

Office of the Secretary of State

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August 16, 2012

Dave Novotney, Ph.D., Interim Superintendent
Willamette Education Service District
2611 Pringle Road SE
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Dear Dr. Novotney:

We have completed a review of selected areas of the Willamette Education Service District's (WESD) project management activities, specifically processes and internal controls managed by the Project Solutions Group (PSG). The purpose of our work was to assess whether findings we identified in previous audits at WESD extended to the project management area.¹

During our review, we examined selected PSG financial documents, contracts, school district billings, and travel reimbursement claims. We interviewed WESD management and staff, WESD Board members, and school district management and personnel. Because this was not a formal audit, we were not required to follow generally accepted governmental auditing standards. Nonetheless, we applied due professional care in conducting our work and preparing this letter.

Background

In 2002, WESD launched the PSG to offer construction project management services to school districts throughout Oregon. PSG offers a "concept to completion" array of services from pre-bond phase to construction close-out. In addition, PSG offers services to school districts for energy efficiency improvements funded with public purpose monies collected from electric companies. From 2008 through February 2012, PSG entered into 111 contracts with school districts for projects ranging from lighting retrofits to building a new elementary school in Eagle Point, Oregon.

Senate Bill 1149, passed during the 1999 Regular Session, requires specified electric companies to distribute energy surcharge funds to Education Service Districts in their service areas. Education Service Districts then distribute the funds to school districts that have eligible schools serviced by those electric companies. The 2011 Legislative Assembly passed House Bill 2960, which provided additional financing options for energy efficiency improvements in schools throughout the state. The bill also directed electric companies to remit Senate Bill 1149

¹ Report No. 2010-11, *Oregon Department of Education: Willamette Education Service District Needs To Be Accountable*

Report No. 2011-07, *Willamette Education Service District: Recommendations Follow-Up*

energy surcharge funds directly to eligible school districts instead of the Education Service Districts.

Results

Our interviews with school district personnel generally indicated a high regard for the services the PSG provides to school districts. Furthermore, PSG did not appear to exhibit most of the problems we identified in previous audits conducted at WESD. The issues we identified during this work were in the areas of communication with the Board regarding the financial position of PSG, maintaining adequate documentation, and documenting and maintaining a record of approvals and transactions. We also identified additional areas that warrant the attention of PSG and WESD management.

Improve Monitoring of PSG's Financial Status and Increase Communications with the Board

Financial information used for setting or varying the course of a program area needs to be accurate and complete. WESD management uses a monthly financial tracking spreadsheet to monitor the fiscal condition of PSG. However, we found that some of the information contained in the spreadsheet and its design did not allow for an accurate portrayal of PSG's fiscal condition. For example, while the spreadsheet reflected a negative position for the 2012 fiscal year, the magnitude of the negative position was not accurate. Therefore, the spreadsheet did not appear to be an accurate tool for management to rely upon for making strategic financial decisions related to the PSG.

Related to the negative position of the PSG, our interviews with some WESD Board members indicated that the PSG should be self-supporting, and that the Board members would want to know PSG's true fiscal condition. WESD management indicated that the Board had been alerted to a declining financial position during the 2012 fiscal year, but, at the time of our review, the Board had not been informed of PSG's negative position. WESD management indicated it was waiting until the end of the fiscal year to see if PSG's financial position improved. WESD's General Fund likely covered some of PGS' expenses during the months it experienced negative cash balances.

We recommend PSG and WESD management ensure that financial tracking mechanisms provide accurate information in order to make timely and informed strategic decisions. We further recommend that the WESD Board be informed timely and accurately of the PSG's fiscal condition.

Improve Contracting Processes

The PSG uses contracts as well as intergovernmental agreements to define the statement of work, terms and conditions, and consideration for project management, construction management, constructability and building commissioning services. Best practices recommend contracts be fully executed (signed by all parties) and changes to the statement of work, terms and conditions, and consideration be documented in fully executed amendments. Furthermore, contract administration files should contain a full copy of the contract and amendments to document the services provided and the resulting financial transactions. This documentation should be readily available for examination.

Without complete documentation of the scope of work and terms and conditions signed by both parties, the PSG cannot fully support the services and the resulting financial transactions, and there is a risk that the parties involved may disagree on the scope, terms and conditions.

Our review of the PSG's contracting processes identified several areas where improvements could be made:

- PSG did not always have copies of fully executed contracts. We reviewed 111 contracts for projects that occurred from January 2008 through February 2012. Nine of those contracts (8%) were not signed by the school district or by WESD's superintendent, and therefore lacked documentation that all parties agreed to and accepted the contract terms.
- Contract amendments addressing scope and consideration changes were not always prepared. For example, we reviewed 18 school district billings to six different school districts from January 2008 through February 2012, and identified seven instances in which the billings extended beyond the contract end date. We also noted one instance in which out-of-scope services were indicated on supporting documentation, but were not specifically identified as out-of-scope on the invoice billed to the school district. PSG did not have evidence that contract amendments had been prepared for any of these contract changes. In addition, we compared contract amounts to total billed amounts for 16 projects and found that seven projects exceeded the total contracted amount. Amendments were not prepared for these contracts.
- Small scope and short timeline projects were not always established in contracts or written agreements. During our review of projects and associated contracts, we observed that there was not a contract available for 33 of the 148 projects we reviewed, or about 22%. These were all denoted as time and materials (T&M) projects. According to PSG management, these T&M projects were usually initiated while PSG was working on another project for a school district and the school district requested PSG do some other small task. The PSG did not consider obtaining any written documentation as to the scope and consideration because the projects were so small, ranging from approximately \$300 to \$16,000.
- Documentation of contracts was not always available for our review. For example, we identified four projects (a little less than 3%) for which no contract was available. In addition, 10 contracts (9%) were missing the scope of services portion of the contract. PSG attributed the missing contracts to three causes: a stolen laptop, departure of project managers, and misplaced or misfiled documentation.

We recommend PSG management ensure that the scope and terms of projects are in writing, contracts are fully executed, and adequate documentation is retained.

More Careful Review Could Improve the Accuracy of School District Billings

PSG staff incur expenses while providing project and construction management services to school districts. These expenses include time and materials as well as travel. Staff enter these expenses into a database that provides information for billings to school districts. PSG's contracts stipulate that the school districts be billed for actual costs, and the contracts typically include staff billing rates.

We found PSG's billings to school districts had some inaccuracies, but by improving review procedures, management could help ensure errors remain minimal. Below are examples of concerns we identified.

- Expenses are entered into PSG's database prior to payment or reimbursement of those expenses. We observed five instances in which the amount in the database differed from what was actually paid. We also noted that there is no mechanism for adjustments to be made to the database to ensure a school district is billed only for actual costs.
- We observed six instances from 18 billings we reviewed in which the supporting documentation was different from the amount billed.
- We identified six instances when the value of staff time billed was not in accordance with contract terms. We believe this resulted from billing templates not having been updated to reflect the project's specific bill rates and classifications as stated in the contract.

In addition, although PSG did not have written procedures, its practice was to bill school districts for project management services only after supervisory review and approval of invoices. However, our review of 18 school district billings identified nine instances in which invoices did not have evidence of supervisory review. PSG management indicated this lack of review could have been an oversight or verbal approval may have been provided. Without documented supervisory review, there is less assurance that school district billings are accurate and approved for payment or issuance.

We recommend PSG management ensure that actual expenses and accurate staff rates are billed to school districts, supporting documentation is maintained to substantiate amounts billed, and invoices are properly reviewed prior to billing. We further recommend PSG develop written procedures for the billing process to help improve accuracy.

Travel Reimbursement Is Generally Well Controlled

Our review of PSG's travel reimbursement claims found controls over the process were generally working as designed. Reimbursement rates were in compliance with rates established in policy. In addition, documentation required by policy to support travel transactions was submitted by staff and retained by management. WESD travel policy requires two signatures on the reimbursement request: the staff member requesting the reimbursement and the supervisor approving the reimbursement. Our review found that PSG consistently adhered to this policy. However, we noted one area of risk that should be addressed. Specifically, on two occasions, a staff member was reimbursed twice for the same travel period. While the travel was authorized in accordance with WESD Board policy, WESD's processes were not effective for detecting these duplicate payments. WESD management indicated the transactions were not entered into the accounting system in such a way that they could be easily detected.

We recommend PSG and WESD management be alert for duplicate payments during the review process and consider whether modifications should be made to the process for detecting duplicate payments.

Dave Novotney, Ph.D., Interim Superintendent
Willamette Education District
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We appreciate your staff's assistance and cooperation during this review. Should you have any questions, please contact Melaney Scott or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION


V. Dale Bond, CPA, CISA, CFE
Audit Manager

VDB:MAS:nmj

cc: Ken Hector, Chair, WESD Board

Willamette

EDUCATION SERVICE DISTRICT

Dave Novotney, Ph.D.
Acting Superintendent

August 20, 2012

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

Dear Director Blackmer:

We have reviewed the management letter from the Secretary of State's Audits Division concerning Willamette Education Service District and specifically our Project Solutions Group (PSG). We accept the report and pledge to continue our agency's dedication and commitment to address each recommendation.

We concur with your audit team's determination that, based on their findings, a formal audit of PSG's processes and internal controls was not necessary. Their review, including identified areas of risk and recommendations for further improvement, are important contributions to our agency goal of continuous improvement. Further, we are pleased that your review documented that our services are held in high regard by Oregon school districts. We have already implemented some of your suggestions and will present a detailed action plan to address each recommendation you presented to our Board of Directors at their September 4, 2012 meeting.

Project Solutions Group is a unique program in Oregon's education community. This group of dedicated professionals provides a tremendously important service to school districts. We take great pride in the experience, expertise and advocacy provided by PSG. We particularly value your assistance in identifying potential improvements and moving us toward best practices in the operation of this important program.

Your review team has been very professional. Thank you for your support and assistance in improving WESD. If you have questions or comments, please feel free to contact us.

Our specific response to individual findings and recommendations follows this letter.

Sincerely,



Dave Novotney, Ph.D.
Superintendent
Willamette Education Service District



Ken Hector
Chair, Board of Directors
Willamette Education Service District

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Willamette Education Service District

Response to Secretary of State: Management Letter Recommendations

August 20, 2012

Willamette Education Service District (WESD) is pleased to accept the findings and recommendations contained in the management letter dated August 16, 2012. The work of the Secretary of State's team is another important step in our agency's continuous improvement process. We are a better agency because of the involvement of the Secretary of State's Audit Division. We address your recommendations in the following text.

Improve Monitoring of PSG's Financial Status and Increase Communications with Board

WESD has greatly improved our internal controls and fiscal practices during the last three years. We are committed to sound financial management of our programs, and have established clear expectations that each program operates in a cost recovery manner. Please note that Project Solutions Group finished the 2011-12 fiscal year with a fund reserve of approximately \$20,000.

Because of the nature of the Project Solutions Group (PSG) business model we believe tracking and communication relating to its financial status is extremely important. Unlike most programs operated by WESD, their revenue varies as contracts with school districts are secured for various projects.

We concur with the recommendation and have improved the monthly fiscal status reports provided to PSG from our Pentamation financial system. Further, the summary document for the director of PSG has been modified to improve the accuracy and timeliness of key financial data used by management to track the program's ongoing financial status.

We also concur with the importance of timely and regular reporting to our Board of Directors relating to PSG's fiscal health. While our overall financial status is reported to the Board each month, we have implemented a quarterly report to the Board that will provide financial status information specific to PSG.

Improve Contracting Processes

To address budget constraints impacting WESD and every Oregon school district, and to assure operation in cost recovery, PSG has implemented reductions in its work force that impact support function for the project managers. We understand, however, that this does not excuse oversights in the operation of the business function. WESD concurs completely with the recommendations relating to contract execution and tracking. We will improve our attention to this part of the business process with the goal of best practice in our operation.

WESD has implemented additional oversight and tracking of PSG contracts by our Business Services Department. Further, training for PSG staff will be implemented in September of 2012 to reinforce expectations relating to contract protocols and requirements. Our goal with these actions will be 100% compliance with the following tenets:

- Contracts with school districts will be fully executed before work begins.
- All changes in scope of work or additional activities will be documented and fully executed by contract amendment.
- Contract end dates and fiscal constraints will be monitored so that amendments can be implemented should project work conditions require additional time or fund allocation.
- Complete documentation of all contracts held by PSG will be maintained and readily available.

More Careful Review Could Improve the Accuracy of School District Billings

We are pleased that the Secretary of State described our billing errors as “minimal”. We believe that accuracy is critical, and agree with the recommendation to continue diligence in this important part of our process.

WESD will work to ensure that protocols continue to be followed and billings receive supervisory review and approval prior to submission to school districts. PSG will work with our Business Services Department to develop written procedures for the billing process that will be presented to the WESD Board of Directors at the September 4, 2012 meeting.

Travel Reimbursement is Generally Well Controlled

Project managers working in PSG must travel frequently to provide the important on-site presence for the projects with which they are involved. We are pleased that our processes were judged “well controlled” and will strive to maintain that level of accuracy and compliance with policy. The anomaly identified where a staff was incorrectly paid twice for one period has been corrected. The transactions in question were repaid, and we have implemented a unique invoice number assigned to each travel voucher, preventing inadvertent double payment.

Summary

We thank the Secretary of State team for their thorough and thoughtful work. Their observations and recommendations will be taken seriously and WESD will work toward full implementation. We will provide a full report of our activity in addressing these recommendations in the public forum of our September 4, 2012 WESD Board meeting. Our progress will be communicated to the Secretary of State, our education partners, WESD staff and the public.