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Office of the State Auditor**

**Department of Education
State Aid**

July 1, 2014 to May 31, 2016

**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, 2014 to May 31, 2016. If you would like a personal briefing, please call me at (609) 847-3470.

A handwritten signature in black ink, appearing to read "Stephen M. Eells".

Stephen M. Eells
State Auditor
September 21, 2016

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Scope

We have completed an audit of the Department of Education's state aid funding of local school districts for the period July 1, 2014 to May 31, 2016. Our audit included financial activities accounted for in the state's General Fund and Property Tax Relief Fund relating to general formula aid as well as Adult Education Aid, Special Education Categorical Aid, and Transportation Aid. Total appropriations for these state aid categories for fiscal years 2015 and 2016 were \$8.62 billion and \$8.63 billion, respectively.

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 were calculated in compliance with the School Funding Reform Act of 2008 (SFRA) or the applicable Appropriations Acts, and whether financial transactions were recorded properly in the accounting system. We also tested for resolution of the significant conditions noted in our prior report dated May 11, 2011.

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. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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

A nonstatistical sampling approach was used. Our samples were designed to provide conclusions on our audit objectives as well as internal controls and compliance. Sample populations were sorted and transactions were judgmentally and randomly selected for testing.

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

Conclusions

We found state aid payments to local school districts were calculated in compliance with the applicable Appropriations Acts, and were reported properly in the accounting system. However, since the Appropriations Acts superseded the SFRA, the funding was not calculated in compliance with the SFRA. In making these determinations, we noted K-12 formula aid and Preschool Education Aid were not always commensurate with the districts' student populations and demographics. We also found the department has not resolved significant conditions noted in our prior report regarding Special Education Categorical Aid and Preschool Education Aid. These issues have been updated and restated in this report.

Background

State aid funding to school districts is appropriated annually. The School Funding Reform Act of 2008 (SFRA) was signed into law on January 13, 2008. The SFRA created formula-based aids designed to provide students in New Jersey with a thorough and efficient education. The aids included in the SFRA are: Equalization Aid, Special Education Categorical Aid, Transportation Aid, Educational Adequacy Aid, Security Aid, Adjustment Aid, School Choice and Preschool Education Aid.

Additional state aid categories were created subsequent to the SFRA. Supplemental Enrollment Growth Aid was distributed pursuant to P.L.2012, c.37. The Appropriations Acts also provided four categories of K-12 formula aid: Under Adequacy Aid, Additional Adjustment Aid, Per Pupil Growth Aid, and PARCC Readiness Aid. With the exception of Additional Adjustment Aid, all non-SFRA aids have remained at their initial funding amount each year per the Appropriations Acts.

Funding Inequities

Funding is not based on current district data.

The SFRA formula distributes aid based on district enrollment and student demographics (income, special education, language barriers, etc.), as well as other factors such as district wealth and property values. In fiscal years 2015 and 2016, funding remained static for each district at the fiscal year 2014 funding level for SFRA formula aid categories (with the exception of School Choice and Preschool Aid). Changes in districts' enrollments, student demographics, and other factors influencing aid were not considered.

The SFRA formula aid has not been distributed per statute since fiscal year 2009. Starting in fiscal year 2010, the Appropriations Acts began superseding part, or all, of the formula. Through fiscal year 2014, the methods followed for the annual calculations blended past and current data from multiple years to determine funding, making the distribution convoluted. During fiscal years 2015 and 2016, no data from either year was applied to the formula to determine funding. Consequently, there were significant differences between actual funding and what the SFRA dictates.

The department prepared different school funding scenarios for informational purposes in fiscal years 2015 and 2016 based on the state budget and the calculations set forth in the SFRA. Using this data, we calculated the portion of the SFRA formula aid each district would have received, if used, and applied that percentage to the total of actual funding for both years. Our review found that 385 districts in fiscal year 2015 and 365 districts in fiscal year 2016 would have received more funding if they received the percentage of aid that they are entitled to in accordance with the SFRA. According to our calculation, one district would have received an additional \$20 million and \$34 million in fiscal years 2015 and 2016, respectively. Conversely, another district would have received \$48 million and \$49 million less during these same fiscal years. Prorating funds based on current district data would have made funding more in line with the SFRA's intent. While this provision has been included in the Appropriations Acts, other language in the Appropriations Acts has been followed and taken precedence.

Additionally, it should be noted that even though the SFRA formula aid was not distributed in accordance with statute, districts may have received Adjustment Aid. This aid is provided so districts do not receive less aid than their fiscal year 2009 amount. In addition, in fiscal year 2014, Additional Adjustment Aid was distributed per the Appropriations Act to ensure districts would not receive less than their fiscal year 2013 funding. Adjustment Aid and Additional Adjustment Aid can be contrary to the objective of the SFRA since funding may exceed the districts' actual needs for their current student populations.

Recommendation

Although the department is distributing funding per the Appropriations Acts, we recommend that the methodology for allocating funding be based on current student population and other demographics.



Special Education Aid

An actual classification rate should be applied 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 services to general special education students. The SFRA funds two-thirds of special education costs through the adequacy budget component of Equalization Aid and one-third through the Special Education Categorical Aid (SECA) formula by applying the state average classification rate of 14.78 percent to district enrollments. Annual appropriations for SECA in both fiscal year 2015 and 2016 were \$763 million. It should be noted that SECA remained at the fiscal year 2014 funding level, for which the average classification rate was applied. The funding methodology was determined by the Appropriations Acts.

As indicated in our prior report, utilizing an average classification rate is only reasonable if districts have an insignificant deviation from the average. Our review of districts with 100 or more special education students in fiscal years 2015 and 2016 found that 234 districts (59 percent) and 258 districts (64 percent), respectively, had an actual classification rate that deviated more than 10 percentage points from the statewide average classification rate of 14.78 percent. As a result, district funding is not commensurate with actual enrollment of classified students in many instances.

Appropriations have not been sufficient to meet the SECA funding requirements of the SFRA formula. We calculated the SECA that a district would have received if their actual classification rate was used (Audit Calculated Aid), as well as the aid they would have received according to the SFRA formula (SFRA Calculated Aid) using the district's enrollment data provided on the Application for State School Aid. We then prorated each calculation to the level of appropriation funding. In addition, we documented the actual amount of aid districts received as well as the district's actual special education classification rate. The following charts show this information for three districts.

Fiscal Year 2015				
District	Actual Classification Rate	Audit Calculated Aid	SFRA Calculated Aid	Actual Aid Received
A	18.93%	\$10,469,564	\$8,200,699	\$8,244,198
B	10.93%	\$9,695,479	\$13,153,172	\$13,260,027
C	0.00%	\$0	\$1,634	\$2,830

Fiscal Year 2016				
District	Actual Classification Rate	Audit Calculated Aid	SFRA Calculated Aid	Actual Aid Received
A	18.25%	\$10,230,931	\$8,381,489	\$8,244,198
B	11.30%	\$10,336,410	\$13,681,275	\$13,260,027
C	0.00%	\$0	\$1,632	\$2,830

Applying the actual classification rate to the calculation of SECA may not affect a district's overall funding. Districts may receive Adjustment Aid which ensures that the district does not receive less funding than their total fiscal year 2009 state aid amount. In addition, the SFRA established maximum state aid growth limits which cap a district's increase in state aid relative to the previous school year. These caps could reduce the amount of SECA that is awarded to a district. The districts included in the charts above did not receive less SECA due to the growth limit cap.

The Task Force on Improving Special Education for Public School Students was established under P.L.2013, c.31. One goal of this task force was to evaluate funding of special education programs for public school students. In their report, released in August 2015, they state that the SFRA does not calculate special education costs for each eligible student, as it does for other enrollment based categories. The Task Force believes that an effective formula should be based on the actual number of special education students in each district rather than applying the state average classification rate.

Recommendation

We recommend that the department seeks legislation to calculate Special Education Aid utilizing actual classification rates.



Preschool Education Aid to SDA and Expansion Districts

Preschool Education Aid should be adjusted for actual enrollment so funding is based on current district needs.

Per the School Funding Reform Act of 2008, Preschool Education Aid is provided only to districts that received Early Childhood Program Aid, Early Launch to Learning Initiative Aid, or Preschool Expansion Aid in fiscal year 2008. Annual Appropriations Act language defined the calculation of Preschool Education Aid in fiscal years 2015 and 2016 for eligible districts. Total aid appropriated was \$652.8 million and \$655.5 million in fiscal years 2015 and 2016, respectively. The aid provided to the 31 SDA school districts and four other school districts that received fiscal year 2008 Preschool Expansion Aid totaled \$608.5 million and \$611.1 million in each respective year and accounted for 93 percent of total appropriations.

As noted in our prior report, these districts annually project their preschool enrollment and receive a fixed amount of aid for each student based on placement. The base per pupil amounts for fiscal years 2015 and 2016 were \$12,788 for pupils enrolled in an in-district program, \$14,375 for pupils enrolled in a licensed child care provider program, and \$7,943 for pupils enrolled in a Head Start program.

The SDA school districts are held harmless to fiscal year 2009 thresholds. They will receive the greater of their calculated fiscal year 2015 or 2016 Preschool Education Aid, as explained above; the amount of aid they received in fiscal year 2009; or their fiscal year 2009 per pupil amount multiplied by their current year total projected enrollment. During our audit period, seven SDA districts were held harmless providing them with \$11.8 million and \$16.5 million in excess funding for fiscal years 2015 and 2016, respectively.

Our review also noted that every district overestimated their projected enrollment in fiscal year 2015, resulting in overpayments to 32 districts totaling \$25.7 million. In fiscal year 2016, 33 districts overestimated their projected enrollment, resulting in 30 districts being overpaid a total of \$32.9 million. However, using actual enrollment data, we determined that seven and ten of the SDA districts in fiscal years 2015 and 2016 would still have been held harmless to their fiscal year 2009 funding, resulting in additional overpayments of \$10.9 million and \$28.2 million, respectively.

The Appropriations Acts required that the districts' allocation of aid shall be set forth in their annual State Aid Notice. However, the Appropriations Act language can be modified, as it is for the School Choice Aid, so that funding is adjusted in the following year for actual pre-budget year enrollment.

Recommendation

Although the department distributed aid in accordance with the Appropriations Acts, we recommend the department seek language which allows subsequent payments to be adjusted based on actual enrollments. We further recommend the elimination of held harmless provisions so that aid is based only on current enrollment data.



Preschool Education Aid to ECPA Districts

Disparity in per pupil amounts leads to imbalanced funding.

A portion of Preschool Education Aid (PEA) is provided to districts that received Early Childhood Program Aid (ECPA) in fiscal year 2008. In accordance with the Appropriations Acts, aid to ECPA districts is calculated by multiplying the district's per pupil aid amount by their projected enrollment. According to department personnel, the calculation of the per pupil aid amounts was based on the amount of PEA the district was awarded in fiscal year 2009 divided by the total number of students reported being served that year. Districts using funds in addition to state aid were generally able to serve more preschool students. However, this potentially lowered their per pupil amounts. In contrast, districts that had low enrollments during that year had higher per pupil amounts. These amounts have subsequently been updated by the consumer price index through fiscal year 2014, and remained constant in fiscal years 2015 and 2016. The ECPA portion of PEA, distributed to 93 districts, totaled \$41.5 million and \$42.2 million in fiscal years 2015 and 2016, respectively.

Districts can operate full-day, half-day, or a combination of both for their preschool programs. The ECPA per pupil amounts are based on full-day preschool programs. Students attending half-day programs receive half of the per pupil amount for each enrolled student. We noted that the per pupil amounts for the 93 districts ranged from \$2,036 to \$27,663. This disproportionate funding creates educational inequities among the students being served by this aid.

Recommendation

We recommend the department establish uniform per pupil amounts to ensure each eligible child has access to comparable preschool programs.





State of New Jersey

DEPARTMENT OF EDUCATION

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CHRIS CHRISTIE
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September 19, 2016

Mr. Stephen M. Eells, State Auditor
Office of Legislative Services
Office of the State Auditor
125 South Warren Street
P.O. Box 067
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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, 2014 to May 31, 2016. The auditors' findings and recommendations, along with our responses are as follows:

Finding Number 1

Funding Inequities – Funding is not based on current district data.

Recommendation

Although the department is distributing funding per the Appropriation Acts, we recommend that the methodology for allocating funding be based on current student population and other demographics.

NJDOE Response

While this recommendation is laudable, the department is bound by the prevailing statute as amended by the legislature and accepted by the administration which requires that the distribution of aid to districts follow the language in the annual appropriation bill.

Finding Number 2

Special Education Aid - An actual classification rate should be applied for Special Education Aid.

Recommendation

We recommend that the department seeks legislation to calculate Special Education Aid utilizing actual classification rates.

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, but of significant importance is the fact that 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. Using district's actual special education enrollment, in the absence of defined excess costs for each classification would result in removing one of the central components on which the census methodology is based – the recognition that there are low incidence/high cost and high incidence/low cost classifications resulting a wide variation in actual expenditure. Finally, a system based on recognizing individual classification would not improve the accuracy of funding according to student needs, but would reduce the current flexibility that districts have in identifying and placing special education students; and would also increase the complexity of the funding formula.

Finding Number 3

Preschool Education Aid to SDA and Expansion Districts - Preschool Education Aid should be adjusted for actual enrollment so that funding is based on current district needs.

Recommendation

Although the department distributed aid in accordance with the Appropriations Act, we recommend the department seek language which allows subsequent payments to be adjusted based on actual enrollments. We further recommend the elimination of held harmless provisions so that aid is based only on current enrollment data.

NJDOE Response

The DOE agrees that the enrollment projections for preschool are generally less accurate than the K-12 projections. We have increased the scrutiny of preschool budgets and continue to encourage districts to increase the accuracy of projections so as to reduce the amount of surplus generated each year. We added a new line (90005) to districts' budget to force them to report and utilize any surplus funds. 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. However, we are also cognizant of the potential for an upward adjustment for individual districts which may result in a net cost to the state.

Finding Number 4

Preschool Education Aid to ECPA Districts – Disparity in per pupil amounts leads to imbalanced funding.

Recommendation

We recommend that the department establish uniform per pupil amounts to ensure each eligible child has access to comparable preschool programs.

NJDOE Response

DOE recognizes that the per pupil amount of aid varies widely across the former ECPA districts. However, the methodology utilized is statutory and any change would require legislative action, either with an amendment of SFRA or with language in the Appropriations bill.

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 (609)633-0259.

Sincerely,



Kevin Dehmer, Chief Financial Officer
New Jersey Department of Education

KD/CP:

c: Commissioner David C. Hespe
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Robert J. Cicchino
Yut'se Thomas