

March 9, 2010

Dear Mr. Dennis and Mr. Mabbott,

Enclosed please find Harney ESD's response to Willamette ESD's audit. As requested by the Oregon Department of Education and the Oregon Association of ESDs, HESD has distributed WESD's audit to its board members, superintendent, and administrative staff to read and respond to each of the audit findings.

While HESD understands the importance of reading and discussing WESD's audit, we believe this process of responding to each WESD's audit finding was an exercise in futility. Any entity that would resort to the following:

- using two sets of books
- answering untruthfully to its boards and constituents
- not allowing its auditors to present their report and finding
- not using best practices and not following the laws and its intent

would not be forthright in this exercise.

The only thing we can tell you is - HESD does its best to be excellent stewards of public monies and will continue to carry out the goals and mission of ESDs and laid out in the Oregon Revised Statutes to the best of our ability.

We have also asked our independent auditor Oster Professional to read WESD's audit and HESD's response. They have provided a response to our practices which is also enclosed.

Thank you

Dennis B. Mills

Dennis B. Mills, Superintendent
Harney ESD Region XVII

Poor Financial Practices

Documentation Non-existent or Lacking

- **“WESD did not maintain adequate documentation or records of financial transactions, including the non-recurring transfer of monies from one fund category to another, decisions to open or close a fund category and treatment of any remaining fund balances, development of charge rates for resolution services, and contractor selection and price negotiations...”**

Harney ESD (HESD) does not have the same issues as WESD. HESD does as our annual financial audits will confirm maintain adequate documentation or records of financial transactions. Opening or closings of funds are made through resolutions which are approved by the HESD Board and recorded in the minutes. HESD has a policy regarding the treatment of funds. Policy DBDB

Development of charge rates for resolution services, contractor selection and price negotiations are addressed in detail in latter parts of this document.

HESD will not be so presumptuous to say that we are perfect. HESD has occasionally missed documents, or not followed policy to the letter; however, these problems are not chronic or even frequent.

HESD believes we are good stewards of public monies and provide a valuable service to our component school district.

Accounting Practices Unduly Complicated

- **“WESD recently determined that about 75 percent of its 68 internal service fund categories were misclassified...”**

HESD does not have the same issue as WESD. HESD only manages 20 funds with the purpose and function of each fund being straightforward.

General Fund – 1
Special Funds - 14 (7 grants, 7 reserve)
Debt Service – 2
Capital Project Funds – 2
Enterprise Fund – 1

HESD does not mix revenues from grants, schools, state, etc... Revenues from schools are recorded under a separate source code than revenues from SSF or local property taxes. Grants are segregated by different funds. There is a procedure in place for receipting, depositing and reconciling funds.

- **“Ultimately, the misclassification of these funds could negatively impact WESD’s ability to present its financial statements in accordance with generally accepted accounting principles, as required by state laws...”**

HESD does not have the same issue as WESD. HESD does not have near the number of funds as WESD. HESD financial statements and reports are simple and straightforward. Revenues and disbursements are presented at the monthly board meeting by funds. Figures in these reports and financial statements are not adapted in any manner. These figures are audited annually by independent auditors (Oster Professional Group) who present their report to our board.

- **“In addition, over the years, revenues and expenditures were transferring in and out of multiple fund categories...”**

HESD does not have the same issue as WESD. HESD does not regularly transfer money in and out of funds. HESD does transfer money annually at the beginning of the fiscal year to debt service and reserve funds. These transfers out of the general fund are found in adopted budget under the 5200 code.

Commingled Funds

- **“Providing services to school districts is at the core of an ESD’s mission. Statute requires that an ESD board expends at least 90 percent...”**

HESD does not have the same issue as WESD. HESD budgets for and annually spends at least 90 of the revenues received from the State School Fund and local revenue sources. Revenues from the State School Fund and local sources are recorded under separate codes unique to the source in the general funds. Expenditures for resolution services are recorded in the general fund. Our calculation of compliance with the “90/10” rule has been reviewed by our independent auditors.

- **“School District monies were not treated in the accounting system as designated funds...”**

HESD does not have the same issue as WESD. HESD has a separate source code for revenues received by the component school districts. These source codes also differentiate what service the revenue should be coded to (printing, fiscal, instructional, etc...). HESD also records what revenues were received by what district. The majority of services provided to the component school districts are paid for by resolution dollars. If a service is cost shared (Music) or for fee based (printing) the school is invoiced for services rendered. Expenditures are recorded under the appropriate department or function.

Furthermore unlike other school districts, HESD’s component school districts would **NEVER** pay HESD for services without first receiving supporting documentation and an

invoice. HESD does not receive component school district monies before services are rendered.

Specific Examples of Poor Financial Practices

- **“WESD’s financial position has sharply declined in the last several years. Specifically, WESD’s equity, as represented by its total net assets, has declined by 81 percent over the last five years...”**

HESD does not have the same issue as WESD. HESD’s total net assets have remained relatively unchanged in the last five years and have in fact increased in the last fiscal year as seen by the audited figures below.

Audit Year	Total Net Assets
2005	\$2,141,086
2006	\$2,292,973
2007	\$2,315,851
2008	\$2,126,860
2009	\$2,785,400

- **“According to its audited financial statements, WESD exceeded its annual budget approved by the Board for fiscal years 2004 through 2008. The unplanned expenditures totaled about \$2.6 million for the five-year period...”**

HESD does not have the same issue as WESD. In the same 5 year time frame, HESD had over expenditures of \$47,760. This amounts to .24% of the total appropriated budget for the same time frame. Most of these over expenditures occurred in 2004 and 2005. These over expenditure were from not making budget resolutions in a timely manner. At no times were the overall fund balances ever over expended. This was corrected by keeping a better check of the budget and making timely budget resolution. No over expenditures were noted in the 2009 fiscal year.

“WESD did not adequately substantiate the rates it published in its Local Service Plan and subsequently charged its component districts...”

HESD may have a similar issue as WESD. While HESD has eliminated fees that were once charged for such services as erate management and email, cost share programs such as music instruction and instructional support are not well documented as to how the fees were determined or substantiated, although at the time of inception all parties were in agreement. The fees for these cost share programs have not increased in the past couple of years. The fees were determined years ago but simply never documented.

While the HESD Board of Directors and component school districts have approved the rates in the Local Service Plan, the WESD audit raises concerns on how these rates are substantiated and documented. The HESD Board of Directors and management will immediately re-evaluate the cost share fees in the Local Service Plan to determine if they are still applicable and reasonably derived. HESD does however incur the majority of the cost for the service for example schools pay \$3,500 for instructional support services while HESD expends over \$130,000.

On occasions Program Directors have charged fees to component school districts that are not approved in the Local Service plan or approved by the Superintendent. Fees for these services were not always substantiated as to how the rate was arrived. This practice will also be evaluated to ensure that fees are not derived in a random nature Fees should not be implemented for resolution services unless a shortage in the budget is determined. Fees for other services such as printing should never exceed a cost recovery rate.

- **“WESD is unable to demonstrate whether school districts have been appropriately charged for the actual services delivered because it failed to reconcile its projected service costs to actual services delivered.”**

HESD does not have the same issue as WESD. With the exception of the cost share services mentioned in issue 3 above, HESD does not charge for resolution services. HESD can substantiate that actual services delivered far exceeds costs to the component school districts incurred.

- **“WESD was unable to demonstrate whether, given its multiple funding streams, it either recovered or exceeded its actual costs for services to Medicaid-eligible students...”**

HESD does not have the same issue as WESD. HESD does not claim Medicaid reimbursements. HESD does file Medicaid administrative claiming on behalf of Harney County School District #3 but does not charge for those services. This is a resolution service.

- **“WESD submits reimbursement claims to Oregon’s Department of Human Services for medical assistance services delivered to Medicaid-eligible students...”**

HESD does not have the same issue as WESD. HESD does not submit reimbursement claims for medical assistance services delivered to Medicaid-eligible students.

- **“We found an inconsistent application of WESD’s indirect cost rate, which is developed using a methodology designed by the U.S. Department of Education...”**

HESD does not have the same issue as WESD. HESD applies for and receives an indirect rate from the Oregon Department of Education. HESD does not vary the indirect cost rate used. HESD does charge less than the approved indirect rate for

budgeting reasons. HESD does not typically receive an approved indirect rate till mid-May. HESD uses a conservative indirect rate (5%) in the budget in order to get the budgeting process started.

- **“WESD used purchase orders to issue checks payable to itself...”**

HESD handles that approximately the same way as WESD but we believe it is the correct procedure.. Rent and indirect charges are made by journal entries which are approved by the Superintendent. However, on the recommendation of our independent auditors – Oster Professional Group – our internal services (printing) and entrepreneurial fund (Eastern Oregon Technology – EOT - fund 500) does invoice HESD for services rendered which HESD pays by check. There may be a couple of checks written a month between funds. These checks are recorded as expenditures in the paying fund and revenue in the receiving fund as per GASB Statement 34 Par. 112(a)(2).. The reasoning behind this decision was transparency thru a paper trail (invoices/checks) and reducing the number of manual journal entries. All checks are reviewed and signed by the board members.

Questionable Spending Practices

- **“For contracts we reviewed, we found that WESD did not competitively select contractors...”**

HESD does not have the same issue as WESD. HESD has always submitted an RFP for contracts over \$5000. HESD has always awarded the contract to the lowest bidder providing that all the criteria of the RFP were met. RFPs are an infrequent occurrence at HESD due to the size our budget. Policy DJC

- **“WESD’s classification of independent contractor violated its own Board’s policy, which includes Internal Revenue Service (IRS) and Oregon Public Employees Retirement System (PERS) eligibility requirements...”**

HESD does not have the same issue as WESD. HESD does not run independent contractors through the payroll process thus independent contractors do not have tax deductions or are eligible for PERS. All independent contractors are paid through A/P and when appropriate receives a 1099. HESD does not have a policy addressing the process (A/P or payroll) independent contractors should be paid nor does HESD feel one should be implemented. It goes without saying that the very nature of being an independent contractor means that one is NOT an employee and should not be paid through payroll.

- **“Additionally, WESD Board policy states that a contractor must be free from the direction and control of the employer...”**

HESD handles that approximately the same way as WESD but we believe it is the correct procedure. Currently HESD does not provide offices, phones or email

addresses for their independent contractors. However, this has happened once in the past (2007-2008) when HESD provided office space to an independent contractor (SPED Director). HESD entered into a contract with an individual to provide special ed services to the component rural school districts. This individual did not have an office and rather than having students' files from the rural schools kept at the person's home, it was determined to be more appropriate and accessible for the office to be located at HESD. This individual was paid thru A/P. In light of the WESD audit, HESD will review and adopt a policy in regards to independent contractors. This policy will be implemented by end of fiscal year.

- **“Contracts often failed to set expectations of contractors...”**

HESD does not have the same issue as WESD. HESD did review the few contracts we have for janitorial and maintenance work. Each contract contains a detailed scope of work to be performed by the contractor.

- **“We identified numerous expenditures with insufficient documentation regarding the business purpose served...”**

HESD does not have the same issue as WESD. HESD only pays on an invoice or reimburses if a receipt is provided. Every check is accompanied by supporting documentation which has been approved by the Program Director. All checks are reviewed and signed by two designated signers, which are either a board member or the Superintendent.

- **“In July 2008, four WESD employees attended a conference in Redmond, OR...”**

HESD does not have the same issue as WESD. Three HESD employees also attended the July 2008 conference in question (OASBO). The three employees shared a condo which was cheaper than renting 2 rooms. Policy DLC

- **“In November 2008, three Board members, the Superintendent, Deputy Superintendent and another WESD employee attended a conference in Arizona...”** HESD handles that approximately the same way but we believe it is the correct policy.

HESD attended the same November 2008 conference sending one board member and the Superintendent both of whom used the recommended conference lodging. Many times conference lodging is chosen not only for convenience but it is economically feasible. In the Arizona example, staying in a location other than the conference site would have incurred the additional expense of renting a vehicle and parking fees. In light of the WESD audit, HESD's Board will re-evaluate this policy. Policy DLC

- **“WESD issued purchase cards to 14 of its employees.”** HESD handles that approximately the same way but believe it is the correct policy...

HESD does not issue purchase cards but HESD has issued 6 credit cards for HESD Superintendent and Program Directors to use for travel and occasional purchases. HESD's policy allows staff to use their credit cards to purchase meals, lodging, registration and fuel when traveling. All travel must be pre-approved by the

business manager and Superintendent. Policy prohibits these cards to be used for personal expenditures. HESD does not view this to be an additional administrative burden. Policy DJAB

- **“We found that even though WESD employees were not in travel status at the time, they used purchase cards to pay for meals during the workday in Salem.” HESD may have a similar issue as WESD.** HESD on occasion has paid for lunch when a meeting runs into a ‘working lunch meeting’ for a lack of a better word. This is a very infrequent occurrence which happens maybe once or twice a year tops. HESD has **NEVER** paid for meals just because an employee didn’t go home for lunch. Without further information, this finding is difficult for us to assess. HESD has a policy addressing local meetings and meal reimbursement. HESD will re-evaluate its policy for relevancy. Policy DLC
- **“We noticed that WESD has an on-site caterer that provides meals and refreshment for various types of meetings, including those attended by individuals or groups from outside the agency, as well as meetings attended by WESD employees only...” HESD does not have the same issue as WESD.** HESD does not have an on-site caterer that provides meals and refreshment for meetings attended by HESD employees or outside agency. Occasionally lunch is provided for HESD in-services / workshops to the component school districts. In a fiscal year, the total cost of food for ALL funds runs less than \$4,000.

- **The conditions and practices noted above impaired the accountability and transparency of WESD operations and its use of public funds, resulting in the loss of credibility and trust with its component school districts and the public.”**

HESD does not have the same issue as WESD. HESD has gone to great efforts to become more transparent and provide as many services to the component school districts as possible from resolutions dollars. Seven of our school districts in Harney County do not have any form of administration such as a principal or superintendent – just the teacher, deputy clerk and board. The notion of duplicate services between ESDs and school districts is simply a fallacy to these rural school districts. These rural schools operate on an annual budget less than \$200,000. Without HESD to assist in leveraging the dollars, these schools could not provide services such as speech and music to their students. HESD represents what ESDs were intended for – to assist school districts with their technology, special education, school improvement and administrative needs.

Insufficient Controls

- **“WESD does not have procedures in place to ensure journal entries prepared by staff are reviewed for accuracy and appropriateness prior to posting in the accounting systems...”**

HESD does not have the same issue as WESD. All manual journal entries are filed separately in a notebook with supporting documentation for our independent auditors

or board members to review. These documents are reviewed and initialed for approval by Superintendent Mills prior to posting. Only the business manager can make manual journal entries by computer program restrictions in place. The business manager does not receipt money nor is a check signer.

- **“WESD does not have an internal policy or procedure to consistently identify approval routes, assign authorized approvers and require staff did not consistently follow existing approval practices...”**

HESD does not have the same issue as WESD. All requisitions/purchase orders are first approved by the Program Director then submitted to the business manager for final approval. On occasion, purchases have been made without prior approval but this is few and far between. Unapproved purchases could be denied for reimbursement.

- **“WESD does not adequately segregate duties or consistently assign backup responsibilities.”**

HESD does not have the same issue as WESD. Internal controls for the segregation of duties were implemented years ago at the request of our independent auditors and have continually been expanded upon. Failure to implement these duties would have resulted in a finding by our independent auditors. HESD has the following internal controls in place in terms of segregation of duties:

- A board member opens, reviews, and initials the bank statements as well as review payroll direct deposits
- Board members and the Superintendent reviews and signs all a/p and payroll checks
- Board members and the Superintendent are the only designated signers on HESD bank accounts
- Superintendent reviews and initials all manual journal entries before posting
- Business manager makes deposits, transfers money , runs payroll checks and gives final approval on purchase orders
- Assistant business manager reconcile bank accounts and runs a/p checks
- Clerk receipts money and enters purchase orders
- EOT clerk invoices

- **“WESD does not have written procedures for when it is appropriate for an employee to be given information system access, who is authorized to make this decision, what level of access is appropriate for a given user, and the periodic review of user lists and access levels.”**

HESD faces the same issue and here is our plan to improve. Again without detailed information this finding is difficult to assess. HESD is assuming this is in regards to internal controls and access to EGMS, Visions (accounting software), federal grants, PERS and online banking.

HESD does not presently have written procedures on who should have access to these systems and at what level they should be granted. Past practice is the Business Manager has access to EGMS, online banking, Federal grants, PERS and Visions and is granted full access. The assistant manager and clerks are given limited access to areas that pertain to their duties. Other users may be granted read only for certain areas.

HESD will implement and adopt a policy addressing this issue by end of this fiscal year.

- **“WESD does not have written procedures that instruct staff as to how to competitively select contractors and document the selection.”**

HESD does not have the same issue as WESD. HESD does have a policy relating to documenting bids, selecting contractors and the procuring of services. The Board serves as the Local Contract Review Board for HESD and awards the bids. Policy DJC and DJC-AR

- **“WESD has created an internal travel policy that states employees are responsible for identifying and using efficient and cost-effective methods of travel...”**

HESD does not have the same issue as WESD. HESD does have a policy that addresses the cost-effective methods of travel and limits for meals, lodging, etc... Prior approval by the Superintendent, Business Manager and Program Director is required. Policy EEAB and DLC

- **“WESD does not have an internal purchase card policy that specifies acceptable purchases for employees and outlines the minimum standards for review of card transactions by the cardholder’s supervisor...”**

HESD does not have the same issue as WESD. HESD does have a policy addressing credit cards and their accepted use. HESD’s policy allows staff to use their credit cards to purchase meals, lodging, registration and fuel when traveling. Travel must be preapproved by the Program Director, Business Manager and Superintendent. Personal purchases are prohibited and could result in the loss of privilege. Policy DJAB

- **“WESD does not have an internal policy to address the purchase of meals and refreshments for staff that are in non-travel status.**

HESD does not have the same issue as WESD. HESD has a policy regarding local meetings. HESD’s will review its policy on local meetings and meals to determine if it is reasonable and fiscally responsible, in light of the WESD audit.

- **“WESD is not enforcing its Board policy that requires evidence of the competitive selection process be maintained for all contracts”**

HESD does not have the same issue as WESD. HESD rarely submits a RFP. However, when a RFP is submitted, HESD’s Board will award the contract to the lowest bidder providing that all the criteria of the RFP were met. Policy DJC

- **“The Business Services department and other departments have not been given the authority to enforce existing policies and procedures, and at times management overrode controls without explanation...”**

HESD does not have the same issue as WESD. HESD’s management and Board members follow and support HESD’s adopted policy.

Little Transparency of Decisions and Activities

- **“WESD has not reported its resolution service expenditures to school districts or to others in a way that demonstrates it has fulfilled the 90 percent distribution to school districts required by statute.**

HESD does not have the same issue as WESD. HESD demonstrates this requirement in a number of ways. In the fall of each year, HESD and its component school districts meet to discuss the Local Service Plan. These Local Service Plan meetings determine the resolution services HESD will provide the component school districts for the following fiscal year. The Local Service Plan provides the estimated cost and FTE associated with each resolution service. The Local Service Plan is approved by HESD and its component school districts and adheres to the 90/10 requirement. Once approved, the Local Service Plan serves as a guide to how HESD should budget General Fund dollars. The Annual Report which is distributed to ODE and the component school districts shows actual revenues and expenditures by resolution services and is reviewed as part of our independent audit. The Annual Report shows how much revenue is received from the component school districts.

- **“WESD could better disclose with school districts its use of Medicaid reimbursements...”**

HESD does not have the same issue as WESD. HESD does not receive Medicaid reimbursements.

Weak Governance Practices

- **“WESD Board members received very little information about the financial status of WESD’s operations and did not question that limited information...”**

HESD does not have the same issue as WESD. Each month, HESD board members receive a report detailing monthly disbursements, a financial report showing budget-to-actual comparison report by fund and a detailed report showing MTD and YTD revenues and expenditures for the enterprise fund. The All Funds report shows YTD revenues and expenditures as well as any amendments to the budget and ending fund balance.

- **“We found that for the last two years, WESD’s contracted financial auditors did not present their audit report and findings directly to the Board...”**

HESD does not have the same issue as WESD. HESD’s independent auditors (Oster Professional Group) present their audit report annually to the Board of Directors. The presentation ends with a question and answer session. HESD has always been receptive to any recommendations made by the auditors, hence the segregation of duties, manual journal entry book, etc...

- **Good governance also requires effective communications...”**

HESD does not have the same issue as WESD. HESD is continuing to find ways to better inform all HESD staff. While Program Directors attend the monthly board meetings, information from the meetings are not always clearly communicated to other staff members. This was a concern that was addressed last year. While staff may participate in weekly or monthly meetings specific to their program, there is a desire to receive more detailed information on the overall health and future of the organization.

Last year HESD began posting board minutes, the Local Service Plan, and Annual Report on the HESD website and distributing detailed financial reports to the staff in Eastern Oregon Technology (Fund 501). The 2009 Independent Audit report can also be found on the website.

The board minutes do not always contain the detailed information or subject matter that HESD’s staff desires. HESD is continually expanding on ways to effectively communicate relevant information with all staff members, component districts and the public.

Emphasis of Stewardship Needed

- **“Upper management of WESD has not taken the necessary steps to ensure an ethical tone and healthy working environment for its staff and to provide better accountability and stewardship for public resources...”**

HESD does not have the same issue as WESD. HESD’s upper management does not wear rose colored glasses. HESD provides an honest account of the financial health and future of the ESD. The HESD Board and management have worked hard on transparency, which we believe translates down to the staff and appreciated by the school districts we serve.

WESD’s audit has made us re-evaluate our policies and open the doors to discussions on how HESD can better serve our schools, staff and public.