

Multnomah Education Service District: Contracting Practices



Charles A. Hibner, Director, Audits Division

Bill Bradbury, Secretary of State

Secretary of State Audit Report

Summary

PURPOSE

The purpose of our audit was to determine whether Multnomah Education Service District's (MESD) contracting and intergovernmental agreement practices were in accordance with contracting laws, best practices and MESD policies.

INTRODUCTION

During the 2007 regular session, the Oregon Legislative Assembly passed House Bill 3141, which authorized the Oregon Department of Education (department), in consultation with a newly established advisory committee, to develop a system for auditing school district business practices. The bill directed the department to contract with the Oregon Audits Division to conduct the audits. The audits are voluntary on the part of districts and may cover business practices in the areas of transportation, food service, grounds maintenance, building and systems maintenance, new construction, purchasing and contracting, and financial practices.

This is the first audit conducted under the new legislation. MESD has recently undergone organizational and staffing changes, and expressed a desire to have its contracting practices evaluated.

RESULTS IN BRIEF

MESD's contracting practices used to procure short-term goods and services were generally in accordance with contracting laws, best practices and MESD policies.

However, we identified opportunities for MESD to improve its contracting practices for personal services contracts, leases, multi-year contracts for goods and services, and intergovernmental agreements. Specifically, our recommendations address such areas as contractor selection, contract development and contract management.

RECOMMENDATIONS

We recommend that MESD develop and implement written contracting policies and procedures to ensure:

- contractors are selected using competitive screening and selection processes;
- contracts are signed by all parties prior to receiving and paying for services;
- contracts, leases and intergovernmental agreements are adequately administered and monitored;
- contract files are organized and meet applicable documentation and retention requirements; and
- intergovernmental agreements are used appropriately and a written record of how price was determined is maintained.

We recommend that these contracting policies and procedures clearly assign responsibilities to the Business Services, Legal Services, and Human Resources departments and program areas, and that staff assigned the responsibilities be adequately trained.

We recommend MESD further develop the monitoring capabilities of the existing contract management and accounting information systems.

We recommend MESD review all unsupported payments to contractors and seek reimbursement for any payments determined inappropriate.

We recommend MESD seek reimbursement from the contractors we determined overcharged MESD and review payments made to these contractors outside our audit period for potential overcharges.

AGENCY'S RESPONSE

The Multnomah Education Service District agrees substantially with the findings and recommendations. Its response can be found beginning on page 6.

Introduction

During the 2007 regular session, the Oregon Legislative Assembly passed House Bill 3141, which authorized the Oregon Department of Education (department), in consultation with a newly established advisory committee, to develop a system for auditing school district business practices. It also established the District Best Business Practices Advisory Committee, whose role is to advise the department on developing the system, including designating best business practices to be used as criteria for the audits. The bill directed the department to contract with the Oregon Audits Division to conduct the audits. The audits are voluntary on the part of districts and may cover business practices in the areas of transportation, food service, grounds maintenance, building and systems maintenance, new construction, purchasing and contracting, and financial practices.

This is the first audit conducted under the new legislation. MESD has recently undergone organizational and staffing changes, and expressed a desire to have its contracting practices evaluated.

Background

The mission of education service districts is to assist school districts and the department in achieving Oregon's educational goals by providing equitable, high quality, cost-effective and locally responsive education services at a regional level.

The Multnomah Education Service District encompasses 171 schools that serve approximately 91,000 students. MESD serves eight school districts including, Portland, Parkrose, Reynolds, David Douglas, Riverdale, Centennial, Gresham-Barlow and Corbett.

MESD is governed by an elected Board of Directors consisting of seven members. Its approved

budget for 2008-09 was approximately \$100 million.

For the period of our review, July 2006 through May 2008, MESD contracted for goods and services and personal services, and entered into leases and intergovernmental agreements that ranged in value individually from \$21.50 to more than \$1.8 million. MESD procured a wide range of goods and services including, among other things, school supplies purchased for individual schools and school districts, leases for alternative high schools, and busing students to the Outdoor School program.

All contracts are initiated by individual programs within MESD (e.g. Special Education Services, Health and Social Services, Instructional Services, Communication Services, Business Services and Technology Services) and are processed by MESD's Business Services, or Legal Services departments. Business Services generally processes contracts for goods and services, including contracts for the Cooperative Purchasing Program used to purchase school supplies. Personal services contracts, leases and intergovernmental agreements are processed by Legal Services. The Human Resources department is also involved in the approval process for personal services contracts.

Audit Results

With a few minor exceptions, MESD's contracting practices for short-term contracts for goods and services were in accordance with contracting laws, best practices and MESD policies.¹

However, we identified opportunities for MESD to improve its contracting practices for personal services contracts, leases, multi-year goods and services contracts, and intergovernmental

agreements. Specifically, our recommendations address such areas as contractor selection, contract development and contract management.

Contracting for Short-term Goods and Services Was Generally Appropriate

We reviewed small, intermediate and competitive sealed bidding contracts for short-term goods and services and found that, with minor exceptions, MESD's contracting practices were in accordance with contracting laws, best practices, and MESD policies.²

For example, consistent with contracting laws and best practices, MESD sought three informally solicited price quotes for technology services, reviewed the quotes, and awarded a contract for approximately \$36,000 to the contractor whose quote was the lowest and determined to best meet MESD's requirements. Payments for this contract were also in accordance with the terms and conditions of the contract.

Contractor Selection Practices Could be Strengthened

The policy of the state of Oregon, as expressed in statute, is that a sound and responsive public contracting system should allow impartial and open competition, protecting both the integrity of the public contracting process and the competitive nature of public procurement. When contractors are not competitively selected, agencies lack assurance they have selected the most qualified contractor at a fair and reasonable price.

We identified practices within MESD that did not appear to encourage open and fair public

¹ We considered short-term contracts for goods and services to be those a year or less in duration.

² Small contracts are those that do not exceed \$5,000. Intermediate contracts are those greater than \$5,000 and less than or equal to \$150,000. Competitive sealed bidding contracts are those over \$150,000.

contracting. Specifically, we found that for nine of the 11 (82 percent) personal services contracts we tested, covering approximately \$1.6 million in payments, contractors were not selected using a competitive process.

For example, MESD did not identify and notify all potential bidders of its intent to procure the services. Further, we found that contractor selection practices MESD used for personal services contracts varied widely among program areas. For example, staff in one program area selected personal services contractors based on known providers in the area. In other programs, contractors were selected based on referrals from outside entities, such as professional consortiums and area superintendents. Variation in contractor selection practices makes oversight of the entire contracting program difficult.

Additionally, we found that 18 of the 22 (82 percent) multi-year service contracts we tested did not have documentation to support the identification and consideration of other vendors. Therefore, we could not determine whether contractors were competitively selected.

Finally, we also found that 18 of 102 (approximately 20 percent) intergovernmental agreements in MESD's contracting system during the time of our review were actually agreements with non-governmental organizations. For instance, MESD entered into intergovernmental agreements with private schools, nonprofit social service organizations and a private health services company. Since MESD did not follow a competitive process to procure these services, it does not have assurance that they were obtained from the most qualified contractor at a fair and reasonable price.

Contract Development Practices Could Be Strengthened

According to contracting best practices, contracts for services must be formal, written documents and should (1) protect the interests of the contracting entity, (2) identify the responsibilities of the parties to the contract, (3) define what is to be delivered, and (4) document the mutual agreement, substance and parameters of what the parties agreed.

The contracts we reviewed did not consistently contain provisions that satisfied these four areas. For example, contracts sometimes lacked deliverable requirements specific enough to ensure the department received what it intended, or omitted penalties for non-performance. We noted that the contract approval process did not require MESD's legal counsel to review these contracts, which may have prevented these problems. Another potential cause was MESD's use of a template for personal services contracts that did not provide adequate space to describe the scope of work, contract deliverables, performance requirements, or payment schedules. Nor did it document legal counsel's review.

We also found that for four of the contracts we reviewed, MESD made approximately \$331,000 in payments for services not included in an existing executed contract. For example, MESD paid \$261,000 for property improvements before it had finalized negotiations with the landlord. While we found a draft amendment to the lease that addressed the improvements, it was never completed or signed by the parties.

MESD also made approximately \$196,000 in payments for services that were provided before a contract was signed by all parties. In one case, MESD paid approximately \$35,000 for

temporary speech language pathology services provided in July 2007, a month before the contract was executed. Without executed contracts, MESD runs the risk of potential disputes with contractors over price, deliverables, and terms and conditions of the contract.

Contract Management Practices Could Be Strengthened

Oregon contracting statutes require local contracting agencies with authority for contract management to assure compliance with the contract terms. Negotiated contracts also allow public agencies to transfer risk to the contractors, such as when contractors are required by the contract to carry professional liability insurance.

Best practices for contract management suggest organized contract files should contain a list of prospective contractors notified for the solicitation, a record of the method used to notify prospective contractors, copies of contractor proposals, a record of the method used for evaluating proposals, a record of the negotiation, and support for charges against the contract.

Additionally, Oregon Administrative Rules require that education service districts retain contract records for six years after the contract expiration.

We found weaknesses in MESD's contract management practices for personal services contracts, multi-year contracts for goods and services, leases and intergovernmental agreements. For example, payments associated with 12 of the 26 (46 percent) contracts we reviewed were not in accordance with contract terms and conditions. These payments included contractor charges that used rates not in agreement with the contract, instances in which required deliverables were provided late or not at all, and payments that did not follow schedules contained in the contract.

For example, in one case, MESD overpaid a technology systems contractor approximately \$64,000 when it continued to pay for things such as implementation services and software licenses that were only included in the first year of the contract. In another example, MESD overpaid a contractor because the annual lease escalation rate the contractor used did not agree to the contract.

We also found that contractors did not meet insurance documentation requirements for most of the contracts we reviewed that contained such provisions. For example, one personal services contractor never purchased the required \$1 million comprehensive general and liability insurance.

Finally, we found that contract files lacked other important documentation. For example, 18 of the 22 (82 percent) contracts we reviewed did not contain documentation showing how contractors were selected. Nor did files for seven contracts contain supporting documentation for payments that totaled approximately \$158,000. Missing documentation included such things as time sheets and travel receipts to support contractor charges.

Contributing Factors to Weak Contract Practices

We noted several factors that contributed to the weaknesses we identified in the areas of contractor selection, contract development and contract management. Specifically, we noted the following factors:

- lack of written policies and procedures for competitive screening and contractor selection, contract administration and monitoring, and the appropriate use of pricing for intergovernmental agreements;
- decentralized contracting duties without adequate oversight;

- lack of clear roles and responsibilities between Business Services, Legal Services, Human Resource departments, and other program areas; and
- an information technology system used to process personal services contracts, leases and intergovernmental agreements that was not directly linked to the accounting system, making it difficult for program staff and managers to monitor payments.

Recommendations

We recommend that MESD develop and implement written contracting policies and procedures to ensure:

- contractors are selected using competitive screening and selection processes;
- contracts are signed by all parties prior to receiving and paying for services;
- contracts, leases and intergovernmental agreements are adequately administered and monitored;
- contract files are organized and meet applicable documentation and retention requirements; and
- intergovernmental agreements are used appropriately and a written record of how price was determined is maintained.

We recommend that these contracting policies and procedures clearly assign responsibilities to the Business Services, Legal Services, and Human Resources departments and program areas, and that staff assigned the responsibilities be adequately trained.

We recommend MESD further develop the monitoring capabilities of the existing contract management and accounting information technology systems.

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reimbursement for any payments determined inappropriate.

We recommend MESD seek reimbursement from the contractors we determined overcharged MESD and review payments made to these contractors outside our audit period for potential overcharges.

Agency's Response:

The Multnomah Education Service District agrees substantially with the findings and recommendations. Its response can be found beginning on page 6.

Objectives, Scope and Methodology

The purpose of our audit was to determine whether MESD's contracting and intergovernmental agreement practices were in accordance with contracting laws, best practices and MESD policies.

The scope of our audit included a review of small, intermediate and competitive sealed bidding contracts for goods and services, personal services contracts, leases and intergovernmental agreements.

To answer our audit objective we interviewed MESD staff and gained an understanding of MESD's contracting practices. We also judgmentally selected contracts for goods and services, personal services contracts, leases, and intergovernmental agreements and tested them for compliance with applicable contracting laws, best practices and MESD policies. Specifically, we performed the following procedures:

- tested 37 small contracts (individually not exceeding \$5,000) and 39 intermediate contracts (those greater than \$5,000 and less than or equal to \$150,000) executed between July 1, 2006 and May 9, 2008;

- tested 22 contracts from the spring 2007 Cooperative Purchasing Program;³ and
- tested 11 personal services contracts, six multi-year contracts for goods and services, five leases and four intergovernmental agreements in place between July 1, 2007 and May 15, 2008. We chose this time period because MESD implemented a new information technology contracting system in July 2007.

We used information contained in MESD's current contracting information systems to identify the population of contracts from which we judgmentally selected items for testing. We also judgmentally selected two contracts contained in the prior contracting system for testing. In addition, we judgmentally selected contracts for testing in order to capture a wide range of contract types. We relied on hardcopy documentation for actual testing and conclusions drawn.

We considered the following criteria for our review:

- ORS 279A Public Contracting-General Provisions;
- ORS 279B Public Contracting-Public Procurements;
- ORS 190 Intergovernmental Cooperation;
- OAR 137, Divisions 46 and 47 Attorney Generals Contracting Rules;
- OAR 166, Division 400 Educational Service Districts, School Districts and Individual School Records;
- Best Practices for Contracts, Price Agreements & Intergovernmental Agreements, including National State

Auditors Association Best Practices in Contracting for Services. (Created for and approved by the Oregon District Best Business Practices Advisory Committee); and

- MESD Local Contract Review Board and agency contracting policies.

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.

³ MESD treated this as a large, competitive sealed bidding procurement, which applies to procurements individually exceeding \$150,000.



October 29, 2008

Charles A. Hibner, Director, Audits Division
Oregon Audits Division
255 Capitol Street NE, Suite 500
Salem, OR 97310

Dear Director Hibner:

Attached is our response to the findings and recommendations to the audit report on Multnomah Education Service District's Contracting Practices. MESD agrees substantially with the findings and recommendations of the audit team. We have already developed an action plan to improve MESD contracting practices.

We reviewed the draft report and participated with your audit team in the exit interview on October 23, 2008. You will be pleased to know that the entire experience for us was educational and informative. The staff from your division should be commended for their sensitivity, expertise and professional conduct from start to finish. In addition to the final report, they provided us with ongoing guidance, contacts and a number of valuable reference resources to assist us with further refinement of our purchasing and procurement practices.

We look forward to our Board receiving the report, and hopefully a return visit from the team to assess our progress in complying with our action plan.

Thank you for your efforts on our behalf.

Sincerely,

Ron Hitchcock, Superintendent
Multnomah Education Service District

Superintendent *Ron Hitchcock*

Board of Directors *Harry Ainsworth* ■ *Janice Gratton* ■ *Jean Haliski* ■ *Zak Johnson* ■ *Ken Kissir* ■ *Kevin Spellman* ■ *Geri Washington*

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Contracting Practices Multnomah Education Service District's Response to Oregon Secretary of State Audit Report

MESD CONTEXT

MESD is one of 20 Education Service Districts in Oregon. Primary customers are the eight K-12 school districts within the Multnomah County service area. As the name implies, MESD is a service provider. MESD programs and services are defined by and tailored to meet the needs and priorities of eight component districts. In round numbers, the MESD general fund (\$34 m) revenue is a combination of State School Support Funds (\$10m) and local property taxes (\$24 m). Ninety percent (\$30m) of the general fund is required by statute to be expended to provide services demanded by, designed by and approved by the component districts. Functionally, the districts contract with MESD to provide services which are more efficiently delivered on a regional basis.

In addition to the general fund, the other revenue fund (fund 2) has revenues of about \$60m. Those revenues are expended for the same beneficiaries. MESD delivers contracted services to component districts and administers grants from federal, state and other sources. Again, MESD functions as a contracted vendor to the districts and subcontractor for state and federal grants.

The menu of MESD services requires extensive, diverse, on-demand, specialized staff and contracting activities. During the time period examined by the Oregon Secretary of State's Audit, MESD executed more than 2,500 contracts with individuals, school districts, private schools, businesses, and governmental, public and private agencies. For most of these contracts, MESD was a vendor or service provider. This audit focused on the other side of the agency's contracting practices, the purchasing and procurement side. In a service provider role MESD is typically an intermediary, seeking to provide goods and services to support requests and meet the demands of component districts.

TIMELINE

- December 6, 2007 MESD volunteers for performance audit
- February 11, 2008 MESD begins planning for internal review and update of purchasing, procurement and hiring practices

- April 4, 2008 MESD articulates action plan and assigns responsibilities
- April 11, 2008 ODE notice of impending audit (internal plan put on hold)
- April 29, 2008 Entrance conference with Secretary of State Audit Team
- May–October 2008 Secretary of State audit, survey, fieldwork, reporting
- October 17, 2008 Secretary of State Audit Team issues draft final report
- October 23, 2008 Exit interview with Secretary of State Audit Team
- October 29, 2008 MESD submits review and comment
- November 2008 Implementation of responses begins

REFLECTIONS ON THE PROCESS

MESD volunteered to be audited by the Oregon Secretary of State. MESD was the first agency to do so. The experience was new for MESD and for the audit team. During the process, including interviews, surveys and field work, MESD found the audit team to be respectful, thorough and professional. MESD agrees substantially with the findings, welcomes the recommendations and will use the summary to improve MESD contracting practices.

The depth of the audit was in stark contrast to previous experience with auditors. An excerpt from MESD's most recent financial audit, by an independent firm, states;

“PUBLIC CONTRACTS AND PURCHASING The District's procedures for awarding public contracts were reviewed and based upon our testing we found no instances of non-compliance with ORS Chapter 279.”

The system of internal controls was viewed as exceeding minimum requirements. Annual reviews by independent auditors did nothing to alter that notion. The Secretary of State Audit Team conducted a comprehensive process review. They spent a substantial amount of time in MESD offices, reviewed MESD practices and records, and

interviewed MESD staff. The team also made frequent references to ORS Chapter 279, but “identified opportunities for MESD to improve its contracting practices for personal services contracts, leases, multi-year contracts for goods and services, and intergovernmental agreements.” MESD will maximize the opportunities for improvement which were identified. The team is invited to return to MESD in March or April of 2009 to assess progress. The audit team is uniquely qualified to measure progress by comparing MESD practices over another five- or six-month span of time.

LESSONS LEARNED

The audit results and recommendations led to the following conclusions and clarifications:

- (1) MESD incorrectly used the \$5,000 threshold as the level at which to initiate a competitive selection process for all contracts, including personal services.
- (2) MESD incorrectly used the IGA (Intergovernmental Agreement) format as the MOU (memorandum of understanding) template for partnership and working agreements.
- (3) MESD was most frequently exposed to liability and risk due to circumventing internal policies and controls.
- (4) The MESD definition and process for procuring personal services is overly-broad.
- (5) The process review and records audit proved to be useful and informative. MESD can emulate the process by implementing regular, internal process reviews and audits.
- (6) Verbal agreements obligate the agency and expose MESD to liability. Fully executing agreements, before goods or services flow, will reduce exposure.
- (7) The competitive selection requirements of ORS 279 must be adhered to, even in special circumstances such as grant partners and services where few contractors exist.
- (8) Tools such as contingency awards, multiple awards, multi-year awards, qualified provider lists and price agreements can accommodate the unique needs of MESD.

ACTION ITEMS—STEPS TAKEN

In December of 2007 MESD volunteered with the District Best Business Practices Advisory Committee to participate with the Secretary of State in a performance audit.

In early 2008 the MESD directors of legal, HR and business services developed a comprehensive action plan to address contracting, purchasing and hiring issues across the agency. Shortly thereafter MESD was notified of the entrance interview with the Oregon Secretary of State Team. It didn't make sense to implement any actions prior to or during the audit. Also, the audit would certainly provide information to inform MESD policy and process reformation. Consequently, MESD is prepared to initiate a response without delay. Steps have already been taken address areas in need of improvement.

- All MESD Directors notified to have their departments cease and desist the practices listed in items 1-3 above during policy development phase. (10/27/08)
- All MESD Directors notified of the process to correct items 4-8 above during the policy development phase. (10/27/08)
- MESD opened discussions with landlords to renegotiate three of five building leases cited in the audit. (Sept '08)
- MESD opened discussions with a vendor to terminate a multi-year contract cited twice in the audit. (Sept '08)
- MESD opened discussions with two contactors to correct over payments cited in the audit. (Sept '08)

ACTION ITEMS—NEXT STEPS

- (1) MESD will assign specific, all-inclusive responsibilities by contract category. Individual MESD departments will oversee small contracts (less than \$5,000) for goods and services. Business Services will oversee intermediate contracts (between \$5,000 and \$150,000) for goods and services. Human Resources will oversee employment and personal services contracts. Administration will oversee leases, intergovernmental agreements and sole source contracts. Legal Services will oversee policies, templates (for legal format) and final approval of all contracts. The target date for formalizing assignments and organization is November 25, 2008, directed by Administration.

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- (2) MESD will create or update all applicable policies and procedures to ensure compliance with Oregon statutes for public contracting. The target date for completing the review and adoption process is December 22, 2008, directed by Legal Services.
 - (3) MESD will assign a single “Contract Manager” to centralize accountability for overseeing policy implementation, staff training and monitoring compliance. The contract manager will conduct regular process reviews and documentation audits. The contract manager will review all multi-year contracts, identify unsupported payments or overcharges outside the scope of the Secretary of State’s audit, clarify terms and conditions which led to errors and seek reimbursement. The target date to assign and develop the role of the contact manager is January 20, 2009, directed by Administration. The target date for contract reviews is March 31, 2009, directed by Contract Manager.
 - (4) MESD will realign the work flow for the contracting process and reduce the number of staff involved. Staff within the work flow will be trained to implement and adhere to internal controls called for by policy or procedure. The target date for completion of realignment and training is February 27, 2009, directed by Contract Manager.
 - (5) MESD will integrate systems. Contract tracking, accounting and filing systems will be connected to provide appropriate access to staff in the work flow. Files will be coded to ensure compliance with retention and billing requirements. The target date for completing systems integration is February 27, 2009, directed by Technology Services.

ACTION ITEMS—CONTRACT PROVISIONS

Based on the audit recommendations, MESD agrees that the following provisions should be addressed in agency contracting policies and included in agency contracts.

- Scope of work
- Performance requirements
- Penalties for non-performance
- Deliverable requirements
- Timelines and deadlines
- Payment schedule
- Provisions for termination
- Provision for reimbursement
- Insurance requirements
- Dated signatures
- Legal review

OVERVIEW—RESPONSIBILITIES, CONTRACT TYPES, REQUIRED ELEMENTS

The chart on the next page portrays the basic elements of the improved MESD contracting process. The chart incorporates elements of the audit recommendations and MESD responses.

CONTRACT TYPE → from most frequently used to least frequently used

Responsibility	Required Elements	Goods/Services, short term/small	Personal Services	Goods/Services, long term/intermediate	Intergovernmental Agreements	Leases	Sole Source Provider
By type	Oversight	Departments	HR	Business	Admin.	Admin.	Admin.
By policy	\$ Limits	Less than \$5000	Up to \$150 K	Over \$5000	Up to policy limit	By policy	By policy
By policy	Time Limits	Less than 1 year	Up to 3 years	Over 1 year	Up to policy limit	By policy	By policy
Legal	Policy	√	√	√	√	√	√
Legal	Template	na	√	√	√	√	√
Contract Mgr	Initiation	na	√	√	√	√	√
Department	Notice	na	Post Opening	Competitive Bid	Mutual Agreement	Negotiation	
Department	Screening	na	competitive	Competitive	na	na	na
Department	Interviews	na	competitive	Competitive	na	√	√
Department	Selection	na	competitive	competitive	na	√	√
Legal	Final Approval	na	√	√	√	√	√
Department	Signatures	√	√	√	√	√	√
Department	Services Flow	Goods/services flow or occupancy only after all steps above this level and all elements are in place					
Department	Administration	√	√	√	√	√	√
Business	Payments	√	√	√	√	√	√
Contract Mgr	Monitoring	√	√	√	√	√	√
Axxerion	Tracking	na	√	√	√	√	√
Technology	Retention	na	√	√	√	√	√



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Public Interest and Improve
Oregon Government**

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Courtesies and cooperation extended by officials and staff of the Multnomah Education Service District were commendable and much appreciated.

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

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