may have represented), bear little resemblance to the actual expenditures.

A close review of pages 43 through 48 of the 2003-04 Comprehensive Annual Financial Report shows a wide range of budget amendments for individual line items on the various programs with very few of the amended amounts bearing any resemblance to the actual expenditures. This seems to be true especially in the “Other” line item category.

RECOMMENDATION

Recommendation 4-9:

Establish a contingency budget to address adjustments required for unanticipated activities. All DPS managers should be expected to adhere to the original adopted budget. Any budget amendments that are required should receive careful review and approval by the Budget Office.

5.0 SUMMARY AND LIST OF RECOMMENDATIONS

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The current financial position being faced by Detroit Public Schools is the result of a management breakdown. The lack of checks and balances provided by a Board of Education assisted in this breakdown as there was no longer any process in place to provide effective oversight regarding financial activities. The laudable goal of providing improved educational programs became the focus of the organization and the availability of the resources to fund these activities became an after thought.

The findings identified in this report represent some of the more obvious issues that could be determined in a diagnostic assessment. The nature of these findings, almost all of which reflect a fundamental inability to establish and maintain sound management principles, indicate that there will be numerous analogous situations that have not been identified in this report.

The lack of an effective budget development process and the absence of a budget document are at the heart of the difficulties currently being faced by Detroit Public Schools. The problems have been compounded by the lack of a long-term perspective, and the inability to recognize that the use of fund balance and resources from the sale of real property would not allow DPS to continue spending at the level that had been established.

With the 15-year payback of the $213 million note, DPS will be paying the price for the current lack of budget discipline and effective internal procedures well into the future. The capacity to manage has been present: there is a sound financial system in place and the staff of the Finance Department understands their role, but without a formal budget document and a structured public financial reporting process (along with a tendency for decisions to be made at the top with limited foresight regarding the financial consequences), DPS may have some effective, innovative programs with no way to finance them in the future.

It is necessary to establish a management approach that will provide Detroit Public Schools with a mechanism to downsize the organization over time as the student enrollment continues to decline. This will require implementation of the recommendations in this report, as a minimum, along with a decision-making process that allows the input of internal and external stakeholders.

The 31 recommendations made by MGT in this diagnostic financial assessment report follow:

- Undertake an in-depth study to determine compliance with school staffing formulas for both the 2003-04 and 2004-05 fiscal years to determine how these circumstances occurred, and establish a process to correct the problem. This study should include contacting other school districts utilizing the PeopleSoft software to determine how they make the position control component of the human resources system operate effectively.

- Transfer responsibility for the management of the position control system to the Budget Office.

- Review the payroll records for all retired teachers and other employees retained by DPS for the 2003-04 and 2004-05 fiscal years to assure that the compensation paid has been consistent with the Letters of Understanding between DPS and DFT (as well as other unions); perform a similar review of purchased services contracts to identify any retired teachers or other former employees that are filling positions in DPS, but are being compensated as consultants; and evaluate any other unique employment arrangements that fail to comply with DPS policies and letters of understanding.

- Review the impact of the building substitute model to determine if it has had a positive financial and operational impact on DPS. This analysis is beyond the scope of the current study; however, there is evidence that the building-level substitute model is costing DPS additional resources, which is not the intent for which it was created.

- Undertake an in-depth organizational review to determine how DPS can reduce the number of central office administrators to be more in line with the average number of central office administrators in the peer school districts.

- Establish a formal process whereby the overall revenue position of DPS and the expenditure position of each department and the overall school-based programs are projected on a monthly basis for the 2005-06 fiscal year. An in-depth monthly review should be prepared by the Chief Financial Officer with an expectation that the cause of any variances from the projections will be addressed immediately.

- Reassess the office space needs for DPS and evaluate options that should result in a reduction in the spaces currently being leased or the possibility of a major relocation of the central office.

- Review the process and evaluation associated with the decision to sell the previous administrative facilities and enter into the current condominium and lease arrangements to determine if the savings identified for the General Fund have been achieved.

- Explore the potential for establishing an early retirement program for non-certificated DPS employees.

- Ensure that the budget for special education complies with the IDEA maintenance of effort requirements, assume that the 2005-06 budget will be developed to meet current compliance guidelines, and that the budget will be expended during the 2005-06 fiscal year.

- Undertake a detailed review of the effectiveness of the provision of textbooks for students to take home and the costs associated with the two-textbook program to include the initial cost of the additional textbooks as well as the number of books that have been lost with no cost recovery to Detroit Public Schools. Also evaluate the entire textbook management process to include the manner in which the inventory is determined and maintained, and use this information as a basis to evaluate potential revisions to the existing program or changes in the overall management of the costs associated with textbooks.

- Analyze the manner in which payroll information is processed and contact other PeopleSoft users in large school districts to determine how they process the payroll with significantly fewer employees. In conducting this analysis, DPS should set as a goal the reduction of at least 20 payroll positions.

- Review the circumstances that led to the increase in expenditures and the need for issuance of a note to assure a positive fund balance in the Food Services Fund.

- Establish the Food Services Fund as an Enterprise Fund, and allocate all costs required to support the program to this fund with an expectation that the fund will be operated in a manner that will allow the program to be financially successful as an Enterprise Fund.

- Develop a formal facilities management planning document that includes a separate page for each school, and identifies surplus properties owned by Detroit Public Schools.

- Establish the Print Shop operation as an Internal Service Fund.

- Complete an inventory of copiers throughout DPS to include the current contracts, and create a process to establish the provision of copier services within the Printing Internal Service Fund.

- Establish the Technology Services Department as an Internal Service Fund.

- Evaluate the potential for the implementation of the Internal Service Fund concept in areas beyond printing, copiers, and technology.

- Complete an inventory of vending machines throughout DPS and develop a Request for Proposal(s) for one vendor to provide exclusive vending machine services with the resources received earmarked to be used to increase the fund balance of the General Fund.

- Undertake an independent review of the services currently being outsourced to determine if each of these contracts is still in the best financial and operational interests of Detroit Public Schools.

- Evaluate the possibility of using the student transportation system to transport mail among DPS schools and central office locations.

- Develop a formal budget document that includes revenue information as well as the number of authorized positions and expenditure data for the prior year, the budgeted and estimated amounts for the current year, and the proposed budget amounts for the year of the budget. This document should also include five-year projections for revenues and expenditures.

- Undertake a formal analysis, under the direction of the Budget Office, for all major budget reductions, to ensure that both the operational and fiscal impacts of budget reductions are identified.

- Establish a budget development process that is focused on goals, and create a budget document that will identify how financial decisions have been and are being made based upon these goals, using GFOA best practices in public budgeting as a general guideline.

- Ensure that principals are provided school-based budgets to manage, and are held accountable for managing their budgets. Under *No Child Left Behind*, this is a critical variable affecting school performance. Principals who abuse this responsibility should be disciplined or removed from school management responsibilities.

- Review the process that led to an overestimate of revenue from the State Aid Foundation to determine how the revenue estimates for this revenue source were overestimated by $20 million for both the 2002-03 and 2003-04 fiscal years.

- Establish a process whereby principals are involved in the evaluation of the estimated enrollment information for their schools, use conservative enrollment estimates, and establish a process within the budget development cycle that provides for any major reductions in staff to occur prior to the beginning of the fiscal year.

- Establish a DPS Budget Advisory Committee to assist in the development of the budget that includes representation from each employee organization as well as citizen groups.

- Establish a policy allowing schools to carry discretionary resources forward into future fiscal years, and include in this policy the requirement that once discretionary resources are assigned to the schools, they will not be reduced by the central office at some point in the future.

- Establish a contingency budget to address adjustments required for unanticipated activities. All DPS managers should be expected to adhere to the original adopted budget. Any budget amendments that are required should receive careful review and approval by the Budget Office.