

BOARD OF EDUCATION OF THE :  
CITY OF VINELAND, CUMBERLAND :  
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 that the OAL does not have jurisdiction to determine the validity of *N.J.A.C.* 6A:10-1.2. The ALJ also concluded that: 1) the Department incorrectly included encumbrances, reserves for inventory and capital reserves in calculating the excess fund balance; 2) the Department erred in including \$1,863,652 of unspent salary and benefits funds in calculating the excess fund balance; 3) the sum of \$74,349 for transportation should be added to the District’s budget as a nondiscretionary item; 4) the District’s request for \$1,000,000 for No Child Left Behind should be denied as beyond the maintenance standard; and 5) the District’s request for \$110,543 for its Second Chance Program should be granted.

The Commissioner concurred with the ALJ’s findings and conclusions with respect to the disputed issues except in three instances wherein the Commissioner rejected the ALJ’s findings and concluded that: 1) the Department correctly included encumbrances, reserves for inventory and capital reserves in calculating the excess fund balance; 2) the Department correctly included \$1,863,652 in unspent salary and benefit funds in calculating the excess fund balance; and 3) the District’s request for \$110,543 in additional funds for its Second Chance Program did not comport with the maintenance budget standard set forth at *N.J.A.C.* 6A:10-1.2 and, therefore, the District’s request for additional funds for this program was denied.

<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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OAL DKT. NO. EDU 4156-03  
AGENCY DKT. NO. 190-6/03

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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 2003-04 school year, and the Initial Decision of the Office of Administrative Law (OAL) have been reviewed. Both the Vineland School District’s (District) exceptions and the Department’s exceptions were duly submitted 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.<sup>1</sup>

Upon careful and independent review of the record, the Commissioner concurs with the Administrative Law Judge (ALJ), 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>In its exceptions, the Department points out that the procedural history set forth in the Initial Decision does not include an essential component to this matter in that there is no reference to the August 27, 2003 determination letter in which the Department issued the District’s preliminary maintenance discretionary Additional *Abbott v. Burke* State Aid for the 2003-04 school year. (Department’s Exceptions at 2-3) In its exceptions, the District also includes a copy of a letter to the ALJ in which it points out that the District is located in Cumberland County, rather than Gloucester County, and that the Initial Decision makes no mention of the District’s appeal of the August 27, 2003 determination letter. (Letter of September 30, 2003 to ALJ Schuster submitted with the District’s Exceptions)

*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). However, to the extent that he may appropriately do so in an administrative proceeding, the Commissioner opines that the regulation at issue is fully consistent with the language and intent of the Court. Thus, like the ALJ, the Commissioner finds the regulatory definition controlling herein, with no conflict between it and the underlying Court order. Accordingly, the Department's application of such regulatory definition in its review and approval of the District's 2003-04 budget is appropriate.

Moreover, upon a thorough review of the record and the parties' exceptions, the Commissioner concurs with the ALJ's determination denying the District's request for funding to modify its No Child Left Behind Program (NCLB) in that the District's proposed NCLB improvement plan, which involves the addition of new materials and additional staffing, is beyond the "maintenance" standard set forth in *N.J.A.C. 6A:10-1.2*. The Commissioner also concurs that the addition of six bus drivers at a cost of \$74,349 is an allowable, nondiscretionary item in that the District is required to provide for the transportation of its students in accordance with regulations, union contracts and State civil service regulations. Additionally, the Commissioner points out that the parties stipulated at hearing that the sum of \$1,370,581 is to be included in the District's proposed budget as a nondiscretionary addition for "out-of district tuition, residential placements and Bayada nurses." (Initial Decision at 6 and Letter on Behalf of the Department of September 22, 2003) With respect to these issues, therefore, the Commissioner accepts and adopts the ALJ's factual findings and determines that his analysis and legal conclusions are consistent 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 \$3,041,818. The Commissioner believes that the ALJ's

analysis reflects a fundamental misunderstanding of the differentiation between the terms “encumbrances” and “accounts payable.” In the context of close out procedures for the 2002-03 budget year, an encumbrance is an accounting tool that permits a school district to set aside funds for purchase orders that were issued during the 2002-03 school year for goods or services that were *not* received as of June 30, 2003. Unpaid purchase orders reserved as encumbrances on the June 30 general fund balance sheet, therefore, reflect liabilities to be honored in the next fiscal year for goods and services not received by June 30. For goods and services received and/or provided by June 30, 2003, the encumbrances become accounts payable on the general fund balance sheet. Thus, 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 2002-03 school year. *See N.J.A.C. 6A:10-1.2*, defining a maintenance budget as “a budget funded at a level such that the district can implement 2002-2003 approved and provided programs, services, and positions\*\*\*.”

The Commissioner points out that, 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, 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 30<sup>th</sup> 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 2002-03 fiscal year expenditures in applying *N.J.A.C. 6A:10-1.2*, but category two purchase orders are considered expenditures in the 2003-04 fiscal year and, thus, are not to be included in development of a “maintenance budget” for the 2003-04 school year pursuant to *N.J.A.C. 6A:10-1.2*.

Assuming the District properly complied with the procedures set forth in the above-mentioned Assistant Commissioner Richard Rosenberg’s letter of September 16, 2003, 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. In its exceptions, the Department avers that:

Petitioner’s Assistant Superintendent for Business and Board Secretary, Kevin J. Franchetta, testified that the projected encumbrance amount is an estimate and that the true amount will not be determined until the [Comprehensive Annual Financial Report] CAFR is issued. In fact, Mr. Franchetta testified that it is

likely that the projected encumbrance amount will be reduced once the CAFR is issued.<sup>2</sup> (Department's Exceptions at 4)

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 Mr. Franchetta's statement that the encumbrance amount is an estimate and the proofs brought to *this* record,<sup>3</sup> 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 2002-03 expenditures. The Commissioner, therefore, concludes that it was entirely appropriate and consistent with general accounting practices, the procedures provided to school districts in Assistant Commissioner Richard Rosenberg's letter of September 16, 2003 for the processing of year-end purchase orders, and *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 2002-03 school budget year in the course of the review of the CAFR scheduled to begin in November 2003.

The Commissioner also finds that the District, which has the burden of proof in this matter, failed to demonstrate on the record that inventory reserves in the amount of \$518,986 and \$153,576 in the capital reserve account<sup>4</sup> represent actual District obligations. The Commissioner, therefore, concludes that the Department appropriately included these reserve funds in the fund balance calculation. As with the encumbrances, any adjustments to be made will be based on updated information in the course of reviewing the CAFR in November 2003.

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<sup>2</sup> The Commissioner notes that the District did not file a reply to these exceptions and, thus, apparently does not dispute the Department's representation of Mr. Franchetta's testimony.

<sup>3</sup> The Commissioner acknowledges that the presentation of such evidence may have been disadvantaged by both a Court Order to expedite proceedings and the unavailability of the CAFR until November 2003.

<sup>4</sup> Although districts are required to establish a capital reserve account, there is no fund balance requirement. *See N.J.A.C.* 6A:26-9.1.

As a result of the Commissioner's conclusions with respect to the appropriateness of the Department's inclusion of encumbrances and reserves in its fund balance calculation, the Department's determination that the District's excess fund balance is \$8,817,650 remains unaltered, subject to adjustment following the CAFR.

The Commissioner also does not agree with the ALJ's conclusion that, since District positions affected by leaves of absences, retirements and resignations, as well as four unfilled positions, were approved positions and the services were provided in the 2002-03 budget year, although through the use of substitutes and temporary hires, those positions meet the maintenance standard so that the District's fund 11 and 15 accounts should be reduced by \$1,863,652, which increases the District's base 2002-03 program budget from 132,392,778 to \$134,256,430. (Initial Decision at 5-6) The Commissioner finds that the ALJ's conclusion is inconsistent with the Court's directive and the maintenance standard which required the Department to consider only *actual* expenditures stemming from goods and services provided in 2002-03 so as to establish a maintenance budget for 2003-04.

Notwithstanding the District's assertion at hearing that, in the 2002-03 school year there were an inordinate number of leaves of absences without pay, retirements, resignations and a higher than normal number of pregnancies which resulted in one-time costs savings in salaries and benefits, the Commissioner points out that teachers take leaves of absences for pregnancies or other reasons every year and that resignations and retirements<sup>5</sup> are also a common occurrence every year. Moreover, although the District provided a lengthy list of individuals who took leaves of absence, retired or resigned during the 2002-03 school year, the District did not bring information to the record to substantiate its claim that the numbers in these various categories and the cost savings resulting therefrom substantially differed from previous

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<sup>5</sup> The Commissioner notes that, with the advent of the "baby boomers" reaching retirement age, the number of retirements may actually increase in the 2003-04 budget year.

years, nor did it explain how it reached the conclusion that the number of pregnancies experienced by the District during 2002-03 could not be expected to continue into the 2003-04 school year. The ALJ states that his conclusions are based, in part, on the fact that “the Department presented no evidence to dispute the testimony of Mr. Phillips that this was an unusual event resulting in part from a higher than normal number of pregnancies.” (Initial Decision at 5) However, pursuant to *N.J.A.C. 6A:24-9.6(c)*, the District bears the burden of proving that the Department’s calculations were unreasonable or otherwise improper and the Commissioner finds that the District failed to meet its burden.

In this regard, the Commissioner emphasizes that the Department’s charge in this matter was to determine the level of 2003-04 funding that would enable the district to continue in a “maintenance” mode, that is, to implement in 2003-04 the programs, services and positions provided in 2002-03. While it is true that dollar amounts paid out prior to June 30, 2003 will not necessarily reflect the actual costs of the positions provided that year, nor can they perfectly predict the actual cost of providing them in the next, it is *equally* true that originally budgeted amounts and other similar projections are no less imprecise. Thus, in the Commissioner’s view, a methodology which preliminarily establishes the 2003-04 cost of providing funding for positions by determining, as nearly as possible without benefit of audit, the actual approved cost of providing them in 2002-2003 and then allowing for reasonable, nondiscretionary adjustments, is a uniform, fair and rational method for estimating future expenditures, such as the costs associated with salaries and benefits, which cannot otherwise be determined with any degree of precision. To the extent that results may be imperfect, even after adjustment following audit, *N.J.A.C. 6A: 10-3.1(g)* provides a mechanism to obtain additional supplemental funding where unanticipated expenditures or unforeseen circumstances warrant. Thus, the Commissioner wholly endorses the Department’s fundamental methodology and determines that the Department



acted appropriately in deducting \$1,863,652 from the 2002-03 base budget so as to establish the District's 2003-04 maintenance budget.

Finally, turning to the District's request for \$110,543 in additional funding for its Second Chance Program, the Commissioner concludes that any increase for this program to expand its hours of operation, notwithstanding the merits of doing so, does not comport with the maintenance budget standard set forth in *N.J.A.C.* 6A:10-1.2. In so determining, the Commissioner points out his disagreement with the ALJ's conclusion that "the implementation of a department-approved plan means an *effective* department-approved plan" (emphasis in text) (Initial Decision at 10), noting that the District, which has the burden in this matter, did not present any evidence that the existing Second Chance Program, which was approved by the Department as a standard education day of seven hours but has been in existence for some time as a five-hour program, has been ineffective. The District, instead, claims that the students in the program would be better served by an expanded program. The Commissioner, therefore, concludes that the Department was correct in rejecting the \$110,543 request in additional funding for the Second Chance Program.

Accordingly, the Commissioner adopts in part and rejects in part the ALJ's findings and conclusions in the Initial Decision as set forth herein.<sup>6</sup>

IT IS SO ORDERED.

COMMISSIONER OF EDUCATION

Date of Decision: October 20, 2003

Date of Mailing: N/A

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<sup>6</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.