New York State Comptroller
THOMAS P. DiNAPOLI

Hawthorne Cedar Knolls Union Free School District

Financial Condition

2023M-4 | June 2023

Division of Local Government and School Accountability

Contents

Report Highlights

Hawthorne Cedar Knolls Union Free School District

Audit Objective

Determine whether the Hawthorne Cedar Knolls Union Free School District's (District's) Board of Education (Board) and officials effectively managed the District's financial condition.

Key Findings

The Board and officials did not effectively manage the District's financial condition. As a result, the District had a deficit general fund balance in each of the last five fiscal years, averaging more than $2.9 million each year. This contributed to the District's overall cash position, which decreased by 71 percent. The largest deficit occurred in the 2020-21 fiscal year, which totaled more than $5.1 million.

Although a multiyear financial plan would provide more transparency regarding the District's long-term financial goals and help guide the Board and officials as they develop District budgets, they did not develop a multiyear financial plan for the District.

Key Recommendations

- Develop a plan to address the fund balance deficit.
- Monitor revenues, expenditures, enrollment and cash flow, and amend the budget as necessary.
- Develop and adopt a multiyear financial plan.

District officials generally agreed with our recommendations and have initiated or indicated they planned to initiate corrective action.

Background

The District is located in the Town of Mount Pleasant in Westchester County. The District was created as a special act public school by the New York State Legislature to provide education to students with special education needs. To provide these services to residential and day students with special education needs, the District works in collaboration with the Jewish Board of Family and Children Services (agency), a private, not-for-profit corporation.

The Board has seven members: five from the agency and two appointed by the New York State Department of Education (SED). The Board is responsible for generally managing and controlling the District's financial and educational affairs.

Quick Facts	
2021-22 General Fund Appropriations	$15.5 million
June 30 Fund Balances	
2018	($2,992,266)
2019	($2,637,078)
2020	($3,651,375)
2021	($5,138,763)
2022	($156,259)

Audit Period

July 1, 2021 – June 30, 2022. We extended our audit period back to July 1, 2017 to analyze financial condition trends.

Financial Condition

Financial condition is defined as a school district's (district's) ability to balance recurring expenditure needs with recurring revenue sources, while providing desired services on a continuing basis. A district in good financial condition generally has the ability to maintain adequate service levels during fiscal downturns. Conversely, a district in poor financial condition usually struggles to balance its budget, may suffer through disruptive service level declines, has limited resources to finance future needs and has minimal cash available to pay current liabilities as they become due.

While public school districts typically rely on real property tax levies to finance the majority of their operations, special act districts do not receive real property tax revenue. Revenue is received from the student's home school district or "sending agency"[1] and is based on enrollment and a reimbursement methodology, which is approved by the New York State Division of Budget. Once the methodology is approved, the Commissioner of Education from SED annually determines the tuition rate that each special act district must charge in conformance with New York State Education Law (Education Law), Article 81. Tuition rates are certified and approved by SED's Rate Setting Unit[2] after the fiscal year ends, because the rates are based on actual expenditures made during the fiscal year.

How Does a Board Effectively Manage Financial Condition?

To effectively manage a district's financial condition, district officials must provide the board with budget status reports at least quarterly to assist them in monitoring the budget. In addition, the board and officials must monitor actual expenditures and compare them with budgeted appropriations to ensure that appropriations are not overspent.

Before the 2021-22 school year, special act districts were not allowed to maintain surplus fund balance.[3] Therefore, it was critical for boards to monitor their district's financial condition. District officials and the Board must monitor enrollment and amend the budget as necessary to ensure there are sufficient revenues to fund expenditures.

1 A sending agency places students in special act school districts according to Article 81 of New York State Education Law. Sending agencies include family courts, local social services districts, the New York State Office of Children and Family Services (OCFS) and the New York State Office of Mental Health (OMH). Local public school districts also may place students with disabilities in special act school districts for day or residential services, based on the recommendations of their committees on special education. The sending agency is billed for the tuition of each student placed in the special act school district.

2 The Rate Setting Unit establishes special education tuition rates for approved programs that educate students with disabilities who are ages 3 to 21 years old and have been enrolled pursuant to Education Law, Articles 81 and 89.

3 For the 2021-22 school year, a special act district could retain 1 percent of total allowable and reimbursable costs for services. In prior years, the District could not retain fund balance.

In addition, the Board should create a written multiyear financial plan. Planning on a multiyear basis allows officials to project revenues, expenditures and fund balance using trends. These projections help the Board assess expenditure commitments, revenue trends and financial risks.

Also, a board uses multiyear plans to set long-term priorities and goals that consider the effects that current budgeting decisions will have on future budgets. The Board should periodically review and update the District's long-term financial plan on an ongoing basis to ensure that the Board's decisions are guided by the most current and accurate information available.

The Board and Officials Did Not Effectively Manage Financial Condition

Although the Board periodically received financial information, it did not effectively monitor revenues and expenditures. Because District officials did not decrease budgeted appropriations due to the shortfall in revenues, we analyzed the District's general fund balance from the 2017-18 through 2021-22 fiscal years.

The District's average annual fund balance deficit exceeded $2.9 million, with the highest deficit being more than $5.1 million at the end of the 2020-21 fiscal year (Figure 1). The Superintendent and Assistant Superintendent for Finance (Assistant Superintendent) told us that there was a long delay before SED sent the District its reconciled tuition rate. As a result, the District was not reimbursed for all its eligible expenditures, which contributed to the deficits (Figure 1).

Figure 1: Fund Balance Deficits

Fiscal Year Ends	2017-18	2018-19	2019-20	2020-21	2021-22
Beginning Fund Balance	($1,167,454)	($2,992,266)	($2,637,078)	($3,651,375)	($5,138,763)
Actual Revenues	$16,840,961	$17,677,544	$16,558,944	$14,647,006	$18,130,005
Actual Expenditures	$18,665,773	$17,322,356	$17,573,241	$16,134,394	$13,147,501
Operating Surplus/(Deficit)	($1,824,812)	$355,188	($1,014,297)	($1,487,388)	$4,982,504
Ending Fund Balance	**($2,992,266)**	**($2,637,078)**	**($3,651,375)**	**($5,138,763)**	**($156,259)**

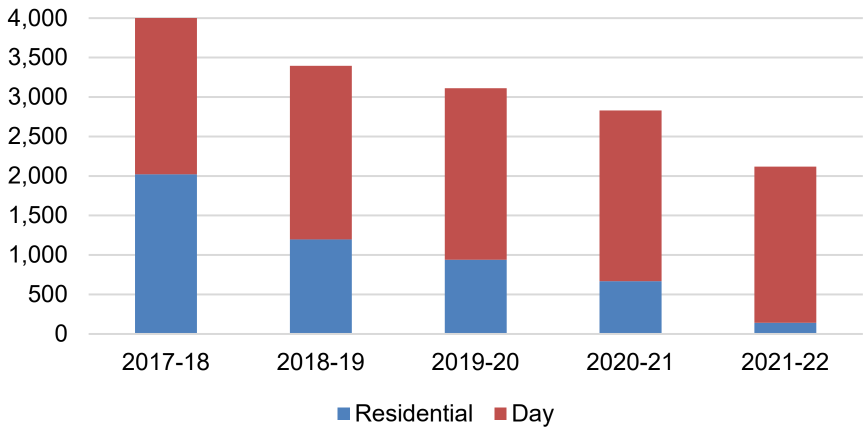
Although the Board decreased staff by 19 employees in January and April 2021, the District still ended the 20-2021 fiscal year with a large operating deficit, which contributed to the District's overall deficit fund balance. Officials told us that it was difficult to cut staff because SED required the District to maintain a specific student-to-teacher ratio.

After SED sent the District's certified tuition rates for the 2013-14 through 2020-21 fiscal years, officials were able to decrease the District's deficit fund balance by approximately $5 million during the 2021-22 fiscal year. This occurred because officials were able to retroactively bill for tuition rate increases, and retain funds that would have been required to be returned to the sending agency, which was calculated only when certified tuition rates were sent to the District.

In addition, the District's enrollment decreased from the 2017-18 through 2021-22 fiscal years. We reviewed student enrollment from June 30, 2018 through June 30, 2022 and determined that the District's enrollment decreased by 1,943 students (48 percent) (Figure 2).

FIGURE 2

Five-Year Student Enrollment



The enrollment decline caused a loss of revenue totaling approximately $9.9 million, of which 97 percent was due to the closure of residential housing.[4] The Superintendent told us that the agency decided to close the residential housing. Although the Board received weekly updates on enrollment, it did not monitor and amend the budget to reflect future revenue shortfalls.

Furthermore, the District's cash position significantly decreased from $1.5 million at the end of the 2017-18 fiscal year to $437,102 at the end of the 2021-22 fiscal year (71 percent decrease). As a result, the District has become dependent on short-term borrowing. If the District's financial condition does not improve, the District may not be able to fund operations and meet its obligations.

4 The District's residential housing is run by the agency and is provided for students who live on the District's campus. Students are placed in residential housing by family courts, local social services districts, OCFS and OMH, according to Education Law, Article 81.

The Board and Officials Did Not Have a Multiyear Financial Plan

The Board did not develop a comprehensive, written multiyear financial plan to help guide long-term decision making. A multiyear financial plan would be a useful tool for the Board to use to determine future needs and how to finance them. Specifically, a multiyear financial plan would help guide officials as they develop future budgets and provide more transparency regarding the District's long-term financial goals.

The Assistant Superintendent told us that when he began employment with the District in July 2021, he was not given a multiyear financial plan from the prior administration or the opportunity to create one, because he had been with the District only for a year. As a result, the District did not have a multiyear financial plan. Without a multiyear financial plan, the Board cannot assess expenditure commitments, revenue trends, financial risks and the affordability of new services.

What Do We Recommend?

The Board should:

1. Develop a plan to address the deficit fund balance.
2. Monitor revenues, expenditures, enrollment and cash flow, and amend the budget as necessary.
3. Develop and adopt a multiyear financial plan. Monitor and update the plan regularly.

Appendix A: Response From District Officials

HAWTHORNE CEDAR KNOLLS UNION FREE SCHOOL DISTRICT
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RAYMOND A. RAEFSKI
Superintendent of Schools

April 21, 2023

Dara Disko-McCagg
Chief of Municipal Audits
Newburgh Regional Office
33 Airport Center Drive, Suite 103
New Windsor, NY 12553

Dear Ms. Disco-McCagg:

I write in accordance with your letter dated April 11, 2023, to the members of the Board of Education of the Hawthorne Cedar Knolls Union Free School District, to set forth our response to the preliminary draft findings you have provided to us in connection with your office's audit of our school district.

The Hawthorne Cedar Knolls Union Free School District (the District) is a Special Act School District located in the suburban Westchester County community of Hawthorne. We are a K-12 public school district that provides a safe and therapeutic environment for day students referred to us by their local Committees on Special Education. We currently serve students from Westchester, Rockland, Putnam, Dutchess, Orange, Sullivan and Ulster counties, as well as the five boroughs of New York City. Our location allows for convenient access for students from all these areas. Our school district comprises two school buildings that serve students with disabilities, whose local school districts are not equipped with the resources necessary to meet certain critical educational needs of these students

Schools:

- Cedar Knolls Academy (K-8)
- Linden Hill/ Achieve Alternative High School (9-12)

Disabilities:

- Emotionally Disabled
- Intellectually Disabled
- Learning Disabled
- Multiple Disabled
- Other Health Impaired
- Speech & Language Impaired
- Traumatic Brain Injury

The majority of our students' primary classification is Emotionally Disabled. We specialize in providing an educational program to students that are severely emotionally disabled with oppositional defiant

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disorder anxiety disorders, bipolar disorder, conduct disorders, obsessive-compulsive disorder, and psychotic disorders. All our students have Individual Educational Plans (IEPs).

Recommendation: Develop a plan to address the fund balance deficit.

Management Response: The District agrees with the audit findings that the District's fund balances were in deficit for the fiscal years from 2018 through 2022. These deficits were largely due to difficult circumstances that the District experienced during the relevant period but that we believe are now behind us. Thus, at the end of the period in question, the deficit was reduced by about 95% compared with the average of year-end deficits during the period as a whole, as set forth in the audit report. Moreover, at the end of fiscal year 2022-23, the District will have a surplus.

The difficult circumstances referred to above arise, in significant part, from the fact that the District, as a Special Act School District, historically provided services to students who were residentially placed in the care of the Jewish Board of Family and Children's Services (the Agency), as well as CSE-placed day students. Thus, our enrollment was significantly reduced by the Agency's decision to close its residential care facilities on the Hawthorne campus. Additionally, during this time, the COVID-19 pandemic resulted in reduced day student enrollments. These substantial drops in enrollment had a significant negative effect on the District's revenue due to the District's legally mandated tuition billing and rate methodology, as outlined below:

<u>TUITION BILLING AND RATE METHODOLOGY</u>

1. As a Special Act School District, our District functions purely on revenues received from the Office of Children and Family Services (OCFS), the Office of Mental Health (OMH), Department of Social Services (DSS), Administration for Children's Services (ACS) or students' home (sending) districts based on tuition billings monthly.
2. The New York State Rate Setting Unit (RSU) is the governing agency that is authorized to establish tuition rates for Special Act School Districts to invoice OCFS, OMH, DSS, ACS and sending districts. RSU awards a prospective tuition rate for a district if it has made a reconciliation for that district for a fiscal year prior to current fiscal year. If not, an interim tuition rate is awarded for cash flow and operational purposes.
3. The District's allowable reimbursable expenses were not reconciled by RSU for more than 8 years, from 2013-14 through 2020-21. Thus, the District billed OCFS, OMH, DSS, ACS and sending districts using a prospective or interim rate for that period, with no major changes to the growth factor or inflation, which is usually added to a previously reconciled tuition rate.
4. Additionally, the Special Act School Districts are required to be in compliance with the tuition rate methodology established by RSU, which mandates that our non-direct care (NDC) costs should not exceed the total direct (student) care (DC) costs by more than 42.86% (30/70). For example, if the total DC costs are $10 million, the allowable NDC costs should not exceed $4.286 million. NDC costs exceeding the allowable limits become non-reimbursable expenses, resulting in a reduction in the reconciled tuition rate. In such situations, Special Act School Districts are required to pay tuition payments received in excess of the reconciled rate back to OCFS, OMH, DSS, ACS and the sending districts unless RSU proposes a waiver of the NDC cost screen, and the New York State Division of Budget approves it.

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FUND BALANCES

1. As stated in your audit report, Special Act School Districts were not allowed to retain fund balances until fiscal year 2021-22, at which time 1% of eligible reimbursable costs were allowed to be retained, followed by 11% in fiscal year 2022-23.

2. The District could have closed its books with a zero or positive fund balances in fiscal years 2013-14 through 2016-17. However, since tuition rates for that period were not reconciled, a portion of the surplus funds generated in those years was required to be set aside as a payable (liability) to sending districts for a total of $2.62 million in its books as directed by its external auditors, resulting in us closing the books with a zero fund balances.

3. In fiscal year 2017-18, the Agency closed one of its two residential facilities on campus, the Residential Treatment Center (RTC), causing the District to lose more than 126 residential students in its enrollment, and thus resulting in a deficit fund balance of over $1.83 million. Together with the accumulated deficit fund balance of $1.16 million carried over from 2016-17, the District closed its books in 2017-18 with a total deficit of $2.99 million.

4. In fiscal year 2018-19, the District slightly improved its deficit fund balance situation by $355,000, as a result of an increase in our tuition rate from our 2017-18 rate of $43,488 to $50,534 in 2018-2019, for a total of $7,046. The increase was to offset the closing of the RTC and the resulting significant drop in enrollment.

5. In fiscal year 2019-20, the global COVID 19 pandemic also reduced the census of the Agency and District. When the Governor mandated the closure of all school districts in March 2020 through June 2020, this froze the Agency's and District's ability to accept students and increase our enrollment, reducing our census, revenue and overall budget.

6. In October 2021, the Agency closed its last residential facility on campus, the "Residential Treatment Facility," which resulted in a loss to the District of over 59 students over the next 6 months, which in turn caused a deficit fund balance of over $1.48 million. The District avoided sustaining a greater deficit by laying off more than 19 employees (including both DC and NDC staff).

7. The District's tuition rates remained almost the same, and unreconciled, through 2021-22. The District billed its sending districts using a prospective rate or interim rate all this time.

8. During the 2021-22 and 2022-23 school years, the District worked closely with the State Education Department and RSU to increase our allowable day student census from 190 to 220; to reconcile our tuition rates; and to decrease our fund balance deficit. As a result, we have decreased our deficit from $5,138,763 in 2021 to $156,259 in 2022. Furthermore, we will finish the 2022-23 year with a positive fund balance.

Recommendation: Monitor revenues, expenditures, enrollment and cash flow, and amend the budget as necessary.

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Management Response: The District agrees with the recommendation and will amend the budget as necessary starting with the 2023-24 fiscal year and thereafter. Please note the following:

1. The closing of both residential facilities in a span of three years, together with zero increases in the interim tuition rate, was a major stress on the District's financial condition since 2017-18. Additionally, the global COVID -19 pandemic played a significant role in the District's decreased enrollment, resulting in a difference between actual and budgetary revenues and expenditures. The decrease in enrollment and interim tuition rate from 2018-2019 through 2020-2021 greatly diminished cash flow.

2. Going forward we will monitor the Board-adopted budget and amend it as needed.

Recommendation: Develop and adopt a multiyear financial plan.

Management Response: The District agrees with the recommendation and will adopt a multiyear financial plan, which it will review and modify as needed. We note, however, that due to our status as a Special Act School District, there are significant factors beyond our ability to predict or control, which we believe are not typically encountered by local school districts, and which will present major challenges in implementing the recommendation. These challenges include:

1. RSU does not provide any assurances to the District that the tuition rate reconciliation for a closed fiscal year will be completed in a timely fashion so that the District will receive a prospective rate to invoice its sending districts in the following fiscal year. The prospective rate includes the most recent reconciled rate plus a growth factor, which is unknown to the District until awarded. Thus, the District will have no choice but to make its best estimates and/or use the existing interim or prospective rate to budget its revenues to develop a multiyear financial plan.

2. As detailed in the management responses above, enrollment is a significant factor that determines future revenues. It is hard to predict enrollment for developing a multiyear financial plan, because several variables that can affect our enrollment cannot be predicted with any confidence, such as future yearly evaluations of each student's IEP and placement, the number of students graduating high school, and any changes in the student's home (sending) district.

Sincerely,

Raymond A. Raefski
Superintendent of Schools

Daniel J. Leffell
President, Board of Education

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Cedar Knolls

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Appendix B: Audit Methodology and Standards

We conducted this audit pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law. To achieve the audit objective and obtain valid audit evidence, our audit procedures included the following:

- We interviewed officials, including Board members and employees of the third-party management company that provided the District with cash disbursement, purchasing and some Treasurer services. We also reviewed policies and Board meeting minutes to gain an understanding of the District's internal controls over its financial condition and multiyear financial plans.
- We reviewed June 2022 bank statements and reconciliations to verify cash balances at the end of the fiscal year. We also calculated the decrease in the District's cash position from the 2017-18 through 2021-22 fiscal years.
- For the 2017-18 through 2021-22 fiscal years, we reviewed and compared budget status reports and trial balances to financials reports to determine whether there were any discrepancies. We also recalculated fund balance at the end of each fiscal year and calculated the change from the highest deficit to current deficit across all five fiscal years.
- We reviewed the general fund's results of operations for the 2017-18 through 2021-22 fiscal years.
- We compared budget-to-actual revenues and expenditures for the 2017-18 through 2021-22 fiscal years.
- We reviewed student enrollment data for day and residential students and calculated the difference from year-end enrollment totals from June 30, 2018 through June 30, 2022.
- We reviewed and tested student enrollment billings against payments received and compared payments to March 2022 bank statement deposits and the cash receipt journal. We scheduled-out and reviewed the deposits from the bank statement to the cash receipt report for March 2022. We also verified receipt with copies of checks that were deposited and compared the individual deposit amounts to the billing sheet and copies of bills sent out. We matched deposits to monthly bills to determine the reliability of the billing process.
- We reviewed short-term debt for the 2017-18 through 2021-22 fiscal years to determine how much the District relied on this type of funding.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and provided to our office within 90 days, pursuant to Section 35 of General Municipal Law, Section 2116-a (3)(c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The CAP should be posted on the District's website for public review.

Appendix C: Resources and Services

Regional Office Directory
www.osc.state.ny.us/files/local-government/pdf/regional-directory.pdf

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas
www.osc.state.ny.us/local-government/publications

Fiscal Stress Monitoring – Resources for local government officials experiencing fiscal problems
www.osc.state.ny.us/local-government/fiscal-monitoring

Local Government Management Guides – Series of publications that include technical information and suggested practices for local government management
www.osc.state.ny.us/local-government/publications

Planning and Budgeting Guides – Resources for developing multiyear financial, capital, strategic and other plans
www.osc.state.ny.us/local-government/resources/planning-resources

Protecting Sensitive Data and Other Local Government Assets – A non-technical cybersecurity guide for local government leaders
www.osc.state.ny.us/files/local-government/publications/pdf/cyber-security-guide.pdf

Required Reporting – Information and resources for reports and forms that are filed with the Office of the State Comptroller
www.osc.state.ny.us/local-government/required-reporting

Research Reports/Publications – Reports on major policy issues facing local governments and State policy-makers
www.osc.state.ny.us/local-government/publications

Training – Resources for local government officials on in-person and online training opportunities on a wide range of topics
www.osc.state.ny.us/local-government/academy

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