# Detroit Innovation Academy

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## Report to the Board of Directors

## Year Ended June 30, 2017

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To the Board of Directors
Detroit Innovation Academy

We have recently completed our audit of the basic financial statements of Detroit Innovation Academy (the "Academy") as of and for the year ended June 30, 2017. In addition to our audit report, we are providing the following results of the audit and informational items which impact the Academy:



We are grateful for the opportunity to be of service to Detroit Innovation Academy. We would also like to extend our thanks to Michelle Kotas, Lisa Mullin, and the entire business office for their assistance and preparedness during the audit. We recognize that preparing for the audit is carried out in addition to your staff's normal daily activities and appreciate the time and attention provided to us. Should you have any questions regarding the comments in this report, please do not hesitate to call.

Plante & Moran, PLLC

July 28, 2017

# Results of the Audit

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July 28, 2017

To the Board of Directors
Detroit Innovation Academy

We have audited the financial statements of Detroit Innovation Academy (the "Academy") as of and for the year ended June 30, 2017 and have issued our report thereon dated July 28, 2017. Professional standards require that we provide you with the following information related to our audit.

## Our Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated February 3, 2017, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities. Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement.

As part of our audit, we considered the internal control of the Academy. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

Our audit of the Academy's financial statements has also been conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Under *Government Auditing Standards*, we are obligated to communicate certain matters that come to our attention related to our audit to those responsible for the governance of the Academy, including compliance with certain provisions of laws, regulations, contracts, grant agreements, certain instances of error or fraud, illegal acts applicable to government agencies, and significant deficiencies in internal control that we identify during our audit. Toward this end, we issued a separate letter dated July 28, 2017 regarding our consideration of the Academy's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements.

## Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our discussion about planning matters on July 18, 2017.

## Significant Audit Findings

### *Qualitative Aspects of Accounting Practices*

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Academy are described in Note 1 to the financial statements.

No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2017.

We noted no transactions entered into by the Academy during the year for which there is a lack of authoritative guidance or consensus.

We noted no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. There were no significant balances, amounts, or disclosures in the financial statements based on sensitive management estimates.

The disclosures in the financial statements are neutral, consistent, and clear.

### *Difficulties Encountered in Performing the Audit*

We encountered no significant difficulties in dealing with management in performing and completing our audit.

### *Disagreements with Management*

For the purpose of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

### *Corrected and Uncorrected Misstatements*

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We did not detect any misstatements as a result of audit procedures.

### *Significant Findings or Issues*

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, business conditions affecting the Academy, and business plans and strategies that may affect the risks of material misstatement with management each year prior to our retention as the Academy's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition of our retention.

### *Management Representations*

We have requested certain representations from management that are included in the management representation letter dated July 28, 2017.

### *Management Consultations with Other Independent Accountants*

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Academy's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

This information is intended solely for the use of the board of directors and management of Detroit Innovation Academy and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

**Plante & Moran, PLLC**

Lisa Vargo

Lisa Vargo, CPA

# Informational Items

### State Aid Funding

**State Aid and the Foundation Allowance** - State of Michigan funding for public schools continued to focus on several recurring themes for the fiscal year ended June 30, 2017: limited increases in the foundation allowance; additional funding boosts for academies at the minimum foundation; continued student count blending formula; and additional resources dedicated to assisting with funding the academies' retirement/postretirement healthcare obligation (MPSERS). One change worth noting was the increase in the number of required school days to 180, up from 175 days, but without a change in the number of required hours of instruction. Many academies were already providing 180 days of instruction, and for those academies, the change did not have an impact.

**2016-2017 Foundation** - For the 2016-2017 fiscal year, the base foundation increased by $60, from $8,169 to $8,229. The State continued its use of the "2X formula" providing academies at the minimum foundation with an increase of $120 per pupil to $7,511. The Academy's foundation allowance was increased to $7,511. For comparison purposes, the Academy's foundation prior to the $470 cut was $7,580, meaning the current foundation is $79/per pupil below the 2011 foundation allowance. In the 2016-2017 State Aid Act, a minimum funding provision continued (Section 20f). This section recognizes that the funding shift toward paying the growing MPSERS expense could significantly harm some academies and districts. Just as in 2015-2016, this categorical guarantees at least a $25 per pupil increase after giving account to the funding changes. For many academies, the increase in the per pupil foundation was significantly offset by the previous elimination of best practice and performance funding. The Academy's net increase exceeded the $25 minimum and no additional funding was provided under this section. This provision continues for 2017-2018.

**2017-2018 Foundation** - For the 2017-2018 fiscal year, the public school academy maximum foundation allowance increases by $120, from $7,511 to $7,631. Additionally, using the "2X formula," the minimum foundation allowance increases by $120 per pupil to $7,631. Based on these changes, the Academy will receive a $120 increase in its foundation allowance, representing an increase of 1.6 percent. New for 2017-2018, an additional per pupil allocation, Section 22n, was created for students counted in high school. For those students, a new categorical providing additional funding of $25 per pupil was created. This funding is not rolled into the foundation calculation.

**Pupil Membership Blend for 2016-2017 and 2017-2018** - The method for counting students was the same for 2016-2017 and for 2017-2018. The funding formula uses calendar year counts with a weighting of 90 percent of the fall count and 10 percent of the February count. 2016 calendar year counts were used for the 2016-2017 fiscal year funding and 2017 calendar year counts are used for the 2017-2018 fiscal year funding. One significant change for 2017-2018 was an enrollment count cap of .75 FTE for students enrolled in a shared-time program. As a result, the Academy cannot generate more than a .75 FTE for a student participating in a shared-time program.

**At-risk Funding** - For 2017-2018, several changes were made to the funding and use of at-risk funds. A few key items include: an increase of about $120 million allocated to at risk (approximately a 30 percent increase), use of funds to support third grade reading proficiency and eighth grade math proficiency, definition of eligible pupils expanded to include all pupils considered economically disadvantaged, and inclusion of hold-harmless and out-of-formula districts/ academies in the at-risk funding formula for the first time, but at 30 percent of the funding that what would otherwise be available.

### Other State Aid Act Changes Impacting 2017-2018

The amendments to the State Aid Act made several other changes impacting academies. Several changes we identified that could impact the Academy include:

**Partnership Model** - Section 21h provides new funding to assist districts and academies assigned by the MDE to participate in a partnership to improve student achievement, including funds for professional development, increased instructional time, mentors, and other costs impacting student achievement.

**MEAP/M-STEP** - The MDE is required to make the kindergarten entry assessment (KEA) available to districts and academies in 2017-2018.

**Enrollment after Fall Count Day** - After the 2016-2017 school aid amendments were passed, which eliminated the ability to prorate a pupil enrolled after the count day, a supplemental appropriation (HB 5291) was passed reinstating the opportunity to prorate a student added after the count day. For 2017-2018, the ability to prorate student count for pupils added after the count day continues.

**Transparency Reporting Requirements** - These content posting requirements continue and include, but are not limited to, deficit elimination plans, enhanced deficit elimination plans, Academy credit card information, budget information, procurement and reimbursement policies, and out-of-state travel information. Transparency reports must be updated on the Academy's website within 15 days of the change.

## State Aid Planning Considerations for 2018-2019 and Beyond

Michigan's economy is steady, but, based on revenue estimating conference predictions, there are financial challenges ahead for the State. As we have seen by the School Aid Fund, revenue continues to grow, but at a slow pace, but the General Fund projections are at a slower pace. The governor's executive recommendations and legislative actions have provided some increases for general operations, but, for many districts and academies, actual increases to support general school operations have been at or below inflation rates. In the last few years, increases have been concentrated in early childhood, at-risk, and in funding for the increasing retirement obligation. While the final State Aid Act amendments provided additional funds for operations in 2017-2018, because of the elimination of performance funding and best practices, for many the net increase in funding was $25/pupil from the levels in place when best practice and performance were provided. In addition, since the 2017-2018 amendments to the State Aid Act were not signed until July 2017, it is possible the revenue estimates used in the initial 2017-2018 school academy budget may need to be revised. As the legislature and governor continue to modify tax policy, plan for State General Fund resource needs, modify the retirement system benefits, and revisit School Aid Fund resource allocations, the growth and availability of School Aid Fund resources to fund K-12 operations is likely to continue to be less than the rate of inflation.

Clearly, the key issue facing the future of school funding is the need to cover the cost of the retirement system. For 2017-2018, modifications to the retirement system have projected to create significant increased costs. While it appears the legislature has provided resources through the School Aid Fund to cover the cost, it means those resources are not available to fund other K-12 operations. The funding theme in the future will likely continue to be how to use School Aid Fund resources to cover the retirement obligation. Funding this obligation will continue to impact the Academy's ability to receive additional resources to fund general education initiatives and monitoring legislative action in this area will be important in predicting future resource available for the Academy.

Careful planning will continue to be key for the Academy to create a cost structure that is sustainable. The use of budget modeling will be essential, especially as the Academy looks to determine actual state funding available to fund operations. In addition, it is important to segregate resources required to fund specific activities, such as federal funding, special education, or at-risk, when assessing the resources available to fund continuing operations. We recommend the Academy fully analyze the projected revenue available to fund operations when entering into multi-year expenditure agreements.

## Early Warning Legislation

"Early Warning Legislation," a 10-bill package of bills, was enacted in 2015. This legislation is designed to identify academies that may be showing signs of fiscal distress, creates a system of reporting this situation sooner than in the past, and requires those academies deemed to be in distress to remit more frequent financial data to the Treasury. The entire early warning system is under the supervision of the Treasury to monitor and assist local academies and charter schools.

One key item was the identification of those academies and charter schools whose total General Fund balance was less than 5 percent of General Fund revenue in each of the last two years. The definition of revenue for the purpose of this test focuses on General Fund unrestricted revenue. Academies that meet this criteria are required to remit the budgetary assumption and expenditure per pupil information to CEPI as the first step in the process. For 2017, this information was due by July 7, 2017, requiring affected academies to compute certain information only one week after their fiscal year ends.

Once remitted, the state treasurer, through the Office of School Review and Fiscal Accountability (OSRFA), may conclude that the potential for fiscal stress may exist. At that time, the Academy may conclude to contract with the ISD (or the authorizing body for charter schools) to review the Academy's financial records and offer recommendations to avoid a deficit. The review would need to be concluded within 90 days of entering into the contract and requires quarterly reporting to the Treasury on the status of implementation of the recommendations.

In their oversight role, OSRFA uses a fiscal projection model to historical financial information database (FID) data. The projection model incorporates four key financial indicators, which are enrollment, revenue, expenditures, and fund balance. School academies are sent a communication to determine if a corrective action plan had been implemented, or if there was an explanation for a decrease in General Fund balance. OSRFA reviews each school academy's response and financial data to determine whether potential fiscal stress existed in the school academy. If fiscal stress is not declared, then they follow up on the academy's corrective actions. If fiscal stress is declared, the academy and others are notified that the academy may contract with the ISD for an administrative review. As of January 2017, there were 15 academies labeled with potential fiscal stress.

For the years ended June 30, 2017 and 2016, the General Fund balance was 12.59 and 7.96 percent of unrestricted General Fund revenue, respectively. The Academy should continue to monitor this figure closely so any required reporting can be done in accordance with the required timelines.

### Fund Balance

Given the current focus of state funding does not provide significant new resources for operations, we feel that it is important for the Academy to maintain an appropriate level of fund equity. We believe that the benefit of the Academy maintaining an appropriate amount of fund equity allows the Academy the ability to maintain its current level of programs, while being able to meet unforeseen circumstances, like the implementation of state aid proration or a significant change in enrollment. This becomes especially important due to the funding caps imposed by school finance reform, increasing retirement and healthcare costs, other cost pressures the Academy is facing, and cash flow needs due to the fact about 18 percent of the Academy's state aid is received after the school year has ended, as well as concerns over the allocation of resources within the School Aid Fund in the future and the fact that the State is increasing its monitoring of each school academy's financial health, including implications from the early warning requirements.

During the 2016-2017 school year, the Academy's General Fund revenue exceeded expenditures by approximately $138,700. This resulted in increasing the General Fund equity to approximately $333,700 at June 30, 2017. Fund balance goals are often stated in terms of a percentage of total expenditures (excluding transfers out). As a point of reference, the statewide average for school academies at June 30, 2016 (excluding Detroit) is approximately 11.37 percent of expenditures (excluding transfers out). Fund equity of 5.5 percent of expenditures would approximately equal the Academy's average accounts payable and payroll for a three-week period, while 11 percent would approximately equal six weeks. The Academy's fund equity percentage is 10.6 percent and equals approximately six weeks of operation. The fund equity increase demonstrates the Academy is moving toward the goal of an 11.37 percent fund equity. Clearly, the Academy will continue to face difficult budget challenges in 2017-2018 to fund recurring operating costs. Given the current focus of how state funding is appropriated, budget planning and fund balance management will continue to be essential elements for the Academy's success.

## Effective School Boards

The mission of a school board is clear - student achievement. School board responsibilities under the authority of state and federal law include: establishing policies by which their schools are governed; employing the superintendent; and approving curriculum, budgets, and collective bargaining agreements. However, not all schools boards achieve the same results. Research (cited by various education entities such as the Center for Public Education and the National School Board Association) shows that school boards in high-achieving districts share common characteristics. How does your school board measure up?

Characteristics of effective school boards include:

1. Commit to a vision of high expectations for student achievement and hold the superintendent and themselves accountable for results
2. Have a collaborative relationship with each other, the superintendent, administrators, teachers and the community based on open communication and the ability to listen to views of others
3. Are knowledgeable of their academy, well prepared, and data-savvy - they come to meetings prepared, ask questions to seek clarification, and use data to drive continuous improvement.
4. Lead as a united team with the superintendent with strong collaboration and mutual trust while respecting the boundaries of each other's roles
5. Keep learning to be informed and effective leaders. Take part in team development activities to build and share knowledge, values, and commitment