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October 13, 2015

The Board of Education
Hawthorne Cedar Knolls Union Free School District
Hawthorne, New York

In planning and performing our audit of the financial statements of the Hawthorne Cedar Knolls Union Free School District (District) as of and for the year ended June 30, 2015, in accordance with auditing standards generally accepted in the United States of America, we considered the District's internal control over financial reporting (internal control) as a basis for designing auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

The memorandum that accompanies this letter summarizes an observation we made during our audit. This letter does not affect our report, dated October 13, 2015, on the financial statements of the Hawthorne Cedar Knolls Union Free School District.

This communication is intended solely for the information and use of the Board of Education, Audit Committee, management, others you deem appropriate within the District, and any governmental authorities you need to share this information with. It is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

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Special Act School District Fiscal Management

The District is a "Special Act" school district that was created through an act of the New York State Legislature. Students are placed in the District through either social service or another school district's Committee for Special Education (CSE). The students who attend the District are certified special education by a CSE.

Unlike other public school districts, the District's budget is not funded through a tax levy; instead, the budget is funded through tuition revenue based on an approved tuition rate. The rate is determined by the Rate Setting Unit (RSU) of the State Education Department (SED) through a process known as the "Rate Reconciliation Process" (Recon). The reconciliation rates are based upon actual expenditures reported by the District two years prior to the current year, and are subject to certain cost screens or caps, as well as limits on cost-of-living adjustments.

Until the reconciliation rate is calculated and approved by the State, the District has to use a prospective rate for current year billings. The prospective rate is an estimated rate provided by the State and is often based on the most recent approved reconciliation rate from a prior year. Because of cost screens adjustments, the rate reconciliation process could sometimes result in a final tuition rate that is not enough to cover all of the District's expenditures, or even lower than the prospective rate used for billings.

Special act school districts may petition SED to increase their rates outside of Recon. This petition is known as a "Waiver". Generally districts request a waiver due to an expansion of program or an increase in administrative or facility costs. Usually the expansion of program is first approved by the district's Regional Associate (the local representative of SED). The waiver must be approved by RSU and then the State's Office of Budget.

The time lag between when actual current year expenditures are made and when actual revenues are received based upon Recon can often be two years or more, creating temporary deficits in the General Fund until such time when the Recon rate is approved and the district can invoice for retroactive rate adjustments, if any. Therefore, New York State encourages special act school districts to borrow for cash flow purposes; these borrowings are in the form of Revenue Anticipation Notes (RANs).

The challenge that special act school districts have, in addition to managing cash flows and borrowing need, is to budget and expend in order to both provide for their educational program as well as to maintain or increase the tuition rate, and at the same time, attempt to minimize vacancies in enrollment. The risk is that special act school districts are not guaranteed to receive a reconciled rate commensurate with their spending.

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