Special Review of Mid Central Educational Cooperative

May 19, 2017

State of South Dakota
Department of Legislative Audit
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Pierre, SD 57501-5070

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MARTIN L. GUINDON, CPA
AUDITOR GENERAL

Honorable Members of the Government Operations and Audit Committee

and

The Honorable Dennis Daugaard,
Governor of South Dakota

and

Members of the Governing Board of the Mid Central Educational Cooperative

We herewith submit our report on the results of work we conducted related to funds that were passed through the State of South Dakota Department of Education (SDDOE) and expended by Mid Central Educational Cooperative (MCEC) and the American Indian Institute for Innovation (AIII). The work we performed resulting in this report builds upon audits of the Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) done as part of the State of South Dakota Single Audits for fiscal years 2014 and 2015 and a Single Audit that we conducted of MCEC for fiscal year 2015.

We wish to thank the personnel of the SDDOE, the Governing Board and personnel of MCEC, and the Board of AIII for being very cooperative and for providing assistance as we conducted this engagement.

Background

GEAR UP is a federal program designed to help low-income students obtain a secondary school diploma and succeed in postsecondary education. The program is funded with federal money that is matched with local money or in-kind match on a dollar for dollar basis. The SDDOE partnered with MCEC and the AIII to carry out this program.

During our planning for the fiscal year 2014 Single Audit for the State of South Dakota, we identified the GEAR UP program as a high risk program and it was selected for audit for that fiscal year. We identified deficiencies in internal controls and noncompliance related to the GEAR UP program during that audit and related written audit findings can be found in Appendix A of this report.

Because our fiscal year 2014 audit of GEAR UP contained written audit findings, we were required to follow-up on those audit findings during the State's fiscal year 2015 Single Audit and we selected the program for audit again during that audit. We again identified deficiencies in internal controls and noncompliance related to the GEAR UP program during that audit and related written audit findings can be found in Appendix B of this report.

GEAR UP federal funding was passed through the SDDOE to MCEC on a reimbursement basis. That is, MCEC made expenditures it believed were allowable under the GEAR UP program and submitted invoices and other documentation to the SDDOE for payment. Thus, during our audits of the GEAR UP program at the State level, we requested various documents from and asked questions of the finance staff at MCEC. As we were finishing our quality control process and clearing audit findings for the State's Single Audit for FY2015, the tragedy occurred at the Westerhuis property. The Division of Criminal Investigation (DCI) conducted an investigation of the fire and financial matters relating to MCEC and Scott and Nicole Westerhuis. Our audit working papers for the State's Single Audits for FY2014 and FY2015 were subpoenaed and we cooperated with the DCI in its investigation as requested.

Because of concerns raised during our audits of the GEAR UP program and the tragedy at the Westerhuis property, we believed it was necessary to conduct additional audit work at MCEC and AIII using authority granted the Department of Legislative Audit under SDCL 4-11-4 and 4-11-2.1. Consequently, we began conducting our work for this report. While we were conducting this work, the Governing Board of MCEC asked us to conduct the Single Audit of MCEC for FY2015 and we engaged with MCEC to perform that audit as well. Thus, we have written audit findings regarding these matters that are contained in the State's Single Audit reports for FY2014 and FY2015, the Single Audit of MCEC for FY2015 and in this report.

Report Contents

This report begins with a summary of our findings and conclusions. Following the summary are specific sections of the report containing more detailed findings, analysis and recommendations for the matters described in the report summary. The response of the Mid Central Educational Cooperative is included at the end of the report.

Sincerely,

Martin L. Guindon, CPA
Auditor General

May 19, 2017

EXECUTIVE SUMMARY

Background

Educational cooperatives are organizations created to provide services to their member school districts. Some are single function providing special educational services while others administer additional grants, programs and contracts for other school districts, the State or directly in cooperation with third parties including the federal government. The smallest of the cooperatives has less than $500,000 of expenditures and the largest has annual expenditures of over $26 million.

The South Dakota Department of Education (SDDOE) has grant agreements and contracts with the cooperatives to administer programs and provide services. These grants and contracts can involve both State and federal funds.

What we did

Our Single Audits of the State of South Dakota for fiscal years 2014 and 2015 included auditing the Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) federal grant program which was a program administered by the SDDOE, the Mid Central Educational Cooperative (MCEC) and the nonprofit organization American Indian Institute for Innovation (AIII). Those audits contained several written audit findings related to the administration of the GEAR UP program. While those audit findings primarily concerned administration and oversight of the GEAR UP program at the State level, they also raised concerns about MCEC's and AIII's administration and oversight of the GEAR UP program. Thus, using the Department of Legislative Audit's statutory authority we followed GEAR UP money from the State to MCEC and to the extent possible to AIII. Because of risks we identified following the GEAR UP money, we also reviewed MCEC's handling of other State and federal money.

Our work for this report involved reviewing selected MCEC financial records from January 2007 through September 2015. We did not conduct financial audits of each of these periods or specifically audit all of the various State, local and federal programs administered by MCEC during this period. Rather, based on risks that we observed, we selectively reviewed MCEC financial records related to certain programs. As we deemed necessary and to the extent possible, we also reviewed AIII's financial records related to the expenditure of State and federal funds received from MCEC.

Our review did not involve determining whether crimes were committed as that is the responsibility of law enforcement agencies. Additionally, our review did not involve evaluating whether State and federal programs administered by MCEC were effective in achieving expected results and outcomes. The objective of our review was to determine whether funds received by MCEC had been adequately accounted for and expenditures of those funds were properly supported by documentation.

A summary of our findings from this review follows. Specific findings with additional details on what we found and our related recommendations follow this summary.

What we found

Inadequate oversight of related parties and conflicts of interest

MCEC began with a primary function of providing special education services to its member school districts. MCEC is governed by a decision making board made up of a school board member from each of its member schools that is supported by an advisory board made up of the superintendent for each of its member schools. As required by state law, MCEC must follow the laws and rules that apply to South Dakota school districts.

Over the years, MCEC began administering additional federal grant programs both as a subrecipient of the State of South Dakota and as a direct recipient on its own behalf. MCEC also began providing services on a contractual basis for other organizations and individuals. Some of these programs and activities had little to do with the member districts of MCEC. As we were told by MCEC Governing Board members, it was explained to them as "money in, money out".

To administer some of these programs, MCEC partnered or contracted with the nonprofit organizations AIII, Oceti Sakowin Education Consortium (OSEC) and the Oceti Sakowin Distance Education Consortium Incorporated (OSDEC). Corporate filings with the South Dakota Secretary of State, publicly available IRS Forms 990 and other documents show that MCEC employees were also employees and officers of these nonprofit organizations at various times during the period of our review. We found no evidence the risks created by these relationships were addressed by MCEC's Director or Governing Board and consequently oversight of the financial activity between MCEC and these organizations was inadequate. Of the MCEC Governing Board members that we interviewed, there were two whose tenure covered MCEC's initiation of business dealings with these related parties. Both told us they did not believe that MCEC's management had adequately informed them of the related party organizations and associated risks. In addition, the nature of these relationships and related transactions were not disclosed in MCEC's annual financial statements.

Additional details regarding MCEC, these related parties and the lack of oversight of these parties can be found in the finding beginning on page 8.

Unauthorized withdrawals from MCEC's bank account

We found that during the period January 2007 through September 2015 unauthorized withdrawals totaling $7,837,967 were made from MCEC's bank account for the payrolls of three nonprofit organizations for which Scott and Nicole Westerhuis managed finances. These withdrawals were accomplished by directly connecting the nonprofit organizations' computerized payroll accounting software to MCEC's bank account. While much of the money was subsequently sporadically deposited back into MCEC's bank account during this period, $1,388,630 remained missing at September 30, 2015. We proposed adjustments to reflect this loss in the audited financial statements of MCEC for fiscal year 2015. This matter is discussed beginning on page 16.

Findings related to the GEAR UP grant program

MCEC failed to correctly identify the nature of its relationship with AIII for administration of the GEAR UP program. Had MCEC correctly identified the relationship with AIII as a subrecipient, MCEC would have been required to monitor AIII's compliance with certain federal regulations, including the requirement to obtain annual financial and compliance audits in accordance with the Federal Single Audit Act.

Federal regulations require that 50 percent of GEAR UP program costs come from cash or in-kind match from non-federal sources. For the federal fiscal years 2013 and 2014, MCEC reported $4 million in matching funds associated with software provided by Microsoft. We were unable to find evidence that the software was used in carrying out the GEAR UP program and identified the $4 million as unsupported costs.

We also identified $65,000 in costs for payroll charges to the GEAR UP grant that were not adequately supported.

Our findings related to the GEAR UP grant begin on page 18.

Findings related to the Teacher Quality grant program

The Teacher Quality grant program was a direct grant to MCEC from the federal government. MCEC partnered with other organizations to carry out the program. However, we found that in some cases written agreements or contracts between these parties were never created and for the agreements that did exist, they were not approved by MCEC's Governing Board.

We reviewed vouchers and supporting invoices for this program and found that the documentation supporting the expenditures was inadequate. As a result, there were unsupported costs of $1,341,409 related to this program.

Our finding related to the Teacher Quality program begins on page 28.

Findings related to the Wakan Gli grant program

Like the Teacher Quality grant, the Wakan Gli grant program was a direct grant to MCEC from the federal government. MCEC partnered with AIII to serve as the administrative organization for the program. We found no evidence that contracts or partnership agreements were ever established between MCEC and AIII for these services. Similarly, we found no evidence of contracts between MCEC and BC Kuhn Evaluation, LLC that was compensated as the program's external evaluator. Also, MCEC's Governing Board minutes did not contain any indication of approval of the agreements or contracts between these parties.

As we found with the Teacher Quality grant, some expenditures charged to the Wakan Gli grant were not supported by adequate documentation and consequently there were unsupported costs of $221,271 related to the program.

Our finding related to the Wakan Gli grant begins on page 30.

Indirect costs issue affecting all programs

We found that information reported to the U.S. Department of Education in MCEC's indirect cost rate agreement was inaccurate. Specifically, we found that MCEC overstated its administrative salaries and benefits costs for certain individuals.

Our finding related to indirect costs begins on page 32.

Conclusions

Inadequate oversight of related parties and conflicts of interest

During the period of our review, Scott and Nicole Westerhuis were the business officials for MCEC, AIII, OSEC and OSDEC. Also, during the entire period that MCEC was involved in administering the GEAR UP, Teacher Quality and Wakan Gli grants, Stacy Phelps was an employee of MCEC and also served as AIII's Chief Executive Officer. As previously noted, we believe AIII was a subrecipient of federal funds passed through MCEC and as such had responsibilities under federal regulations for administering these funds.

Neither the Director of MCEC nor the Governing Board identified the risks presented by these conflicts of interest and thus failed to provide adequate oversight of the financial affairs of MCEC as it related to money passed through to AIII, OSEC and OSDEC. Similarly, in our review of AIII records related to the GEAR UP, Teacher Quality and Wakan Gli grants, we did not find evidence that AIII's governing board or its Chief Executive Officer Stacy Phelps provided adequate financial oversight of these grants.

Inadequate financial oversight allowed Scott and Nicole Westerhuis to conduct the financial affairs of these organizations in an environment which lacked proper financial controls and accountability. As a result, MCEC suffered significant financial loss and unsupported expenditures for federal programs it was responsible for administering.

Degradation of documentation

Symptomatic of the lack of financial controls in this environment is something we characterize as a degradation of documentation. That is the existence and adequacy of documentation to support expenditures degraded as the potential for oversight by a third party became less likely.

Although concerns regarding the GEAR UP program led to our conducting this review, the supporting documentation for expenditures of this program was better than for the Teacher Quality and Wakan Gli grant programs. We believe this is because the SDDOE as prime recipient of the funds was providing some oversight and requiring documentation to support GEAR UP program expenditures. We have reported separately on deficiencies in SDDOE's oversight in the Single Audit reports for the State of South Dakota for 2014 and 2015. (See Appendices A and B)

The Teacher Quality and Wakan Gli programs as direct grants to MCEC did not have a pass-through entity overseeing the administration of the programs and as stated previously the MCEC Governing Board was told it was "money in, money out". Consequently, we found weaker documentation available to support expenditures from these programs. This weaker documentation existed primarily for expenditures of these programs made through AIII, OSEC and OSDEC.

Finally, when we looked at records related to these programs at AIII we found even weaker accounting records and supporting documentation for program expenditures. We also found no evidence that AIII ever had audited financial statements.

Other programs and activities at MCEC

As previously stated, this review focused on the programs for which we found the highest risk and we have reported our findings on those programs. We did not find similar risk in other programs and activities conducted by MCEC and so we did not specifically review records related to those programs. We believe the risk was lower for these programs because they affected and involved the member schools of MCEC and consequently MCEC Governing Board oversight of these programs and MCEC's policies and procedures were more effective.

Other recommendations

Organizations must review policies and procedures related to their banking and payment systems. Electronic banking and payment systems present new risks and policies and procedures must be adapted to address those risks.

Governing boards and management of organizations must place a certain level of trust in the people that are employed to administer and provide financial accountability for their organizations. However, this trust cannot be absolute. Governing boards and management must provide oversight of and require effective performance and financial reporting for all of an organization's programs and activities. Such accountability does not indicate a lack of trust, but rather protects governing boards, management and employees from the consequences of those who violate the trust that has been placed in them.

Inadequate Oversight of Financial Activities

Finding:

The Mid Central Educational Cooperative (MCEC) Governing Board and Director did not provide adequate oversight of the financial activity of the cooperative.

Analysis:

Background Information

MCEC is an educational service cooperative with fourteen member school districts that was organized to provide services for the member schools. MCEC's primary function is to assist member schools in providing a less restrictive educational environment for special needs children as well as working with the school districts to help serve the needs of all children grades K-12.

MCEC has a governing board which is made up of a school board member from each of the member school districts. The powers delegated to members of the Governing Board shall be the same as for any individual serving on a member's school board and therefore it is understood that the powers delegated to a school board by the state are delegated to the Governing Board as a whole. No authority is granted to board members acting as individuals.

The Director of MCEC is the chief executive officer of the Governing Board and is responsible for the administrative and advisory functions of the Governing Board. Planning, policy making and evaluation are the functions of the Governing Board. According to MCEC policy, the Director is responsible for the administration of its policies, the execution of Governing Board decisions, the operation of internal machinery designed to service MCEC programs and for keeping the Governing Board informed about the operations and problems of the cooperative.

Over the past several years, MCEC expanded the services that it was providing and the federal grant programs that it was administering to include programs that were not directly related to the member districts and were not overseen by the SDDOE. However, we found no evidence that MCEC's Governing Board or Director assessed the risks associated with providing those new services and programs and consequently did not adapt policies and procedures to address those risks. Of the MCEC Governing Board members that we interviewed, there were two whose tenure covered MCEC's expansion of services and programs. Both told us they did not believe that MCEC's management had adequately informed them of the risks associated with providing the new services and programs. The following failures in oversight of MCEC programs occurred.

Failure to Identify Related Parties and Conflicts of Interest

The MCEC Policy Manual states:

> Employees of the Board will not engage in nor have a financial interest, directly or indirectly, in any activity that conflicts (or raises a reasonable question of conflict) with their duties and responsibilities in the Mid Central Educational Cooperative system.

> Employees will not engage in work of any type where information concerning customer, client, or employer originates from any information available to them through Mid Central Educational Cooperative sources.

Although this policy prohibits financial interests that would conflict with employees' responsibilities to MCEC, we found no procedures that required employees to identify and report outside employment or other financial interests to the Governing Board or Director. We also did not find any procedures for assessing the risk of doing business with potential partners or contractors that were used to carry out MCEC's programs. As discussed in the following paragraphs, MCEC failed to identify related parties and conflicts of interest.

American Indian Institute for Innovation (AIII)

MCEC partnered with AIII to administer the Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) grant as well as the Teacher Quality and Wakan Gli grant programs. At the time that MCEC established the GEAR UP partnership with AIII, Stacy Phelps and Scott Westerhuis were employed by MCEC as the Outreach Coordinator and Business Manager, respectively. In reviewing AIII's IRS Form 990 filed annually for calendar years 2008 through 2014, we found that Stacy Phelps was identified as AIII's Chief Executive Officer (CEO) and Scott Westerhuis was identified as AIII's Chief Financial Officer (CFO). Thus, this partnership created a situation where Scott Westerhuis was the CFO of both MCEC and AIII and Stacy Phelps would be involved in administering MCEC programs for both organizations.

The Superintendent of a MCEC member school district was also an employee of AIII for the fiscal years 2013 through 2016. His compensation was reported in AIII's publicly available IRS Form 990 for 2013 and 2014. The member school district had a contract with AIII for the Superintendent services. As that district's Superintendent, he also served on MCEC's Advisory Board. The Superintendent informed us that MCEC Director Dan Guericke suggested the arrangement with AIII for him to provide superintendent services under contract with the member school district.

All of this Superintendent's compensation costs at AIII were billed to the member school district for his services. The contract between the member school district and AIII for the period July 1, 2014 through June 30, 2016 for superintendent services was signed by a member of the member school district governing board. That district board member has served as a MCEC Governing Board member since fiscal year 2011. Thus, the member school district's representatives on the MCEC Governing Board and Advisory Board should have been aware that the member district had a contractual relationship with AIII and that MCEC had a business relationship with AIII where Scott Westerhuis and Stacy Phelps served as CFO and CEO.

Additionally, we found that the member school district's contracted Superintendent's net paycheck, as an employee of AIII, was actually paid from MCEC's checking account by electronic transfer as discussed in the finding beginning on page 16. The Superintendent told us that he was not aware that his net pay was being paid from MCEC's checking account because all communication he received from AIII regarding his pay indicated that AIII was making payment.

Oceti Sakowin Education Consortium (OSEC) and Oceti Sakowin Distance Education Consortium Incorporated (OSDEC)

MCEC also partnered with OSEC and OSDEC to provide services to participating GEAR UP schools. As reflected in annual reports filed with the Secretary of State's office, IRS Form 990's and/or claims submitted to MCEC for payment, Scott Westerhuis and Nicole Westerhuis were authorized to file or submit business documents on behalf of OSDEC and OSEC, respectively. Some of the documents do not include their titles but just reflect that they were authorized officials while other documents include their titles: Scott Westerhuis was identified as the CFO of OSDEC and Nicole Westerhuis was identified as the Business Manager for OSEC. Nicole Westerhuis also had a full-time employment contract with MCEC in its business office. As a result, Scott Westerhuis and Nicole Westerhuis were involved in the business transactions between MCEC and OSEC/OSDEC.

MCEC Employees Were Compensated from Multiple Organizations

Scott Westerhuis, Nicole Westerhuis and Stacy Phelps were all employees of MCEC and at various times were compensated by the nonprofit organizations (NPOs) identified above. The following table summarizes the compensation these people received:

	Salary Payments by Organization		
Name/Year	**MCEC**	**NPOs**	**TOTAL**
Employee 1			
2009	$ 51,783.32	$ 87,000.00	$ 138,783.32
2010	$ 57,566.64	$ 96,750.00	$ 154,316.64
2011	$ 61,400.00	$ 75,750.00	$ 137,150.00
2012	$ 61,650.00	$ 72,000.00	$ 133,650.00
2013	$ 61,813.50	$ 107,000.00	$ 168,813.50
2014	$ 64,681.54	$ 84,249.50	$ 148,931.04
Employee 2			
2009	$ 14,366.64	$ 87,000.00	$ 101,366.64
2010	$ 56,144.39	$ 96,750.00	$ 152,894.39
2011	$ 53,500.00	$ 75,750.00	$ 129,250.00
2012	$ 53,166.68	$ 57,000.00	$ 110,166.68
2013	$ 57,475.03	$ 96,021.00	$ 153,496.03
2014	$ 61,434.83	$ 91,477.50	$ 152,912.33
Employee 3			
2009	$ 66,225.03	$ 91,450.00	$ 157,675.03
2010	$ 68,250.00	$ 80,000.00	$ 148,250.00
2011	$ 68,750.00	$ 72,000.00	$ 140,750.00
2012	$ 68,250.00	$ 72,000.00	$ 140,250.00
2013	$ 68,250.00	$ 72,000.00	$ 140,250.00
2014	$ 69,615.00	$ 76,200.00	$ 145,815.00

While reviewing payroll records of AIII, we also found three additional MCEC employees that received payments from AIII totaling $118,943.51 that were in addition to the salaries they received from MCEC. These payments were coded in AIII's records as contractual service payments. These contractual service payments started in 2009 and continued through 2014. We found no evidence that any contracts existed for these services or documentation that any work was actually performed for AIII.

We also identified six employees of MCEC whose salaries and benefits were reimbursed by the NPOs. We found no evidence of contracts that explained the nature of the services provided by these MCEC employees.

Failure to Disclose Related Party Transactions

The nature of the employment and operational relationships between MCEC and AIII, OSEC and OSDEC makes them related parties of MCEC. Generally accepted accounting principles (GAAP) require material related party transactions to be disclosed in the notes to the financial statements for governmental organizations such as MCEC. Although MCEC's audited financial statements report that they were prepared in accordance with GAAP, there were no related party transactions reported in any of the financial statements for the period of our review. We believe the amounts were material and should have been disclosed.

Inadequate Oversight of Partner Organizations

Since key employees of MCEC also held positions with partnered entities, significant risks existed that needed to be addressed in the policies and procedures for authorizing and approving transactions between the partner entities. We interviewed MCEC Governing Board members and they indicated that the Board did not have a clear understanding of Stacy Phelps', Scott Westerhuis' and Nicole Westerhuis' responsibilities or their financial involvement with AIII and OSEC. Director Dan Guericke informed us that he believed Scott Westerhuis was a financial advisor or consultant to AIII.

We noted the following deficiencies with regard to overseeing transactions with the partnered entities:

1. Our review of reimbursement claim forms submitted by AIII to MCEC for Teacher Quality grant expenditures found that these forms were signed by Scott Westerhuis as the claimant. MCEC's voucher to support payment by MCEC was also approved by Scott Westerhuis and Director Dan Guericke (see exhibit 1 on pages 14-15 for example). The conflict that existed with Scott Westerhuis as both AIII's claimant and MCEC's approving officer exposed MCEC to potential violation of federal regulations, and an increased risk of fraud, waste, and abuse. Since Director Guericke was approving these vouchers, we believe he should have recognized the risks associated with these transactions and consulted with the Governing Board to develop policies and procedures to mitigate those risks. Further information on these claims can be found in our finding on page 28.

2. One of the MCEC Governing Board's responsibilities is to review and approve monthly receipts and expenditures for its various programs. We interviewed MCEC Governing Board members who indicated that although GEAR UP expenditures appeared in their monthly reports, the Governing Board did not specifically review support for expenditures relating to the GEAR UP program because the GEAR UP program had an advisory oversight council which they were told approved all expenditures relating to the GEAR UP program. Based on our interviews with

South Dakota Department of Education (SDDOE) employees and a member of the advisory oversight council, there was no formal review and approval of GEAR UP expenditures during the advisory oversight council meetings.

3. Director Guericke was responsible for keeping the Governing Board informed about the operations of the cooperative. In addition, State law requires that all contracts and agreements be approved by the Governing Board. We were unable to find Governing Board approval of seventeen contracts and agreements between MCEC and partner organizations that were signed by the Director. In addition, we found contractual service payments made to organizations for which we could find no evidence of there being contracts in place to support these payments. Thus, we believe the Director failed to inform the Governing Board and obtain Governing Board approval for certain operational activities relating to federal programs. The finding on page 18 discusses additional concerns we had with certain agreements between MCEC and AIII.

Lack of Competition in Contracting for Services

MCEC's policy and state law require compliance with South Dakota procurement statutes. Our review of MCEC's files and interviews of Director Guericke revealed no evidence that competition was used in the process of contracting with educational services vendors and consultants. Although many of MCEC's contracts with vendors or consultants were for professional services which are exempt from South Dakota State law requiring competitive bids, we believe additional policies and procedures should have been in place to introduce competition into the procurement of these services to ensure the terms of contracts were fair, reasonable, and not contrary to the public interest.

BC Kuhn Evaluation, LLC was a consulting firm that wrote the original grant applications for the GEAR UP, College Access, and Teacher Quality grants. In the applications, the firm included itself in each of these grants as a partner that would be providing advisory services. In the case of the GEAR UP grant, the firm also provided evaluation services which is a conflict of interest.

We were informed by Director Guericke that BC Kuhn Evaluation, LLC wrote the original grant applications for the GEAR UP, College Access, and Teacher Quality grants for no charge. He stated that it is a customary practice in education for the grant writer to then write themselves into the grant, as a partner, to be compensated for services performed. This was the case for each of these three grants. We believe this type of arrangement introduces risk as it doesn't allow for competition in the procurement of services that are provided by the grant writer.

We reviewed contracts and related payments for services provided by BC Kuhn Evaluation, LLC. We did not conduct procedures to determine whether or not payments for services provided by BC Kuhn Evaluation, LLC were fair and reasonable. However, we did identify the following concerns with regard to payments made to this vendor.

MCEC's accounting records showed that BC Kuhn Evaluation, LLC was paid $294,680 that was coded to the GEAR UP grant from January 6, 2012 through June 3, 2015. There were four contracts between MCEC and BC Kuhn Evaluation, LLC for services to the GEAR UP program during this time period. Three of these contracts specified that BC Kuhn Evaluation, LLC was to assist in the administration of the GEAR UP program. A fourth contract provided that BC Kuhn Evaluation, LLC would perform the formative evaluation of the grant for 2014 even though the firm had been assisting with administration of the

GEAR UP program for the same period. In addition, for three of the four contracts we were unable to find evidence in the MCEC Governing Board minutes that these contracts had been approved by the Governing Board.

MCEC's accounting records showed that BC Kuhn Evaluation, LLC was paid $186,460 that was coded to the College Access grant from November 10, 2011 through June 3, 2015. BC Kuhn Evaluation, LLC contracted with MCEC, from August 14, 2014 through August 13, 2015, to assist in the administration of the College Access program. MCEC agreed to pay $35,000 over the term of this contract and we found evidence in Board meeting minutes that this contract was approved by the Governing Board. We found no other contracts or evidence of MCEC Governing Board approval of contracts to support the remaining $157,294 paid to BC Kuhn Evaluation, LLC for services to the College Access grant program.

MCEC's accounting records showed that BC Kuhn Evaluation, LLC was paid $728,700 that was coded to the Teacher Quality grant from November 6, 2009 through June 3, 2015. We found one subaward agreement in place between MCEC and BC Kuhn Evaluation, LLC for the time period from October 1, 2009 through September 30, 2010. MCEC paid BC Kuhn Evaluation, LLC $118,021 for the period of this subaward. We found no other subawards or contracts with BC Kuhn Evaluation, LLC for the remaining $610,679 that was paid from the Teacher Quality grant. Additionally, we found no evidence in the MCEC Governing Board meeting minutes that the Board had approved any contracts with BC Kuhn Evaluation, LLC relating to the Teacher Quality grant.

Effects of Inadequate Oversight of Related Parties and Conflicts of Interest

MCEC's failure to establish adequate policies and procedures to address the risks associated with related parties and conflicts of interest allowed misappropriation of MCEC funds to continue undetected for several years as discussed in the finding on page 16. In addition we identified significant unsupported expenditures for the GEAR UP, Teacher Quality and Wakan Gli grant programs as discussed in the findings on pages 20-31.

Recommendations:

1. We recommend MCEC review its policies and procedures and revise them to reflect current services provided and the risks associated with providing those services.

2. We recommend MCEC improve its conflict of interest policies and procedures.

3. We recommend MCEC ensure that contracts or agreements be created for all contractual services associated with each program or activity and that these contracts or agreements be approved by the Governing Board.

4. We recommend MCEC introduce competition into the process of contracting for professional services.

South Dakota Partner for Teacher Quality Grant

Reimbursement Claim Form - Due on the 5th of the Month

Partner Name: American Indian Institute for Innovation

Partner Address: PO Box 228
Platte, SD 57369

Reporting Period May 2010

	A	B	C	D	E
	Approved Budget	Previously Claimed Expenditures	Currently Claimed Expenditures	Total Claimed Expenditures	Budget Balance
Salaries	$ 143,000	$ 66,257	$ 37,950.00	$ 104,206.65	$ 38,793.35
Benefits	$ 47,190	$ 21,864.70	$ 12,523.50	$ 34,388.20	$ 12,801.80
Travel	$ 45,216	$ 1,550.80	$ 272.16	$ 1,822.96	$ 43,393.04
Equipment	$ 6,150	$ -	$ -	$ -	$ 6,150.00
Supplies	$ 4,900	$ 1,352.00	$ -	$ 1,352.00	$ 3,548.00
Contractual	$ -	$ -	$ -	$ -	$ -
Other	$ -	$ -	$ -	$ -	$ -
Total Direct Costs	$ 246,456	$ 91,024.15	$ 50,745.66	$ 141,769.81	$ 104,686.19
Indirect Costs	$ 19,716	$ 7,281.93	$ 4,059.65	$ 11,341.58	$ 8,374.90
Total Costs	$ 266,172	$ 98,306.08	$ 54,805.31	$ 153,111.39	$ 113,061.09

I declare and affirm under the penalties of perjury that this claim is in all things true and correct and that costs were incurred during the fiscal year (July 1 through June 30). I further agree to comply with the provisions of the Civil Rights Act of 1964 and regulations issued there under regarding non-discrimination in federally assisted programs.

5/18/10

Signature Date

Voucher and Warrant

Mid Central Cooperative

Claim of: AMERICAN INDIAN INSTITUTE FOR
PO BOX 228
PLATTE SD 57369

Vendor No. AIII
Check No. 4 134702
Check Date 06/16/2010
Paid by Check

Account Number	PO Number	Invoice Number	Description	Invoice Date	Amount
12 2490 000 111 109		6-17-10	TEACHER QUALITY SALARY	06/17/2010	37,950.00
12 2490 000 210 109		6-17-10	TEACHER QUALITY BENEFITS	06/17/2010	12,523.50
12 2490 000 319 109		6-17-10	TEACHER QUALITY INDIRECT	06/17/2010	4,059.65
12 2490 000 334 109		6-17-10	TEACHER QUALITY TRAVEL	06/17/2010	272.16
				Total:	54,805.31

SW

Verification by SCOTT WESTERHUIS
Date: 06/16/2010

Signed ____________________
(SCOTT WESTERHUIS)

Approved by DAN GUERICKE
Date: 06/16/2010

Signed ____________________
(DAN GUERICKE)

Unauthorized Withdrawals from Mid Central Educational Cooperative (MCEC) Checking Account

Finding:

Unauthorized withdrawals totaling $7,837,967 were made from MCEC's checking account from January 2007 through September 2015. While some of the money was returned, as of September 2015, $1,388,630 remained unpaid.

Analysis:

During our review, we found electronic payments made from MCEC's checking account that were not permitted by law or authorized by MCEC's Governing Board or Director. We noted transactions in MCEC's bank statements that were identified as, "electronic dbt Intuit payrolls Quickbooks". Intuit payroll software is a component of Quickbooks accounting software and in this case was used to make withdrawals from MCEC's checking account for other nonprofit organizations' payrolls. MCEC's accounting software vendor is Software Unlimited and MCEC does not use Quickbooks for processing its payroll.

We reviewed MCEC's bank statements from 2007 through 2015 to determine the amount of Quickbook's payrolls withdrawn from MCEC's checking account. We found that payrolls for three nonprofit organizations were being withdrawn from MCEC's checking account. The three nonprofit organizations were: 1) Oceti Sakowin Education Consortium (OSEC), 2) Oceti Sakowin Distance Education Consortium (OSDEC), and 3) American Indian Institute for Innovation (AIII). Scott and Nicole Westerhuis were the business officials for these three organizations for the period we reviewed and would have been responsible for processing the payrolls for these organizations.

There is no authority in state law for MCEC to loan money to or pay the general expenses of nonprofit organizations. We did not find any evidence that either the Director of MCEC or the MCEC Governing Board authorized payroll withdrawals for the three nonprofit organizations. We interviewed the Director of MCEC and he told us that he was not aware that OSEC and AIII payrolls were being withdrawn from MCEC's checking account. We also interviewed MCEC Board members and they informed us that they were not aware that OSEC and AIII payrolls were being withdrawn from MCEC's checking account.

We determined that $4,946,353 of OSEC/OSDEC payrolls were withdrawn from MCEC's checking account from January 2007 through November 2013. We did find periodic payments made back to MCEC from OSEC/OSDEC; however, $619,153 was not returned to MCEC's checking account and we view this as a loss due to misappropriation of MCEC's funds.

We also found that $2,891,614 of AIII payrolls were withdrawn from MCEC's checking account from February 2012 through September 2015. We did find periodic payments made back to MCEC from AIII; however, $769,477 was not returned to MCEC's checking account and we view this as a loss due to misappropriation of MCEC's funds.

The total loss due to misappropriation of MCEC's funds as a result of the unauthorized payroll withdrawals was $1,388,630. We recommended adjustments to MCEC's financial statements to report this amount as a loss.

Recommendation:

1. We recommend MCEC strengthen internal controls over electronic banking transactions and consult legal counsel to determine whether recovery of the misappropriated funds is possible.

Subrecipient Monitoring

Finding:

Mid Central Educational Cooperative (MCEC) did not have adequate internal controls in place to properly identify subaward agreements and monitor subrecipient compliance with federal regulations.

Analysis:

Failure to Identify the American Indian Institute for Innovation (AIII) as a Subrecipient

Federal regulations provide criteria for determining whether an agreement between two parties involving the expenditure of federal funds is a subaward to a subrecipient or a contract for services. In addition, those regulations describe the responsibilities of the pass-through entity when an agreement is determined to be a subaward to a subrecipient. Those responsibilities include monitoring the activities of subrecipients to ensure that the subrecipient is complying with federal laws and regulations when expending federal funds. Federal law requires that subrecipients expending $500,000 or more in federal funds during their fiscal year have an audit conducted in accordance with the requirements of the federal Single Audit Act.

In October 2012, MCEC partnered with the American Indian Institute for Innovation (AIII) to provide services related to the Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) grant. The partnership agreement between MCEC and AIII did not provide for a specific amount of GEAR UP funds that AIII was authorized to expend, but rather incorporated the total budget for the program by reference. According to the agreement, MCEC was to reimburse AIII monthly upon receipt of a detailed reimbursement voucher showing all expenses and AIII was only to be reimbursed for expenses that were allowable under the GEAR UP program and in accordance with the approved budgets.

Using the criteria provided in federal regulations, we determined the partnership agreement between MCEC and AIII was a subaward of GEAR UP funds and not a contract for services. As a subaward, AIII would be considered a subrecipient of the GEAR UP funds. According to AIII's annual IRS form 990 filed for calendar years 2012, 2013, and 2014, the AIII recognized revenue from direct and pass-through federal awards in excess of $500,000 in each of these three years. Thus, we believe AIII should have had a Single Audit for the years 2012, 2013, and 2014. However, we found no evidence that Single Audits of AIII for those periods were performed. Had Single Audits of AIII been completed, the Single Audit reports would have been subject to review and approval by the Auditor General, in accordance with South Dakota Codified Law (SDCL) 4-11-2.1. MCEC had no internal controls in place to ensure that its agreement with AIII was correctly identified as a subaward and that AIII had complied with the Single Audit Act and SDCL 4-11-2.1. We also believe additional subrecipient monitoring should have been performed by MCEC because of the nature of employment relationships that existed for employees and officers of MCEC and AIII. These relationships are discussed in the finding on page 8.

Amended Agreements

During our review we also found amended GEAR UP partnership agreements between MCEC and AIII. The following is a summary of the dates of signature of the original and amended partnership agreements for each Federal fiscal year (FFY):

Date of Original FFY 2014 Agreement	March 7, 2014
Date of Amended FFY 2014 Agreement	April 11, 2014
Date of Original FFY 2015 Agreement	February 26, 2015
Date of Amended FFY 2015 Agreement	April 10, 2015

The amended GEAR UP partnership agreements voided the original agreements and removed language regarding the cooperative relationship between the two parties working the program together using the GEAR UP budget. The amended agreements portray the relationship as a contract for services and provided that expenses would be reimbursed upon approval. If the relationship between MCEC and AIII was a contract for services, payments to AIII pursuant to the contracts would not be considered federal financial assistance in determining whether AIII was required to have audits conducted in accordance with the federal Single Audit Act. However, as previously stated, we believe the substance of the relationship between MCEC and AIII made AIII a subrecipient of GEAR UP funds passed through MCEC.

We found that the amended agreements for FFY 2014 and FFY 2015 were created on the same day which was after FFY 2014 had already ended. In addition, we found no evidence in the MCEC Board minutes that these agreements were presented to and approved by the MCEC Board. The amended contracts were signed by the Director of MCEC, Dan Guericke, and the CEO of AIII, Stacy Phelps, who was also an employee of MCEC.

<u>Recommendation:</u>

1. We recommend MCEC implement internal controls to ensure that subrecipients are correctly identified and that they are appropriately monitored in accordance with federal regulations.

GEAR UP Grant Matching Requirements

Finding:

The Mid Central Educational Cooperative (MCEC) did not comply with the matching requirements of the Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) grant.

Analysis:

Federal regulations require that at least 50 percent of GEAR UP project costs be matched with cash or in-kind contributions from non-federal sources and that matching contributions be verifiable. The regulations also specify that a grantee must make substantial progress toward meeting the matching percentage for each year of the project period.

The South Dakota Department of Education (SDDOE) partnered with MCEC for the administration of the GEAR UP grant. The partnership agreement placed the responsibility for compliance with the GEAR UP matching requirements with MCEC. This responsibility required that MCEC demonstrate how matching contributions benefited the GEAR UP program and that these contributions were properly supported and verifiable.

MCEC reported matching contributions in the form of 500 donated Microsoft DreamSpark Premium software licenses valued at $2 million for each of the federal fiscal years 2013 and 2014, totaling $4 million. We were informed by MCEC that these licenses were used to support middle and high school students that participated in the summer and after school programming components of the GEAR UP program.

We interviewed an official from the South Dakota School of Mines and Technology who was actively involved in the GEAR UP summer program. He informed us that the Microsoft DreamSpark Premium software licenses were not used in the GEAR UP summer program. However, he told us that Microsoft C# programming classes were taught during the summer program using computers and Microsoft software owned by the South Dakota School of Mines and Technology. We also interviewed ten individuals representing 17 of the 33 schools identified in the approved GEAR UP State Application Package and they informed us that none of their schools used the Microsoft DreamSpark Premium software in after school programs. Further, although the Microsoft matching amounts represented approximately one-third of the combined matching and federal funds supporting the GEAR UP program for 2014 and 2015, we found no mention of the Microsoft DreamSpark Premium software licenses in the formative evaluation reports on the GEAR UP program for those years. Finally, we found no other evidence at MCEC to support that the Microsoft DreamSpark Premium software licenses were used in the GEAR UP program. Because we were unable to verify the Microsoft DreamSpark Premium software licenses were used in the GEAR UP program, we considered $4 million to be unsupported match for 2014 and 2015.

MCEC also reported a matching contribution in the form of payroll from a partner school totaling $165,185. The partner school and MCEC arrived at this amount by first determining that GEAR UP served grades six through eight which represented 37% of the eight grades in the school. Total General Fund payroll for all eight grades was then multiplied by 37% resulting in $165,185. There was no documentation to identify what the actual payroll costs were for the grade six through eight teachers or whether any of the activities of those teachers actually supported the GEAR UP program. Thus we considered the $165,185 to be unsupported match.

Recommendation:

1. We recommend MCEC establish internal controls to ensure compliance with federal program matching requirements.

GEAR UP Unsupported Payroll Charges

Finding:

Unsupported salaries and wages were charged to the Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) grant.

Analysis:

We obtained Mid Central Educational Cooperative's (MCEC) employment contracts with Stacy Phelps for periods from September 2008 through October 2015 (see exhibit 2 on pages 24-25 for an example). The contracts identify Mr. Phelps as MCEC's Outreach Coordinator and Native American Technical Advisor. The employment contracts for fiscal years 2014 through 2016 specified that Mr. Phelps would work 185 days each year for MCEC in this capacity. None of the contracts mention the GEAR UP program.

The December 2014 MCEC Board minutes report that Scott Westerhuis informed the Board that MCEC owed the State $214,000 for overcharging indirect costs to the GEAR UP grant. He indicated that MCEC reserves would be used to pay this amount. On March 5, 2015 MCEC wrote a check to the South Dakota Department of Education (SDDOE) for $214,818.08 to pay back the SDDOE and the GEAR UP grant for these overcharges. Fifteen days later on March 20, 2015, MCEC billed the SDDOE $65,000 for GEAR UP summer program services performed by Mr. Phelps, as a MCEC employee.

Partnership agreements, from 2012 through 2015, between MCEC and the American Indian Institute for Innovation (AIII) specified that AIII would administer the six week GEAR UP summer program (see exhibit 3 on pages 26-27 for an example). Thus, billing the SDDOE $65,000 for Mr. Phelps's GEAR UP summer program services as a MCEC employee is inconsistent with the MCEC/AIII partnership agreements. We found no evidence of amendments to either the employment contracts or partnership agreements to support this billing.

We also reviewed MCEC's accounting records for salary expenditures for Mr. Phelps and determined that only $8,446 of his salary was coded to GEAR UP over a three year period. We found nothing in the MCEC payroll records to support the $65,000 payroll charge to GEAR UP for Mr. Phelps. MCEC accounting records show Mr. Phelps's salary was charged to the following federal programs for the period we reviewed:

FFY Ended Sept 30:	General Federal Grants	Teacher Quality	Wakan Gli	GEAR UP	Total
2008	$ 10,833	$	$	$	$ 10,833
2009	66,244				66,244
2010	68,250				68,250
2011	68,750				68,750
2012	31,964	29,404	3,441	3,441	68,250
2013	29,015	32,077	3,754	3,754	68,600
2014	55,738	10,693	1,251	1,251	68,933
2015	72,374				72,374

Based upon the information discussed in the previous paragraphs, we identified $65,000 as unsupported costs.

Recommendation:

1. We recommend MCEC implement internal controls to ensure compliance with federal regulations and ensure federal programs are billed actual payroll costs which are supported by appropriate documentation.

Contract No. EMP2013020

MID-CENTRAL EDUCATIONAL COOPERATIVE

EMPLOYEE'S CONTRACT

THIS CONTRACT, executed in duplicate this 4th day of April 2013, by and between Stacy Phelps, herein referred to as EMPLOYEE, and the **MID-CENTRAL EDUCATIONAL COOPERATIVE** located in the City of Platte, Charles Mix County, South Dakota, herein referred to as MID-CENTRAL.

WITNESSETH:

I, Stacy Phelps, EMPLOYEE, agree to perform the duties as herein specified for the period of time as outlined below.

Period of time: July 1, 2013 through June 30, 2014.

Duties as specified: duties as per Mid-Central Educational Cooperative job description and other duties as specified by the director or governing board of the Mid-Central Educational Cooperative.

It is further agreed that the yearly salary for the period of time specified shall be $68,250.00, to be paid in 12 monthly payments of $5,687.50.00 each. First payment of this contracted salary will be made on July 20, 2013.

EMPLOYEE shall serve as the Outreach Coordinator/Native American Technical Advisor of the Mid-Central Educational Cooperative for 185 days beginning July 1, 2013 through June 30, 2014.

It is agreed that the pay period shall be monthly, with time accruing from the first day of each month to the last day of each month. MID-CENTRAL agrees that the monthly payment shall be made minus withholdings as provided by law, and shall be paid in the form of a school district warrant properly drawn and signed by the business manager and the chairman of the Governing Board, and presented to the EMPLOYEE on or before the 20th of each month for that work period.

It is further agreed that the EMPLOYEE is entitled to fifteen (15) days sick leave, accumulative to fifty-five (55) days, and two days personal leave, non-accumulative, and not deducted from sick leave. EMPLOYEE is entitled to the holidays as per negotiated agreement.

All other Fringe Benefits as per 2012-2013 negotiated agreement.

The employee negotiated agreement will become a part of this contract the same as if set forth in full herein.

First payment of this contracted salary shall be on or before July 20, 2013 with final payment being on or before June 20, 2014.

This agreement shall continue in full force and effect for the term specified herein, unless annulled by mutual consent of the contracting parties, or by operation of the law.

As per SDCL 3-18-8.2, this contract is being issued under the same terms and conditions of the current contract. Contracts will be amended upon completion of the negotiation process.

THIS CONTRACT MUST BE IN THE OFFICE OF THE MID-CENTRAL EDUCATIONAL COOPERATIVE NO LATER THAN April 19th, 2013, TO BECOME VALID AND BINDING ON THE PARTIES.

IN WITNESS THEREOF, the EMPLOYEE signed and Mid-Central has caused this contract to be executed by its officers as provided by law on the day and year indicated above.

EMPLOYEE'S SIGNATURE:	DATE: 4/18/2013
CHAIRMAN: Lloyd Persson	DATE: 5-15-13
BUSINESS MANAGER:	DATE: 5-15-13

Mid-Central Education Cooperative
PO Box 228
Platte, SD 57369

Mid Central Ed Cooperative
612 S. Main Street
PO Box 228
Platte, SD 57369

(Hereinafter referred to as Agency)

American Indian Institute for Innovation
ATTN: Stacy Phelps
PO Box 7564
Rapid City, SD 57709

(Hereinafter referred to as Provider)

The Provider hereby enters into an Agreement for Services with the Agency.

Dates for Services will be October 1, 2013 until September 30, 2014.

I. The Provider:

A. The Provider's Federal Identification Number or Social Security Number is

B. The Provider agrees to provide the services for the SD Gear Up grant as follows:

The Agency and Provider agree to administer the grant expenses cooperatively using the attached budget and scope of work. All expenses will need approval by Agency before being spent. Approved expenses will be reimbursed to the provider according to the approved budget. Only those expenses allowable under OMB A-87 will be reimbursed.

- Administer the 6 week summer program.
- Provide services including Native American community outreach, cultural relations, TV & radio shows.
- Provide Targeted School Services as per budget and scope of work documents.
- Administer Student Honors Program as per budget and scope of work documents.
- Administer Microsoft Programming Program as per budget and scope of work documents.

II. The Agency:

The Agency will reimburse the provider monthly on receipt of a detailed reimbursement voucher showing all expenses. Provider will only be reimbursed for those expenses allowable under the SD Gear Up grant and in accordance with the attached budget. Reimbursements requested by the 5th of the month will be paid by the 20th of the same month.

This contract serves as a binding agreement between the provider and agency and may be cancelled by either party for any reason, with or without cause, upon thirty (30) days written notice. If either party terminates the contract for any reason, Agency agrees to pay funds in accordance with the services listed above but only to the extent in which services have been provided.

The provider agrees to hold harmless and indemnify Agency, its officers, agents, and employees, from and against any and all actions, suits, damages, liability or other proceedings which may arise as a result of performing services hereunder. This section doesn't require provider to be responsible for or defend against claims or damages arising solely from acts or omissions of Agency, its officers or employees.

The provider shall comply with all federal, state, and local laws, regulations, ordinances, guidelines, permits and requirements applicable to providing services pursuant to this agreement, and will be solely responsible for obtaining current information on such requirements.

The provider shall maintain documentation for all work performed under this agreement and shall transfer all said documentation to the agency at the end of the contract.

In the event of a dispute, the parties agree to fully participate, in good faith, in professional mediation in accordance with state laws of South Dakota. The costs of mediation shall be divided equally between the parties.

This contract contains the entire agreement between the parties, and is subject to and will be constructed under the laws of the State of South Dakota.

In witness hereto the parties signify their agreement by signature affixed below:

3-7-14
Agency Signature Date
Mid Central Cooperative
Daniel Guericke, Director
PO Box 228
Platte, SD 57369

3/9/14
American Indian Institute for Innovation Date
Stacy Phelps
PO Box 7564
Rapid City, SD 57709

Teacher Quality Grant

Finding:

Teacher Quality (TQ) grant subaward agreements were not approved by Mid Central Educational Cooperative's (MCEC) Governing Board. TQ grant expenditures were not adequately supported.

Analysis:

The U.S. Department of Education (USDOE) awarded MCEC the TQ grant on September 1, 2010 and MCEC was given yearly allocations which ran through September 30, 2014. The last grant award allocation notification indicated that MCEC had been awarded a total of $5,626,226 over the course of the four-year period. MCEC was the fiscal agent for the TQ grant and thus was responsible for fiscal oversight, drawdowns of federal funds, and providing contracts to all partners. MCEC received federal funds directly from the USDOE for this grant on a reimbursement basis.

MCEC partnered with four entities to help administer the TQ grant: the University of South Dakota (USD), American Indian Institute for Innovation (AIII), Rural Learning Center (RLC) and BC Kuhn Evaluation, LLC. According to the approved federal budget, each grant partner had specific objectives they would meet as well as an approved budget.

Subaward Agreements

We found a total of six subaward agreements between MCEC and its TQ grant partners. Only USD had a subaward agreement in place for each of the years that it provided services. The other three partners had a subaward agreement for only the period from October 1, 2009 through September 30, 2010. Thus, payments were made to AIII, RLC, and BC Kuhn Evaluation, LLC from October 2010 through September 2014 that were not covered by subaward agreements. In addition, we found no evidence in our review of MCEC's Governing Board meeting minutes that the six subaward agreements were ever presented for approval or approved by the Governing Board. State law requires subaward agreements to be approved by the Governing Board.

Inadequately Supported Expenditures

Federal regulations require that grant recipient expenditures be adequately supported by documentation in order for those expenditures to be reimbursed by federal funds.

We reviewed vouchers and supporting invoices for a sample of TQ expenditures totaling $1,839,513. Our review identified that vouchers totaling $1,106,458 (60% of the sample of expenditures reviewed) did not have adequate support. The invoices submitted for payment only included a reimbursement claim form which details the expenses by expense category and includes the following columns: approved budget, previously claimed expenditures, currently claimed expenditures, total claimed expenditures and budget balance (see exhibit 1 for example). There was no additional evidence to support the expenses claimed by each partner.

Our review of MCEC's accounting records also found that five employees charged time directly to the TQ grant from October 2011 through January 2014 totaling $234,951. This consisted of the Business

Manager, Assistant Business Manager, two Administrative Assistants, and an Outreach Coordinator. We found no evidence, in the form of timesheets or effort logs, to support the time charged to the TQ grant.

Over the course of the TQ grant award, AIII billed MCEC $717,369 for the salaries of ten AIII employees. We compared the amount billed for AIII salaries to the AIII accounting system and found only $511,023 was recorded as TQ salaries in AIII's records. Thus, there was no support for $206,346 in AIII salaries billed to MCEC for the TQ grant. Included in this $206,346 were salaries for three employees who were MCEC employees but appear to never have been employees of AIII.

For the $511,023 recorded as TQ salaries in AIII's accounting records, there were no timesheets or effort logs to support the charges to the grant. $199,125 of the $511,023 (39%) was for the AIII salaries of Scott Westerhuis, Nicole Westerhuis and Stacy Phelps who were all also employees of MCEC. We also found that $200,883 of the $511,023 was actually paid from MCEC's checking account using unauthorized electronic transfers as discussed in the finding on page 16. Of note is the fact that the AIII salaries of Scott Westerhuis, Nicole Westerhuis and Stacy Phelps were paid by physical check drawn on AIII's bank account whereas other employees were paid by unauthorized electronic transfers from MCEC's checking account.

Because of the inadequately supported expenditures discussed in the previous paragraphs, we identified $1,341,409 as unsupported costs.

Recommendations:

1. We recommend MCEC develop internal controls to ensure all contracts and grant agreements are approved by the Governing Board.

2. We recommend MCEC develop internal controls to ensure compliance with federal regulations relating to cost principles.

3. We recommend MCEC develop internal controls to properly document employees' time working on federal programs in accordance with federal regulations.

Wakan Gli Grant

Finding:

Supporting documentation for contractual services and payroll charges to the Wakan Gli grant was inadequate. In addition, we found no evidence that Mid Central Educational Cooperative (MCEC) entered into contracts or agreements with the partners or contractor identified in the Wakan Gli grant application.

Analysis:

The U.S. Department of Education (USDOE) awarded MCEC the Wakan Gli grant in 2009 and provided yearly allocations which continued through 2014. In MCEC's Schedule of Expenditures of Federal Awards (SEFA) for 2010 through 2014, MCEC reported Wakan Gli expenditures totaling $936,806. MCEC was the fiscal agent for the Wakan Gli grant and received federal funds directly from the USDOE on a reimbursement basis.

Lack of Contracts and Partnership Agreements

According to the approved grant application, MCEC partnered with the American Indian Institute for Innovation (AIII) to serve as the administrative organization and house the main Wakan Gli office. Over the course of the grant, AIII was paid a total of $146,497 and these payments were recorded in MCEC's accounting records as contractual services payments. We found no evidence that contracts or partnership agreements between MCEC and AIII were ever established for these services. The approved grant application also identified Brinda Kuhn as the contractor to perform the external evaluation of the Wakan Gli program. We found no evidence that a contract between MCEC and Brinda Kuhn was ever prepared for these services. In addition, we found no evidence in our review of MCEC's Governing Board meeting minutes that contracts or partnership agreements were ever approved by the Governing Board for these services. According to MCEC's policies, Scott Westerhuis, as the business official for MCEC and AIII, and Dan Guericke, Director of MCEC, were responsible for ensuring that contracts or partnership agreements were created and approved by the MCEC Board for these services.

Unsupported Expenditures

Federal regulations require that a grant recipient's expenditures be adequately supported and documented before drawing federal funds for reimbursement.

As noted above, contractual service payments were made from MCEC to AIII totaling $146,497. We found no payroll expenses associated with Wakan Gli in AIII's accounting records, thus the billings from AIII that were paid by MCEC were not supported by actual expenses incurred and we considered the $146,497 as unsupported costs. These transactions between MCEC and AIII were not at arm's length. Scott Westerhuis was the business official for both MCEC and AIII. According to MCEC's policies, Scott Westerhuis and Dan Guericke, Director of MCEC were responsible for ensuring adequate supporting documentation existed prior to making payments to AIII.

The MCEC Wakan Gli original grant application identified Stacy Phelps as the program's intended principal investigator and MCEC requested $80,000 for the position. The USDOE denied the principal investigator position in the Wakan Gli grant award document. However, MCEC reimbursed AIII $85,539 with Wakan Gli funds and the payment was described in the MCEC accounting system as "Wakan Gli days by Stacy Phelps". These charges to the Wakan Gli grant were not authorized by the USDOE and are part of the unsupported costs identified in the preceding paragraph.

The MCEC Wakan Gli original grant application identified Brinda Kuhn as the external evaluator and MCEC requested $120,000 for the position. The USDOE reduced the amount to be paid for this position in their Wakan Gli grant award document to $20,000. MCEC made payments to BC Kuhn Evaluation, LLC totaling $37,974 with Wakan Gli funds. MCEC paid BC Kuhn Evaluation, LLC $17,974 more than was authorized by the USDOE and we found no evidence that the USDOE amended the original budget for these additional costs; consequently we identified the $17,974 as unsupported costs.

We compiled a list of expenditures charged to the Wakan Gli grant from MCEC's accounting records for the years 2009 through 2014. Over this time period, there were six MCEC employees with salaries and benefits coded to the Wakan Gli grant totaling $203,297. We found no documentation, in the form of timesheets or effort logs, to support these amounts charged to the Wakan Gli grant. Such documentation is required by federal regulations and consequently we identified the $203,297 as unsupported costs.

<u>Recommendations:</u>

1. We recommend MCEC develop internal controls to ensure all contracts and grant agreements are approved by the Governing Board.

2. We recommend MCEC develop internal controls to ensure compliance with federal regulations relating to cost principles.

3. We recommend MCEC develop internal controls to properly document employees' time working on federal programs in accordance with federal regulations.

Compliance with Indirect Cost Federal Requirements

Finding:

Information reported to the U.S. Department of Education (USDOE) in Mid Central Educational Cooperative's (MCEC) indirect cost rate agreement was inaccurate.

Analysis:

Indirect costs are those that have been incurred for common or joint purposes. These costs benefit more than one program and are generally administrative in nature. Indirect costs are normally charged to federal programs by the use of an indirect cost rate.

Federal regulations provide the procedures by which local governmental units can enter into an agreement with the federal government to be reimbursed for indirect costs associated with administering federal programs. These procedures require a local governmental unit to prepare an indirect cost rate agreement that calculates an indirect cost rate based upon actual prior period cost accounting information. This indirect cost agreement is then submitted to the USDOE for the approval of an indirect cost rate that can be used to recover indirect costs when the local government requests reimbursement for costs associated with administering federal programs.

We reviewed the approved indirect cost rate agreement for fiscal years 2014 and 2015. This agreement was prepared by MCEC using actual fiscal year 2013 accounting information. To calculate an indirect cost rate, the MCEC created an Administrative Services Pool using actual fiscal year 2013 administrative salaries and benefits for those individuals that charged all of their time or a portion of their time to administrative activities. Federal regulations require that these indirect costs be supported by actual accounting records and not be based upon estimates.

There were eleven MCEC employees identified in the approved indirect cost rate agreement whose salaries and benefits were charged entirely or partially to administrative activities totaling $481,531. We found evidence in the fiscal year 2013 accounting records that five of these eleven individuals charged time to various activities/programs that was different than the information provided to the USDOE in the approved indirect cost rate agreement. In all five instances, more costs associated with these five individuals were included in the indirect cost rate agreement than were actually reflected as administrative costs in the accounting records. After adjusting the Administrative Services Pool for overstated employee amounts, we determined that the administrative salaries and benefits should have been $203,657. Thus, the Administrative Services Pool presented to the USDOE by MCEC was overstated by $277,874.

Federal regulations require a local government to certify that the costs contained in the indirect cost rate agreement are true and correct. Based upon the evidence we obtained, we don't believe the costs identified in the indirect cost rate agreement and submitted to the USDOE were true and correct.

Recommendation:

1. We recommend MCEC develop internal controls to ensure that its indirect cost agreement only includes actual administrative costs and that those costs are properly supported.

CURRENT AUDIT FINDINGS AND RECOMMENDATIONS

Federal Compliance Audit Findings:

Finding No. 2014-002:

Controls were not effective to ensure subrecipient compliance with allowable cost and matching requirements.

CFDA Title: Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP)
CFDA Number: 84.334
Federal Award Number: P334S110022
Federal Award Year: 2013, 2014
Federal Agency: Department of Education
Type of Finding: Material Weakness
Category of Finding: Subrecipient Monitoring

Analysis:

The South Dakota Department of Education (DOE) has a partnership agreement with Mid-Central Educational Cooperative (MEC) to carry out the GEAR UP activities/responsibilities. The agreement states, in part: "The State agrees to make monthly fixed installments in the amount of $50,000. Additional installments will be made monthly based upon receipt of a detailed invoice submitted by the Grant Partner that documents actual expenses incurred and matching documentation." The DOE performs desk reviews of monthly billings; however, monitoring controls were ineffective to ensure compliance with the allowable costs/cost principles and matching requirements. In addition to our review of the DOE's subrecipient monitoring procedures, we reviewed certain records of the MEC. Based upon our review of those records, we developed audit findings 2014-003 and 2014-004. As a result, compliance with the allowable costs/cost principles and matching compliance requirements was not met.

RECOMMENDATION:

1. We recommend the Department strengthen controls to ensure subrecipients are in compliance with applicable grant agreement and compliance requirements of the GEAR UP grant.

Auditee's Corrective Action Plan:

The Department of Education agrees with Department of Legislative recommendations of strengthening controls to ensure this subrecipient's compliance. The Department has significantly increased its level of expenditure review in FY 2015 based on past experience with this subrecipient. If questionable or undocumented costs are noted during the expenditure review, the cost is removed and payment is withheld pending a satisfactory response from the subrecipient. When potential issues of compliance are noted the Department provides technical assistance to the subrecipient in an effort to correct these issues.

We will continue to strengthen our knowledge of the requirements by attending training and further examining the requirement of the grant. In addition, the Department will continue to provide technical assistance to the subrecipient and encourage its staff to strengthen its knowledge of the requirements by attending training and further examining the requirement of the grant.

Finding No. 2014-003:

The subrecipient did not comply with allowable costs and cost principles requirements.

CFDA Title: Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP)
CFDA Number: 84.334
Federal Award Number: P334S110022
Federal Award Year: 2013, 2014
Federal Agency: Department of Education
Type of Finding: Material Noncompliance
Category of Finding: Allowable Costs/Cost Principles

Questioned Costs: $118,444.51

Analysis:

Direct Costs
All costs incurred under the GEAR UP program are subject to cost principles found in Title 2 of the Code of Federal Regulations (CFR), part 225. Per the grant agreement, this program is subject to U.S. Office of Management and Budget (OMB) Circular A-87. This circular establishes principles for allowability of costs charged to federal programs. In order for a cost to be allowable under OMB Circular A-87, the costs must be incurred. This circular does not allow costs to be charged to a program that are based on a budget, but are not yet incurred.

Due to ineffective controls described in finding number 2014-002, our review of a sample of monthly invoices from Mid-Central Educational Cooperative (MEC) indicated there was a total of $31,258.51 in costs reimbursed by South Dakota Department of Education (DOE) that were unallowable. The DOE reimbursed $31,228.91 in program costs based upon costs with no proof of actual expenses and additionally reimbursed $29.60 in error.

Indirect Costs
The DOE also reimburses MEC on a monthly basis for indirect costs relating to the GEAR UP grant. The most recent approved indirect cost rate for FY 2013 was 9.8% using a distribution base of direct salaries and wages. However, the U.S. DOE General Administrative Regulations (EDGAR) limit the indirect cost rate to a maximum of 8% for this program. Due to the ineffective controls described in finding number 2014-002, indirect costs approved and reimbursed by the DOE from MEC used the 9.8% rate on a distribution base of salaries and wages and an overpayment of indirect costs of $12,144.45 occurred. The 9.8% rate was also used on a distribution base of employee benefits, travel, supplies, and other expenses for an overpayment of $42,470.72. As a result, a total overpayment of indirect costs of $54,615.17 occurred.

Payroll
U.S. Office of Management and Budget (OMB) Circular A-87(8)(h) states:

> "(4) Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation which meets the standards in subsection 8.h.(5) of this appendix...

(5) Personnel activity reports or equivalent documentation must meet the following standards:

- (a.) They must reflect an after-the-fact distribution of the actual activity of each employee,
- (b.) They must account for the total activity for which each employee is compensated,
- (c.) They must be prepared at least monthly and must coincide with one or more pay periods, and
- (d.) They must be signed by the employee.
- (e.) Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards but may be used for interim accounting purposes..."

The DOE reimburses MEC on a monthly basis for personnel services. The DOE receives an Excel file from MEC that documents each employee that worked on the GEAR UP grant, the amount charged to the grant for that employee, and the percentage of time that employee worked on the grant. The Excel file does not comply with OMB Circular A-87 which requires payroll documentation to reflect total activity for which the employee is compensated. The DOE did not have effective controls, as described in finding number 2014-002, to identify this noncompliance.

MEC employees complete effort logs in which the employee records a description of work completed on a daily basis and the hours worked. There were no effort logs prepared by two Senior Advisors until the week ending October 28, 2013. The GEAR UP grant was charged a total of $32,570.83 for these two employees for the months of July, August, September, and October 2013. Due to the ineffective internal controls described in finding number 2014-002, the DOE reimbursed all payroll costs relating to these employees during that time period. As there were no effort logs, or equivalent personnel activity reports, to substantiate their time for these four months, these are questioned costs.

<u>RECOMMENDATIONS</u>:

2. We recommend the Department implement controls to ensure compliance with allowable cost requirements.

3. We recommend the Department determine whether reimbursement of questioned costs from MEC is appropriate.

<u>Auditee's Corrective Action Plan</u>:

The Department of Education agrees with Department of Legislative Audit recommendations of strengthening controls to ensure this subrecipient's compliance. The Department has significantly increased its level of expenditure review in FY 2015 based on past experience with this subrecipient. If questionable or undocumented costs are noted during the expenditure review, the cost is removed and payment is withheld pending a satisfactory response from the subrecipient. When potential issues of compliance are noted the Department provides technical assistance to the subrecipient in an effort to correct these issues.

We will continue to strengthen our knowledge of the requirements by attending training and further examining the requirement of the grant. In addition, the Department will provide technical assistance to the subrecipient and encourage its staff to strengthen its knowledge of the requirements by attending training and further examining the requirement of the grant.

The Department will ask the subrecipient to clarify or provide additional supporting documentation for the question costs. The Department will review the subrecipient's response and make a determination whether reimbursement or other actions are appropriate.
The Department will also ask the subrecipient to provide a corrective action plan, if appropriate, to ensure compliance with federal cost principles.

The Department has requested that the subrecipient reimburse the over recovery of indirect costs it received due to the application of its indirect cost rate to the incorrect direct cost base.

Finding No. 2014-004:

The subrecipient did not comply with matching, level of effort, and earmarking requirements.

CFDA Title: Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP)
CFDA Number: 84.334
Federal Award Number: P334S110022
Federal Award Year: 2014
Federal Agency: Department of Education
Type of Finding: Material Noncompliance
Category of Finding: Matching, Level of Effort, Earmarking

Analysis:

Title 34 of the Code of Federal Regulations (CFR), part 694.7 specifies that at least 50 percent of the GEAR UP project costs be matched with cash or in-kind contributions from non-Federal sources. We identified three different issues relating to matching non-compliance, as described below.

Match Contribution Amount
The Department of Education (DOE) has partnered with Mid-Central Education Cooperative (MEC) for the administration of GEAR UP and consequently matching is documented at MEC. This partnership agreement specified a match of $3,567,649 would be provided by MEC for the project period of September 26, 2012 through September 25, 2013. This agreement also specified that:

> "Documentation of matching contributions must contain adequate source documentation for the claimed cost sharing, provide clear valuation of in-kind matching and provide support of cost sharing by grant partners. Matching contributions must be valued in accordance with U.S. Office of Management and Budget (OMB) circulars and the Education Department General Administrative Regulations (EDGAR)."

We reviewed the non-Federal matching amounts recorded for the 2012-2013 project year and determined that MEC under-matched the amount in the agreement by $606,438.32 or 17%. The DOE did not adequately review total non-federal match amounts for the program year to ensure MEC had met compliance with the agreement.

Duplicate Match Contribution Records
34 CFR 80.24(b)(3) states:

> "Neither costs nor the values of third party in-kind contributions may count towards satisfying a cost sharing or matching requirement of a grant agreement if they have been

> or will be counted towards satisfying a cost sharing or matching requirement of another Federal grant agreement, a Federal procurement contract, or any other award of Federal funds."

In our review of a sample of non-Federal matching contributions, we identified two matching contributions that were both counted toward matching requirements for each of two different Federal grant agreements.

Documentation of In-Kind Match
34 CFR 80.24(b)(6) states:

> "Costs and third party in-kind contributions counting towards satisfying a cost sharing or matching requirement must be verifiable from the records of grantees and subgrantee or cost-type contractors. These records must show how the value placed on third party in-kind contributions was derived."

34 CFR 80.24(d) states:

> "Valuation of third party donated supplies and loaned equipment or space. (1) If a third party donates supplies, the contribution will be valued at the market value of the supplies at the time of donation..."

34 CFR 74.23(f) states:

> "Donated supplies may include such items as expendable equipment, office supplies, laboratory supplies, or workshop and classroom supplies. Value assessed to donated supplies included in the cost sharing or matching share shall be reasonable and shall not exceed the fair market value of the property at the time of the donation."

Due to ineffective controls described in finding number 2014-002, our review identified an individually significant in-kind matching contribution that was not adequately supported. MEC provided a letter to the DOE from Microsoft valuing a contribution of $2 million for providing 500 DreamSpark Premium software licenses. The letter did not indicate how the value was derived. Based upon our review of the retail price listed on the Microsoft website of $499 per one year license, we compute a matching contribution value of $249,500, resulting in a difference in value of $1,750,500. In addition, the records of the in-kind match did not identify what students benefited from using the software.

As a result, the Department was not in compliance with federal matching requirements.

RECOMMENDATION:

4. We recommend that the Department implement procedures to monitor subrecipient matching amounts to ensure compliance with federal requirements.

Auditee's Corrective Action Plan:

- Match Contribution Amount – The agreement with Mid Central should not have been written to indicate a specific dollar amount. This amount was based on the budgeted amount and actual expenditures were less than anticipated, which resulted in a lesser amount of match required. The agreement should have been written to reflect a 1 to 1 match based on actual expenditures. The current agreement will be amended to state that Mid Central needs to provide a match contribution of 1 to 1 based on all grant expenditures (including the State's), instead of a specific figure.

- Duplicate Match – We concur with the finding and recommendation to implement procedures to monitor subrecipients matching amount to avoid duplication and utilization of the correct forms. The Department will monitor and examine match documentation for duplication.

- Documentation of In-Kind Match – The in-kind contribution we show the match is adequately met if not exceeds the amount needed to satisfy the matching requirements for the grant. The FMV of the DreamSpark Premium is not a license but a subscription to 579 separate software applications. The FMV of these applications is valued by Microsoft at $300,000 per student with the knowledge that not every software application will be used but none the less purchased. With this knowledge the FMV of each of these applications would be applicable to match since we are looking at the FMV of the applications that would be purchased.

CURRENT AUDIT FINDINGS AND RECOMMENDATIONS

Federal Compliance Audit Findings:

Finding No. 2015-003:

The South Dakota Department of Education (DOE) did not have adequate controls in place to properly monitor subrecipient compliance with federal regulations or evaluate and mitigate risk associated with related party transactions.

CFDA Title: Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP)
CFDA Number: 84.334
Federal Award Number: P334S110022
Federal Award Year: 2013; 2014; 2015
Federal Agency: Department of Education
Type of Finding: Material Weakness
Category of Finding: Subrecipient Monitoring

Analysis:

The DOE had a partnership agreement with Mid-Central Educational Cooperative (MEC) for administration of the GEAR UP program. According to the agreement, the DOE awarded MEC $3,391,732 for Federal Fiscal Year (FFY) 2013, $4,793,992 for FFY 2014 and $4,287,228 for FFY 2015. The agreement states, in part:

> The State will serve as the lead partner and will be responsible for ensuring that the project is carried out by the partnership group in accordance with Federal requirements.
>
> ….
>
> The State agrees to make monthly fixed installments in the amount of $50,000. Additional installments will be made monthly based upon receipt of a detailed invoice submitted by the Grant Partner that documents actual expenses incurred and matching documentation.

MEC partnered with the American Indian Institute for Innovation (AIII) to administer portions of the GEAR UP program using the program budget and scope of work provided by the DOE. The partnership agreement between MEC and AIII did not provide for a specific amount of GEAR UP funds that AIII was authorized to expend, but rather incorporated the total budget between the DOE and MEC by reference. According to the agreement, MEC was to reimburse AIII monthly upon receipt of a detailed reimbursement voucher showing all expenses and AIII was only to be reimbursed for expenses that were allowable under the GEAR UP program in accordance with the approved budgets.

U.S. Office of Management and Budget Circular A-133 (Circular A-133), section 210 provides criteria for determining whether an agreement involving the expenditure of federal funds is a subaward or a contract for services. Using these criteria, we determined the partnership agreement between MEC and AIII was a subaward of GEAR UP funds and not a contract for services. As a subaward, the DOE would be considered the pass-through entity and the AIII would be considered a subrecipient of the GEAR UP funds.

Section 400(d) of Circular A-133 describes the responsibilities of a pass-through entity with regard to the federal subawards made to subrecipients. These responsibilities include monitoring the activities of subrecipients to ensure compliance with federal laws and regulations. Federal law requires that subrecipients expending $500,000 or more in Federal awards during their fiscal year have an audit conducted in accordance with the requirements of the Single Audit Act and Circular A-133.

According to AIII's Internal Revenue Service Form 990-PF (form 990) filed for 2012, 2013, and 2014, the AIII recognized revenue from direct and pass-through federal awards in excess of $500,000 in each of these three years. Thus, we believe AIII should have had a Single Audit for the years 2012, 2013 and 2014. However, we found no evidence that Single Audits of AIII for those periods were performed. Neither the DOE nor MEC had internal controls in place to ensure that MEC's agreement with AIII was correctly identified as a subaward and that AIII had complied with the Single Audit Act.

While we believe Single Audits of AIII should have been performed because it met federal requirements for such an audit, we also believe audits should have been required of AIII by the DOE and MEC because of the nature of employment and contractual relationships that existed between employees and officers of MEC and AIII. The following employment and contractual relationships existed during our audit period.

Stacy Phelps was both an employee of MEC and the Chief Executive Officer (CEO) of AIII. We found that $65,000 of Stacy Phelps' MEC salary was reimbursed by the DOE from GEAR UP funds for FFY 2014. In addition, in August 2014 MEC reimbursed AIII $34,000 from GEAR UP funds for contractual services provided by Stacy Phelps. Although AIII was reimbursed $34,000 for Stacy Phelps's services in 2014, we found that AIII's form 990 for calendar 2014 reported zero compensation for Stacy Phelps. In addition, we found that Scott Westerhuis, MEC's Business Manager during 2014, was also identified as AIII's Chief Financial Officer on its form 990 for 2014.

MEC also partnered with Oceti Sakowin Education Consortium (OSEC) to administer portions of the GEAR UP program. According to the OSEC form 990 submitted for OSEC's fiscal year ended June 30, 2014 Nicole Westerhuis, wife of Scott Westerhuis, was compensated $38,521 as the Business Manager of OSEC. Nicole Westerhuis also had an employment contract with MEC for its fiscal year ended June 30, 2014 in the amount of $59,740.

The audited financial statements of MEC and the accompanying notes to the financial statements did not disclose any of these relationships or the related transactions. Generally accepted accounting principles require the terms of material related party transactions to be disclosed in the notes to the financial statements for governmental organizations such as MEC.

Since key employees of MEC were also in compensated officer positions of AIII, a significant subrecipient of GEAR UP pass-through funds, there were significant risks that needed to be addressed by specific subrecipient monitoring procedures at the DOE and MEC. Procedures implemented by the DOE did not address these risks and as a result, the DOE exposed itself to potential violation of federal regulations, and an increased risk of fraud, waste, and abuse of grant funds.

RECOMMENDATION:

1. We recommend that the DOE adopt additional subrecipient monitoring procedures to ensure compliance with federal regulations and mitigation of the risks associated with related party transactions.

Auditee's Corrective Action Plan:

The Department of Education agrees with Department of Legislative Audit recommendations of adopting additional subrecipient monitoring procedures to ensure compliance with federal regulations and mitigation of the risks associated with related party transactions. Throughout FY2015, the Department implemented increasing levels of expenditure review and compliance monitoring for the Gear Up grant. This included annual review of the independent audit reports and requiring that MEC upload supporting documentation for all expenses being claimed to a system called Egnyte. The Department also reviewed the independent audit reports for signs of risk in the operations of MEC. Each year, the independent audit reports came back with no significant findings. Regarding expenses being claimed, if questionable or undocumented costs were noted during the expenditure review, the cost was removed and payment was withheld pending a satisfactory response from the subrecipient. When potential issues of compliance were noted the Department provided technical assistance to the subrecipient in an effort to correct these issues.

Despite these efforts, the Department continued to note questionable or unsupported costs. In September 2015 the Department began processes to terminate the partnership with MEC at the end of then current award period. On September 16, 2015, the Department notified MEC of the intent to terminate via phone. A subsequent termination letter was issued on September 21, 2015.

While the Department does perform a risk assessment of new grantees, we will implement a system to perform a more in depth risk analysis of the financial management capacity of potential subawardees of discretionary or competitive grant programs, including their ability to identify and appropriately document match. The department will also perform a more in depth review of key staff. Beginning in FY2017, the department will require grantees to submit a conflict of interest policy and to submit documentation disclosing any related parties.
The Department will require any entities providing subawards to affirmatively notify the Department of any subawards and to submit to the Department a signed written acknowledgment by both the entity and the subrecipient acknowledging that: 1) they are aware of federal requirements regarding subawards and 2) any entity receiving a subaward is required to meet audit requirements under uniform guidance if their total federal awards exceed the threshold.

As stated previously, the Department has terminated its partnership with MEC for the Gear Up program. In order to insure that students continue to receive services, the Department is partnering with the South Dakota Board of Regents (BOR) to continue activities under the Gear Up grant and is working closely with the individuals involved to make sure they are aware of all federal requirements and insure they are being followed. To accomplish this, the Department created a new position whose duties are to work on the Gear Up program to ensure that federal program requirements are being met and students continue to receive services. Department administrative staff have attended trainings specific to federal grants management. Department and BOR staff will attend future training opportunities specific to Gear Up and on federal grant management and will provide additional training and support to all grant partners.

Finding No. 2015-004:

The Mid-Central Educational Cooperative (MEC) did not comply with matching requirements.

CFDA Title: Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP)
CFDA Number: 84.334
Federal Award Number: P334S110022
Federal Award Year: 2014
Federal Agency: Department of Education
Type of Finding: Material Noncompliance
Category of Finding: Matching, Level of Effort, Earmarking

Analysis:

Title 34 of the Code of Federal Regulations (CFR), part 694.7 specifies that at least 50 percent of the GEAR UP project costs be matched with cash or in-kind contributions from non-Federal sources.

The South Dakota Department of Education (DOE) partnered with MEC for the administration of GEAR UP and required matching contributions were documented by MEC. The partnership agreement specifies that:

> Documentation of matching contributions must contain adequate source documentation for the claimed cost sharing, provide clear valuation of in-kind matching and provide support of cost sharing by grant partners. Matching contributions must be valued in accordance with U.S. Office of Management and Budget (OMB) circulars and the Education Department General Administrative Regulations (EDGAR).

34 CFR 80.24(b)(6) states:

> Costs and third party in-kind contributions counting towards satisfying a cost sharing or matching requirement must be verifiable from the records of grantees and subgrantee or cost-type contractors. These records must show how the value placed on third party in-kind contributions was derived….

34 CFR 80.24(d) states:

> Valuation of third party donated supplies and loaned equipment or space. (1) If a third party donates supplies, the contribution will be valued at the market value of the supplies at the time of donation....

Our review identified individually significant in-kind matching contributions that were not adequately supported for the Federal Fiscal Year (FFY) 2014 GEAR UP grant, which had a project period of September 26, 2013 through September 25, 2014. We reviewed the non-Federal matching amounts recorded for the FFY 2014 grant and identified three different issues as described below:

1. MEC provided the DOE with a match contribution in the form of payroll from a partner school totaling $165,185.09. The payroll logs provided show the entire payroll for the summer months of July and August, 2014 for all teachers in the first through eighth grades totaling $1,785,784.72. The school and MEC determined that only 25% of the total salaries are paid

from the General Fund of the school and therefore only 25%, or $446,446.18, of the salaries could be used as a match for GEAR UP. The school and MEC next determined that GEAR UP only served grades six through eight which equated to 37% of the total grades available from first through eighth and as a result, $165,185.09 of the $446,446.18 was used as an in-kind match. Documentation did not identify which teachers actually taught grades six through eight or if their activities would be allowable under GEAR UP.

2. MEC provided a letter to the DOE from Microsoft valuing a contribution of $2 million for providing 500 DreamSpark Premium software licenses. The records for the in-kind match did not identify how the software was used to meet the purpose of the grant or the number of students using the software. In addition, the same documentation submitted by MEC and used for the FFY 2013 match was also used for the FFY 2014 match. According to the approved federal budget in the DOE's GEAR UP grant application, the total in-kind match contribution for Microsoft Programs was budgeted to be $750,000 per year. The match claimed for Microsoft totaled $2,000,000, which is $1,250,000 more than the budget approved by the U.S. Department of Education. The excess in match claimed for Microsoft resulted in less match than budgeted being provided for salaries and benefits, supplies and equipment, and other contractual services.

3. MEC provided an invoice to the DOE from Learning Solutions valuing an unlimited number of licenses for Reading Plus and Think Through Math software programs at a value of $746,000 each for a period of two years. $225,000 was paid by MEC to Learning Solutions for each software program and was subsequently reimbursed by the DOE as part of the GEAR UP program. The remaining $521,000 difference between the value and amount paid for the software programs was used as contribution for in-kind match for a total of $1,042,000. The records provided did not show how the $746,000 value was derived. Additionally, the records did not identify the number of students using the software, or how the software was used to meet the purpose of the program. According to the approved federal budget in the DOE's GEAR UP grant application, the total in-kind match contribution for Math and Reading Programs was budgeted to be $150,000 per year. The match claimed above totals $1,042,000 over two years which is $742,000 more than the budget approved by the U.S. Department of Education. The excess in match claimed for Learning Solutions resulted in less match than budgeted being provided for salaries and benefits, supplies and equipment, and other contractual services.

As a result, the DOE was not in compliance with federal matching requirements. Because the GEAR UP grant is a multi-year program, questioned costs would not be calculated until the end of the award period.

RECOMMENDATION:

2. We recommend that the DOE implement procedures to monitor subrecipient matching amounts to ensure compliance with federal requirements.

Auditee's Corrective Action Plan:

The Department of Education agrees with the Department of Legislative Audit recommendation to implement procedures to monitor sub recipient matching amounts. Throughout FY2015, the department implemented increasing levels of review on all Gear Up fiscal activities, including documentation of match. Despite efforts to obtain adequate source documentation from MEC, the department continued to have concerns about MECs ability to meet match requirements. Concerns regarding MEC's ability to provide appropriate match was a factor in the Department's decision to terminate its partnership with MEC for the Gear Up program. In September 2015 the Department began processes to terminate the partnership with MEC at the end of the current award period. On September 16, 2015, the Department notified MEC of the intent to terminate via phone. A subsequent termination letter was issued on September 21, 2015.

The Department has made multiple requests to MEC for match documentation since the termination of the contract with MEC. The Department has not received timely and sufficient responses from MEC. As a result, the Department has engaged a specialist to help in acquiring adequate supporting documentation for match for the Gear Up grant. The Department will identify and catalog existing match documentation and conduct outreach to Gear Up sub recipients to document recoverable match.

The Department will maintain oversight to ensure key BOR staff possess experience in documenting match in compliance with federal requirements. Department staff and key BOR staff have attended training opportunities specific to Gear Up and federal match requirements and will continue to attend additional developmental trainings required under the Gear Up grant.

Finding No. 2015-005:

Controls were not effective over proper monitoring of the subrecipient to ensure compliance with allowable costs and cost principles requirements.

CFDA Title: Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP)
CFDA Number: 84.334
Federal Award Number: P334S110022
Federal Award Year: 2013, 2014
Federal Agency: Department of Education
Type of Finding: Material Weakness
Category of Finding: Allowable Costs/Cost Principles, Subrecipient Monitoring

Analysis:

Per the federal grant award for GEAR UP, costs incurred are subject to the cost principles outlined in U.S. Office of Management and Budget (OMB) Circular A-87, which is codified in Title 2 of the Code of Federal Regulations (CFR), part 225. 2 CFR 225, Appendix B, Section 8(a) states:

> Compensation for personnel services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under Federal awards, including but not necessarily limited to wages, salaries, and fringe benefits. The costs of such compensation are allowable to the extent that they satisfy the specific requirements of this and other appendices under 2 CFR Part 225, and that the total compensation for individual employees:
>
> ….
>
> (3) Is determined and supported as provided in subsection h.

2 CFR 225, Appendix B, Section 8(h) states:

> h. Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.
>
> (1) Charges to Federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally accepted practice of the governmental unit and approved by a responsible official(s) of the governmental unit.
>
> ….
>
> (3) Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having firsthand knowledge of the work performed by the employee.
>
> (4) Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation….
>
> (5) Personnel activity reports or equivalent documentation must meet the following standards:
>
> (a) They must reflect an after-the-fact distribution of the actual activity of each employee,
> (b) They must account for the total activity for which each employee is compensated,
> (c) They must be prepared at least monthly and must coincide with one or more pay periods, and
> (d) They must be signed by the employee.
> (e) Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards….

For Federal Fiscal Year (FFY) 2014 thirteen Mid-Central Educational Cooperative (MEC) employees had a portion of their salaries and benefits charged to the GEAR UP program and subsequently reimbursed by the South Dakota Department of Education (DOE). For eleven of these employees, monthly payroll distribution reports were submitted to the DOE along with the reimbursement requests to support the actual salaries paid to the employees each month. For two of the employees, Stacy Phelps and Scott Westerhuis, the reimbursement request for these employees' salaries was submitted in one lump sum at the end of the year and no supporting payroll distribution reports were included with the reimbursement request. Salaries and benefits charged to the program for FFY14 for these two employees totaled $88,973.03. Upon request during our audit, the DOE did obtain supporting documentation from MEC to substantiate that the costs were allowable. Therefore, no questioned costs were identified as a result of this finding.

Since the form of the salary reimbursement request for Stacy Phelps and Scott Westerhuis differed from the form used for other MEC employees and because of the risks that existed due to the relationships described in finding 2015-003, the DOE should have ensured that supporting payroll documentation was obtained for these two employees before being reimbursed.

RECOMMENDATION:

3. We recommend the DOE strengthen controls to ensure subrecipients are in compliance with the applicable grant agreement and compliance requirements of the GEAR UP grant prior to issuing payment.

Auditee's Corrective Action Plan:

The Department of Education agrees with Department of Legislative Audit recommendations of strengthening controls to ensure subrecipients are in compliance with applicable grant agreement and compliance requirements of the GEAR UP grant prior to issuing payment. Throughout FY2015, the Department implemented increasing levels of expenditure review and compliance monitoring for the Gear Up grant. This included annual review of the independent audit reports and requiring that MEC upload supporting documentation for all expenses being claimed to a system called Egnyte. The Department also reviewed the independent audit reports for signs of risk in the operations of MEC. Each year, the independent audit reports came back with no significant findings. Regarding expenses being claimed, if questionable or undocumented costs were noted during the expenditure review, the cost was removed and payment was withheld pending a satisfactory response from the subrecipient. When potential issues of compliance were noted the Department provided technical assistance to the subrecipient in an effort to correct these issues.

Despite these efforts, the Department continued to note questionable or unsupported costs. In September 2015 the Department began processes to terminate the partnership with MEC at the end of then current award period. On September 16, 2015, the Department notified MEC of the intent to terminate via phone. A subsequent termination letter was issued on September 21, 2015.

In order to comply with the grant agreement with the US Department of Education and to insure that students continue to receive services, the Department is partnering with the South Dakota Board of Regents (BOR) to continue activities under the GEAR UP grant. The BOR is a state entity that administers the State's six universities and two specialty schools. The BOR has its own internal auditor responsible for risk management and control. Furthermore, the Department created a new position whose duties are to work on the Gear Up program to ensure that federal program requirements are being met. Department administrative staff have attended trainings specific to federal grants management. Department and BOR staff will attend future training opportunities specific to Gear Up and on federal grant management and will provide additional training and support to all grant partners.

RESPONSE OF MID-CENTRAL EDUCATIONAL COOPERATIVE
AND ITS BOARD OF DIRECTORS
TO THE SOUTH DAKOTA DEPARTMENT OF LEGISLATIVE AUDIT'S
SPECIAL REPORT OF MAY 19, 2017

MAY 17, 2017
PLATTE, SOUTH DAKOTA

INTRODUCTION

Mid-Central Educational Cooperative and its Board of Directors ("MCEC" and/or "Board") submits this Response to the South Dakota Department of Legislative Audit's ("DLA") Special Report (dated May 19, 2017) ("Special Report").

Throughout this process, MCEC and its Board have been guided by its commitment to transparency and to assist law enforcement authorities and the DLA in all efforts to investigate this matter. At every step of the process, MCEC and its Board have been committed to finding the truth, no matter the issue.

MCEC and its Board conclude that those individuals who were involved in the fraudulent and illegal financial activities did not want MCEC or its Board to know of their actions and purposely concealed their activities from the Board.

DLA's Special Report has not identified any facts that would have put MCEC or its Board on notice of the fraudulent and illegal activities of Scott and Nicole Westerhuis. There is nothing that MCEC or its Board could have reasonably done to prevent this complex scheme of fraudulent and illegal activities.

OVERVIEW

MCEC

MCEC is a service unit consisting of thirteen (13) member school districts organized to provide services of a special nature for the member schools.[1] MCEC's primary function is to assist its member schools in providing a least restrictive educational environment for special

[1] MCEC's thirteen (13) members schools are Armour School District; Burke School District; Colome School District; Corsica-Stickney School District; Ethan School District; Gregory School District; Kimball School District; Mount Vernon School District; Plankinton School District; Corsica-Stickney School District; Wessington Springs School District; White Lake School District; and Wolsey-Wessington School District.

needs children birth through 21 served by them, as well as working with the schools to help serve the needs of all children grades K-twelve.

MCEC's Board is made up of a school board member from each of the member school districts. The powers delegated to the Board's members is the same as for any individual serving on a member's school board. Therefore, the powers delegated to a school board by the state are delegated to the Board as a whole. No authority is granted to the Board's members acting as individuals.

The Director of MCEC is the chief executive officer of the Board and is responsible for the administrative and advisory functions of the Board. Planning, policy making, and evaluation are the functions of the Board. The Director is responsible for the administration of its policies, the execution of the Board's decisions, the operation of internal machinery designed to service MCEC programs, and for keeping the Board informed about the operations and problems of the cooperative.

South Dakota Department of Education and GEAR UP

In 2005, the South Dakota Department of Education (SD DOE) obtained a six-year Gaining Early Awareness and Readiness for Undergraduate Program (GEAR UP) grant from the United States Department of Education (US DOE). The grant was used to fund South Dakota's GEAR UP program.

In 2011, the SD DOE received a new six-year GEAR UP grant from the US DOE. This grant was also used to fund South Dakota's GEAR UP program. In its GEAR UP application, the SD DOE certified that it would "establish a proper accounting system in accordance with generally accepted accounting standards or agency directives." The SD DOE also certified that it would "establish safeguards to prohibit employees from using their position for a purpose that constitutes or presents the appearance of personal or organizational conflict of interest, or personal gain."

The SD DOE entered into a partnership agreement with MCEC to act as a grant partner to carry out grant activities/responsibilities for the GEAR UP program. This agreement stated in part: "The State [of South Dakota] will serve as the lead partner and will be responsible for ensuring that the project is carried out by the partnership group in accordance with Federal requirements."

It should be noted that the DLA's Special Report includes its 2014 Single Audit for the State of South Dakota (*see* Appendix A). This 2014 Single Audit found the following:

- The SD DOE's controls were not effective to ensure subrecipient compliance with allowable cost and matching requirements for the GEAR UP program (Finding No. 2014-002).
- The SD DOE failed to adequately oversee the subrecipient's allowable costs and cost principles requirements for the GEAR UP program (Finding No. 2014-003).
- The SD DOE did not adequately review total non-federal match amounts to ensure the subrecipient's had met compliance with the agreement for the GEAR UP program (Finding No. 2014-004).

The DLA's Special Report also includes its 2015 Single Audit for the State of South Dakota (*see* Appendix B). This 2015 Single Audit found the following:

- The SD DOE did not have adequate controls in place to properly monitor subrecipient compliance with federal regulations or evaluate and mitigate risk associated with related party transactions for the GEAR UP program (Finding No. 2015-003).

- The SD DOE failed to implement procedures to monitor subrecipient matching amounts to ensure compliance with federal requirements for the GEAR UP program (Finding No. 15-004).
- The SD DOE failed to implement effective controls over proper monitoring of the subrecipient to ensure compliance with allowable costs and cost principles requirements for the GEAR UP program (Finding No. 2015-005).

American Indian Institute for Innovation

The American Indian Institute for Innovation (AIII) is a domestic nonprofit corporation organized under South Dakota law in 2008. AIII's intended purpose was to develop and implement solutions to assist in improving the quality of life for American Indians. Its partnerships with tribal communities, organizations, and other stakeholders was meant to engage cultural traditions and values to develop education programs and opportunities that emphasize Science, Technology, Engineering, and Mathematics (STEM). AIII's Board of Directors consisted of John B. Herrington, Chris Eyre, and Carlos Rodriguez.

MCEC and AIII

MCEC partnered with AIII to administer portions of the GEAR UP program using the program budget and scope of work provided by the SD DOE. The partnership agreement between MCEC and AIII did not provide for a specific amount of GEAR UP funds that AIII was authorized to expend, but rather incorporated the total budget between the SD DOE and MCEC by reference. According to the agreement, MCEC was to reimburse AIII monthly upon receipt of a detailed reimbursement voucher showing all expenses and AIII was only to be reimbursed for expenses that were allowable under the GEAR UP program in accordance with the approved budgets.

Scott and Nicole Westerhuis

Scott Westerhuis served as MCEC's Business Manager for over eighteen (18) years (1997 to 2015) and was responsible for overseeing MCEC's entire financial operation. Scott Westerhuis was also responsible for managing the GEAR UP project. Nicole Westerhuis served as MCEC's Grant Manager from 2009 to 2014 and as Assistant Business Manager in 2014-2015.

Westerhuis Incident & Law Enforcement Investigation

On September 16, 2015, the SD DOE informed MCEC that the SD DOE was considering terminating its partnership with MCEC for the GEAR Up program. On September 17, 2015, Scott Westerhuis, Nicole Westerhuis, and their four (4) minor children passed away in a fire at their home in Platte, South Dakota. A law enforcement investigation concluded that Scott Westerhuis killed himself and his family and that the family was living outside of their financial means.

During its investigation, law enforcement authorities reviewed the financial records of MCEC, AIII, Scott Westerhuis, Nicole Westerhuis, and other corporations created or run by Scott and Nicole Westerhuis. During a review of these financial records, law enforcement determined that Scott and Nicole Westerhuis engaged in fraudulent and illegal business activities using their positions at MCEC and AIII. These fraudulent activities began as early as 2010.

Ultimately, investigators determined that Scott and Nicole Westerhuis embezzled well over $1 million dollars.[2]

MCEC'S RESPONSE TO DLA'S FINDINGS

In its Special Report, the DLA's findings focus primarily upon (1) MCEC's and its Board's alleged failure to maintain adequate oversight of its financial activities; (2) unauthorized withdrawals made from MCEC's bank account by Scott and Nicole Westerhuis; (3) MCEC's and its Board's oversight of the GEAR UP program, Teacher Quality Program, and Wakan Gli program; and (4) MCEC's and its Board's alleged oversight of related parties and conflicts of interest. However, the DLA also acknowledges that "[g]overning boards and management of organizations must place a certain level of trust in the people that are employed to administer and provide financial accountability for their organizations."

MCEC takes these allegations very seriously. However, MCEC disagrees with the DLA's finding of any alleged deficiencies. It is apparent that no amount of reasonable oversight would have detected the complex scheme of fraudulent and illegal activities conducted by Scott and Nicole Westerhuis.

Scott Westerhuis served as MCEC's Business Manager for over eighteen (18) years and his primary duties were to oversee MCEC's entire financial operation and manage the GEAR UP program. Nicole Westerhuis served as MCEC's Grant Manager and Assistant Business Manager for six (6) years.

Scott and Nicole Westerhuis were Platte natives, well respected members of the Platte community, and trusted overseers of MCEC's financial activities.

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[2] *State of South Dakota v. Stephanie A. Hubers*, Charles Mix County Crim. 16-104, Probable Cause Affidavit of Special Agent Brett Spencer (dated March 10, 2016).

Unfortunately, Scott and Nicole Westerhuis were living outside of their financial means. As a result, they engaged in a complex scheme of fraudulent and illegal business activities using their positions at MCEC and AIII. In fact, investigators determined that the scheme devised by Scott and Nicole Westerhuis resulted in them embezzling over $1 million.[3]

Scott and Nicole Westerhuis commenced their complex scheme in 2010. From the very beginning, Scott and Nicole Westerhuis concealed their scheme of fraudulent and illegal activities by:

- Deceiving the Board by fraudulently advancing monies from MCEC's General Fund to AIII for AIII's payroll. This was done because AIII was not meeting its financial obligations each month. Therefore, Scott and Nicole Westerhuis would secretly remove monies from MCEC's General Fund and make direct deposits into AIII's employees' accounts (*i.e.,* AIII would use MCEC as AIII's "bank"). However, these direct deposits would not show as MCEC payments because Nicole Westerhuis was using a Quickbooks or Intuit payroll processing. Therefore, MCEC's bank statements would show Intuit payroll. The payments would also show up as Intuit on AIII's employees' direct deposits. By November 2015, AIII owed MCEC approximately $800,000.00 for payroll. These type of activities would have required the approval of the Director and the Board. At no time did the Board have knowledge of these fraudulent activities.

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[3] *Id*. Scott and Nicole Westerhuis furthered their fraudulent scheme through their activities in several corporations, including AIII, American Indian Institute for Innovation and Excellence (AIIIE), Oceti Sakowin Education Consortium (OSEC). *Id.*

- Deceiving the Board by fraudulently using between $40,000.00 to $150,000.00 of MCEC's monies on a monthly basis. At no time did the Board have knowledge of these fraudulent activities.
- Deceiving the Board by fraudulently providing a former MCEC employee with a monthly check from AIII for doing little to no work because Scott Westerhuis "believed the employee was worth more than MCEC could pay her." Scott Westerhuis was upset that MCEC was not paying this employee more money. As a result, from 2009 to 2014, the employee received almost sixty (60) checks totaling over $55,000.00 in payments from AIII. At no time did the Board have knowledge of these fraudulent activities.
- Deceiving the Board by running MCEC's financial affairs "like a pyramid" with Scott Westerhuis as the "ultimate decision maker." At no time did the Board have knowledge of these activities.
- Deceiving the Board by paying an MCEC employee additional income ("hush money") because Scott Westerhuis feared that the employee would inform the Director and the Board of his fraudulent and illegal activities. At no time did the Board have knowledge of these fraudulent activities.
- Deceiving the Board about MCEC's financial records. At certain times, MCEC's financial records prompted questions by the Board. Board members would confront Scott and Nicole Westerhuis about certain financial discrepancies. Scott and Nicole Westerhuis would then blatantly lie to the Board by stating that the discrepancies were due to "void checks," "journal entries," or other seemingly plausible and

reasonable explanations. At no time did the Board have knowledge of these fraudulent activities.

- Deceiving the Board by creating false entries in MCEC's financial records. At no time did the Board have knowledge of these fraudulent activities.
- Deceiving the Board by forbidding other MCEC employees from talking about or divulging the fraudulent activities during monthly Board meetings. At no time did the Board have knowledge of these fraudulent activities.[4]
- Deceiving the Board as to its responsibilities in administering the GEAR UP program.
- Deceiving the Board by stating that MCEC's only responsibility was to serve as bookkeeper for the GEAR UP program.
- Deceiving the Board by stating that the GEAR UP Board and SD DOE were responsible for making all administrative decisions regarding the GEAR UP program and its budget.

The DLA's Special Report seems to imply that if certain monitoring activities would have been implemented by the Board, it would have discovered these fraudulent and illegal activities. However, the Board did everything that could reasonably be expected to ensure adequate oversight of its financial activities, including receiving a yearly audit from Schoenfish & Co. in Parkston, South Dakota. There is no basis to conclude that the Board could have detected the complex scheme of these fraudulent and illegal activities based upon the deceitful conduct of Scott and Nicole Westerhuis and the Board's reliance on professionals who were retained to annually review MCEC's financial records.

[4] *Id.*

Scott and Nicole Westerhuis organized and implemented their fraudulent and illegal scheme. Despite the Board's efforts, its employees – Scott and Nicole Westerhuis – violated the Board's trust, resulting in one of the most tragic incidents in South Dakota's recent history. However, there is nothing that the Board could have reasonably done to prevent this complex scheme of fraudulent and illegal activities.

CORRECTIVE ACTIONS

The DLA's Special Report provides a series of recommendations for MCEC going forward. MCEC and its Board take these recommendations very seriously and thank the DLA for its assistance. However, as of June 30, 2017, MCEC will terminate its provision of educational services to its member schools. Therefore, the DLA's recommendations for future improvements become moot.

CONCLUSION

MCEC and its Board cooperated fully with law enforcement authorities and the DLA's investigations. A plethora of witnesses told law enforcement authorities and the DLA that not only did MCEC and its Board not know about the fraudulent and illegal activities of Scott and Nicole Westerhuis, but also that MCEC and the Board could not have known about them. These illicit activities were deliberately kept secret and out of view by Scott and Nicole Westerhuis.