



**New Jersey State Legislature
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City of Newark School District

Fund Balance at June 30, 1999

**Richard L. Fair
State Auditor**

98/99

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The Honorable Donald T. DiFrancesco
President of the Senate

The Honorable Jack Collins
Speaker of the General Assembly

Mr. Albert Porroni
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Office of Legislative Services

Enclosed is our report on the review of the City of Newark School District's fund balance at June 30, 1999. If you would like a personal briefing, please call me at (609) 292-3700.

A handwritten signature in black ink, appearing to read "Richard L. Fair".

Richard L. Fair
State Auditor

May 15, 2000

Table of Contents

Page

Scope 1

Objectives 1

Methodology 1

Conclusions 1

City of Newark School District

Scope

We have completed a review of the City of Newark School District's fund balance at June 30, 1999. Our review included an analysis of the district's financial statements and reports. We have not audited or reviewed the financial statements of the City of Newark School District and therefore we express no opinion or any other form of assurance on them.

Objectives

The objectives of our review were to provide the legislature with information about the cause and amount of the City of Newark School District's fiscal year 2000 budgetary deficit and possible need for supplemental state aid. We did not review expenditures or other financial transactions for propriety as the Department of Education and the district have retained other auditors for this purpose.

This engagement was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

During the course of our engagement we reviewed and analyzed the district's budgets and spending plans and compared them to audited and unaudited financial reports and databases obtained from the district's active and inactive computer systems. We reviewed Advisory Board minutes and audit reports issued by the internal audit unit. We also interviewed personnel of the district and the Department of Education to obtain an understanding of the budgeting process and internal controls.

Conclusions

The state assumed control of the City of Newark School District in July 1995, after the close of fiscal year 1995. At the time, Newark's cost per pupil ranked among the highest in the state in most major categories and the June 30, 1995 general fund balance was \$69.9 million. Throughout state control, the district remained one of the highest in spending

per pupil and the general fund balance at June 30, 1999 was reduced to \$9.6 million which is fully encumbered. The depletion of the surplus is a result of several factors. The main reason is simply that expenditures have remained constant while revenues have decreased.

During the first two years of state control, fiscal years 1996 and 1997, the spend-down of the fund balance was budgeted and gradual. Due to a \$26 million grant from the Department of Education in late fiscal year 1997, the fund balance at June 30, 1997 actually increased to \$83.3 million. It has only been since fiscal year 1998 that large bites have been taken out of the fund balance.

Throughout the period since fiscal year 1995, spending for the district has remained fairly level, with an average inflation factor of 1.2 percent. Total salary expenditures during fiscal years 1997 to 1999 have increased less than one percent from \$321 million to \$323 million. During this time, pupil counts declined. Most salary and other costs are based on the fixed number of schools/classrooms, rather than the number of pupils. Beginning in fiscal year 1998, actual pupil counts have a direct impact on revenues. These actual annual pupil counts, after six years of using 1991 counts, formed the basis for the entitlement revenue amounts. This change resulted in a reduction of 4,000 funded pupils in fiscal year 1998, reduced revenues of \$39 million and is the major reason for the continued necessity to budget a large portion of fund balance to cover the gap between spending and revenue. It was in anticipation of this fiscal year 1998 revenue reduction and the district's need to use its surplus that the Department of Education granted \$26 million supplemental funding during fiscal year 1997. Similar supplemental awards, however, were not granted to offset the reduced revenue effects experienced during subsequent fiscal years, so the drain and ultimate elimination of the fund balance was imminent. By the end of fiscal year 1999, no undesignated fund balance (surplus) remained. In fact, the total fund balance of

What is the district's projected deficit for the end of fiscal year 2000 and how much supplemental funding will be needed to make Newark whole?

\$9.6 million was not enough to cover outstanding purchase orders of \$15.6 million.

For fiscal year 2000, the district has been operating under an unapproved, unbalanced spending plan that anticipated \$471 million in general fund revenues, \$471 million in expenditures, and payment of prior year encumbrances of \$15.6 million. Based on our discussions with district officials, assuming that all \$471 million of anticipated revenues are received by the school district, we see no need for additional funding. This plan, however, already anticipates that the district will receive \$37.4 million in supplemental discretionary funding. We project no ending fiscal year fund balance available for subsequent year's expenditures.

As we have previously mentioned, expenditures are somewhat fixed, increasing with inflation. To balance future year budgets, unless the district reduces expenditures, they will continue to require total state funding of \$371 million annually and additional funding for cost of living increases.

How much of the spend-down was caused by the overspending of the budget?

In fiscal years 1996 through 1999 the district did not spend more than they budgeted. In fiscal year 2000, general fund expenditures are projected to be within \$5 million of the spending plan.

In fiscal year 1999 the district spent \$20 million in capital improvements which were not budgeted, but which were funded through debt, rather than current state aid.

What areas deserve further audit consideration?

Although the reported district expenditures are consistent from year to year, we make no conclusions as to the propriety or efficiency of these expenditures. There were items that came to our attention that could merit additional review for possible cost savings. These areas include the following:

- Salary and employee benefit costs comprise over 80 percent of the total cost. Although

not unusual, because of the magnitude of these expenditures, they merit additional review.

- The district annually subsidized the food service fund with \$8 million. The per pupil food service cost (subsidy) is the highest in the state and nearly double that of the second highest.
- Administrative costs and operating and maintenance costs, led by their respective salary and benefit costs, rank among the highest in the state. The district has more administrators compared to faculty than nearly all other comparable districts in the state.
- The untimely preparation and approval of budgets and the necessity of large transfers between line items indicate weaknesses in the budgetary process and controls over spending. Large differences were found in our comparison of individual line items of the original budget to actual expenditures.

Currently, the Department of Education and the district have engaged public accounting firms to compile and audit the district's financial statements. Other public accounting firms have been engaged to review the propriety of expenditures and identify cost efficiencies. We recommend that these reports be submitted to the legislature on conclusion.