Committee Meeting

of

SENATE EDUCATION COMMITTEE

AND

ASSEMBLY EDUCATION COMMITTEE

"Testimony on the budget shortfall in the Newark School District"

LOCATION: Committee Room 6
State House Annex
Trenton, New Jersey

DATE: June 19, 2000
9:30 a.m.

MEMBERS OF COMMITTEE PRESENT:

Senator Robert J. Martin, Co-Chairman
Assemblyman David W. Wolfe, Co-Chairman
Senator Joseph A. Palaia
Senator William L. Gormley
Senator Byron M. Baer
Senator Shirley K. Turner
Assemblyman Joseph R. Malone III
Assemblyman E. Scott Garrett
Assemblyman Jeffrey W. Moran
Assemblyman Gerald H. Zecker
Assemblyman Raul "Rudy" Garcia
Assemblyman Craig A. Stanley

ALSO PRESENT:

Darby Cannon III
Kathleen Fazzari
Theodore C. Settle
Office of Legislative Services
Committee Aides

Christine Shipley
Nataile A. Collins
Senate/Assembly
Majority Committee Aides

Carrie Mitnick
Jason Teele
Senate/Assembly
Democratic Committee Aides

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ASSEMBLYMAN DAVID W. WOLFE (Co-Chairman): I'd like to call the meeting to order. I know some of the Senators are still coming in, although some of the people who wish to testify have some time constraints, so we're going to get started as people come in.

I know that Senator Baer has indicated that he's on his way. And Senator Gormley is coming in.

Before we get started, I want to thank all of you for being here, not only the Committee members, but also the members of the public. This is a continuation of a hearing which was really recessed in March. We recessed at that time, pending forensic review of the budget of Newark schools. And we apparently have that information right now.

And today we have, really, three people who wish to testify. No. 1 is the State Auditor, Mr. Rick Fair, who will speak first; and then Dave Hespe, the Commissioner of Education; and Joseph Del Grosso of the Newark School Union.

I don't have any prepared statement. Maybe the Senator may want to say something. We're here to hear testimony, not to review what we talked about before. And I would hope that when we're done, all of our testimony can be referred to the appropriate legal authority for review in case there is a problem that needs to be looked into further.

Senator Martin.

SENATOR ROBERT J. MARTIN (Co-Chairman): I would just note that we -- when we met last time, I believe it was in March, we had indicated we would have this follow-up meeting. We had hoped it would have come earlier, but we felt it was important that we could get as much financial data as we could from the Department, which was also relying upon its consultants to be able to put that information together. So I think we're in better shape today to go forward. And I'm as anxious to hear the testimony as you are.

So--

ASSEMBLYMAN WOLFE: You're the Chairman.

SENATOR MARTIN: Well, Co-Chairman for this function, so we'll begin with the State Auditor, Mr. Fair.

RICHARD L. FAIR: Good morning, and thank you for inviting us to testify regarding a review of the Newark school district.

Joining me today is Nick Nicomini, an Audit Manager of our office, and John Termyna, the individual who was in charge of the review.

My testimony today is going to be extremely short. I'm here just to answer one question. And that question is, what happened to the Newark school district surplus.

Our report, which was issued last month, concluded that the $69.9 million fund balance existed at the time of the State takeover in 1995 -- was systematically and deliberately used to cover operating deficits in fiscal years 1998 and 1999.

Throughout the period of State takeover, spending for the district has remained fairly level, with an average annual increase of only about 1.2 percent. So it was not an extraordinary increase in spending which caused the erosion of the fund balance, but rather a decrease in revenues without a related decrease in spending.

As you know, the State changed its method of funding school districts starting in 1998. Actual annual pupil counts became the basis of State funding. This change resulted in a reduction of approximately 4000 funded pupils in 1998 for Newark and cost the school district nearly $39 million in revenues.

In 1998 -- the 1998 budget for Newark, the decrease in revenues did not result in a related decrease in expenditures. Instead, the budget showed that existing fund balances were to be used to cover the revenue shortfall. So it was clearly the intent of management to use the fund balance to cover the operating deficit and not cut costs.

This was also the case in fiscal years 1999 and 2000. The budgets submitted by Newark did not show any reduction in spending. Instead, management looked to existing fund balances and State supplemental funding to make itself whole. There appeared to be no intention whatsoever, on the part of the Superintendent, to cut spending. Therefore, it is clear to us that the erosion of the fund balance was both systemic and deliberate.

Newark now finds itself in a situation where it no longer has cash reserves. The district must now either find additional sources of revenues or cut costs.

There are areas in Newark which we believe require further investigations. As a matter of fact, we're still looking in those two areas. They are food service areas and the administrative costs. Newark ranks highest in the State in these two areas.

We do know that the Department of Education has hired a number of consulting firms to look at costs and recommend areas of possible savings. We also believe that the current administration in Newark is aware of the problems, and they are working towards solving and recommending budget solutions.

Once again, I would like to thank the Committee for the opportunity to testify today, and I would be happy to answer any questions you may have.

SENATOR MARTIN: We're open to questions.

Senator Gormley.

SENATOR GORMLEY: When you say intentional, would you categorize them as violations of the law?

MR. FAIR: No, I would not. I mean, the budget shows a starting surplus, and they use that starting surplus as part of their revenue base.

SENATOR GORMLEY: Okay. So what you're saying is the actions that were taken by the Superintendent diminished the surplus, but were within the boundaries of the Superintendent's discretion?

MR. FAIR: Based-- I'm not really sure of the law behind that, but I mean, clearly, the documents that were being sent to the school district -- to the State showed that they were using surpluses to cover--

SENATOR GORMLEY: But the point is, they were reporting everything they were doing to the State.

MR. FAIR: Absolutely.

SENATOR GORMLEY: And they were showing that they were going into the surplus so that-- They were abiding by the State reporting procedures.

MR. FAIR: Yes.

SENATOR GORMLEY: Okay.

SENATOR MARTIN: Following up on that-- When the State took over the district, the district had a hefty surplus, which was how much?

MR. FAIR: Almost $70 million -- $69.9 million.

SENATOR MARTIN: And at what point was -- did the district reach a point where it no longer had a surplus, but in fact, started to create a deficit.

MR. FAIR: I believe -- correct me if I'm wrong here. I believe the year 2000 -- Fiscal Year 2000 school budget basically showed that there was no starting surplus.

SENATOR MARTIN: Fiscal Year 2000 meaning--

MR. FAIR: The year we're in right now.

SENATOR MARTIN: Which began July 1999.

MR. FAIR: July 1999.

SENATOR MARTIN: That deficit then occurred -- it started to have a deficit balance some time in last year's school budget.

MR. FAIR: That's correct.

SENATOR MARTIN: And we know, also, since the district -- until some time around the beginning of this year, had not done any audits or not completed the audits from, at least, the previous two years, one could say, I suppose, that they weren't sure where they were in relation to either a surplus or a deficit because they hadn't figured out how much they had drawn down their surplus in the prior two years.

MR. FAIR: I believe they're still working on those numbers. I don't believe they have firm numbers yet for 1999 or 2000.

SENATOR MARTIN: I guess-- I'll speak for myself, but I think I may be speaking for a lot people when I say, wouldn't someone who's in charge have some understanding that they had reached a point where they were now operating on a credit card system some time in the previous school year?

MR. FAIR: I would believe the answer to that question is yes.

SENATOR MARTIN: Thank you.

ASSEMBLYMAN WOLFE: I would just like to ask--

I believe part of your testimony indicated that there was almost like a systemic drawdown on the surplus. You just-- I'm not saying-- You're reporting to those numbers to back up-- Are you-- Did you uncover the source of this requirement that this money be drawn down. Was this from the Superintendent, the Commissioner?

MR. FAIR: This came from budget documents that were submitted from the school district to the State where they showed beginning surpluses--

ASSEMBLYMAN WOLFE: Right.

MR. FAIR: --and the fact that when the State reduced its level of funding, they never reduced costs. So the bottom line is, you're going to use -- eventually use up all of your--

ASSEMBLYMAN WOLFE: But I guess what I'm looking at is the decision to begin eating into or using that surplus to cover operating losses. At what point did that begin, and who gave that order?

MR. FAIR: I believe it began in 19 -- Fiscal Year 1998, when the revenues first dropped off as a result of the new funding mechanism. And the

Superintendent, through the budget process, started showing everybody that they were going to be using surpluses because they weren't going to reduce costs.

ASSEMBLYMAN WOLFE: Okay, thank you.

SENATOR MARTIN: Just one--

When we met in March, we had talked about the fact that we weren't sure exactly where the spending was going. If I understand what you're saying today, in general terms, is the spending, pretty much, followed the same patterns as it had in previous years. And so the structural deficit that occurred was simply on the basis of the State, which was making its payments based on a dollar per pupil amount -- was that -- was a serious reduction, but the costs were paid as if the school enrollment had remained stable during that period of time.

MR. FAIR: Yeah, that's exactly correct. I mean, one of the questions that I thought came out of the meeting last March was, did they start spending excessively. And that's the first thing that we looked at. And we saw that they didn't start spending excessively.

SENATOR MARTIN: All the lines remained--

MR. FAIR: All the lines--

SENATOR MARTIN: --more or less, where they had been in prior years.

MR. FAIR: An average of 1.2 percent increase, and that's--

SENATOR MARTIN: And there were no great fluctuations in individual lines, programmatic or--

MR. FAIR: No, no.

SENATOR MARTIN: --employment positions and so forth.

MR. FAIR: No.

SENATOR MARTIN: Senator Gormley.

SENATOR GORMLEY: Yes.

The approval process-- The Superintendent laid this all out, so this was not done in a secretive manner. Fair comment? I mean, what we are reviewing today was contained in the budget documents two years ago.

MR. FAIR: Yes, sir.

SENATOR GORMLEY: Okay. So they went right by the numbers that they presented.

MR. FAIR: That's correct.

SENATOR GORMLEY: Now, those budgets were presented to the Department of Education.

MR. FAIR: Yes, to the County Superintendent.

SENATOR GORMLEY: To the County Superintendent. Who signed off on the budgets? I mean, who, in the chain of command-- Who in the-- Let's do a couple of names. That's always fun.

Who in the chain of command-- Let's not be generic. Who in the chain of command signed off on that budget? When you reviewed it, and you saw who it was forwarded to-- Who was the name of the person who signed off on the budget that shouldn't have been signed off on?

JOHN TERMYNA: For all fiscal years, up through Fiscal Year 1999, all the budgets were properly approved. From time to time, they would come in late, and they would be approved late, but all of those budgets were approved.

SENATOR GORMLEY: But who--

SENATOR MARTIN: Whom.

SENATOR GORMLEY: Whom. Don't do grammar at this point. Everybody gets it.

Professor Martin interjects grammar. Okay. That's all I need to complete my June.

Go ahead.

MR. TERMYNA: The process is to submit the budget to the County Superintendent, who then approves that budget.

SENATOR GORMLEY: So the County Superintendent--

MR. TERMYNA: Who is a member of State government.

SENATOR GORMLEY: We understand that. Every county will explain that to you at length.

Who is the County Superintendent? I'm just curious.

MR. FAIR: I don't know. I don't know off the top of my head.

SENATOR GORMLEY: So that was signed off by the County Superintendent -- those budgets that were submitted. Do we know if it went up any higher in the order within the Department of Education? All we know is that the County Superintendent signed off on it.

MR. TERMYNA: That is the only person--

SENATOR GORMLEY: That's the only documentation that you have seen as to who signed off on the budget.

MR. TERMYNA: Yes. I'm sure it went to the State.

SENATOR GORMLEY: I just want to go by what you had in front of you. You saw the County Superintendent signed off on those budgets.

MR. TERMYNA: That's correct.

SENATOR GORMLEY: Fine. Thank you.

SENATOR MARTIN: Again, along those lines, when the County Superintendent approves that budget, isn't-- Wasn't there information in the way that budget was framed to suggest that there might be greater revenues? For example, no one-- If I understand this correctly, no one knew how much of a surplus Newark had at any point in time because they were told this January they didn't know how much they had and how much they were spending. So what did the budget indicate, that there might have been more surplus than what there actually was, or was it sort of open-- Would the County Superintendent-- I'm not trying to say there was -- I think it was a she -- she did it well or did it poorly. But was there enough information that she would understand that the district was now running in the red?

MR. FAIR: I don't know. When you saw the budget, it didn't look like they were running in the red. When you saw the budget-- They were basically using surpluses that they budgeted from prior years' budgets to carry forward -- to cover the operating deficits in subsequent years' budgets. The problem was that there was not reconciliation between the budgets and the actual financial statements because there was no actual financial statements prepared or audited.

SENATOR MARTIN: And when those budgets were submitted to the County Superintendent, I assume that the Superintendent and the key financial officers of the school district had to have not signed off. They prepared the budget for the submission. So they were aware of what -- what they were, if not signing off to, at least had -- were presenting to the higher-ups.

MR. FAIR: Absolutely. And that's exactly why I said that it was systemic and deliberate because, obviously, they were showing that they were using prior years' surpluses to cover operating deficits in subsequent years.

ASSEMBLYMAN WOLFE: I believe, when Commissioner Tespe -- Commissioner Hespe spoke to us in March, he indicated to us that there were -- the records indicated that reports are not -- monthly reports are not flowing to the Superintendent's office -- the County Superintendent -- and efforts by the State Department to get those reports in, apparently, did not result in any sufficient numbers getting in.

So I would-- Maybe when the Commissioner comes up, we can follow that line a bit further.

ASSEMBLYMAN MALONE: Dave.

ASSEMBLYMAN WOLFE: Yes.

ASSEMBLYMAN MALONE: I guess, as the Senator said, this month of June has been somewhat unique, I think. I feel like I've been in the twilight zone with some of the things that have come up.

I'm not worried whether they used surplus to build their budget; everybody uses that. I'm worried about whether there were expenditures made beyond surplus that ran them into a deficit situation. Did that occur?

MR. FAIR: Actually, I believe that that's exactly what the Commissioner is going to testify to. What we understand is that they've identified additional expenditures that wouldn't have been identified as part of the budgetary process and weren't recorded.

ASSEMBLYMAN MALONE: So they expended funds above and beyond what was budgeted without any funds to back that up.

MR. FAIR: I believe that's what the Commissioner is going to testify to.

ASSEMBLYMAN MALONE: Okay. So that gets to where we want to be today, I think -- not whether they appropriately spent $70,000. It's the additional $60,000 or $70,000 that was spent, I think, that had people concerned -- that nobody seems to know how and what they spent it on.

In your statements earlier, there was no illegal or inappropriate purchases made with any of these funds. Is that correct?

MR. FAIR: No. I didn't say that because we haven't audited that year. We're still up there. I just came to testify in terms of what happened to the surplus.

ASSEMBLYMAN MALONE: Okay. Do you have-- Do you reasonably think that there are misappropriations or illegal expenditures?

MR. FAIR: I'm not ready to testify one way or the other on that.

ASSEMBLYMAN MALONE: Okay.

If there are, who should have been reasonably expected to put a stop to those inappropriate or illegal expenditures?

MR. FAIR: I believe it would be the Superintendent, who's ultimately responsible for the operations of the school district.

ASSEMBLYMAN MALONE: Since Newark was a takeover district, what responsibility would the State have had in that particular situation?

MR. FAIR: I'm not really that familiar with the law. I mean, they had the same oversight responsibilities.

My understanding is that the primary difference between the State takeover district and any other school district is that the State appoints the superintendent, who then appoints the business manager and-- I mean, I believe that's the difference. So I would assume they have the same monitoring responsibility.

ASSEMBLYMAN MALONE: So during the period of time that you're up--

You've been up there for how long doing this?

MR. FAIR: We left in March, almost immediately following the last hearing.

ASSEMBLYMAN MALONE: That's when you started to do your review?

MR. FAIR: That's when we started.

ASSEMBLYMAN MALONE: So you've been up there, basically, for little over two months.

MR. FAIR: That's correct.

ASSEMBLYMAN MALONE: And you're up to what period of time, now, in doing your review?

MR. FAIR: Well, what we did was just an overview in terms of answering the one question -- what happened to the surplus. Now we're actually looking at the operations of food service to see whether or not there's ways to save money in that area.

ASSEMBLYMAN MALONE: Okay, but the question-- Really, the question wasn't so much just the surplus, it was the additional $60 million or so that was overspent.

MR. FAIR: And I believe that -- Peat Marwick -- not Peat Marwick, but Ernst and Young has already done an analysis of that. The Commissioner is going to testify the results of that analysis. And I don't have that in front of me.

ASSEMBLYMAN MALONE: Okay, but since you are the -- I'm assuming -- the official official bean counter--

MR. FAIR: Yes.

ASSEMBLYMAN MALONE: --who's going up there and doing a meticulous job of finding out what's going on, wouldn't it be logical that we ask the official official bean counter as to what's going on officially?

MR. FAIR: Absolutely. I'm just saying that I'm not ready to answer that question.

ASSEMBLYMAN MALONE: Okay, because as far as I'm concerned, it's been like pulling wisdom teeth with very inept pliers to try to get an answer.

MR. FAIR: It would actually take more than two months of analysis to really answer that question.

ASSEMBLYMAN MALONE: Okay.

MR. FAIR: We're up there. We're going to continue to stay up there until we have answers to those questions.

ASSEMBLYMAN MALONE: Could it be appropriate, through the Chairs, that we, maybe -- once you get an answer, that we get that answer and in a very clear and straightforward kind of way as to exactly financially what happened and who was responsible.

MR. FAIR: Certainly.

ASSEMBLYMAN MALONE: Thank you very much.

ASSEMBLYMAN WOLFE: We have three people lined up here: Assemblyman Garcia, Senator Gormley, and Assemblyman Garrett.

SENATOR MARTIN: Just before you speak, Rudy.

I think the Committee should be aware that, and I think most of you are, the State Auditor is appointed by the Legislature, both the Senate and the Assembly -- one of the functions we do. And Mr. Fair works for us. We did direct him in March, although he had indicated he was going to anyway because it was a triggering mechanism. But we did direct him to act as our representative and to try and sort these things out.

And also, in relation to Assemblyman Malone's question earlier, there are-- To my knowledge, there are at least three ways in which the State assumes some oversight in Newark. One is, generally, under CEIFA -- when we passed CEIFA, there are responsibilities of the State to look at districts that run into problems. And the Commissioner is given additional responsibilities that he no longer -- that he didn't have prior to CEIFA being adopted in 1996. This is also because this is an *Abbott* district. There are special considerations that take part in our special needs districts. And thirdly, as was pointed out, because it's a State takeover district, there's still additional authority. So there's a number of different authorities in which the State assumes some responsibilities in Newark, two of which are unique to the fact that it's an *Abbott* district and a State takeover district.

Assemblyman Garcia.

ASSEMBLYMAN GARCIA: Thank you, Mr. Chairman.

My question is, when the budgets were presented to the Superintendent, they were drawing down from their surplus every year to cover their operating expenses. But the actual expenditures-- Did they follow the line items on their budget because what they-- My concern is that they could have put on paper that their budget -- their budgeting may be *X* amount of dollars for text books, and actually expending it somewhere else. Did we have an opportunity to review that?

MR. FAIR: Yeah, there were a number of transfers.

So, to answer your question, no, they did not follow the exact thing that was in the budget. They requested a number of transfers. They transferred an amount of money -- large amounts of money from one account to another.

ASSEMBLYMAN GARCIA: And those transfers-- Do they have to be approved by the County Superintendent, as well?

MR. FAIR: No.

ASSEMBLYMAN GARCIA: So the Superintendent can just make those transfers unilaterally?

MR. FAIR: Okay, the answer is yes.

ASSEMBLYMAN MALONE: I think it has to go through the board, though. If they make transfers, don't they have to go through the board?

SENATOR MARTIN: I think there's-- Maybe we can find out from the Commissioner. I'm sure he has representatives. But the law has some protective measures, whether they were followed or not. I think you have, for a certain period of time -- you can't, but then, toward the end of the year, you can make transfers.

It's routinely done, as I understand it, by school districts. Whether they did it according to law and did it to a large extent, that remains to be seen.

ASSEMBLYMAN GARCIA: See, the whole question goes to where the money actually went. And to say the expenditures remained the same, when they have 4000 less pupils -- and that didn't raise a red flag -- makes it seem that some of the moneys that may have been budgeted for certain line items were then utilized in a different fashion and a different manner. And I think that's something that I would certainly like to know. I think it would be useful for the Committee to know, when we have an opportunity to review all that, if you haven't already.

MR. FAIR: Certainly, we'll do that.

ASSEMBLYMAN WOLFE: Senator Gormley.

SENATOR GORMLEY: I'm still curious about this budget process. Excuse my being naive about it.

When the budget is approved-- So the budget was approved in 1998 and 1999 by the County Superintendent. That used up the surplus. In 1998, how much of the surplus was used up of the $69 million?

MR. FAIR: Fifty-three million dollars.

SENATOR GORMLEY: Oh, $53 million.

Okay, now, in 1999, how much of the surplus was used up?

MR. FAIR: It's $21 million.

SENATOR GORMLEY: Now, I'm not good with math, but we just got beyond the surplus in those two years that were approved by the superintendent.

UNIDENTIFIED MEMBER OF COMMITTEE: Five million.

SENATOR GORMLEY: Thank you. I was exaggerating. I knew it was $5 million, but thank you so much, Assemblyman.

So, in those two years, we had budgets that were approved by the County Superintendent that not only went beyond the surplus, it expended money that was not there.

MR. FAIR: No. It also had additional supplemental appropriations -- supplemental revenues. So, I mean, the budget for Fiscal Year 1999 did not show a deficit.

SENATOR GORMLEY: Okay. It showed-- Well, in the year 2000-- Oh, I knew I'd get it eventually, wouldn't I. Okay. Now, what was-- When were the expenditures made that went beyond the money that was available. When did that-- When was the threshold crossed? When did we reach that date where we used up the surplus and started to go into money that we didn't have? What was the approximate time line? See, we didn't have a time line on the money. When you have a time line on the money, then you can judge the actions of the individuals making the approvals. What's the time line?

MR. FAIR: They never overexpended their budget through 1999. So the problem obviously began this year, in the year 2000.

SENATOR GORMLEY: Okay, but that began last July.

MR. FAIR: July 1.

SENATOR GORMLEY: That began last July 1. But the budget approved for last July 1--

MR. FAIR: That's the problem, Senator, it's never been approved. That process has-- They've never gone through the approval process.

SENATOR MARTIN: One of the things I understand is they don't close their books at the end. They don't make all the payments due from last year on June 30. And there were a lot of residual bills that were -- you can attribute to last year and even the year before, which have now come home to roost now.

SENATOR GORMLEY: But I'm not-- And I'm not disputing what you're saying, but there appears to be a system in place where there is always an excuse for no responsibility because-- I'm just trying to find a time line on money, who approved it and when, and finding out who is responsible. But there is always an excuse for a lack of responsibility. That's the way-- It sounds like that.

So what we did is-- Through 1999, they ran through the surplus, but you're saying they didn't go beyond.

MR. FAIR: That's correct.

SENATOR GORMLEY: But they went ahead with the 2000 budget anyway.

MR. FAIR: That's correct.

SENATOR GORMLEY: Did it have the County Superintendent's approval?

MR. FAIR: No.

SENATOR GORMLEY: No. So they went ahead anyway with it, despite the fact the County Superintendent wouldn't approve it.

MR. FAIR: That's correct.

SENATOR GORMLEY: And the County Superintendent noted that they wouldn't approve it.

MR. FAIR: That's correct. And I believe the County Superintendent knew that it was the intention of the Superintendent of the school to spend more than the revenues that the she was planning on receiving.

SENATOR GORMLEY: So the County Superintendent notified the Department.

MR. FAIR: I would believe so.

SENATOR GORMLEY: Thank you.

ASSEMBLYMAN WOLFE: Thank you.

Assemblyman Garrett, do you have a question?

ASSEMBLYMAN GARRETT: Yeah.

Just to clarify what you said. Forgive me again for--

One follows up on Rudy's question.

What I thought I heard you say was that part of the structural -- that there was a structural deficit there in place and that we sort of knew it and that it was because the State was lowering its figures due to -- its support due to the lower pupil count, but the expense side of the equation was staying where it was based upon the old pupil count, and that's why you have a structural deficit.

MR. FAIR: That's correct.

ASSEMBLYMAN GARRETT: And I guess Rudy's question, which is sort of the same as mine in a way, is, we were still paying out -- we still had to pay -- we were still paying out at the higher figure, based on the higher pupil figures, even though we knew we had a low figure -- lower pupil count.

MR. FAIR: That's correct. They didn't-- In other words, much of the costs of the school district are, what we call, fixed costs.

ASSEMBLYMAN GARRETT: Okay.

MR. FAIR: I mean, the costs of buildings, the costs of teachers-- Unless you decide to close schools or cut the number of teachers, which, by the way, salaries are 80 percent of the cost of the school district -- you're not going to save a lot of money. So even though there's been a 4000 reduction in pupils, if you don't, somehow, close down some schools to cover that, you're not going to be able to cut costs.

ASSEMBLYMAN GARRETT: Okay. And I'm not an educator, so the other 20 percent, or whatever the expenses-- Were there any adjustments made to that due to the change in the per pupil costs?

MR. FAIR: They were all minor.

ASSEMBLYMAN GARRETT: I mean, I just know from my neck of the woods, when we have school districts, and most of our schools are increasing in population from where I come from -- and so the schools are always saying, "Send us more money because we have more kids." But in a couple of them, where they are going down-- They always have to make the adjustments. When it goes down, they have to make an adjustment to the budget. And I guess that just didn't happen.

MR. FAIR: Didn't happen.

ASSEMBLYMAN GARRETT: And the second thing -- I just want to be sure I understood -- follows Senator Gormley's comments.

The Commissioner's going to testify, I guess, that -- what is in fact that case revealed by your budget --revealed by your audit as opposed to what the budgets actually showed.

MR. FAIR: No, actually, what he's going to testify to-- There's five accounting firms plus the State Auditor at Newark right now.

ASSEMBLYMAN GARRETT: Okay.

MR. FAIR: I believe that the Commissioner's going to testify with regard to what one of the public accounting firms has found, in terms of actual expenditures that have occurred. And we have not looked at that yet, only because there was no sense in doing the same thing that one of the public accounting firms were going to be doing, which we will now do in the future.

ASSEMBLYMAN WOLFE: Assemblyman Stanley, any questions?

ASSEMBLYMAN STANLEY: Thank you, Chairman.

I want to, first of all, just make a quick comment about the report -- the title of the report because I have made it clear, and I thank my colleagues for not referring to this as, necessarily, the Newark school district because it is not the Newark school district, it's a State-operated district in Newark. And the title of the report says the City of Newark School District, which could be misleading. It may-- And it may, in fact, perhaps unduly, misrepresent the fact that the district is, in fact, under State control, and it's operated by the State. And I would even recommend that the title say, The State Operated Newark school district, and I think that would clarify that particular point.

One of the questions that I had, and it's actually in reference to some of the language in the report that states -- that speaks to the, I guess, lack of evidence as to the -- whether the financial statements -- whether they have any assurance or whether they're -- and I guess I quote the fact that this body -- or this -- the Auditor has not audited or reviewed the financial state of the city of Newark school district, and therefore express no opinion or any other form of assurance on them.

And it seems that -- and those are the documents, I guess, that you are-- Aren't those the documents that you base your conclusions on?

MR. FAIR: Yeah, what-- Basically, what that is-- That's language that's required by the standards of my profession, by the way.

What that means is that the information that we're basing this report on was not audited by us. It was information that was supplied to us by the school district. And we did not look behind those reports and audit the numbers that determined the accuracy of those numbers.

ASSEMBLYMAN STANLEY: Okay.

And again, the review-- You didn't review the expenditures or other financial transactions for propriety. And I guess there are other auditors involved in doing this. But you haven't done that, and you can't testify to the accuracy or the propriety of these transactions.

MR. FAIR: No. Actually, my office doesn't do that. My office-- When we go into a school district, we look at the work that's already been done. The school districts are required to annually have an audit -- a financial statement audit by a public accounting firm. And rather than go and do that audit again, we rely on the work that that firm did and start looking beyond those numbers. So we normally, for any school district, will not do the financial statement audit.

ASSEMBLYMAN STANLEY: But normally, is that done before you've done your audit, or--

MR. FAIR: Yeah, we try to get it done before we do the audit. We wait for them to finish before we go in.

ASSEMBLYMAN STANLEY: Okay.

But then that was not the case in this instance because of the timeliness of the issue and the fact that we needed something as soon as possible.

MR. FAIR: That's correct. And we wouldn't-- I believe the audit's not-- I don't even believe the audit's completed today.

ASSEMBLYMAN STANLEY: Okay.

So it's somewhat difficult to say that-- You know, it's almost like basing all of this on something that really hasn't been necessarily proven yet.

MR. FAIR: That's right. That's why it's hard to answer some of the questions when you asked how they spent more money that was budgeted-- The answer that I have to give you is the information we're hearing-- The answer is yes, but we don't know the extent of it because we haven't got the audit from the public accounting firm to date.

ASSEMBLYMAN STANLEY: The other thing I just wanted to ask-- The 9.6-- There was some-- Just to follow up what some of the other questioning -- with respect to the deficit, when it started, and that kind of thing. I know it's very difficult, but--

According to your report, on June 30, 1999, the deficit was-- I'm sorry, the General Fund balance was reduced to $9.6 million. But that still wasn't enough. Actually, that $9.6 million fund balance did not even cover the $15.6 million in outstanding purchase orders, correct? So they were actually-- If you look at the budget, they were really in deficit at that point, even though they had a fund balance, correct?

MR. FAIR: The thing you need to understand there is that just because there are purchase orders outstanding, that doesn't mean that's necessarily the expenditure. As a matter of fact, subsequent to this report being issued, they've canceled a number of those purchase orders. So they didn't-- The expenditure never occurred as a result of it.

I mean, that's the problem with looking at those numbers -- is they'll obligate money thinking they have a purchase order outstanding, but they really haven't purchased the goods yet, so they're really just applying it to the current year fund balance.

But to answer your question, it looks as though they're in a deficit situation going into Fiscal Year 2000.

ASSEMBLYMAN STANLEY: Okay.

ASSEMBLYMAN WOLFE: Senator Palaia-- I'm sorry, Senator Turner, then Senator Palaia.

SENATOR TURNER: I'm not clear on the auditing process. I realize you came in in March, and you conducted an audit, but I thought I heard you reference, was it, five other certified public accounting firms that have been auditing this entire budget?

MR. FAIR: I wouldn't use the term audit to describe what we've done in Newark, thus far. What we did was-- We went in there to try to determine what happened to the surplus. At least, the question that I heard during testimony last March -- that is, did they start going crazy with their spending? Was that the reason that the deficit -- it now occurred. So we really haven't done a full-blown audit up there. And the reason--

SENATOR TURNER: But if you have five public--

MR. FAIR: We have one public accounting firm that is doing the audit -- one public accounting firm that is doing -- preparing the financial statements for the school district. Another public accounting firm is doing the audit of those financial statements. A third public accounting firm is doing a, what they call, forensic auditing, which is looking at expenditures to determine whether or not there is any criminal intent behind those expenditures. Another public accounting firm is doing an efficiency type of review to determine whether or not they can save some money. And the fifth public accounting firm is doing something with regard to program elements of the school district.

SENATOR TURNER: All of those public accounting firms are engaged in this process, and no one knew, prior to your audit, that there was something amiss -- that they were deficit spending?

MR. FAIR: I believe the Department knew that there was a problem with-- I don't know. I can't answer that question, Senator.

SENATOR TURNER: How long have the five firms been engaged?

MR. FAIR: Since-- A lot-- At least one of the firms -- October of last year. I can't answer that question.

SENATOR TURNER: You probably wouldn't know, either, how much we have spent for the--

MR. FAIR: No.

SENATOR TURNER: --for these five, highly placed, magnificent CPA firms. How much has it cost us--

ASSEMBLYMAN WOLFE: Excuse me, Senator, perhaps Commissioner Hespe will be able to testify on that because these gentlemen are talking about a separate audit abatement commitment.

Senator Palaia.

SENATOR PALAIA: First off, I want to thank you for your forthright comments, really. I'm really looking forward to your end product -- to the whole thing.

Two quick questions. Under the line-item transfer-- It has taken place, you said. Who approves those? Does that get to the county sup? It's all done in-house?

MR. FAIR: Yeah. From my understanding, they're done in-house, and the way that the State knows about this is their monthly reporting. But that never occurred.

SENATOR PALAIA: That's troublesome -- that line-item transfer can take place, some large, some small-- I don't see any oversight on that. You say they submit reports at the end of the month?

MR. FAIR: They were supposed to.

SENATOR PALAIA: Okay, they were supposed to.

SENATOR MARTIN: Senator Palaia, just so you know.

SENATOR PALAIA: Yes.

SENATOR MARTIN: And I can be corrected if I'm wrong on this, but the State also has an office, I forget its exact term, which is in the Cedar Street State headquarters. Although they don't do the monthly report, there is an office in there that does provide oversight of the financials in Newark. So they have a second mechanism other than those nonproduced monthly reports.

SENATOR PALAIA: Thank you.

The other question--

SENATOR MARTIN: I think it's called like the internal review team.

SENATOR PALAIA: This has to do with the State audit that took place. And I just want to follow up on something.

It said here, the district annually subsidized the food service for $8 million. Their per pupil food service subsidy is the highest in the state and nearly double that of the second highest. Now, at the end of your report, will we know why we are dealing with something twice as high as the second school district?

MR. FAIR: That's exactly what we're looking at.

SENATOR PALAIA: That, to me, would be extremely important. A figure like that is unconscionable.

MR. FAIR: We were asked, immediately after we issued that report, to please go back in and take a look.

SENATOR PALAIA: Very good.

Thank you, Mr. Chairman.

ASSEMBLYMAN WOLFE: Senator Baer.

SENATOR BAER: Thank you.

I'm not sure whether you can answer these questions or whether they need to be answered by the Commissioner. But let me try.

I understand a lot's been identified, in terms of what some of the problems were and some of the corrective action. What is not clear to me is what procedures were in place previously to prevent these problems from happening. And why did they not work. Or alternatively, were there inadequate procedures in place to have prevented these problems and why weren't they--

MR. FAIR: I believe the procedures in place are twofold. One, the mandate by the Department of Education that they have an annual audit to verify the accuracy of the expenditures. The second thing is the review of the monthly expenditure reports. They're supposed to be submitted by school districts. The problem here is that neither one of those occurred. The monthly reports were not submitted, and the audits were not-- So there was a breakdown in the control system.

SENATOR BAER: If they had occurred, would they have been sufficient to have prevented these problems or, at least, would it have been possible to have prevented these problems if normal action had been taken and this information was available as a result of this information?

MR. FAIR: See, the problem, Senator, in my mind, except for the fact that those reports were not submitted-- Nobody did anything wrong. It's just that the information that was being sent from the school district to the State-- No one took any action on that information.

SENATOR BAER: Well, let me ask further. With all the various paperwork and procedures of all sorts that need to be submitted, is there, or was there, any procedure in place that would virtually, automatically flag if there was something that wasn't prepared or submitted that was supposed to be?

MR. FAIR: I believe everybody knew that the district was not complying with the control procedures. They knew that the monthly reports weren't coming in. They knew that the audit wasn't filed timely. But nothing happened as a result of it. I'm not sure what could have happened as a result of it. But people knew that there was a breakdown in the controls. There's just no way you couldn't know that. You would know-- The County Superintendent would know if they didn't get their report filed timely. And the State would know if they didn't get their audit report filed timely. So people knew.

SENATOR BAER: And what procedures should be required when such a thing becomes known -- such things become known?

MR. FAIR: That's such a difficult question, Senator, because I'm not sure. If a school district doesn't comply with reporting requirements, what do you do to the school district? I mean, I really can't answer that question because the alternative would be to cut funding, and to do that would mean harm to schools. So I really don't have an answer to that. I have to be honest with you, I don't know.

SENATOR BAER: Okay. Thank you. Perhaps you're not the person to answer that.

Thank you very much.

ASSEMBLYMAN WOLFE: Okay, do any other Committee members have any further questions for Mr. Fair?

ASSEMBLYMAN MORAN: I do, Mr. Chairman.

ASSEMBLYMAN WOLFE: Okay.

ASSEMBLYMAN MORAN: Thank you.

I have just a few brief questions.

First of all, I want to be assured that the youngsters in Newark were not deprived of their quality education that we're so interested in providing for these youngsters because of what's happened here. And I feel -- speaking to people from Newark and representatives of those communities -- that we can feel that they have not been unjustified of their quality education that we've all fought so that they have.

I have some brief questions -- is that-- In the 1998-1999 budget, how much of that budget was from surplus, and how much of that budget was supplemental?

MR. FAIR: Nineteen hundred ninety-nine -- $12 million and some surplus--

ASSEMBLYMAN MORAN: Nineteen hundred ninety-nine.

MR. FAIR: Twelve million dollars was from surplus.

ASSEMBLYMAN MORAN: Twelve million dollars surplus.

Supplemental?

MR. FAIR: You have to bear with us for a second.

ASSEMBLYMAN MORAN: Well, while you're looking it up, I would also like to know 1999-2000, and also, from reading the brief report pages that I've read, the 2000-2001 similar figures.

MR. FAIR: Two thousand-- I can answer the 2000-2001-- I know that budget has not been submitted yet. And in the 2000 -- Fiscal Year 2000 budget -- 1999-2000 hasn't been approved yet. I can tell you what--

ASSEMBLYMAN MORAN: What is your-- Well, in the report, you have an anticipated $60 million in supplemental. What is the 2000-2001 surplus anticipated to be drawn -- to draw down?

MR. FAIR: Zero.

ASSEMBLYMAN MORAN: Zero.

So it's a $512 million budget, $38 million more -- an 8 percent increase, plus the $60 million supplemental.

MR. FAIR: I believe that's correct.

ASSEMBLYMAN MORAN: Now, can we go back to 1998-1999? The supplemental--

MR. FAIR: Yeah, the supplemental core curriculum was $31 million, $700,000.

ASSEMBLYMAN MORAN: And for 1999-2000 surplus.

MR. TERMYNA: The surplus--

MR. FAIR: Okay. In 2000, there was no surplus either.

ASSEMBLYMAN MORAN: In 1999-2000 there was no surplus? And what was the supplemental?

MR. FAIR: That was the $32 million that we told you.

ASSEMBLYMAN MORAN: No, we're talking 1999-2000.

MR. FAIR: Okay. I guess I'm a little confused. Could you give me-- What years are you interested in, 1999 and 2000 fiscal years?

ASSEMBLYMAN MORAN: Correct.

MR. FAIR: All right.

So, going from 1998-1999, you wanted to know the surplus.

ASSEMBLYMAN MORAN: Correct.

You gave Senator Gormley a $21 million figure. I assume that's the 1999-2000.

MR. FAIR: That's 1999 going into 2000.

ASSEMBLYMAN MORAN: And that's $21 million in surplus?

MR. FAIR: Twenty-one million dollars.

And then going from 1999 into 2000, there's no surplus.

ASSEMBLYMAN MORAN: Okay, so the 2000-2001 budget that's being prepared--

MR. FAIR: Would -- certainly could not have a surplus because I know they have no money.

ASSEMBLYMAN MORAN: Right, there's not-- But you're not carrying over 1999-2000 money into surplus--

MR. FAIR: No, no.

ASSEMBLYMAN MORAN: --because, obviously, we're short.

MR. FAIR: It's all gone.

ASSEMBLYMAN MORAN: And there's a $38 million increase in the overall budget for this year, plus there's a $60 million supplemental. So, if you're supplemental-- What was your supplemental for 1999-2000?

MR. FAIR: Hold on.

I have a feeling the questions you're asking would probably be better answered by the Commissioner because I don't know what his definition of supplemental is. I mean, there's a number of different programs that the State funds to Newark. So I'm not sure which one of those he's calling supplemental. I'm sorry.

ASSEMBLYMAN MORAN: Two last questions, if I may, Mr. Chairman.

Are they currently using the GAAP system, and have we started to reconstruct the GAAP system from previous years?

MR. FAIR: That's correct. They're using generally accepted accounting principles as a basis for reporting, No. 1. And No. 2, one of the public accounting firms are reconstructing the books for Fiscal Year 1999 and Fiscal Year 2000.

ASSEMBLYMAN MORAN: My last question, through you, Mr. Chairman--

Are all contracts being honored?

MR. FAIR: To the best of our ability, I believe the answer to that is yes. I mean, we don't know. We haven't seen anything that we thought might be a problem in that area.

ASSEMBLYMAN MORAN: I'll save those questions about the budget for the Commissioner.

Thank you, Mr. Chairman.

ASSEMBLYMAN WOLFE: Okay.

ASSEMBLYMAN STANLEY: Mr. Chairman, I have one more question, if I may.

ASSEMBLYMAN WOLFE: Okay, Assemblyman.

ASSEMBLYMAN STANLEY: Thank you.

. I just wanted to know if you hit, in your audit-- Have you looked at the Capital Fund? I understand that the fund balance that we're talking about-- I guess that's the General Fund balance, but that doesn't have anything to do with, maybe, dollars that would have been in the Capital Fund that would have been specifically targeted toward capital improvements and that type of thing. Did you look at that at all in your audit?

MR. FAIR: No, we didn't look at any of the special revenue funds, which would include the capital project funds. No, we didn't. I didn't look at that at all. We were just looking at the General Fund balance.

Obviously, if we're going to go up there and do some additional work, in terms of the whole financial structure for the school district, we're going to have to look at all the various funds.

ASSEMBLYMAN STANLEY: Okay, thank you.

ASSEMBLYMAN WOLFE: Thank you very much, Mr. Fair and your staff, for your time and your testimony. I know you said you were going to be very brief, but you certainly indulged us.

Thank you very much.

Okay, now I'd like to ask Commissioner Hespe if he would come forward.

I want to apologize for the faux pas with your name, Mr. Hespe -- Commissioner.

COMMISSIONER DAVID C. HESPE: I'm just getting too big for those seats, though. That's the problem.

ASSEMBLYMAN WOLFE: Okay.

SENATOR MARTIN: We'll have to see whether it's a Freudian slip or not.

COMMISSIONER HESPE: Can I have the Superintendent and the DA come up as well, Mr. Chairman?

ASSEMBLYMAN WOLFE: Sure, as long as you introduce everybody here.

COMMISSIONER HESPE: I certainly can.

ASSEMBLYMAN WOLFE: It's all yours. Thank you.

COMMISSIONER HESPE: Thank you, Chairman Wolfe and Chairman Martin and members of the Committee.

First, I'd like to introduce State-operated Superintendent Marion Bolden; Betsy DeMatteo, the Business Administrator for the district; and our new Assistant Commissioner for Finance, Tom McMahon, who has taken Mike Azzara's place.

I'm here at your request to provide an update on the financial status of the Newark school district. We've been working very closely with the district to rebuild its financial operations. It's certainly been a daunting task for all involved, which has made it all the more challenging, in my mind, by the need to focus not only on the past, but on the future, as well. I think we've made significant progress in all these areas since we last presented to you on February 24.

First, I'd like to start out with some good news. I don't think we've heard too much good news this morning, so let me start out with some. We're in the final stages of completing a budget for the Newark school district for the 2000-2001 school year. We should be receiving that budget in final form from Marion, shortly. The General Fund appropriation will be $512 million, which is $38 million more than the 1999-2000 budget. It represents real growth in that budget, recognizing the need to put in place programs like Whole School Reform, programs like Early Childhood, and the other supplemental programs required under *Abbott.* But I would like to underscore that this budget represents real growth, which is on top of the steps we've taken to eradicate the structural problem so that the current educational programs can be maintained.

The Newark school district, with this funding, is spending above parity and is among the highest spending *Abbott* districts. The children of Newark, I do believe we can honestly say, in answer to Assemblyman Moran's question, are being well served by this budget. The State is certainly proud of its commitment to this district.

Before I go on to some of the issues that have been raised this morning, let me just say-- Let me just give you a sense of how the proposed budget will benefit Newark school children.

The additional funds will enable Newark to implement a new alternative education program in six high schools, expand its successful science program, launch a district-wide elementary school writing initiative. Funds will be available to upgrade school libraries, purchase musical instruments, support school athletics, and establish new before- and after-school programs. There will be funds to hire more language and speech teachers, and there will be sufficient resources to hire full-time facilitators in elementary schools entering the third cohort of Whole School Reform, as well as teacher-tutors for those schools that have selected the Whole School Reform model Success for All.

I think you can see, there are exciting things beginning and happening in the Newark school district over the next year. We should not lose sight of this fact as we delve into the remainder of my testimony.

When I appeared before you on February 24, I presented a lengthy, detailed report explaining, to the best of our knowledge, how the Newark school district developed the structural problems that resulted in a shortfall in the 1998-1999 school year, which was repeated this year. I told you then that it was our opinion the problem resulted from financial controls not being in place and the absence of an accounting system that would have given the district the ability to know how much money it actually had on hand from year to year and from month to month.

As our February report stated, and I'll quote, "The 1997-1998 budget indicated a sizeable structural deficit, which was carried over into the 1998-1999 school year. The 1997-1998 budget was balanced through surplus. However, in 1998-1999, we believe there was insufficient undesignated surplus to cover the structural deficit, so an actual shortfall -- actual deficit occurred."

That, in a nutshell, was the conclusion of our report. Based upon the facts we had in February, we gave you our best estimate regarding the size of that shortfall. I presented you with a series of recommendations and steps that the Department would take to remedy the situation and to prevent it from happening again.

I also announced that the Department was sending independent accounting firms into the district. Their mission was to provide a more precise picture of the district's finances, to conduct a forensic audit so we could know, with greater certainty, how the money was actually spent, and to examine the district's management structure and operations with an eye on improving accountability and efficiency.

Today, I want to let you know what we have done to implement the recommendations we presented to you in February. I will share with you what we've learned so far from our consultants from our audit teams and what we are still waiting to find out.

When you review the information we are providing today, I hope you will share our belief that while there are some serious and continuing problems in Newark, they have not had any negative impact on the education of the district's 45,000 school children.

The health, safety, and education of the children have been, and remain, our No. 1 priority. Despite financial difficulties and operational problems, State intervention, I believe, has given the children of Newark the best opportunity they have had in years to graduate with the knowledge and skills necessary for them to succeed. Remarkable things that will have a lasting and beneficial impact are happening in classrooms across the city. It is a fact that should not be lost in this discussion.

Since February, the Department, working in conjunction with the Newark school district, has made significant progress in implementing the recommendations contained in our original report. Past mistakes could have been avoided if there had been stronger and clearer lines of communication between the Department and the district. We have put in place a system that we believe will prevent communication breakdowns in the future.

Marion and I personally meet at least once a month, often more than that. We talk on the phone, probably, at least once a week. And that's at our level. At the Assistant Commissioner level, Tom speaks with Marion almost on a daily basis, as do John Sherry, our Assistant Commissioner of Field Services, who also interacts with the Business Administrator, Betsy DeMatteo.

Communication, I think, is being worked out. Teamwork, in our minds, is the key to success and the key to preventing the problems that we saw in the past. I think there's a joint understanding of the need to maintain this communication, and equally important, to follow up so that words are converted into appropriate actions.

Our independent audit teams have been busy in the district. What they have found has confirmed our earlier fears. According to the draft financial reports, the Newark school district's 1998-1999 budget, which was approved by the Department in the spring of 1998, indicated that the district would carry forward $22 million of surplus from the 1997-1998 school year into the 1998-1999 school year.

In fact, the 1997-1998 audit, which was not completed until the fall of 1999, a year and a half after those decisions were being made, indicated that the surplus actually available to be carried forward was only $12.73 million. In essence, the district booked $9.25 million more in surplus than it had. The district also had additional unbudgeted expenses. The combination of these errors provided a shortfall for 1998-1999 of approximately $12.5 million.

I think this greatly oversimplifies the complexities of the financial problems being faced by the district, but I did want to provide an understandable snapshot of the problem which we believe the district encountered in the 1998-1999 school year.

The questions that many of you asked this morning-- I think, why did the district miscalculate its surplus in spending? As we indicated in February, and as the State Auditor indicated, the district could not prepare monthly financial statements. It was not operating a GAAP-compliant system. It could not track its payroll, and it's financial report for 1997-1998 was not available until over one year later, months after the close of the 1998-1999 cycle. All of these operational failures were documented in our February report, and I believe it could have provided the information necessary to take corrective action.

Next, I would like to talk about the programmatic justification you requested from us in February.

Last month, I sent a memo to the Chairman of this Committee indicating that the district will receive $60 million in supplemental funding for the 2000-2001 school year. Of that amount, $46 million will be used to fund the recurring shortfall, and $14 million to fund preexisting contractual obligations, such as salary increases and fixed obligations. We there, at that point, attached a programmatic justification -- a fairly lengthy one -- for that $60 million, which indicated which educational programs and services would need to be eliminated without that funding level.

We also indicated in the memo that additional sums will be required for Whole School Reform and supplemental programs for the coming school year. We're estimating, at this point, that those programmatic costs will require additional supplemental funding of $17 million, which is conditioned upon some efficiency savings we believe we will be able to achieve through, perhaps, implementing some of the recommendations of the report and some ideas that the leadership of the district has. We're continuing to work on the district's budget. We're, certainly, still awaiting the results of the final finalized 1998-1999 audit by the KPMG firm.

Today, we're providing you with an update of those figures in the attached documents. One is entitled the Reconciliation for Supplemental Funding. These new numbers reflect the CAFRA and the audit that we have at this point. You should know that we are continuing to work with the district on that 1998-1999 audit. There are certain payroll and accounting records which are incomplete or nonexistent. We're working with the district, KPMG, Ernst and Young, and Pricewaterhouse to complete that work.

You should also know that some of the problems encountered by KPMG are being analyzed by Pricewaterhouse as part of its forensic audit. The Pricewaterhouse audit is not yet finished. We expect that to be concluded later in the summer.

Pricewaterhouse, so far -- and Pricewaterhouse is the one doing the forensic work -- has identified identical payments. They have identified unrecorded checks. They have identified that supporting documentation for a substantial part of the disbursements is missing. We can't forget, this is the reason that we asked Pricewaterhouse to do this work. I think, whenever you hire forensic accounting firms, they will go back, and they will take apart the district's expenditures and identify all issues. And they are doing that. And I think, they're doing that quite successfully.

Since the early states of our examination into the Newark deficit, we have said that we have not found any concrete evidence that funds were spent on anything other than necessary programs and services. I've also said consistently, that if we were ever to find information to the contrary, we would bring it to the attention of the proper authorities.

My message to you today is the same. I would hesitate to jump to any conclusions until all of the auditors have completed their work, especially the Pricewaterhouse firm. When the results are in from that audit, I will provide you with that information. I will certainly take whatever action is necessary and is justified by the conclusions in those reports.

You must understand that a lot of the problems, in the district, we've encountered are deeply rooted. They preexisted the State operation and will take a tremendous amount of hard work to fix. We must also understand the problems completely, and these reports will allow us to do that. The whole purpose of bringing consultants in, and there are a lot of them in the Newark district, is because I'm committed to fixing this problem, and I'm committed to fixing this problem right. It's going to take time to do that. It's going to take some money to do that. But I do not want this problem to continue any longer. And we're going to make sure that it does not. Although they may portray negative images about the operation of these districts, these reports do place the district in a fishbowl. They do put the district under a microscope. But they are essential if we are going to fix the issues up in Newark.

Now, you've heard, this morning, from the State Auditor. The Auditor's report of May 15 focused on Newark's fund balance. It was a snapshot at a fixed point in time. And certainly, as we have discussed earlier this morning, we have moved considerably beyond that point. We are learning more about the state of the district's finances with each passing week. And what we're presenting today, I believe, is a more -- a much fresher snapshot in time, but we've heard that the State Auditor will remain in the district. We thank him for that. We thank him for his help in working with us on this very difficult issue.

Talking about difficult issues, I believe the current school year's budget was very difficult, in and of itself. The unfolding nature of the district's finances did not allow for any real reasonable financial planning for 1999-2000. We didn't even get the prior year's -- the 1997-1998 CAFRA back until the fall of 1999. It doesn't allow much reasonable financial planning at all. The district is finishing this year, and beginning next year, with a severe cash flow situation. We do believe that we'll finish the year without any problems, but you should realize that there is a cash flow issue with this district. A lot of the supplemental funding that was provided for this year will not come until next year in relief to the district, but we're comfortable that we will end the school year without any major difficulties.

We're pleased that, in terms of the district's business operations, monthly financial reports are being filed. The district is GAAP compliant, utilizing the State's chart of accounts so we can track what the district's doing. There's a new financial system in place, a payroll system. Although continuing to cause problems, I believe we have progressively improved and are committed to continuing to improve. We also encounter some delays with the generation of monthly reports by the Treasurer of School Moneys. The reconciliation of checks with the bank is ongoing, and we anticipate the first Treasurer reports in many years, if not decades, will be filed over the summer.

Perhaps the most troubling aspect of the district's business operations that still remains is the lack of adequate internal controls. This is probably the most serious issue now confronting us, now that we have the 2000-2001 budget ready to move forward -- is the issue of internal controls. The KPMG audit, the Deloitte and Touche management study, and the Pricewaterhouse observations all indicate that the district's internal controls require an overhaul. We will proceed along two tracks. First, we will immediately establish a disbursement tracking team to assist district leadership in ensuring that all expenditures are properly approved and documented. Second, we are developing model internal controls. I think, definitely, district leadership is very committed to putting these controls into place for the long-term benefit of the district.

There's no doubt that the Newark school district can be run more efficiently. Probably, every school district you can say the same thing for. But we have had the Deloitte and Touche study that suggests a number of ways Newark can streamline its operations and improve accountability while saving tens of millions of dollars a year in the process. We'll be discussing what steps to take next with the Superintendent and will then immediately move into Phase II, which will include developing specific plans of action that can be implemented in targeted areas. So what we're going to do is take the study that Deloitte did, identify certain areas where we believe we can achieve -- make the district more efficient, and then we'll move into Phase II, which is, actually, specifically identifying those areas.

We're committed to doing everything we can to get the district on a sound financial footing. We'll stay the course and set matters right, no matter how long it takes.

Included in the report we submitted to you in February is a long list of accomplishments and success stories for improving education in the districts. Since the list was prepared-- We heard some critics have dismissed it as self-serving or embellished. That's why we're very pleased -- very proud to submit to the Committee today, a copy of an independent report commissioned by the Committee of Advocates for Newark's Children on the impact of State intervention. The report was prepared by the Community Training and Assistance Center in Boston. This national, not-for-profit organization is recognized as one of the leading school reform organizations in the United States.

The CTAC report is proof that, from the perspective of what's best for the children of Newark, our involvement in Newark is a success. I urge you to read about the significant academic strides that have been made in Newark, how the district has sharpened its focus on student achievement, how thousands of parents are now participating in school improvement planning efforts, how expectations for students have been raised, how student performance has improved in multiple areas, how student behavior has improved, how student attendance has improved, how classroom conditions have improved.

The report talks about how there is a renewed sense of confidence in the school system, how the support and commitment of corporations and foundations has risen dramatically, and how a majority of parents, teachers, students, and administrators share a common belief that the Newark schools are improving. I think that's a pretty good report card, and one that any commissioner and any superintendent would be proud to receive.

With that, we have enclosed, in this packet, some documents for your consideration. We are not going away on this issue. We will be providing you with additional documents as they become available to us. And we'll be glad to work with you for your understanding of what we've found and what we will find in the district operations because we want you to have a comfort level that we are getting at this problem, we are committed to getting at it, and we're committed to doing what's right for the children of Newark.

So, with that said, I'll open to any questions.

ASSEMBLYMAN WOLFE: Thank you very much, Commissioner. I certainly-- I think the Committee-- I will speak for all of them. Thank you for your thoroughness and the information and the backup materials. I know we have a lot to look at and to digest.

I just really have one question before I turn it over to Senator Palaia, who has a question.

Amongst all the things that you said, you said you still have problems getting monthly reports from the Treasurer of School Moneys. Who is the Treasurer of School Moneys?

COMMISSIONER HESPE: There are two reports. The first is a monthly financial reconciliation form, the A-148s. Those have been filed since January. The second form is the 149, which is prepared by the Treasurer of School Moneys, who is a city employee. And basically, the main impediment to the filing of the 149s in the past has been they didn't have an A-148. But now that we have A-148s, we're working on the A-149s. And we hope that once the bank check reconciliation-- The bank has to get caught up on the reconciliation. As soon as that happens -- it should happen very shortly -- we should have them very shortly. We should have the 149s filed.

ASSEMBLYMAN WOLFE: Is this individual being abstinent? Are they not doing their job? Are they ignoring our request?

COMMISSIONER HESPE: I don't think they have the information I guess they need to file their report, and the bank-- I think the piece missing now is the bank reconciliation. And that is basically getting caught up as we speak.

ASSEMBLYMAN WOLFE: Thank you.

Senator Palaia, you indicated you had a question.

SENATOR PALAIA: Commissioner, I appreciate your forthrightness in dealing with this subject. I'd like to ask a real broad question here.

This bill -- the takeover bill is over 13 years old now. Do you still-- Do you think it's still apropos to have the takeover bill? Does it need amending, or should we just disband the thing and say, "We have the wherewithal, within the Department of Education, to make sure these school districts are complying with the rules and regs of the State?" It's a question that has to be answered because right now we're spinning our wheels. But we have to look at this and say, "Should we continue with it, or should we disband it?"

COMMISSIONER HESPE: Yeah, I think the issues we're confronting today are probably a bad basis for making that decision because

I do believe the State takeover law has resulted in some dramatic improvements in the three districts so far. But you referred to additional authority the Commissioner has been given under the school funding law passed in 1996, and I believe that certainly makes the need for future takeovers -- certainly reduces that need for future takeovers.

But I definitely think the State operation law should remain on the books. I do believe there are situations which may require future State intervention at that level. And I would just not try to jump from this issue of financial operations in a district. Newark is our largest district. The situation is difficult there at the time the State operation began, and unfortunately, it just did not improve.

SENATOR PALAIA: So you'll continue to monitor it and get back to us--

COMMISSIONER HESPE: Oh, absolutely.

SENATOR PALAIA: --if you think it needs amending or just some -- a little fixing up?

COMMISSIONER HESPE: Yeah, definitely. We'll be taking this issue on in the fall -- regarding the return of a district to local control--

SENATOR PALAIA: Right.

COMMISSIONER HESPE: --Jersey City. So we will be returning to this issue.

And I guess your question is, Senator, for me to take a look at what else might need to be changed in that law--

SENATOR PALAIA: Exactly.

COMMISSIONER HESPE: --at the same time. And I will certainly do that for you and get back to you.

SENATOR PALAIA: If we have to do something to shore it up, that's fine, we should.

Thank you, Mr. Chairman.

COMMISSIONER HESPE: We'll look at that. We'll get back to you, Senator.

SENATOR PALAIA: Thank you, Mr. Chairman.

ASSEMBLYMAN WOLFE: Assemblyman Malone.

ASSEMBLYMAN MALONE: Commissioner, the-- What brought us to the point in Newark that we had to take over Newark? I mean, I don't need a long-- I mean, what were some of the major problems in Newark that brought us to the situation where we had to take over Newark?

COMMISSIONER HESPE: Well, in a nutshell, a district is taken over when we don't believe that that district has the ability to track a course for the district. So it's really poor decision making that's the reason for a State operation. We don't believe that a district can set a course that will lead them to the student performance gains, to the administrative efficiencies that we want to occur in that district. So it's really that the State doesn't believe that that district has the decision-making capacity to lead that -- lead the students to a higher performance.

ASSEMBLYMAN MALONE: I guess the question I want to ask-- If they had a surplus-- I don't know if they had a surplus because I don't know if the records were right. I have to be honest with you.

If they, in fact, had a financial surplus-- I mean, was it poor test scores, I'm assuming, that was a major factor? Was it inappropriate use of funds? I mean, was there a report done that says Newark should be taken over?

COMMISSIONER HESPE: Yeah, absolutely. There is actually-- There are a couple of different reports done. There is a court case. We can provide you with all that information. But I think the main things you'll find are governance issues, student performance issues, and administrative issues.

ASSEMBLYMAN MALONE: And in the case where you have taken over, specifically, without getting too detailed, what are your Department's responsibilities and your responsibilities when you do take over a district?

COMMISSIONER HESPE: Under the State operation law, our main engagement is to find a superintendent who can go in and take the reins of the district and to make those decisions which could not have been made before State operation. And so a tremendous amount of authority is vested in the State Superintendent. All the authority of the school board is vested in the State Superintendent. Certainly, there are lines of communication -- lines of authority between the Department and the State Superintendent. But the State Superintendent has tremendous authority -- assumes all authority that the local board and the superintendent would have, prior to the State operation. So there's tremendous authority vested in the superintendent.

SENATOR PALAIA: You have to understand something--

Excuse me.

This doesn't happen overnight. This can go as long as three years--

ASSEMBLYMAN MALONE: Okay.

SENATOR PALAIA: --of noncompliance before you even get to that point.

ASSEMBLYMAN MALONE: Okay, that's--

SENATOR PALAIA: Go ahead.

ASSEMBLYMAN MALONE: In continuation--

In essence, are you really saying that the State takeover really handles the day-to-day operations from a State Department of Education, or is it really relegated to the State-appointed Superintendent to do that?

COMMISSIONER HESPE: Well, I think it's both. In areas that are problematic, I think the Department intervention is significant. For example, over the last six -- seven -- eight months, the Department's interaction on the business operations has been almost a daily interaction. So it does vary depending upon the amount of assistance the district needs. But for the most part, the superintendent is allowed to chart a course of the district and to do all the day-to-day operations, only the Department will get involved more intensively on issues that turn out to be problematic.

ASSEMBLYMAN MALONE: If you had to evaluate the process that we've gone through over the last three years, in an objective and honest way, are you relatively pleased with the progress that has been made since the State took over Newark?

COMMISSIONER HESPE: Absolutely. In terms of student performance indicators, definitely. The CTAC report, which we gave to you, I thought, was very significant because it charted all of those progress indicators from community involvement to student performance to some of the administrative issues that have been taken up.

The answer is clearly yes.

ASSEMBLYMAN MALONE: Even given all of the turmoil that's been brought to light in the last six months, you're still generally pleased, and I'm assuming the Superintendent's pleased what she has seen since she took over.

COMMISSIONER HESPE: I think the answer, definitely, to that, is yes. We definitely-- This is just, I think, a very large blemish on an otherwise pretty good record of moving this district forward. I think if you ask the Superintendent and myself, we much prefer spending all of those hundreds of hours we've spent over the last six months on student improvement programs. And I know Marion's frustrated because of always being pulled back to this issue, but we said it was going to be a priority in February -- the highest priority, and we're treating it as such to get this issue under line. But definitely, I know in Marion's mind, and my mind as well, we'd much rather be spending this time on student performance.

ASSEMBLYMAN MALONE: And just one last question.

How long do you think this procedure that we're going through currently with this upheaval is going to last? And when will it be put behind us so that we can get on to the business of truly educating and worrying about the kids?

COMMISSIONER HESPE: I think it will be phased. I think-- Until the final phases are completed, it could be almost a year -- my guess is -- because right now, Pricewaterhouse is looking at a snapshot from July 1998 to

December 31, 1999. We might very well ask them to go farther back in time before that point. So it could be a while.

The Deloitte study is going to enter Phase II. That will take a few months to go. So it could be a year before the final phases, but I do think we're probably at the hump right now of activity. And hopefully, that activity will start as we get all -- the 149s start getting filed.

One of the big accomplishments that I think will go unnoticed, and I don't want it to, is actually the budget being filed for next year, this week. It's a very good budget, and it took a long time coming. A lot of work was put in on it. But these are all issues we need to address before we get over the hump, and we are, which is the good news.

ASSEMBLYMAN MALONE: Is the public involved in that budget process to the extent that they're involved in other, non-*Abbott* districts?

COMMISSIONER HESPE: Yeah, there's going to be a hearing, I guess, within-- Every district has a budget hearing, and we'll have a hearing within the next week or so, Betsy?

ELIZABETH E. DeMATTEO: The 28th.

COMMISSIONER HESPE: The 28th.

So yes, there will be a hearing, just as in every other district.

ASSEMBLYMAN MALONE: Thank you very much.

ASSEMBLYMAN MORAN: Chairman Wolfe.

ASSEMBLYMAN WOLFE: I'll get to you in just a minute.

Senator Turner.

SENATOR TURNER: You indicated that a number of very large, well-respected, high-powered CPA firms are engaged in this whole process. How long have they been engaged in this process?

COMMISSIONER HESPE: Ernst and Young has been engaged since the -- been working on the district's financial reporting since the winter-spring of 1999. KPMG is the audit firm, so they've been involved in various points in the development of the audits. Deloitte and Touche has been retained on the management study since March of this year, I believe -- March of '00. And Pricewaterhouse has been engaged in doing the forensic auditing work since March of 00, I believe.

SENATOR TURNER: Have any of them given us a report of the work that they've done?

COMMISSIONER HESPE: Yeah, we have-- Certainly, Ernst and Young is doing the financial, so they're day-to-day operational work. Deloitte and Touche -- you have Phase I of their report. KPMG is doing the audit, and we have provided -- or will provide you when that audit is completed with the audit report. And Pricewaterhouse is doing the forensic work.

I provided a short indication in my statement as to what they're finding. We'll have a more formal report for you. Over the summertime, they should have completed that phase -- that 18-month phase during the summertime.

SENATOR TURNER: What is the cost of all of this auditing?

COMMISSIONER HESPE: The KPMG is-- We've booked-- How much?

MS. DeMATTEO: About $180,000.

COMMISSIONER HESPE: About $180,000 is KPMG. Deloitte was approximately $300,000. Pricewaterhouse -- approximately $500,000. And Ernst is--

MS. DeMATTEO: Their latest is $235,000.

COMMISSIONER HESPE: Two hundred thirty-five thousand dollars.

SENATOR TURNER: And how is this adding to the education of our children -- spending all this money on CPA firms. We had our State Auditor, who was brought in in March, and he's come back already with a report. And we have all of these high-powered CPA firms who are still working at it, and they still haven't provided us with much at all.

COMMISSIONER HESPE: I think the State Auditor was very clear that he was relying on the audits being prepared by these entities as the basis for his report. And this is-- The Deloitte study is regarding efficiencies in the district. And I think that was one of the things that the Committee members indicated, very clearly, that they wanted us to pursue in February to make sure that this district was being operated efficiently. And as even the State Auditor noted, even in his brief work in the district, he has indicated that he is going to go back in on the food services piece. So I think the efficiency piece is something that definitely needs to be looked at.

The KPMG is an expense that every district will have. Every district needs to have an audit done by a certified public accountant, so that would be a cost that any district would have.

So it really comes down to Pricewaterhouse. And Pricewaterhouse is important because the question being asked over and over to me by the

Committee members is, how can we be sure that the money did not go to someplace it shouldn't have gone. And there is no other way to give you that answer without bringing a forensic accountant in to take a look at that issue. I'm not going to sit here and say to you I know the answer if I don't. And the answer is I don't know. And the only way I'm going to get you that answer is through the forensic accounting firm.

So the short answer is, absolutely none of that money is going to support student improvement in the district. However, it all goes to support the credibility and integrity of what we're doing. And given the fact that we are seeking large sums of money from the State, in terms of supporting student improvement, I think the integrity and credibility of the operations of the district become exceptionally important. And I think that requires what we're going through here. But I don't--

I think you might have misunderstood the State Auditor. He is not doing independent auditing in that district. He's relying upon the raw audits being performed by the companies that we've indicated as the basis for his decisions and his judgements.

So I think you might have misunderstood, Senator.

SENATOR TURNER: Well, given the amount of money we're spending, how is this going to help us in terms of our comfort level -- that this is not going to occur in Jersey City or Paterson, where the State is currently in control of those districts?

COMMISSIONER HESPE: Yeah, there's going to be a review of the internal controls in both of those districts. But you should be aware that Jersey City's business office -- that's actually won awards nationally for their efficiency and their ability. So you should be aware that you-- I think it's-- I just would not take the label of State Operated District to assume that there are problems in the business office in Jersey City and Paterson.

Certainly, we are looking at everything in those districts to make sure there is not any problems that we -- and the lessons we can learn from Newark. But at this point, we think those operations are sound.

SENATOR TURNER: Thank you.

ASSEMBLYMAN WOLFE: Assemblyman Stanley, you had a question.

ASSEMBLYMAN STANLEY: Yes, thank you, Chairman.

First, I want to thank the Commissioner for coming here today and also for being very open with members of the Legislature and myself. And I understand that much of what we're talking about predates you as Commissioner. A lot of what we're talking about predates Marion Bolden as Superintendent.

And let me just say, for the record, that the people in the city of Newark really have very high regard for the Superintendent, Marion Bolden. I think she's doing an excellent job in what are very, very far short of the best of circumstances.

I just had a couple of questions with respect to the reduction in revenues that precipitated the so-called deficit spending, I guess one might put it as.

Now, the 4000-- There was some comment made about 4000 students being reduced -- or a 4000 reduction in pupils in the city of Newark.

And that-- Did that not occur over a period of time? Can you just kind of bring that in for me?

COMMISSIONER HESPE: Sure, Assemblyman.

CEIFA-- In the first year of CEIFA, we went back onto an enrollment basis for funding. Don't forget, we had that hold harmless from -- around a period of a multiple number of years -- the formula was not enrollment driven. It was basically a hold harmless formula. So, in the first year of CEIFA, we did not just take the difference in enrollment between the prior year and that year, we actually took that entire spread of enrollment trying to be fair to districts that have had enrollment gains so that, during that entire period of the hold harmless, we used -- we took account of the enrollments.

So when you said, did this happen over-- Yeah, the enrollment drop happened over that period of time of the hold harmless and was effectuated in that first year of CEIFA. It was an average percentage, I guess, over that period of time.

ASSEMBLYMAN STANLEY: Okay, so they lost-- In one year, we lost 4000 students? Is that what--

COMMISSIONER HESPE: No, no. The formula took the loss over those five years -- took into an average, I think -- the average enrollment gain or loss over that five-year period. And that then turned into the enrollment driver for the first year of your CEIFA aid. And that, therefore, translated into a $30 million State aid loss. So that was the first thing that the district had to confirm -- was that CEIFA-driven State aid loss--

ASSEMBLYMAN STANLEY: Okay, so that was $30 million in one year.

COMMISSIONER HESPE: That's right.

ASSEMBLYMAN STANLEY: Okay.

COMMISSIONER HESPE: And then that -- because you mentioned this-- I might as well just follow the whole line. Three things happened. The first was the CEIFA State aid loss. The second was the $26 million in municipal overburden aid given to the district in January of 1997. And then third would be parity aid of around $20 million, which the district received in 1997-1998.

Those are the three things.

Now, the municipal overburden aid of $26 million-- At the time, it was indicated that money would be -- allow the district to phase out, so to speak, the loss of the $30 million-plus of State aid over a period of time. It was a one-time, nonrecurring $26 million, which was supposed to buffer the district's loss of that State aid over a period of time. So the district was-- I think it anticipated to step down that $30 million reduction over a period of time.

And then parity aid came in the year thereafter. So that was another complicating factor. That all went to -- under the court mandate, all went to new programs. So it couldn't be used to offset current spending patterns. It had to be used for new programs.

So those things are all in the mix -- I guess was your question, Assemblyman -- what was going on at the time in terms of the revenues. I think that's a real quick snapshot of what it was.

ASSEMBLYMAN STANLEY: Okay. Do you have any information with respect to the Capital Fund for Newark and what that was at the time of the takeover and what it currently is?

COMMISSIONER HESPE: Not right now, but if you're interested, we will get that for you, certainly, Assemblyman. You just want the Capital -- because we give you Capital funding from the 1995-1996, 1996-1997, 1997-1998, and the 1998-1999. We can give you those years' Capital funding levels so you can see what happened during that period of time.

ASSEMBLYMAN STANLEY: Sure. I think that would be good.

The only reason I mention that -- because if there is a possibility that moneys could have been taken out of Capital to fund other things that maybe shouldn't have been funded out of Capital--

COMMISSIONER HESPE: Okay, we'll get you that.

ASSEMBLYMAN STANLEY: Sure.

And the thing that I've been most concerned about, Mr. Chairman, is that we make sure that students in Newark aren't negatively affected by what we're talking about here. I mean, obviously, there have been some problems in terms of management -- of fiscal matters. But the No. 1 concern of mine, and I think of everyone on this panel, is that no student in Newark is hardshipped, is denied an adequate education, as opposed to, perhaps, pressures being placed upon the State by its own -- placed upon the State-operated district by the State itself.

You know, it's interesting, the State putting pressure on the State, which, I guess, is something you can't avoid in this situation. But to cut costs where it would, in fact, become problematic, where it would, in fact, lead to things like teachers not being hired, supplies not being available--

And I want to-- And I think everyone on this panel made assurances last time we met that that would not -- that we would not allow that to be the case. And I'm not so sure that that hasn't happened, but I have a-- As a matter of fact, when this first came down, I said, "Over my dead body would one student suffer." And I'll tell you Sunday I felt like I was going to die. But this morning, I made a miraculous recovery. So maybe that's some good news on the horizon.

But can you tell me what we need to do to make sure that the Newark budget is whole, and can you assure me that no student would suffer or has suffered as a result of this situation? How have we been able to keep people being paid? You know, we've got salaries and things that have had to been paid over this course. And with this kind of deficit -- how we kept paying people, you know, for one thing.

And also, what assurances do we have that next year we won't encounter a structural deficit similar to the one we have this year?

COMMISSIONER HESPE: Those are very fair questions, Assemblyman. I'm going to take a first shot, then I'm going to hand it over to Marion and Betsy.

I think the first issue was this year -- what happened this year. And as I indicated, this was a tough year because there was a real cash flow problem during most of this year, given the fact that there was supplemental funding available to make sure that the books balance this year. But most of that supplemental funding will not reach the district coffers until next year --

until this year has closed. So there has been certainly cash flow issues throughout this year. And I think through a lot of hard work from Marion and Betsy, they've actually been able to make this all work out. But there certainly have been, I think, issues throughout this year regarding the cash flow. And they've had to take some steps, but I don't think those, in any way, impact upon the education of the students.

Now, for next year, I think, as we indicated at the front, there's going to be considerable growth in the budget to ensure that the students get the programs that they're entitled to -- they get the education they're entitled to. So we can be certain that the answer to your question is, absolutely, no. The students aren't being negatively impacted by any of the business operation issues that we've been discussing.

And then just one last issue. What should we do about the structural deficit? And I do agree that we should try to fill that shortfall permanently. And I think we're going to try to do that in the next round of the funding law -- just try to fill that gap so that we don't have to be constantly facing a cash flow issue. We're going to look at doing that in the next State aid run. So I think that's the last of the three-part question.

I'll turn it over to Marion for some of the issues about students.

MARION A. BOLDEN: Let me first say that the issue for you and the issue for me is the same -- that having youngsters victimized by what happened is certainly not something that I would sit and allow to happen either, if I had any control over it. And I think this year was probably the roughest year for us in terms of even perception that principals have.

You have to understand that July 21 -- our schools had budgets. They had budgets that were not approved. And those budgets represented far more than they actually got. So when you go from school to school, you're going to hear different commentary from principals. They thought that they had far more in terms of educational supplies. And by the time we struck a budget for this school year and got those budgets out to the school, they had to live with less than they had anticipated.

That did not impact some schools like others because there are principals who are very resourceful and plan ahead. I do have to say that this year, it was distracting because of issues of budget. Even when the budget was finally put together, schools could then move forward. But understand that for three or four months, they were not absolutely clear as to what it is they were going to be able to spend. That's distracting.

Those things we dealt with. And in putting this budget together -- which we do have a finalized budget that I signed off on -- Ms. DeMatteo has signed off on -- the county has yet to do that -- that they will know, going into the school year, what their budget is and what resources they have available.

I am going to say that even when that's done, you're going to have principals that are going to say that they don't have enough. You're going to have a superintendent that says that she doesn't have enough. But you're going to find that in every single *Abbott* school district.

What we had to do was sit down and look at our budgets. And in terms of what has happened, you have to understand, too, that I had to be concerned, are we going to be penalized because of what happened. I don't think that that's the case. I think that there certainly has been discussions between the district and the Department, and some of them have been very heated, but I don't think that we've been dealt with any differently than any other *Abbott* school district. That's the assurances that I can give to you.

And the issues that I guess were--

And the Commissioner has to take a position. Given all that's happened, when I ask for money in the budget, there has to be documentation and there has to be a justification and there has to be an instructional need. And I think that's what we provided.

We have the lowest test scores in the State of New Jersey when it comes to science. I have, in my program, a very significant increase when it comes to science education. Would I like to have more money for technology? There's no question about it. And I guess other districts will, as well. But I finally feel some comfort and some relief that, at least, the budget that we have put together for next school year will serve the needs. We have our 21 schools that are in Whole School Reform. Their budgets are developed differently than the other districts -- or the other schools that are Cohort 3. And their's, pretty much, has been phased in.

So there also needs to be an understanding -- and I have talked to the principals -- that there are different cohorts of implementation with Whole School Reform. And we have a good majority of our schools that are in Cohort 3. And so they don't have the tutors that Cohort 1 and 2 schools have. And they're not necessarily happy with that, but that is something that we're living with.

And again, is it the best of times in Newark? I have to say no it's not. But I think that in terms of getting over the hump and stabilizing our finances-- I think that there's an awful lot that's been done.

Anyway, I hope that that answers your question. There are things that I would like to have had included. I think, though, that in terms of fairness and equity to *Abbott* school districts-- I think that we are going to be able to move our instructional program forward for next year.

ASSEMBLYMAN STANLEY: Thank you, Superintendent.

And the last question for the Commissioner.

Senator Turner had made mention of the, I guess, million-plus dollars that are being spent for audits. Are these moneys that come out of the Newark State-operated school district, or are they dollars right out of the Department of Education?

COMMISSIONER HESPE: Yeah, they're a mix. Some are paid by the Department, some come through the district. But all of those consultants are supplemental funding, so they're not being pulled from the program.

ASSEMBLYMAN STANLEY: Thank you.

Thank you, Chairman.

ASSEMBLYMAN WOLFE: Assemblyman Moran.

ASSEMBLYMAN MORAN: Thank you, Mr. Chairman.

Again, thank you, Commissioner, for being here -- and your staff.

Listening to people talk, going over the status report of the Newark Public Schools, the conditions and the resolution, I have to tell you, you've come a long way.

COMMISSIONER HESPE: This is the hard work of the two individuals to my left.

ASSEMBLYMAN MORAN: And a lot of the ideas gave me some ideas that we ought to be incorporating into regular public schools across the state.

COMMISSIONER HESPE: Actually, we agree with you on that. We are, through the intensity we're applying to this situation-- We're learning a lot -- that everyone might be able to do that.

ASSEMBLYMAN MORAN: A number of points--

One point I want to make is that Assemblyman Stanley had pointed out -- about the 4000 students with CEIFA--

ASSEMBLYMAN WOLFE: Assemblyman, can you just push the button there for your mike? (referring to PA microphone)

ASSEMBLYMAN MORAN: He had brought up the 4000 students with the CEIFA. You know, we can't lose site of the fact as to the left-hand side of the ledger where school districts lost their youngsters. And in fact, over the 10 percent differential in the CEIFA language of the law that was phased out-- Those communities that students, such as those that I represent -- we did not get funding for those students.

So when we look at that, we've got to look at it -- the total picture because where, in the case of Newark and the urban communities where they're losing population, and communities that I represent -- where they're gaining population-- There's got to be an equalization there somewhere, and I know you're aware of it.

And I thank you for letting me bring that point up, Mr. Chairman.

The other point is that when we talk about the supplemental appropriations for our urban *Abbott* districts, are we talking about over and above the CEIFA allocation per pupil that's allocated for them under the CEIFA law?

COMMISSIONER HESPE: Yeah, it's above parity-- It's (*a*) above what CEIFA provides, (*b*) it's above what parity provides, and (*c*) it's above Human Services money to community-based early childhood programs.

ASSEMBLYMAN MORAN: So this is over and above what the *Abbott* decision really called for in a per pupil expenditure.

COMMISSIONER HESPE: No, this is exactly what-- Well, the *Abbott* decision called for two things, (*a*) parity with the wealthiest districts, and (*b*) funding supplemental programs that are deemed necessary. And the supplemental funding allows those necessary programs to be put in place. And there's a need for these programs.

ASSEMBLYMAN MORAN: Sure.

COMMISSIONER HESPE: The district is, you know-- If you've chartered the district in terms of spending, it's a very high-spending district, but you -- Marion can tell you about the struggle she's having to try to put in place programs that she believes are necessary. And we're certainly going to be looking at the efficiency side and trying to find places where we can move some more money into -- from areas of inefficiency to--

ASSEMBLYMAN MORAN: Sure.

COMMISSIONER HESPE: --priorities for the district. But this money is necessary. And it's a lot of money. The district will probably be spending around $12,600 per pupil. So it's a tremendous -- with the new supplemental funding award, but it's necessary. These are the costs of doing the programs well.

ASSEMBLYMAN MORAN: Commissioner, I'm not arguing that point. I agree with you.

Something that Senator Palaia brought up is that, are there any suggestions or ideas that we ought to seriously be looking at to amend the existing law to make it a little bit more compatible to today and the different things that are happening?

One thing that I find interesting is that, talking to the State Treasurer, as well as listening to you and talking to others -- is that we had a situation in Newark where we had spending outside of the scope of that line item for items that we still don't know what they were spent for. The GAAP system is supposed to correct that to make sure it doesn't happen.

In suburban, non-*Abbott* school districts-- If we do that, we're brought up on charges. You can lose your license -- your certificate to practice in New Jersey, and your board of education members are brought up on ethics charges.

Do we have anything in the code -- do we have anything in the statute that says that when this happens, somebody, somewhere, can be held accountable?

COMMISSIONER HESPE: Well, I think the issue, certainly, is that it should never happen. And it's never envisioned that it would happen. And as we said in the February report, there's a lot of reasons for why this happened. The complexities of this are -- proportion-- I don't think any of us -- even, I think, you, Assemblyman -- and you certainly know this territory better than most people in the state, if not most business administrators in the state know these issues--

And this is surprising. I think Tom, who is a top-notch business administrator in a non-*Abbott* district-- And I think he got shell-shocked very quickly after taking a look at what was going on in there.

I'm going to ask Tom to say a couple of words about that, but I think this is a dimension of a problem that we've never seen, and I think there were problems at first in coming to grips with just what the problems that were in this district and how to fix them. And I think that it is a No. 1 priority of the district.

And certainly, I don't want to say anything about Beverly Hall or Dr. Klagholz because I think both of them focused on student achievement and probably didn't understand how bad things were in the district. And God bless them for focusing on student improvement in the district because that's what it's all about. But this underlying problem was not really addressed in a way that I think would solve it. And it's complexities of the problem--

And I'm not a business administrator. I don't understand a lot of the technical aspects, but I'll turn it over to Tom, who does.

ASSISTANT COMMISSIONER THOMAS McMAHON: Yes, basically, I think, when you get to the underlying cause and problems, it goes all the way down to internal controls and the people that work in the business office on a day-to-day operation and input purchase orders and have supporting documentation for delivery of goods and all the basic things that we think about as givens. And I think the reports that we're looking at, and some of the management studies for efficiency are going to find that that, in fact, is a great deal of the problem in Newark -- that they have to look at those internal controls and policies and procedures for cutting purchase orders, paying the bills, things that are the cornerstone of all the financial documents that you're talking about.

A lot of people are making mention of what was in 1998-1999 and how come the audit's not finished and what kind-- It's only as good as the documents that you have. And all those documents start with the person who keys in a purchase order, the person who keys in a piece of revenue -- a check that comes into the district or a wire transfer that comes into the district. And that, in fact, is where a lot of the effort is going to go and why some of the studies we're doing, in terms of efficiency, are so important and why it's not an overnight fix -- you can understand if we're talking about people that have been working there for years -- maybe looking at reallocating staff to certain departments, training people in certain departments on new computer systems, on new payroll systems, and proper procedures to handle those systems. That, I think, is the key to the financial success of the Newark school system.

ASSEMBLYMAN MORAN: Through you, Mr. Chair, one last question to Dr. McMahon.

When a school district such as Newark keys in a purchase order, is it automatically systematically reduced to the correct code and shows a new balance, or do they just work out of shoe boxes and say, "We'll just keep on spending until somebody tells us to stop?"

ASSISTANT COMMISSIONER McMAHON: Well, as of the new system-- Since they've become GAAP compliant over this year, and the fact that they have a new computer system from January of this year, I can assure you that now that is, in fact, happening. It's coming down off the line item.

But again, that's obviously a key question -- an important part of the procedures in Newark. If the person keying in puts it on the wrong line item, you've got a problem. Of course, the system will find it now and say it's overdrawn, but those are the kind of things, I think, that we're seeing and working on in Newark. But I can assure you, at this point, that it's not a shoe box, and it will obviously show up if it's overdrawn.

ASSEMBLYMAN MORAN: Okay, thank you very much.

Thank you, Mr. Chairman.

ASSEMBLYMAN WOLFE: Senator Palaia.

SENATOR PALAIA: Just a quick question.

Could you tell me what percent of this State-operated school budget is paid for by the people in the city of Newark?

COMMISSIONER HESPE: I think it's $80 million.

SENATOR PALAIA: I mean, they pay 20 percent of what the--

COMMISSIONER HESPE: Out of $500 million, so it's $80 million -- any math whizzes out there--

SENATOR MARTIN: Well, we know it just went over $80 million because that's the -- the Auditor said in February that's what allowed him to be able to go in and conduct an audit.

It's also, I think, my understanding that Newark has not increased a dime of additional revenue for many, many years. They just keep paying their -- what they had in the past.

COMMISSIONER HESPE: All *Abbott's* tax rates have been frozen for a number of years.

SENATOR PALAIA: So, in other words, the city of Newark pays about 20 percent of what the total budget is. And the State is picking up 80 percent of that cost, correct?

ASSISTANT COMMISSIONER McMAHON: I think it may be higher than that.

COMMISSIONER HESPE: Yeah, I think it's around the mid 80s if I--

SENATOR PALAIA: Mid 80s?

COMMISSIONER HESPE: Mid-- The State share, I think, is in the mid 80s.

SENATOR PALAIA: Mid 80s.

COMMISSIONER HESPE: Mid to low 80s.

SENATOR PALAIA: Wow. I'll just say wow.

Thank you.

ASSEMBLYMAN WOLFE: Assemblyman Garrett.

ASSEMBLYMAN GARRETT: Two areas of questions.

Did I hear you make a comment that you said you support--

First of all, thank you for coming out. I guess it's getting near the end here.

Did I hear you say that you see a likelihood -- maybe you used other words -- of significant increases in funding for the -- from the State, I presume -- for the school system for the next go-around?

COMMISSIONER HESPE: Yeah, we've approved $17 million of supplemental funding for next year on top of what we've already approved.

Is that what your--

ASSEMBLYMAN GARRETT: Yeah, that's sort of the question.

How do we make those decisions today, in light of the fact that we're looking at the -- not the audit, but the review that we just heard a moment ago, prior to your testimony, where they're raising just a couple of questions from their review -- or audit -- such things saying, you know, this is one of the highest spending school districts in the state, spending is up in areas like food service, administrative costs, led by the respective salaries ranked among the highest in the state, and so on and so forth?

Before we make the statement that they're getting more money, don't you first want to conclude that their extremely high spending is appropriate, and we're going to make up for it?

COMMISSIONER HESPE: Actually, we approved $17 million additional spending, but we've conditioned that upon $12 million and change of efficiencies. So we're already booking efficiencies for the district based upon the -- what we've seen, at least to what Marion and Betsy have seen and what we've seen in Deloitte's study. So we are booking substantial cuts in order to come up with--

I think the total figure we want for next year is $30 million directed at these programs. We believe the way to get there is $17 million of additional State funding and $12-plus million in efficiency savings. So we've actually booked that into this next year's budget -- substantial efficiency savings.

ASSEMBLYMAN GARRETT: How do you come up with that percentage?

Maybe that's a question for you. How do you come up with a percentage of what you anticipate -- expected savings are until you know what the actual problem is?

ASSISTANT COMMISSIONER McMAHON: The Deloitte study earmarks a couple of key areas that needed to be corrected. And after examining some of those and looking at maybe starting some of the phases in January, we felt as though $12 million was a realistic figure that could support the spending for the students in Newark.

COMMISSIONER HESPE: Also, Assemblyman, in the supplemental funding awards given to all *Abbott* districts, we've conditioned those awards on an efficiency review in all *Abbott* districts, and so those awards could decrease based upon those efficiency studies that we're doing. So we actually have done that for all *Abbott* districts. Newark's not being singled out.

ASSEMBLYMAN GARRETT: So the percentage increase that they're still getting, even with the--

COMMISSIONER HESPE: Eighty percent, overall.

ASSEMBLYMAN GARRETT: The other -- second area of questions--

You made the comment in regard to the reports of the Treasurer of School Moneys, and I think you just, offhand, said something like, "We haven't seen those."

COMMISSIONER HESPE: Yeah, to tell you the truth, I'm not really sure when was the last time those have been filed. It's been a long, long time.

ASSEMBLYMAN GARRETT: And then someone else -- you had a question -- who is the Treasurer of School Moneys? You said that's a city employee. But then you sort of defended him in respect because you said that part of the reasons -- he hasn't been able to -- he or she hasn't been able to do it is because of the lack of reconciliation of checks with the bank. So it's not the bank's problem, it's somebody else. Who is--

COMMISSIONER HESPE: Well, it's actually the-- In order to file the 149s, you need two things. You need the bank reconciliation and the A-148s. So the 148s are being provided, so they have that. The reconciliation at the district level-- All you need is the check reconciliation.

ASSEMBLYMAN GARRETT: So who wasn't doing the job?

ASSISTANT COMMISSIONER McMAHON: Well, basically, it's a problem getting the report, right now, from the bank. And basically, what the treasurer does is balance the checkbook. And he needs the checkbook, which is the A-148 provided by the district, so he has the check register. And now they're waiting for the bank statement from the bank. And the bank is having difficulty reconciling by the outstanding purchase orders that exist in the district. And why that's a problem for the bank is because you need the financial records from the past to find all the outstanding checks. And as you can see from some of the audits, getting all those records together is a cumbersome process at times.

ASSEMBLYMAN GARRETT: At the last hearing we had in the other room, it seemed to me there were two lines of concern. At least, I had two lines of concerns. One was the one that seems to be addressed, or beginning to be addressed, and that was where is the money? Did it go to the kids, didn't it go to the kids, and so on and so forth? And that's what this audit, if you will, that we just heard about--

The other line of concern that I sort of had was, who was supposed to be doing the reports? Who knew the reports weren't being done? And how come the Department wasn't following up on the fact that the reports weren't being done?

We can come up with the greatest system in the world, which is what we appear to do -- and I commend you for coming out here with a better mousetrap, as far as reviews and audits and so on and so forth. But I still get the sense, and correct me if I'm wrong, that at the end of the day, when the State takes over the school system, if the municipal employee is not providing a report, and that's because the bank doesn't have the records, and that's because somebody in the school system is not providing the financial report, all that information, through the County Superintendent, is getting up to the State DOE. And at the end of the day or quarter or year or two years or three years or five years, somebody at the DOE is ultimately responsible for saying, "Gee, those financial reports weren't given to the bank, weren't given to the Treasurer of Moneys in Newark so that we can get this."

And that was the other area of inquiry. How come they weren't done, and how come Newark was not put on the spot all along for five years?

COMMISSIONER HESPE: Yeah, that was the issue that-- We developed a series of recommendations in the February report. And actually, today, in the handout that you have, you have a status of each one of those recommendations. And those recommendations get at that institutional failure that you cited -- why did it occur -- communication issues we cited, organizational reporting issues. And then we came up with some discrete recommendations to try to make sure that those failures don't occur again. And you have a status report of each one of those in your handout.

ASSEMBLYMAN GARRETT: And so, as Senator Gormley, who isn't here anymore, raised a question -- who is responsible for each thing-- Will this tell me, because I'm just getting this now?

COMMISSIONER HESPE: Actually, the February report basically went through all of those issues of responsibility and failure. And actually, we cited that the business administrators certainly -- large number of questions regarding the state of that office-- And a lot of those issues will also get further information on -- from forensic work that's being done that's really focusing on actual -- the manual checks being cut, other checks being cut, and that, as well.

So I think you'll-- (*a*) the February report went into that, and (*b*) a lot of those decisions are going to have to wait for the forensic work to be done.

ASSEMBLYMAN GARRETT: I'm just briefly looking at this. This is really just a condition and a resolution. It doesn't say who was the person responsible and why--

COMMISSIONER HESPE: Which one was that?

ASSEMBLYMAN GARRETT: Maybe I'm looking at the wrong one.

COMMISSIONER HESPE: No, I think there's another document in there, as well, on the recommendations that--

We'll make sure that if it's not in your packet, you get that because we did develop that.

ASSEMBLYMAN GARRETT: It was not.

COMMISSIONER HESPE: Okay, we'll get it for you. I'm sorry about that, Assemblyman.

There is a document actually citing all the recommendations in the February report and giving a status, and we'll make sure that you have--

ASSEMBLYMAN GARRETT: Well, I'm not looking just for the status of the recommendation. That's after the fact. I think part of what-- The other half of the inquiry back in February was who or what was it -- that why the reports weren't being generated? Not what, but who, was it that was not getting the reports done.

The prior witness made the comment, when someone asked him about the reports-- He said, "Well, I don't know what you do to a school district that doesn't provide the reports."

Now, what happens to my school district, or a Morris County school district, that doesn't supply the DOE with reports for three or four or five years?

COMMISSIONER HESPE: It's a monitoring issue, and my guess is -- which leads to the State operation in the end, which is none of the-- The conundrum here is that what happens if Toms River, for example, didn't follow these-- That would be a monitoring issue for them. And monitoring, of course, is the way we decide if a district--

ASSEMBLYMAN GARRETT: But there is-- I mean, should I be able to go back from this hearing and reassure my superintendents and school boards, when they get sort of nervous at times and say, "Look, you have absolutely nothing to worry about because even if you don't do those reports this year or next year or next year or next year, you're not going to jail, the superintendents aren't going to lose their license, no one's going to be penalized, there's no ramifications to this whatsoever. The worst that's going to happen is that the Department, a few years down the road, is going to come in and come up with recommendations out of--" Is that what I can tell them?

COMMISSIONER HESPE: No, I think that would not be the right message. I think the right message is the Department will issue a corrective order for them to do that. And certainly coming out of this we did a survey of all the *Abbott* districts as to why -- whether or not they were doing their reporting on time. And the couple we found were not up to date, we issued orders for them to get up to date. So the issue is we'll make sure they get up to date.

Here, the problem was that it was unclear in the lines of authority. And the communication between -- back and forth -- the district--

You know, the issue of these reports-- They weren't hidden, certainly. And they certainly weren't ignored. Corrective actions were taken. I think it's the -- that feedback loop. You could even pick one of the strategic plans for this district a couple years back and see, in that strategic plan, that the district was going to start filing those reports. And the question really becomes, where did this feedback loop break down because I think -- widely known in the Department that the district wasn't filing reports-- It was equally widely known that the district was taking steps to start filing those reports.

And I think the issue really became, what information was known regarding how difficult it was, why certain actions were failing. I think that's the organizational and communication issues that we're getting at in the recommendations of the February report.

ASSEMBLYMAN GARRETT: I'll just close on this.

After that report -- after that hearing in February, we got -- I guess all of us got the report from -- or letter -- whatever you want to call it, from the former Commissioner. From the tone of his letter, I think he felt like he was being -- that all the fingers were pointing at him saying, "Gee, it went up the line of command." And the Committee seemed to be pointing all the blame at him for this whole thing. And his letter was sort of in defense of that.

I always liked the former Commissioner, and I thought, "Gee, maybe we shouldn't be pointing all the fingers at him. Maybe there are some other people or other things along the line. Maybe it's not all his fault that everything wasn't done just as we here, in 20/20 hindsight, would have liked it to be done."

COMMISSIONER HESPE: And I agree with that, but unfortunately, the problem is that when you have institutional failures, the fingers are going to be pointed, under some theory of respondeat superior, to the person in charge. And that's unfortunate because I -- certainly the blame doesn't lie with him exclusively, if much at all.

But there are multiple lapses, both at the district level and Department level, that led to this problem. And it's difficult to say that it was Leo's fault. And you think a lot of fingers were pointed in his direction under the respondeat superior theory, but being in this chair, I know that -- how many things happen in this Department that I don't have a clue about -- in any large bureaucracy. And that's the type of thing that we're trying to get at, at least in terms of the State-operated districts, through the recommendations and the report.

ASSEMBLYMAN WOLFE: I think I'm in Latin class -- respondeat superior. What's that?

COMMISSIONER HESPE: Just--

You're the law professor right there.

He can explain that one.

ASSEMBLYMAN WOLFE: All right.

Thank you.

Assemblyman Malone, you had a question.

ASSEMBLYMAN MALONE: Yeah, just a couple of questions of the Superintendent.

SENATOR MARTIN: Something like the buck stops here.

COMMISSIONER HESPE: The buck stops here, I think, is a very apt way to put it.

SENATOR MARTIN: We know the bucks, we can't find where it's supposed to stop. (laughter)

ASSEMBLYMAN MALONE: Is there a listing of any programs or services that were cut this past year? Did you have to cut any services or programs?

MS. BOLDEN: I slowed some initiatives, yes.

ASSEMBLYMAN MALONE: Okay. Forget the initiatives. Were any programs cut--

MS. BOLDEN: No.

ASSEMBLYMAN MALONE: --or any services cut?

MS. BOLDEN: No.

ASSEMBLYMAN MALONE: Okay.

So in essence, the kids in Newark, even with all this dilemma, were--

Now, given the fact that there was a 4000 student decrease over the last three or four years-- As Assemblyman Moran mentioned, had that happened in any other school district to the same kind of proportions, there would be significant changes in the operation and/or programs at a school district. So, if no programs were cut, and I'm assuming there was a reduction in funding going to Newark based on that fund -- that cut. Was there, in fact, a loss of funding going to the school district in Newark because of the reduction in enrollment?

ASSISTANT COMMISSIONER McMAHON: There was. In fact, that's part of the problem.

ASSEMBLYMAN MALONE: In the bottom line, when it's all said and done, did Newark receive less money this year than they did last year?

COMMISSIONER HESPE: On a per pupil basis?

ASSEMBLYMAN MALONE: I don't care what you call it. On a bottom line-- Forget how you calculated it, was the amount of-- Even though they had a 4000 student reduction, was there a bottom-line reduction in the amount of money going to the Newark schools this year versus last year?

COMMISSIONER HESPE: I think the answer is no.

ASSEMBLYMAN MALONE: Was there an increase in money going to Newark from last year to this year?

ASSISTANT COMMISSIONER McMAHON: I think the answer is yes, a slight amount.

ASSEMBLYMAN MALONE: So even though they had a 4000 student reduction, they received more money as a bottom line this year than they did last?

COMMISSIONER HESPE: I think that's with all *Abbott* districts because we're asking them to put in place enhanced programs, and the cost of those programs--

ASSEMBLYMAN MALONE: I'm going to--

COMMISSIONER HESPE: You're going to get there. All right. Yes, yes.

ASSEMBLYMAN MALONE: I just want the answers to the questions. I don't need to have more questions.

COMMISSIONER HESPE: Okay. All right. Very good.

ASSEMBLYMAN MALONE: The issue is, you had a reduction of 4000 students.

COMMISSIONER HESPE: Yes.

ASSEMBLYMAN MALONE: There was an increase in funding going to *Abbotts*. There's going to be an additional increase this upcoming year, even though the amount of student loss will probably even be more than that.

COMMISSIONER HESPE: I think-- Well, No. 1, the loss of 4000 students occurred between 1993 and 1997. The district's enrollments have been stable since, probably, 1996 or 1997. They've been stable. So that loss of enrollment has occurred in the mid 1990s. The enrollments have been stable the last few years.

ASSEMBLYMAN MALONE: Okay, then I'll ask--

During that period of time, did the amount of money going to the Newark school districts go up or down?

COMMISSIONER HESPE: What period of time?

ASSEMBLYMAN MALONE: The period you just mentioned to me.

COMMISSIONER HESPE: Okay.

ASSEMBLYMAN MALONE: During the declining period of time, did the moneys going to Newark go up or down?

COMMISSIONER HESPE: The CEIFA-- The first year of CEIFA provided a $30 million loss to the district, which was buffered by a $26 million nonrecurring municipal overburden grant in January of 1997, which was supposed to allow the district then to phase in that State aid loss. But then, the *Abbott* decision was decided that totally changed--

ASSEMBLYMAN MALONE: Let me ask it another way.

COMMISSIONER HESPE: Okay.

ASSEMBLYMAN MALONE: In each of the years, from, let's say, 1993 through the year 2000, was there any year that money -- the amount of money going to the Newark school district was less than the year before -- the total amount of money going to a school district?

COMMISSIONER HESPE: I think the answer is yes, 1997-1998, but I'm not-- We'd have to look at that one.

ASSEMBLYMAN MALONE: So from 1993 up to 2000, you think there may have been one year when it was less.

COMMISSIONER HESPE: I think the first year of CEIFA, it was likely, but then parity aid came in, so--

ASSEMBLYMAN MALONE: Is there some way of finding out--

COMMISSIONER HESPE: We will get back to you on that.

ASSEMBLYMAN MALONE: --if we draw a line and look at the last line from 1993-1994, 1994-1995, how that number went in a one-page graph or just a straight-line number?

That's all.

COMMISSIONER HESPE: We will get that for you.

ASSEMBLYMAN MALONE: And I'm not suggesting that there should be. What I'm saying--

COMMISSIONER HESPE: In just State aid -- just want to focus on State aid.

ASSEMBLYMAN MALONE: No, total amount of moneys going from the State.

COMMISSIONER HESPE: Yeah, the State aid.

ASSEMBLYMAN MALONE: I don't care what category you call it, how you call it, what you call it, or everything else. I want to know the bottom amount of money -- bottom-line amount of money going to Newark. And I think that gets right to the question that Assemblyman Stanley asked.

I mean, we want to make sure that there is not retribution to the students in Newark for some anomalies that may have occurred. And I think there should be some reassurance that we can see this in a very simple graph or just six or seven numbers, as to the total amount of State aid going to Newark over that period of time -- just to get an idea of, in fact, how they were funded and what you project--

Do you know what was given -- now, we're almost at the end of this year -- the total amount of money that is going to Newark for this year and how much is going to Newark for next year?

COMMISSIONER HESPE: Got it, from FY 1993 to FY '01.

ASSEMBLYMAN MALONE: Okay, because I know there are some problems with the audits and everything else.

COMMISSIONER HESPE: We'll asterisk the ones we're not certain of.

ASSEMBLYMAN MALONE: Okay.

And just one last question. Now, you may not have the answer to this.

The average teacher's salary in Newark-- Do you know what that is, approximately?

MS. BOLDEN: We're using $50,000 as the average.

ASSEMBLYMAN MALONE: Okay. And that is wide range from one year experience up to, let's say, 35 years experience.

MS. BOLDEN: Well, the guide is 13 years to maximum.

ASSEMBLYMAN MALONE: Okay. Could we be supplied with a teachers' guide and an administrators' guide to see what the salary ranges are? I'm assuming you don't have the first year. If we could have that, I'd appreciate that, also.

Thank you very much.

ASSEMBLYMAN WOLFE: Thank you, Assemblyman.

I know that Senator Martin said he wanted to have the last word.

However, I just want to ask one more thing before we get on to our last presenter.

Assemblyman Garrett picked up on the line that I raised before, and that was the noncompliance issue. If a district repeatedly does not comply with requests for reports or something, what really happens? And I think last time on that, when you gave your testimony, Commissioner, I made some, perhaps, off-color response that got printed in one of the newspapers, and people said do I really talk like that. And I guess, perhaps, when I get angry--

I would just go back to that again. That is, what message are we sending to those districts that do what they need to do -- and then what other districts please to do on their own schedule.

Now, you say, perhaps, there might be some sanctions. I know, prior to your getting there -- and I know we've talked about the former Commissioner-- I mean, when you have a district that has a pattern of, basically, thumbing it's nose at higher authority, let's say, at what point does the buck stop, literally -- I mean, that term you just said--

What was it?

COMMISSIONER HESPE: I like, the buck stops here.

ASSEMBLYMAN WOLFE: It just seems to me that we're sending a message, and we have been sending a message that we, you know, "Get it in when you can, and we'll just keep it going."

COMMISSIONER HESPE: Yeah, that's why, for -- definitely, Newark is a different story. And I think you can tell from the tenor of our testimony over the last six months that we've taken this very, very seriously, in terms of making sure this never happens again in Newark.

But rest assured that in all other districts in this state-- I think, hopefully, they'll be getting the message from this, that we take it very seriously and we've taken some very dramatic steps in Newark to make sure this never happens again.

And if I can ask John Sherry, who is our Assistant Commissioner of Field Services-- Certainly there are -- in other districts who have not complied with some of the reporting requirements-- And we take it very seriously. We immediately issue corrective actions. And if those corrective actions aren't followed up -- there are serious repercussions.

ASSISTANT COMMISSIONER JOHN M. SHERRY: The Commissioner is correct.

When we do not receive the report from the district, they'll be contacted. They'll be asked to get us the report. They might have to develop a corrective action plan. It may be noted in their monitoring report. So I think, if you talk to most of the districts out there, they'll let you know that we take very seriously their reporting responsibility to us.

ASSEMBLYMAN WOLFE: Okay, thank you.

The other question I had, then I'll turn it over to Senator Martin, is-- I think in response to Senator Palaia's question, you repeated -- or someone repeated the fact that 80 percent of the moneys go, basically, for teachers' salaries. Then you said that 85 percent of the moneys is coming from the State.

That comes back to some of these other issues. And that is -- that question of the bureaucracy -- the State Auditor's report -- there seemed to be a large administrative component in the Newark schools, whether you call it the Newark takeover schools or the Newark schools. There seems to still be that.

I just wonder, coming back to what Assemblyman Moran and Assemblyman Malone had said-- In those years where there is a corresponding drop-off in pupil registration in that district, was there a corresponding drop-off in the number of teachers?

COMMISSIONER HESPE: Yeah, those are, because there are always ins and outs on the overall number of teachers.

ASSEMBLYMAN WOLFE: Right.

COMMISSIONER HESPE: I don't know. I don't have the answer to that question.

ASSEMBLYMAN WOLFE: Would there be a corresponding drop-off in the number of administrators.

Now, I'm not talking about necessarily administrators -- principals or assistant superintendents-- I know that much of what you're trying to do requires implementation by people who were there for years working at these jobs. I'm not saying -- let's say, very responsible jobs -- whether people who have Civil Service positions, who are there for specific reasons, with a certain responsibility--

Do we, or will we, get down to the point of really looking at how far down does this foot-dragging go to comply with requests that you made -- the Superintendent makes? I mean, how far can we really go to see that we get some corrective action?

COMMISSIONER HESPE: I think, in terms of the internal controls, those are exactly the issues we're going to be looking at. We have this disbursement team that we're going to put in place right away to make sure that all disbursements are authorized and documented and try to do the short-term issue in terms of the internal controls. But the long-term issue is doing exactly that -- is looking at the various bureaucracies within the district and seeing where the job is getting done, where the job is not getting done and why, and what can be done to stop it.

So those are the issues that will have to be -- questions will have to be asked and answered in that long-term fix of the internal controls. But for the short-term, we're going to try to put something in place right away.

MS. BOLDEN: I just wanted to add to that. In terms of-- The budget did increase, but it did not necessarily reflect addition of administrative -- to the contrary. In terms of some of the things that we've looked at-- We had class size reduction that we had to deal with. So there may be more teachers for that.

But when we looked at putting together this budget, we reduced-- I mean, there's no assistant directors in our organization anymore. When we looked at the SLT offices, we took a special assistant out. So there's a very conscientious effort to deal with administration reduction, as well as other efficiencies and cost savings, so that more of the money goes directly into the classroom.

ASSEMBLYMAN WOLFE: Senator Martin.

SENATOR MARTIN: I don't have a last word. I do have a couple comments and then a couple questions.

I think that the issue raised by Assemblyman Garrett and others, including Chairman Wolfe, without accountability, is--

We would expect the Department to deal with the -- if there is criminal indications that Pricewaterhouse reveals, I assume that we will vigorously seek to identify those people and obtain restitution if possible.

But the other issue, I think, that bothers all of us here is the fact that a district that seemed to, at least to some people, understand that there was deliberate overspending -- not to have any type of repercussions does send a terrible message, either that Newark and the State-takeovers or the *Abbott* districts are somehow different and they don't have to be responsive, or maybe the message extends to every district, that if you screw up bad enough, you're safe.

That's why I think this point that we keep going back to -- looking for some accountability-- I don't know anybody-- I don't know whether heads should have rolled, but I don't see anybody who has, essentially, left Newark and been, in some way, burdened by this obligation. Everybody's sort of taken a walk and got promoted or removed themselves from the district.

I think that troubles me and, I think, many members of the Committee.

It's also an observation that Senator Palaia and I shared. When this district was not a State-takeover district, there was a feeling, I think was borne out by the facts, that Newark couldn't spend the money that the State started giving it fast enough when the original *Abbott* decisions came in, which is why they ran up a budget. It required them-- They had red tape and the State approval. And yet, in the three years that the State has taken over Newark, they've not only been able to spend all the money that the State has given them, they have run -- they've gone in such a reverse course that we now wonder whether that will be corrected by even the protections you put in because we're still not sure whether there's employees who will be able to carry that out.

I have a couple of specific requests I would make to you, Commissioner. And that is, Shirley had pointed out-- She was asking questions about the consultants. I'm not clear that we have identified, besides for the five accounting firms-- I know of at least two other firms who are providing large-scale performance-type -- if not auditing or accounting, at least, some type of review -- Anderson and Allen.

COMMISSIONER HESPE: They work for you.

SENATOR MARTIN: So I'd be interested to know if there are any others. And just for my own mind -- to get a list of the consultants, what their salary is, and what they're doing, as well as the State Auditor, just so we get a sense of who is responsible for what, and how much are we paying those folks.

COMMISSIONER HESPE: Okay.

SENATOR MARTIN: I'm not saying it's your fault on that. We may be largely responsible.

COMMISSIONER HESPE: We'll get everyone, regardless of who they work for. Okay?

SENATOR MARTIN: I also-- There was a request -- concern about payroll, that the Assemblyman had asked before. I assume that all of the teachers and the in-house people are being paid this year. I know you said while there's some payments that won't be made, I assume that's to vendors who will, simply, be delayed payments. But in terms of the ongoing school operations, there will not be any -- won't cut school a week early, we won't interfere with summer school programs or any programmatic educational areas. That will all be covered, as we understand it, through next year.

Finally, I would like to-- As far as these two Committees, and what we're doing as a responsibility-- I would ask that some type of a management action plan be provided to us on, I'm going to suggest, a quarterly basis. If that's not able to be met, perhaps some other time frame--

But I think we need to be kept updated. I'm not sure we have to take this form of grilling you and grilling others. But I would appreciate the kind of work that you did and the preparation that you provided as to where these various time frames are -- that we could expect to continue that. Perhaps you could develop a plan that we could review and then, possibly, approve.

COMMISSIONER HESPE: No, that's a good idea. In our recommendations, we indicated that we needed to have more constant communication with the Joint Committee or any other group that you want us to. So that's a good idea. And we'll do it for you.

My guess is, we should have another report, probably, in September -- probably be the right time line. A lot of things will happen over the summer. So we'll have something to you by the end of September.

SENATOR MARTIN: Perhaps with that, we could pick up the strand that Senator Palaia talked about, which is to consider the State-takeover plan.

One of the things that came up today, and I know you've mentioned before-- We have Civil Service employees, in only a handful of school districts, Newark being one of them, I think Jersey City is another, and I'm not sure whether the testing for those positions -- and if someone is not right, especially in this financing area, which I think some questions arose -- whether there should be some steps we could -- we should be taking statutorily -- or you, regulatory. But we don't want to have incompetent people in the wrong positions. Is that some defect in the State-takeover law which has contributed to this large shortfall?

So I would appreciate that.

COMMISSIONER HESPE: We'll address that. In the report, we'll address that.

SENATOR MARTIN: Thank you.

COMMISSIONER HESPE: Thank you.

ASSEMBLYMAN WOLFE: Okay, Commissioner and staff, I appreciate your being here today. I think you're very forthcoming. And thank you for your time.

COMMISSIONER HESPE: Thank you, Assemblymen.

Thank you, Senators.

Thank you.

ASSEMBLYMAN WOLFE: Okay, next is Mr. Joseph Del Grosso, President of Newark School Union.

JOSEPH DEL GROSSO: Good morning, Chairman Wolfe.

ASSEMBLYMAN WOLFE: Thank you. Thanks for being here.

MR. DEL GROSSO: And good morning to all the members of the Joint Committee.

Enclosed in the information that I'm giving out are the results of a survey delineating the conditions presently existing within Newark schools.

Newark's children, and the quality of their education, are being harmed because of the budget deficit created during the administration of Beverly Hall and Leonard Hellenbrand. I dare say that you would never let your children or grandchildren suffer such educational squalor.

More importantly, these deplorable conditions have reoccurred over the past three years, beginning in the months of January and February and continuing to the end of each school year.

In January and February, the Chief Operating Office Leonard Hellenbrand, would advise the administrators that funds had been exhausted requiring that the purchase of supplies and equipment be severely curtailed.

This is another best kept secret of the last administration. A system cannot be expected to produce a thorough and efficient education when it repeatedly runs out of money within the first four months of each fiscal year.

Contrary to what others may say, this is what has happened in Newark over and over again. How do we measure the annual education loss to 43,000 children when such conditions exist in New Jersey's largest district, conditions that existed for the last three years, and how it affects children.

Five accounting firms are now with Newark, and every tax dollar that we pay is money taken away from children.

Let's look at some of the results of the Klagholz and Hall tenure.

At one particular school, E. Alma Flagg, very few supplies -- no crayons, colored pencils, scissors, or construction paper; teachers have to buy their own their own bulletin board paper; substitute music teacher that was there since October -- so music is not taught; lack of Internet access.

We look at First Avenue School, which, by the way, has class sizes that average about 42 children -- furniture shortages, desks, chairs; window shades broken -- not closing; no library; Xerox equipment old and not functioning and inadequate; new computers are needed in the classrooms.

Franklin School: no librarian; no art supplies; no paints; no construction paper; no school-funded after-school program.

George Washington Carver: insufficient textbooks and workbooks; insufficient paper towels, toilet tissue, and garbage bags; insufficient writing paper, chalk, and paper clips; ceiling leaks from light fixture; classrooms overcrowded; teachers' desks broken; broken wall maps never replaced.

Fifteenth Avenue: lack of new desks and chairs, all are broken and too small; ceiling needed painting for five years; paint chips falling onto the students; Success for All tutoring positions are staffed by substitute teachers, not certified personnel; no books, magazines, nor any nonprint material ordered for the library; part-time librarian; no music teacher and no music program.

Broadway Elementary: not enough textbooks; no music program.

Burnet Street: shortage of pencils; shortage of paper.

Harold Wilson: library lacking in books.

Here's an interesting one. The Gladys Hillman-Jones Modern Middle School, which was constructed just recently, under Hall's administration -- cost the taxpayers $7 million to put that school back into condition: only 25 language books and workbooks for a total of 345 students; lack of overhead projectors, VCRs, tape recorders, journals, construction paper, pencils, pencil sharpeners. In fact, we had to loan that school a typewriter because, although we did spend $6.5 million to reconstruct it, they forgot to have a typewriter so that the clerks could adequately put in time reports and things of that nature.

And I think the report goes on.

Lafayette Street School: roof over the auditorium leaks; furniture is in need for children and teachers; money is needed to purchase science equipment for individual classrooms; a new library was promised.

And it goes on.

No matter what anybody says here, I think the Commission, in the first hearing, put in letters that I sent to Commissioner Klagholz, as well as to members of this Committee, that date back all the way to 1995, apprizing them of these very situations, apprizing them that overspending was going on in various budgets, apprizing them of the different effects that it was having on the education of children.

It's also had a deteriorating effect on employees. This is what the Commissioner handed in today, telling you what some of the things that were wrong were.

Schools and offices have no knowledge of their budgets or available funds. There was no budget process. There's no budget process in place for the year 2000-2001.

Shortage of staff in the accounting department-- Let me explain that. When the State took over, part of the State-takeover law was that they indiscriminately fired everybody in the accounting department. That didn't happen in Jersey City. The Commissioner is right -- that Jersey City has better financial controls in place. But that's because we didn't blanketly fire everyone in the accounting department.

But Leonard Hellenbrand, the person that you hired from New York, who called us all, including all of you, a bunch of country bumpkins, which I took offense to, got rid of all the people in the accounting department and said he could do it himself.

Consequently, we face what we face today: Two years in arrears for paying for the State for the Teachers' Protective Annuity Fund, which is our pension, and FICA -- I had to threaten to go to court because our W-2 forms, which you're supposed to get in January, we didn't get until March, and then, when we did receive them, they were in error, and 8000 employees had to refile their tax returns, 8000; six months in arrears for billings to the State for their reimbursements to the district for the Teachers' Protective Annuity Fund and FICA; two years in arrears for billing to the State for the cost of internal auditors; lack of controls and processes irregular for all existing fiscal controls.

Senator Martin was completely correct in what he said about accountability. The very people that Dr. Hall hired are still there. They received generous raises for everything that they have done. One of them brought us a great payroll software for our new payroll system. It cost the taxpayers millions -- not even New Jersey compliant. They have to bring in another payroll company, which they hired now. And guess how many millions that's going to cost the taxpayers.

The Commissioner, I think, is being honest and forthright. And I'm pleased with Commissioner Hespe's openness and forthrightness. But I think Commissioner Hespe hit it on the head. In a big bureaucracy, you seldom hear about every single aspect of what's going on in your domain. And I think a lot of this, he hasn't heard. And a lot of it hasn't been told to him.

I still see people in the school system who created the monster that we see with the fiscal controls and the fiscal monitoring being rewarded, and business goes on as usual for them. What message does that send? What message does that send to the other 600 school districts in New Jersey? What message does it send to teachers within that particular school district?

I don't think that we can afford much longer -- to see Newark in the condition that it is. And I agree with a lot of the questions that this Committee asked and its forthrightness in trying to get to the root of the problem, even in directing someone’s attention and focus to how State-takeover laws can be amended to produce, maybe, a better government system over the districts, which I agree with. There are school districts that need the State’s help. But certainly, we didn’t need the help that we received, you know, under this takeover.

I think if you go to the Hippocratic oath that doctors take, it says, “At least physician do no harm.” When the State took over, we expected, more than likely with optimism, that there would be some positive changes. Quite to the contrary, where are the positive changes?

I’ve included some articles from a national education newspaper, which is a national paper that goes around the country and is read by most school districts all around the nation. “Red Ink in Newark Mars State Takeover,” “State Audits Find New Budget Shortfalls in Newark.” I don’t think that we’ve come to the end of the budget shortfalls that we’re going to find, nor do I think that we’ve come to the end of the adverse effects that they have on the children.

Principals budgets were sent back five times this year for cutting. All the requisitions that they put in for supplies that they needed to run their schools had to be returned. And those supplies were not given to them. I mean, principals can’t run schools, teachers can’t do what they need to do unless supplies are adequate. I don’t look at--

Other people may look at this as a political problem. I’ve never looked at it as a political problem because, quite frankly, Democrats, Republicans, whatever we are, there was a need, at one time, for State takeover. People on both sides of the aisle saw it, and I don’t think that it’s a political thing to say what is wrong with the system, and no one should try to capitalize, I don't believe, politically.

I believe it is an educational problem that we have here. One that requires, maybe, a better look at governance and one that says to us, "Yes, there are some dramatic problems that are occurring in Newark."

I go into the schools. And before we survey anything and look at the surveys, I go into the school to visibly see if what the surveys are telling me are true. And I can tell you here, with forthrightness, that I'd be willing to, under oath, say what I see in the Newark Public Schools.

I wonder if anybody else would take that challenge that was here today to tell you what's going on in the Newark Public Schools.

I thank all of you for your time. And again, I say to this Committee, you've done a great job because after the first hearing, people really did take a better look at what was going on. And I saw that positive change from the first hearing. And I suspect that even more will happen because of this particular meeting.

I thank both Chairman Wolfe and Chairman Martin and all the members of this Committee.

Thank you very much.

ASSEMBLYMAN WOLFE: Thank you.

MR. DEL GROSSO: If you have any questions, I'd be happy to answer them.

ASSEMBLYMAN WOLFE: Thank you very much, Mr. Del Grosso.

I'd also like to thank the members of the Committee who were here for the entire hearing and those who were here partially.

And also, for the people who sat through the entire proceedings--

But before we go, I don't know if it would be appropriate, because we don't have too many joint meetings, but I know that the auditors and the Commissioner indicated that the audits would be submitted to, at least, the Governor's Office or the administration for their review. But I would ask, if I would, perhaps, be in order, if the Committee submit its entire written testimony to the Department of Criminal Justice or the Attorney General for its review of our entire testimony, if that would be appropriate.

Okay, thank you very much.

(MEETING CONCLUDED)