

BOARD OF EDUCATION OF THE :  
TOWNSHIP OF NEPTUNE, :  
MONMOUTH COUNTY, :

PETITIONER, : COMMISSIONER OF EDUCATION

V. : DECISION

NEW JERSEY STATE DEPARTMENT :  
OF EDUCATION, :

RESPONDENT. :

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#### SYNOPSIS

Petitioning “Abbott” District appealed the Department’s determination of its 2003-04 preliminary “maintenance budget,” alleging that the Department’s review was not in accordance with the July 23, 2003 order of the Supreme Court.

The ALJ determined, by interim Order dated September 10, 2003, that the OAL does not have jurisdiction to determine the validity of *N.J.A.C.* 6A:10-1.2. In these proceedings, the ALJ found: 1) the Department correctly excluded tuition and maintenance reserves in its calculation of the District’s projected fund balance; 2) the District’s additional \$2 million tax levy is an “available resource” to the District and the Department properly allocated and reduced the District’s discretionary aid by the amount of this tax revenue; 3) the District is not entitled to the initial preschool expansion aid award of \$204,210; 4) the action of the Department in adding to the District’s fund balance a receivable in the amount of \$594,001, representing the last payment of Additional *Abbott v. Burke* State Aid for the 2002-2003 school year is correct; and 5) the Department’s method of calculating the District’s projected fund balance by including encumbered funds is incorrect.

The Commissioner concurred with the ALJ’s findings and conclusions with respect to the disputed issues with the exception that the Commissioner concluded that the Department correctly included the District’s encumbered funds in projecting the District’s fund balance consistent with the Department’s accounting manual and instructions to the school districts with respect to the processing of year-end purchase orders, *N.J.A.C.* 6A:23-2.2 and *N.J.A.C.* 6A:10-1.2.

<p>This synopsis is not part of the Commissioner’s decision. It has been prepared for the convenience of the reader. It has been neither reviewed nor approved by the Commissioner.</p>
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The record of this local “Abbott” District’s appeal of the Department of Education’s (Department) decision on its supplemental funding request for the 2003-2004 school year, and the Initial Decision of the Office of Administrative Law (OAL) have been reviewed. Exceptions and replies thereto were filed by both the Board of Education of the Neptune School District (District) and the Department in accordance with the schedule established in response to the Court’s order for expedition and were considered by the Commissioner in reaching this decision.

Initially, upon careful and independent review of the record, the Commissioner concurs with the Administrative Law Judge’s (ALJ) September 10, 2003 Order Relative to “Maintenance Budget,”<sup>1</sup> that the OAL does not have jurisdiction to determine directly or indirectly the validity of *N.J.A.C.* 6A:10-1.2, as such determination is solely within the jurisdictional purview of the Appellate Division or the Supreme Court. R. 2:2-3(a); *see, also,*

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<sup>1</sup> The District did not file a request to the Commissioner for interlocutory review of this Order, but its exceptions to the Initial Decision urge the Commissioner to “reject the ALJ’s determination of the ‘maintenance budget’ issue.” (District’s Exceptions at 5)

*Pascucci v. Vagott*, 71 N.J. 40, 51-52 (1976); *Wendling v. N.J. Racing Com'n*, 279 N.J. Super. 477, 485 (App. Div. 1995). Moreover, even if it were to be assumed, *arguendo*, that the OAL has jurisdiction to determine “a choice of law” as argued by the District, the Commissioner finds that the Department’s definition of “maintenance budget,” as detailed in N.J.A.C. 6A:10-1.2, does not differ in any appreciable way from the Supreme Court’s definition of that term contained in its Budget Order of July 23, 2003. Consequently, the Department’s application of such regulatory definition in its review and approval of the District’s 2003-2004 budget is wholly appropriate.<sup>2</sup>

Upon a thorough and independent review, the Commissioner concurs with the ALJ’s determinations that: 1) the Department correctly excluded tuition and maintenance reserves in its calculation of the District’s projected fund balance; 2) the District’s additional \$2 million tax levy is an “available resource” to the District and the Department properly allocated and reduced the District’s discretionary aid by the amount of this tax revenue; 3) the District is not entitled to the initial preschool expansion aid award of \$204,210<sup>3</sup>; and 4) the action of the Department in adding to the District’s fund balance a receivable in the amount of \$594,001, representing the last payment of Additional *Abbott v. Burke* State Aid for the 2002-2003 school year is correct. With respect to these issues, therefore, the Commissioner accepts the ALJ’s factual findings and determines that his analysis and legal conclusions are consistent

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<sup>2</sup> Consequently, pursuant to N.J.A.C. 1:1-14.10(j), the Commissioner adopts the ALJ’s interim Order of September 10, 2003.

<sup>3</sup> The ALJ points out that the District indicated in its post-hearing brief that it will not pursue its preschool expansion aid claim at the present time. (Initial Decision at 15) However, stating that he is uncertain whether the District’s intention is to withdraw its claim or whether it has chosen not to present arguments on this issue, the ALJ made findings on this issue and concluded that the District was not entitled to the \$204,210 preschool expansion aid “because that award was based on an early childhood plan that was subsequently amended and reduced, as stipulated by Neptune.” (*Id.* at 17) The sole mention of this claim in the District’s exceptions to the Initial Decision appears in the District’s conclusion:

(3) require the DOE to provide the District with the pre-school expansion aid\*\*\*. (District’s Exceptions at 13)

with the Supreme Court's Order of July 23, 2003, as well as the Department's regulatory amendments adopted on August 22, 2003.

However, the Commissioner does not concur with the ALJ's finding that the Department erred in calculating the District's projected general fund balance by including encumbered funds in the amount of \$2,274,763 because "amounts that are set apart for the purpose of paying the legal obligations of the school district cannot be considered as 'undesignated' fund balances." (Initial Decision at 12) The Commissioner believes that the ALJ's analysis reflects a fundamental misunderstanding of the differentiation between the terms "encumbrances" and "accounts payable," and how these terms are used in conjunction with an accrual or modified accrual basis of accounting. As correctly explained by the Department in its exceptions:

An encumbrance is an accounting tool that permits a school district to set aside funds for purchase orders that were issued during the 2002-2003 school year for goods or services that were *not* received as of June 30, 2003. In the Department's manual, *Financial Accounting for New Jersey Public School Districts* (web site omitted), school districts were directed to account for unpaid purchase orders in which goods or services were received by June 30<sup>th</sup> as accounts payable liabilities, and account for purchase orders to be honored in the subsequent fiscal year by reserving them as encumbrances on their June 30<sup>th</sup> general fund balance sheets. \*\*\* If a school district complied with the manual, then the encumbrances on its June 30<sup>th</sup> balance sheet reflect liabilities for goods and services that were not received by June 30<sup>th</sup>. Encumbrances should not be deducted from a district's fund balance as of June 30, 2003, because the underlying goods and services were not actually received in the 2002-2003 school year. *See N.J.A.C. 6A:10-1.2* ( a maintenance budget is funded at a level so a district can implement 2002-2003 approved and "provided" programs, services, and positions, with adjustments for "actual" 2002-2003 expenditures).

The Department's inclusion of encumbered funds in Neptune's fund balance calculation does not conflict with the accrual method

of accounting. Pursuant to *N.J.A.C. 6A:23-2.2*, school districts are required to use an accrual or modified accrual basis of accounting.

Accrual is a method of accounting

that records the financial effects on a district board of education of transactions...that have cash consequences for the district in the periods in which those transactions...occur, rather than only in the periods in which cash is received or paid by the district. [*N.J.A.C. 6A:23-1.2.*]

An accrual reflects the fact that an obligation has been incurred or a revenue has been earned. Under the modified accrual method, an obligation is incurred when a school district has received a good or service and thus is obligated to pay for it, regardless of when the payment is made. For example, if the district received textbooks on June 2, 2003, but did not receive the invoice nor make the payment for the textbooks, the district has still incurred the legal obligation to make payment. Encumbrances are not “accrued” because the underlying obligations have not occurred yet. Those obligations will occur when the goods or services are provided. (Department’s Exceptions at 3-5)

The Commissioner finds that the above explanation is consistent with the record in the matter entitled *Board of Education of the City of Burlington v. New Jersey State Department of Education*, Commissioner Decision No. 581-03, decided October 20, 2003. Therein, Keith Costello, Budget Manager/Examiner for the Department of Education, Office of Abbott Implementation, testified that, by memo dated September 16, 2003 to all school districts, Assistant Commissioner Richard Rosenberg addressed the procedures to be followed for open purchase orders and encumbrances on the school district’s books as of June 30. The September 16, 2003 memo states, in pertinent part:

Open purchase orders at June 30, 200X should be classified into the following two categories for review and reclassification:

1. Category one represents purchase orders for which the goods have been received or the services have been rendered at June 30th that have not been paid. These purchase orders must be expensed in the current audit period, the related encumbrances reversed, and a liability (accounts payable) established. If the invoice has not been received the amount must be estimated. In accordance with GAAP, an expenditure is recorded when goods are received or services are rendered.
2. Category two represents purchase orders which will be honored in the subsequent year. These purchase orders will be rolled over into the next fiscal year and will be shown in the June 30<sup>th</sup> general fund balance sheet as a reserve for encumbrances. Per NCGA Statement 1, paragraph 91 “encumbrances outstanding at year-end represent the estimated amount of the expenditures ultimately to result *if unperformed contracts in process at year-end are completed. Encumbrances outstanding at year-end do not constitute expenditures or liabilities.*” (emphasis in text) (Exhibit R-1, in evidence) (*Board of Education of the City of Burlington v. New Jersey State Department of Education*, slip opinion at 17)

Accordingly, category one purchase orders and the related encumbrances are to be considered 2002-2003 fiscal year expenditures in applying *N.J.A.C. 6A:10-1.2*, but category two purchase orders are considered expenditures in the 2003-2004 fiscal year and, thus, are not to be included in development of a “maintenance budget” for the 2003-2004 school year pursuant to *N.J.A.C. 6A:10-1.2*.

The District insists that the Commissioner should accept the ALJ’s conclusions with respect to encumbrances because: 1) “the ALJ had the opportunity to evaluate all of the testimony and documentary information before him at the hearing in reaching his conclusion that the DOE erred in increasing the District’s fund balance by improperly excluding valid encumbrances” (District’s Reply Exceptions at 3); 2) “the ALJ heard the District’s testimony on how the list of encumbrances was developed and what the encumbrances represented” (*Ibid.*); and 3) the Department bases its exceptions to the ALJ’s conclusions “on a document that was *not*

introduced into evidence and on factual assertions that are not part of the record.” (emphasis in text) (*Id.* at 2) Notwithstanding these assertions by the District, the Commissioner finds that the resolution of whether it was appropriate for the Department to include encumbered funds in the fund balance calculation does not turn on credibility determinations or documents “not introduced into evidence,” but, instead, on whether the encumbered goods and/or services were received by June 30, 2003. Assuming the District properly complied with the procedures set forth in the Department’s accounting manual and Assistant Commissioner Richard Rosenberg’s letter of September 16, 2003, as set forth above, encumbrances for goods and services received by June 30, 2003 were to be reversed and a liability (accounts payable) established. The District’s encumbrances outstanding at year-end, therefore, represent the estimated amount of the expenditures ultimately to result if unperformed contracts in process at year-end are completed, and, thus, encumbrances outstanding at year-end do not constitute expenditures or liabilities. Although there is no dispute that expenditures for goods and/or services received by June 30, 2003 should be deducted from the District’s fund balance, based on the proofs brought to this record, the Commissioner is unable to determine which, if any, of the District’s encumbrances have become accounts payable by virtue of the receipt of the encumbered goods or services on or before June 30, 2003 so as to be considered 2002-2003 expenditures.

The Commissioner, therefore, concludes that it was entirely appropriate and consistent with the Department’s accounting manual, *Financial Accounting for New Jersey Public School Districts*, the instructions with respect to the processing of year-end purchase orders provided to school districts in Assistant Commissioner Richard Rosenberg’s letter of September 16, 2003, *N.J.A.C.* 6A:23-2.2 and *N.J.A.C.* 6A:10-1.2 to include the encumbered funds in the fund balance calculation. Any adjustments to be made will be based on updated

information with respect to the June 30, 2003 encumbrances and accounts payable for the 2002-2003 school budget year in the course of the Comprehensive Annual Financial Report (CAFR) review scheduled to begin in November 2003.

Finally, in its exceptions, the Department seeks what it terms a “correction of a factual error” regarding the District’s request for State supplemental aid, stating:

[D]uring the hearing, Neptune Business Administrator David Mooij pointed out that line item 00284 on the Department’s worksheet (Ex. P-4) incorrectly indicates that the district requested \$8,843,176 in Additional *Abbott v. Burke* State Aid. In fact, Neptune requested \$7,651,967 in additional aid, a difference of \$1,191,209. (Ex. P-2) In order to properly account for this factual error, Neptune’s estimated discretionary aid must be reduced by an additional \$1,191,209, to \$4,045,615. (Department’s Exceptions at 2)

In response, the District vigorously objects to this “correction,” averring that this “alleged” error was fully discussed at hearing and that “the DOE budget manager testified ‘that the error was on the revenue side and that this has no effect on the final aid amounts.’” (District’s Reply at 2) The District further claims that this is a disingenuous attempt by the Department to further reduce the District’s discretionary aid.

In reviewing the Initial Decision, with respect to the Department’s budget manager’s testimony, the ALJ states that:

Mr. White acknowledged that the \$8,843,176 amount set forth in Line 00284, is incorrect (P-4). He stated that this occurred because the school district failed to provide the revised actual budget. He also indicated that the error was on the revenue side and that this has no effect on the final aid amounts. (Initial Decision at 7)

Given the lack of specificity or any analysis of the effect of this “alleged” error in the Initial Decision, the absence of a transcript of the proceedings, and the silence of the record on this issue, the Commissioner cannot, based on the record before him, resolve this dispute.



Ordinarily, this matter would be remanded for an evidentiary hearing to fully develop the record so that a determination could be made, but, in light of the Supreme Court Order to expedite proceedings in this matter, the Commissioner concludes that the most effective approach to resolve this matter is to direct that the effect on discretionary aid, if any, of the “alleged” error be reviewed as a part of the November CAFR. In the event that a dispute remains after the CAFR, either party may subsequently seek relief by filing a Petition of Appeal to the Commissioner.

Accordingly, the Initial Decision is adopted with modification, as set forth herein.<sup>4</sup>

IT IS SO ORDERED.<sup>5</sup>

COMMISSIONER OF EDUCATION

Date of Decision: October 20, 2003

Date of Mailing: N/A

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<sup>4</sup> The Commissioner so determines, based upon the proofs brought to *this* record, while acknowledging that the presentation of such evidence may have been disadvantaged by both a Court Order to expedite proceedings and the unavailability of the Comprehensive Annual Financial Report (CAFR) until November 2003, which will reveal the District’s true audited fund balance and available revenue, if any, as of June 30, 2003. In any event, beyond his determination herein, the Commissioner underscores the availability of a mechanism for Abbott districts to address needs, arising during the year due to unanticipated expenditures or unforeseen circumstances, for additional resources to implement Department-approved programs and services. *N.J.A.C.* 6A:10-3.1(g).

<sup>5</sup> Pursuant to *P.L.* 2003, *c.* 122, “*Abbott*” determinations are final agency actions appealable directly to the Appellate Division of the New Jersey Superior Court.