

# Secretary of State Audit Report

Kate Brown, Secretary of State

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## Willamette Education Service District Needs To Be Accountable

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### Summary

In August 2009, members of the Oregon Legislature, the Oregon Superintendent of Public Instruction and the Willamette Education Service District (WESD) Board of Directors (Board) asked the Audits Division to review WESD's financial practices. We also received a report of financial mismanagement at WESD through our Government Waste hotline.

Education service districts (ESDs) were established by the Legislature to provide local school districts with services that they could not otherwise afford such as programs for children with special needs, computer network services, attendance services, and criminal history background checks of prospective employees.

ESDs are funded through a combination of state school funds, local revenues, state and federal grants, and contracts with local districts. ESD boards are required to spend at least 90 percent of all amounts they receive from the State School Fund and local revenues on services or programs approved by their component school districts.

WESD serves 21 school districts in Marion, Polk and Yamhill counties, as well as other districts. For fiscal year 2010 WESD has a budget of about \$78.4 million and it currently employs about 670 staff.

The purpose of our audit was to identify needed improvements in WESD transparency and management control to help assure future accountability. Our audit identified extensive and obvious weaknesses at WESD that would not persist in an organization that is responsibly governed, well managed, and open to concerns raised by staff. Documentation was missing or inadequate, funds were commingled, accounting transactions were overly complicated, appropriate controls were lacking, expenditures were questionable, services were not procured with proper contracts, management ignored or hid problems, and staff proposals for improvement were not finalized.

Moreover, the poor management and financial practices we identified prevented us from determining specifically how WESD spent money it was entrusted with. For example, WESD was not able to demonstrate with any confidence that school districts received the 90 percent share of resources that they were due, the most basic of questions.

We recommend the Board and management establish sufficient controls; increase transparency of decisions and activities; improve governance practices; and emphasize a culture of integrity from leadership down through every level of the organization.

## **Agency Response**

Responses from WESD and the Oregon Department of Education are attached at the end of the report.

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## Background

### Role of Education Service Districts

Education service districts (ESDs) were established by the Oregon Legislature to provide local school districts with services that they could not otherwise afford. As provided in state statute, the mission of ESDs is to “assist school districts and the Department of Education in achieving Oregon’s educational goals by providing equitable, high quality, cost-effective and locally responsive educational services at a regional level<sup>1</sup>.”

ESDs take advantage of economies of scale by using a more centralized approach for providing services. For example, ESD programs include services for children with special needs (hearing screenings and nursing), computer network services, attendance services, and criminal history background checks of prospective employees.

The core business purpose of ESDs is to deliver services districts request through the resolution process. In the spring, each ESD develops a Local Service Plan with its component school districts that identifies services the ESD will provide to all districts using each district’s share of available monies, plus any additional services a given district may choose to purchase. The plan is adopted by the ESD board and approved by resolution when at least two-thirds of the component school districts vote in favor of the plan. The State School Fund and local revenues support resolution services.

The State School Fund is appropriated by the Legislature, and the Superintendent of Public Instruction calculates and distributes monies to the ESDs each fiscal year. They also receive local revenues in the form of property taxes, as well as revenue from state-managed forestlands. ESD boards are statutorily required to expend at least 90 percent of these monies, referred to as “resolution dollars,” on services or programs the component school districts have approved through the Local Service Plan resolution process. In addition, ESDs may provide services to component school districts through various federal, state and school district grants and contracts, as well as reimbursements for Medicaid services.

### Willamette Education Service District

Willamette Education Service District (WESD) is one of 20 education service districts serving Oregon’s 36 counties. The number of counties served by WESD grew through a merger with Yamhill Education Service District in 2003. WESD currently serves 21 school districts within Marion, Polk and Yamhill counties, as well as other districts throughout Oregon.

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<sup>1</sup> Oregon Revised Statute (ORS) 334.005

WESD's mission is "providing leadership and services for teaching and learning communities." WESD's approved budget for fiscal year 2010 is about \$78.4 million and it currently employs about 670 staff.

Unlike other ESDs in the state where board members are elected to represent specific geographic zones, WESD is one of the three ESDs participating in a pilot program the Legislature established in 2005. As a result, WESD has a nine-member Board of Directors (Board). Five members were elected by component school districts to represent geographic zones. The remaining members, who were appointed by the elected members, include one at-large member and one member each representing public post-secondary institutions, social service providers and the business community within the region.

## **Stewardship of Public Resources Imposes Responsibilities**

As a custodian of public resources, WESD has fundamental responsibilities for exercising sound stewardship over the monies entrusted to it. These responsibilities include complying with laws, establishing and maintaining effective internal controls, ensuring that information is reliable and providing appropriate reports to demonstrate its use of public resources to carry out its assigned duties. By fulfilling these responsibilities, WESD can demonstrate accountability and transparency, which are critical aspects of government organizations.

In addition to the responsibilities described above, state policy places responsibility on employees who authorize expenditures of public resources for the "good judgment" and "lawfulness" of the expenses.<sup>2</sup> Expenses are to be for authorized purposes and are to be a reasonable and appropriate use of public resources. For example, government officials are required to comply with legal restrictions embodied in the annual appropriated budget. It is imperative that government officials ensure and demonstrate compliance with these restrictions, as well as any other legal restrictions on the use of public resources.

## **Allegations of Financial Impropriety**

In the summer of 2009, WESD's Business Services Director made public reports of financial mismanagement and harassment. Shortly thereafter, WESD hired an audit firm to investigate certain allegations of financial improprieties in five different areas. Concurrently, WESD also hired an investigator to review allegations of employee harassment and intimidation. In October 2009, after the audit firm and investigator issued reports of their findings, the Board terminated its contract with WESD's Superintendent.

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<sup>2</sup> Oregon Accounting Manual (OAM) 10.40.00 PO

In August 2009, we were asked by members of the Legislature, the Oregon Superintendent of Public Instruction and the Board to perform an independent review of WESD's financial practices. We also received information through the Secretary of State's Government Waste hotline related to financial mismanagement at WESD.

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## Audit Results

Our audit identified extensive and obvious weaknesses at WESD that would not persist in an organization that is responsibly governed, well managed, and open to concerns raised by staff. Documentation was missing or inadequate, funds were commingled, accounting transactions were overly complicated, controls were lacking, expenditures were questionable, services were not procured appropriately, problems were ignored or hidden, and improvements staff proposed were not finalized. The poor management and financial practices we identified prevented us from clearly determining how WESD spent public resources it was entrusted with.

### Poor Financial Practices

Our review of selected financial reporting and other fiscal practices at WESD disclosed pervasive weaknesses that impaired accountability and transparency. For example, we encountered insufficient or missing financial documentation, overly complicated financial transfers, and commingled funds. As a result, the source of funds for expenditures, such as the funds used to purchase the Pentamation information system, is difficult or impossible to determine. The most basic question of whether school districts received their 90 percent portion of resolution dollars cannot be answered in a straightforward manner with any assurance.

#### ***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. Additionally, with the exception of two hourly rates, files did not contain documentation of department or superintendent-level final approvals for rates charged to component school districts for services.

#### ***Accounting Practices Unduly Complicated***

WESD recently determined that about 75 percent of its 68 internal service fund categories were misclassified. These fund categories include a mix of revenue from WESD and school districts, as well as grant monies. Based on our understanding of these revenue sources and WESD's accounting structure, the monies contained in these fund categories could potentially belong in other fund categories such as the general fund, special revenue funds or enterprise 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 law. Moreover, any adverse opinions resulting from a financial audit would impact WESD's ability to obtain loans, issue bonds and receive public monies from entities like the Oregon Department of Education (ODE).

In addition, over the years, revenues and expenditures were transferred in and out of multiple fund categories. The large number of transfers through the multiple fund categories makes transactions very difficult to track. Moreover, lack of supporting documentation compounds the problem of understanding the reason for each transaction.

### ***Commingled Funds***

Providing services to school districts is at the core of an ESD's mission. Statute requires that an ESD board expend at least 90 percent of its State School Fund and local revenues on services or programs that have been approved by the ESD's component school districts through the resolution process<sup>3</sup>. However, WESD could not demonstrate to us that it met this statutory requirement on a year-to-year basis or in aggregate over the period we reviewed.

School district monies were not treated in the accounting system as designated funds. Rather than accounting for key funds separately, as other ESDs we visited do, WESD reports that its funds are commingled, obscuring the calculation of school districts' 90 percent portion of resolution dollars and the 10 percent portion WESD retains. Recently, WESD hired a contractor to determine whether school districts received monies and/or services they were due. At the conclusion of our fieldwork, this review had not been completed. In addition, at the end of our audit work, WESD identified a report containing information relating to school district monies. However, it was unclear at this point whether that report was based on actual expenditures.

In contrast, we contacted the other three largest ESDs in Oregon and found that they provide annual information to their stakeholders on how they have fulfilled the statutory requirement. These ESDs also report an itemized list of services provided to individual school districts for resolution dollars, as well as services provided through contracts and grants.

### ***Specific Examples of Poor Financial Practices***

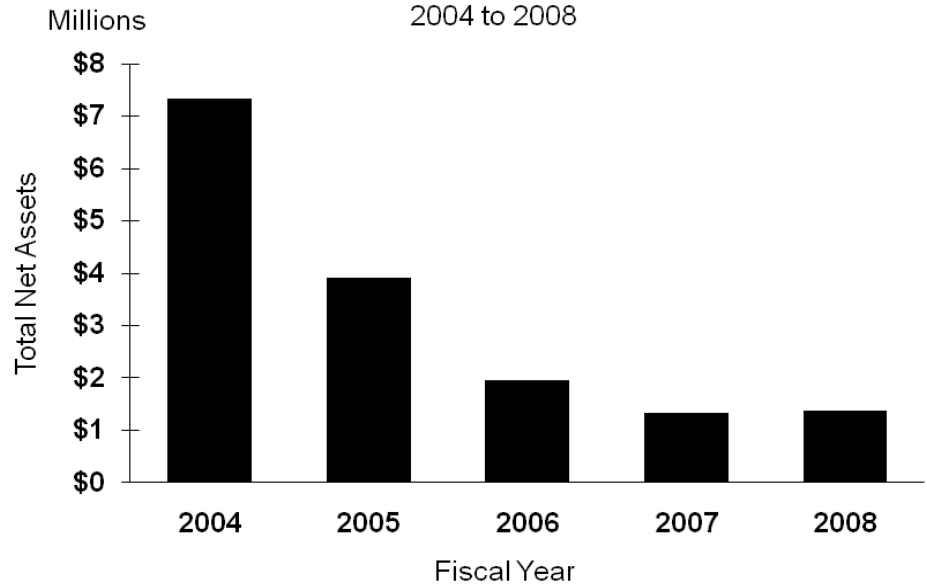
- WESD's financial position has sharply declined in the last several years. Specifically, WESD's equity, as represented by its total net assets, has declined 81 percent over the last five years from about \$7.3 million in fiscal year 2004 to \$1.4 million in fiscal year 2008 (see Figure 1). This information was readily available in the audited financial statements accessible to the Board and management, but neither used the information to take action to address the issue of declining financial position.

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<sup>3</sup> ORS 334.177(1)

## WESD FINANCIAL POSITION

2004 to 2008



Note: Total net asset values reflect prior period adjustments reported by financial auditors in fiscal years 2005 and 2006 financial statements for fiscal years 2004 and 2005, respectively.

- 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. While Board members told us that they were not aware of these excessive expenditures, we found that this information was disclosed to the Board in the last five audited financial statement reports prepared by WESD's contracted financial auditors.
- WESD did not adequately substantiate the rates it published in its Local Service Plan and subsequently charged its component districts. For example, in the past, WESD did not consistently document the basis for its service rates for some special programs and technology services. In addition, prior to fiscal year 2009, hourly service rates were developed without input from the Special Programs Director. While more documentation exists for fiscal year 2009, many rate decisions remained unsubstantiated. This included a 20 percent increase in courier service rates over the prior year. At the conclusion of our audit, however, staff reported that more documentation is available for fiscal year 2010 rate decisions.
- 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. Staff reported that resolution rates were developed from projections of service delivery levels and costs for the upcoming year. However, at the end of the year, any differences (i.e. overages or shortages) were not identified



and adjustments were not applied to the subsequent year. Based on interviews with staff, the only exception to this practice was for alternative education classrooms when component school districts required WESD to perform a comparison of projections to actual costs for the fiscal years 2008 and 2009. In contrast, the other three largest ESDs in Oregon reconcile projected to actual costs and carry forward any remaining balance for their component school districts to use the following year.

- 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. In fact, we found that WESD included the same projected costs into multiple cost pools. For example, we traced costs for one physical therapist and found personnel and other associated costs were included in the rates or budgets related to resolution services, regional program services and Medicaid fee for service. We confirmed with WESD that this was also consistent with other staff participating in the Medicaid fee for service program.
- WESD submits reimbursement claims to Oregon's Department of Human Services for medical assistance services delivered to Medicaid-eligible students. However, WESD was unable to demonstrate how it fulfilled its contractual requirements with ODE for the use of Medicaid reimbursements. For example, the early intervention and early childhood special education contract includes a provision that any net Medicaid reimbursement revenue related to the program shall be dedicated for that purpose. Based on WESD's records for fiscal years 2008 and 2009, about \$181,000 in Medicaid reimbursements was received from early intervention and early childhood special education services. However, WESD could not demonstrate that it spent these reimbursements on early intervention and early childhood special education services.
- 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. The purpose of the indirect cost rate is to allocate the proportion of indirect costs each program should bear for federal and state grants and contracts, as well as other activities. For fiscal year 2009, ODE certified an indirect cost rate of 9.84 percent for WESD using audited expenditure data from fiscal year 2008. Yet, the indirect cost rate WESD applied ranged from zero to 9.84 percent depending on the fund category. WESD could not provide documentation to substantiate its rationale for varying its indirect cost rates, which could result in an inequitable allocation of indirect costs to various programs.
- WESD used purchase orders to issue checks payable to itself. These checks were issued to move monies between fund categories rather than recording journal entries in the accounting system. The practice of using checks in this way is problematic because it adds to administrative

workload and processing time, increases the likelihood of deposit or account coding errors, and increases the risk of fraudulent checks being issued and cleared.

## Questionable Spending Practices

- For contracts we reviewed, we found that WESD did not competitively select contractors. Furthermore, management and other staff stated that contractors are often times selected based on known relationships with the contractor (e.g. former WESD or school district employees).
- WESD's classification of independent contractors violated its own Board's policy, which includes Internal Revenue Service (IRS) and Oregon Public Employees Retirement System (PERS) eligibility requirements. We found that many of WESD's independent contractors appear to be working more as employees rather than independently from WESD. For example, a PERS requirement contained in Board policy states that an independent contractor is usually paid by the job or on a straight commission. Several contracts we reviewed indicated compensation was based on an hourly rate. For example, an independent contractor hired to perform "general financial consulting" was to be paid at a rate of \$90.00 per hour or \$525.00 per day.
- Additionally, WESD Board policy states that a contractor must be free from the direction and control of the employer. However, some of WESD's independent contractors have offices or cubicles at WESD; have WESD email addresses, telephone numbers and business cards; and use WESD computers and other equipment to perform contractual duties.
- Contracts often failed to set expectations of contractors. Most of the contracts we reviewed did not contain a detailed scope of work to be performed by the contractor. For example, one contract listed the type of work to be performed simply as "consulting." Several of the contracts we reviewed did not contain a maximum "not-to-exceed" amount. In addition, most contracts we reviewed were not fully executed (signed) by the contractor and/or WESD prior to the start of work as indicated by the contract "Dates of Service."
- We identified numerous expenditures with insufficient documentation regarding the business purpose served. Examples of questionable expenditures include:
  - In July 2008, four WESD employees attended a conference in Redmond, Oregon. Three employees stayed in higher-priced condominiums rather than the resort's available hotel rooms. The cost of the condominium was \$215 per night compared to \$120 for the hotel room. Based on the length of stay, the total cost difference was \$950.

- In November 2008, three Board members, the Superintendent, Deputy Superintendent and another WESD employee attended a conference in Arizona. The conference lodging rate was \$224 per day, which exceeded the federal lodging rate by \$102 per night. The collective conference lodging expense for the conference was \$1,836 above the federal lodging rate, which we used as a best practice for lodging reimbursements.
- WESD issued purchase cards to 14 of its employees. Some of the employees used their purchase cards to pay for personal items, and later reimbursed WESD for those charges. Employees also used purchase cards to pay for meals and refreshments while traveling. These practices placed an additional administrative burden on Business Services staff because staff had to determine whether purchases were allowable and whether the employee also submitted a request for travel reimbursement. We also found that some purchase card transactions were not reviewed by a supervisor prior to payment.
- We found that even though WESD employees were not in a travel status at the time, they used purchase cards to pay for meals during the workday while in Salem.
- We noticed that WESD has an on-site caterer that provides meals and refreshments 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. WESD's practice is to be reimbursed by individuals or groups outside of the agency and to pay for meals and refreshments catered for its own meetings. We requested the invoices for catering services for the last several months and found that WESD paid approximately \$11,000 for catering provided during September and October 2009. According to WESD, about \$4,500 of that amount was to be reimbursed by individuals or groups outside of WESD.

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. In addition, WESD did not know if it was operating at a gain or a loss. Without that information, the Board and management were unable to make informed decisions about services and adjust rates over time. Moreover, WESD can not provide its component school districts or the local tax payers with the assurance that resources it was entrusted with were ultimately used to provide services for school children.

## Insufficient Controls

Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achieving WESD's objectives. Weak controls could also put WESD at risk of waste, abuse and theft. We found that WESD lacks policies and procedures in a number of areas:

- 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. Journal entries are used by WESD for accounting transactions such as adjustments and transfers between funds.
- WESD does not have an internal policy or procedure to consistently identify approval routes, assign authorized approvers and require approval of financial transactions. Moreover, staff did not consistently follow existing approval practices. For example, we found that supervisor approvals for purchase card and travel expenditures were not documented.
- WESD does not adequately segregate duties or consistently assign backup responsibilities. For example, we found one staff member has high-level access across multiple systems integral to business processes, such as access to online bank information and universal access to the accounting system that includes the ability to write checks. There is also no backup staff member assigned for many of these functions.
- 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.
- WESD does not have written procedures that instruct staff as to how to competitively select contractors and document the selection.
- WESD has created an internal travel policy that states employees are responsible for identifying and using efficient and cost-effective methods of travel. The policy established limits for meals, but has no limits for lodging and rental cars.
- 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. Although draft policies and procedures were proposed, WESD did not finalize them.

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

We also found instances when WESD Board policies were not enforced.

- WESD is not enforcing its Board policy that requires evidence of the competitive selection process be maintained for all contracts.
- Additionally, we received information that WESD did not verify that contractors met the independent contractor qualifications prior to executing contracts.
- 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. For example, when staff raised questions about travel costs that appeared to be excessive or not in compliance with WESD's travel policy, they were told to make the payment and not question the charges.

## **Little Transparency of Decisions and Activities**

Transparency is one means of increasing accountability. Access to information about WESD operations and decisions can build stronger relationships and credibility with school districts and members of the public. Transparency also allows these groups to raise questions that improve WESD activities and better serve the interests of students.

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. In comparison, we visited three of the largest ESDs in the state and each described ways in which they are able to account for resolution monies. For example, two of the ESDs publish the projected, actual and any carryover of school district monies in their annual reports. Furthermore, they also publish resolution and contract funds expended by service and by component school district.

WESD could better disclose with school districts its use of Medicaid reimbursements. Up-front costs related to Medicaid services were paid by a variety of sources, including school districts. Additionally, the reimbursement monies WESD received were then used at its discretion. It is unclear whether all the reimbursements directly benefited the programs where these up-front costs were incurred. For example, WESD directed about \$484,000 from Medicaid reimbursement fund categories to make lease payments for the Pentamation information system, as well as pay penalties and interest to the IRS. In contrast, other ESDs reported Medicaid reimbursements flow back to the school districts or directly offset budgets for impacted programs.

Other ESDs actively use advisory committees and publish committee information in their annual reports. Advisory committees make

recommendations that impact their component school districts and perform activities that include sharing common problems and solutions, identifying new district needs or revising current services, determining recommendations for program and service priorities, and assisting staff in communications with local district personnel. While WESD states it uses advisory committees to review Local Service Plan rates and perform other functions, the roles, responsibilities and composition of its committees are not published in its annual report to its districts.

When we contacted other ESDs to learn how they operate, we found that they all communicate with their districts in a more open and transparent way. Examples of various communication methods include:

- distributing unused ESD resolution monies (10%) to component school districts rather than accumulate a fund balance, and reporting the distribution;
- assigning an ESD representative to attend all component school district board meetings and report back on any items significant to the ESD; and
- developing a clear, detailed and comprehensive Agreements and Understandings document between the ESD and component school districts that includes use of advisory committees, allocation of resolution dollars, restrictions related to pass-through dollars, identification of service rates by funding source (i.e. resolution dollars versus contract dollars), and carry forward of any unused school district monies.

## **Weak Governance Practices**

An agency is strongly influenced by the actions and expectations of its board of directors. The effectiveness of a board is related to its independence from management, extent of its involvement and scrutiny of activities, and the appropriateness of its actions. A board must be prepared to question and scrutinize management's activities, present alternative views and have the courage to act in the face of obvious wrongdoing.

WESD Board members received very little information about the financial status of WESD's operations and did not question that limited information. For example, Board members only received a highly summarized one-page budget-to-actual comparison report each month. Additionally, presentations from program directors did not contain financial information. Board members stated that they only received positive information about programs and WESD operations. Beginning in September 2009, the Board began receiving a more detailed monthly budget-to-actual comparison report and program directors began presenting information regarding the current financial status of programs.

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. Instead,

the former Superintendent and the Business Services Directors made presentations. The audit reports provided financial information and identified numerous concerns that could have alerted the Board to WESD's actual financial condition.

We found that the Board prepared its evaluation of the former Superintendent using only feedback from the former Superintendent herself. The Board did not seek information about the Superintendent's performance from anyone else within WESD or its various stakeholders. In contrast, the Oregon School Board Association has produced an ESD Superintendent Evaluation Workbook that outlines a three-part evaluation tool based on performance standards, progress towards the goals established by the board and superintendent, and a 360-degree evaluation by members of the community, component school districts and staff.

Good governance also requires effective communication. In an organization the size of WESD, communications should occur in a broad sense, flowing down, across and up the organization. We heard from staff that communications throughout WESD has been poor. There has not been an effective mechanism to disseminate information from the Superintendent and other top management to staff in the various departments. According to staff, some information has not been clearly communicated, creating confusion within WESD.

During our audit, we presented our concerns to the Acting Superintendent and the Board Chairman, and encouraged them to communicate the concerns to the Board. We learned later that our briefings were not shared with other members of the Board. Furthermore, concerns WESD's contracted financial auditors presented to the Acting Superintendent and Board Chairman in September 2009 and again in November 2009 were not made known to other Board members until December 2009. All board members have a fiduciary responsibility and need timely information regarding WESD issues.

## **Emphasis on Stewardship Needed**

Values are a fundamental aspect of an organization. Employees of an organization apply these values, positive or negative, in the course of their work. Values are embedded in management's philosophy and operating style; the integrity and ethics that are communicated and reinforced; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction the board of directors provides.

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. For example, we were told that monthly budget to actual reports presented to the Board between July 2007 and May 2009 that contained fund balances for internal

service funds were changed from negative balances to positive balances before being presented to the Board.

In addition, we were told that over the years staff has attempted to express their concerns regarding various practices to their supervisors and upper management, but the concerns were ignored. A letter written in 2005 by the Oregon School Employees Association stated that, in addition to union-related issues, it had received numerous complaints from its members concerning the patronizing and/or paternalistic attitudes of management. The letter also expressed concerns about WESD responding in a retaliatory manner when concerns, issues and/or objections were raised. Moreover, during our audit several staff members told us they suffered retaliation for expressing their concerns about WESD's operations.

Other ESDs we contacted have created a mechanism for staff to take concerns to the board if they feel as though management is not addressing their concerns. For example, three board policies we reviewed elevated the grievance process to the board level and deemed the board's decision as final. In contrast, WESD's Board policy does not allow staff to bring concerns directly to the Board. Rather, policy requires that the Superintendent address staff concerns.



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## Recommendations

### We recommend the Board take the following actions:

- Hire a Superintendent who will take the necessary steps to establish effective management controls, improve governance practices, increase transparency, and build a culture of integrity at WESD.
- Build an accountability system that ensures all Board members obtain a sound understanding of WESD.
  - Obtain regular briefings from the Superintendent on plans, actions taken, and results regarding WESD operations, finances, accomplishments and challenges.
  - Supplement its contract for the annual financial audit with periodic reviews of internal controls of purchasing, contracts, and other public stewardship topics. Schedule Board briefings for the independent financial auditors to present their results and any identified internal control weaknesses.
  - Establish regular communications with school district board members and management in order to improve transparency and working relationships.
  - Create a mechanism for WESD staff to communicate concerns directly to the Board.
  - Establish a communications system that ensures all Board members are informed of important issues facing WESD, and WESD management is responsive to requests for more detailed information.
- Define roles and expectations and establish Board policies and recommendations to improve WESD.
  - Establish a WESD code of ethics and supporting policies and procedures that represent the Board's philosophy on public stewardship.
  - Review and ensure that WESD management resolves any issues of concern identified in communications with contract financial auditors, WESD staff, school district officials, and the Oregon Department of Education.
  - Conduct at least annual performance reviews of the Superintendent using methods that produce meaningful

assessments and plans of action, such as those recommended by the Oregon School Boards Association.

**We recommend the new WESD Superintendent and management take the following actions:**

- Establish expectations and act accordingly to create a working environment that values good stewardship of public resources.
- Maintain an accounting system that produces transparent financial information showing how WESD managed and distributed its monies and services to school districts.
- Upgrade WESD’s system of internal policies, procedures, and internal controls to better align with best practices in other government organizations. Areas of particular concern that we identified include:
  - designating school districts monies separately within its accounting system;
  - documenting and maintaining a record of approvals and transactions;
  - developing and enforcing procedures for contracted services;
  - developing comprehensive policies and procedures in the areas of travel reimbursements, purchase cards, and catered meals;
  - developing and implementing written procedures that address financial reporting and accountability; and
  - ensuring the Business Services department and others have the authority to enforce written policies and procedures.
- Improve communications with WESD employees and respond in a timely way to issues and concerns they raise.

**We recommend the Oregon Superintendent of Public Instruction take the following action:**

- Identify and promote best practices among ESDs on the use and reporting of services, costs, and public resources with the purpose of increasing accountability and transparency.

## **Agency Response**

Responses from WESD and ODE are attached at the end of the report.

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## Objectives, Scope and Methodology

The purpose of our audit was to identify needed improvements in WESD transparency and management control to help assure future accountability.

In order to meet our audit objective, we reviewed numerous documents related to WESD specifically and ESDs in general. These included state statutes and administrative rules, federal guidelines, the Oregon Accounting Manual, the Oregon Program Budget and Accounting Manual for School Districts and Education Service Districts, WESD Board resolutions and meeting minutes, Board policies, and other WESD internal policies and procedures. In addition, we reviewed reports prepared by contractors hired to review allegations at WESD, financial reporting documents from other ESDs, and best practices literature prepared by organizations such as the Oregon School Board Association and the Committee of Sponsoring Organizations of the Treadway Commission. We also attended Board meetings and a meeting of Board members and WESD staff.

We spoke with Board members, WESD's Acting Superintendent, various program directors, Business Services and other departmental staff, members of component school districts, contractors hired as the Interim Business Services Director and the Interim Human Resources Director, and Oregon School Board Association staff. We also met with the superintendents and financial officers from Clackamas, Multnomah and Northwest Regional ESDs.

We also reviewed cost allocation plans, budgets, service rate development documents, annual reports to stakeholders, and information from the internet-based Local Service Plan through which districts purchase services from WESD. In order to gain familiarity with WESD's accounting structure, we also reviewed accounting processes, staff-generated reports from WESD's accounting system, and examples of various transactions and available supporting documentation.

We analyzed audited financial statements for fiscal years 2004 through 2008 to identify changes in WESD's reported financial condition. These audits were conducted by various independent financial auditors WESD hired.

In order to corroborate staff concerns relating to various financial practices, we reviewed travel expenditures, purchase card use and approval processes, meals and refreshments purchases, and professional services contracting. We limited our review of professional services contracting to the selection process, contract terms and conditions, contract approval processes and the classification of independent contractors.

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

# Willamette

EDUCATION SERVICE DISTRICT

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Ed Dodson • Michael Eichman • Phil Frey • Ruth Hewett • Frank W. Pender, Jr. • Jack Stoops • Larry Trott • Mark Trumbo • Dora Velasco  
BOARD OF DIRECTORS

January 28, 2010

Gary Blackmer, Director  
Secretary of State, Audits Division  
255 Capitol Street NE, Suite 500  
Salem, OR 97310

Dear Director Blackmer:

We have reviewed the report from the Secretary of State's Audits Division concerning Willamette Education Service District (WESD). We accept the report, and pledge to fully implement the recommendations. We have already begun to do so, based on both internal and external evaluations of our agency initiated by the WESD Board of Directors last summer.

As leaders, we take responsibility for correcting the weaknesses in governance, management and financial practices described in this audit report. The report is a snapshot of WESD at a time when these weaknesses were identified, but few steps toward improvement had been taken. This is no longer the case. We have made progress in recent months, and our agency is more accountable, transparent and collaborative today than it was last summer.

The partnerships with our component school districts are central to WESD's mission. We have failed to fulfill some of our responsibilities to our districts, specifically in ensuring their voice in developing our services and models for their delivery. Further, our communication and fiscal reporting has been inadequate. To address these issues we have engaged in earnest, open collaboration with the superintendents of our component school districts. This collaboration will result in partnerships for service delivery that are efficient and cost effective, while emphasizing responsive, high quality services. We will provide districts with accurate and timely communication on the fiscal and programmatic detail of our activities. Quarterly progress reports will be provided to our stakeholders, as well as interim updates at each WESD Board meeting and monthly Executive Council meeting.

This period in our agency's history has been trying, particularly for our employees. On behalf of our Board of Directors and administrative team, we want you to know that throughout this difficult time, even as programs have been downsized and jobs have been lost, WESD employees

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Dave Novotney, Ph.D., Acting Superintendent

Marion Center

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Phone: 503-588-5330 Fax: 503-363-5787

Polk Center

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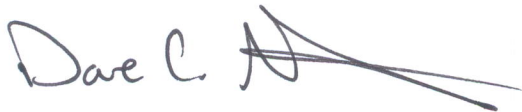
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have continued to provide our school districts, schools, educators and students with outstanding programs and services. We have continued to serve children and students with special needs (birth to 21 years old), English language learners, migrant students and numerous other specialized populations. Our service to school districts has continued with school improvement, student and business information systems, educational technology and many other programs. Our employees are to be commended. To WESD employees, we say this: *We honor and appreciate your hard work and dedication, and we pledge to work with you – to involve you and to listen to you – as we move forward.*

We will work closely, openly and honestly with our stakeholders and staff to implement all of the audit recommendations and continue with other improvement initiatives underway and in development. We are committed to accountability, to transparency, to collaboration and to communication. We believe that the majority of the recommendations will be implemented by the end of this school year, and all recommendations implemented and refined by the end of 2010. We will communicate our progress, and request a return visit from the Secretary of State Audits Division after one year to affirm our complete implementation of the recommendations contained in this report.

The actions we have already completed, the improvements currently in progress and the changes yet to come are described in the following response. If the response generates questions, please feel free to contact me.

Sincerely,

A handwritten signature in black ink that reads "Dave C. Novotney". The signature is written in a cursive style with a long, sweeping horizontal line extending to the right.

Dave Novotney, Ph.D.  
Acting Superintendent  
Willamette ESD

# Willamette Education Service District

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## Response to Secretary of State Audit Report

January 28, 2010

### **WESD CONTEXT**

WESD is one of twenty Education Service Districts in Oregon. Primary customers are the twenty one component school districts within the WESD geographic service area comprised of Marion, Polk and Yamhill counties. A broad range of supportive and direct services are provided to districts, schools, educators and students. WESD staff are respected for their high quality, professional services and their commitment to the education community in which they participate.

WESD employs approximately 670 staff and operates for fiscal year 2010 with a budget of about \$78.4 million. Funding comes from federal, state and other fund sources, with WESD serving as a contracted vendor to the component districts and as a subcontractor for state, federal and foundation grants. In the vendor role, WESD is often an intermediary, seeking to provide goods and services to support requests and meet the demands of the districts.

### **PROCESS OBSERVATIONS**

The Secretary of State audit took place at WESD during a time of tremendous activity focused on agency evaluation and improvement. Concurrent fiscal review processes were also underway, complicating an already difficult task for the audit team. Throughout the process WESD found the audit team to be respectful and professional. WESD accepts the audit findings, and welcomes the recommendations as objective suggestions for improvement that are being incorporated into an agency wide process already underway. Under the direction of the Board and Acting Superintendent Novotney, WESD is implementing changes and improvements in agency business practice and internal controls that will bring fiscal stability and accountability. The agency is collaborating with the Oregon Department of Education, the Secretary of State's Office, WESD's new external auditing firm (Pauly, Rogers and Co.) and a team of external consultants to ensure the development, approval, training and implementation of the highest standards of fiscal management and public accountability.

### **ACKNOWLEDGEMENT OF FINDINGS**

WESD agrees substantially with the audit findings as an accurate reflection of practice issues that have been problematic for the agency, or as identification of areas where business processes lacked controls and documentation. Prior to completion of the audit, improvements were being implemented to address those issues. Documentation standards are being strengthened, fund classification is being streamlined and classification errors corrected, and financial reporting to the Board and component school districts has significantly improved in detail and transparency. Governance relating to the selection and supervision of contractors is being revised and clearer policy regarding expenditures and

reimbursements have already been implemented. Business process controls are being strengthened, utilizing existing procedures currently in place with other Oregon ESDs and districts.

### **ACTION ITEMS—RECOMMENDATIONS**

The WESD Board, administration and staff will continue to work with care and integrity toward agency improvement.

Recommendations from the Secretary of State's audit report will be fully implemented. The majority of the following recommendations will be developed, staff trained and fully implemented by June 30, 2010. All recommendations will be fully implemented, reviewed and refined as necessary by December 31, 2010.

WESD will provide formal quarterly progress reports on the status of implementing these recommendations, as well as other improvement initiatives, to its stakeholders. Interim status reports on improvement progress will be provided at each WESD Board of Directors meeting, at monthly Executive Council meetings and in monthly meetings with Union Leadership. These reports will, of course, be shared with WESD staff. WESD pledges complete transparency as we continue to address agency improvement.

### **Board Recommendations**

The action items that follow in this section respond directly to bulleted or sub-bulleted recommendations contained in the recommended Board actions section of the Secretary of State audit report, page 17 and 18.

- The Board has contracted with the firm of Willis, Green & Assoc. to facilitate a process of recruitment and selection for a permanent WESD Superintendent. Input from the public, stakeholders and staff is being obtained for inclusion in the process of selection.
- WESD Board and agency leadership are collaborating on the content and format for a comprehensive Board training curriculum that will be used for full Board training when complete and approved. The curriculum will then be used to train new Board members. Annual update training will also be scheduled and implemented.
- Frequency and content detail of Board briefings has been increased substantially. The Board has moved from monthly to twice monthly meetings, and receives detailed fiscal and programmatic reports at each meeting and between meeting updates as appropriate.
- The Board is in the process of approving enhanced fiscal controls. Independent audit results will be presented directly, and in person, to the Board by WESD's new audit firm (Pauley, Rogers and Co.).
- Board communication with component districts is being enhanced through improved financial reporting, collaborative participation in service planning and rate setting. Agency or Board developments and changes are provided directly to component districts.
- The Board has established public/staff comment opportunities prior to and following each Board meeting. Direct access to Board members through email is facilitated on the agency website.



- Board communication has been improved to include regular detailed briefings described above, as well as issue driven reports delivered as identified. The Board is included in communication from the agency directed to component districts and stakeholders addressing these issues. Response to requests by the Board for additional information or clarification will be the responsibility of the Superintendent and the Department Director responsible for the program area in question.
- The Board process of policy development and review is being evaluated and strengthened to clearly delineate roles and responsibilities for stewardship of agency governance. The Board has begun collaboration with the Oregon School Boards Association as a partner in this review.
- Board policies on ethics and professionalism will be reviewed and strengthened. An agency initiative to orient staff to changes, elicit meaningful dialogue and instill this governance into agency fabric will be commissioned.
- The Board's level of active engagement in agency oversight and leadership is critical to WESD's success. Board members are better able to discharge their responsibilities with the improved accountability and transparency in agency reporting. The improved information flow also facilitates Board follow-up and resolution on identified issues.
- The Board policies on annual performance review of the WESD superintendent will be opened for Board review and revision. Policy language will be added that mandates solicitation of feedback and input on the superintendent's performance from ODE, component districts and other stakeholders and from agency staff. This feedback will be included with other accepted assessments and review of established goals in determining the superintendent's performance.

### **Superintendent/Management Recommendations**

The action items that follow in this section respond directly to bulleted or sub-bulleted recommendations contained in the recommended Superintendent and management actions section of the Secretary of State audit report, page 18.

- WESD management will work with internal resources, assistance from partner ESDs and districts, and established standards of fiscal practice to improve agency internal controls and transparency. These policies and procedures will be trained and enforced to assure vigilant stewardship of public funds.
- WESD Business Department has developed reporting templates for component districts that reflect best practice standards in tracking fund allocation and distribution. When Board approved and adopted by districts, regular reports of district expenditure with remaining balances will be provided.
- WESD internal policies, procedures and internal controls are being revised and enhanced with assistance from consultants, the Oregon School Boards Association, and partner ESDs and school districts.
- A complete review and correction of fund classification has been completed and component district funds are clearly identifiable. Individual tracking reports by district are in development as described above.

- WESD is working with Chief Financial Officers from ESDs and districts to adopt Business Services procedures that establish standards for practice, documentation and record retention on both financial reporting and the process for transaction approval and completion.
- Contract policies are being reviewed and improved to better define procedures for procuring and overseeing contracted services.
- Procedures have already been implemented providing clear and improved governance relating to purchase cards, expense reimbursement, travel status, meeting expense and catering.
- WESD Business Department staff have begun evaluating established procedures for financial reporting and accountability provided by various government organizations for agency adoption.
- WESD administrative staff have begun training on new policies and procedures, including agency expectations regarding the training, implementation and enforcement of new and existing governance.
- Communication has been established as one of WESD's four key guiding principles. Communication standards have been established, with additional development at the Department level in process. Staff avenues that allow for the safe and transparent raising of concerns are being emphasized, with follow-up communication relating to concern evaluation/resolution.

#### **Oregon Superintendent of Public Instruction Recommendation**

WESD pledges to collaborate with the Oregon Department of Education, Oregon Association of Education Service Districts and the Oregon School Boards Association to engage the education community toward an open network of resource and information sharing intended to enhance the identification and promotion of best practices across our shared responsibilities. Common issues and practice related to the development of governance, service delivery and Board training will be considered.

#### **SUMMARY**

WESD has made significant progress on an agency wide initiative focused on improving agency operations. This initiative is grounded in four key guiding principles of Communication, Collaboration, Transparency and Accountability. We are confident that we will successfully implement each recommendation in the Secretary of State audit report, as well as overall agency improvements focused on agency fiscal stability, enhancing organizational integrity and regaining the public trust. We will communicate our progress, and will request a return visit from the Secretary of State Audit Division after one year to affirm our complete implementation of the recommendations contained in this report.

SUSAN CASTILLO  
State Superintendent of Public Instruction



OREGON DEPARTMENT OF EDUCATION  
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Phone (503) 947-5600 • Fax (503) 378-5156 • www.ode.state.or.us

January 25, 2010

Sheronne Blasi  
Audits Division  
Oregon Secretary of State's Office  
Public Service Building Suite 500  
255 Capitol Street NE  
Salem, OR 97310

Thank you for meeting with the Oregon Department of Education on January 13, 2010 to review with us the draft audit of the Willamette Education Service District.

**In the report the Audits Division recommends that the Oregon Superintendent of Public Instruction take the following action:**

Identify and promote best practices among ESDs on the use and reporting of services, costs, and public resources with the purpose of increasing accountability and transparency.

**Please see ODE's Response:**

The department agrees that identifying and promoting best practices that are adopted by ESDs will help increase accountability and transparency. Over the next twelve months, the department will convene meetings with various stakeholder groups that have an interest and expertise in best practices. The department has already spoken with the leadership of the Oregon Association of Education Service Districts (OAESD) about working together to identify and promote best business practices. Information gleaned from these efforts will be shared with ESDs and posted on the department's web site. Additionally, as existing resources allow, the department will use other methods to research best practices and make this information available to ESDs through avenues such as e-mail communications and the department's web site.

Thank you for your time and recommendations. If you have any questions, please feel free to contact me.

Sincerely,

A handwritten signature in black ink that reads "Ed Dennis". The signature is written in a cursive, flowing style.

Ed Dennis  
Deputy Superintendent of Public Instruction

Cc: Amelia H. Eveland  
James E. Scott  
Tenzin Choephel

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## About the Secretary of State Audits Division

The Oregon Constitution provides that the Secretary of State shall be, by virtue of her office, Auditor of Public Accounts. The Audits Division exists to carry out this duty. The division reports to the elected Secretary of State and is independent of the Executive, Legislative, and Judicial branches of Oregon government. The division audits all state officers, agencies, boards, and commissions and oversees audits and financial reporting for local governments.

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### Audit Team

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Sheronne Blasi, MPA, Principal Auditor

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Tenzin K. Choephel, MPA, Senior Auditor

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Amelia H. Eveland, MBA, Staff Auditor

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This report, a public record, is intended to promote the best possible management of public resources. Copies may be obtained from:

internet: <http://www.sos.state.or.us/audits/index.html>

phone: 503-986-2255

mail: Oregon Audits Division  
255 Capitol Street NE, Suite 500  
Salem, OR 97310

The courtesies and cooperation extended by officials and employees of the Willamette Education Service District during the course of this audit were commendable and sincerely appreciated.