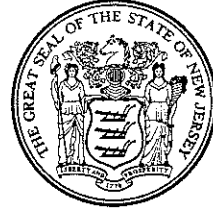


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**New Jersey State Legislature  
Office of Legislative Services  
Office of the State Auditor**



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**Department of Education  
State Aid**

July 1, 2009 to February 28, 2011

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**Stephen M. Eells  
State Auditor**

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Enclosed is our report on the audit of the Department of Education, State Aid for the period of July 1, 2009 to February 28, 2011. If you would like a personal briefing, please call me at (609) 292-3700.

A handwritten signature in black ink that reads "Stephen M. Eells".

Stephen M. Eells  
State Auditor  
May 11, 2011

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### *Scope*

We have completed an audit of the Department of Education's state aid funding for the period July 1, 2009 to February 28, 2011. Our audit included the financial activities accounted for in the state's General Fund and Property Tax Relief Fund. Total state aid appropriations for fiscal years 2010 and 2011 were \$10.1 billion and \$10.3 billion, respectively. We also reviewed controls over American Recovery and Reinvestment Act (ARRA) monies totaling \$1.1 billion that were utilized by the department to implement the school funding formula in fiscal year 2010.

The prime responsibility of the Department of Education in the area of state aid is to administer and distribute state school aid to local school districts.

### *Objectives*

The objectives of our audit were to determine whether state aid payments to local school districts had been calculated in compliance with the School Funding Reform Act of 2008 and other established methodology, whether financial transactions were recorded properly in the accounting system, and whether ARRA funds were properly allocated to school districts and separately accounted for in the state's accounting system. Additionally, we reviewed the impact property tax abatements have on state aid. We also tested for resolution of the significant condition noted in our prior report dated September 22, 2005 regarding School Choice Aid.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section I, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

### *Methodology*

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, the administrative code, and policies of the department. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of financial transactions. We also read the budget messages, reviewed financial trends, and interviewed department personnel to obtain an understanding of the programs and internal controls.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions, as well as internal control and compliance attributes. Transactions were judgmentally selected.

To ascertain the status of findings included in our prior report, we identified corrective action taken by the department and performed tests to determine if the corrective action was effective.

## *Conclusions*

We found that state aid payments to local school districts were calculated in compliance with the School Funding Reform Act of 2008 (SFRA) and other established methodology, and were reported properly in the accounting system. We also determined that ARRA funds were properly allocated to school districts and were separately accounted for in the state's accounting system as required. We also found that the significant issue noted in our prior report has been resolved. In making these determinations, we noted an opportunity for cost savings relating to Preschool Education Aid, and a more accurate and reasonable way to fund special education costs meriting management's attention. In addition, we found property tax abatements reduce a district's ratable property base and thus may increase state aid requirements for certain districts.

## *Background*

The School Funding Reform Act of 2008 (SFRA) was signed into law on January 13, 2008. Pursuant to the act, an adequacy budget is calculated for each school district. The adequacy budget, which is supported by both state and local funds, represents the cost of providing a thorough and efficient education. The calculation of the local share is based on district wealth as measured by aggregate income and property value. As these two values increase, local share requirements increase proportionally. However, the total assessed value of a district's real property does not include abated properties. As a result, state aid requirements may be increased in some districts since equalization aid is distributed to school districts for the portion of the adequacy budget that is not supported by the local share.

Through the distribution of adjustment aid, the SFRA guaranteed every school district a minimum two percent increase in state aid for fiscal year 2009. Adjustment aid was also awarded in fiscal years 2010 and 2011 to ensure districts did not receive less state aid than they received in fiscal year 2009. In subsequent years, adjustment aid will continue; however, it will be reduced for districts experiencing enrollment declines of greater than five percent. The SFRA also established a maximum state aid growth limit that caps a district's increase in state aid relative to the previous school year at 20 percent. However, the maximum growth limit for fiscal years 2010 and 2011 was reduced by the annual appropriation act to five and zero percent, respectively.

A property tax abatement is a reduction of or exemption from taxes on real property granted by a local government to a business or developer for a specified length of time. As previously explained, including the taxable value of abated properties in the local share calculation can potentially reduce state aid. State aid savings, however, would not be realized for districts receiving adjustment aid since any reduction in equalization aid would be offset by an increase in adjustment aid to ensure fiscal year 2009 funding levels are maintained. For example, local share requirements for two sample districts would have increased by \$600,000 and \$300,000, respectively, in fiscal year 2010 if abated properties with a taxable value of \$21.2 million and \$12.9 million were included in the local share calculation. Although equalization aid for these two districts would have decreased, a reduction in overall state aid would not have been realized since one district received adjustment aid and the other was capped at the effective state aid growth limit.

The total taxable value of tax exempt property in each municipality can be found on the New Jersey Department of Community Affairs website. Various categories are displayed including "partial exemptions and abatements." Within this category, total taxable property values ranging from \$1,000 to \$359.1 million were reported for 141 municipalities. Only four of these districts did not receive adjustment aid or have a state aid growth limit reduction in fiscal year 2010.

Although state aid to some districts would be reduced with the inclusion of abated properties, these savings would be redistributed to other districts in accordance with the SFRA.

## **Preschool Education Aid to SDA Districts**

### **Payments should be based on actual enrollment.**

In accordance with the School Funding Reform Act of 2008 (SFRA), preschool education aid is provided to districts that received early childhood program aid, early launch to learning initiative aid, or preschool expansion aid in fiscal year 2008. A total of \$596 million was appropriated for preschool education aid in fiscal year 2010, of which \$550 million was distributed to the 31 SDA school districts, formerly known as Abbott school districts.

Annually, SDA districts project their preschool enrollment and receive a fixed amount of aid per pupil based on placements. The per pupil aid amounts for fiscal year 2010 were \$11,890 for pupils enrolled in an in-district program, \$13,366 for pupils enrolled in a licensed child care provider program, and \$7,385 for pupils enrolled in a Head Start program.

Our review noted that 25 SDA districts overestimated their preschool enrollment in fiscal year 2010. Collectively, the projected preschool program enrollment for the 31 SDA districts was 1,480 pupils greater than the actual enrollment which is a four percent error rate. The largest disparity, 765 pupils, was with the provider program where 51 percent of the pupils were placed. SDA district enrollments for in-district and Head Start preschool programs were also overestimated by 331 and 384 pupils, respectively. One district overestimated their preschool enrollment by 358 pupils resulting in an additional \$4.7 million in aid. Our review also noted that five districts underestimated their preschool enrollment by a total of 147 pupils.

If payments for preschool education aid were adjusted based on actual enrollments, the department could have saved \$18.4 million in fiscal year 2010.

### **Recommendation**

Although the department distributed preschool education aid to the SDA districts in accordance with the SFRA, we recommend the department seek legislation to allow payments to be adjusted based on actual enrollments.



## **Special Education Aid**

### **An actual classification rate should be utilized for special education aid.**

Pursuant to the School Funding Reform Act of 2008 (SFRA), special education aid is provided to school districts to support the costs of providing individualized program plans to students with disabilities. The SFRA funds two-thirds of special education costs through the adequacy

budget calculation and one-third through the special education categorical aid formula by applying the state average classification rate of 14.69 percent to district enrollments. Annual program costs calculated for fiscal years 2010 and 2011 were \$2.3 billion.

Utilizing an average rate is only reasonable if districts have an insignificant deviation from the average. Our review of fiscal year 2010 and 2011 enrollments found that approximately 60 percent of districts with 100 or more special education pupils had an actual classification rate that was plus or minus 10 percentage points from the statewide average classification rate of 14.69 percent. As a result, district funding is not commensurate with enrollments in many instances. For example, Elizabeth City received special education aid funding of \$34.1 million in fiscal year 2010. This amount, however, would have been reduced to \$24.5 million if the formula utilized their actual classification rate of 10.51 percent instead of the average rate of 14.69 percent. Conversely, Camden City received \$23.5 million in fiscal year 2010. If their actual classification rate of 20.2 percent was used, their entitlement would have increased by \$8.7 million to \$32.2 million.

As previously explained, changes to specific state aid category entitlements may not affect overall funding levels if a district received adjustment aid or was capped at the growth limit. Camden, for example, received \$51.5 million in adjustment aid during fiscal year 2010 so any increase to their special education aid entitlement would have been offset by a proportionate decrease to their adjustment aid. The fiscal year 2010 state aid originally calculated for Elizabeth was reduced by \$2.0 million to reach the maximum growth rate of five percent. As a result, the actual state aid savings realized from utilizing their actual classification rate would have been \$7.6 million instead of \$9.6 million.

Actual funding needs for district special education programs may not be adequately provided under the current formula. Many district programs will continue to be over or underfunded at the state level as long as the average classification rate is utilized

### **Recommendation**

Although the department distributes special education aid in accordance with the SFRA, they should seek legislation allowing for the actual classification rate to be utilized in the formulas.

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State of New Jersey  
DEPARTMENT OF EDUCATION  
PO Box 500  
TRENTON, NJ 08625-0500

CHRIS CHRISTIE  
Governor

KIM GUADAGNO  
Lt. Governor

CHRISTOPHER D. CERF  
Acting Commissioner

May 11, 2011

Mr. Stephen M. Eells, State Auditor  
Office of Legislative Services  
Office of the State Auditor  
125 South Warren Street  
P.O. Box 067  
Trenton, NJ 08625-0067

Dear Mr. Eells:

**SUBJECT: Response to OLS Audit Report of the Department of Education, State Aid**

The New Jersey Department of Education (DOE) has received and reviewed the Office of Legislative Services (OLS) Audit Report of the Department of Education, State Aid for the period July 1, 2009 to February 28, 2011. The auditors' findings and recommendations, along with our responses are as follows:

**Finding Number 1**

Payments for preschool education aid should be based on actual enrollment.

**Recommendation**

Although the department distributed preschool education aid to the SDA districts in accordance with the SFRA, we recommend the department seek legislation to allow payments to be adjusted based on actual enrollments.

**NJDOE Response**

The DOE agrees that the enrollment projections for preschool are generally less accurate than the K-12 projections. Since the preschool enrollment projections are typically higher than actual enrollments, the state could potentially save money by adjusting preschool aid for actual enrollments in the current year, consistent with the prior years. However, there is also the potential for an upward adjustment for individual districts or a net cost to the state.

[www.nj.gov/education](http://www.nj.gov/education)

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## **Finding Number 2**

An actual classification rate should be utilized for special education aid.

## **Recommendation**

Although the department distributes special education aid in accordance with the SFRA, they should seek legislation allowing for the actual classification rate to be utilized in the formulas.

## **NJDOE Response**

The DOE respectfully disagrees with the recommendation to use an actual classification rate in the special education funding formula. Applying the district's actual classification rate would not necessarily result in a more accurate calculation of special education aid. The foundation of the census methodology is to utilize state averages for both the cost and special education classification rate, resulting in state aid commensurate with enrollment. As districts have classification rates that are either higher or lower than the state average, districts also have classified students that have costs both above and below the state average. For example, a district may have a high classification rate but an average cost far below the state average, or vice versa. The DOE recognizes these variations exist, which is why application of both the average classification rate and average "excess cost" for special education are used in the census driven aid calculation. Additionally, extraordinary special education aid is provided to ensure that districts receive additional assistance for students with very high needs and more than likely higher cost than that provided in the census formula. We feel that application of the district's actual special education enrollment would result in removing one of the central components on which the census methodology is based, and ultimately would not improve the accuracy of funding according to student needs.

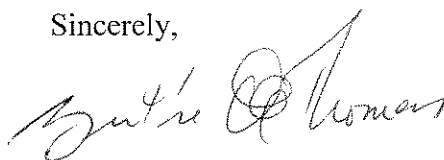
The prior funding method for special education utilized the actual enrollment within each district by severity of disability classification (labeled as Tiers I – IV). This type of funding provides a fiscal incentive to classify students. In developing the new funding formula (SFRA), the policy decision was made to move to the census based method for funding special education. This method was upheld by the NJ State Supreme Court in its Abbott XX decision (Abbott ex rel. Abbott v. Burke, 199 N.J. 140, 971 A.2d 989 (2009)).

Finally, the SFRA requires the state to commission an independent study of the special education census method "to determine if adjustments in the special education funding formulas are needed in future years to address the variations in incidence of students with severe disabilities requiring high cost programs and to make recommendations for any such adjustments" (N.J.S.A.18A:7F-55f). The DOE has retained the services of Augenblich, Palaich, and Associates (APA) to conduct a comprehensive investigation of the census method and its effects on NJ school districts. We anticipate that the final report will be available in the coming months.

Mr. Stephen Eells, State Auditor  
May 11, 2011  
Page 3 of 3

We trust that our responses satisfy the concerns raised in the audit report. Should you have any questions or need further information, please contact me at 984-4948.

Sincerely,

A handwritten signature in black ink, appearing to read "Yut'se O. Thomas". The signature is fluid and cursive, with a large initial "Y" and "T".

Yut'se O. Thomas, Acting Assistant Commissioner  
Division of Finance & Regulatory Compliance

YOT/SE/CP/doe response- state aid  
c: Christopher D. Cerf  
Gregg Edwards  
Robert J. Cicchino